

California bill would modify what triggers a real property tax reassessment and would add new property tax filing requirements

April 9, 2014

In brief

As amended on April 1, 2014, [Assembly Bill 2372](#) proposes that a 'change of ownership' in real property held by a legal entity will occur if 100% of that legal entity's interest is sold or transferred within a three-year period, even if no one person or entity acquires more than 50% of the entity's ownership interests. Such a change of ownership would trigger property tax reassessment for the property. Additionally, the bill would impose significant reporting requirements regarding the transfer of legal entity interests. A.B. 2372 is substantially similar to A.B. 188, which was introduced last year and died in committee.

The proposed changes would create significant tax and business concerns for companies operating in California. Businesses, especially publicly traded corporations, with California property should be aware of the proposed 100% interest transfer rule and the additional burden imposed by the proposed reporting requirements. Companies should continue the process of evaluating their contracts to determine if increases in property tax costs can be passed through to their tenants as we suggested in our alert on A.B. 188. Finally, companies should consider the impact these changes may have on their internal reporting, as well as the rate of return for real estate in California.

The proposed legislation raises significant unanswered questions. For example, would publicly-traded companies be compelled to report to the State Board of Equalization every time its shares are sold? Would publicly-traded companies be required to file a deed every time its shares are sold? These are questions that should be resolved through the legislative process or through regulatory guidance.

In detail

Current property tax valuation - 'change in ownership'

In 1978, California voters approved Proposition 13, which added Article XIII A to the state Constitution and dramatically changed the state's system of

property taxation. One of the purposes of Proposition 13 was to restrict the valuation and assessment of real property. As a result, California provides that the appraised value of real property, for real property tax purposes, is determined when real property is purchased,

constructed, or when a *change in ownership* has occurred.

Change in ownership following transfers of legal entity interests

A change in ownership is relatively easy to identify when real property, or certain lease-

hold interests, are transferred from one person or entity to another. However, when interests of a legal entity are transferred, at what point does an ownership change occur regarding the real property owned by the entity?

The following provides general rules regarding transfers of legal entity interests.

- **Transfer of legal entity interests - generally not a change in ownership.** Generally, a transfer of interest in a legal entity does not constitute a change in ownership of the real property owned by the entity. Thus, purchases or transfers of corporate voting stock, partnership ownership interests, LLC membership interests, or ownership interests in a legal entity are not changes in ownership of the real property owned by the legal entity.
- **Change in ownership occurs once there is a 'change in control.'** A change in ownership of real property owned by a legal entity occurs when any person or entity obtains control of the entity through direct or indirect ownership or control of more than 50 percent of the voting stock of a corporation, or of more than a 50 percent ownership interest in any other type of legal entity. All the real property owned by the legal entity (and any entity under its control) as of the date of the change in control is subject to reassessment for property tax purposes.
- **Corporate reorganizations - not a change in ownership.** Corporate reorganizations do not result in a change in ownership of

real property when all of the corporations involved are members of an affiliated group and the reorganization qualifies under IRC section 368 (and under similar California statutes).

- **Proportional property transfer - not a change in ownership.** Any transfer of real property between an individual or individuals and a legal entity, or between legal entities, that results solely in a change in the method of holding title to the real property, and in which the proportional ownership interests of the transferors and transferees in the real property remain the same after the transfer, is not a 'change in ownership.'

Reporting Requirements

Reporting a change in control or change in ownership of a legal entity is to be distinguished from reporting a transfer of real property to or from a legal entity or between legal entities.

Transfers of real property are to be reported to the county assessor via a *Preliminary Change of Ownership Report* or *Change in Ownership Statement* when a document or deed effecting a change in ownership is recorded. These forms are available from the county assessor or county recorder.

Whenever there is a change in control or a change in ownership of a legal entity that owns California real property, the person or legal entity acquiring control or ownership must file a *Statement of Change in Control and Ownership of Legal Entities* (Form BOE 100-B) with the State Board of Equalization within 90 days of the date of the change in control or change in ownership, even if an exclusion otherwise applies. A failure

to file Form 100-B will result in a penalty of 10 percent of the tax applicable to the new base year value if a change in control or ownership occurred, or 10 percent of the current year's taxes if no change in control or ownership occurred.

Changes proposed under AB 2372

Change of ownership upon 100% transfer of legal entity interest

AB 2372 would provide that a change of ownership of real property held by an entity occurs when 100% of the ownership interests in the entity is sold or transferred in a 'single transaction.' The bill provides that:

- A 'single transaction' means a transaction in which 100% of ownership interests are sold or transferred in either: (1) one calendar year; or (2) within a three-year period beginning on the date of the original transaction when any percentage of ownership interests are sold or transferred.
- Acquisition of more than 50% ownership interests of the legal entity by any one entity or person is not required.
- The ownership interests sold or transferred may be accomplished by "merger, acquisition, private equity buyout, transfer of partnership shares, or any other means. . . ."

New reporting requirements for transfer of legal entity interests

AB 2372 adds significant reporting requirements regarding the transfer of legal entity interests.

A change of ownership interest in a legal entity that owns real property must be reported to the State Board of Equalization (SBE) within 90 days of the date the ownership change occurs.

This requirement apparently includes a change in the ownership interest of legal entities that hold *leasehold interests*. Furthermore, there is no requirement that a change in control of the entity occur for reporting to be required.

A deed must be recorded with the county recorder by the owner of real property whenever there is a change of ownership interest in a legal entity holding an interest in California real property, even if the owner of the real property does not change.

AB 2372 adds a requirement that a legal entity must report to the assessor within 90 days any transfers of legal entity interests subsequent to transfers of legal entity interests excluded from a change in ownership by the proportional ownership interest transfer exclusion (described above).

Increased penalty for current reporting requirements

A failure to satisfy the current reporting requirement of filing the Form 100-B with the SBE within 90 days of a change in control or ownership will result in a penalty of 20 percent, increased from the current 10 percent penalty.

The takeaway

A significant change proposed by AB 2372 is that a transfer of 100% of an entity's interest would qualify as a change in ownership. The bill suggests that the reason for this change is because currently such a transaction should qualify for reassessment but often does not because of the ability to divide ownership shares. As written, the bill raises several concerns.

- A 100% transfer of interest may be accomplished 'by merger' under the bill. Will corporate reorganizations, currently excluded

from a change in ownership, continue to be excluded? We anticipate that the current provision excluding specified corporate reorganizations will take precedence over the provisions of AB 2372. However, specific guidance will be needed to provide certainty.

- One hundred percent of a legal entity's interest could be transferred pursuant to the current proportional ownership interest transfer exclusion. Will AB 2372 take precedence over the proportional ownership interest transfer exclusion?

The new reporting obligations proposed under AB 2372 should be troubling to businesses owning California real property, particularly publicly traded corporations. The bill would require that any 'change in the ownership interests' of a legal entity holding California real property would trigger reporting obligations to the SBE. The reporting is not conditioned on a 100% interest transfer, or even a 50% change in control, but *any* 'change in the ownership interests.' Does this mean that publicly traded companies, whose shares get traded on a daily basis, are compelled to report such changes to the SBE? Would local assessors feel empowered to request disclosure of every traded share on audit?

Similarly, the bill provides that any 'change of an ownership interest' in a legal entity holding California real property triggers the requirement to record a deed, even when the owner of the real property remains unchanged. Are deeds required to be recorded every time a publicly traded share of a corporation is sold?

"The approach taken in AB 2372 is to modify the change in ownership rules to address perceived issues when

ownership interests are divided," observes Jon Sperring, a Principal in PwC's National State and Local Tax Practice in Sacramento and formerly tax counsel to past State Board of Equalization Member and Board Chairman, Dean Andal. "AB 2372 is potentially a trap for the unwary with its targeted substantive change and new reporting requirements," Jon also opines. Dean Andal, now a PwC State and Local Tax Director in San Jose comments, "although the likelihood of passage is unknown, we can't count it out just yet given the current political make-up of the legislature."

AB 2372 authorizes the SBE to promulgate regulations to carry out the purposes of the act. The SBE will need to issue regulations to answer the questions raised by AB 2372 if enacted in its current form.

Let's talk

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