

CA Supreme Court: Documentary Transfer Tax May Apply to Transfers of Legal Entity Interests

Overview

On June 29, 2017, the California Supreme Court, in *926 North Ardmore Avenue, LLC, v. County of Los Angeles*,¹ (“*Ardmore*”) held that the Documentary Transfer Tax (“DTT”) may be imposed under California Revenue and Taxation Code (“CRTC”) Section 11911 when a transfer of an interest in a legal entity results in a change in ownership of real property within the meaning of CRTC Section 64(c) or (d) so long as there is a written instrument reflecting a sale of the property (including the transfer of beneficial ownership of the property) for consideration.²

This Tax Alert provides some background on the DTT, summarizes the California Supreme Court’s decision in *Ardmore* and provides some taxpayer considerations.

Background on Documentary Transfer Tax

CRTC Section 11911 is part of the Documentary Transfer Tax Act and permits counties and cities to impose the DTT “on each deed, instrument or writing by which any lands, tenements, or other realty sold within the county shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, . . . , when the consideration or value of the interest or property conveyed (exclusive of the value of any lien or encumbrance remaining thereon at the time of sale) exceeds one hundred dollars (\$100).”³ CRTC Section 11911 is derived from a provision of the former federal documentary stamp act which also imposed a tax on written instruments conveying “lands, tenements, or other realty sold” in return for consideration.⁴ Los Angeles County’s DTT provision uses “substantively identical language, with slightly different punctuation.”⁵

Factual and Procedural Background in *Ardmore*

Ardmore involved the transfer of the beneficial ownership of an apartment building located at 926 North Ardmore Avenue (“*Ardmore Property*”). The *Ardmore Property* was originally owned by a husband and wife. In 1972, they transferred it into a family trust for their benefit.⁶ When the husband passed away in 2007, the *Ardmore Property* was transferred into an administrative trust (“*Trust*”) for the benefit of the wife. The couple’s two sons were the named trustees (“*Trustees*”) of the *Trust*.⁷ The *Trustees* formed two entities: 1) 926 North Ardmore Avenue, LLC (“*LLC*”), and 2) BA Realty, LLLP (“*BA Realty*”).⁸ The *Trust* was the sole member of the *LLC*, and the *Trust* also held a 99 percent limited partnership interest in *BA Realty*.⁹ Next, the *Trustees* executed a grant deed transferring the *Ardmore Property* to the *LLC*. Then, they transferred the membership interest in the *LLC* to *BA Realty*.¹⁰ Finally, the *Trust* divided its 99 percent interest in *BA Realty* and distributed it to four subtrusts (“*Wife’s Subtrusts*”), all of which were established for the benefit of the wife.¹¹

¹ *926 North Ardmore Avenue LLC v. County of Los Angeles*, Case No. S222329 (Cal. 2017). The California Supreme Court’s opinion is available [here](#).

² *Ardmore* at 20-21.

³ Cal. Rev. & Tax. Code §11911(a).

⁴ *Id.* at 7-8.

⁵ *Id.* at 8.

⁶ *Ardmore* at 1.

⁷ *Id.*

⁸ *Id.* at 2.

⁹ *Id.* The other one percent of *BA Realty* was a general partnership interest held by *BA Realty Management, LLC*, which was solely owned by the *Trust*.

¹⁰ *Id.*

¹¹ *Id.*

In 2009, approximately 90 percent of the partnership interests in BA Realty were transferred from the Wife's Subtrusts to two trusts (one for each son) in exchange for promissory notes from the sons' trusts. Following these transfers, each son's trust owned approximately 45% of the limited partnership interests in BA Realty, and approximately 9% continued to be owned by one of the Wife's Subtrusts.¹² These transfers were effectuated by written instruments (i.e., various agreements and promissory notes) but the writings did not mention the Ardmore Property and were not recorded with the Los Angeles County registrar-recorder ("Recorder").

As required under CRTS Section 480.2(a), the LLC filed a statement with the Board of Equalization to report these transfers for property tax purposes.¹³ Based on that statement, the Los Angeles County Assessor determined that the 2009 transfer resulted in a change in ownership under CRTS Section 64(d) and issued a supplemental property tax assessment to the LLC. The 2009 transfers constituted a change in ownership for property tax purposes under CRTS Section 64(d), a point which was not disputed in the litigation.¹⁴

Based on that 2009 property tax change in ownership, the Recorder sent a notice to the LLC demanding payment of the DTT. The LLC paid the DTT, and filed a refund claim challenging the DTT assessment. In its claim, the LLC argued that DTT "is a levy on written instruments that transfer ownership of real property, not on written instruments that transfer legal entity interests."¹⁵ The LLC also argued, in the alternative, that "no tax was due because (1) BA Realty, the entity transferred, did not hold legal title to the [Ardmore Property]; (2) the LLC, which held title to the [Ardmore Property], was not transferred; and (3) legal title to the [Ardmore Property] did not change."¹⁶ Los Angeles County denied the LLC's refund claim and the LLC filed a suit for refund. Subsequently, the trial court denied the LLC's refund claim and the California Court of Appeal affirmed the trial court's decision.¹⁷ The Court of Appeal held that the DTT may be imposed under CRTS Section 11911 whenever a transfer of a legal entity interest resulted in a change in ownership under CRTS Section 64(c) or (d).¹⁸ On November 3, 2014, the LLC filed a petition for review with the California Supreme Court.¹⁹

Summary of the California Supreme Court's Decision in *Ardmore*

The California Supreme Court ("Court") upheld the decisions of the lower courts, and concluded that "a written instrument conveying an interest in a legal entity that owns real property may be taxable, even if the instrument does not directly reference the real property and is not recorded."²⁰ The Court relied heavily on the fact that both CRTS Section 11911 (and Los Angeles County's DTT ordinance) and the federal stamp act expressly state that tax does not apply if a partnership interest is transferred when the partnership does not terminate (within the meaning of the Internal Revenue Code) and continues to hold the subject realty. The Court reasoned that there would be no need for such an exemption if the California Legislature did not intend the tax to apply to transfers of partnership interests in other circumstances.²¹ (The dissenting opinion countered that, where there is a termination within the meaning of the Internal Revenue Code, the partnership is "treated as having executed an instrument whereby [the realty held by the partnership] was conveyed, for fair market value." In the opinion of the dissent, the exemption should be read to mean that the DTT was only intended to apply to documents directly conveying real property.)²²

The Court also looked to federal authorities, explaining that the California "Legislature's intent, in enacting the [DTT Act], was 'to perpetuate the federal administrative interpretations' of the stamp act."²³ Thus, if the DTT Act provided no guidance on whether a specific transaction was taxable, counties should look to federal authorities construing the

¹² BA Realty Management LLC continued to hold its 1% general partnership interest.

¹³ *Id.* at 3.

¹⁴ *Id.* at 3-4.

¹⁵ *Id.* at 5-6.

¹⁶ *Id.* at 6.

¹⁷ *Id.*

¹⁸ *Id.*; *926 North Ardmore Avenue, LLC v. County of Los Angeles*, Case No. B248536 (Cal. Ct. App. Sept. 22, 2014) (emphasis added). The California Court of Appeal opinion is available [here](#).

¹⁹ The Petition was granted on January 14, 2015. The California Supreme Court heard oral arguments on April 5, 2017.

²⁰ *Id.* at 13.

²¹ *Id.* at 9-11.

²² *Id.* at *Dissent* p.4.

²³ *Id.* at 14.

stamp act to make that determination.²⁴ The Court stated that, consistent with federal cases on this issue,²⁵ “the critical factor in determining whether the [DTT] may be imposed is whether there was a sale that resulted in a transfer of beneficial ownership of real property.”²⁶ The Court then stated that the property tax change in ownership rules were designed to identify precisely the types of indirect real property transfers that the DTT Act was designed to tax.²⁷ Specifically, the Court stated that the change in ownership provisions, including CRTC Section 64(c) and (d), provide rules for distinguishing between ‘true’ changes in ownership from ‘paper’ ones and that they identify a subset of beneficial interest transfers that are significant enough to approximate new ownership and thus, warrant property reappraisal.²⁸ (The dissenting opinion countered that the federal cases involved transfers made by deed [an element that did not exist in the *Ardmore* case] and whether the transfer of legal title also resulted in a change in beneficial ownership of the realty. In the dissent’s opinion, the more appropriate question was whether the DTT applies when there is a change in beneficial ownership in the absence of a deed or other document conveying legal title.)²⁹

In summary, the Court concluded that written instruments existed that reflected the transfer of beneficial ownership of the Ardmore Property to the sons’ trusts.³⁰ Additionally, the evidence presented at trial demonstrated that each son’s trust had paid the Wife’s Subtrusts for the interests that they acquired in the Ardmore Property and thus, this payment was consideration for the sale.³¹ Therefore, the Court held that the 2009 transfer of the BA Realty interests was subject to the DTT.

Considerations

The California Supreme Court’s decision is not yet final. On July 13, 2017, a petition for rehearing was filed.³² If the California Supreme Court’s decision in *Ardmore* does become final, it expands the scope of the DTT levy to documents, whether or not recorded, by which entity interests are transferred for consideration, and the transfer constitutes a change in ownership under CRTC Section 64(c) or (d).

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²⁴ *Id.* at 15.

²⁵ The Court noted that federal courts on this issue have focused on whether there was a change in beneficial ownership of the real property. *Id.* at 17.

²⁶ *Id.* at 19.

²⁷ *Id.* at 20. The Court also noted that “[t]he are, of course, transactions that the change in ownership rules and the [DTT Act] treat differently. For example, the transfer of real property for no consideration, e.g., a gift, can result in a ‘change in ownership’ (see Cal. Code Regs., tit. 18, § 462.001), but is exempt from the transfer tax) § 11930.” *Id.*, n.19.

²⁸ *Id.*

²⁹ Dissent at 7-8.

³⁰ *Id.* at 20.

³¹ *Id.* at 20-21.

³² Generally, the County of Los Angeles must serve and file their answer to the petition for rehearing within eight days after the petition is filed, however, the Chief Justice may relieve a party from a failure to file a timely petition or answer before the Supreme Court decision is final and for good cause. Cal. R. of Ct., tit. 8, R. 8.536(b). Generally, the petition for rehearing is deemed denied if the court does not rule on the petition before the decision is final. Cal. R. of Ct., tit. 8, R. 8.536(c). The decision becomes final 30 days after the decision is filed unless, before the 30-day period (or any extension thereof) expires, the Court orders an extension—not to exceed a total of 60 additional days. Cal. R. of Ct., tit. 8, R. 8.532(b). On July 13, 2017, the Court extended the time for granting or denying the petition for rehearing in *Ardmore* to September 27, 2017. If the California Supreme Court grants the petition for rehearing, the decision and any opinion filed in the case will be vacated until further notice. Cal. R. of Ct., tit. 8, R. 8.532(e).

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