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No. 2009/041

September 14, 2009

TO COUNTY ASSESSORS:

APPLICATION OF THE STEP TRANSACTION DOCTRINE

Recently, we have received numerous inquiries regarding change in ownership transactions involving properties where the current market value is less than the factored base year value. Specifically, a property owner transfers his/her property to a second party, and then the second party transfers the property back to the original owner, often on the same day. The apparent intended consequence is to record a change in ownership that would establish a new base year value at a lower current market value, thereby reducing property tax obligations. County assessors have inquired as to whether the step transaction doctrine could be applied to these transactions. The answer is yes.

The step transaction doctrine is applied when a series of transfers are used to transfer real property in order to circumvent the change in ownership laws.<sup>1</sup> The general principle is that whether a transaction is a change in ownership depends upon the substance of a transaction rather than its form. That is, the doctrine focuses on whether each step of a transaction may stand alone or, rather, whether the transaction should be treated as a whole.

In *Shuwa Investments Corp. v. County of Los Angeles*, the California Court of Appeal set forth three tests for determining the application of the step transaction doctrine for property tax purposes:<sup>2</sup>

- *End result test.* Under the end result test, if it appears that a series of transfers were really component parts of a single transaction intended from the beginning to be taken for purposes of reaching the end result, the step transaction doctrine may apply and the intermediate steps may be disregarded.
- *Interdependence test.* Under the interdependence test, if the steps or transfers taken were so interdependent that the legal relations created by one transaction or transfer would have been fruitless (apart from the parties' intention to qualify for an exclusion) without completing the entire series of steps, then the step transaction doctrine may apply and the intermediate steps may be disregarded.
- *Binding commitment test.* Under the binding commitment test, if the structure of the transactions establishes that there is an agreement that once the first step or transfer is

<sup>1</sup> *Shuwa Investments Corp. v. County of Los Angeles* (1991) 1 Cal.App.4<sup>th</sup> 1635, 1648-1649.

<sup>2</sup> *Shuwa, supra*, at p. 1648.

taken that the parties are obligated to complete the remainder of the steps, the step transaction doctrine may apply and the intermediate steps may be disregarded.

While the same set of facts may meet the criteria for more than one of the three tests, only one test needs to be satisfied for the step transaction doctrine to apply.<sup>3</sup> The existence of a business purpose for any of the transfers does not necessarily prevent the step transaction doctrine from being applied in a particular situation; however, it is a factor, along with all other facts and circumstances, that should be considered when analyzing the entire transaction to determine whether the step transaction doctrine should be applied.

When processing change in ownership transactions, county assessors should be particularly cognizant of multiple transactions involving the same parties. To ensure that these tax-avoidance transactions do not involve employee-owned property, we remind county assessors that they should have effective procedures for maintaining the integrity of assessments of employee-owned property (see Letter To Assessors 2008/058).

If you have further questions regarding the step transaction doctrine, please contact the Assessment Services Unit at 916-445-4982.

Sincerely,

/s/ David J. Gau

David J. Gau  
Deputy Director  
Property and Special Taxes Department

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<sup>3</sup> *McMillin-BCED/Miramar Ranch North v. County of San Diego* (1995) 31 Cal.App.4<sup>th</sup> 545, 556.