CASE NO.: S222329

CRC 8.25(b)

IN THE SUPREME COURT OF CALIFORNIA

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926 NORTH ARDMORE AVENUE LLC,
Petitioner and Appellant,

v.

COUNTY OF LOS ANGELES,

Defendant and Respondent.

SUPREME COURT
FILED

NOV 25 2014

Frank A. McGuire Clerk

Deputy

After a Decision of the Court of Appeal,
Second Appellate District, Division Seven,
on Appeal from the
Superior Court for the County of Los Angeles,
The Honorable Rita Miller, Judge Presiding
Trial Court Case No. BC 476670
Court of Appeal Case No. 2d Civil No. B248356

ANSWER TO PETITION FOR REVIEW

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I.

SUMMARY OF WHY REVIEW SHOULD BE DENIED

The Petition and the CalTax letter supporting review proceed from the fundamentally mistaken assumption that the Court of Appeal decision represents a change in the law. It does not. The Documentary Transfer Tax Act ("DTTA") has applied to transfers of real property effected through sale of LLC interests since the advent of the LLC mechanism for holding property in the 1990's. What has changed are the enforcement tools recently provided by the Legislature for the express purpose of collecting the tax due on such transactions. (Rev. & Tax. code §§ 408(b); 408.4.)

Contrary to the arguments raised in support of review, DTT is an excise tax on the privilege of conveying real property by means of a written instrument, and is not a recording fee. The tax applies even if the transferring document is not recorded. (*Berry v. Kavanagh* (1943) 137 F.2d 574, 575-576; *Raccoon Development Inc. v. United States* (Ct.Cl. 1968) 391 F.2d 610, 613; *Fielder v. City of Los Angeles* (1993) 14 Cal.App.4th 137, 145.) The question is what types of documents effect such a conveyance (i.e., that reflect "realty sold"), and thus fall within the scope of the taxing provision.

Petitioners and their supporters recognize, as they must, that the DTTA sometimes extends beyond traditional recorded deeds, and into what Petitioners refer to as "constructive conveyance[s]." The real argument is

not over whether unrecorded transactions can trigger DTT, but rather the more mundane question of which unrecorded transactions are taxable.

The Court of Appeal correctly recognized that when the DTTA does not explicitly address a particular type of transaction - especially innovative transactions involving new mechanisms for holding property - it is appropriate to look to the "analogous" treatment in the property tax statutes. This makes perfect sense. In both cases, the Legislature is addressing the same basic question regarding the economic realities of the transaction: has real property been transferred? This approach is also well-supported by established law. As Petitioner recognizes, this was precisely the approach and rationale adopted by the *Thrifty* court. (*Thrifty Corp. v. County of Los Angeles* (1989) 210 Cal.App.3d 881.)

Contrary to Petitioners arguments, the special provisions for continuing partnerships (Rev. & Tax. § 11925) demonstrates the soundness of the Court of Appeal's conclusion. This provision begins with an exception to the application of the taxing provision under certain limited circumstances (§ 11925(a)), and then provides attendant rules for such transactions (§ 11925(b)). Rather than expressing the sole circumstances in which unrecorded "constructive conveyances" are taxable, the existence of this limited exception actually demonstrates that such transactions are indeed generally taxable.

The amendments to Section 11925, Statutes of 1999, chapter 75, extending the exception to entities treated as partnerships for federal tax purposes - but not further - likewise provides the Legislature's own answer to Petitioner's concerns over "distortions in the choice of corporate forms," and indeed shows nuanced legislative consideration of the taxability of the various means by which real property can be sold by the means of transferring interests in the owning entity.

The Legislature's failure to amend the DTTA to explicitly state that such transactions are taxable does not answer the question presented here. This could just as easily represent the Legislature's belief that no amendment was necessary, because the DTTA, as construed by *Thrifty* (*Thrifty Corporation v. County of Los Angeles* (1989) 210 Cal.App.3d 881), is already adequately clear. It is certainly inappropriate to assume as Cal-Tax has argued that the Legislature accepted one interested party's arguments against the proposal. (*Dyna-Med, Inc. v. Fair Employment and Housing Com.* (1987) 43 Cal.3d 1379, 1396 [". . . Unpassed bills, as evidence of legislative intent, have little value."].) As is usually the case, the Legislature's inaction here proves nothing.

II.

DESCRIPTION OF THE DOCUMENTARY TRANSFER TAX

The Documentary Transfer Tax ("DTT") applies whether or not change in ownership documents evidencing the change of ownership of real property are presented to the recorder for recordation.

Ordinarily, the recorder collects the DTT at recordation of the documents that evidence the change of ownership of real property. The DTT, however, attaches to the event of the change of ownership and not to the recordation of the change of ownership documents. Consequently, since liability for the DTT accrues on the delivery to the transferee of the documents that transfer or convey real property and not on the recordation of such documents, the recorder may seek collection of the DTT where the parties have not filed nor intend to file the documents that evidence the transfer, i.e., the change in ownership of the real property.

Part 6.7 of Division 2 of the Revenue and Taxation Code, §§ 11901, et seq., entitled the "Documentary Transfer Tax Act" ("DTTA") authorizes a county board of supervisors to ". . . impose, on each deed, instrument, or writing by which any . . . 'real property sold in the county is transferred or conveyed to a person or legal entity.'"

Section 11911 states:

> The board of supervisors of any county or city and county, by an ordinance adopted pursuant to this part, may impose, 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, by his or their direction, 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) a tax at the rate of fifty-five cents ($0.55) for each five hundred dollars ($500) or fractional part thereof.

The title of the act and § 11911 that authorizes the county to impose the tax are expressly directed at documents that transfer or convey real property and are not directed at the recordation of documents that transfer or convey real property. The Act is a transfer tax, not a recordation tax.

The provisions of the Act set forth at Chapter 1 (General Provisions and Definitions), §§ 11901 et seq.; Chapter 2 (Authorization for Tax), §§ 11911, et seq.; and Chapter 3 (Exemptions) §§ 11921, et seq., all relate to documents that transfer or convey real property, i.e., the event of transfer. Chapters 1 through 3 do not deal with the recordation of real property transfer documents. Instead the subject matter of the three chapters deals with, expands and focuses on the actual transfer or conveyance of real property as the taxable event.

Selling real property is one of the incidental rights that pertains to real property ownership. The parties to real property transfers or conveyances need not record documents that evidence transfers or conveyances of real property. They voluntarily do so to protect the priority of their interest in real property by giving constructive notice of their interest in property. The transfer or conveyance of real property does not occur on the recordation of the document. The transfer takes place on the delivery of the document that evidences the transfer to the buyer or purchaser. In other words, the tax is not a tax on giving constructive notice by recordation of a document that shows an interest in real property, but the tax is an excise tax on the exercise of the right to transfer real property.

Chapter 4 of the Act (Administration), §§1193 et seq., deals with the collection of the DTT. Section 11932 requires that documents that are presented to the recorder for recordation show on the document or related documents the amount of the tax. This section only prescribes a precondition for recordation. This section does not deal with the imposition of the tax nor does it specify when the liability for the tax accrues.

Section 11933 provides that the recorder shall not record the document until the recorder collects the tax imposed by the Act. Additionally, § 11933 specifies that the recorder may rely on the amount of the tax as stated in the documents presented for recordation or do his own independent inquiry into the correct amount of the sales price and

corresponding amount of the tax. This independent audit and investigatory authority to determine the consideration or value of the interest conveyed is also set forth in the Ordinance. This investigatory authority relating to the consideration or value of the interest conveyed supports the proposition that the DTT is a tax imposed on transfers of real property and not on recordation of such transfers.

The principle that the DTT is a tax on the event of selling, conveying or transferring real property is supported by *City of Huntington Beach v. Superior Court* (1978) 78 Cap.App.3d 333. The City of Huntington Beach adopted an ordinance in 1967 that imposed a "real property transfer tax" based on the schedule of rates prescribed by the Act. In 1974, the city repealed its 1967 DDT due to the Act's restrictive rate schedule and adopted in its place a "real property transfer tax" ordinance that imposed a higher rate schedule that generated more revenue for the city than the Act's rate schedule. However, it appears that other features of the 1967 ordinance, other than the rate schedules, were carried over to the 1974 ordinance. One feature of the 1974 ordinance, presumably present in the 1967 ordinance, is that the tax is a "real property transfer tax" that is "... due at the time the deed or instrument of transfer was delivered; and it became delinquent if unpaid at the time the instrument was recorded." (*City of Huntington Beach v. Superior Court, supra,* p. 337.)

The Court in *City of Huntington Beach, supra*, pages 340-341 states:

Under the principles established by the foregoing authorities, the transfer tax imposed and collected by the City of Huntington Beach was not a property tax. Real property taxes are imposed on the ownership of property as such; they recur annually on a fixed date; and no personal liability arises from their nonpayment, the sole security for the taxes being the property itself. (*Douglas Aircraft Co., Inc., v. Johnson* (1939) 13 Cal.2d 545, 551.) The absence of those characteristics distinguishes the instant transfer tax from a real property tax. Liability for the tax in question arises only when property is conveyed; the transferor and transferee become jointly and severally liable for the tax upon delivery of the instrument of transfer; and the tax is a debt collectible by an action against the persons liable. The tax is, therefore, on the exercise of one of the incidences of property ownership and as such is an excise tax. (*Douglas Aircraft Co., Inc., v. Johnson, supra*, 13 Cal.2d 545, 551.) The fact that the tax is based on the "value of the consideration" which in turn may have some relationship to the assessed value of the property does not make the tax a property tax. CA(9)(9) A privilege tax "does not become a property tax simply because it is proportioned in amount to the value of the property used in connection with the privilege which is taxed." (*Ingels v. Riley* (1936) 5 Cal.2d 154, 160.)

III.

LEGAL ARGUMENT

A. PETITIONER ARDMORE FAILS TO IDENTIFY A LEGAL ISSUE WORTHY OF THIS COURT'S REVIEW.

1. The Court of Appeals' Decision is Consistent with Longstanding Law.

It has long been the law that a documentary transfer tax is owed on a transfer regardless of whether the document evidencing the transfer is recorded, and this principle has been relied on by the Los Angeles County Registrar-Recorder. (6 CT 1224 [legal advice rendered in 1971 to the County Recorder "The County may collect the tax owing on unrecorded documents by any method which is reasonable and adminstratively workable."]) (See also *Endler v. United States* (D.N.J. 1953) 110 F.Supp. 945, 948; *Raccoon Development Inc. v. United States* (Ct.Cl. 1968) 391 F.2d 610, 613.)

In the case that is the subject of the Petition, the sons of Gloria Averbook, acting as trustees of their irrevocable trusts, entered into a purchase agreement with BA Realty, LLLP ("BA Realty"), on January 8, 2009, to acquire 44.59 percent of that entity (collectively 89.18 percent). (Trial exhibit 61, pp. 667, 669, part II, box J.) BA Realty owned the entire membership interest of Petitioner and three other LLCs holding title to apartment houses. (*Id.*, p. 678.) The purchase price was based upon an

appraisal of BA Realty and its constituent assets. (Trial exhibits 22, 43 [see especially p. 926].) The sale was memorialized with promissory notes, security agreements, and partial guarantees by the purchasers. (Trial exhibits 32 through 40.)

The State Board of Equalization reported the sale to the Los Angeles Assessor as constituting a change in ownership for property tax purposes. Petitioner later admitted that its property changed ownership for property tax purposes (7 CT 1543:14-17), and the Los Angeles County Registrar-Recorder subsequently issued a notice and demand for payment of a DTT in the amount of $10,998.40.

BA Realty incurred a sale of more that fifty percent of the total interest in partnership capital and profits as of January 8, 2009. (7 CT 1546 [RFAs 14 and 15]; 1547 [RFAs 17 and 18].) Petitioner is a disregarded entity for purposes of federal and state income tax law, and its income is reported on the return of BA Realty. (Plaintiff's ex. 61, p. 678.) For purposes of section 708, Petitioner is treated as a division of BA Realty, and is subject to reassessment upon the constructive termination of BA Realty. (26 CFR § 301.7701-2(a); § 1.708-1(b)(2).)

The County's DTT ordinance -- Los Angeles County Code, chapter 4.60 -- generally mirrors Revenue and Taxation Code section 11911, et seq. The County's ordinance as originally enacted in 1968 included the

provision that the DTT ordinance should be interpreted consistently with the former documentary stamp regulations of the Internal Revenue Service. The County's ordinance in this area was amended in 1984, however, to delete the reference to federal regulations, thereby "allowing the County to administer the tax in accordance with state law." (7 CT 1557.)

The leading California case in the DTT area, *Thrifty Corporation v. County of Los Angeles* (1989) 210 Cal.App.3d 881, ("*Thrifty*") was decided in May 1989, with the Court observing that although the California Documentary Transfer Tax law did not define the phrase "realty sold," it was "sufficiently similar to the phrase 'change in ownership' contained in the same code and governing an analogous subject [real property transfers for property tax purposes], to warrant that each phrase be defined to have the same meaning." (*Id.* at 210 Cal.App.3d 886.)

The *Thrifty* Court's approach provides valuable guidance for the administration of the DTT. For example, the issue being analyzed in in 82 Ops. Cal. Atty. Gen. 56, was whether a DTT was owed on a transfer of real property from a parent corporation to a wholly-owned subsidiary corporation The Attorney General opined that a tax was not owed relying principally on the guidance provided by *Thrifty* and noting:

> Our interpretation of section 11911 is also consistent with a recent pronouncement of legislative intent with respect to the application of the Act to corporate transfers. With specific

regard to the transfer of property from a corporation to a limited liability company, the Legislature has recently declared:

"It is the intent of the Legislature that existing business entities, such as partnerships and corporations, be permitted to convert into or transfer real property to, limited liability companies without incurring a documentary transfer tax ***provided*** that the direct or indirect proportionate interests in the property remain the same." (Stats. 1996, ch. 57, § 29; emphasis added.)

Petitioner admits that a majority of the membership interest in BA Realty transferred for consideration on January 8, 2009, but asserts that this basis for constructive termination under § 708 (and thereby a basis for a DTT assessment under Rev. & Tax. § 11925), should be disregarded. It is mistaken. See, e.g., 1 CT 154 (report of the U.S. Senate regarding Public Law 85-859, relating to the antecedent federal excise tax) [". . . Where there is a termination of a partnership within the meaning of section 708, subsection (b) of new section 4383 treats the partnership as having transferred all stock, certificates of indebtedness, and real property hed by the partnership. Real property is taxed on the basis of its fair market value, exclusive of the value of any lien or encumbrance on the property. Consequently, once there has been a "termination" of the partnership within

the meaning of section 708, the taxes apply with respect to all of the assets in the partnership subject to documentary stamp tax."].)

California property tax law defines a change in ownership in Rev. & Tax. section 60. Section 64(d) of the code provides that the transfer of more that 50 percent of the total interests of a legal entity requires a reassessment of the entity. The similarity of approach reflected in the text of section 708, and suggests that the literal definition of "termination" contained in section 708 should apply when defining a transfer of real property for purposes of the DTT. Petitioner's argument at trial, in contrast, was that the express terms of section 708 should be deemed modified by the grantor trust rules contained in the Internal Revenue Code.

Petitioner asserts that even if a reassessment of BA Realty were required pursuant to section 11925(b), that a reassessment would not then reach to the realty assets owned by BA Realty that are held in the form of an LLC. It argues that though Petitioner is a disregarded entity for income tax purposes, it should be recognized as an entity distinct from BA Realty for excise tax purposes, citing 26 CFR § 301.7701-2 (c) (iv) and (v). (Petition, 19-20.) Petitioner's challenge is not persuasive. The sections it relies on pertain to federal tax obligations, not to that of a state excise tax.

Instead, relying on property tax law for guidance, if a change in ownership of a legal entity does occur, then ". . . all of the property owned directly or indirectly by the acquired legal entity is deemed to have

undergone a change in ownership." (Cal. Code of Regs., title 18, § 462.180(d)(1)(C).)

The same result is suggested in the regulation interpreting section 708, "if the sale or exchange of an interest in a partnership (upper-tier partnership) that holds an interest in another partnership (lower-tier partnership) results in a termination of the upper-tier partnership, the upper-tier partnership is treated as exchanging its entire interest in the capital and profits of the lower-tier partnership." (Title 26, Code of Federal Regulations § 1.708-1 (b) (2).) This rule applies with equal effect to single member LLCs for purposes of the Internal Revenue Code. (McKee, Nelson, Whitmire, 1 Federal Taxation of Partnerships and Partners (4th ed. 2007) § 3.06[3], p. 3-78; RT 38:6-7.) Petitioner, a disregarded entity, is considered a branch of BA Realty and is also subject to DTT reassessment upon BA Realty's change in ownership.

2. Where the DTTA is Not Explicit, it is Appropriate to Look to the Property Tax Change in Ownership law.

As the opinion of the Second Appellate District, Division Seven, makes clear, limited liability companies were not a recognized form of legal entity at the time the DTTA was first enacted. The Legislature enacted the DTTA, effective January 1, 1968, and LLCs were first recognized in California in 1994.

Nonetheless, the *Thrifty* case supports the point that the courts and tax administrators may look to the property tax law in interpreting the DTTA. Doing so does not change the character of the DTT, rather what has changed over time are the enforcement tools available to administer and collect the tax. The Legislature has signaled its endorsement of a more robust DTT administration and collection, by providing additional tax administration tools in 2009 (chapter 522, SB 816) and in 2011 (chapter 320, AB 563.) In enacting these additional tools, the Legislature has looked to property tax provisions and procedures as an appropriate approach.

Petitioner uses the term "constructive conveyance" in its Petition, and by doing so recognizes that the DTT has a broader scope than a conventional escrow and closing. The triggering event in a non-conventional transaction remains the same – a sale of realty – however, the recorder's enforcement tools are not static, but have been enhanced by the Legislature.

It is a record fact in the pending matter that Petitioner was a disregarded entity for income tax purposes and that the beneficial ownership of Petitioner's apartment house was reflected in the ownership of the profits and capital of BA Realty. Approximately ninty percent of that ownership transferred on or about January 8, 2009, and it is appropriate to look to Rev. & Tax. code § 11925, and analogous provisions of the

California property tax law for guidance determining Petitioner's liability for a DTT assessment.

3. Petitioner's Belated Claim of Constitutional Infirmities Should Not be Considered

Petition asserts that the Court of Appeals' reference to Rev. & Tax. code sections 408 and 408.4 implemented a retroactive tax increase that was at odds with Proposition 13. The CalTax amicus letter in support of the Petition for Review takes this argument to a new level arguing that the effect of the appellate court's opinion is an unauthorized tax increase. The arguments are unfounded.

Petitioner's complaint alleged that the DTT assessment levied upon it by defendant violated Proposition 13, Proposition 218, and Proposition 26. (1 CT 8:11-18, para. 29.) Petitioner abandoned this claim at trial. (Cf., Petitioner's trial brief, 8 CT 1576.) Petitioner and CalTax should not now be heard to present for the first time on appeal issues that were raised in issues that were raised in Petitioner's complaint but abandoned at trial. (*Flannery v. Prentice* (2001) 26 Cal.4th 572, 591.)

Even if Petitioner's claim of constitutional infirmities was timely, which they are not, they would still fail. The incident of the DTT has not changed, rather the Legislature has seen fit to provide local government

with additional enforcement powers to better implement the full scope of the DTTA.

III.

CONCLUSION

The Court of Appeal's opinion is supported and reasonable. The Petition should be denied.

DATED: November 24, 2014

Respectfully submitted,

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CERTIFICATE OF WORD COUNT PURSUANT TO RULE 8.360

The text of this document consists of 4,143 words as counted by the Microsoft Office Word 2010 program used to generate this document.

DATED: November 19, 2014

Respectfully submitted,

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DECLARATION OF SERVICE

STATE OF CALIFORNIA, County of Los Angeles:

Anahit Maryanyan states: I am and at all times herein mentioned have been a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen years and not a party to nor interested in the within action; that my business address is 648 Kenneth Hahn Hall of Administration, 500 West Temple Street, County of Los Angeles, State of California; that I am readily familiar with the business practice of the Los Angeles County Counsel for collection and processing of correspondence for mailing with the United States Postal Service; and that the correspondence would be deposited within the United States Postal Service that same day in the ordinary course of business.

That on November 24, 2014, I served the attached ANSWER TO PETITION FOR REVIEW, upon Interested Parties by depositing copies thereof, enclosed in a sealed envelope and placed for collection and mailing on that date following ordinary business practices in the United States Postal Service, addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed on November 24, 2014, at Los Angeles, California.

Anahit Maryanyan