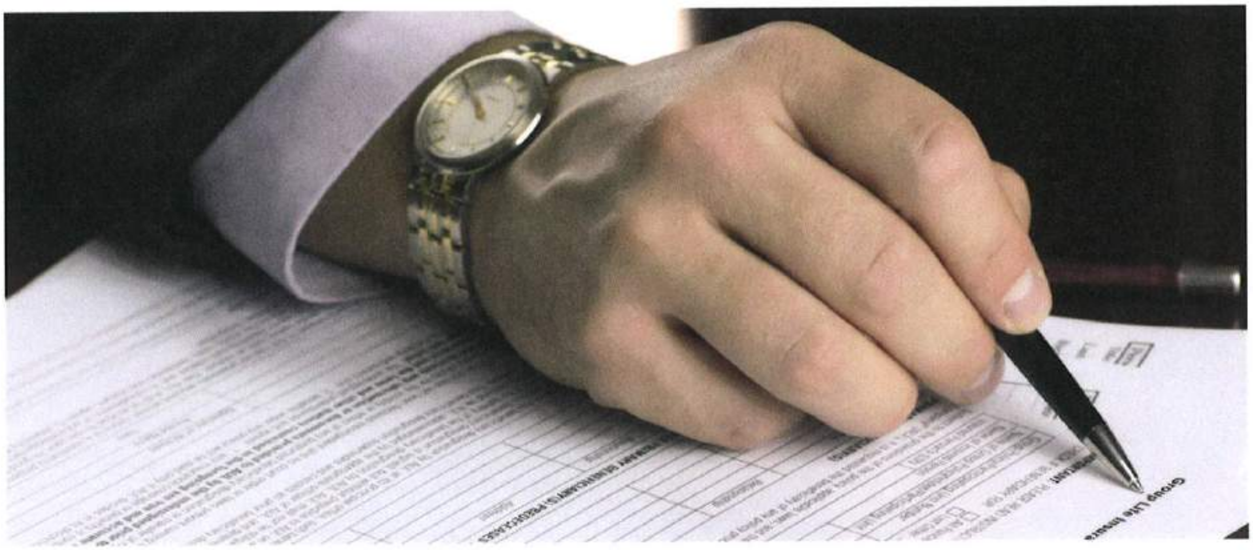
Chapter 14



Partnerships & Corporations

Chapter 14 Goals:

- What is a partnership
- What are the various ways to own real estate
- Understand real estate syndication
- What are the different parties to a partnership or corporation
- Understand what a Real Estate Investment Trust (REIT) is

Chapter 14: Partnerships & Corporations

This chapter will explore the situations in which property ownership is held by more than one party: partnerships and corporations.

Key Terms

business opportunity broker bulk sale Bulk Sales Act C Corporation community property corporate hierarchy corporation domestic partnership equity real estate investment trust fictitious name foreign corporations	Franchise Investment Law franchise sale general partner joint tenancy joint ventures limited liability Limited Liability Company (LLC) Limited Liability Partnership (LLP) limited partner mutual agreement	partition action partnership Real Estate Investment Trust (REIT) real estate syndication right of survivorship S Corporation tenancy in common tenancy in partnership timeshare Uniform Partnership Act (UPA) unincorporated association

Partnerships

A **partnership** is when two or more parties legally agree to work together in order to make a profit or to achieve a goal.

Civil Code Section 16202 states that the association of "two or more people to carry on as co-owners in a business for profit establishes a partnership, whether parties intend to form a partnership or not."

All partnerships must obtain a tax ID number and file tax returns with the IRS. These returns will report business income, deductions, gains, and losses. Partnerships do not pay income tax, however; rather, taxes are "passed through" to partners' personal tax returns. This prevents a partnership from being taxed twice.

A partner's personal taxes and debt are distinctly separate from a partnership.

A partnership also has many of the same rights as individuals in regards to financing, including the ability to obtain financing, purchase assets, and/or pay down debt.

Lenders also have judgment rights against partnerships.

Fictitious Name in a Partnership

A **fictitious name** refers to a business name that does not indicate the real names of a partnership's owners. It is illegal for an individual or a partnership to conduct business under a fictitious name until the name has been registered with the state. This allows the public to ascertain the identities of the owners of a business.

Individuals or partnerships that wish to perform business under a fictitious name must obtain a fictitious name certificate within 40 days of creating the business (Business and Professions Code 17900).

The business must then produce a fictitious name statement in a newspaper of general circulation in the county where the fictitious name was filed within 30 days of the fictitious name's existence (Business and Professions Code 17917). The statement must also be filed with the county clerk.

A fictitious name certificate expires after five years and must be re-registered prior to its expiration.

Terminating Partnerships

Partnerships can be terminated in various ways, including:

- Mutual agreement
- Death of a partner
- Bankruptcy of one of the partners
- Bankruptcy of the partnership
- Court order resulting from a partner dispute

If a partner dies, his or her heirs are only entitled to the deceased partner's portion of the partnership. Unless agreed to by the partners before the deceased partner's death, the heirs do not have the right to continue the business.

Case Review: *Enea v. Superior Court* (2005)

In the case, *Enea v. Superior Court* (2005) 132 Cal.4th 1559., involved a partner's breach of fiduciary duty.

Enea and a lawyer (Daniels) had a partnership that centered around a single asset: an office building. Enea discovered that Daniels was renting the office building to his own law firm at a below market rate. This reduction in monthly rent led to the partnership making less money, thereby altering the partnership percentages. Enea sued Daniels over a breach in fiduciary duty.

In Superior Court, Daniels requested summary judgment, citing Corporation Code 16404 (b). It states it is not unlawful for the partner of a partnership to conduct business in a manner fitting to his or her own separate business interests.

The court ruled in favor of Daniels. Enea appealed. The Court of Appeals contended that Daniels was not entitled to rent the property to his own firm at below market rate. The court reasoned that such an act would, in effect, use partnership assets for the sole benefit of one partner, thereby changing the profit equation and partnership percentages. It ruled in favor of Enea.

Types of Partnerships

Limited Liability Partnership (LLP)

A **limited liability partnership (LLP)** is a business partnership formed by two or more individuals whereby one of the individuals is a general partner. Partners cannot be corporations.

Typically, limited partnerships are utilized for agreements with a limited timeframe.

Although being a partner in a partnership guarantees the same rights, one partner may hold more authority or liability than the other. Roles are defined based on a partner's level of skill, capital contribution, and activity in the partnership.

Both partners can contribute financially to a partnership, as well as purchase real property on behalf of a partnership.

A **general partner** is an active partner who is responsible for the day-to-day operations and management of a partnership's business, including financial and developmental aspects. LLPs must have at least one general partner who bears liability for the partnership's actions and obligations. A general partner is legally liable in the same way that owners of a simple partnership are liable.

A **limited partner** is a "silent partner" who is not involved in the management of the business. Typically, such a partner only invests capital into an LLP. It is illegal for a limited partner to indicate that he or she is a general partner, as such a statement is misleading to consumers and potential investors. Limited partners receive liability protection as long as they do not take on a managerial role. If they do increase their role in an LLP, they may be treated as a general partner.

For example, assume Jon and Henry form a general partnership for the purpose of purchasing real estate. Henry contributes real estate expertise and connections to find properties, while Jon's capital is used to purchase properties. In this scenario, Henry would likely be the general partner.

A partnership in which all partners have equal liability -- and share in profits and losses equally -- is called a **general partnership**.

LLPs must be made in writing and clearly indicate each partner, its share, and its contribution towards the partnership.

An LLP cannot advertise their business as a corporation, or in another manner not consistent with the true nature of its business. LLPs must include the term "A California Limited Partnership" when referencing the partnership.

LLPs must be registered with the Secretary of State's office. If any changes in the status of the LLP occur, partners are required to submit changes by completing an Amendment to Certificate of Limited Partnerships Form (Form LP-2). Foreign partners must file additional applications and have a principal office and agent of record in the state.

All LLPs must pay yearly franchise dues to the state in order to conduct business in California.

Cancellation of an LLP requires partners to complete the LLP certificate of Cancellation (LP-4/7). There is no filing fee for cancellation.

Case Review: *BT-1 v. Equitable Life Assurance Society* (1999)

The case, *BT-1 v. Equitable Life Assurance Society* (1999) 75 Cal.4th 1406., involved an LLP partner's breach of fiduciary duty.

A partnership consisted of a general partner (Equitable Life Assurance Society) and a limited partner (BT-1). The partnership purchased a building with a sizable mortgage debt ($60 million). Later, Equitable Life was able to purchase the partnership's mortgage debt at a reduced price of $38.5 million. It then demanded payment from BT-1, positioning itself as a lender in the partnership. When BT-1 could not pay, Equitable Life terminated the partnership. It foreclosed on the debt and the deed of trust, thereby becoming the sole owner of the building.

BT-1 brought legal action against Equitable Life for violating its fiduciary duties. The Superior Court argued that the partnership agreement granted a partner the right to purchase mortgage debt. Therefore, Equitable Life's actions were permissible. The court ruled in favor of Equitable Life.

BT-1 appealed. The Court of Appeals ruled that a partner did not have the right to act as a lender on behalf of the partnership, unless otherwise noted in the agreement. Therefore, Equitable Life had violated its fiduciary duties in the partnership. The court ruled in favor of BT-1.

Limited Liability Company (LLC)

A **limited liability company (LLC)** is a business partnership formed by two or more parties that provides members with the tax advantages of a partnership, while giving them limited liability.

Owners of an LLC are referred to as members. Unlike LLPs, these members can be individuals or corporations. An LLC does not require there to be a general partner who is liable for the partnership's obligations.

The advantages of an LLC include:

- *"Pass through" taxes*
- *Legal protection*: an LLC's business assets are legally separated from members' personal assets, which protects members' real and personal property, and business income. LLCs also have limited liability for business debts.
- *No residency requirement*: Unlike LLPs, LLCs do not need to be created by permanent residents of a state or county.

In order to form an LLC, members must do the following:

- Choose a business name that is currently not in existence
- File Articles of Incorporation. It will include the business name, address, and member names.
- Create an Operating Agreement. This lays out the roles and responsibilities of each member, the division of profits, and the specifics of the partnership's business operations.
- File the paperwork with the Secretary of State's Office

Joint Ventures

A **joint venture** is a partnership established between two or more individuals for the purpose of completing a specific project.

Joint ventures are similar to LLPs; however, they are typically created for a limited period of time, rather than as a long-term business.

Unlike a typical partnership, partners' authority in a joint venture is limited. However, joint ventures are typically led by a managing partner who bridges the goals and intentions of all partners to create a uniform business plan.

Partners in a joint venture combine their skills, capital/equity, and products in order to make money and increase revenue. They also share in the venture's profits and losses.

The advantages of a joint venture include:

- *Increased flow of capital and expertise*: may reduce the time it take to enter a market
- *Limited liability*: liability is spread over multiple partners
- *"Pass through" taxes*

Partnership Property Ownership

Uniform Partnership Act (UPA)

The **Uniform Partnership Act (UPA)** was passed as a means of governing business partnerships. It provides rules regarding partnership formation, fiduciary duties, and the ownership of partnership assets.

The Act's provisions that govern property in partnerships include:

- All partners have an equal right to possess a property for partnership purposes, unless otherwise stipulated
- Partners do not have the ability to assign a partnership's property, unless all partners have agreed to the assignment
- No partner can possess a partnership's property in a manner not fitting of the partnership's original goal
- A partnership's property cannot be transferred to another party without the consent of all partners

Types of Partnership Property Ownership

There are three types of ownership whereby two or more individuals hold stake in a property:

- Joint Tenancy
- Tenancy in Common
- Community Property

Property deeds typically indicate the type of tenancy or partnership held between co-owners. If co-owners do not specify that a tenancy is a joint tenancy, a partnership, or a community property, a tenancy in common is automatically created.

Joint Tenancy

Joint tenancy refers to when two or more parties hold an equal, undivided interest in a property.

In California, all four aspects of joint tenancy must be established in order for a property to be considered a joint tenancy:

1. *Title*: both parties acquire the title to a property through the same deed
2. *Interest*: both parties possess the same percentage of ownership in a property, making the interest undivided. Interest in a property is established by a tenant's acquisition of the "same conveyance, commencing at the same time, and held by the same possessor." (Civil Code Section 683)
3. *Time*: the acquisition of a property occurs at the same time
4. *Possession*: both parties have equal rights to access and use a property

If any of the four aspects of joint tenancy are missing, the property will instead be a tenancy in common.

A joint tenancy can be created through a written agreement, negotiable instrument, or transfer.

All joint tenants have the same rights.

Joint tenants enjoy unrestricted use and access of property, unless it infringes upon the right of enjoyment of the other tenants, or willfully excludes them.

Joint tenants have a duty to contribute to standard property expenses. Typical expenses include mortgage payments, property taxes, maintenance costs, and HOA fees (if applicable). Joint tenants also have the legal right to verify the accounting used to calculate the profit and losses associated with the property. If one of the joint tenants fails to keep current with their portion of expenses, the violating party may be subject to a loss in their stake in the property.

Joint tenants are not obligated to pay for costs other than standard property expenses. For example, if one joint tenant makes elective repairs or improvements to a property, he or she cannot require other tenants to contribute to the cost of those alterations.

However, if the alterations drastically improved the property's value, the joint tenant who made them will recover a higher portion of the profit upon the sale of the property. (Conversely, that joint tenant will be held liable if the alterations negatively affect the property value.)

Joint tenants also have the right to retain financing. Typically, lenders who provide joint tenancy funding require the joint tenant to purchase life insurance in the event that he or she dies prior to the debt being paid off.

Should a judgment be filed against a joint tenant, the property will transfer to the surviving joint tenants and the judgment against the property will be suspended. If a joint tenant with a judgment dies, the property will be transferred without the debt to the other joint tenants.

In the event that joint tenants have a dispute over profits or responsibilities, courts may intervene to help parties equally divide assets and responsibilities.

Right of Survivorship

The main provision of joint tenancy, however, is regarding property survivorship.

The **right of survivorship** transfers a joint tenant's share in real property to the other tenant(s) in the joint tenancy upon a joint tenant's death.

Therefore, a joint tenancy property is not transferred to an heir through a will or intestate succession upon the joint tenant's death. Rather, a joint tenant's interest in a property terminates upon his or her death. In the case of a joint tenancy with two owners, the surviving tenant holds absolute possession of the property.

For example, say Brett, Marissa, and Phil own a joint tenancy property. If Brett dies, Brett's family receives no interest in the property. Rather, Marissa and Phil continue on as joint tenants. If Marissa then passes away, Marissa's family also does not receive any interest in the property. Instead, Phil now owns an undivided interest in the property and becomes the owner in severalty.

Corporations cannot own property in joint tenancy. This is because corporations outlast human life, therefore, conflicting with a joint tenancy's right of survivorship.

A joint tenancy is typically not subject to probate because the terms of a deceased party's estate do not apply. However, the surviving joint tenant must submit an affidavit of death for the deceased tenant in order to transfer title.

The surviving joint tenant is not liable for the debts of the deceased joint tenant, even if the deceased tenant used the property for securing a debt. If, however, a living joint tenant falls behind on debt payments, creditors may be able to force an execution sale to recoup both unpaid debts. If an execution sale is completed, the joint tenancy terminates.

Terminating a Joint Tenancy

A joint tenancy can be terminated in many ways, depending on whether the tenants wish to retain an interest in the property or not.

If a joint tenant does not wish to retain an interest in a property, he or she may terminate a joint tenancy in the following ways:

1. *By executing a quitclaim deed to convey his or her interest in a property to a third person.*
   This must be done in the presence of a notary and submitted to the County Recorder's Office. A joint tenant does not need the approval of the other joint tenants in order to transfer interest in the property. The third person then becomes a tenant in common with the remaining joint tenants; the third person cannot become a joint tenant, as the four conditions of a joint tenancy (time, title, possession, and interest) do not apply.

   For example, say John, Sean, and Don are three joint tenants that own a property on Mayfield Ave. If John transfers his stake to a third party (Chris) prior to his death, Sean and Don will remain as joint tenants, while Chris becomes a tenant in common.

2. *By filing for bankruptcy.*
   This will terminate the joint tenancy for the bankrupt tenant only; it does not end the joint tenancy for the other joint tenants.

If a joint tenant does wish to retain an interest in a property, he or she may terminate a joint tenancy in the following ways:

1. *A joint tenant may transfer his or her interest in a property to a third person, and then have that interest transferred back.*
   The third person is known as a "straw man", or a placeholder. In this case, an individual is able to sever his or her joint tenant status, but keep his or her interest in a property as a tenant in common. A "straw man" is not necessary in California, however, as a joint tenant can transfer the property directly to himself/herself.

2. *A partition action.*
   A **partition action** is a court-ordered action that forces the division of a joint tenancy property into equal tenant shares. Should a property partition create unequal shares, or if a property is impossible to divide, parties can agree to sell the property and split the profits equally.

3. *All tenants agree to convert a joint tenancy into a tenancy in common.*
   This ensures that the tenants' heirs will receive their shares of the property when they die.

Joint tenancy law is relatively complex. Therefore, it is advisable to speak or hire an experienced attorney prior to terminating or transferring a joint tenancy.

Tenancy in Partnership

Joint tenancy is distinct from tenancy in partnership.

A **tenancy in partnership** refers to when a partnership -- rather than its individual partners -- is the legal entity that purchases property. This results when a partnership agrees to share in the profit and loss of a purchased property.

If the partnership dissolves, or a partner dies, the tenancy in partnership terminates. Should both partners die at or near the same time, the property would be vested in the hands of the deceased legal representatives.

Case Review: *Riddle v. Harmon* (1980)

The case, *Riddle v. Harmon* (1980) 102 Cal.3d 524., involved a wife who was denied the right to terminate joint tenancy with her husband.

Shortly before her death, a property owner (Mrs. Riddle) was made aware that because the property she owned was held in joint tenancy with her husband (Mr. Riddle). Consequently, the property would automatically transfer to Mr. Little upon her death. On the advice of her attorney, Mrs. Riddle used a grant deed to transfer the property to herself. This terminated the joint tenancy and made Mrs. Riddle a tenant in common. This subsequently prevented the property from being transferred to Mr. Riddle. Shortly after, Mrs. Riddle died. Mr. Riddle then sued the executor of Mrs. Riddle's estate (Harmon), to quiet title to Mrs. Riddle's interest in the property.

The Superior Court cited that there was no historical precedent for selling a property to oneself. It argued that in order to break a joint tenancy, a joint tenant had to transfer a property to a "straw man", then have the interest transferred back. Therefore, it ruled in favor of Mr. Riddle. Harmon appealed. The Court of Appeals argued that the "straw man" law used by the lower court was outdated. It argued that a joint tenant can reassign property interest at his or her discretion without the use of a "straw man". It ruled in favor of Harmon.

Case Review: *Formose Corp. v. Rogers* (1952)

The case, *Formosa Corp. v. Rogers* (1952) 108 Cal.2d 397., involved a partition action.

Two tenants in common held a 19/81 interest in a motion picture movie studio:

Formosa Corp. (19) and Mary Pickford Rogers, et. al. (81). Formosa Corp. spent a significant amount of money constructing buildings on studio land and wished to collect interest and could not due to financial factors. It filed a partition action against Rogers in order to force a sale to collect interest on its investment.

The Superior Court ruled that the burden of proof falls on the party seeking partition to show that a sale is necessary. The court held that by dividing the land according to the percentage of ownership, the values of the parcels would be substantially reduced. Therefore, the court ruled in favor of Rogers.

Tenancy in Common

Tenancy in common refers to when two or more parties hold an undivided interest in a property through percentage shares.

Unlike joint tenancy, tenants in common can be created at different times. Therefore, an individual may obtain an interest in a property years after other individuals have entered into a tenancy in common.

A property deed should be used to document each tenant in common's undivided interest in the property. If a deed does not state the interest, it is assumed that all tenants hold an equal percentage.

However, tenants in common may have different ownership shares. For example, one tenant in common may own 25% ownership in a property, while the other owns 75%. Regardless of their share, however, all tenants in common have ownership rights over (or an undivided interest in) the entire property. This includes an unrestricted right of possession. Therefore, no portion of the property can be divided with the purpose of excluding one or more tenants in common.

(Any exception must be indicated in an agreement, such as "tenant in common is a silent partner and does not have the right to use, possess, and alter the property".)

For example, assume Marge and Bill are tenants in common. Marge has a 60% share in the property, while Bill has a 40% share. However, during the tenancy in common, Bill still maintains an equal interest in the property. Therefore, he can access, use, and alter the entire property, not just 40% of it. In the event that the property sells, however, Bill is only entitled to 40% of the overall profit, while Marge is entitled to 60%.

Ownership rights in a tenancy in common are the same as in a joint tenancy.

Tenants in common contribute to the cost of standard property expenses and necessary repairs. They pay a portion that is proportional to their share in the property. If one of the tenants in common fails to keep current with their portion of expenses, the violating party may lose their share in the property.

Tenants are not obligated to pay for elective repairs or improvements to the property.

Any matters that affect all tenants in common must be approved by all tenants. This includes making elective repairs or improvements to the property, renting the property to a third party, or deciding to sell the property. If the property is rented, all tenants in common are entitled to a proportional share of the rental income.

All tenants in common have the right to request accounting paperwork.

Tenants in common have the right to sell or transfer their portion of ownership to a third party. The other tenants in common do not have the legal right to prevent one tenant from doing so.

In the event of a tenant in common's death, his or her share in a property is transferred to an heir through a will or to the state if the tenant has no will.

Typically, lenders do not provide financing to tenants in common. In the event that a tenant in common defaults on a debt, a lender would only be able to foreclose on the defaulting tenant's share in the property, not the property as a whole. Therefore, a tenancy in common is not a smart investment strategy for lenders.

There are two main ways of terminating a tenancy in common:

- all tenants agree to terminate the tenancy in common
- partition action

Community Property

Community property refers to all property and assets acquired and owned during the course of a marriage or domestic partnership.

Prior to 1975, a husband in California had legal control of all community property. This meant that he could manage, alter, transfer, and/or sell community property without the consultation of his wife. Reforms passed on January 1, 1975 granted both spouses equal ownership of community property under the law.

Community property includes:

- Real property
- Income
- Debt
- Assets (i.e. pensions, business interests, 401Ks)

Community property is shared equally between spouses/partners if it is acquired or owned during the course of a marriage/domestic partnership.

For example, say a wife saves money from her job and invests in a business. As the funds used to purchase the business were acquired during the marriage, it is considered community property. Therefore, her husband has equal rights to it.

The following are not considered community property:

- Real property owned prior to a marriage/domestic partnership
- Assets or real property acquired with separate funds that were not earned during a marriage/domestic partnership
- Income earned during a legal separation
- Money or assets gifted specifically to one spouse/partner
- Money or assets transferred to one spouse/partner through a will
- Rental income from a spouse/partner's separate property
- Damages granted from a personal injury case

If one spouse/partner possesses property or assets prior to a marriage/domestic partnership, it is not considered community property. However, if the spouse/partner co-mingles that property or assets with those shared with the other spouse/partner, it becomes community property.

Ownership rights allow both spouses/partners to manage aspects related to community property, including leasing, re-financing, purchasing, and/or selling.

In order to sell community property, both spouses/partners must sign the property deed. It is unlawful for one spouse/partner to make a gift of community property without the consent of the other spouse/partner.

Debts incurred during a marriage/domestic partnership are considered community property, even if they were only incurred by one spouse/partner. Debt collectors may be able to seize other community property in order to satisfy those debts. Any community property earned by an indebted spouse/partner may also be at risk for debts incurred prior to the marriage/domestic partnership.

When a couple files for divorce/legal separation, community property is divided equally amongst spouses/partners. If one of the spouses/partners contributed separate money and/or assets, that spouse/partner is entitled to take it back without it being divided.

Should one spouse/partner die without a will, property title will automatically transfer to the surviving spouse/partner.

Case Review: *Marriage of Rico* (1992)

The case, *Marriage of Rico* (1992) 10 Cal.4th 706., involved a dispute over whether a divorcing couple had equal interest in community property.

An unmarried couple (Rico) purchased a home together. The husband contributed over $36,000, while the wife contributed $1,500. One year later, the couple married and refinanced their home as tenants in common. Eight years later, the couple divorced. The wife brought legal action against the husband, claiming that she was entitled to half the fair market value of the property.

The Superior Court ruled that while the couple's arrangement had become a tenancy in common -- which assumes equal ownership between tenants -- the husband had a separate, unequal interest in the property due to his larger contribution prior to the marriage. The court used the original capital investment, including the down payment, mortgage payments, taxes, and cost of repairs, as the measure of reimbursement. The wife appealed. The Court of Appeals affirmed the lower court's ruling.

Case Review: *Marriage of Branco* (1996)

The case, *Marriage of Branco* (1996) 47 Cal.4th 1621., involved a dispute over community property.

A married couple (Branco) decided to divorce. During the marriage, the husband had contributed money towards the mortgage payments of a home that the wife had owned from a previous marriage. In doing so, he reduced the wife's loan principal. The husband brought legal action against the wife so that the money that he had contributed to her mortgage was deducted from the portion of community property to which she was entitled.

The Superior Court argued that the husband was entitled to interest in the property if he had contributed towards it. Therefore, it ruled in favor of the husband.

Case Review: *In re: Marriage of Stitt* (1983)

The case, *In re Marriage of Stitt* (1983) 147 Cal.App.3d 579., involved a dispute regarding community property.

A couple (Stitt) got married. After the wedding, the wife purchased a property. She alone held title to that property and had a mortgage in her name. However, mortgage payments were paid out of a joint account. Soon after, the wife deeded the property to her husband and herself as joint tenants. (Only her name remained on the property title, however.) Years later, the wife filed for divorce. She claimed she had the right to take the property in the divorce, as only her name was on the property title. The husband sued.

The Superior Court argued that while the property title did not indicate that the husband was a co-owner, the property had been purchased during the marriage and was therefore, community property. The court granted the husband interest to the property.

Domestic Partnerships

A **domestic partnership** refers to the legal relationship between two unmarried individuals who cohabitate and share a common domestic life. Domestic partners may be prospective spouses, long-term unmarried couples, elderly couples, and -- until 2015 -- same-sex couples.

The following are requirements for establishing a domestic partnership:

- Both partners are over 18 years old
- Both partners are in the proper mental state to authorize a domestic partnership
- Partners are not related
- Partners share the same residence
- Neither partner is already in a domestic partnership

In 2003, the California Assembly introduced The California Domestic Partner Rights and Responsibilities Act (also referred to as Assembly Bill 205). The Act granted domestic partners the same rights and responsibilities afforded to spouses under state law, including community property rights.

Like spouses, domestic partners have the right to create financial agreements that protect their current and future situations. For example, how assets will be transferred in the case of one partner's death. Unless an agreement violates a specific law, it is considered legally valid.

Case Review: *re Marriage of Campbell* (1999)

The case, *re Marriage of Campbell* (1999) 74 Cal. 1058., involved a dispute regarding community property.

A couple (Campbell) got married. In the early years of the marriage, the husband had hardly any income. The wife contributed a significant amount of money to the marriage, including investments in her husband's business and a $66,000 contribution to repair a house that the husband purchased prior to the marriage. The investments were made with an (unwritten) understanding that the husband would pay back the debts.

After several years, the couple divorced. The husband claimed that the wife was not entitled to any portion of the property he had purchased prior to the marriage. The wife claimed that she had directly contributed towards the property, and therefore, she was entitled to an interest in the property. The husband cited Family Code Section 852, which requires a transmutation of real property to be made in writing in order to be valid.

The Superior Court stated that the property in question was not community property and therefore, the wife was not entitled to an interest in it. It ruled in favor of the husband. The wife appealed. The Court of Appeals upheld the lower court's ruling. However, it did order the wife to be reimbursed for the financial contributions she had made towards the husband's house.

Case Review: *Estate of Leslie* (1984)

The case, *Estate of Leslie* (1984) 37 Cal.3d 186., involved a dispute over whether a husband was considered the "surviving spouse" after his wife's death.

A husband and wife were married in Mexico. For the next nine years, they lived together in California in a property owned by the wife prior to the marriage. (She had owned the property with her ex-husband.) The wife died without a will and the property went into probate. At this point, the husband learned that his marriage to his wife had not been properly recorded according to Mexican law. Therefore, he was denied his right to his wife's property. He filed a petition to obtain interest in his deceased wife's separate property.

The Superior Court denied the husband's petition. The husband appealed. The case made its way to the Supreme Court. The Supreme Court reversed the lower court's ruling. It argued that the husband was considered the surviving spouse on the grounds that it was clear that both were partners with one another. Therefore, the husband had a legal interest in the wife's separate property, and was now the sole owner of that property.

Case Review: *Estate of Vargas* (1974)

The case, *Estate of Vargas* (1974) 36 Cal.3d 714., involved a deceased party who had two wives.

A man (Vargas) had two wives who were not aware of each other's existence. The discovery was made upon Vargas' death. The first wife claimed that as the first wife, she was legally entitled to Vargas' entire estate. Even if the second wife was considered a putative wife, she was not entitled to an equal share because she was married for less time. A putative spouse is a person who lives with another party to whom he or she is not legally married with the good faith understanding that they are married to that party. It is not a legally valid marriage.

The Superior Court disagreed. It ordered Vargas' property be split equally between the first and second wife.

Corporations

A **corporation** is a legal business entity that possesses the same rights and duties as an individual.

Corporations possess many of the same rights as individuals, including the right to enter into a contract, obtain or provide financing, hire employees, own assets, pay taxes, and sue or be sued. Unlike humans, however, corporations do not expire. As long as a corporation conducts business, its name and rights continue on.

Corporate Hierarchy

The **corporate hierarchy** is comprised of the corporation's owners/shareholders, a board of directors, and appointed corporate officers.

Owners/shareholders are investors who buy and sell stake in a corporation. Their liability in the company does not extend beyond their capital investment.

Owners/shareholders typically do not engage in any management capacity other than voting on important issues, such as the selling of a significant percentage of corporate assets and funds.

There are exceptions, however. For example, if a corporation goes public and one of the corporation owners/shareholders buys a majority stake in the company, he or she may be given managerial authority. Should an owner/shareholder have the managerial capacity to hire him/herself, it must be a "reasonable compensation." If compensation is above reasonable standards, the IRS has the ability to consider the salary as taxable income, rather than a deductible expense.

Owners/shareholders vote in a board of directors. The board oversees a corporation's activities and acts in the interests of the owners/shareholders. It also possesses ultimate discretionary power over the corporation. A board of directors is responsible for appointing corporate officers, including the CEO.

A CEO is responsible for the day-to-day management of a corporation. He or she establishes company practice, financial models, and corporate structure, as well as the hiring of personnel and finding suitable office space to employ the business. As a significant percentage of large corporations are sold in the long run, a CEO is generally not the founder of the corporation.

It is common for owners/shareholders of large corporations to sell minority positions to the public, while retaining majority ownership.

Corporations must be separate from owners/shareholders, board members, or corporate officers. The IRS will not grant corporation status to companies that co-mingle personal and corporate accounts.

Standard corporate taxes include: social security taxes, Medicare taxes, income taxes, withholding taxes, and federal unemployment tax.

Corporations are entitled to special tax deductions, such as writing off expenses or owner/shareholder bonuses. However, owners/shareholders who lose money cannot deduct on their loss.

Owners/shareholders have the ability to bring a lawsuit against a corporation.

Types of Corporations

There are various kinds of corporations as described by law.

A corporation can be any size. Larger corporations may have hundreds of owners/shareholders with high levels of capital investment that finance large-scale business endeavors. Conversely, smaller corporations may be created merely for beneficial tax deduction purposes.

Corporations may be a publicly traded company that issues stock, or a private corporation. If a corporation does not have the capacity to sell stock, it is categorized as a non-stock corporation.

C Corporations

When a business is incorporated, it automatically becomes a C Corporation.

A drawback to a C Corporation is "double taxation". A C Corporation's income and expenses are taxed at the time they are generated. Owners must also pay a personal income tax on corporate profits when they are distributed as dividends.

S Corporations

In order to avoid the "double taxation" of a C Corporation, many business entities may instead create an S Corporation. In an S Corporation, the corporation itself is not taxed; rather, shareholders and/or owners are only taxed once when corporate profits are distributed on their personal tax returns.

The following are requirements for creating an S Corporation:

- *Must be a "domestic" corporation.* Domestic means that the business must be headquartered in the state where it primarily conducts business.
- *Must have fewer than 100 shareholders*
- *Must possess only one class of stocks*

Financial institutions and insurance companies cannot conduct business as S Corporations.

Foreign Corporations

A foreign corporation is an entity that conducts business in a state other than the one in which it was incorporated. For example, if Babtec was incorporated in Los Angeles, it would be considered a foreign corporation if it conducted business in New York.

In order to conduct business in a foreign state, corporations must obtain prior approval from the Secretary of State. This approval gives a foreign corporation the same legal rights as a domestic corporation.

Unincorporated Associations

A less common type of corporation is an unincorporated association. An **unincorporated association** is any type of organization created for social improvement.

Unincorporated associations are used by religious institutions, social centers, educational facilities, and other community-based entities or initiatives. Due to the collective goals of associations, they are typically considered partnerships.

In California, unincorporated associations can obtain real property title for conducting the activities laid out in the organization's initiatives. Should the organization use a property for purposes other than originally intended, the organization may lose its ability to retain the property title.

Unincorporated associations are required to file taxes, whether they make a profit or not. However, there are laws that allow unincorporated associations to apply for tax-exempt status.

Investment Properties

Real Estate Syndication

Real estate syndication is the process of combining funds and expertise from numerous investors in order to fund real estate projects.

Typically, one party with real estate skills, connections, and/or expertise partners with a capital investor in order to develop and/or purchase property assets as a partnership. In this way, the roles in a real estate syndication are similar to those of an LLP: the syndicator (or general partner) is responsible for finding attractive real estate opportunities while the investor (or silent partner) is responsible for contributing capital.

Syndication is one of the most common ways for individuals or corporations to become an interest holder in real property without investing money.

Partners in such an arrangement are typically taxed as individuals.

Real Estate Investment Trust (REIT)

A **real estate investment trust (REIT)** is a type of investment tool that give investors of all income levels the ability to combine their capital investments with other investors to purchase income-generating property or mortgages leveraged by real property.

President Dwight Eisenhower enacted the Real Estate Investment Trust Act in 1960.

REITs enable investors to own a percentage of a property without the liability associated with buying, developing, or financing real estate. This allows inexperienced investors of minimal means to invest in an asset that traditionally increases in value over time.

REITS are managed by a board of trustees that develop the purchasing and development strategy of the company. Unlike standard partnerships or other forms of property ownership, REITs typically pay investors back through dividends. Most REITs are publicly owned companies, some of which are on the stock exchange.

The requirements of a valid REIT are:

- Must have at least 100 investors
- A minimum of 75% of the REIT's assets must be invested into real estate (either real property and real estate mortgages)
- Must be a corporation for tax purposes
- Must be managed by a trustee or a board of directors
- A minimum of 75% of income must come from rental income on real property or interest from mortgage loans
- Must pay a minimum of 90% of its income through shareholder dividends
- Five individuals cannot possess more than 50% of the REIT
- The interests of investors must be transferable shares, or a certificate

REITs may be used to purchase real property or mortgage. Many REITs are hybrid trusts that invest in both real property and mortgages.

An **equity real estate investment trust** refers to when investors use REIT money to purchase residential and commercial real estate. This is the most typical REIT. Real estate assets may include a mall, shopping center, hospital, hotel, retail space, or development of office buildings. Investor income is generated through rental income.

Conversely, REIT investors make money from purchasing mortgages by charging interest.

Timeshares

A **timeshare** is a type of property ownership that grants two or more investors the exclusive right to use real property for a specific amount of time.

Typically, timeshares have a definite period of time in which each timeshare owner can use the property. The ownership of a timeshare may be for a minimal amount of years, or it may last for an indefinite period of time.

Timeshares are typically purchased as vacation properties.

Timeshares can be a risky investment because it is difficult to re-sell the property. The government has passed legislation that grants a buyer of a timeshare a right of rescission of seven days.

Subdivision of more than twelve timeshare estates is regulated by the Real Estate Commissioner.

Business Sales

Franchise Sale

A **franchise sale** refers to the purchasing and selling of the right to use an existing business's financial model and brand name for a specified period of time. A franchisee pays a franchisor for the rights to use the franchisor's name, logo, advertising, products, and other franchise-related components.

The most common types of franchises are restaurant chains and convenience stores.

Purchasing a franchise does not give the franchisee absolute discretion, however. A franchisee must follow the standard policies and procedures that have made the franchise successful. A franchisor is responsible for training a franchisee how to appropriately manage the business. This includes how to operate equipment, service clients, and make products.

Franchise opportunities can be exclusive or nonexclusive. A franchisor is not required to estimate the profit level of the prospective franchise, but he or she must disclose all financial information as it relates to the ownership of the franchise.

Franchisors make money by taking a percentage of the gross revenue of every franchise. (They are not entitled to a percentage of the profits.) Franchise fees vary based on the company, location, and potential profit level.

A typical fee structure includes:

- Royalty fee
- Percentage of the total gross revenue
- Cost of training and new fees

The **Franchise Investment Law** regulates the franchise industry.

Its main provisions relate to disclosures. The Law requires that a prospective franchisee must be provided with as much relevant information about the company as possible, including the cost of products, the cost of service, and the general process of the business. All disclosures must be provided at least ten business days prior to the sale of a business opportunity.

All franchises that have 25 or less locations, or less than $5 million in annual sales, must register their business offerings with the California Commissioner of Corporations.

Bulk Sales Act

A **bulk sale** is the transfer or sale of most, or all, of a business's assets. Such assets include properties, materials, supplies, products, and other inventory vital to the operations of the business.

The **Bulk Sales Act** was created to protect the interests of lenders when a bulk sale occurs.

A sale is subject to the Bulk Sales Act if a business's primary activity is the sale of stock and/or more than 50% of the business is being transferred. Certain sales are exempt from the Bulk Sales Act, however, including:

- service-based businesses whose primary purpose is the sale of stock
- minority position sales
- business sales with assets exceeding $5,000,000
- a business valued at less than $10,000

The Bulk Sales Act requires a seller to inform lenders of an impending sale prior to the finalization of the sale. The purpose of this provision is to allow a lender the opportunity to recoup its investment. This is done through a formal notice of sale.

A proper notice of sale includes the following:

- Statement indicating that a bulk sale is set to transpire
- Names and addresses of all associated parties
- Transaction date
- Property address
- General description of the property being sold or transferred, including assets, properties, inventory, and equipment
- List of all businesses names associated with the company or entity being purchased
- Statement indicating escrow terms

A notice of sale must be recorded by the county recorder's office and delivered to the county tax collector's office twelve days before the sale. The notice must also be published in the local market (i.e. newspapers, magazines, bulletin boards).

The Bulk Sales Act also requires an escrow account to be created to ensure that funds from a sale are diverted to a lender. This prevents a business owner from avoiding paying off a debt. Any business sales that are over $2 million, or that transfer stock or otherwise intangible items of value, are exempt from this provision.

California law does not require a buyer of a business opportunity to take on a seller's debt, unless the buyer agreed to purchase the business with its outstanding debt.

Business Opportunity Brokers

A **business opportunity broker** is a professional who specializes in the transfer and sale of business opportunities. When an existing business owner decides to sell his or her business, a business opportunity broker assists them in selling or leasing that business.

The sale or lease of a business opportunity typically requires the transfer or sale of a property. For this reason, licensed real estate brokers have the authority to represent buyers and sellers of business opportunities.

A business broker must adhere to the same fiduciary duties as other real estate professionals, including full and accurate disclosure, confidentiality, and proper advisement. Among the responsibilities specific to a business opportunity broker are:

- *Assess risk*: brokers determine the risk associated with buying or selling a business.
- *Appraisals*: brokers are tasked with appraising the value of a business. This is done by analyzing a business's income, assets, and expenses (i.e. property taxes, mortgage payments, business expenses) and determining how it will continue to perform based on past performance.
- *Locate buyers*: Because of their experience, access to clientele, and ability to connect with other business brokers, business brokers have the ability to retain maximum value for the sale of a business opportunity. This is much different than a business owner who can maximize the final sale price of the business opportunity by locating the ideal buyer.
- *Prequalify business buyers*: a broker determines whether a potential buyer qualifies for a business loan or has the means to purchase the business.

Case Review: *Salazar v. Interland* (2007)

The case, *Salazar v. Interland* (2007) 152 Cal.4th 1031., involved a dispute over whether a business opportunity broker had to be licensed.

A business (AT&T) was looking to sell its existing small- and medium-sized customer contracts. It hired a business opportunity broker (Salazar) to find a suitable buyer. Salazar did not have a broker's license, but still introduced AT&T to a potential buyer (Interland) and arranged meetings between the two companies. Interland ultimately agreed to purchase AT&T's customer contracts.

Upon the close of the sale, Interland refused to pay Salazar over his failure to have a license. Salazar sued, alleging that he was owed commission for the sale, and for every new client gained by Interland as a result. He sought $20 million in damages.

The Superior Court argued that the transaction constituted a business opportunity sale, and therefore, Salazar was required to be a licensed real estate broker. The court indicated that the purpose of "licensing requirements is to protect public from incompetent or untrustworthy practitioners". It ruled in favor of Interland. Salazar appealed. He argued that the transaction was not a business opportunity sale, as it was not the sale of the entire company, only a portion of it. The Court of Appeals reasoned that any business transaction, regardless of size or percentage of the company, must be arranged by a licensed real estate broker. It upheld the lower court's ruling.