

STRICTER PENALTY REGARDING CHANGE IN OWNERSHIP FOR PROPERTY TAX PURPOSES

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Once again, our government is taking active steps to ensure the collection of your tax dollars.

California is imposing stricter penalties to motivate taxpayers to report changes in ownership or control within a property-owning entity, so that property taxes can be increased appropriately.

Under California law, real property owned by a partnership, limited liability company, corporation or other legal entity is subject to reassessment upon a change of ownership or control within such legal entity. A change of ownership or control can occur if a transfer of interests in the legal entity results in (a) a party acquiring more than 50% of the interests, or (b) cumulative transfers of more than 50% of the original co-owners' interests. Assume, for example, that a partnership has owned a parcel of property for many years, which property has appreciated significantly in value. Partner A, who owns a 52% interest in the partnership, transfers its entire interest to Partner C. Although such transfer does not involve the transfer of fee title to the property, it involves a "change of ownership" of the partnership for property tax purposes, thereby triggering reassessment of the property.

In order to assist county assessors in generating property tax revenues, a few years ago California implemented a law requiring legal entities owning real property to report internal changes of ownership or control to the California State Board of Equalization ("SBE"). The SBE then disseminated this information to county assessors for reassessment purposes.

Under prior law, a penalty was not imposed for failure to report the change in ownership or control to the SBE, unless the SBE affirmatively requested the report in writing and the taxpayer failed to file its report within 45 days after such request. The penalty was then extinguished if the taxpayer filed its report within 60 days after being notified of the penalty.

Effective January 1, 2010, however, California imposes a 10% penalty for failure to report a change of ownership or control within 45 days from the earlier of (a) the date on which the change of ownership or control occurs, or (b) the date on which the SBE requests the taxpayer to report the change of ownership or control. In short, the taxpayer can no longer wait for the SBE's prompt in order to avoid the penalty. In addition, the penalty is no longer automatically extinguished if the taxpayer files its report within 60 days of being notified of the penalty.

This new law does not impact direct transfers of real property, which normally involve the recordation of a deed and corresponding filing of a preliminary change of ownership report with the county. It does, however, make several other changes regarding changes in ownership. In summary, whenever you are making internal transfers within a legal entity, it is important to (i) ascertain whether the transfer triggers a change of ownership or control for property tax purposes, and (ii) timely report any such change of ownership or control to the SBE. Remember, a change of ownership or control can involve a legal analysis and occur in instances other than upon the transfer of a majority interest.

Colby Campbell is the lead attorney in our firm with respect to entity formation and transfers, and she can be consulted with respect to any of the issues set forth in this bulletin.