

New California Deadlines for Disclosing Certain Proposition 13 Changes in Ownership

Craig A. Becker • Lawrence L. Hoenig

Effective January 1, 2010, California will require any entity undergoing a merger, acquisition or other transaction constituting a Proposition 13 change in ownership under Revenue and Taxation Code (“R&TC”) section 64(c) or 64(d) to file an appropriate change in ownership statement (BOE Form 100-B) within 45 days of the transaction or face a 10 percent penalty. *Cal.SB 816, 2009 Stats.Chap. 622*. The new provisions also tighten penalty enforcement, as described below. Currently, no penalties are imposed unless the disclosure statement is not filed within 45 days after the California State Board of Equalization (“BOE”) requests the filing.

Existing Statutory Provisions—In Effect through December 31, 2009

R&TC section 64(c) specifies that a Proposition 13 “change in ownership” occurs when a partnership, LLC, corporation or other entity owning California real property undergoes a “change in control.” A “change in control” occurs when a direct or indirect owner of the entity increases its equity ownership from a level less than (or equal to) 50 percent to more than 50 percent.

R&TC section 64(d) addresses another Proposition 13 “change in ownership” situation, namely where property had previously been transferred to a legal entity in a transaction that was not a Proposition 13 change of ownership because the property’s prior owners (the “original co-owners”) received the same proportional interests in the transferee legal entity. R&TC section 64(d) specifies that a Proposition 13 “change in ownership” will occur if these original co-owners, in one or more transactions, subsequently transfer ownership interests in the legal entity that cumulate to more than 50 percent of their original co-ownership interests.

The affected entity in a section 64(c) or 64(d) “change in ownership” is required to file a “Statement of Change

in Control and Ownership of Legal Entities” (Form 100-B) with the BOE, listing all of the parcels of California real property held by the entity. *R&TC §§ 480.1, 480.2*. The BOE forwards the completed filing to the affected county assessors, who reassess the property.

Currently Form 100-B must be filed within 45 days after the pertinent transaction, but no penalty is imposed unless the affected entity fails to return the form within 45 days after the BOE mails a request for the form. *R&TC §§ 480.1, 480.2, 482(b)*. BOE requests are typically made as a result of disclosures on the entity’s annual California income tax return disclosing the transaction (Questions J and K on FTB Form 100). The penalty for failing to timely file is generally 10 percent of the entity’s annual property tax on the reassessed values. *R&TC § 482(b)*. However, under current law there are fairly lenient exceptions under which the penalty may be abated.

New Provisions—Effective January 1, 2010

The new provisions change the existing compliance requirements in three ways.

First, in order to avoid a penalty, the Form 100-B must now be filed within 45 days after **closing** any section 64(c) or 64(d) “change in ownership” transaction, rather than 45 days after the BOE requests the form. This not only accelerates the filing, but also requires taxpayers to independently ascertain what transactions might constitute a “change in ownership.”

Second, the 10 percent penalty will be automatically applied if Form 100-B is not filed within 45 days of the transaction. *R&TC § 482(b)*. There no longer is an automatic waiver if the filing is made within 60 days of a late filing notice from the BOE.

Third, any request for a reasonable cause waiver of a late filing penalty must now be applied for and secured from the County Board of Supervisors (rather than the BOE). *R&TC § 483(b)*. Moreover, entities with properties in several counties will separately need to request penalty waivers from each county, rather than making one request to the BOE.

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Implications for Future Transactions Involving Entities with California Realty

Evaluating the need for a Form 100-B filing will now be a required compliance item for many corporate and partnership transactions involving entities that own California real property. This would apply to every section 64(c) transaction, which would include many merger and acquisition transactions, and every section 64(d) transaction as described above. Taxpayers may no longer wait for a BOE request for Form 100-B. They must determine on their own when there is or is not a

“change in ownership” requiring this filing. When in doubt, clients should protectively file Form BOE 100-B to avoid penalty risk.

A close reading of the statute and its effective dates indicates that any 2009 “change in ownership” should be governed by existing rules and not be penalized as long as Form 100-B is completed within 45 days of a BOE request. The BOE website indicates the same. However, those entities completing 2009 transactions may want to avoid any questions by filing Form 100-B within 45 days after the transaction.

California Ballot Measures Would Cut Proposition 13 Protection for Commercial Properties

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On November 5, 2009, two ballot initiatives to remove certain Proposition 13 property tax protections for California commercial property were filed with the state’s Attorney General.

- The first initiative, titled the “Protect the Homeowners and Close Corporate Tax Loopholes Act” (No. 09-0077, the “Reassessment Initiative”), would remove the Proposition 13 limits on assessed value of commercial real property and subject such property to reassessment at fair market value at least once every three years.
- The second initiative, titled the “Education and Taxpayer Fairness Act” (No. 09-0078, the “Rate Initiative”), would raise the property tax rate on commercial real property by 55 percent (from 1 percent to 1.55 percent) and reserve the incremental property tax revenue for California public schools.

Neither initiative would change any of the existing Proposition 13 protections for residential real property.

The California Teacher’s Association (CTA) is likely the principal sponsor of both these initiatives.

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Before either initiative can be put on any statewide ballot, the proponents must first collect petitions with 694,354 (certified) signatures. For the initiatives to be placed on the November 2, 2010 ballot, certain analyses and summaries at the state level and then collection of signatures and the requisite certification would need to be completed by June 24, 2010. Majority approval of the voters would be required to pass any initiative that made it to a statewide ballot. *Cal.Const. Art. II, § 10(a)*.

Background on California’s Proposition 13

California’s Proposition 13 (Article XIII A of the California constitution) provides, among other rules, two significant restrictions on California property taxation.

- The assessed value of California real property on each lien date must be the lesser of the property’s fair market value or its indexed base year value. The indexed base year value is the property’s fair market value as of its last change of ownership (plus increases to reflect the value of any new construction), increased by an annual inflation factor of no more than 2 percent. *Cal.Const. Art. XIII A, § 2(b)*.
- The property tax rate applied to the above determined assessed value of California real property cannot exceed 1 percent. *Cal.Const. Art. XIII A, § 1(a)*.

The Reassessment Initiative would remove the base year value assessment limit, requiring that commercial real property be reassessed at its fair market value no less often than every third lien date. The Rate Initiative would subject commercial real property to a 1.55 percent annual property tax rate, instead of the 1 percent rate otherwise applicable under Proposition 13.

Common Provisions in the Two Proposed Initiatives

Both initiatives apply their respective higher property tax structure only to commercial real property. Both define commercial real property as “non-residential real property that is not used for commercial agricultural purposes.” More specifically, the initiatives provide that the higher taxing structure would **not** apply to either:

- Property used and zoned for commercial agricultural production.
- Single family or multi-family dwelling units used as a permanent residence (including residential rental property), or zoned to be used as a permanent residence, including the underlying land.¹

Both initiatives provide businesses an annual exemption from property taxes for the first \$1 million of tangible personal property, but specify that the exemption does not extend to boats and airplanes not used in the daily operation of the business.²

Both initiatives double the annual homeowner’s exemption (from \$7,000 to \$14,000), and double the maximum income tax credit for renters (from \$120 to \$240).³

Both initiatives specify that the incremental revenue will first be used to reimburse counties for lost revenue from the increased exemptions. In the case of the Reassessment Initiative, local assessors would also be reimbursed for the increased cost of regularly reassessing commercial real property. In the case of the Rate Initiative, the state’s general fund revenues would be reimbursed for lost state income tax revenue from increased property tax deductions.

¹ 09-0078 Prop.Cal.Const. Art. XIII A, §§ 1(b), (d)(1); 09-0077 Prop.Cal.Const. Art. XIII A, §§ 2.5(a), (b)(1).

² Prop.Cal.Const. Art. XIII, § 2, Prop.Cal.Rev.& Tax.Code § 210.

³ Prop.Cal.Const. Art. XIII, § 3(k), Prop.Cal.Rev.& Tax.Code § 218(a).

Differences Between the Two Proposed Initiatives

The Rate Initiative would apply a higher property tax rate (1.55 percent, rather than 1 percent) to the existing Proposition 13 valuation standards for commercial property (*i.e.*, assessed values set at the lower of the indexed base year value and fair market value).⁴ The incremental tax revenues (after reimbursements for lost revenue from increased exemptions and increased income tax deductions) would be segregated in a separate trust fund to be used solely for California public schools. 78 percent of the net incremental property tax revenue would go to K-12 public schools, and the remaining 22 percent would be split equally between California community colleges and California State University System. The Rate Initiative also includes additional provisions attempting to insure that California schools continue to receive the same funding from existing revenue sources, so that the new funding from the proposed higher tax rate is indeed new additional revenue for the California schools. The higher tax rate would first take effect as of the January 1, 2011 lien date, and apply to the 2011-12 fiscal year.

The Reassessment Initiative would preserve the existing 1 percent property tax rate. However, it would require that all commercial real property be reassessed up to (or down to) its current fair market value at least once every three years, thereby removing the current Proposition 13 protection limiting assessed values to a property’s indexed base year value.⁵ County assessors would require substantially more staff to perform these periodic appraisals, which in turn would lead to a larger volume of assessment appeals, particularly on larger properties. Incremental revenue from this initiative would be included with all other general property tax revenues and allocated among existing governmental uses (including the public schools). The required three-year cycle of commercial property reassessments would commence on the January 1, 2012 lien date.

Nothing precludes passage of both initiatives. As noted above, each initiative addresses a separate Proposition 13 protection for commercial real property, and both initiatives otherwise use consistent definitions and provide for consistent increased exemptions. Accordingly, if both were passed, commercial real property would be regularly reassessed at its fair market

⁴ 09-0078 Prop.Cal.Const. Art. XIII A, § 1(b).

⁵ 09-0077 Prop.Cal.Const. Art. XIII A, § 2.5(a), Prop.Cal.Rev.& Tax.Code § 405.6.

value, and would also be taxed at the higher 1.55 percent rate.

Implications for Commercial Real Estate

If passed, these initiatives would create added tax property tax burdens on the owners and tenants of California commercial real estate. Property owners,

tenants, and prospective tenants will want to monitor the progress of these ballot initiatives for purposes of current and future lease negotiations. They will want to pay very close attention to property tax pass-through clauses, both on triple net leases and on gross leases with expense stops, in order to specify which party would bear the costs of these potential property tax increases.

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