



New California Documentary Transfer Tax Implications for M&A Deals

On June 29, 2017 the Supreme Court of California published its decision in *926 North Ardmore Avenue, LLC v. County of Los Angeles*. The new “law of the land” in California is that, if a sale of interests in a legal entity will trigger a reassessment of real property held by such entity for California property tax purposes, documentary transfer tax will generally be due where that property is located. Accordingly, transfer tax provisions will likely take on greater significance in M&A deals involving entities that directly or indirectly own California real property.

Documentary Transfer Tax & *926 North Ardmore Avenue, LLC*

California law authorizes cities and counties to impose a documentary transfer tax “on each deed, instrument, or writing by which any . . . realty sold within the [city or county] shall be granted, assigned, transferred, or otherwise conveyed” if “the consideration or value of the interest or property conveyed” exceeds \$100. In General Law Counties, the combined county and city rate is \$1.10 per \$1,000 of consideration, or fractional part thereof. Charter Counties may impose tax at a higher rate. Historically, most counties have not sought to impose documentary transfer tax in connection with corporate M&A transactions.

In *926 North Ardmore*, the Supreme Court of California held that documentary transfer tax may be imposed whenever a transfer of an interest in a legal entity triggers a reassessment of real property held by such entity for California property tax purposes, so long as there is a written instrument reflecting a sale for consideration.

Generally, the transfer of an interest in a legal entity does not result in a change in ownership, and thus reassessment, of real property held directly or indirectly by such entity. However, there are two exceptions to this rule. First, a change in ownership of all real property owned by a legal entity occurs if an entity or person acquires direct or indirect control of the legal entity. Second, a change in ownership of real property owned by a legal entity occurs if (i) the legal entity acquired the subject real property in a transaction that was deemed not to be a change in ownership because the transferors of such property to the legal entity (the “Original Co-Owners”) maintained their proportional ownership in the property through their ownership of the acquiring legal entity, and (ii) shares or ownership interests representing more than 50% of the total interests in the legal entity are subsequently transferred by any of the Original Co-Owners in one or more transactions. Either of these two events will cause a reassessment of real property, including fee interests, leases with a remaining term of 35 years or more (including options) and perpetual and exclusive easements.

The Documentary Transfer Tax Act provides one very limited exemption. Tax does not apply to transfer of interests in a partnership (or entity treated as a partnership) which holds real property if (i) the partnership is treated as a continuing partnership under Internal Revenue Code section 708, and (ii) the continuing partnership continues to hold the realty concerned. As a practical matter, the exemption will never apply when more than 50% of the interests in a partnership are transferred to a single person.

Questions? Contact:

Justin Hepworth

Phone: 714.424.8293
jhepworth@sheppardmullin.com

Robert Waldow

Phone: 714.424.2856
rwaldow@sheppardmullin.com

John Bonn

Phone: 978.335.6864
jbonn@sheppardmullin.com

Keith Gercken

Phone: 415.774.3207
kgercken@sheppardmullin.com

Matthew Richardson

Phone: 714.424.2815
mrichardson@sheppardmullin.com

Amy Trankino

Phone: 858.720.8960
atrankino@sheppardmullin.com