

WealthCounsel:

Legal Entity Change in Ownership Law for Estate Planners

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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

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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.

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How to not Commit Malpractice

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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

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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.”

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Inter-spousal Exclusion

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

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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

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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

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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

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Entity Transfers

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

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Entity Transfers

- ▶ Revenue and Taxation Code §64(c) 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.

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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

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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

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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

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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.

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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 ($25\% + 25\% + 5\% = 55\%$)

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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

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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%

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The “Taint”

- ▶ LLC owned by Husband (50%), Son 1 (20%), Son 2 (20%), and Daughter (10%)
- ▶ Husband dies and transfers 5% to Son 1, 5% to Son 2, and 40% to Daughter
- ▶ No change in ownership – However any party can trigger a change in ownership by transferring .1% – reliance on other parties

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The “Taint”

- ▶ Same LLC owned by Daughter (50%), Son 1 (25%), Son 2 (25%) (50% already transferred)
- ▶ Son is terminally ill – 6 months to live
- ▶ Solution – transfer interest to individuals (62(a)(2)) – no change
- ▶ Terminally ill Son can then do Parent-Child transfer (discuss next) or at least there is only a change in ownership on Son’s 25% interest

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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).

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Penalty

- ▶ SB 816 (effective 1/1/10) amended the penalty for failing to file a change of ownership statement as required by Sections 480.1 and 480.2.
- ▶ Prior to 1/1/10, a 10% penalty only attached if a legal entity failed to respond to a request to file a change of ownership statement from the SBE.
- ▶ Further, even if the legal entity failed to respond, the penalty was automatically abated if the legal entity responded within 60 days of the notice of penalty.

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Penalty

- ▶ After 1/1/10 – pursuant to Section 482, if a change of ownership statement is not filed within 45 days from the date of the change of control, a 10% penalty will apply to the taxes applicable to the new base year value.
- ▶ Additionally, SB 816 eliminated the automatic abatement provision.
- ▶ The penalty may now only be abated if (1) a change of ownership statement is filed; (2) an application for abatement is filed with the AAB within 60 days of the notice of penalty; and (3) the AAB finds that the failure to timely file a change of ownership statement was due to reasonable cause and not willful neglect (Code Section 483).

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Penalty

- ▶ SB 507 (effective 1/1/12) extends the filing period from 45 days to 90 days.
- ▶ Further, the Assessor now must abate the 10% penalty if the SBE's written request to file a BOE-100-B was based upon erroneous information.

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