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California transfer tax

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A recent California Supreme Court decision resolving a question about the applicability of documentary transfer taxes could dramatically affect the calculus of entity ownership transfers in California.

Subject to certain exemptions, California's Revenue and Taxation Code permits the levy of a tax on each instrument that conveys real property. The amount of the transfer tax is based on the value of the real property and varies based on the city and county where the property is located. Imposition of the transfer tax is straightforward in those transactions where an instrument directly conveying real property, such as a grant deed, is being recorded. Less clear are those transactions, such as mergers and acquisitions, which do not involve recordation of an instrument that directly conveys real property, but that do involve a change in control of an entity that has a beneficial ownership interest in real property.

The California Supreme Court clarified the issue in *926 North Ardmore Avenue, LLC v. County of Los Angeles*, 2017 WL 2806261 (June 29, 2017). In *926 North Ardmore*, the California Supreme Court held that Section 11911 of California's Revenue and Taxation Code permits the levy of a documentary transfer tax on a written instrument that transfers a legal entity interest whenever such transfer results in a change in ownership of real property within the meaning of Section 64, subdivision (c) or (d) of the California's Revenue and Taxation Code. According to the California Supreme Court, a transfer tax may be imposed where there has been a transfer of an interest in a legal entity if three conditions are met: (1) there is a written instrument evidencing the entity interest transfer, (2) the transfer is for consideration, and (3) the transfer results in a "change in ownership" of the entity's real estate.

This ruling has significant consequences for transactions that involve the transfer of ownership of entities that indirectly own California real property. Even though a transaction may not result in or even require the recordation of a grant deed, if that transaction constitutes a change of ownership of an entity that owns a beneficial interest in real property, it may result in the imposition of a transfer tax. As a result, participants in mergers, acquisitions or restructurings that involve entities which own real property must now be aware that a change in ownership of the entity could require the payment of documentary transfer tax, even if legal title to the real property is never directly conveyed. Depending on the facts, these additional taxes could dramatically change the complexion

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of a transaction for the parties involved. Going forward, transactions involving the indirect transfer of California real property should be carefully structured—taking into account the applicability of documentary transfer tax and to ensure conformity with the relevant county’s specific process for compliance.

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