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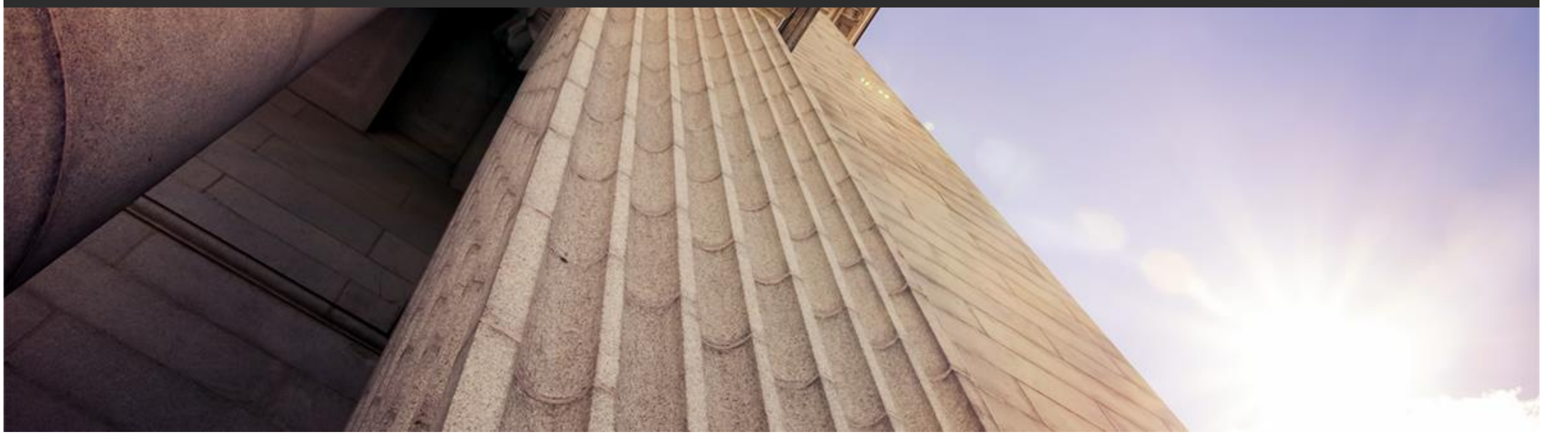

April 2018

California Documentary Transfer Tax Litigation Update

California’s Documentary Transfer Tax Act (Rev. & Tax. Code §§ 11901, *et seq.*) is based upon the former federal Documentary Stamp Tax Act first enacted by Congress to raise revenues for the Spanish-American War. The federal law was repealed, effective Jan. 1, 1968, and simultaneously California, like many other states, picked up the tax with conforming legislation authorizing counties and cities to adopt their own documentary stamp tax on transferring of interests in real property. This means that in California, in most situations, there are three levels of code related to any imposition of tax: state, county, and city.

In the early days of California’s documentary transfer tax administration, most localities’ codes were identical to state code, meaning they were identical, word-for-word, and simply imposed the tax at the standard rate of $1.10 per $1,000 of value. As time passed, however, the tax rate, the local laws, and the practices among counties across the state began to vary greatly. Many of these variances are due to California’s “Home Rule” with respect to charter cities found in Article XI, section 5(a) of the California Constitution. The Home Rule, as interpreted by the courts in cases such as *Fielder v. City of Los Angeles*, *Fisher v. County of Alameda*, and *Cohn v. City of Oakland*, gave charter cities the courage to change not only the rate of tax (to as high as $30 per $1,000 of value today), but also local laws surrounding the tax. Many localities now have exemptions or impositions of tax not found in state law (*e.g.*, City of Oakland, City and County of San Francisco, Santa Clara County).

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To further complicate matters, much of the law with respect to documentary transfer tax is found in court decisions. In *Thrifty Corp v. County of Los Angeles*, the court decided that 35 plus year leases approximated ownership in real property (including tenant options to extend the lease in calculating this 35 year test) were also subject to transfer tax because California's property tax law used that same length of time in Revenue and Taxation Code Section 61 as a change in ownership trigger for reassessment for property tax purposes. *Thrifty's* holding was later confirmed. None of this law is in the Documentary Transfer Tax Act nor is it codified in nearly any local (county or city) ordinances. Finally, in 2017, the California Supreme Court decided 926 N. Ardmore Avenue, LLC v. County of Los Angeles holding, in essence, that changes in ownership which would trigger a reassessment for property tax purposes under Revenue and Taxation Code Sections 64(c) and (d) are also triggers for documentary transfer tax. As before, this rule is also not codified.

The foregoing developments have led to an increase of disputes in the documentary transfer tax area that are likely to continue. Common issues include:

- Valuation of real estate on taxable transfers. The tax is often wrongly applied to the purchase price of a going concern that includes intangibles and/or personal property, although it is only applicable to the value of real estate; there are additional valuation questions with respect to long-term leases and allocated values on purchases of multiple parcels.
- Whether transfers are subject to the tax. This issue often arises with the transfer of long-term leases or sales of the fee simple subject to a long-term lease; when charter cities or other localities amended their code out of conformity with state law; and in situations where there is a change in ownership under Revenue and Taxation Code Section 64 but the partnership does not terminate for IRC 708 purposes. This issue is further complicated by the fact that Congress repealed IRC 708.
- Whether the *Ardmore* decision is retroactive (whether taxing authorities can go after tax for prior years).
- Whether penalties and interest are applicable (in most jurisdictions they are not).
- The rate of tax (all increases in tax, whether by rate or by addition of new impositions by charter cities, must be approved by voters by the appropriate margins at the appropriate elections).

Given the state of the law in California, there is a lot of uncertainty. With proper legal counsel many risks can be adequately measured and mitigated. For disputes with local taxing authorities, it is imperative that procedures be followed so that taxpayers' rights are preserved and that the issues are raised properly.

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