California State
Board *of* Equalization

Legislative Bill Analysis

County-Assessed Properties Division

Senate Bill 1319 (Bates)
Date: February 21, 2020 (Introduced)
Program: Property Taxes
Sponsor: Author
Revenue and Taxation Code Sections 64, 480.1, 480.2, 480.9, 482, and 486
Effective: Upon chaptering

Mark Durham (Chief) 916.274.3423
Glenna Schultz (Analyst) 916.274.3362
Ronil Dwarka (Revenue) 916.274.3391
Analysis Date: April 10, 2020

Summary: Creates a new "change in ownership" event for real property owned by legal entities when 90 percent or more of direct or indirect ownership interests in that legal entity transfer or sell in a planned single transaction. Also removes floating homes from the change in ownership statement non-filing penalty.

Specifically, this bill:

- Requires reassessment of a legal entity's real property holdings when 90 percent or more of its ownership interests are sold or transferred in a "single transaction," except when the sale or transfer qualifies for an exclusion from change in ownership. *Section 64(c)(1)(B)(i)*
- Defines a "single transaction" to mean a plan consisting of one or more sales or transfers of ownership interests that occur on or after January 1, 2021. *Section 64(c)(1)(B)(ii)(IV)*
  - Creates a rebuttable presumption that sales or transfers are part of a single transaction when the transferees (buyer) are related persons/entities or fiduciaries per federal law,[1] thus effectively allowing counting of the cumulative ownership interests of all the related parties to reach the 90 percent or more threshold. *Section 64(c)(1)(B)(ii)(IV)(ia)*
  - Creates a rebuttable presumption that sales or transfers occurring within a 36-month period are part of a single transaction, thus allowing cumulative counting of ownership interest transfers to reach the 90 percent threshold. *Section 64(c)(1)(B)(ii)(IV)(ib)*
  - Includes sales or transfers that occur within a 36-month period, beginning on the date of the first sale or transfer of ownership interests that occurs on or after January 1, 2021.
- Provides that "sold or transferred" does not include:
  - Certain transfers that occur upon death (i.e., inheritance). *Section 64(c)(1)(B)(ii)(V)(ia)*
  - Publicly traded corporate stock or partnership interest sales occurring in regular trading activity on an established securities market. *Section 64(c)(1)(B)(ii)(V)(ib)*
- Provides that the indirect ownership or transfer of ownership interests is to be measured proportionately. *Section 64(c)(3)*
- Provides that once an ownership interest is counted to determine whether a change in control or ownership of a legal entity has occurred, a subsequent transfer of that interest is not counted again in determining whether any other sale or transfer of ownership interests results in a change in ownership of the real property reassessed as a result of the change in control or ownership. *Section 64(f)*

---

[1] 26 United States Code section 267(b).

- Requires the State Board of Equalization (BOE) to prescribe new regulations to carry out the purposes of this section. *Section 64(g)*
- Requires the legal entity to report a change in ownership event to the BOE within 90 days. *Sections 480.1, 480.2, 482*
- Increases the penalty from 10 percent to 15 percent for legal entities that do not report a reassessable event to the BOE. *Sections 480.1, 480.2, 482*
- Requires the BOE to notify County Assessors when legal entity reassessment events occur. *Section 480.9*
- Requires the BOE to report to the Legislature the frequency of reassessments occurring under the new change in ownership event and its economic impact by January 1, 2023. *Section 486*

Separate from the changes regarding legal entities, this bill removes floating homes from the penalty provisions when a change in ownership statement is not timely filed with the County Assessor. *Section 482*

Fiscal Impact Summary: The annual revenue gain could amount to about $348 million.

Existing Law: For property tax purposes, real property is reassessed from its Proposition 13 protected value (called a "base year value") to its current market value when real property undergoes a change in ownership.[2] Different change in ownership laws apply to a person who buys real property than to a person who obtains ownership interests in a legal entity that owns real property.[3]

Interests in Real Property. Revenue and Taxation Code (RTC) section 61(j) provides that a change in ownership includes the transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person. As a general rule, the law requires a reassessment equal to the percentage interest transferred. If the ownership interests in the real property are identical before and after a transfer, the transfer may be excluded from reassessment under RTC section 62(a)(2). Property Tax Rule 462.180 extends these provisions to transfers of real property between separate legal entities.

Interests in Legal Entities. RTC section 64 sets forth the change in ownership provisions for the purchase or transfer of ownership interests in legal entities (e.g., stock in a corporation, membership interests in a limited liability company, or interests in a partnership) that own real property. As a general rule, under RTC section 64(a), transfers of ownership interests in legal entities do *not* constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property. However, there are two exceptions wherein the transfer of ownership interests in a legal entity would trigger a change in ownership:

- **Change in Legal Entity Control.** RTC section 64(c)(1) requires reassessment when any person or entity obtains control through direct or indirect ownership or control of more than 50 percent of corporation voting stock, or obtains more than a 50 percent ownership interest in any other type of legal entity. The reassessment applies to all real property owned by the acquired legal entity (and any entity under its control).
- **Cumulative Transfers by "Original Co-owners**." RTC section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50 percent of the total interests in a legal entity are transferred by any of the "original co-owners" in one or more

---

[2] California Constitution, article XIII A, section 2; RTC section 110.1.
[3] California Constitution, article XIII A, section 2; RTC sections 60 – 69.5.

transactions.[4] The reassessment applies to only the real property previously excluded from change in ownership under RTC section 62(a)(2).

Indirect Ownership. Existing statutes do not specify the method of counting indirect ownership of legal entity ownership interests.

Counting Interests. Currently, ownership interests of spouses are not counted together as a single unit, regardless of whether the ownership interests are separate property or community property. With respect to immediate families, parents, children, and siblings' interests are also counted separately for each person.

Self-Reporting Requirement. Existing law requires legal entities to file a change in ownership statement (LEOP COS)[5] with the BOE within 90 days of a change in control or ownership under RTC section 64(c) or (d). In the case of a change in control under RTC section 64(c), the person or legal entity that *acquired* control of the legal entity is responsible for filing the LEOP COS.

Requirement to File Upon Request. In addition to the self-reporting requirement to file a LEOP COS, the BOE may send a LEOP COS to an entity to complete and file with the BOE. Annually, the BOE canvasses legal entities with a query on the state income tax return. County Assessors and other interested parties may send referrals reporting possible changes.

Penalty. A penalty applies if the LEOP COS is not filed within 90 days of the date of (1) change in control or ownership, or (2) the BOE's request to file. The penalty amount is either:

- 10 percent of the taxes applicable to the new base year value if a change in control or change in ownership has occurred, or
- 10 percent of the current year's taxes if *no* change in control or change in ownership has occurred.

Floating Homes. RTC section 229 provides that floating homes are not vessels, but are treated as real property for property tax assessment purposes. Similar to real property and manufactured homes, when a floating home changes ownership, the buyer or transferee is required to file a change in ownership statement (COS) with the County Assessor.[6] If the County Assessor sends a request to file a COS and the COS is not timely filed, a penalty applies.[7]

---

[4] **Proportional Ownership Interests Exclusion Creates "Original Co-owner" Designation.** Under RTC section 62(a)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests in the real property are *exactly* the same before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the persons holding ownership interests in the legal entity immediately after the transfer are considered "**original co-owners**" for purposes of tracking subsequent transfers by original co-owners of those interests. When such transfers cumulatively exceed 50 percent, the real property previously excluded from reassessment under RTC section 62(a)(2), is deemed to undergo a change in ownership, and is, therefore, subject to reassessment under RTC section 64(d).

[5] Legal Entity Ownership Program (LEOP) change of ownership is detailed on page 7 of this analysis.

[6] RTC section 480.

[7] RTC sections 480(c) and 482.

Proposed Law:

Transfers of Ownership Interests in Legal Entities: Change in Ownership Trigger Event. This bill provides that when 90 percent or more of the direct or indirect ownership interests in a legal entity transfer in a single transaction, the transfer of the ownership interests is a change of ownership of the real property the legal entity owns, including real property owned by a legal entity under its control. A change in ownership triggers reassessment. *Section 64(c)(1)(B)*

"**Single transaction**" means a plan consisting of one or more sales or transfers of ownership interests that occur on or after January 1, 2021. *Section 64(c)(1)(B)(ii)(IV)*

Rebuttable Presumption. There is a rebuttable presumption that a sale or transfer is part of a single transaction if *either* of the following occur:

- The transferees are persons described in section 267(b) of title 26 of the United States Code (U.S.C.), which describes transactions between related taxpayers and fiduciaries. *Section 64(c)(1)(B)(ii)(IV)(ia)*
- The sales or transfers occur within a 36-month period, commencing on the date of the first sale or transfer of the ownership interests. *Section 64(c)(1)(B)(ii)(IV)(ib)*

"Control" means control as described in RTC section 64(c)(1)(A) (i.e., obtaining control through direct or indirect ownership or control of more than 50 percent of the ownership interests)*. Section 64(c)(1)(B)(i)*

Double Counting. Once an ownership interest transfer counts towards a transaction that triggers reassessment, a subsequent transfer of that interest may not be counted again. *Section 64(f)*

Indirect Ownership Measurement. For purposes of RTC section 64(c), legal entity ownership interests owned by another legal entity will be considered as being owned by, or transferred to, its owners proportionately. *Section 64(c)(3)*

No Control Standard. Unlike existing law, under the proposed reassessment trigger, it is immaterial whether or not any one legal entity or person acquires more than 50 percent of the ownership interests. *Section 64(c)(1)(B)(i)*

Sold or Transferred. The term "sold or transferred" does not include the following:

- **Inheritance.** A transfer does not include a transfer of ownership interests that occurs upon death, without payment for the ownership interests by or on behalf of the transferee, other than taxes due with respect to the transfer. *Section 64(c)(1)(B)(ii)(V)(ia)*
- **Securities Market Trades Excluded.** A transfer does not include a sale of stock or interests in publicly traded corporations or publicly traded partnerships in the regular course of a trading activity on an established securities market. However, this exclusion is inapplicable if the shares are acquired as part of a merger, acquisition, private equity buyout, transfer of partnership shares, or any other means that otherwise triggers the new reassessment provision. *Section 64(c)(1)(B)(ii)(V)(ib)*

"**Legal entity**" means a corporation, a partnership, a limited liability company, or other legal entity. *Section 64(c)(1)(B)(ii)(II)*

"**Ownership interests**" means corporate voting stock, partnership capital and profits interests, limited liability company membership interests, and other ownership interests in legal entities. *Section 64(c)(1)(B)(ii)(III)*

Regulations. The BOE is required to prescribe any needed regulations. *Section 64(g)*

LEOP COS. Related to the LEOP COS required to be filed with the BOE, this bill:

- **Increases Penalty.** Increases the penalty from 10 percent to 15 percent for failure to file a LEOP COS with the BOE. *Section 480.1, 480.2, 482*
- **Franchise Tax Board (FTB) Questions**. Requires FTB to add a question on franchise income tax returns to address the new change in ownership event. *Section 64(e)*
- **Requires County Assessor Notification.** Requires the BOE to notify County Assessors if a change in ownership occurs as described by new section 64(c)(1)(B) or existing section 64(c). *Section 480.9*

Floating Homes. This bill removes floating homes from the penalty provisions for not timely filing a change in ownership statement with the County Assessor. *Section 482*

Effective Immediately. This bill takes immediate effect; however, the new change in ownership event proposed by this bill will apply to transfers of interests in legal entities that first occur on or after January 1, 2021.

In General: **Property Tax System.** In 1978, voters changed California's property tax system with the approval of Proposition 13. Under this system, a property's assessed value is based on its 1975 fair market value until the property changes ownership. Thereafter, annual assessed value increases are limited to 2 percent or the inflation rate, whichever is less. When real property changes ownership, it is reassessed to its current market value, which is generally the sales price, and annual future increases to that value are subject to the same limits.

Change in Ownership. While Proposition 13 provided a "change in ownership" reassessment trigger, it did not define this key phrase. The Assembly Revenue and Taxation Committee appointed a special Task Force to recommend the statutory implementation for Proposition 13 and define change in ownership. The Task Force consisted of 35 members, including legislative and BOE staff, County Assessors, public and private sector attorneys, and trade associations.

The Task Force published its findings in the *Report of the Task Force on Property Tax Administration***,** California State Assembly Publication 723, January 22, 1979. The Assembly Revenue and Taxation Committee also published a report that contains additional background on defining change in ownership called *Implementation of Proposition 13, Volume 1, Property Tax Assessment***,** California State Assembly Publication 748, October 29, 1979.

Property Owned by Legal Entities. One issue the Task Force faced was how to apply Proposition 13's change in ownership provisions to real property owned by a legal entity. For instance, would a transfer of ownership interests in a legal entity that owns real property be considered a transfer of the real property interests and, thus, a change in ownership? The Task Force considered two alternatives: the "separate entity theory" and the "ultimate control theory."

- **Separate Entity Theory.** The separate entity theory respects the separate identity of the legal entity. Accordingly, as long as the legal entity owns the property it will not be reassessed, even if all of the ownership interests in the legal entity transfer.
- **Ultimate Control Theory.** The ultimate control theory looks through the legal entity to determine who holds the ownership interests and, thus, who has "ultimate control" of the legal entity. Under this theory, real property owned by the legal entity is reassessed only when a single holder of ownership interests gains control of the legal entity through the acquisition of a majority of the ownership interests.

The Task Force recommended the separate entity theory be adopted for two reasons (however, ultimately the hybrid system currently in place was enacted). The Report states:

> (a) The administrative and enforcement problems of the ultimate control approach are monumental. How is the County Assessor to learn when ultimate control of a corporation or partnership has changed? Moreover, when the rules are spelled out (and the Task Force actually drafted ultimate control statutes) it became apparent that, without trying to cheat, many taxpayers, as well as County Assessors, would simply not know that a change in ownership occurred. The separate entity approach is vastly simpler for taxpayers and County Assessors to understand, apply, and enforce. Transfers between individuals and entities, or among entities, will generally be recorded. Even if unrecorded the real property will have to be transferred (by unrecorded deed or contract of sale, for example). Taxpayers can justifiably be expected to understand that a <u>transfer of real property</u> is a change in ownership and must be reported to the County Assessor.[8]

Tax Burden. The Task Force expressed concern that a tax burden shift to residential taxpayers could occur under its separate entity theory since commercial and industrial property changes ownership less frequently than residential property. The definitions originally proposed for legal entities using the separate entity theory were chosen to mitigate administrative difficulties. Because of this concern, the Task Force proposed that the Legislature study the idea of a constitutional amendment to periodically appraise commercial and industrial property at current market value noting:

> Such a constitutional change would also result in far greater simplicity in the treatment of legal entities. If commercial and industrial properties were to be periodically reappraised for reasons <u>other</u> <u>than</u> change in ownership, the difficult and controversial policy issues in choosing between the "ultimate control" approach or "separate entity" approach, outlined previously, would largely be avoided.
>
> The Task Force commends the principle of such a change to the Legislature for additional study.[9]

In 1979, the initially codified change in ownership definitions for ownership interests in legal entities were based on the separate entity theory, as recommended by the Task Force. However, thereafter, subdivision (c) of RTC section 64 was added to provide that a change in ownership occurs whenever there is a change in control by a transfer (or transfers) of more than 50 percent of the total ownership interests to a single person or entity.

According to the Assembly Revenue and Taxation Committee's *Implementation of Proposition 13*, subdivision (c) of RTC section 64, the "majority-takeover-of-corporate stock" provision was added "out of

---

[8] *Report of the Task Force on Property Tax Administration*, January 22, 1979, pages 46-47.
[9] Ibid, pages 57-58.

a concern that, given the lower turnover rate of corporate property, mergers or other transfer of majority controlling ownership should result in a reappraisal of the corporation's property -- an effort to maintain some parity with the increasing relative tax burden of residential property statewide, due to more rapid turnover of homes. It was also a trade-off for exempting certain transfers among 100% wholly-owned corporations..."[10]

Change in Ownership Tracking. RTC section 255.7 requires the County Recorder to provide the County Assessor with a copy of an ownership transfer document as soon as possible when a change in ownership is recorded. County Assessors discover most real property changes in ownership via grant deeds or other documents recorded with the County Recorder. However, real property owned by a legal entity may undergo a "change in ownership" with no grant deed or other document recorded that could alert the County Assessor to a reassessment. These types of changes in ownership are self-reported directly to the BOE by the entity involved.

BOE's Legal Entity Ownership Program. As noted previously, it is difficult for property tax administrators to independently discover reassessable events involving legal entities because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity. Because of these difficulties, the law requires the BOE to participate in the discovery of changes in ownership and changes in control of legal entities under RTC section 64(c) and (d).[11]

The BOE participates in this discovery through a program called the Legal Entity Ownership Program (LEOP). Under the LEOP, which started in January 1983, the BOE:

- Receives a list of legal entities from the FTB that have reported a change in control or change in ownership on their income tax returns.
- Receives referrals from County Assessors as a result of information obtained in local publications or business property statement filings.
- Sends a LEOP COS called the "Statement of Change in Control or Ownership of Legal Entities" to each entity that indicated involvement in a change in control or ownership on its FTB tax return, unless a LEOP COS was already self-reported to the BOE.
- Analyzes completed LEOP COS's to determine whether there has been a change in control or ownership.
- Notifies County Assessors of changes in control and ownership.

Annual Canvassing. RTC section 64(e) requires an annual canvassing of legal entities via the state income tax return. The FTB transmits to the BOE the names and mailing addresses of the legal entities that report a change in control and/or a change in ownership on the income tax return for further investigation. If a LEOP COS has not been self-reported directly to the BOE reporting the change in control or ownership event, the BOE makes a written request to the legal entity to file a LEOP COS to determine if it experienced a change in control or ownership or obtained control of another entity that owned real property in California requiring reassessment.

---

[10] Assembly Revenue and Taxation Committee's *Implementation of Proposition* 13, page 27. The referenced exemptions are RTC section 64(b), which excludes transfers of ownership interests between affiliated corporations, and RTC section 62(a)(2), which excludes transfers which result in a change in the method of holding title to real property while the proportional ownership interests remain unchanged.

[11] Chapter 1141 of the Statutes of 1981 (AB 152).

The BOE also makes formal written requests to legal entities to investigate other possible changes in ownership based on information obtained from County Assessors and interested parties' referrals. Additionally, at the local level, businesses are canvassed via the annual business property statement filed with the County Assessor.

Consequences of Ultimate Discovery. Generally, the statute of limitations in RTC section 532 limits escape assessments to either four or eight years for prior tax years. But due to concerns with intentional concealment of legal entity changes in ownership, provisions enacted in the late 1990's removed the statute of limitations to ensure there would be no financial advantage to concealing the event. Thus, RTC section 532(b)(3) requires that an escape assessment be made for every tax year a legal entity fails to file or fails to timely file the LEOP COS as required by RTC section 480.1 for a RTC section 64(c) change in control, or RTC section 480.2 for a RTC section 64(d) change in ownership.

Guide to Change in Ownership Reporting Statutes

RTC Section	Subject (Click on link to view sample forms)
64(e)	California Income Tax Returns • Corporate – Form 100 - Question C • Partnership – Form 565 - Question J • LLC – Form 568 - Question J • Filed with FTB • FTB transmits information to BOE
480	COS – BOE-502-AH • Transfers of Real Property, Manufactured Homes, and Floating Homes • Filed with County Assessor
480.1	LEOP COS – BOE-100-B • Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change in Control under RTC section 64(c) • Filed with BOE
480.2	LEOP COS – BOE-100-B • Transfers of Legal Entity Interests • Legal Entity Ownership Program (LEOP) • Change in Ownership under RTC section 64(d) • Filed with BOE
481	COS and PCOR – Confidentiality
482	Failure to File Penalties • COS – RTC section 482(a) [Penalties related to RTC section 480] • LEOP COS RTC section 482(b) [Penalties related to RTC sections 480.1 and 480.2]
483	Failure to File Penalties – Penalty Abatement • COS RTC section 483(a) and (b) [Penalties related to RTC section 482(a)] • LEOP COS RTC section 483(c) [Penalties related to RTC section 482(b)]

Background:

Related Initiative. Initiative 1864 (19-0003), among other changes, proposes to add section 1.7 to article XIII A of the California Constitution. This proposed section adds two reassessable events for legal entities. One adds the change in control provisions of RTC section 64(c)(1) to the Constitution. The other adds a change in ownership event when 90 percent or more of the direct or indirect ownership interests in a legal entity are sold or transferred in a single transaction, which is similar to the language proposed by SB 1319. However, these provisions provide that the plan includes sales or transfers that occur within a 60-month period, whereas the time period under SB 1319 is 36 months. The proponents of this initiative have submitted signatures to county election officials for verification. County election officials must submit the results of the signature validation to the California Secretary of State by April 22, 2020. If enough signatures are deemed valid, this initiative will be added to the November 3, 2020 ballot.

Split Roll Initiatives. Typically, the term "split roll" means taxing various property types (for example, residential v. commercial) according to a different tax rate or value standard. A true "split roll" is not possible without a constitutional amendment. Initiative 1851 (17-0055, Amdt.#1), which is eligible for the November 3, 2020 ballot, proposes to amend the Constitution to require certain commercial and industrial real property to be taxed at fair market value. Initiative 1870 (19-008A1), which has until April 14, 2020 to gather signatures, similarly requires certain commercial and industrial real property to be taxed at fair market value.

Legal Entity Change in Ownership Legislation. The following table summarizes efforts to trigger more frequent reassessments of legal entity owned property.

Year	Bill	Summary
2018	SB 1237 (Bates)	Reassess when 90 percent of direct or indirect ownership interests transfer in a single planned transaction in a 3-year period. Failed passage in committee.
2015	AB 1040 (Ting)	Reassess when an unspecified percentage of the direct or indirect ownership interests transfer in a single planned transaction in a 3-year period. Died in committee.
2015	SB 259 (Bates)	Reassess when 90 percent of direct or indirect ownership interests transfer in a single planned transaction in a 3-year period. Held in committee.
2014	AB 2372 (Ammiano)	Reassess when 90 percent of ownership interests cumulatively transfer. Held in committee.
2013	AB 188 (Ammiano)	Reassess when 100 percent of ownership interests transfer in a single transaction in any rolling 3-year period. Held in committee.
2012	AB 2014 (Ammiano)	Convene legal entity task force to update the work done by the 1979 task force. Died in committee.
2011	AB 448 (Ammiano)	Reassess when 100 percent of ownership interests transfer in a single transaction in any rolling 3-year period. Died in committee.
2010	AB 2492 (Ammiano) 5/18/10 Version	Reassess when 100 percent of ownership interests transfer in a single transaction. Died.

[continued]

Year	Bill	Summary
2010	AB 2492 (Ammiano) 4/8/10 Version	Reassess property owned by publicly traded companies every 3 years (rebuttable presumption). Property owned by other types of legal entities reassessed in proportion to the percentage of legal entity ownership interests transferred.
2005	SB 17 (Escutia) As Amended 4/19/05	Reassess when more than 50 percent of the ownership interests transfer in a calendar year (excluding publicly traded companies). Died.
2005	SB 17 (Escutia) As Introduced 12/06/04	Every 3 years reassess property owned by publicly traded companies (rebuttable presumption). Property owned by other types of legal entities reassessed in proportion to the percentage of legal entity ownership interests transferred.
2003	SB 17 (Escutia)	Legislative intent to redefine change in ownership for nonresidential commercial and industrial property. Died.
2003	SBx1 3 (Escutia)	Legislative intent to redefine change in ownership for nonresidential commercial and industrial property. Died.
2002	SB 1662 (Peace)	Reassess nonresidential property when cumulatively more than 50 percent of ownership interests transfer. Broaden the state and local sales and use tax base and reduce both the state and local sales and use tax rate. (Legislative intent) Died.
2001	AB 1013 (Leonard)	Reassess when more than 50 percent of ownership interests transfer. Died.
2000	AB 2288 (Dutra)	Every 3 years reassess legal entity owned property. (Rebuttable presumption change in ownership occurred.) Possible income tax credit to homeowners based on fair market value of homes from additional revenue. Reduce the sales and use tax rate by 0.25 percent. Died in committee.
1992 Prop. 167	Failed 41.16 percent yes, 58.84 percent no	Among various tax related items, included a provision to modify legal entity change in ownership definitions. Proponent: California Tax Reform Association
1991	SB 82 (Kopp)	Reassess when cumulatively more than 50 percent of ownership interests transfer. Died.

Commentary:

1. **Author's Statement.** Senate Bill 1319 proposes to create a new "change in ownership" event for legal entity owned real property that occurs when 90 percent or more of the direct or indirect ownership interests in that legal entity transfer in a planned single transaction. Excludes family transfers upon death and publicly traded stock transactions. Increases penalties from 10 percent to 15 percent of taxes due for failure to file a legal entity change in control statements with the BOE.[12]

2. **Floating Homes.** Manufactured homes and floating homes are in a similar situation in that they are treated differently for property tax purposes. RTC section 229 provides that floating homes are not vessels, but are treated as real property for property tax assessment purposes. Under RTC section 480, whenever a change in ownership of real property, a manufactured home, or a floating

[12] https://bates.cssrc.us/content/my-legislation.

home occurs, the transferee must file a change in ownership statement with the County Assessor. RTC section 480(c) requires the change in ownership statement to contain a notice which states that the failure to file the change in ownership statement will result in a penalty. When the County Assessor sends a request to file a change in ownership statement and the statement is not filed timely, a penalty is imposed pursuant to RTC section 482(a). This bill removes floating homes from this penalty requirement. This would create an inequity between RTC sections 480 and 482 in that transferees of floating homes are required to file a change in ownership statement, whose wording requires that a penalty applies if a transferee of a floating home fails to file the change in ownership statement. However, no penalty would be imposed if a floating home transferee refuses to file upon a County Assessor's request. The author may want to consider leaving the penalty requirement for floating homes in RTC section 482, to be consistent with RTC section 480.

3. **This bill requires County Assessors to reassess property following events that currently may not trigger a reassessment.** A new change in ownership triggering event is created to address cases in which the sellers of the legal entity transfer shares as part of a "single transaction" even if no one person or entity obtains control. Currently, "control" by one person is required to trigger reassessment. This bill primarily addresses the ability of persons to break up ownership into multiple legal entities to avoid reassessment (it also addresses the fact that married couples are not currently treated as a single unit). Two presumptions are created (discussed below) to help determine when shares have sold as part of a "single transaction."

4. **Reassessment examples.** Under this bill, reassessment may be required in the following situations where a company or business has real estate holdings:

   - A married couple buys a company with real estate holdings. (Under current law, ownership of the company is considered to be held 50/50 with neither spouse in control. Thus, this transfer does not meet the "change in control" test.)
   - A company's current managers or employees buy the company from the retiring owners and no one person acquires control.
   - A business (with no one in control) buys a competitor's business.
   - A business (with no one in control) buys a supplier

5. **A "planned" transaction.** This bill appears more limited than similar legislation introduced in earlier years in that the "single transaction" definition now requires the existence of a plan (see proposed section 64(c)(1)(B)(ii)(IV)). The plan requirement raises numerous uncertainties for tax practitioners and administrators. What conditions rise to the level of a plan?

   - Does a plan require a detailed written document (or oral guidance) developed by expert counsel hired by the buyer to structure a non-reassessable transaction?
   - Does a plan require the consensual agreement of both the buyer and the seller?
   - If there is no coordinated plan by the transferors to sell, is the definition met? For example, when two partners sell their interests to unrelated transferees over a 36-month period (one partner retires) and 24 months later the other needs to liquidate for an unrelated reason, is this reassessable?

6. **Technical suggestion.** Proposed section 64(c)(1)(B)(ii)((ib) specifies that:

   "The sales or transfers occur with a 36-month period, commencing on the date of the first sale or transfer of the ownership interests that occurs on or after January 1, 2021."

   The author may want to consider changing the phrase "*with* a 36-month period" to "*within* a 36-month period."

7. **The rebuttable presumption.** This bill adds a rebuttable presumption element (see proposed section 64(c)(1)(B)(ii)(IV)). Generally, a rebuttable presumption is an inference that, in the absence of any evidence to the contrary, is to be made and accepted as an established fact. The presumption permits (but does not require) the BOE or County Assessor to assume that certain sales or transfers are part of a single transaction when, in fact, they may not be. Usually presumptions are created for administrative convenience. However, if the BOE or County Assessor chooses to investigate the transaction, the presumption may be rebutted by a review of other evidence. Where contradictory evidence exists, the presumption may be overcome.

8. **Rebutting the presumption.** As noted above, the BOE or County Assessor could choose to assert single transaction status without further investigation when either of the two conditions is met. If the taxpayer challenged the presumption, what evidence must the taxpayer present? More important, what precisely is being rebutted? Will they rebut that any pre-conceived plan existed or was contemplated? How could the taxpayer rebut a negative? Do they rebut that multiple transfers occurring on different dates were not "part of a plan" or that they were not "transferred in a single transaction?" For example, if the taxpayer planned for two transfers that fell under the 90 percent threshold, and a third unexpected transfer occurred within 36 months pushing the transaction over the threshold, do they rebut by claiming that the third transfer was not part of the plan or not part of an original "single transaction?"

9. **Indirect Ownership.** This bill includes a sale or transfer of indirect ownership interests in the types of transfers that count toward a single transaction. However, this bill does not provide a definition of "indirect" ownership.

10. **Discretion.** The bill appears to give both BOE and the County Assessor substantial discretion in change in ownership findings, such as the discretion to assert that a plan existed, and with respect to the evidence necessary to rebut the presumption. Is a conversation with the buyer enough for the BOE or County Assessor to rebut the presumption? These ambiguities could lead to inconsistent administration in the counties. County Assessors can independently process a legal entity change in control or ownership, without a LEOP COS being filed with BOE if the County Assessor is aware of the transaction.

11. **Who are related transferees?** Under the federal law that this bill cross references, the following persons are considered related taxpayers. (26 U.S.C. section 267(b).)

    - Members of a family: the family of an individual includes only brothers and sisters, spouse, ancestors, and lineal descendants; and
    - An individual and a corporation of which more than 50 percent in value of the outstanding stock is owned, directly or indirectly, by or for such individual;
    - Two corporations that are members of the same controlled group;
    - A grantor and a fiduciary of any trust;

- A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
- A fiduciary of a trust and a beneficiary of such trust;
- A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
- A fiduciary of a trust and a corporation of which more than 50 percent in value of the outstanding stock is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
- A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
- A corporation and a partnership if the same persons own:
  - more than 50 percent in value of the outstanding stock of the corporation, and
  - more than 50 percent of the capital interest, or the profits interest, in the partnership;
- An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;
- An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or
- Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

12. **Related Transferees – Open Ended.** The related transferee provision does not have any time frame. (See proposed section 64(c)(1)(B)(ii)(IV)(ia).) Is it intended to be open ended (more than 36 months), or, is it intended to be limited to a single, non-cumulative transaction? Would a parent's plan to transfer 5 percent a year to children over a long period of time trigger reassessment once the 90 percent or more threshold is reached?

13. **Spouses and Siblings – Single Unit.** Currently, interests owned by spouses are not treated as a single unit. This bill alters this longstanding rule. Furthermore, sibling interests would be treated as a single unit. Multiple generations would also be treated as a single unit: grandparent, parent, grandchild.

14. **Under current change in ownership definitions, when legal entities are purchased or otherwise acquired, whether their real property is reassessed to current market value generally depends on whether there is a change in control.**

    Scenario 1 (Control): If *one* legal entity or person buys 100 percent of the ownership interests in another legal entity, then absent an exclusion, the law requires a reassessment of all the real property owned by the acquired legal entity. Since the acquiring legal entity or person obtains more than 50 percent of the ownership interest in the acquired legal entity under RTC section 64(c), this is a "change in control."

Scenario 2 (No Control): If three *different* legal entities or persons buy 100 percent of the ownership interests in that same legal entity in equal shares, there is no reassessment**.** In this scenario, each new buyer only has a 33 1/3 percent ownership interest in the acquired legal entity and no one entity or person has control.

In both scenarios, the acquired legal entity has entirely new owners, but only Scenario 1 results in reassessment.

DATE	TRANSACTION	REASSESSMENT
5/1/19	**Scenario 1** Established Company (EC) **buys 100% of the ownership interests** in Startup Company (SC) SC owns 5 properties in various locations in California SC purchased properties in 2000, 2002, 2005, 2008, 2012	**EC Obtains Control of SC** **Reassess** all 5 properties to market value on May 1, 2016.
5/1/19	**Scenario 2** Three Venture Capitalists (VC_1, VC_2, VC_3) **buy 100% of the ownership interests** in SC in equal shares.	**Neither VC_1, VC_2, or VC_3 singularly control SC: each have 33 1/3%** **No Reassessment** of any SC-owned property The 5 properties retain the assessed value established at the time acquired by SC

15. **New Change in Ownership Trigger Point.** This bill adds a new reassessment trigger event with respect to transfers of ownership interests in legal entities. Properties will be reassessed whenever 90 percent or more of a legal entity's ownership interests are transferred. Currently, only if a transfer of ownership interests causes a "change in control" of the legal entity (i.e., pushing one person or legal entity up and over the 50 percent ownership interest threshold) is the property owned by that legal entity reassessed to its current value. This bill changes the law to require reassessment of Startup Company's five properties in the Scenario 2 transaction discussed above, if these transfers occurred on or after January 1, 2021.

16. **This bill attempts to treat the transfer of ownership interests in legal entities more like the transfer of real property interests**. Any transfer of *real property interests* results in a change in ownership, absent an applicable exclusion, while transfers of *ownership interests in a legal entity* do not result in a change in ownership of property owned by the legal entity unless RTC section 64(c)(1) or (d) are triggered. (See RTC section 64(a).) The following illustrates the disparate treatment:

    - **Transfer of Real Property Interest.** Four individuals each own a 25 percent interest in a property. Each sale of an individual's 25 percent interest in the property triggers a 25 percent reassessment. (ABCD to EFGH)
    - **Transfer of Ownership Interest in Legal Entity.** If the same property is *owned by a legal entity* in which the same four individuals each own a 25 percent interest, a sale of an individual's

25 percent interest in the legal entity will not cause a reassessment of the property owned by the legal entity. This is true even if there is a complete turnover of ownership interests in a single event. Only if one person obtains control (defined as ownership interests of more than 50 percent) of the legal entity is reassessment triggered. (ABCD to EFGH)

Progression of Transactions	**Transfer Date**	**Owners After Transfer**	**Percent Reassessed if *Real Property Interests* Transfer Under Current Law**	**Percent Reassessed if *Legal Entity Ownership Interests* Transfer Under Current Law**	**Percent Reassessed if *Legal Entity Ownership Interests* Transfer Under SB 1319**
A sells 25% to E B sells 25% to F C sells 25% to G D sells 25% to H	**01/15/21**	EFGH	**100%**	**0%**	**100%**[1]
E sells 25% to I	04/05/21	FGHI	25%	0%	0%
F buys G's 25% F buys H's 25%	09/10/22	FI 75%/25%	50%	**100%**[2]	**100%**[2]
F buys I's 25%	10/15/23	F	25%	0%[3]	0%
F sells 50% to J	12/30/24	FJ	50%	0%[4]	0%
F sells 50% to K	**01/30/25**	JK	**50%**	**0%**	**100%**[5]

1. *All New Owners – But No One in Control.* Transfer of 100 percent of ownership interests. This bill's new change in ownership trigger point results in reassessment. Property reassessed to its market value on January 15, 2021.
2. *Change in Control.* On September 10, 2022, F acquires "control" of the legal entity; F now owns 75 percent of the legal entity's ownership interests. Current law requires a 100 percent reassessment of the property to its value on September 10, 2022.
3. *No Change in Control.* F owns 100 percent of the legal entity as of October 15, 2023. But, since F previously obtained control of the legal entity on September 10, 2022. No reassessment under current law.
4. *Loss of Control.* F owns 50 percent and J owns 50 percent. No one controls the legal entity. While F has lost control, no one gained control. No reassessment.
5. *Cumulative Transfer.* 100 percent of the ownership interests are cumulatively transferred. Property reassessed to its fair market value on January 30, 2025.

This bill provides that when 90 percent or more of the ownership interests in the legal entity transfer in a single transaction that occurs on or after January 1, 2021, a change in ownership of the legal entity will occur, resulting in reassessment of property owned by it.

The disparate treatment between ownership interests in real property and legal entities is illustrated in columns 4 & 5 of the table above. Column 6 shows this bill's reassessment consequences when legal entity ownership interests transfer. (Note: Only the first and last transfers that take place on January 15, 2021, and January 30, 2025, respectively, reflect the changes made by this bill. The other transfer examples reflect existing law.)

17. **Is the transfer of ownership interests in legal entities without reassessment consequences unintentional?** The Proposition 13 Task Force debated the issue of how to treat sales and transfers of legal entity ownership interests. The Task Force recognized the potential long term effect of the original definitions noting "(t)he Task Force admits that some of its own recommendations, such as those regarding legal entities, while the best of a seemingly 'no-win' choice of options and adopted to mitigate administrative difficulties, may, in the long run, further exacerbate this [tax burden] shift to residential property because it will result in fewer potential commercial and industrial property transfers being recognized for reappraisal purposes." Consequently, the Task Force proposed that the Legislature later consider a constitutional change to periodically reappraise commercial and industrial property. In 2012, AB 2014 was introduced to create a new task force to study this issue. After nearly 35 years, this bill seeks to add a new definition to those initially created to cause more frequent reassessment when property is owned by a legal entity.

18. **This bill addresses ownership interests in legal entities that are transferred indirectly to another legal entity or person.** With sufficient planning and legal advice under current law, it might have been possible to structure transactions that transfer property via a legal entity to new owners indirectly using multiple tiers of legal entities and minimize or preclude reassessment under the new change in ownership trigger. As such, this bill includes indirect ownership transfers and provides that indirect ownership interests should be proportionately counted.

    However, as currently written, there is a potential inconsistency surrounding the phrase "including the real property owned by legal entities under its control," in section 64(c)(1)(B)(i). For example, if Company A, which is owned 60 percent by Company B, purchases real property, and Company B undergoes a 95 percent transfer of ownership interests, section 64(c)(1)(B)(i) states that the real property owned by Company A, which was under the control of Company B pursuant to the definition of "control" in section 64(c)(1)(B)(ii)(I), would undergo a 100 percent change in ownership reassessment. However, under section 64(c)(3), may be construed as requiring only 60 percent of the property be reassessed.

19. **This bill affects all types of real property owned by a legal entity.** This bill does not differentiate between residential and commercial property. All types of real property owned by a legal entity (partnerships, limited liability companies, corporations, etc.) are subject to the new triggering event. Thus, this bill could impact single family homes, multi-family properties (such as apartments, duplexes and mobilehome parks), agricultural property, family farms,[13] and small businesses.

20. **Change in Ownership Exclusions.** This bill provides that when 90 percent or more of the direct or indirect ownership interests in a legal entity are sold or transferred in a single transaction, the purchase or transfer of the ownership interests results in a change in ownership of the real property owned by the legal entity, including the real property owned by legal entities under its control, whether or not any one legal entity or person that is a party to the transaction obtains

[13] The parent-child change in ownership exclusion does not apply to transfers of ownership interests in legal entities, except to the extent the uncodified note of RTC section 63.1 is followed [section 2 of Stats. 1987, Ch. 48 (AB 47), as amended by section 6 of Stats. 2006, Ch. 224 (SB 1607)].

control, except when the sale or transfer qualifies for an exclusion from change in ownership under any other law or does not result in a change in ownership under any other law. Does the author intend to apply the change in ownership exclusions for transfers of real property to transfers of interests in legal entities?

RTC section 63 excludes from change in ownership any transfers between spouses. Property Tax Rule 462.220(b) and (c) provide that a change in ownership does not include transfers of ownership interests in legal entities (1) resulting in one spouse or registered domestic partner obtaining control under RTC section 64(c), or (2) by "original co-owners" which would otherwise be cumulated or counted for purposes of RTC section 64(d).

Effective October 9, 2019, Assembly Bill 872 (Stats. 2019, ch. 685) added subdivision (r) to RTC section 62 to exclude from change in control or ownership any parent to child transfer of stock in a qualified corporation that owns qualified property, provided that the transfer is due to the death of a parent. A "qualified corporation" is a corporation that meets all of the following conditions:

- Created between March 1, 1975 and November 6, 1986, inclusive.
- The only stockholders in the corporation have been the parents and their children.
- The corporation owns qualified property.

"Qualified property" is a parcel that contains the principal residence of the parent prior to their death and has been the continuous place of residence of a child of the parent since the creation of the qualified corporation.[14]

Under this bill, the direct or indirect ownership interests in a legal entity that are sold or transferred between parents and children may still be "counted" if the section 62(r) exclusion does not apply. RTC section 63.1, which contains the parent-child and grandparent-to-grandchild exclusions, specifically provides in RTC section 63.1(c)(8) that this exclusion does *not* apply to transfers of interests of legal entities, other than a transfer of an interest of a unit or lot within a cooperative housing corporation, a pro rata ownership interest in a tenant-owned mobilehome park, or a pro rata interest in a floating home marina.

21. **Williamson Act property.** In practical application, Williamson Act property and other property under contract and eligible for special assessment provisions (such as the Mills Act for historical property) will not be impacted *provided* the property remains under contract. The law requires these properties to be assessed at the *lowest* of three specified values. While a new base year value would be reset if a change in ownership occurs under the new trigger, this value would likely be greater and will not become the basis of assessed value.

22. **Regulations.** This bill requires the BOE to prescribe regulations as may be necessary to carry out the bill's purposes. The BOE already has this authority pursuant to Government Code section 15606(c). Property Tax Rule 462.180 clarifies changes in ownership of legal entities.

23. **BOE implementation and revenue impact report to the Legislature.** This bill requires the BOE to report the revenue impact and frequency of reassessments resulting from the new change in ownership trigger by January 1, 2023. However, the BOE does not obtain assessed value changes of properties owned by legal entities. To gather this data, County Assessors must track and report

[14] Letter To Assessors No. 2020/002.

to the BOE the necessary data once the County Assessor completes the reassessment of the properties owned by the legal entity.

Additionally, the information obtained by January 1, 2023 will not reflect reassessments that occur in a 36-month period as set forth in section 64(c)(1)(B)(ii)(IV)(ib), because only 24 months will have transpired.

24. **Related initiative.** Initiative 1864 (19-0003) proposes to add section 1.7 to article XIII A of the California Constitution. This proposed section adds a change in ownership event when 90 percent or more of the direct or indirect ownership interests in a legal entity are sold or transferred in a single transaction. However, proposed section 1.7 provides that the plan includes sales or transfers that occur within a 60-month period, whereas the time period under SB 1319 is 36 months.

25. **Split Roll Initiative.** Typically, the term "split roll" means taxing various property types (for example, residential v. commercial) according to a different tax rate or value standard. In the context of reassessment of legal entity owned property, some use the term to reference modifying the change in ownership provisions related to legal entity ownership interests to trigger more frequent reassessment, such as this bill proposes. A true "split roll" is not possible without a constitutional amendment. Initiative 1851 (17-0055, Amdt.#1), which is eligible for the November 3, 2020 ballot, proposes to amend the Constitution to require certain commercial and industrial real property to be taxed at fair market value. Initiative 1870 (19-008A1), which has until April 14, 2020 to gather signatures, requires certain commercial and industrial real property to be taxed at fair market value.

26. **Modifying "Change in Ownership" provisions.** While Proposition 13 amended the Constitution to provide that a "change in ownership" triggers reassessment, it did not define the phrase. Statutory language defines the term and specifies transfers included or excluded from a change in ownership. Thus, statutory amendments modifying the original statutory definitions are permissible.

Costs: The BOE's cost to administer this bill is pending. Legal entity changes in ownership are complicated. This bill represents the first substantive change to legal entity change in ownership law since the initial definitions were crafted. This bill requires new regulations; changes to existing regulations, handbooks, taxpayer guidance materials, change in ownership reporting forms and instructions; and an additional question on the state income tax return. Furthermore, currently relied upon annotated letters on legal entity change in ownership law will not always be relevant. Additional resources will be needed to research, study, and answer new opinion requests from within the agency, the counties, and taxpayers. Under this bill, since an ownership interest is not counted again once it has been counted to determine whether a change in control or ownership of a legal entity has occurred, County Assessors and the BOE would be required to search for and identify all previous ownership transfers in order to verify whether the interest transferred had already been counted. Additionally, the existing LEOP database may need to be updated to track the percentage interested transferred in order to ensure the 90 percent threshold is enforced and double counting does not occur. For the Legislative report, the BOE would need to coordinate with each County Assessor's office since the BOE does not currently obtain any value information on properties affected by a change in control or ownership, to track the bill's revenue impact as required.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Revenue Impact: **BACKGROUND, METHODOLOGY, AND ASSUMPTIONS.** Existing property tax law specifies a change in ownership occurs when a legal entity or other person obtains a controlling or majority ownership interest in the legal entity. SB 1319 requires real property owned by a legal entity be reassessed whenever 90 percent or more of the ownership interests in that legal entity are sold or transferred in a single transaction. "Single transaction" means a plan consisting of one or more sales or transfers of ownership interests on or after January 1, 2021, including those that occur within a 36-month period, as defined. The bill subjects real property owned by legal entities to reassessment more often than under current law. The result is an increase in assessed value and an increase in property tax revenue.

Estimating the revenue increase is difficult, as we do not know how many times such transactions occur in California. However, based on a recent sample of county assessment roll data, staff estimates 2018-19 legal entity assessed values to be $1.155 trillion.

Each year, the BOE conducts a statewide commercial sales study to determine the effective assessment level (i.e., the percentage difference between assessed value and market value) for commercial/industrial property in order to determine the assessment level for rail transportation property (the 4R Ratio). The latest study, based on the 2018-19 assessment roll, finds the effective assessment level is about 57 percent. Applying this ratio to the estimated legal entity-owned assessed value, we estimate current legal entity market value to be:

$1.155 trillion / 57 percent = $2.026 trillion

While it is difficult to predict the annual number of legal entity property reassessments under SB 1319, staff used the aforementioned commercial sales study to determine the rate of transfer of all commercial property. Our study suggests four percent of commercial properties on average are subject to reassessment each year to current market value. Assuming legal entities track closely with the commercial property rate of transfer, the revenue impact at the basic one percent property tax rate is:

Estimated	**Estimated**	**Estimated**	**Estimated**	**Estimated**	**Estimated**
Legal Entity Assessed Value	4R Ratio	Legal Entity Market Value	Increase in Assessed Value	Annual Rate of Transfer	Annual Revenue Gain at the Basic 1 percent Rate
$1.155 trillion	57 percent	$2.026 trillion	$871 billion	4 percent	$ 348 million

This bill would also increase the penalty from 10 percent to 15 percent of taxes due for failure to file or failure to timely file legal entity change in control statements with the BOE. BOE staff reports that the number of transactions subject to this penalty could be as high as 30 percent of all filings. However, assuming the average legal entity property tax bill to be $3,000, we estimate the revenue impact of an increased penalty to be less than $1 million annually. This amount may decrease over time as the increased penalty becomes a deterrent to late filing.

REVENUE SUMMARY: Based on the preceding assumptions, the annual revenue gain could amount to about $348 million.

QUALIFYING REMARKS: The revenue estimate is based on limited county roll data. It gives an indication of the order of magnitude of the revenue impact of SB 1319. The impact will vary from year to year depending upon the number of annual transactions and the value of properties owned by a legal entity.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.