



# SALT Alert!



## **SALT Alert! 2017-011: California Supreme Court Upholds Imposition of Documentary Transfer Tax on a Change in Ownership of Entity That Holds Title to Real Property**

**On June 29, 2017, the California Supreme Court issued a long-awaited opinion in [926 N. Ardmore Ave. LLC v. County of Los Angeles](#). The court, affirming the Court of Appeal, held that the County of Los Angeles could impose a documentary transfer tax on the transfer of a controlling interest in a legal entity when there was “an actual transfer of legal beneficial ownership made for consideration.”**

### **Background**

This case involved a series of transactions among trusts maintained for the benefit of certain family members. The subject property, an apartment building located at 926 North Ardmore Avenue, was held in a single-member LLC (Ardmore) owned by BA Realty, a limited liability partnership owned by the family trust. The family trust distributed its interest in BA Realty to several subtrusts. The subtrusts then sold interests in BA Realty to irrevocable trusts established for the benefit of the sons and heirs of Ardmore’s owners. As required, Ardmore reported these sales to the State Board of Equalization through a “statement of change in ownership of legal entities.” Ardmore’s statement asserted that the family trust’s initial distribution of BA Realty to the various subtrusts did not qualify as a “change of ownership” of Ardmore’s real property because the surviving spouse remained the beneficial owner of the property through her status as beneficiary of the subtrusts. The statement did not address whether the subtrusts’ subsequent transfer of one-half of their interests in BA Realty to the two irrevocable trusts constituted a “change of ownership” under the relevant property tax provisions. The Office of the Assessor for the County of Los Angeles, believing that it did, issued a supplemental property tax bill that Ardmore paid without objection.

The Registrar-Recorder/County Clerk for the County of Los Angeles subsequently demanded that Ardmore pay documentary transfer tax based on the value of the apartment building. Ardmore disagreed that any documentary transfer tax was due, and the litigation ensued. After a trial court and the appeals court ruled in favor of the County, Ardmore appealed.

## California Supreme Court Decision

At the outset, the court recognized that the question before it was one of statutory interpretation. Under California's Tax Transfer Act, a county is permitted to levy documentary transfer tax 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 . . ." <sup>1</sup> Ardmore asserted that the scope of the documentary transfer tax was restricted to instruments that referred to and referenced "realty" and were recorded. The instruments at issue, which transferred interests in BA Realty—a legal entity—did not refer to the apartment building or its location and were never recorded. In Ardmore's view, this meant they were not subject to the documentary transfer tax.

After determining that the statutory language itself was ambiguous and, standing alone, could be interpreted both as suggested by Ardmore and the County, the court determined it was necessary to look at the statute in the context of other authorities. In doing so, the court rejected Ardmore's argument that certain other sections of the Transfer Tax Act, which was drawn from the federal documentary stamp act repealed in 1964, evidenced that only the transfer of real property triggered the tax. Specifically, section 11925 of the Transfer Tax Act, which was incorporated into the Los Angeles Code, provides an exemption from the documentary transfer tax for certain transfers of realty held by a partnership if, following the transfer, the partnership is considered a continuing partnership and continues to hold the realty. The court reasoned that the existence of this exemption evidenced that legal entity transfers could trigger the tax; otherwise, excluding certain legal entity transfers would not be necessary. Other sections of the Transfer Tax Act addressing the recording of documents did not change this analysis. The fact that a document subject to the tax could not be recorded unless the tax has been paid did not mean that only documents submitted for recording were subject to the tax. Another section requiring that every document submitted for recording show the location of the realty did not mean that only documents showing the location of realty were subject to the tax. The court 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.

Next, the court addressed the propriety of the County's tax assessment and whether the Recorder properly used the state's property tax statutes to determine whether a "change in ownership" occurred. Ardmore argued that the Recorder's reliance on the property tax law was misplaced, and that the Legislature never intended the change in ownership rules to apply to the Transfer Tax Act because the property tax rules were enacted later and were in a different section of the Revenue and Tax Code. Ardmore urged the court to look to federal authorities construing the federal stamp act, which it argued, stood for the proposition that only written instruments directly referencing and transferring real property were subject to tax. <sup>2</sup>

The court found no authority addressing the federal stamp act's application to a transaction like the one at issue, which it observed was not surprising given that LLCs did not exist when the stamp act was effective. Rather, the court determined the federal authorities addressing the stamp act made clear that the critical factor in determining whether documentary transfer tax may be imposed is whether there is a sale that results in a transfer of beneficial ownership of real property. In the court's view, the property tax "change in ownership" provisions provide rules for distinguishing "true" changes in ownership from "paper" ones and were "designed to identify precisely the types of indirect real property transfers that the Transfer Tax Act is designed to tax." Agreeing with the appeals court, the court concluded that section 11911 of the Transfer Tax Act permits the imposition of a documentary transfer tax whenever a transfer of an interest in a legal entity

results in a change in ownership of real property, as long as there is a written instrument reflecting a sale of the property for consideration. Here, there were written instruments reflecting the transfer of the beneficial ownership of the apartment building and sufficient evidence showing that the trusts of the two sons had paid for the interests they acquired in the building.

### The Dissent

Associate Justice Kruger was the sole dissenter. She observed that “there is a certain amount of appeal to the notion that a transaction that counts as a property transfer for purposes of the property tax laws should also count as a property transfer for purposes of the documentary transfer tax.” However, in her view, this result has “no support” in the language of the Transfer Tax Act or in “the over-150-year history of the documentary transfer tax.”

### Next steps

A footnote in the opinion states that a Recorder’s office employee testified at trial that some taxpayers, like Ardmore, had taken the position that no transfer tax was due on the transfer of a legal entity interest, while others paid the tax. That said, this is arguably a significant expansion of the scope of the documentary transfer tax and there is no indication that the holding cannot be applied retroactively. In addition, it appears unlikely that there are grounds to appeal further (i.e., no constitutional question). Please contact [Gina Rodriguez](#) with questions.

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<sup>1</sup> Cal. Rev. & Tax Code section 11911. The County of Los Angeles’ tax code includes a provision that uses substantially identical language.

<sup>2</sup> California’s Transfer Tax Act section 11911 is derived from a provision of the former federal documentary stamp act, and the opinion noted that it was understood by the Legislature that the Transfer Tax Act would be implemented in accordance with federal authorities implementing the stamp act.