

M e m o r a n d u m

To: Ms. Glenna Schultz
Policy, Planning and Standards Division

Date: February 10, 2000

From: Kristine Cazadd
Sr. Tax Counsel

Subject: *Revenue and Taxation Code Section 66 – Distribution from Employee Benefit Plan to its Participants.*

This is in response to your phone question as to whether the distribution of separate parcels of *real property* from an employee benefit plan to each of the participants is excluded from change in ownership under Section 66(a). Based on the legislative history of this section, the rule (Rule 462.240 (d)), and the few opinions issued, it appears that subdivision (a) of Section 66 exclusion would apply:

“Change in ownership shall not include . . . the distribution . . . of a participant’s or beneficiary’s interest in an employee benefit plan.”

The requirement relevant to any such distribution however, is that the value of the parcels or property interests distributed to each of the plan participants must represent the present value of the interests each held in the benefit plan.

1. Since its enactment, Section 66 has been strictly construed because it excludes from reappraisal specific transfers between an employer and an employee benefit plan, even though the ownership interests may not remain the same after the transfers.
2. The provision at issue here is the distribution provision of Section 66(a) which expressly prohibits the possibility of reappraisal whenever a participant's or a participant's beneficiary becomes vested or eligible for the benefits. (Annotation No. 220.0181, Eisenlauer letter 5/2/85, Milam letter 6/10/80, attached.) The intent of the provision was to prevent a change in ownership that could arguably occur if, in the case of a benefit plan that owned real property, (1) a new employee received a vested interest, (2) an employee terminated his interest and was no longer a participant, or (3) an employee retired and became eligible for the distribution of benefits under the plan. Addressing Section 66 in the Property Tax Assessment Report prepared by the Assembly Revenue and Taxation Committee, October 29, 1979, at page 30, Section 66 is described as a change in ownership exclusion applicable to the “... distribution or termination of a participant’s ... interest in such plan as described in the Employee Retirement Income Security Act of 1974.”¹

¹ As defined in 29 USCA sec.186(c) (the Employee Retirement Income Security Act of 1974) at the time this statute was enacted, an "employee benefit plan" means any plan, fund, or program established by an employer to provide retirement income to employees or a deferral of income by employees for periods extending after the termination of employment. A "participant" is any employee or former employee who is eligible to receive a benefit under the plan, and a "beneficiary" is a person designated by a participant who is or may become entitled to benefit under the plan. (Annotation No. 220.0183, Eisenlauer letter 2/14/91, attached.)

In determining upon distribution whether the plan participants must take undivided interests in the real property from the plan, or may take individual interests in separate parcels, two issues must be considered. First, since there is no "proportionality of ownership interests requirement" in Section 66 like those expressed in Section 62(a)(1) and (a)(2), the percentage of *ownership* interests in the property before and after distribution is not the test to be applied.² The fact that an employee benefit plan in which two participants were vested, owned 100% of the parcels before the distribution, and each of the two participants owned 100% in only half of the parcels after distribution does not prohibit the application of Section 66(a).³ Secondly, the express language in Section 66(a) requires that any such distribution from the benefit plan must constitute only the "*participant's or beneficiary's interest*" in the benefit plan. To be eligible for the exclusion, the benefit plan must distribute to a participant property or assets representing exclusively the present value of that participant's interest in the plan. Therefore, each distribution of real property from the plan to the participant must be examined in light of this requirement.

3. Where, as here, the benefit plan is being terminated or partially terminated and the parcels of real property in the plan are being distributed directly to each of the two eligible participants, the question is whether the actual value of the participants' interests *under the plan* are reflected by the separate parcels of property being distributed to each of them. If the ten parcels being distributed to Participant A represent the present value of his interests in the benefit plan, and the three parcels being distributed to Participant B represent the present value of his interests in the benefit plan, then the transfers would be within the plain meaning of the Section 66(a) exclusion.

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Attachments: Annotation No. 220.0181 and Milam Letter 6/10/80,
SB 2351 Legislative Analysis

cc: Mr. Dick Johnson, MIC:63
Mr. David Gau, MIC:64

² As indicated in the Legislative Analysis of SB 2351 (Deddeh) 1986 (attached), Section 66 raises a constitutional question because it provides that a contribution of real property to an employee benefit plan is NOT a change in ownership (in direct contravention of the Constitution). It is fundamentally contradictory in that certain, clear changes in ownership are declared not to be changes in ownership. (For example, there is no requirement to maintain proportional ownership interests so that a transfer under Section 66 would constitute merely a change in the method of holding title as in Section 62(a)(2).) As such, there has long been a serious question as to whether Section 66 is consistent with constitutional reappraisal requirements.

³ There is also no proportionality of ownership interests required at the creation, vesting, or transfer of a participant's interest in an employee benefit plan. Under Section 66(a), when a new employee "vests" under a benefit plan that owns real property, he/she has technically acquired a interest in real property. As his/her vested interests in the plan increase throughout the years of employment, so do the employee's property interests. Whether the benefit plan allows the employee to vest his/her interests in separate parcels or in undivided interests in all of the parcels, these "acquisitions" of real property interests would result in changes in ownership apart from the exclusion in Section 66(a).