



## STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA  
 PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082  
 TELEPHONE 916-324-2646 • FAX 916-323-3387  
 www.boe.ca.gov

BETTY T. YEE  
 First District, San Francisco

BILL LEONARD  
 Second District, Ontario/Sacramento

MICHELLE STEEL  
 Third District, Rolling Hills Estates

JEROME E. HORTON  
 Fourth District, Los Angeles

JOHN CHIANG  
 State Controller

RAMON J. HIRSIG  
 Executive Director

October 30, 2009

**Re: Request for Legal Opinion in connection with BOE-100-B filing for K  
 B (C 0000-0000-0098), and BOE-100-B filing for U.S. , Inc. (C 0000-  
 0000-0078)  
 Assignment No.: 09-126**

Dear Mr. :

This is in response to your letter of July 20, 2009, wherein you requested a written opinion concerning the property tax implications of a 2000 merger of two corporations into one surviving corporation. As the result of a form BOE-100-B, *Statement in Change in Control and Ownership of Legal Entities*, submitted on behalf of the corporations, the Board of Equalization's Legal Entity Ownership Program (LEOP) requested additional information regarding the merger and concluded that a change in ownership of the property owned by the merging corporations occurred as a result of the merger.

As explained below, we agree with the determination made by LEOP that a change in ownership of the property owned by the merged corporations occurred as a result of the merger; however, such change in ownership occurred as a result of the transfer of such real property between legal entities, and not section 64, subdivision (c)(1).

### **Factual Background**

Based on your letter of July 20, 2009, and the supporting documentation you provided, on December 31, 2000, K B (KB) and U.S. (US) (together Merged Corporations) entered into a Plan of Agreement and Merger (Plan) whereby both corporations would merge with and into K B, Inc. (Surviving) in a reorganization intended to qualify as a tax-free reorganization under Internal Revenue Code (IRC) section 368(a)(1)(A). (Merger). Along with your letter, you provided a "Statement of Exchange" which showed stock ownership in KB and US pre-merger, and in K B, Inc. post-merger.

On April 27, 2006, LEOP received a BOE-100-B, *Statement in Change in Control and Ownership of Legal Entities*, for each of the corporations involved in the Merger. In a letter to Surviving, dated June 12, 2008, LEOP requested additional information regarding the Merger. You responded with a letter dated July 2, 2008. LEOP sent another letter dated May 22, 2009, stating their conclusion that the Merger resulted in a change in ownership of the properties owned by US and K. You again responded with a letter dated June 15, 2009.

### **Law and Analysis**

Article XIII A, section 2 of the California Constitution allows the reassessment of real property upon a "change in ownership." A change in ownership is defined in Revenue and Taxation Code<sup>1</sup> section 60 as "a transfer 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." Therefore, unless an exclusion applies, a change in ownership occurs upon the transfer of any interest in real property, including a transfer to a corporation or other legal entity. (Rev. & Tax. Code, § 61, subd. (j); Property Tax Rule<sup>2</sup> (Rule) 462.180, subd. (a).) However, section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as corporate voting stock, does not constitute a transfer of the real property owned by the legal entity. Section 64, subdivision (c)(1), provides that when an individual obtains ownership or control of more than a 50 percent ownership interest in a legal entity, there is a change in ownership of the real property owned by the legal entity in which the controlling interest is obtained. (Rev. & Tax. Code, § 64, subd. (c)(1).)

IRC section 368 governs tax-free reorganizations for purposes of federal income tax. IRC section 368(a)(1)(A) is a "statutory merger or consolidation" and must be effected pursuant to statute or statutes necessary to effect the merger or consolidation, in which, as a result of the operation of such statute or statutes, all of the assets and liabilities of a target corporation transfer to an acquiring corporation, and target ceases to exist.<sup>3</sup> In exchange, target shareholders receive acquiring stock. Such a reorganization is sometimes referred to as a "statutory merger" or an "A reorganization."

The Plan provides that the Merger is effected pursuant to the applicable laws of the State of California and the State of Colorado.<sup>4</sup> California Corporations Code section 1100 states that "Any two or more corporations may be merged into one of those corporations." Corporations Code section 1107, subdivision (a) states:

Upon merger pursuant to this chapter the separate existence of the disappearing corporations ceases and the surviving corporation shall succeed, without other transfer, to all the rights and property of each of the disappearing corporations and shall be subject to all the debts and liabilities of each in the same manner as if the surviving corporation had itself incurred them.

---

<sup>1</sup> All section references are to the Revenue and Taxation Code unless otherwise specified.

<sup>2</sup> All subsequent references to "Rules" are to the Property Tax Rules promulgated under Title 18 of the California Code of Regulations.

<sup>3</sup> 26 C.F.R. § 1.368-2(b)(1)(ii) (2009).

<sup>4</sup> Plan of Agreement and Merger, Recital C and Art. 1.

The Plan further provides for Merged Corporations' shareholders to receive Surviving stock.<sup>5</sup>

Therefore, pursuant to the terms of the Plan as well as the California Corporations Code under which the Plan was effectuated, as a result of the Merger, the assets of the Merged Corporations were transferred to Surviving by operation of law. Pursuant to sections 60 and 61, subdivision (j) and Rule 462.180, subdivision (a), the transfer of property from one corporation to another is a change in ownership of such property transferred. Therefore, the transfer of any California real property to Surviving as a result of the Merger resulted in a change in ownership of that property. However, the transfer of Surviving stock to former Merged Corporations shareholders would not result in a change in ownership of any California real property owned by Surviving prior to the Merger, unless one person or entity obtained more than 50 percent of Surviving stock.<sup>6</sup> (Rev. & Tax. Code, § 64, subs. (a) and (c)(1).) Such, however, does not appear to be the case.

In Property Tax Annotation 220.0066, the Legal Department opined that a merger of one bank entity (SM Bank) into another (M Bank) resulted in a transfer of SM Bank assets to M Bank by operation of law, resulting in a change in ownership of any real property transferred.<sup>7</sup> While you state, in a June 15, 2009 letter to Lisa Thompson of LEOP, your opinion that this portion of the Annotation is not applicable because the surviving corporation did not own property subject to taxation in California, such fact is irrelevant here. Instead, the proper inquiry is whether California real property was transferred to another legal entity without the benefit of an exclusion from change in ownership. As explained above, the Merger resulted in the transfer, by operation of law, of Merged Corporations assets to Surviving. Therefore, unless such transfer qualifies for an exclusion, any California real property will undergo a change in ownership.

Section 64, subdivision (b) sets forth an exclusion from change in ownership for any corporate reorganization that qualifies under IRC section 368 and is a nontaxable event under California law, but only if all corporations involved are "members of an affiliated group." In addition, subdivision (b) excludes from change in ownership transfers of real property or legal entity ownership interests among members of an affiliated group. "Affiliated group" is defined as "one or more chains of corporations connected through stock ownership with a common parent corporation" where both of the following conditions are met: (1) one hundred percent of the voting stock (exclusive of any share owned by directors) of each of the corporations (except the parent corporation) is owned by one or more of the other corporations; and (2) the common parent corporation owns, directly, 100 percent of the voting stock (exclusive of shares owned by the directors) of at least one of the other corporations. Pursuant to this definition, the Merged Corporations and Surviving were not members of an affiliated group since they were not owned by a common parent corporation and not related in a qualifying manner. Therefore, even though the Merger qualified under IRC section 368(a)(1)(A), the Merger does not qualify for this exclusion.

Section 62, subdivision (a)(2) provides an exclusion from the definition of change in ownership for proportional ownership interest transfers between legal entities or between legal entities and an individual. To qualify for the exclusion, such transfers must result solely in a

---

<sup>5</sup> Plan of Agreement and Merger, Art. 2.

<sup>6</sup> We also assume that the pre-Merger shareholders of Surviving were not original coowners within the meaning of section 64, subdivision (d).

<sup>7</sup> Annotation 220.0066 involved a "reverse triangular merger" which, as you know must also qualify as a statutory merger.

change in the method of holding title to the real property, and the proportional ownership interests of the transferors and transferees must remain exactly the same both before and after the transfer in each and every real property transferred. (Rev. & Tax. Code, § 62, subd. (a)(2); Rule 462.180, subd. (b)(2).)

Your letter states that there is *nearly complete* commonality among the shareholders of the two merged corporations. However, for the exclusion of section 62, subdivision (a)(2) to apply, *complete* proportionality between the transferees and the transferors is required. In other words, the shareholders' interests in K and US as represented by their voting stock must have been the same prior to the Merger, and after the Merger, those same shareholders' must have the exact same interests in Surviving. Based on the Share Exchange Table attached to your letter, it appears that this is not the case. Before the Merger not all K shareholders were US shareholders and not all US shareholders were K shareholders. For example, before the Merger, Joyce had an interest in US but no interest in K. After the Merger, Joyce had a 2.33 percent interest in class B stock of Surviving. Therefore, before the Merger, Joyce had no interest in real property owned by K and after the Merger had an interest in the property transferred from K to Surviving as a result of her ownership of the Class B stock.

We are not aware of any other exclusions for which the Merger may be eligible. Thus, any California real property transferred to Surviving as a result of the Merger will undergo a change in ownership.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Daniel Paul

Daniel Paul  
Tax Counsel

DP:yg

J:/Prop/Prec/Legal Enties/09-126.doc

cc: Mr. David Gau MIC:63  
Mr. Dean Kinnee MIC:64  
Mr. Todd Gilman MIC:70  
Ms. Lisa Thompson MIC:64