

February 23, 1983

Dear _____:

This is in response to your letter of January 10, 1983, to Mr. Glenn Rigby in which you ask for our opinion on the property tax consequences of a transfer of certain real property to an irrevocable trust and a subsequent amendment to the term of the trust. Specifically, it is our understanding that on February 22, 1982, certain real property in Humboldt County was transferred to an irrevocable trust for a term of 12 years and 5 months, after which time M_____, reaches the age of 21 years. As of March 1, 1982, the county assessor reappraised the property as a change in ownership because the term exceeded 12 years in duration (See Rev. & Tax. Code, Section 62 (d).) Thereafter, on December 15, 1982, the trust was "retroactively" amended to reduce the term to 11 years and 11 months.

We are of the opinion that the amendment of the trust had no effect on the March 1, 1982, appraisal of the property. It appears from the documents that the intention of the parties was to have the property held in trust until both of the children beneficiaries attained 21 years of age. Pursuant to this intention, the deed and trust instruments were executed, delivered and accepted. The subsequent amendment was not for the purpose of correcting any mistake, but rather apparently for the purpose of attempting to bring the transfer within the change in ownership exclusion provided in Section 62(d) of the Revenue and Taxation Code. In this regard, I direct your attention to the case of Freeman v. Commissioner of Internal Revenue, (303 F. 2d 580 (1962)) in which the court stated at pp. 584-585:

It is quite true that in matters of tax liability, as in other fields, substance is generally to be preferred to form. But it is not correct to say that the form which a transaction takes is unimportant from the standpoint of tax liability. Indeed, not be considered to be the owner of the 40% interest for change in ownership purposes.

Revenue and Taxation Code section 64 contains the change in ownership provisions applicable to transfers of ownership interests in legal entities, such as corporate stock or partnership interests. Subdivision (c) of that section provides that when a corporation, partnership or other person obtains "control, as defined in Section 25105, in any corporation, or obtains a majority ownership interest in any partnership" through the purchase or transfer of corporate stock or partnership interests, there shall be a change in ownership of the property owned by the corporation or partnership.

Section 64 is implemented and interpreted by subdivision (j) or Property Tax Rule 462 (18 Cal. Code of Regs. §462). Subdivision (j) (4) (A) provides, in part, that when any corporation, partnership or other person obtains "direct or indirect ownership" of more than 50% of the total interest in both partnership capital and profits, there is a change in ownership of the partnership property. Specifically, the subdivision provides, in part, "upon the acquisition of such direct or indirect ownership or control, all of the property owned directly or indirectly by the acquired legal entity is deemed to have undergone a change in ownership".

Nothing in either the statute or the regulation deals specifically with the question of whether the trustee of a trust which owns an interest in a partnership should be considered to be

an owner of the partnership interest for purposes of the provisions described above. Further, we are not aware of any appellate court decision dealing with this issue. Thus, our conclusions must be based upon our interpretation of the language of the statute and regulations.

Subdivision (c) of Revenue and Taxation Code section 64 makes a clear distinction between the change of ownership standard applied to corporations (i.e., control as defined in section 25105) and the standard applied to partnerships (i.e., majority ownership). This distinction is reflected in Rule 462, which contains separate provisions for corporations and partnerships. The portion of the regulation dealing with the partnerships, subdivision (j) (4) (A) (ii), refers to "direct or indirect ownership of more than 50% of the total interest of both partnership capital and profits". This standard is distinct from the standard applicable to corporations, which refers to ownership or control. Even though the language of the closing paragraph in subdivision (j) (4) (A) refers to "direct or indirect ownership or control" the preceding language makes clear that the reference to "control" is included because it refers to the standard applied to corporations. We have never interpreted this language as extending the "control" standard to partnerships. Thus, the question is not whether R. Mc had control of more than 50% of the partnership interest. It is whether R. Mc had direct or indirect ownership of more than 50% of the partnership interest.

The facts presented indicate that the subject 40% interest in the partnership was owned by the four educational trusts (10% each). The discussion presented on behalf of R. Mc seems to concede that he does not have direct ownership of the 40% partnership interest. There is a suggestion, however, that as trustee, he has indirect ownership. The suggestion that R. Mc indirectly owns the 40% interest is apparently based on the argument that he has control of the asset and, therefore, has indirect ownership of it. As indicated in the statute and regulation, there is a clear distinction made between ownership and control. For partnership purposes, control is not tantamount to ownership. Indirect ownership occurs, for example, where A owns all of the stock of Corporation X which owns a 40% interest in partnership P. In that situation A would be the indirect owner of the 40% interest in P. In our opinion, R. Mc does not have indirect ownership, as that term is used in Rule 462, of the 40% partnership interest held by the four educational trusts simply because R. Mc is the trustee of each of those trusts. Thus, under the facts presented, we conclude that R. Mc held only a 45% interest, rather than an 85% interest, in the subject partnership in 1982. When R. Mc acquired the additional 15% partnership interest, he acquired a majority ownership interest, which triggered a change in ownership under the terms of Revenue and Taxation Code section 64(c) and Rule 462(j).

A number of arguments are advanced on behalf of the taxpayer's position based upon an April 11, 1983 letter written by Eric Eisenlauer, Board staff attorney, and upon two court cases interpreting Revenue and Taxation Code section 25105 for franchise tax purposes. For various reasons, we do not find these authorities to be persuasive.

Mr. Eisenlauer's letter deals with the question of whether an individual had obtained control of the voting stock of a corporation. Had the partnership at issue here been a corporation, we might have agreed with the taxpayer's position, based upon Mr. Eisenlauer's letter. As explained above, however, the standard applicable to partnerships is ownership and not control. Thus, Mr. Eisenlauer's letter is not applicable to the situation before us.

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In Rainbird Sprinkler Mfg. Corp. v. Franchise Tax Board (4/25/91) 229 Cal. App. 3d 784, the court dealt with the question of whether some 17 corporations engaged in various aspects of the manufacture and sale of Rainbird sprinklers should be treated as a unitary business for franchise tax purposes where a majority stock interest in each corporation was held by a mother and her two children. The Rainbird decision discusses a related case dealing with a similar issue. See Hugo Neu-Proler Internat. Sales Corp. v. Franchise Tax Board (1987) 195 Cal. App. 3d 326. Since those decisions deal with Revenue and Taxation Code section 25105, the standard applicable to corporations, we fail to see how they apply to the partnership problem presented here. Further, we have previously considered these decisions and have concluded that these decisions have no legal effect upon property tax change in ownership questions. Attached for your information is a copy of my July 10 memo on this subject.

The views expressed above are, of course, advisory in nature. 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,

(Original signed by)

Richard. H. Ochsner
Assistant Chief Counsel

RHO:ta
3781D
Attachment

Cc: Mr. John W. Hagerty
Mr. Verne Walton
Mr. Eric F. Eisenlauer