



STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 324-6593

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CINDY RAMBO
Executive Director

July 10, 1989

Dear Ms.

Your letter dated May 2, 1989, to _____, has been referred to the undersigned for reply. The facts as set forth in your letter and as communicated to me via telephone can be summarized as follows:

Facts

The ownership of a partnership owning real property in California is currently as follows:

- (i) The parents (H and W) own a 34 percent interest;
- (ii) The son (S) owns a 33 percent interest; and
- (iii) A corporation (C), wholly owned by S, owns the remaining 33 percent interest.

The partners contemplate the following transfer or steps:

1. S and C will transfer all their respective partnership interests to H and W, as joint tenants.
2. Thereafter, H and W will either have the partnership transfer its real property to themselves as joint tenants or to a trust of which they are the sole beneficiaries.

You have requested an opinion of the change in ownership consequences of the above-described proposed transactions.

Law and Analysis

Unless otherwise specifically noted, all section references are to the Revenue and Taxation Code.

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Section 64 provides in pertinent part as follows:

(a) Except as provided in subdivision (h) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as . . . partnership interests, shall not be deemed to constitute a transfer of the real property of the legal entity.

* * *

(c) When a corporation, partnership, other legal entity or any other person obtains control, as defined in Section 25105, in any corporation, or obtains a majority ownership interest in any partnership or other legal entity through the purchase or transfer of corporate stock, partnership interest, or ownership interests in other legal entities, such purchase or transfer of such stock or other interest shall be a change of ownership of property owned by the corporation, partnership, or other legal entity in which the controlling interest is obtained.

Pursuant to Rule 462(j)(4)(A) of the Property Tax Rules of Title 18 of the California Code of Regulations, obtaining a majority ownership interest in a partnership within the meaning of section 64(c) is effected by obtaining direct or indirect ownership or control of more than 50 percent of the total interest in both partnership capital and profits.

No facts have been presented indicating that section 61(h) is applicable.

As to section 64(c), if the proposed transfers result in either H or W obtaining direct or indirect control of more than a 50 percent interest in partnership capital and profits, then, in such event, a change in ownership will be deemed to have occurred. In this case, you do not specify how H and W presently hold title to their 34 percent partnership interest. Assuming that title is held as joint tenants, the result of step 1 will be H and W holding 100 percent of the partnership interest as joint tenants.

Letter to Assessors No. 83/17 (July 15, 1983) states that it is the opinion of the legal staff that a husband and wife holding

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an ownership interest in a legal entity as joint tenants are to be considered as separate individuals, each owning 50 percent of the entity. While referenced rule 462(j)(4)(A) refers to indirect control, we have not interpreted this rule to mean that the interest owned in a legal entity by one spouse is to be automatically imputed to the other. Therefore, the proposed transfers to H and W should, for our purposes, result in H and W each, respectively, being considered the beneficial owner of exactly 50 percent of the partnership.

As section 64(c) speaks in terms of taxpayers obtaining a majority partnership interest (consisting of more than 50 percent), the transfers you propose should not result in a change in ownership under the provisions thereof.

The above conclusion is dependent, however, upon the withdrawal of partners C and S not causing a dissolution of the partnership. As you may be aware, section 15031 of the Corporations Code provides, inter alia, that the withdrawal of a partner causes the dissolution of a partnership unless otherwise provided in a written agreement signed by all the partners prior to the date of withdrawal.

Section 64(d), as referenced above in section 64(a), applies to property transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by section 62(a)(2). In such cases, the persons holding ownership interests in such legal entity immediately after the transfer are considered the "original coowners." Whenever more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions, a change in ownership shall be deemed to have occurred. In this case, 66 percent of the partnership's interests are changing hands. Therefore, if section 64(d) is applicable because there has been a previous transaction excluded from change in ownership by section 62(a)(2), a change in ownership may result even in the absence of a change in control.

Section 63.1 provides an exclusion from change in ownership consequences for certain qualifying transfers between parents and their children. Such exclusion is not applicable, however, to transfers of partnership interests. Section 63.1 only applies to transfers of "real property" and that term, as defined in subdivision (c)(6), does not include interests in a legal entity.

Should H and W, after acquiring all partnership interests pursuant to the above, thereafter transfer such partnership

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interest to a trust of which they are the sole beneficiaries, such transfer should be excluded from change in ownership consequences so long as the requirements of section 62(d) are otherwise satisfied.

Further, if, after H and W have acquired 100 percent ownership of the partnership, they choose to have the partnership transfer the property to themselves as joint tenants or to a trust which they beneficially own in equal shares, such transfer should also be excluded from change in ownership consequences. This exemption would result from the fact that such transfer would only constitute a change in the method of holding title in which proportional ownership interests remain the same after the transfer. Section 62(a)(2). If H and W are both the grantors of a trust and the trust's sole present beneficiaries, they will be its sole beneficial owners for our purposes. See section 62(d).

During our telephone conversation, we discussed section 63.1 in more detail. Such section provides an exclusion for qualifying transfers between parents and children of: (i) a principal residence or (ii) up to \$1,000,000 of full cash value of other real property. The legislative history of such provision, as set forth in Chapter 48 of the 1987 Statutes, provides as follows:

It is the intent of the Legislature that the provisions of Section 63.1 of the Revenue and Taxation Code shall be liberally construed in order to carry out the intent of Proposition 58 on the November 4, 1986, general election ballot to exclude from change in ownership purchases or transfers between parents and their children described therein. Specifically, transfers of real property from a corporation, partnership, trust, or other legal entity to an eligible transferor or transferors, where the latter are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, shall be fully recognized and shall not be ignored or given less than full recognition under a substance-over-form or step-transaction doctrine, where the sole purpose of the transfer is to permit an immediate retransfer from an eligible transferor or transferors to an eligible transferee or transferees which qualifies

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for the exclusion from change in ownership provided by Section 63.1. Further transfers of real property between eligible transferors and eligible transferees shall also be fully recognized when the transfers are immediately followed by a transfer from the eligible transferee or eligible transferees to a corporation, partnership, trust, or other legal entity where the transferee or transferees are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, if the transfer between eligible transferors and eligible transferees satisfies the requirements of Section 63.1. Except as provided herein, nothing in this section shall be construed as an expression of intent on the part of the Legislature disapproving in principle the appropriate application of the substance-over-form or step-transaction doctrine. (Emphasis added.)

As discussed, it might be possible to restructure your proposed transaction in some fashion so as to make effective use of the parent-child exclusion. Should such restructuring prove to be a possibility, it seems unlikely, in view of the above-quoted expression of legislative intent, that an assessor would aggressively apply the step-transaction doctrine so as to find a change in ownership.

As you may be aware, where a taxpayer utilizes a series of transfers or steps to effect a transfer which might otherwise have been accomplished by fewer transfers or steps, we generally recommend that any steps in the transaction be disregarded if the county assessor concludes that they are not supported by a business purpose other than avoiding higher property taxes. However, the legislature has specifically expressed its intent that such doctrine not be applied as indicated in the above-quoted provision so as to frustrate the parent-child exclusion.

The views expressed in this letter are advisory only and are not binding upon the assessor of any county. You may wish to consult the Marin Assessor and any other involved assessor in order to confirm that the subject property or properties will be assessed in a manner consistent with the conclusions stated above.

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Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,

A handwritten signature in cursive script that reads "Robert Lambert". The signature is written in dark ink and is positioned above the typed name.

Robert W. Lambert
Tax Counsel

RWL:wak
2533H

cc:



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Boverly
letter dated memo
for 1-3-91

WILLIAM M. BENNETT
First District, Kentfield

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Third District, San Diego

PAUL CARPENTER
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

CINDY RAMBO
Executive Director

November 21, 1990

Re: Request for Letter Response Change of
Ownership for Proposition 13 Purposes.

Dear Mr. _____ :

This is in response to your letter of October 2, 1990 to the attention of Mr. Richard Ochsner in which you request our opinion as to whether there would be a "change in ownership" and thus a reassessment of the subject properties under the following facts and proposed transaction contained in your letter.

FACTS

A California limited partnership ("Partnership") owns existing real property located in California consisting of raw land and rental buildings. The Partnership's interests are owned 99.9612% by the Father (90% by the Father in the capacity as a general partner, and 9.9612% by the Father in the capacity as a limited partner). The remaining .0388% is owned by Father's two Children's Trusts (.0194% by each child's Trust). Father's Partnership interests are held in the name of Father's "Revocable Living Trust" under which the Father, while alive, is the sole income and principal beneficiary.

Each Child's Trust is an inter vivos irrevocable trust. Each Child's Trust provides for the accumulation of income. Principal and accumulated income from each Child's Trust is distributed to that child for the child's health, medical and educational needs, and for the support and maintenance of the child according to the child's standard of living. On the death of the child, the Trustee may allow the child to appoint property to other persons, if the Trustee deems appropriate in the Trustee's sole discretion. If such power is not exercised, then the property is distributed to that child's issue in trust.

Prop 13 - Pa
Ch. 1 - Prop 13

Father presently owns outside of the Partnership other real property ("New Properties") consisting of raw land and rental buildings, which the Father desires to contribute to the Partnership for the business purpose of centralized management and estate planning. Title to these New Properties is presently held in the name of Father's Revocable Living Trust. Accordingly, the Father proposes to do the transactions described below.

PROPOSED TRANSACTION

Father proposes to transfer .0388% of the New Properties to the two Children's Trusts, after which the Father and the Trusts would transfer the entire amount of the New Properties to the Partnership as follows:

1. First, the New Properties presently in the name of Father's Revocable Living Trust by way of grant deed are gifted equally to the two Children's Trusts in the amount of .0388% (.0194% to each Child's Trust). Therefore, after the grant deed gift from Father to each Child's Trust, Father will own 99.9612% of each New Property as a tenant-in-common, and each Child's Trust will own .0194% of each New Property as a tenant-in-common. This transfer of .0388% of the New Properties represents less than \$1,000,000 of full cash value for California property tax purposes of all real property transferred by Father to the two Children's Trusts.

2. Second, Father and the Trust shall file a claim pursuant to Proposition 58 that the transfers between Father's Revocable Living Trust and each Child's Trust are excluded from being a change in ownership and reassessed due to Proposition 58 as a parent-child transfer.

3. Third, Father and the two Children's Trusts shall transfer by grant deed their entire tenancy-in-common interests of the New Properties to the Partnership. Prior to the above transaction and after this transaction, Father's Revocable Living Trust and the Children's Trusts own the identical percentage interests in the Partnership and in the New Properties, 99.9612% and .0388%, respectively.

For purposes of this opinion, we assume that transfers proposed to be made by Father will in fact be made by Father's Revocable Living Trust since title is held by the Trust and there is no mention of a proposed transfer from Father's Revocable Living Trust to Father.

LAW AND ANALYSIS

"Change in ownership" is defined by section 60 of the Revenue and Taxation Code as a:

[T]ransfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.

Section 61 provides in relevant part that except as otherwise provided in section 62, "change in ownership" as defined in section 60, includes, but is not limited to:...

(i) The transfer of any interest in real property between a corporation, partnership or other legal entity and a shareholder, partner or any other person.

Section 62(a)(2) states that a "change in ownership" does not include:

Any transfer between an individual or individuals and a legal entity or between legal entities...which results solely in a change in the method of holding title to real property and in which the proportional ownership interests of the transferors and the transferees, whether represented by stock...or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

See also Property Tax Rule 462(j)(2)(B).

As you know, the California Electorate passed Proposition 58 in November 1986 which added subdivisions (g), (h) and (i) to Section 2 of Article XIII A of the California Constitution. In part, Proposition 58 excluded from change in ownership transfers of the principal residence of the transferor and the first \$1,000,000 of the full cash value of all other real property between parents and children which were made after the effective date of the amendment (i.e., on or after November 6, 1986).

Section 63.1, which is the implementing legislation for Proposition 58, provides at subdivision (c)(7) that as used in 63.1:...

"Transfer" includes, and is not limited to, any transfer of the present beneficial ownership of property from an eligible transferor to an eligible

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transferee through the medium of an inter vivos or testamentary trust.

Stats. 1987, Ch. 48 is the legislation which added section 63.1 to the Revenue and Taxation Code. Section 2 of Stats. 1987, Ch. 48 provides:

SEC. 2. It is the intent of the Legislature that the provisions of Section 63.1 of the Revenue and Taxation Code shall be liberally construed in order to carry out the intent of Proposition 58 on the November 4, 1986, general election ballot to exclude from change in ownership purchases or transfers between parents and their children described therein. Specifically, transfers of real property from a corporation, partnership, trust or other legal entity to an eligible transferor or transferors, where the latter are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, shall be fully recognized and shall not be ignored or given less than full recognition under a substance-over-form or step-transaction doctrine, where the sole purpose of the transfer is to permit an immediate retransfer from an eligible transferor or transferors to an eligible transferee or transferees which qualifies for the exclusion from change in ownership provided by Section 63.1. Further, transfers of real property between eligible transferors and eligible transferees shall also be fully recognized when the transfers are immediately followed by a transfer from the eligible transferee or eligible transferees to a corporation, partnership, trust or other legal entity where the transferee or transferees are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, if the transfer between eligible transferors and eligible transferees satisfies the requirements of Section 63.1. Except as provided herein, nothing in this section shall be construed as an expression of intent on the part of the Legislature disapproving in principle the appropriate application of the substance-over-form or step-transaction doctrine.

Section 65.1(a) states the general rule that except for a joint tenancy interest described in section 62(f), when an interest in a portion of real property changes ownership, only the interest transferred shall be reappraised except that:

A purchase or change in ownership of an interest with a market value of less than 5 percent of the value of the total property shall not be reappraised if the market value of the interest transferred is less than ten thousand dollars (\$10,000) provided, however, that transfers during any one assessment year shall be cumulated for the purpose of determining the percentage interests and value transferred.

The first step of the proposed transaction is the transfer by the Father's Revocable Living Trust of a .0194% interest in each of the New Properties to each Child's Trust. This step will qualify as a transfer between parent and child which is excluded under section 63.1 if it results in a transfer of the present beneficial ownership of the subject real property from the Father to the children as provided in section 63.1(c)(7). Since Father is the sole income and principal beneficiary of his Revocable Living Trust, a transfer by that Trust is clearly a transfer of Father's present beneficial interest in the property. While the question of whether the children receive a present beneficial interest in the property is not free of doubt because each Child's Trust provides for accumulation of income, we have taken the position that one may be a present beneficiary of a trust even though the right to receive income is discretionary so long as no one else presently has a right to income or principal. Here, the trustee is to distribute principal and accumulated income from each Child's Trust to that child for the child's health and medical needs and for the support, and maintenance of the child according to the child's standard of living. No part of the income or principal of a Child's Trust is to be distributed to anyone but the child during the lifetime of the child. Accordingly, since nobody but a child presently can receive income or principal from a Child's Trust, each child has a present beneficial interest in the property for purposes of section 63.1 in our view. Therefore, since the .0388% interest to be transferred between trusts is less than \$1,000,000 of full cash value, all of the property transferred to the Children's Trusts would be excluded from change in ownership under Proposition 58 and section 63.1.

If, for any reason, the transfers to each Child's Trust were held not to comply with the requirements of section 63.1, the de minimis rule of section 65.1(a) set forth above may apply to some, if not all, of the New Properties transferred to the Children's Trusts. This would require a further parcel-by-parcel analysis based on information which has not been provided.

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The second step of the proposed transaction is the transfer by Father's Revocable Living Trust and the Children's Trusts of their respective tenancy-in-common interests in the New Properties to the Partnership. Since the proportional ownership interests of Father's Revocable Living Trust and the Children's Trusts in each of the New Properties would remain the same after the transfers of the New Properties to the Partnership as they were prior to the transfers to the Partnership, such transfers, which would result solely in a change in the method of holding title to the real property, should be excluded from change in ownership under section 62(a)(2).

However, since there clearly would be a 100% change in ownership if Father's Revocable Living Trust were to transfer New Properties directly to the Partnership without first transferring fractional interests to the Children's Trusts (Property Tax Rule 462(j)(2)(B)(ii)), a question arises as to the applicability of the step-transaction doctrine.

Generally, our position with respect to the application of the step-transaction doctrine is that where a taxpayer utilizes a series of transfers or steps to effect a transfer which might otherwise have been accomplished by fewer transfers or steps, any steps which the county assessor concludes are not supported by a business purpose other than avoiding higher property taxes should be disregarded.

An exception to the step-transaction doctrine exists where transfers are made in order to take advantage of the parent-child exclusion as indicated in section 2 of Stats. 1987, Ch. 48 set forth above. The quoted language describes a situation which closely parallels the proposed transfers described in your letter. That is, section 2 of chapter 48 refers, in part, to a parent-child transfer of real property (qualifying under Revenue and Taxation Code Section 63.1) followed by a transfer from the eligible transferees to a partnership in which the transferees are the sole beneficial owners. In the proposed transaction described in your letter, the qualified parent-child transfer would be followed by a transfer of the beneficial tenancy-in-common interests of the parent and children in the real property to the Partnership which is wholly-owned by both the parent and the children. While the Partnership is not wholly owned solely by the children and, thus, the proposed transaction does not strictly match the pattern described in section 2 of chapter 48, we are of the opinion that under the described circumstances the distinction is not sufficient to deprive the proposed transaction of the benefits of chapter 48. While the question

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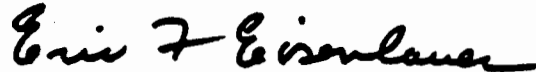
is not necessarily free of doubt, we conclude that the proposed transaction falls within the intent of the Legislature expressed in section 2 of chapter 48 and, for that reason, the step-transaction doctrine would not apply.

Accordingly, the transfers proposed should be excluded from change in ownership under sections 63.1 and 62(a)(2) and the step-transaction doctrine should not be applied. It should be noted that because of the application of section 62(a)(2), Father's Revocable Living Trust and the Children's Trusts would be considered "original co-owners" as defined in section 64(d) for purposes of determining whether a change in ownership of New Properties will occur when interests in the Partnership are subsequently transferred.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusion stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Eric F. Eisenlauer
Tax Counsel

EFE:ta
2777D

cc: Mr. John W. Hagerty
Mr. Verne Walton