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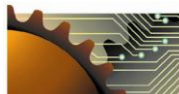
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THE CALIFORNIA RAILROAD INDUSTRY



Date: January 6, 2014
To: Members, Assembly Revenue and Taxation Committee
From: Gina Rodriguez, CalTax Vice President of State Tax Policy
Subject: **OPPOSITION to AB 561 (Ting), as proposed to be amended**

CalTax and the organizations listed in this letter oppose AB 561 (Ting), which would allow counties and/or cities to impose a potentially massive and illegal tax increase on commercial, industrial, and residential rental property by adopting the "change in ownership" definition from property tax law for purposes of determining whether a documentary transfer tax is due.

Background. California's documentary transfer tax (DTT) took effect in 1968, to replace the repealed federal Documentary Stamp Tax on sales of real property. All 58 counties apply the DTT at a rate of \$1.10 for each \$1,000 of consideration or value of realty sold (exclusive of existing liens). Cities also may enact ordinances to impose the DTT. The noncharter city rate is one-half of the county rate and is credited against the county tax due; charter cities, however, may impose a DTT at a higher rate under the municipal affairs doctrine in the California Constitution. If a charter city imposes the DTT at a rate higher than the noncharter rate, then the city DTT does not serve as a credit against the county DTT.

What the Bill Does. AB 561 would expand the application of the DTT to legal entities that own real estate, and undergo a change in ownership for property tax purposes. The bill would expand the definition of "realty sold" to include, but not limited to, any acquisition or transfer of ownership interests in a legal entity that would constitute a change in ownership of that legal entity's real property under property tax statutes. Therefore, the bill would interject the concept of the property tax definition of "change in ownership" into the sale, transfer or conveyance of real property. Even prior to Proposition 13, when the stock of a company changed hands, for example, the DTT was not triggered because there was no "writing" evidencing "realty sold." The legal entity that owned the property didn't change, but this bill would arbitrarily expand the definition of "realty sold" to circumstances where there is no "transfer" of real property.

We oppose this bill for the following reasons:

Constitutionally Questionable. AB 561 would expand application of the DTT, and it no longer would be a tax on the recordation of an instrument reflecting a sale of property, but a tax on a change in ownership for property tax purposes. A change-in-ownership assessment trigger is based on the value of the property changing ownership. Therefore, the DTT under AB 561 may be considered an *ad valorem* tax in excess of the 1 percent cap under Sec. 1 of Art. XIII A of the California Constitution.

Art. XIID of the California Constitution imposes a restriction on the imposition of any tax or fee as an incident of property ownership, except an *ad valorem* tax, or a special tax that receives a two-thirds vote of the people. This bill may be unconstitutional because the DTT would become an *ad valorem* tax. If it is not determined to be an *ad valorem* tax, and is a special tax, it requires a two-thirds vote of the electorate.

Creates an Administrative Nightmare. The bill would cause an administrative nightmare for local governments. Changes in ownership of legal entities typically involve mixed assets, generally with no stated or allocated purchase price for the realty on which the DTT can be determined. This is in contrast to direct sales of realty. How would one establish the value? A

county recorder's office usually collects the DTT as an excise tax for the privilege of recording a document. Under this bill, there would be no recordation.

R&TC Sec. 11935 currently prohibits values determined for purposes of the DTT from being used for assessment purposes. The bill, therefore, would force taxpayers to have to litigate value subject to tax twice, once for DTT purposes, and once for *ad valorem* tax purposes

Traps the Unwary. Currently, the “triggering event” for payment of the DTT is absolutely clear – the transfer of real property ownership. AB 561 undoubtedly would cause some property owners to inadvertently trigger the tax from transfers of equity interests that are not the equivalent of property sales. Under AB 561, the DTT would apply to transfers of partial entity level interests (whenever a person or firm gains more than 50% control), but presumably would trigger tax on 100 percent of the real estate owned (so, taxing the value of minority holders too).

Improperly Imposed Without Use of Land Records. The imposition of the DTT when there has been a change in ownership of a legal entity ignores the most basic requirements of the transfer tax — the sale of real property and the act of recording. The DTT is imposed on the privilege of using the land records of California to protect an owner's legal rights to real property. Transfers of stock and other ownership interests create an entirely different set of legal rights and relationships, and do not make use of the land records. Imposing the DTT on transfers of ownership interests can be justified only as a means to enhance the revenue base.

Inappropriately Taxes Broad Based Transactions. Under AB 561, the DTT potentially would be triggered on all legal entities that own any real estate, and is of concern to a very broad base. However, the bill would disproportionately affect real estate companies and many ordinary course commercial real estate transactions. These include: (1) the issuance of equity interests by a real estate entity to a money investor who acquires management rights; (2) the buyout by some stockholders or partners of a real estate venture of other equity owners in the case of a management dispute; (3) transfers of equity interests to family members for estate-planning purposes; and (4) the issuance of equity interests to individuals who provide management services to a real estate entity.

Creates Complexity and Uncertainty. AB 561 would create unnecessary complexity and uncertainty in the administration of the DTT. For example, how does one apply existing DTT exemptions and exclusions to transfers of equity interests? This uncertainty itself (aside from the tax) would have a cost to commercial real estate projects and owners in California, as well as local governments that are unsure of the appropriate application of the tax.

Higher Taxes Are Barriers to Job Growth and Investment. When compared to other states, California imposes the highest base sales and use tax rate in the country. Adding more local taxes would only hinder job growth and investment in California. In 2011, at least 254 companies left California, citing the state's high overall tax rates and onerous regulations as their top reasons, according to Spectrum Location Solutions, which tracks the migration of businesses. Nonetheless, California recently increased the sales/use and income tax rates while a number of states – such as Arizona, New Mexico, and New York – are offering incentives to draw businesses out of California. A news report released in February 2013 indicated that, after passage of Propositions 30 and 39, CEOs of 24 California companies committed to an Arizona business recruitment council that they will leave California, taking an undisclosed number of jobs with them. Tax increases slow economic growth, generating less revenue for public services.

Bad for the Economy and Consumers. The Legislative Analyst's Office found that higher property taxes on business and investment property would increase costs to businesses, which

could result in higher product prices, reduction in employees' salaries and a reduction in overall economic activity. Higher prices on products and services would make California businesses less competitive in national and global markets.

For the foregoing reasons, the listed organizations must oppose this legislation.

Air Logistics Corporation	California Retailers Association
Apartment Association of Greater Los Angeles	California Tank Lines, Inc.
Apartment Association, California Southern Cities	California Taxpayers Association
Associated Builders and Contractors of California	California Travel Association
Associated General Contractors of America	Chemical Transfer Co., Inc.
Building Owners and Managers Association of California	Commercial Real Estate Development Association
California Apartment Association	Family Business Association
California Association of Realtors	Howard Jarvis Taxpayers Association
California Attractions and Parks Association	International Council of Shopping Centers
California Bankers Association	Motion Picture Association of America
California Building Industry Association	National Association of Real Estate Investment Trusts
California Business Properties Association	National Federation of Independent Business
California Chamber of Commerce	San Diego County Apartment Association
California Downtown Association	Santa Barbara Rental Property Association
California Grocers Association	Silicon Valley Leadership Group
California Healthcare Institute	TechAmerica
California Independent Petroleum Association	Tenet Healthcare Corporation
California Land Title Association	West Coast Leasing, LLC
California Manufacturers & Technology Association	West Coast Lumber & Building Material Association
California Mortgage Bankers Association	Western Manufactured Housing Communities Association
California New Car Dealers Association	
California Railroad Industry	
California Restaurant Association	

cc: The Honorable Philip Ting