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STATE BOARD OF EQUALIZATION

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August 6, 1990

Dear Mr. _____:

This is in response to your letter of April 21, 1990 requesting advice on the application of Proposition 58 to the transfer of your father's personal residence to your brother _____.

I have also received a copy of your note dated June 20, 1990, to which you attached a letter written by your father on March 12, 1982, which expresses the wishes of your father as to the disposition of his estate. As we recently discussed, I have also received a copy of the letter written by your brother, _____, to our Assessment Standards Division, dated May 28, 1990. This letter states that recent inquiries made by your brother to various county assessor offices has shown that there are inconsistencies from county to county in the application of Proposition 58 to parent/child transfers pursuant to will or trust where the property is left to two or more children "share and share alike".

Based on the information provided in your letter and in _____'s letter, I understand that your father, _____, and his wife _____, had three children, _____, _____, and _____. _____ passed away in 1982 and on June 3, 1983, your father executed an intervivos trust which was prepared for him by _____, Attorney at Law. In addition to certain stocks and bonds, _____, as trustor, transferred to the trust a residence at Lake _____ in _____ County and his principal residence in _____ County. The trust was revocable until the trustor's death. It retained a life interest in the trustor and upon his death provided for distribution of the trust estate to his children, _____, _____, and _____, "share and share alike".

Among the various powers expressly granted to the trustee in Exhibit A of the trust is the following:

"(p) In any case in which the Trustee is required, pursuant to the provisions of this instrument, to divide any trust property into parts or shares for the

purpose of distribution or otherwise, the Trustee is authorized, in the Trustee's discretion, to make the division and distribution in kind, including undivided interests in any property, or partly in kind and partly in money, and for this purpose to make such sales of the trust property as the Trustee may deem necessary, on such terms and conditions as the Trustee shall see fit."

Your father passed away in September of 1989. Your brother, _____, is interested in acquiring sole ownership of your father's residence in _____. He will provide a promissory note secured by a deed of trust to the other two children as a means of financing the difference between the market value of the residence and his one-third share of the trust assets. Apparently the difference in value amounts to about 15 percent of the market value of the residence.

As the result of an inquiry from Mr. _____, you have been advised by _____, Chief of the Standards Division of the Assessor's Office, that while the county would apply Proposition 58 to exclude the transfer of the _____ residence to the three children from reassessment, it would treat the transfer of the property to the sole ownership of _____ as a reassessable transfer of a two-thirds interest of the property. You have asked that we review the terms of your father's trust and the other information supplied and provide our opinion as to the correctness of the assessor's determination. As I recently discussed with you, my conclusion, after reviewing the information supplied and the applicable authorities, is that the transfer of the _____ residence to your brother qualifies as an excluded parent/child transfer except to the extent that the value of the property exceeds the value of his one-third share of trust assets.

Proposition 58 added subdivision (h) to section 2 of Article XIII A of the Constitution. Briefly, subdivision (h) excludes from change in ownership the purchase or transfer of the principal residence of the transferor in the case of the purchase or transfer between parents and their children. It also excludes the purchase or transfer of the first \$1 million of the full cash value of all other real property between parents and their children.

Subdivision (h) is implemented by Revenue and Taxation Code section 63.1. Section 63.1, in part, defines "transfer" as including any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an intervivos trust. It seems clear, therefore, that if the transfer of the _____ residence

to your brother qualifies as a transfer from your father pursuant to the terms of his intervivos trust then the transfer qualifies for inclusion under these provisions of the Revenue and Taxation Code and the California Constitution.

The provisions for distribution of your father's trust estate provide that it shall go to the three children "share and share alike." This direction indicates that the three children are to share equally in the trust estate. The question, of course, is whether the three children each receive a one-third interest in each individual trust asset. Subdivision (p) of Exhibit A of the trust grants to the trustee express authority to make distributions in kind and so forth. While I, frankly, had some difficulty in deciding whether this was a clear, broad grant of discretion to the trustee to distribute all trust property in kind, that dilemma is resolved by the provisions of the Probate Code dealing with trust administration found at Sections 16000 and following.

Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

"The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata" (added by Chapter 820 of the Statutes of 1986).

California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McColgan (1948) 84 Cal.App. 2d 208. Thus, where the trust instrument conflicts with a statutory power, the instrument controls unless a court, pursuant to Probate Code section 16201, relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including section 16246.

The powers granted to the trustee under Exhibit A of your father's trust expressly provides that they are "In addition to all other powers and discretions granted or vested in a Trustee by law." It does not appear, therefore, that any limitation on the powers conferred by statute was intended under your

father's trust. Thus, the trustee has the power to distribute the trust assets in kind on either a pro rata or non-pro rata basis. Accordingly, the distribution to your brother of the property would be properly characterized as a transfer under the terms of the trust from your father to your brother for the purposes of Proposition 58 and section 63.1, to the extent that the value of the property did not exceed the value of your brother's one-third interest in the total trust estate. The excess, which you state is about 15% of the value of the property, could not qualify as a transfer from your father to your brother since it would exceed the direction that the three children share and share alike. To that extent, the transfer must be considered to be a transfer from the other beneficiaries pursuant to a sale of their interest to your brother.

It must be recognized that we are dealing here with the provisions of a trust rather than a will. Under the provisions of the Probate Code, we would not necessarily reach the same result had the distribution been made pursuant to a will. Under the Probate Code provisions applicable to wills, the general rule is that a devise of property to more than one person vests the property in them as owners in common. Probate Code Section 6143 provides that unless a contrary intention is indicated by the will, "a devise of property to more than one person vests the property in them as owners in common." See also Estate of Pence (1931) 117 Cal.App. 323, at 331, holding that a devise to more than one person to "share and share alike" indicates a gift in common. See also Noble v. Beach (1942) 21 Cal.2d 91, 94; and, Estate of Russell (1968) 69 Cal.2d 200, 214-215. Of course, many wills contain provisions which grant discretion to distribute the property in kind on a pro rata or non-pro rata basis or something equivalent. In light of the general principle that the intention of the testator as expressed in the will controls the legal effect of the dispositions made in the will (Probate Code Section 6140 (a)) a clear grant of broad discretion to distribute the property in kind on a pro rata or non-pro rata basis must be given due recognition. In the absence of such a clear grant of broad discretion in the will, however, or an appropriate judicial determination of the meaning of the provisions of the will, assessors are entitled to rely on the general rule set forth in Section 6143 of the Probate Code.

As demonstrated by the above discussion, this is a difficult area of the property tax law and we are in agreement with your brother's suggestion that our Assessment Standards Division should provide guidance to assessors to assist them with these complex problems. By copy of this letter, I am requesting that the division prepare an appropriate advisory letter to county

assessors setting forth guidelines consistent with the views expressed above.

As I believe we have discussed, the opinions expressed in this letter are advisory in nature and are not binding upon any assessor. I have, however, taken the liberty of furnishing a copy of this letter to both the County and County Assessors' Offices, for their information.

Very truly yours,



Richard H. Ochsner
Assistant Chief Counsel

RHO:sp
2520D

cc:



STATE OF CALIFORNIA

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Fourth District, Los Angeles

KATHLEEN CONNELL
Controller, Sacramento

E. L. SORENSEN, JR.
Executive Director

September 10, 1996

Attorneys at Law

Attention:

Re: Proposition 58 Reassessment Exclusion

Dear Ms. :

This is in response to your letter to me of August 8, 1996 in which you request our opinion as to whether a "change in ownership" for property tax purposes occurred and if so, to what extent under the following facts described in your letter and set forth below. For the reasons stated hereafter, we are of the opinion that no "change in ownership" occurred.

Factual Background

The decedent died on October 20, 1994. Her estate consisted of cash and her principal residence, all held in the ABC 1993 Family Trust. The decedent resided in the real property with her son prior to her death. The son still resides in the residence.

The Trust provides that following the decedent's death, the Successor Trustee should divide the trust estate into equal shares and distribute one share to each of the decedent's two children, a daughter and a son, free of trust. In the Trust, "trust estate" refers to "the assets listed in Schedule A and to any other property received by the Trustee." Furthermore, the Trust provides that "the Trustee is authorized to allot and make the division or distribution, pro rata or otherwise, in cash or in kind, including undivided interests in any property, or partly including undivided interest in any property, or partly in cash and partly in kind, in the Trustee's discretion." (Art. Sixth, Sec. A, p. 11.) The Trust also provides that the Trustee has the power to "encumber,

mortgage or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee." (Art. Fourth, Sec. G, p. 7.)

The Successor Trustee believed that the Trust estate had a net worth of approximately \$322,000, with the real property valued at approximately \$310,000 and all other property valued at \$12,000. Pursuant to the Trust provisions, the Successor Trustee sought to distribute approximately \$161,000 net worth of assets to each child. On April 24, 1995, before making any distributions, the Successor Trustee obtained a loan and Deed of Trust against the Trust real property for \$160,000. The assets of the Trust then consisted of cash, including loan proceeds and the real property encumbered by the Deed of Trust.

On June 2, 1995, the Successor Trustee was ready to distribute the Trust property, and made a non pro rata distribution of \$150,000 of the Trust's cash to decedent's daughter. On June 22, 1995, the Successor Trustee made a non pro rata distribution of the real property to decedent's son individually, subject to the \$160,000 loan and Deed of Trust.

On June 22, 1995, the Successor Trustee executed a proper Claim for Reassessment Exclusion for Transfer Between Parent and Child. He submitted it to the Alameda County Recorder on June 26, 1995.

The Assessor issued a Notice of Supplemental Assessment on January 12, 1996 regarding the reassessment of one-half of the real property after the death of the parent and the distribution of the real property to the decedent's son. The property was previously on the tax roll at \$47,441. The Assessor appraised it at only \$220,000, one-half of which is \$110,000. Thus, the new assessed value is \$133,441. Subtracting the \$47,441 already taxed, the Assessor issued a Supplemental Assessment to the son of \$86,000 and a supplemental tax of 1.2990% thereon, or \$1,117.14.

The Assessor has indicated that the property was reassessed because "there was not enough money in the trust estate to equally distribute cash to [the daughter]...The Trustee obtained a cash loan to distribute cash to [the daughter] instead of a 50% interest in the above referenced property." The Assessor relies heavily on a Letter to Assessor dated January 23, 1991, No. 91/08, entitled "Change in Ownership Consequences of Real Property in an Estate or Trust Distributed on a "Share and Share Alike" Basis" (LTA 91/08).

Law and Analysis

As you are aware, Revenue and Taxation Code¹ section 60 defines a "change in ownership" as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

¹ All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Section 61 provides that, subject to exceptions not here relevant, "change in ownership, as defined in section 60, includes, but is not limited to:...(g)[a]ny interests in real property which vest in persons other than the trustor...when a revocable trust becomes irrevocable."

Proposition 58 added subdivision (h) to section 2 of Article XIII A of the California Constitution. Briefly, subdivision (h) excludes from change in ownership the purchase or transfer of the principal residence of the transferor in the case of the purchase or transfer between parents and their children. It also excludes the purchase or transfer of the first \$1 million of the full cash value of all other real property between parents and their children.

Subdivision (h) is implemented by section 63.1. Section 63.1(c)(7), in part, defines "transfer" as including any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos trust. It seems clear, therefore, that if the transfer of the decedent's principal residence to the decedent's son qualifies as a transfer from decedent pursuant to the terms of her inter vivos trust, then the transfer qualifies for exclusion from change in ownership under Proposition 58 and section 63.1.

The Board has addressed this issue in its LTA 91/08, a copy of which is attached, which provides in part:

"The key to whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is whether the trust instrument limits the trustee's powers to distribute property.

"Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

'The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata.' (Added by Chapter 820 of the Statutes of 1986.)

"The statement 'a distribution in kind may be made pro rata or non-pro rata,' means that the trustee has a choice in how he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries common ownership in all the assets of the trust estate (pro rata) or can allocate specific assets to individual beneficiaries (non-pro rata).

"California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McClogan (1948) 84 Cal. App.

2d 208. Thus, where the trust instrument conflicts with statutory power, the instrument controls unless a court, pursuant to Probate Code Section [16201], relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including Section 16246.

“Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rate or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust’s assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1.”

In this case, the Trust does not limit the statutory trustee powers contained in Probate Code sections 16220 through 16249. In fact, as indicated above, Article Sixth, Section A, of the Trust provides for the Trustee’s distribution powers similar to but no less broad than those specified in Probate Code section 16246. Also, as indicated above, the Trustee has the power to encumber, mortgage, or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee. This provision is identical to Probate Code section 16228.

It is clear under LTA 91/08 discussed above that where a trustee’s powers are as broad as they are in this case and where the trust requires distribution in equal shares, a trustee may distribute a 100 percent interest in a parcel of real property to a beneficiary without triggering a change in ownership as long as the value of the parcel received by the beneficiary doesn’t exceed the value of his or her share of the trust property. Thus, where the trust property consists solely of two parcels of real property of equal value and the trust requires distribution in equal shares to the two children, the trustee may distribute one parcel to one child and one parcel to the other child without causing a change in ownership as long as the trustee’s statutory powers are not limited by the trust instrument.

Similarly, if the same trust contained one parcel of real property and cash in an amount equal to the value of the real property, no change in ownership would result from a distribution of the real property to one child and the cash to the other child.

This case is different from the latter example only in that the successor Trustee encumbered the Trust real property in order to distribute the trust estate in equal shares by distributing cash to one child and equity in the principal residence of equal value to the other

child. As indicated above, the Successor Trustee had the power to encumber the real property and to make the non-pro rata distribution. In effect, the Successor Trustee exercised his power to encumber in order to be able to exercise his non pro rata distribution power. The creation of a security interest or the substitution of a trustee under a security instrument, if that occurs, is not a change in ownership (§62(c)). Accordingly, it is our view that the distribution made by the Successor Trustee in this case does not result in a change of ownership because the distribution of the real property under the Successor Trustee's powers was a transfer from the decedent to her son "through the medium of an inter vivos...trust" within the meaning of section 63.1(c)(7) and the guidelines of LTA 91/08. The fact that the assessor valued the real property at an amount less than what the Successor Trustee believed the property was worth for purposes of encumbering the property and distributing the trust estate does not change that result. As LTA 91/08 makes clear, where a trustee's statutory powers are not limited by the trust instrument and the trust instrument requires a share and share alike distribution to children, no change in ownership resulting from a transfer between siblings occurs unless a trust beneficiary receives real property valued in excess of the value of his or her share. As pointed out in the example in LTA 91/08, where a beneficiary receives real property which is encumbered, the encumbrance must be considered in determining whether a beneficiary has received real property valued in excess of his or her trust share. In this case, the son did not receive more than his share of the trust estate and, based on the Assessor's valuation, in fact, received less than his share of the trust estate. Accordingly, there was no transfer of real property between siblings and thus, no change in ownership.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Eric F. Eisenlauer
Senior Tax Counsel

EFE:sao
Attachment
cc:

County Assessor

Mr. James Speed - MIC:63
Mr. Dick Johnson - MIC:64
Ms. Jennifer Willis - MIC:70