



California Supreme Court Confirms: Pony Up the Documentary Transfer Tax

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The California Supreme Court just dealt a blow to taxpayers who transfer interests in real estate-owning LLCs and other entities. In *926 North Ardmore Avenue, LLC v. County of Los Angeles* (Cal. S. Ct. No. S222329, June 29, 2017), the Court upheld a 2014 Court of Appeal decision that the Los Angeles County recorder could impose documentary transfer tax (**DTT**) on such a transfer — not just on a transfer of the underlying real estate where a deed is actually recorded — based *solely* on California’s DTT enabling statute. The 6-1 decision is a sweeping victory for California counties and cities (sixteen of which submitted briefs to support Los Angeles County’s position), which can now impose DTT on these transactions without an ordinance or voter approval.

Background

California Revenue & Taxation Code (**R&TC**) section 11911 allows a county or city to impose DTT on each deed, instrument, or writing by which real property shall be granted, assigned, transferred, or otherwise conveyed. R&TC section 11925 expressly provides that DTT may not be imposed on the transfer of a partnership or LLC interest if the entity continues as the same partnership for income tax purposes under Internal Revenue Code (**IRC**) section 708 and continues to hold the real property concerned; however, if the entity terminates for income tax purposes under IRC section 708 as a result of the transfer, then R&TC section 11925 allows DTT to be imposed even though no deed is actually recorded. California practitioners have long taken the position that, absent such a technical tax termination, transfers of interests in legal entities owning real estate were not subject to DTT.

Some California charter cities (which, unlike general law cities, do not need state legislation authorization in order to levy taxes) and counties have enacted ordinances expanding the reach of the DTT. For example, San Francisco provides that any transfer in a legal entity resulting in a change of ownership for property tax purposes under Proposition 13 will also require DTT. Some counties (such as Santa Clara and Napa) have enacted similar ordinances. Los Angeles County did not enact a similar ordinance, but the County recorder

publicly stated on its web site that it would impose DTT on transfer of interests in an entity, even if a deed is not recorded, which result[s] in a greater than 50% interest in control of the legal entity being transferred.

In *926 North Ardmore*, the Supreme Court held that Los Angeles County could impose DTT in these circumstances. Essentially, the Court's reasoning was that there was enough case law and indication of the California legislators' intent in the statewide DTT enabling statutes to independently support Los Angeles County's position. The Court also relied heavily on Proposition 13 and its change in ownership rules. (The transfer in *926 North Ardmore* was a change in ownership for Proposition 13 purposes and the taxpayer never so disputed.)

What to do?

The Supreme Court's decision gives practitioners yet more headaches in trying to close a real estate transaction and figuring out the transferor's and transferee's tax liabilities:

- Implicit in *926 North Ardmore* is the Court's acquiescence to governance by web site, at least in the instance of DTT. This approach may be convenient for counties and cities, but it is bad for practitioners and taxpayers doing their due diligence to determine whether DTT to a particular transfer: They must go beyond reviewing a city's or county's ordinances to canvassing the Internet for any stray forms or notices by the county or city where the real estate is located. For example, the Los Angeles County recorder's notice that it will apply the DTT to entity transfers – the policy at issue in *926 North Ardmore* -- is not apparent on the web site: One must dig through several obscure links in the site to find it.
- The Court's conflating the DTT with Proposition 13 creates landmines even for taxpayers who successfully navigate a county's or city's web site to determine whether DTT applies. R&TC section 64 provides different ways in which a transfer of interests in a legal entity can result in a change in ownership under Proposition 13, one of which applied in *926 North Ardmore*. However, that such a transfer is excluded from a change in ownership under Proposition 13 may not necessarily mean that it is excluded from DTT. For example, the R&TC does not treat as a change in ownership a situation where an LLC purchases property (which is then reassessed to reflect the purchase price) and over time there are cumulative transfers of more than 50% of the interests, so long as *no single* person or entity acquires more than 50% ownership. Los Angeles County's notice, however, is imprecise and would appear to impose DTT even in such a circumstance; and nothing in *926 North Ardmore* prevents this result. (The Santa Clara and San Francisco ordinances as currently written, by contrast, more closely adhere to the language in R&TC section 64 and therefore are clearer that DTT should not apply in this circumstance.) One can posit other situations where there may be a Proposition 13 change in ownership but no DTT or, conversely, DTT but no Proposition 13 change in ownership. This confusion will leave taxpayers in the lurch as to whether to pay DTT, and *926 North Ardmore* will force courts to sort out these issues absent clarifying changes to the DTT statute by the California legislature.
- If there is a sale of interests in an entity and DTT applies, then the purchase agreement should specify which side pays the DTT, just as would be the case for a direct transfer of real estate where a deed is recorded. (Normally the seller pays the county portion and the sides split the city portion, at least where there is a purchase and sale involving an actual deed.) The DTT is generally \$1.10 per each \$1,000 of consideration, though rates in chartered cities may be far higher (as in San Francisco). If there is a cashless transfer of interests in an entity outside of the sale context (for example, a reorganization of an LLC, a gift, or a transfer out of trust as was the case in *926 North Ardmore*) and DTT applies, one of the parties will need to find the cash to pay the tax.
- *926 North Ardmore* makes it more important than ever that the taxpayer duly file a Form BOE-100-B (Statement of Change in Control and Ownership of Legal Entities) with the California State Board of Equalization within the deadline (generally, 90 days after a transfer of an interest in an entity). The purpose of this form is to alert the Board (and, through the Board, the local assessor) as to whether a transfer of interests in a legal entity has occurred which might be a Proposition 13 change in ownership triggering reassessment; but this form is also the means by which a city or county may be alerted to whether DTT applies. A taxpayer need not file this form for every transfer of an entity interest, but may be required to file it even if there is no change in ownership for Proposition 13 purposes. A taxpayer can use Form BOE-100-B to educate the Board (and city or county) as to

why a transfer is not a change in ownership for Proposition 13 and, by extension, not subject to DTT. For example, if the ultimate indirect interests of the owners in property after the transfer are exactly the same as before, then there should be no Proposition 13 change in ownership and, by extension, no DTT.

- If a taxpayer wants to take the position that an interest transfer does not trigger DTT even if such transfer does trigger a Proposition 13 reassessment (as we note above, there are inconsistencies between the two schemes which *926 North Ardmore* leaves to future litigation), the best course of action is probably to reserve for the amount of the DTT; file the Form BOE-100-B if required; and wait for the statute of limitations to pass for the city or county to assert the DTT (generally 4 years, though a city or county may assert that the statute is tolled if there is no Form BOE-100-B or the government otherwise has no notice of the transfer potentially triggering the DTT).
- If a transfer of an entity interest triggers DTT but does not require the taxpayer to file a Form BOE-100-B, then neither the R&TC nor any county or city ordinance appears to provide a form or procedure for reporting and paying the DTT. Counties and cities will need to come up with the necessary forms and procedures in our post-*926 North Ardmore* world.