

Property Tax Savings with Legal Entities

South Bay Estate Planning Council

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Proposition 13: California Constitution Article XIII A

- ▶ Limited Annual Increases in Assessed Value of Real Property to an Inflation Factor, Not to Exceed 2% Per Year (“Trended Base Year Value”)
- ▶ Prohibited Reassessment of a New Base Year Value except Upon:
 - a) Change in Ownership or
 - b) Completion of New Construction

Proposition 8

- ▶ Provides Property will be assessed at the “Trended Base Year Value” or the Fair Market Value as of January 1 (Revenue & Taxation Code §51(a)(2)).

Definition of Change in Ownership: Revenue & Taxation Code § 60

▶ Three Elements:

1. Transfer of a present real property interest;
2. Including the beneficial use thereof; and
3. The value of the interest is substantially equal to the value of the fee.

Non-proportional Transfers

- ▶ Husband and Wife own Blackacre as community property
- ▶ For asset protection purposes, Husband and Wife transfer Blackacre to family limited partnership owned 99% by Husband and Wife as community property and 1% by a corporation owned by Husband, Wife and Daughter.
- ▶ Reassessable change in ownership

Proportional Transfers

- ▶ Revenue & Taxation Code §62(a)(2) excludes from a change in ownership “Any transfer 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 real property and in which proportional ownership interests of the transferors and transferees... remain the same after the transfer.”

Inter-spousal Exclusion

- ▶ Revenue & Taxation Code §63 provides, in part, that “a change in ownership should not include any inter-spousal transfer”

Proportional Transfers

- ▶ Husband owns Blackacre as separate property
- ▶ Husband transfers Black Acre into LLC owned 50% by Husband and 50% by Wife
- ▶ Reassessable change in ownership

Spousal Transfer Redone

- ▶ Husband transmutes Blackacre to community property
- ▶ Husband and Wife transfer Blackacre into LLC owned 50% by Husband and 50% by Wife
- ▶ No change in ownership

Legal Entity CIO - Overview

- ▶ §64(a) provides the general rule that transfers of legal entity interests are not reassessable changes in ownership.
- ▶ Trusts are generally not legal entities for property tax change in ownership purposes.
- ▶ Ownership of LLCs and Partnerships is measured by capital and profits interests.
- ▶ Ownership of corporations, for Section 64 purposes, is measured by voting stock.

Entity Transfers

- ▶ LLC is owned 90% by Mother and 10% by Son
- ▶ LLC purchases Blackacre
- ▶ Mother dies and leaves 50% of her interest to Son and 50% of her interest to Daughter
- ▶ 100% reassessment

Entity Transfers

- ▶ LLC is owned 100% by Mother
- ▶ LLC purchases Blackacre
- ▶ Mother dies and leaves 100% of her interest to only child
- ▶ 100% reassessment

Entity Transfers

- ▶ Revenue and Taxation Code §64(c)(1) provides that a change in ownership occurs when a person obtains control of more than 50% of the *voting stock* of a *corporation* or obtains more than 50% of the *ownership interest* in any partnership, *LLC* or *other legal entity*.

Entity Transfers Redone

- ▶ LLC is owned 90% by Mother and 10% by Son
- ▶ LLC purchases Blackacre
- ▶ Mother dies and leaves:
 1. 50% of her interest to Daughter; 44% to Son and 6% to Daughter-in-law (or Grandchild); or
 2. Mother could structure her estate so that Daughter and Son each end up with 50% of LLC
- ▶ No change in ownership

Entity Transfer Redone

- ▶ Mother owns 100% of LLC and has only 1 child
- ▶ LLC purchases Blackacre
- ▶ Mother dies and leaves:
 1. 50% to Son and 50% to Daughter-in-law
 2. 50% to Son and 50% to Grandchildren
- ▶ No change in ownership

The “Taint”

- ▶ Mother owns 100% of Blackacre
- ▶ Mother places Blackacre in LLC she owns 100% of – No change in ownership 62(a)(2)
- ▶ Mother dies and leaves LLC 50% to Son and 50% to Daughter
- ▶ Change in ownership

The “Taint”

- ▶ Section 64(d) provides that if property was transferred to a legal entity then in addition to the “*one person obtaining control (64(c)) rule*” there is also a change of ownership when more than 50% of the original coowner’s interests are cumulatively transferred.

The “Taint”

- ▶ LLC owned by Husband (50%) and Wife (50%) (assume “taint” applies)
- ▶ Husband dies and transfers his 50% to Son (25%) and Daughter (25%)
- ▶ Wife transfers 5% to Son
- ▶ Change in ownership ($25\%+25\%+5\%=55\%$)

The “Taint”

- ▶ LLC owned by Husband (50%) and Wife (50%) (assume “taint” applies)
- ▶ Husband dies and transfers his 50% to Son (25%) and Daughter (25%)
- ▶ Son transfers 5% to Friend
- ▶ No change in ownership – Interest transfers only count once

The “Taint”

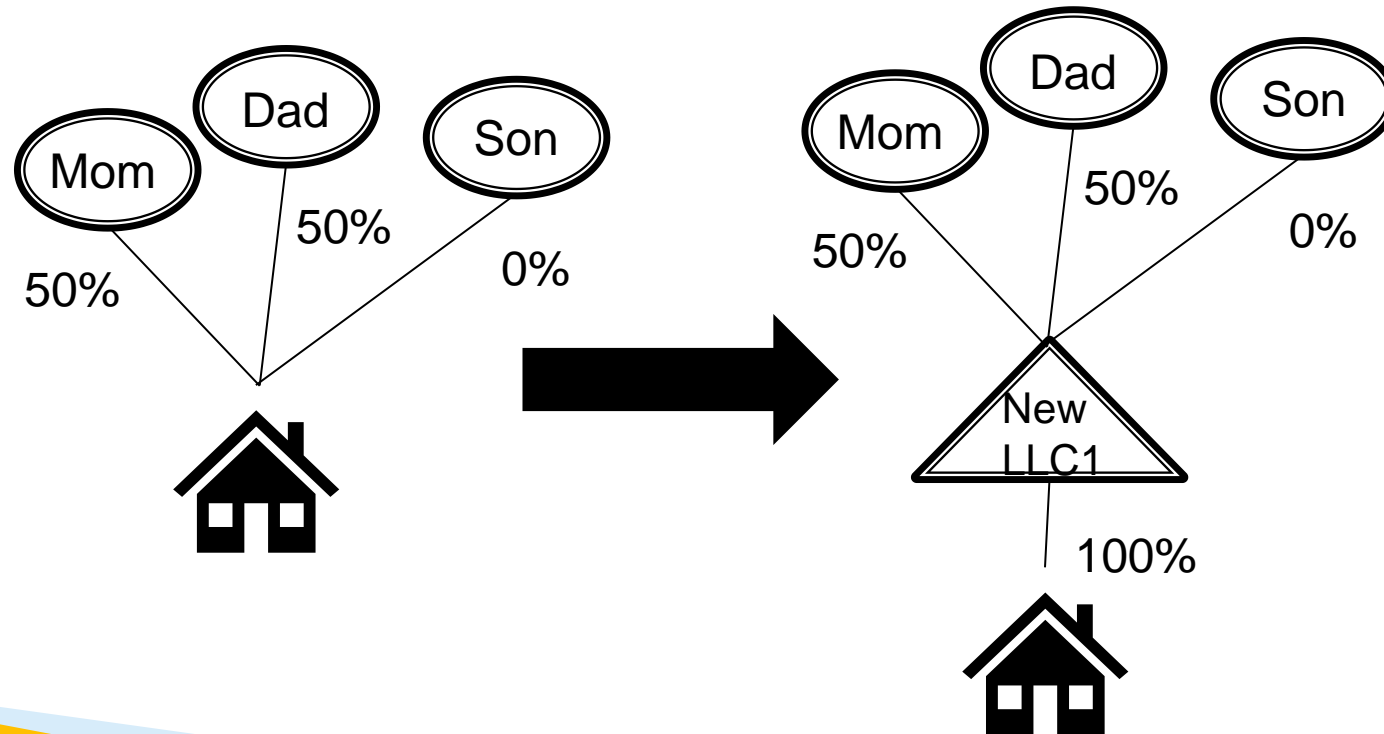
- ▶ LLC owned by Husband (25%), Wife (25%), Daughter (25%), and Son (25%)
- ▶ Husband dies and transfers 25% to wife
- ▶ Son transfers 25% to Friend
- ▶ Daughter transfers 25% to Friend
- ▶ No change in ownership
- ▶ Inter-spousal transfers don't count towards the 50%

Reporting Requirements

- ▶ Revenue & Taxation Code § 480.1 – Whenever a legal entity experiences a change of ownership “as defined in subdivision (c) of Section 64, a signed change in ownership statement...shall be filed...within 90 days from the date of the change of control...”
- ▶ Revenue & Taxation Code §480.2 imposes the same requirement for a change of ownership that results pursuant to Section 64(d).

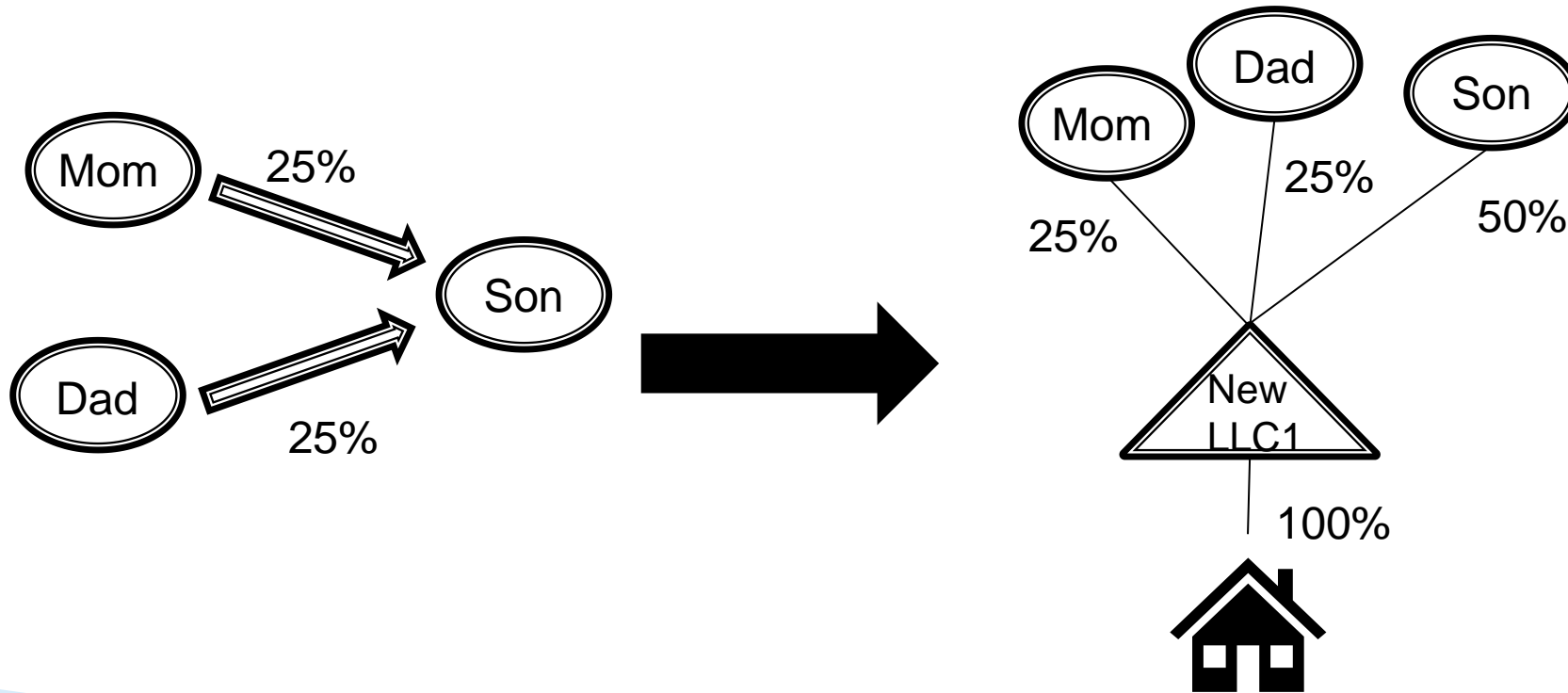
Legal Entity Planning Technique

- ▶ 1. Proportionally transfer property into a new LLC. The transfer is excluded under Section 62(a)(2), and entity is “tainted”.



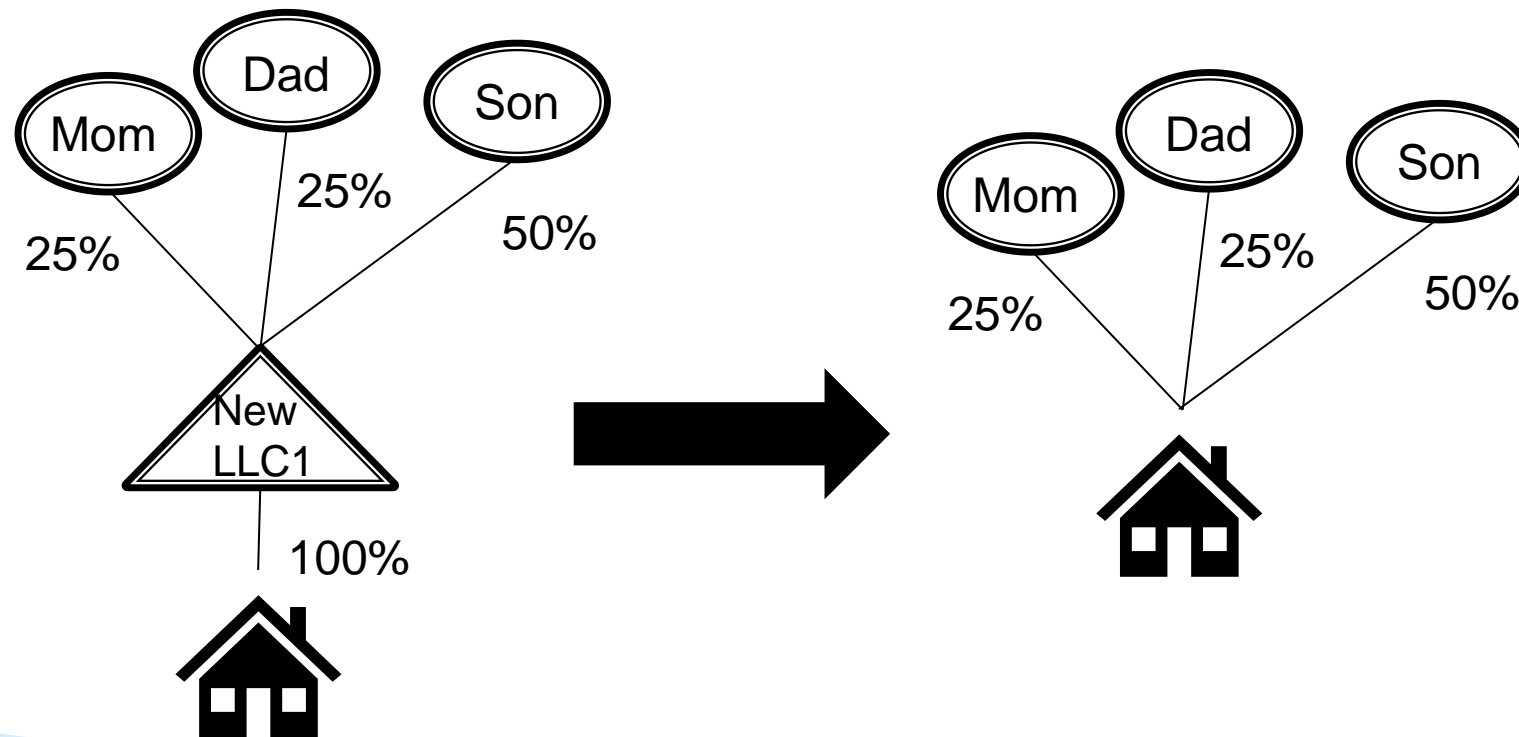
Legal Entity Planning Technique

- ▶ 2. Transfer up to 50% of the **LLC interest** to Son. Cumulatively no more than 50% LLC interest transferred.



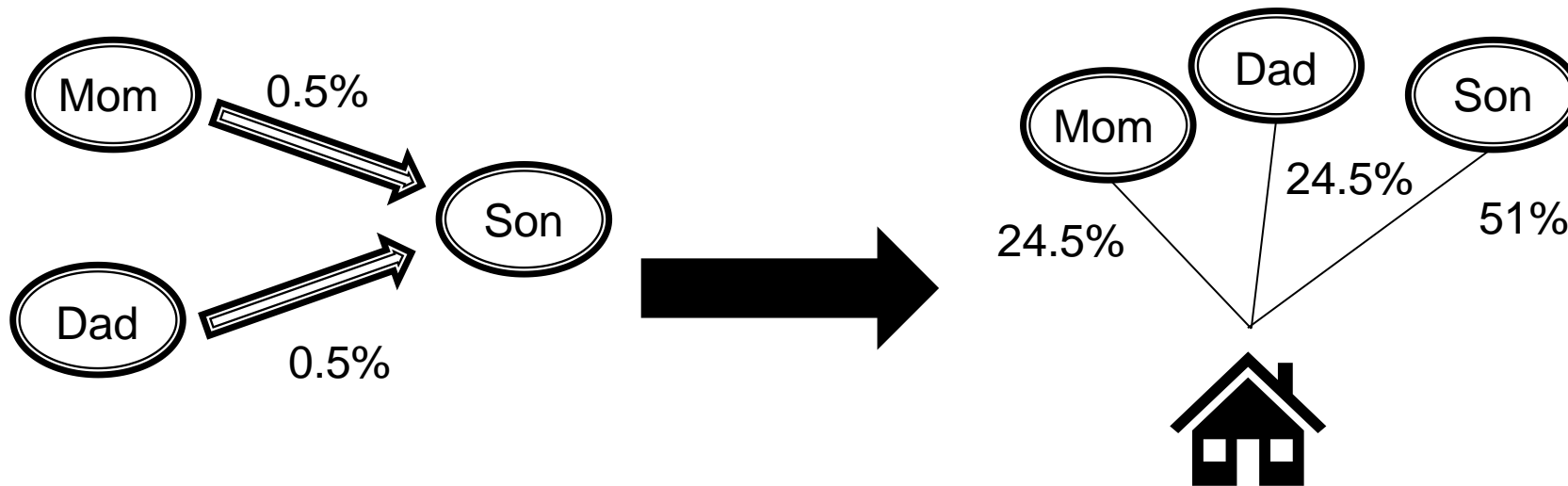
Legal Entity Planning Technique

- ▶ 3. Transfer property out of the LLC, to be held by its members in the same proportion. Excluded under 62(a)(2).



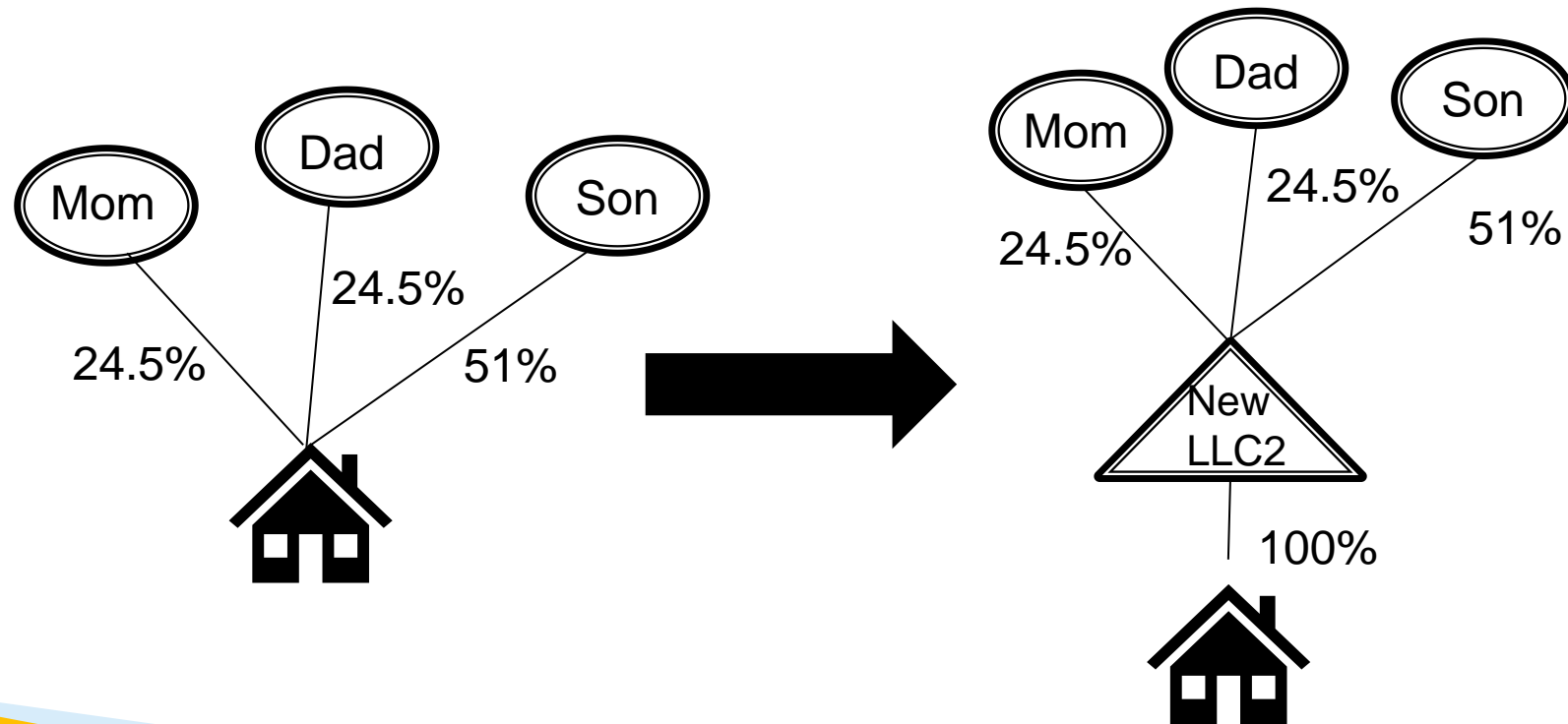
Legal Entity Planning Technique

- ▶ 4. Transfer 1% of the property to Son. Transfer may or may not be excluded depending if the property will be Son's principal residence.



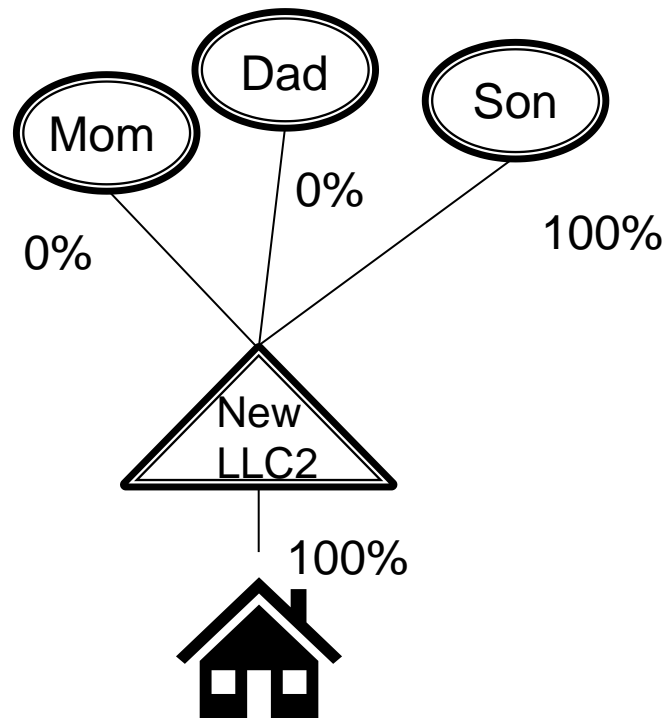
Legal Entity Planning Technique

- ▶ 5. Transfer property into a different new LLC. The transfer is excluded under Section 62(a)(2), and the cumulative counter is reset to 0%.



Legal Entity Planning Technique

- ▶ 6. Remaining transfer of LLC interest to Son will cumulatively be no more than 50% and son will not acquire majority ownership. Thus, no reassessment.



Legal Entity Planning Technique

- ▶ 6. Step Transaction is a major concern. There should be substantial time between each of the steps to potentially avoid the transactions being collapsed, resulting in reassessment.
- ▶ Depending on the facts, different techniques can be employed to work around Prop 19's parent-child rules. For example, using the joint tenancy rules.

Prang v. Los Angeles County Assessment Appeals Bd. (2024) 58 Cal.5th 1152

- ▶ The Supreme Court of California upheld the court of appeals decision which determined that “stock” applies to all classes of stock, including voting and non-voting, for purposes of Section 62(a)(2) – proportional interest transfer exclusion.
- ▶ This case creates new planning opportunities using corporations and voting and not voting stock.