

M e m o r a n d u m

To: Mr. Dean Kinnee (MIC:64)
Chief, County-Assessed Properties Division

Date: June 2, 2010

From: Richard S. Moon
Tax Counsel IV

Subject: *Request for Legal Opinion – Change in Ownership, Private Golf Club Memberships Assignment No. 09-255*

This is in response to your November 25, 2009, memorandum to Assistant Chief Counsel Randy Ferris requesting our opinion as to the change in ownership treatment of real property owned by private golf clubs, described in your memorandum as "equity membership organizations," when there is a transfer of membership in the organization.

Our understanding is that private golf clubs in California are most commonly organized as nonprofit mutual benefit corporations (hereafter mutual benefit corporations or corporations) under the California Corporations Code.¹ As explained in further detail below, a mutual benefit corporation has wide latitude in drafting their articles of incorporation and bylaws to allow its members a multitude of rights that may potentially include specific rights to real property owned by the corporation. For that reason, if members are granted rights to real property such that beneficial ownership of property is conveyed, a transfer of such membership should be considered a change in ownership of the property to which that membership gives rights. However, if membership does not convey an interest in real property akin to beneficial ownership, as in a mere license to use the property, the transfer of a membership interest in a club would not be a change in ownership of any of the property owned by the club pursuant to Revenue and Taxation Code² section 64, subdivision (a). If, however, one member or director gained more than 50 percent of the voting interest in the club, a change in ownership of all of the real property owned by the club would occur pursuant to section 64, subdivision (c)(1). We also believe that the provisions of section 62, subdivision (a)(2) (hereafter section 62(a)(2)) and section 64, subdivision (d) apply to mutual benefit corporations.

Equity Club Membership Organizations

A mutual benefit corporation is a corporation formed under Part 3 of the California Corporations Code³ principally for the mutual benefit of its members (fraternal organizations, tennis clubs) or for the mutual benefit of all those engaging in a particular type of business (trade associations) or

¹ Corp. Code, § 7110 et seq.

² All further statutory references are to the Revenue and Taxation Code unless otherwise specified.

³ Corp. Code, § 5059.

activity (automobile clubs).⁴ There is no doubt that they are "legal entities" within the meaning of section 64. They may be formed for any lawful purpose that does not include the distribution of gains, profits, or dividends to members except upon dissolution.⁵ They can, however, provide that their members or directors have distribution rights upon dissolution of the corporation.⁶

You cite a 2007 article in which "equity memberships" are described as follows:

Equity membership programs are those in which the club facilities are owned by a nonprofit corporation and each member of the club has an ownership or "equity" interest in the club. As an "equity" member of a club, a member has a right to vote on club matters following turnover of developer control, the members manage and operate the club facilities (directly by a board of directors or through a management company) and the members jointly become responsible for the financial obligations of the club operations.

We note, however, that there is nothing in the article that explicitly identifies the clubs described as organized under or not organized under California law. Obviously, for change in ownership purposes, the relevant law is the California Revenue and Taxation Code and the California Corporations Code. Thus, we first note that referring to all memberships in a mutual benefit corporation as "equity" membership organizations is inaccurate since the Corporations Code does not set forth different "types" of memberships (e.g., some that include equity in the organization, and some that do not). Notably, there is no requirement in the Corporations Code that members are given equity, or a proprietary interest in the club.

Instead, the Corporations Code provides for wide latitude in the rights and responsibilities a mutual benefit corporation can grant to its members. In fact, the Corporations Code provides that mutual benefit corporations may admit members *as provided for in its articles or bylaws*, or it may provide that it will have *no* members.⁷ Furthermore, pursuant to Corporations Code section 5056, a member is merely a person that has the right to vote for the board of directors or vote on changes to the articles or bylaws;⁸ but it should be noted that clubs may confer some or all of the rights of a member to someone who does not have voting rights.⁹ As well, the term "member" may also be used to describe persons associated with the club even though they are not "members" within the meaning of Corporations Code section 5056.

Thus, if a club grants a "membership" that allows the mere use of club property, the transfer of such a membership would not be a change in ownership. Likewise, if a club grants a "membership" that includes the ability to vote for members of the board of directors and the right to receive a distribution of property upon dissolution, there would be no change in ownership upon a transfer of such a membership since such a membership would carry rights similar to the rights that stockholders have in a general business corporation.

⁴ Cal.Jur.3d § 773

⁵ See Corp. Code, § 7410 et seq. However, so long as the distribution restrictions are properly observed, mutual benefit corporations may be formed for the purpose of making a profit. (Corp. Code, § 7140, subd. (l).)

⁶ Corp. Code, § 7411.

⁷ Corp. Code, § 7310, subd. (a).

⁸ Corp. Code, § 5056, subd. (a).

⁹ Corp. Code, § 5056, subd. (b).

However, unlike general business corporations, where the stockholders have no rights in the corporate property,¹⁰ it appears that members in a mutual benefit corporation may be granted current rights in the property owned by the mutual benefit corporation. As noted, mutual benefit corporations have wide latitude in the rights and responsibilities it can grant to its members. For example, a mutual benefit corporation may confer upon members the right to determine the consideration for which memberships shall be issued,¹¹ allow its members the right to determine rules regarding transfers of membership,¹² determine classes and redemption of memberships,¹³ issue memberships having differing rights, privileges, preferences, restrictions, or conditions,¹⁴ levy dues and assessments,¹⁵ and may provide that membership is required as an incident to ownership of an interest in real property.¹⁶

Change in Ownership of Real Property Held by Mutual Benefit Corporations

As explained above, membership in a mutual benefit corporation may include various rights including significant rights in property legally titled in the name of the corporation.¹⁷ In that case, the members should be treated as the owners of the real property, and not merely as owners of the corporation. And, pursuant to section 60, transfers of such memberships should be considered a change in ownership of the percentage of the property to which that membership gives rights. This would be true, for example, when a member has rights to a specifically identifiable portion of property as in the Property Tax Annotation (Annotation) described below.

In Annotation 220.0437 (April 3, 2001), we opined that a transfer of a "Home Site Permit" attendant to a certificate of membership in a mutual benefit corporation was a transfer of a present interest in real property subject to a change in ownership. This was because the membership was a prerequisite for acquiring possession of a lot to which the member had exclusive use and development rights, as well as the right to buy and sell. Thus, in the back-up letter to this Annotation we concluded that:

It seems clear to us that the holder of the Home Site Permit is the primary owner of the property, because that person holds the vast majority of the incidents of ownership – the primary sticks in the bundle of rights representing ownership: occupancy, exclusive use and enjoyment, the right to build, the right to rent the property and the right to sell the property.¹⁸

For this reason, to determine whether a transfer of membership is a change in ownership of some percentage of real property owned by the corporation, a review must be made of the corporation's bylaws and articles of incorporation to determine the rights the members have in

¹⁰ See 9 Witkin, Summary of Cal. Law (10th ed. 2008) Corporations, § 1.

¹¹ Corp. Code, § 7132, subd. (a)(3).

¹² Corp. Code, § 7320, subd. (a)(2).

¹³ Corp. Code, § 7332, subd. (a).

¹⁴ Corp. Code, § 7330.

¹⁵ Corp. Code, § 7350, subd. (b).

¹⁶ Corp. Code, § 7350, subd. (c).

¹⁷ We note that it could be argued that the grant of ownership rights in property would be a violation of the Corporation Code's prohibition against the distribution of property to members of a mutual benefit corporation except upon dissolution. However, we offer no opinion on that issue.

¹⁸ Back-up Letter to Annotation 220.0437, at p. 5.

the real property. If those rights grant sufficient, current ownership rights in the real property to the member, a change in ownership results on a transfer of that membership.

However, if those rights result, for example, in a mere license or right to use property owned by the corporation, no change in ownership results upon the transfer of such a membership.¹⁹ In such a case, the member should be considered to have transferred a mere ownership interest in the corporation itself, similar to the transfer of stock in a business corporation. Therefore, when a member in a club transfers such a membership either to another member or to the club itself, that transfer is excluded from change in ownership pursuant to section 64, subdivision (a), which, in relevant part, provides:

the purchase or transfer of *ownership interests in legal entities*, such as corporate stock or partnership or limited liability company interests, shall not be deemed to constitute a transfer of the real property of the legal entity. (Emphasis added.)

No authoritative basis in law, whether constitutional, statutory or judicial, exists that would require mutual benefit corporations to be treated differently than business corporations in the taxation of real property a mutual benefit corporation owns, provided the mutual benefit corporation retains the beneficial ownership of the real property.²⁰ Further, the fact that mutual benefit corporations do not issue "stock" does not negate the fact that a membership interest that conveys an ownership interest in the corporation is an ownership interest for purposes of section 64, subdivision (a). Therefore, it is our opinion, that for purposes of transfers of membership interests in a club that do not also convey sufficient rights to real property, a membership interest in the club is an ownership interest of a legal entity for purposes of section 64, and a transfer of such a membership interest is not a change in ownership of property owned by the corporation pursuant to section 64, subdivision (a).

We do note, however, that since we have equated membership interest in a club with "ownership" interest for purposes of section 64, it naturally follows that the percentage of the club owned by the member is the voting interest percentage held by that member as a result of his membership in the club. Therefore, if a single member were to obtain more than 50 percent of the voting interest in a club, the club would undergo a change in control pursuant to section 64, subdivision (c)(1) which provides that:

When a corporation, partnership, limited liability company, other legal entity, or any other person obtains control through direct or indirect ownership or control of

¹⁹ We assume that this is the case for the typical private golf club. Nothing in this memorandum should be interpreted to suggest that we believe that intensive effort by county assessors is required to verify that mutual benefit corporations have not transferred specific rights in real property to their members or that this should be a prominent focus of any survey conducted by the County-Assessed Properties Division.

²⁰In Annotation 220.0438 (April 3, 2002), we opined that transfers of membership interests in a fishing club organized as a mutual benefit corporation resulted in changes in ownership of the real property owned by the club. Although we assumed that no exclusive rights of occupation and use of specifically identifiable portions of the real property in question were conferred on the subject members, it is unclear from the back-up letter to Annotation 220.0438 whether we were aware of provisions in the relevant articles of incorporation or bylaws that indicated that the membership interests at issue conferred other specific rights to the real property in question that were sufficient to effect a change in ownership. To the extent the back-up letter's analysis rested solely on a theory that the absence of "stock" ownership automatically granted members of a mutual benefit corporation possessory rights to the corporation's real property, such an analysis is incorrect. In any case, whether due to an incomplete or an erroneous analysis, Annotation 220.0438 should be deleted to avoid unnecessary confusion.

more than 50 percent of the voting stock of any corporation, or obtains a majority ownership interest in any partnership, limited liability company, *or other legal entity* through the purchase or transfer of corporate stock, partnership, or limited liability company interest, or ownership interests in other legal entities, including any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained, the purchase or transfer of that stock or other interest shall be a change of ownership of the real property owned by the corporation, partnership, limited liability company, or other legal entity in which the controlling interest is obtained. (Emphasis added.)

As well, the proportional ownership interest exclusion found at section 62(a)(2) should also apply to mutual benefit corporations. It provides that a change in ownership does not include:

Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, that results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer. The provisions of this paragraph shall not apply to transfers also excluded from change in ownership under the provisions of subdivision (b) of Section 64. (Emphasis added.)

However, upon the exclusion of a transfer under section 62(a)(2), section 64, subdivision (d) provides the following:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in that legal entity immediately after the transfer shall be considered the "original coowners." Whenever shares or other ownership interests representing cumulatively 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 of that real property owned by the legal entity shall have occurred, and the property that was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised.

Again, since we have equated ownership with membership, the proportional ownership interest should be measured by members, or by the board of directors if there are no members, for purposes of the section 62(a)(2) exclusion. The members or directors must then become "original co-owners" in the mutual benefit corporation such that if a voting interest change in the members or board of directors of more than 50 percent occurs, there would be a change in ownership of the property previously excluded under section 62(a)(2). For example, if two mutual benefit corporations merge and they had the identical same five members before and after the merger, any real property transferred in the merger would be excluded from change in ownership under section 62(a)(2), and as a result, the five members would become original co-owners. Subsequently, if 3 of the 5 members changed, more than 50 percent of the voting

interest would have changed, and a change in ownership of the previously excluded property would result.

RM:yg

J:/Prop/Prec/2010/Changeownshp & Legal Entities/09-255.doc

cc: Mr. David Gau MIC:63
 Mr. Todd Gilman MIC:70