

Court of Appeal Holds Transfer Tax Applies to Legal Entity Changes in Ownership

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In 926 North Ardmore Avenue, LLC v. County of Los Angeles,¹ the 2nd District Court of Appeal held that Proposition 13 changes in ownership prompted by transfers of legal entity interests should also be characterized as “realty sold,” resulting in the imposition of realty transfer taxes under the California Documentary Transfer Tax Act in cases even where no real property interests are transferred at all.

BA Realty LLLP (“BA Realty”) owned 100 percent of 926 North Ardmore Avenue LLC (“Ardmore”), which owned an apartment building in Los Angeles. In 2008, the partners in BA Realty transferred 90 percent of their partnership interests to two trusts (45 percent each). The transfers resulted in a change in ownership and reassessment of the apartment building for Proposition 13 (“Prop 13”) purposes under R&TC § 64(d).²

The Los Angeles County Registrar-Recorder imposed a documentary transfer tax (“DTT”) under the standard California Documentary Transfer Tax Act (“DTTA”) that only applies to “realty sold,”³ claiming that a Prop 13 change in ownership is sufficient evidence of “realty sold” subject to transfer tax.

The DTTA allows counties to pass an ordinance that imposes a DTT on “each deed, instrument, or writing by which any lands, tenements or other realty sold within the county shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers”⁴ Los Angeles County has adopted this DTTA language verbatim in the Los Angeles County Code § 4.60.020.

¹ Los Angeles County Super. Ct. No. BC476670 (September 22, 2014).

² Under R&TC § 64(d), if there have been cumulatively more than 50 percent of the interests in an entity transferred by any of the original co-owners, there is a re-assessable change in ownership of the entity’s property that was previously excluded from reassessment under R&TC § 62(a)(2).

³ R&TC §§ 11911-11930. Under the DTTA, counties and general law (non-charter) cities may enact transfer tax ordinances but must conform them to the standard provisions in the DTTA.

⁴ R&TC § 11911.

An emerging issue for some time has been whether DTTs may be imposed when there is only a transfer of interests in a legal entity that owns real property and there is otherwise no “deed, instrument or other writing” recorded and real property is not being sold or transferred.

Because the DTTA does not explicitly provide for a DTT on the transfer of legal entity interests (other than for transfers of partnership interests that result in a partnership termination under IRC § 708⁵), some local governments view the transfer of legal entities that own real property (rather than the actual transfer of the property itself) as a circumvention of the DTT. As a result, several counties and cities have amended their ordinances to impose the taxes on legal entity interest transfers if the transfer is a Prop 13 change in ownership of the entity’s property under R&TC §§ 64(c)(1) or 64(d). In 2008, voters in San Francisco amended its transfer tax ordinance to provide that the definition of “realty sold” includes any transfer of legal entity ownership interests that constitutes a “change in ownership” of the entity’s property under R&TC §§ 64(c)(1) and 64(d).⁶ Napa,⁷ Monterey,⁸ and Santa Clara⁹ Counties, and the city of Oakland,¹⁰ have made similar amendments to their ordinances.

Los Angeles County has not amended its ordinance, which continues to adhere to the standard DTTA and taxes only “realty sold,” without explicitly including Prop 13 changes of ownership. Nonetheless, in 2010, Los Angeles County began imposing DTTs on transfers of legal entity interests that resulted in Prop 13 changes in ownership under R&TC §§ 64(c)(1) and 64(d), relying on *Thrifty Corp. v. County of Los Angeles*¹¹ and *McDonald’s Corp. v. Board of Supervisors of Mendocino County*.¹² (Ardmore in its briefs claimed that the County’s website notice of this practice at the time did not include R&TC § 64(d), and today the website states, “The collection is consistent with case law that defines ‘realty sold’ as having the same meaning as changes in ownership for property tax purposes in RTC § 64(c)(1).” To this day, the notice fails to explicitly include R&TC § 64(d).)

Both *Thrifty* and *McDonald’s* involved the question of whether certain lease transactions (i.e., transfers of an actual real estate interests) should be characterized as “realty sold” subject to DTT. Neither case involved the transfer of legal entity interests where the entity’s real property did not transfer at all.

In *926 North Ardmore*, the Court of Appeal held that a transfer of legal entity interests resulting in a change in ownership under either R&TC §§ 64(c)(1) or 64(d) comes within the definition of “realty sold” within the meaning of the DTTA. The court relied upon *Thrifty* and *McDonald’s* because those cases held that the

⁵ R&TC § 11925. Even though there may have been a federal income tax termination of BA Realty under IRC § 708, the court accepts that the IRC § 708 partnership termination provision in R&TC § 11925 only applies when a “partnership entity holds title to the realty.” Thus, R&TC § 11925 would not apply because the apartment building was not owned by the partnership BA Realty, but instead by BA Realty’s wholly owned LLC (Ardmore), which was not a partnership for federal income tax purposes. See *Ardmore*, pp. 29-30, fn. 11.

⁶ City and County of San Francisco Business and Tax Regulations Code Article 12-C, Section 1114. Under R&TC § 64(c)(1), if a single person or entity obtains direct or indirect ownership or control of more than 50 percent of a corporation’s voting stock, or direct or indirect ownership of more than 50 percent of a partnership’s or limited liability company’s capital and profits, there is a change in control of that entity and its real property is reassessed to fair market value. Under R&TC § 64(d), if there have been cumulatively more than 50 percent of the interests in an entity transferred by any of the original co-owners (as defined therein), there is a re-assessable change in ownership of the entity’s property that was previously excluded from reassessment, regardless of whether a single person or entity obtains a majority of the interests.

⁷ Napa County Code § 3.24.020 defines “realty sold” as any change in ownership under the R&TC, “with special reference to” R&TC §§ 64(c) and (d).

⁸ Monterey County Code § 5.32.020 defines “realty sold” as any change in ownership under the R&TC, “including but not limited to” R&TC §§ 64(c) and (d).

⁹ Santa Clara County Ordinance Code § A30-39.6 replicates the language from R&TC §§ 64(c) and (d) in its entirety.

¹⁰ Oakland Municipal Code § 4.20.020 states that the transfer tax is imposed on all “changes in control and ownership of legal entities,” which is defined in § 4.20.030 as meaning changes in ownership and control of entities under R&TC § 64.

¹¹ 210 Cal. App. 3d 881 (1989).

¹² 63 Cal. App. 4th 612 (1998).

term “realty sold” as used in the transfer tax laws is “sufficiently similar to the phrase ‘change in ownership’ ... to warrant that each phrase be defined to have the same meaning.”¹³ Here, the court in *926 North Ardmore* went further than *Thrifty* and *McDonald’s*, concluding that the DTT can be applied even when there was no transfer of real property interests at all, as long as there is a transaction that constitutes a Prop 13 change in ownership subject to reassessment. The court concluded that its reliance on these cases was supported by:

1. The adoption in 2011 of R&TC § 408.4, which requires assessors to provide information about unrecorded changes in control or ownership under R&TC §§ 64(c)(1) or 64(d) to recorders investigating whether a transfer tax is owed. (Arguably this provision is meant to assist counties which had amended their ordinances to explicitly tax these transfers.)
2. The fact that the Legislature had not rebuked or otherwise abrogated the holdings in *Thrifty* and *McDonald’s* that certain lease transactions triggering a Prop 13 change in ownership constituted “realty sold.”
3. The fact that Los Angeles County warned taxpayers on its website that it would start applying the transfer tax in these cases.
4. The lack of action by the Legislature to oppose the counties that have taken action to amend their ordinances to extend the DTT to Prop 13 changes of ownership, or against Los Angeles County’s practice of assessing the DTT based on its website notice.

The court rejected the taxpayer’s arguments that the court should look to the decisions interpreting the federal stamp tax act since the DTTA was based on that act. The court instead based its decision on what it sees as the Legislature’s *current views on the DTT*, not what the Legislature intended in 1967. Since the DTTA was adopted in 1967, “there have been changes in California law suggesting the Legislature endorses the view that [R&TC §] 11911 permits counties and cities to impose a documentary tax on transfers of interests in legal entities that result in a ‘change of ownership’ within the meaning of section 64.” Thus, the court concludes the term “realty sold” as used in a 1967 DTTA statute, must have the same meaning as the term “change in ownership,” coined and defined by Prop 13 and statutes adopted in 1979 (12 years later) as part of the implementation of Proposition 13.

The court failed to address the fact that the Legislature had failed to pass legislation specifically amending the DTTA to add legal entity changes in ownership to the definition of “realty sold,” most recently in Assembly Bill 561 in 2014. The failure of the Legislature to pass this proposed *change* in the existing DTTA by adding certain additional transactions as covered by the DTTA indicates that the current statutory scheme does not permit the application of the DTT to legal entity interest transfers.

If this case is not overturned, it opens the door for all California counties to impose DTTs where they had never been before. Whether counties will impose the tax retroactively remains to be seen.

While *926 North Ardmore* is certified for publication, there is a movement underway to petition the Supreme Court for depublication. In addition, we understand that the taxpayer intends to seek review of the decision by the California Supreme Court.



¹³ 210 Cal. App. 3d at p. 886; 63 Cal. App. 4th at p. 616.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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