No. S222329

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

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926 North Ardmore Avenue, LLC,
a California limited liability company,
Plaintiff and Appellant,

v.

County of Los Angeles,
Defendant and Respondent.

After a Decision by the Court of Appeal
Second Appellate District, Case No. B248356
Los Angeles County Superior Court, Case No. BC 476670
The Honorable Rita Miller, Judge Presiding

REPLY IN SUPPORT OF PETITION FOR REVIEW

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INTRODUCTION

The County's Answer is largely irrelevant to the question presented in the Petition for Review (the "Petition"). The Answer focuses on three main contentions: (1) that the documentary transfer tax ("DTT") "is an excise tax on the privilege of conveying real property by means of a written instrument, and is not a recording fee" (Answer, p. 1); (2) that petitioner 926 North Ardmore Avenue LLC ("Ardmore") is liable for a DTT under Revenue and Taxation Code section 11925[1] (*id.*, p. 10); and (3) that the interpretation of section 11911 has not changed since its enactment and only the "enforcement tools recently provided by the Legislature" have changed. (*Id.*, pp. 1, 15.) None of these contentions addresses the importance of, or need for, review in this case.

With respect to the first contention, while the County devotes approximately one-third of its Answer to arguing that the DTT "is an excise tax on the privilege of conveying real property by means of a written instrument, and is not a recording fee" (Answer, pp. 1, 2, 4-7), Ardmore has never contended otherwise. (See Petition, pp. 1-2, 5-6.) The issue presented in the Petition is not whether the DTT is a recording fee, but whether, as *held for the first time* by the Court of Appeal, "a documentary tax may be applied to transfers of interests in *legal entities*" that hold title (directly or indirectly) to real property, even if no conveyance of the realty itself takes place, as long as "the transfer results in a 'change of ownership' of the entity within the meaning of section 64." (Petition, p. 1, quoting slip opn., p. 30.)

With respect to its second contention, the County argues that even if Ardmore is not liable for the DTT pursuant to section 11911, it is liable for

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[1] Unless specified otherwise, all statutory references are to the Revenue and Taxation Code.

the tax under section 11925 because BA Realty LLLP ("BA Realty"), the entity which previously held Ardmore, is a "terminated partnership" within the meaning of that provision. (Answer, p. 10.) But this issue has not been presented to this Court: The Court of Appeal correctly held that section 11925 has no applicability to this action, and the County has not sought review of that issue.

Finally, the County devotes the remainder of its Answer to its third contention that since its enactment in 1967, section 11911 has authorized the imposition of a DTT based on nothing more than a *change in ownership of a legal entity* that directly or indirectly holds title to real property. The County argues that the only aspects of the Documentary Transfer Tax Act ("DTTA") that have changed since 1967 "are the enforcement tools recently provided by the Legislature [in sections 408(b) and 408.4] for the express purpose of collecting the tax due on [certain] transactions." (Answer, p. 1; accord, *id.*, p. 15.) But this argument *conflicts* with the Court of Appeal's analysis that *in light of subsequent legislative enactments of sections 408(b) and 408.4*, the scope of section 11911 should be interpreted "to impose the documentary transfer tax where an unrecorded transfer of interests in a legal entity has resulted in a 'change in ownership' within the meaning of section 64 . . . ." (See slip opn., p. 25.) Significantly, the County cites no case (state or federal) that has ever suggested this interpretation before the instant decision.

Ultimately, none of the County's arguments addresses the significant, review-worthy question presented in the Petition. The County fails to address: (1) the manner in which the Court of Appeal's opinion upends well-settled expectations regarding the scope of the DTTA throughout the State; (2) the broad, negative implications that the Court of Appeal's opinion will have for subsequent corporate structuring; and (3) the serious constitutional concerns that arise from expanding the reach of a tax

based on subsequently enacted statutes, none of which was enacted pursuant to the requirements for enacting new or higher taxes set forth in Article XIII.A of the Constitution.

Revealingly, the County's Answer implicitly acknowledges that this case presents an important issue of law warranting review because it contends that "§ 11911 . . . [is] directed at documents that transfer or convey real property" (Answer, p. 5, underline in original) and admits that "[t]he real argument is not over whether unrecorded transactions can trigger [the DTT], but rather the more mundane question of which unrecorded transactions [amount to such a conveyance and] are [thus] taxable." (*Id.*, pp. 1-2.) Mundane or not, the question of which unrecorded transactions constitute transfers or conveyances and are therefore subject to the DTTA presents a significant question of law that must be settled on a statewide basis, the resolution of which will have far-reaching consequences. For these reasons, in addition to those set forth in the Petition, Ardmore respectfully requests that this Court grant review.

ARGUMENT

A. The County's Contention That The DTTA Applies, Even If The Transferring Document Is Not Recorded, Is Irrelevant.

The County dedicates much of its Answer to arguing that the DTTA "applies even if the transferring document is not recorded." (Answer, p. 1; accord, *id.*, pp. 2, 4-7.) But nowhere in the Petition does Ardmore assert that the imposition of the DTT turns on whether a document was recorded; thus, the County's contention is a mere red herring.

Instead, Ardmore contends that the incidence of the DTTA turns on whether there is a "deed, instrument, or writing by which any . . . realty sold . . . shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers" (see Petition, pp. 1-2, quoting § 11911), and that no DTT is owing here because "the DTTA . . . 'tax[es]

. . . [only] the exercise of the right or privilege of *transferring* real property,'" and in this case, there was not an actual transfer of realty. (Petition, p. 6, quoting *City of Huntington Beach v. Super. Ct.* (1978) 78 Cal.App.3d 333, 340.)

By merely arguing that the DTTA applies even where a transferring document is not recorded—an issue that Ardmore has not disputed—the County revealingly dodges the primary issue presented for review: whether the DTTA permits the imposition of a documentary transfer tax absent any document evidencing an actual conveyance or other transfer of realty, so long as there has been a "change in ownership" under section 64 of an entity that holds, directly or indirectly, title to real property. (Petition, pp. 15-16.) Significantly, the County makes no effort to explain how a transfer of ownership *of an entity* that holds title to realty (among other things) constitutes an actual "gran[t], assign[ment], transfe[r], or . . . convey[ance]" of "realty sold" within the meaning of section 11911. Indeed, such an interpretation of the statute not only admits of no discernible limiting principle, but also marks a dramatic departure from prior appellate interpretations of the DTTA and the origins of section 11911.[2]

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[2] No prior appellate decision has ever suggested, even in dicta, that a mere change in ownership of some entity upstream at some point in the chain of direct or indirect ownership from the entity actually holding title to the realty could trigger imposition of the DTTA. Indeed, the Court of Appeal has long held that section 11911 should be construed in conformity with its counterpart under the now-repealed Federal Stamp Act (former 26 U.S.C. § 4361). (*Brown v. County of L.A.* (1999) 72 Cal.App.4th 665, 668; *Thrifty Corp. v. County of L.A.* (1989) 210 Cal. App.3d 881, 884.) 26 U.S.C. § 4361 did not impose a documentary tax on transfers of interests in corporate entities directly or indirectly holding title to realty. (*United States v. Seattle-First Nat'l Bank* (1944) 321 U.S. 583, 589-590 [holding that identically worded predecessor to

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B. The Court of Appeal's Opinion Contradicts The County's Contention That Only The Enforcement Mechanism For The Documentary Transfer Tax Has Changed.

Equally wide of the mark is the County's second major contention that sections 408(b) and 408.4 are merely enforcement provisions that do not change the meaning of the DTTA.

Specifically, the County argues that "[the DTTA] . . . has applied to transfers of real property effected through sale of LLC interests since the advent of the LLC" and that the only aspects of the DTTA to have changed since that time are "the enforcement tools recently provided by the Legislature for the express purpose of collecting the tax due on such transactions. [§§] 408(b); 408.4." (Answer, p. 1; accord, *id.*, p. 15.)

But in arguing that section 11911 has always applied to a change in ownership of a legal entity, the County fails to acknowledge that it was not until 2010 that the County Recorder's office announced *for the first time* that it would "enforce 'collection of Documentary Transfer Tax . . . on legal entity transfers where no document is recorded, but which resulted [in] a greater than 50% interest in control of the legal entity being transferred.'" (3 RT 433:14-434:1.) No court and no agent of the County had ever made such a pronouncement before, and other localities that define their local transfer tax to adopt section 64's "change in ownership" provision have expressly amended their tax codes to do so.[3]

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former 26 U.S.C. § 4361 did not apply where the "realty was not conveyed to or vested in respondent by means of any deed, instrument or writing"].)

[3] (See, e.g., County of Santa Clara Code, § A30-39.6; County of Monterey Code, § 5.32.020; County of Napa Code, § 3.24.020; City and County of San Francisco Business and Tax Regulations Code, Art.

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Moreover, the County's argument that sections 408(b) and 408.4 are merely "enforcement mechanisms" that do not change section 11911's meaning conflicts with the Court of Appeal's express reliance on these enforcement mechanisms to construe section 11911 more broadly than this provision has ever been construed. Before the Court of Appeal's decision, no court had ever suggested, let alone held, that section 11911 authorizes a DTT upon a change in ownership within the meaning of section 64 of an entity holding title to real property. In adopting this expansive reading of the statute, the Court of Appeal looked to sections 408(b) and 408.4 as "persuasive evidence" that section 11911 should be interpreted to *extend* the DTTA to the transfer of interests in legal entities that hold title to real property. (Slip opn., p. 25.) Specifically, the Court of Appeal posited that "the language in the text and history of both SB 816 [§ 408] and AB 563 [§ 408.4] contain persuasive evidence that the Legislature intended to provide local officials the ability to impose the documentary transfer tax where an unrecorded transfer of interests in a legal entity has resulted in a 'change in ownership' within the meaning of section 64, subdivisions (c) and (d)." (*Ibid.*)

Thus, the County's contention that sections 408(b) and 408.4 did not retroactively amend the DTTA directly contradicts the Court of Appeal's reasoning *and* reinforces one of Ardmore's primary arguments in support of

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12-C, § 1114.) Of course, the County may only impose documentary transfer taxes that are authorized by the DTTA (1967 Cal. Stat. ch. 1332, § 2), and Ardmore maintains that the DTTA does not authorize such a tax where the sale of an interest in a legal entity results in a change of ownership under section 64. The enactment by the Counties of Monterey, Napa, and Santa Clara of non-conforming ordinances and the prospect of other such ordinances after the Court of Appeal's decision is an additional reason to grant review.

review—that the Court of Appeal erred in reading subsequent legislative enactments to have imported state property-tax provisions directly into the DTTA.

C. The County's Few Arguments Regarding The Proper Interpretation Of Section 11911 Are Wrong And Fail To Disprove The Need For Review.

In contending that the Court of Appeal's opinion does not represent a change in the law warranting review, the County advances a number of arguments that are simply wrong. They therefore fail to disprove the need for review.[4]

1. Section 11925 Provides No Support for the Court of Appeal's Decision.

First, the County argues that section 11925 "demonstrates the soundness of the Court of Appeal's conclusion" because it creates "an

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[4] The County also fails entirely to address the myriad adverse consequences that the Court of Appeal's holding will have for the structuring of corporate entities, which were raised by numerous amici in support of the Petition. (See, e.g., Peter B. Kanter, Letter of Amicus Curiae Morrison & Foerster LLP, In Support of the Petition for Review, November 21, 2014 [explaining that the Court of Appeal's holding will create unprincipled inconsistencies between transfers of interests in partnerships and similar transfers in other corporate forms]; Clark R. Calhoun, Alston & Bird, Letter Requesting De-Publication of the Decision of the Court of Appeal, November 20, 2014 [discussing the unprincipled inconsistencies and administrative difficulties that the Court of Appeal's opinion creates]; Kenneth Gear, Leading Builders of America, Amicus Letter in Support of Petition for Review, November 20, 2014 [explaining that the Court of Appeal's opinion will affect at least 1,132 transactions per year]; Teresa Casazza, Letter of Amicus Curiae California Taxpayers Association In Support of the Petition for Review, November 6, 2014 [explaining that the Court of Appeal's opinion will lead to administrative difficulties and provoke DTT litigation].)

exception to the application of the taxing provision under certain limited circumstances." (Answer, p. 2.) To the extent the County is trying to suggest that section 11925, subdivision (b) provides support for the imposition of the DTTA on transfers of interests in corporate entities other than partnerships (see, e.g., *id.*, pp. 15-16), there is no merit to such a suggestion.

The only transfer of an interest in an entity for which the statute authorizes a DTT is the transfer of an interest in a "partnership or other entity treated as a partnership for federal income tax purposes" *that results in its termination* under section 708(b) of the federal Internal Revenue Code. (§ 11925, subds. (a), (b).) In that case, section 11925, subdivision (b) gives rise to a constructive conveyance of the realty, expressly providing that the "partnership or other entity shall be treated as having executed an instrument whereby there was conveyed, for fair market value . . . , all realty held by the partnership or other entity." (§ 11925, subd. (b).) Only under those circumstances does the transfer of an interest in a partnership—which is expressly treated as the execution of an instrument conveying realty—trigger an imposition of a DTT.

In short, not only is section 11925, subdivision (b) the sole exception authorized by the statute to the general rule that requires "the actual transfer or conveyance of real property as the taxable event" (Answer, p. 5), but it is also an exception to the general rule *forbidding* the imposition of such taxes on continuing partnerships or entities treated as partnerships that hold title to realty. (§ 11925, subd. (a).) Yet, the County offers no rationale for its supposition that "it is appropriate" to look to that section for "guidance" regarding the imposition of taxes on transfers of interests in other types of legal entities. And it fails entirely to address the many reasons given by Ardmore as to why the imposition of such taxes is contrary to the plain

language of section 11911, long-standing precedent, and the evident intent of the Legislature.

2. The County Misreads *Thrifty*.

In arguing that *Thrifty* "supports the point that the courts and tax administrators may look to the property tax law in interpreting the DTTA" (Answer, p. 15), the County takes *Thrifty*'s reliance on property tax law entirely out of context. It also ignores *Thrifty*'s reiteration that section 11911 should be construed in conformity with long-settled interpretations of the erstwhile Federal Stamp Act on which the DTTA was based and which did not impose a documentary tax on transfers of interests in corporate entities directly or indirectly holding title to realty. (See *Seattle-First, supra*, 321 U.S. at 589-590 [holding that identically worded predecessor to former 26 U.S.C. § 4361 did not apply where the "realty was not conveyed to or vested in respondent by means of any deed, instrument or writing"].)

In sum, *Thrifty* is a largely unremarkable case in which the Court of Appeal considered whether the transfer of a *leasehold interest* of a particular duration constituted a taxable transfer of property under the DTTA. In order to answer this question, the Court of Appeal looked *first* to regulations interpreting the former Federal Stamp Act. (*Thrifty, supra*, 210 Cal.App.3d at p. 884.) Federal law provided the initial answer that a leasehold *can* create a taxable interest in real estate. (*Id.*, at p. 885 ["[U]nder former federal law a lease was subject to a transfer tax when it was of sufficient duration to approximate an interest such as an estate in fee simple or a life estate."].) Federal law did not, however, shed light on the latter issue of the *duration* of a leasehold that approximates an ownership interest subject to taxation. Only after failing to find the answer to this question under federal law did the court look to section 61, a state property law provision, in order to determine how long a leasehold must continue in

order to become an ownership interest. (*Id.*, at pp. 884-885; see also *McDonald's Corp. v. Board of Supervisors* (1998) 63 Cal.App.4th 612, 615, adopting *Thrifty*.) In so doing, the Court of Appeal said nothing to suggest that the DTTA—an *excise* tax—generally incorporates state property tax provisions. And it certainly did not suggest that the DTTA applies to any sale of interests in an entity that results in a change of ownership under section 64.

3. The County Ordinance's 1984 Amendment Is Irrelevant.

The County suggests that even if the DTTA is constrained by federal interpretations of the Federal Stamp Act, the County's mirror-image ordinance is not because the ordinance "was amended in 1984 to delete the [originally enacted] reference to federal regulations, thereby 'allowing the County to administer the tax in accordance with state law.'" (Answer, pp. 10-11, quoting 7 C.T. 1557.)

Not only is this argument beside the point, but it is also meritless. First, the Court of Appeal's decision was expressly based on its interpretation of the DTTA, not the County's ordinance. Second, the County may only impose documentary transfer taxes that are authorized by the DTTA (1967 Cal. Stat. ch. 1332, § 2), the interpretation of which is guided by the Federal Stamp Act.[5] Thus, the County's deletion of its ordinance's express reference to federal regulations does not expand its scope, which is constrained by state law, which, in turn, is guided by the Federal Stamp Act.

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[5] The legislative history of the documentary transfer tax ordinance of the City of Los Angeles establishes that it was intended to conform except for the rate of tax. (4 C.T. 884-895; 5 C.T. 897-903, 911-928.)

D. The County's Claims Regarding The Application Of Section 11925 To This Case Are Not Properly Before This Court.

The County appears to argue that section 11925, subdivision (b) is an alternate basis for imposing a tax on the transfer of interests in BA Realty because Ardmore was a disregarded entity for income tax purposes and is a "branch of BA Realty." (Answer, pp. 13-15). But the Court of Appeal expressly and correctly rejected the County's position; Ardmore did not raise that issue in its Petition for Review; and the County has not sought review of that issue.

Specifically, the Court of Appeal rejected section 11925, subdivision (b) as a basis to rule against Ardmore. It ruled that section 11925, subdivision (b) does not apply to this case because BA Realty, a partnership, did not hold realty pursuant to section 11925: "BA Realty did not hold title to the realty; instead, it owned Ardmore, which held title to the realty." (Slip opn., p. 31; see also *id.* at p. 32 fn. 12 ["we agree with Ardmore's argument that section 11925 is not applicable to this transaction"].) While the County implies that this holding is wrong, it has failed to preserve this issue for consideration under Rule of Court 8.504(c). Indeed, this Court has made clear that if an answer to a petition for review challenges a holding that was not raised in the petition, that holding will not be reconsidered unless the respondent either files a cross-petition presenting it for review or clearly asserts in its answer that "if [this court] grant[s] review [of the issues raised in the petition, it] should also address [the Court of Appeal's alternate holding]." (*Scottsdale Ins. Co. v. MW Transportation* (2005) 36 Cal.4th 643, 654 fn. 2.) The County did neither.

But even if this issue were properly raised, it lacks merit and is not worthy of review for at least two reasons. First, the County provides no basis for its assertion that Ardmore is a "disregarded entity" for purposes of state excise taxes. (Answer, p. 13.) To the contrary, Ardmore would have

been regarded as a separate entity under the now-repealed Federal Stamp Act, upon which the DTTA was patterned. (See, e.g., Treas. Reg. § 301.7701-2(c)(2)(iv), (v).) Moreover, Ardmore is treated as a separate corporate entity for purposes of most, if not all, other taxes under state law. (See, e.g., § 19 ["person" for taxation purposes includes a "limited liability company"]; § 11912 [requiring DTT to be paid by "any person" who "makes, signs or issues any document or instrument subject to the [DTT]"]. In sum, the fact that Ardmore is a disregarded entity for *income tax* purposes has no bearing on its status with respect to taxes imposed under an entirely different body of law, such as state excise-tax law.

Second, even if section 11925, subdivision (b) did apply to this transaction, Ardmore would owe no tax under that provision because BA Realty did not terminate under 26 U.S.C. § 708(b), which is necessary in order to trigger a DTT under section 11925, subdivision (b). As the Court of Appeal observed, without ultimately reaching the issue, Gloria Averbook remained the owner for federal income tax purposes of more than 64 percent of BA Realty *before and after* the transaction and thus did not transfer more than 50 percent of her interest in the partnership for these purposes, which section 708(b) requires for purposes of a termination. (See slip opn., pp. 3 & 31 fn. 12; Petition, p. 9.)

E. Petitioner Did Not Waive Its Position That The Court Of Appeal's Opinion Raises Serious Constitutional Issues.

Finally, there is no support for the County's contention that Ardmore has waived its argument that the Court of Appeal's opinion raises constitutional concerns.

Citing *Flannery v. Prentice* (2001) 26 Cal.4th 572, 591, the County argues that Ardmore may not now contend that the Court of Appeal's opinion effectuated a retroactive tax increase "that was at odds with Proposition 13" and other provisions of the Constitution. (Answer, p. 16.)

Flannery, however, merely precludes a new *issue* from being raised for the first time on appeal,[6] and Ardmore raises no new issues here.

Throughout trial and on appeal, Ardmore argued that sections 64 and 408 did not alter section 11911. (See AOB, p. 28; 8 C.T. 36, 38-39).[7] In its Petition, Ardmore continues to argue that sections 408 and 408.4 could not be used to alter section 11911's meaning. The Court of Appeal's reliance on sections 408 and 408.4 to interpret section 11911 so as to apply to changes in the ownership of entities raises significant constitutional concerns. In advancing these arguments, Ardmore merely presents additional arguments in connection with the vigorously litigated issue of section 11911's interpretation. Because the proper interpretation of section 11911 has been vigorously litigated and is squarely before this Court, there is nothing that prevents Ardmore from raising an additional rule of statutory construction—that a statute should be construed to avoid constitutional infirmities (see Petition, p. 23)—when the Court of Appeal's opinion raised those very infirmities in the first instance.

Finally, even were it the case that Ardmore's constitutional argument presents a new issue that could have been raised below, this Court can exercise its discretion to consider this issue, because "it presents a pure question of law on undisputed evidence." (*Mitchell v. United Nat'l Ins. Co.* (2005) 127 Cal.App.4th 457, 470-471.) Significantly, the County has no response to these constitutional infirmities or to the need to correct

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[6] (See Answer, p. 16 ["As a matter of policy, on petition for review, [the Supreme Court] normally do[es] not consider any issue that could have been but was not timely raised in the briefs filed in the Court of Appeal."].)

[7] The application of section 408.4 to section 11911 was raised by the Court of Appeal. (Slip opn., pp. 23-24.)

them before other counties, cities, and courts follow the County's lead in expanding the reach of the DTTA and other tax statutes.

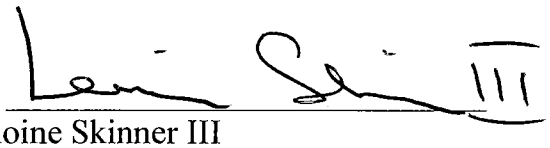
CONCLUSION

The County's Answer fails to demonstrate that the Court of Appeal's opinion does not present important, broadly significant issues of law warranting this Court's review. The Petition should therefore be granted.

DATED: December 4, 2014

Respectfully submitted,

FISHERBROYLES, LLP

By: 

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CERTIFICATE OF WORD COUNT

Pursuant to California Rules of Court, rule 8.504, subdivision (d)(1), the undersigned certifies that this Reply in Support of Petition for Review contains 4197 words as counted by the word count feature of the Microsoft Word program used to generate this brief, not including the tables of contents and authorities, the cover information, the signature block, and this certificate.

DATED: December 4, 2014

Respectfully submitted,

FISHERBROYLES, LLP

By: _____
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CERTIFICATE OF SERVICE

I, Lemoine Skinner III, declare as follows:

I am an active member of the State Bar of California and am not a party to this action. My business address is 1334 8th Ave., San Francisco, CA 94122. On December 4, 2014, I served the following document on the following persons:

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☑ **BY MAIL:** I deposited in the United States mail at San Francisco, California a copy of the attached Reply in Support of Petition for Review in a sealed envelope, with postage fully prepaid. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing set forth in this declaration.

☑ **(STATE)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on December 4, 2014.

Lemoine Skinner III