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November 21, 2008

**Re: *Change in Ownership – Transfers of Real Property from Trusts to an LLC***  
***Assignment No.: 07-457***

Dear Mr. \_\_\_\_\_ :

This opinion is in response to your letter dated October 25, 2007 to Robert Lambert, Assistant Chief Counsel, regarding the application of Revenue and Taxation Code section 62, subdivision (a)(2) to certain transfers of real property from several trusts to a limited liability company.

For the reasons set forth below, we conclude that no reassessment of the real property will occur because the proposed transactions would merely result in a change in the method of holding title to the property.

**BACKGROUND AND FACTS**

Three trusts currently own cotenancy interests in 20 parcels of California real property. These trusts are:

- (1) D \_\_\_\_\_ (D \_\_\_\_\_), as trustee of the Marital Trust under the D \_\_\_\_\_ Family Trust dated May 22, 1998 (the Marital Trust);
- (2) D \_\_\_\_\_, as trustee of the Survivor's Trust under the D \_\_\_\_\_ Family Trust dated May 22, 1998 (the Survivor's Trust); and
- (3) D \_\_\_\_\_, as trustee of the Trust recorded March 27, 1970 in Ventura County, California as Document No. xxxxx in Book xxxx at Pages xxx-xxx in the Records of the County Recorder (the D \_\_\_\_\_ Trust).

The D Trust, the Survivor's Trust and the Marital Trust shall collectively be referred to herein as the "Dean Trusts."

Your letter references two other trusts that also own cotenancy interests in some of the properties at issue, which you call the C Trust and the C R Trust (together, the Charles Trusts). Because the Charles Trusts are not involved in the proposed transaction, your opinion request only involves those interests held by the Dean Trusts.

### The Properties

The Dean Trusts own collectively 100% of the cotenancy interests in four of the 20 properties at issue. The Charles Trusts are cotenants with all three Dean Trusts in another four of the properties at issue and are cotenants with the Marital Trust and the D Trust on 12 of the properties at issue.

Specifically, the varying cotenancy interests in the 20 properties, identified and numbered in Exhibit "A" to your letter, are as follows:

- (a) For properties numbered 1 through 8, and 12 through 15 (the A Properties), the D Trust owns a 20.444 percent cotenancy interest and the Marital Trust owns a 31.1 percent cotenancy interest; the Survivor's Trust owns no interests and the remaining cotenancy interests are owned together by the Charles Trusts;
- (b) For properties numbered 9, 10, 11 and 20 (the B Properties), the D Trust owns a 20.444 percent cotenancy interest, and both the Survivor's Trust and the Marital Trust each own a 15.55 percent cotenancy interest; the remaining cotenancy interests are owned together by the Charles Trusts;
- (c) For properties numbered 16 and 19 (the C Properties), the D Trust owns a 39.66 percent cotenancy interest, and both the Survivor's Trust and the Marital Trust each own a 30.17 percent cotenancy interest; the Charles Trusts own no interests;
- (d) For properties numbered 17 and 18 (the D Properties), the D Trust owns a 39.66 percent cotenancy interest and the Survivor's Trust owns a 60.34 percent cotenancy interest; the Marital Trust and the Charles Trusts own no interests.

### The Marital Trust

The Marital Trust is irrevocable and D is its sole trustee and sole income beneficiary. As trustee, he does not have a sprinkle power. Upon D's death, the trust corpus will be distributed to his issue.

The Survivor's Trust<sup>1</sup>

The Survivor's Trust is revocable and D is its sole trustee and sole income beneficiary. D has the power to revoke the Survivor's Trust at any time. Upon D 's death, the trust corpus will be distributed to his issue.

The D Trust

The D Trust is irrevocable. D is the sole trustee, is the sole present income beneficiary, and has a special power of appointment in his capacity as beneficiary.

In describing the D Trust's terms, your letter states:

The Trust Agreement provides, in Article IV A, that **the trustee** has a limited power of appointment, which he may exercise during lifetime or at death, to distribute accumulated income or principal of the trust to his children, his spouse, his children's descendants and the spouses of his children, and their descendants. Because the Trust Agreement requires that all trust income be distributed no less frequently than annually to D during his lifetime, the reference to "accumulated income" can only apply to income of the trust that has accrued since the most recent distribution and before D 's death. To the extent this limited power of appointment is not exercised, upon the death of D , the D Trust will terminate and the trust corpus will be distributed to the issue of D . (Emphasis added.)

Specifically, in its Article IV, Distribution of Income and Principal of Trust Estate, the D Trust provides for a special power of appointment as follows:

The Trustee shall hold, manage and distribute the property in the trust estate under the terms and conditions following:

A. The Trustee shall pay to or apply for the benefit of D during his lifetime in monthly or other convenient installments, not less frequently than annually, all of the net income of the trust estate.

In addition, D shall have the unrestricted power to invade the principal of this trust to the extent of Five Thousand (\$5,000.00) Dollars or five (5%) percent of the principal annually, whichever amount is greater. This power shall not be cumulative, but the power with respect to each year shall, if not exercised, lapse on the last day of each calendar year the power is held.

D also shall have the power to invade the principal of this trust to the extent necessary for his education, support in

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<sup>1</sup> We assume that D 's spouse, M D , is deceased because the Survivor's Trust and Marital Trust are in effect.

his accustomed manner of living, his maintenance and his health, together with the expenses of invalidism.

**D also shall have a power of appointment with respect to all or any part of the principal of this trust, and any accumulated income, which he may exercise, either outright or in trust, at his death (provided that his Will specifically makes reference to the existence of this power of appointment) or during his life as he may choose.** Such power shall be limited to appointment among one or more of the group consisting of D's children, his spouse, his children's descendants, and this power of appointment shall on no account be exercised in favor of himself, his estate, his creditors or the creditors of his estate. (Emphasis added.)

We respectfully disagree with your interpretation of the provisions in the D Trust that D, as trustee, has "a limited power of appointment." The explicit language says "D" has this power and when other provisions of the trust give powers to the trustee, as such, the trust specifically refers to "the Trustee." Thus, we interpret the above highlighted provisions from the D Trust as giving to D a special power of appointment in his capacity as the sole present beneficiary of the trust income.

#### The Proposed Transaction

The proposed transaction involves the Dean Trusts transferring all of their cotenancy interests in all 20 properties to a newly formed California limited liability company, LLC (the "Company"). In return, each of the Dean Trusts will receive a membership interest<sup>2</sup> in the Company with an initial capital account balance equal to the aggregate value of the respective cotenancy interest contributed and a percentage interest in profits and losses of the Company based upon the relative value of that trust's capital contribution as compared to the aggregate value of all contributions. The Company's operating agreement provides that income, loss and distributions are to be made pro rata in accordance with each member's percentage interest in the Company.

After the capitalization of the Company with the Dean Trusts' cotenancy interests, the Company would own 100 percent of the four properties previously owned 100 percent by the Dean Trusts (the C Properties and the D Properties), and would be a cotenant with the Charles Trusts of the other 16 properties (the A Properties and the B Properties). In addition, after the capitalization of the Company, according to Exhibit "A" to the draft Company Operating Agreement, the Company ownership interests in capital and profits will be owned 36.86 percent by the Marital Trust, 23.48 percent by the Survivor's Trust, and 39.66 percent by the D Trust.

#### **LAW AND ANALYSIS**

Section 60 of the Revenue and Taxation Code<sup>3</sup> defines a "change in ownership" as a transfer of a present interest in real property, including the beneficial use thereof, the value of

<sup>2</sup> As you know, under California law, the ownership interest in an LLC is called a membership interest. Corp. Code, § 17001, subd. (z). For property tax purposes, the ownership interests in an LLC are represented by the percentage of ownership in both the capital and profits of the LLC. See Rule 462.180, subd. (d)(1)(B).

<sup>3</sup> All section references are to the Revenue and Taxation Code unless otherwise indicated.

which is substantially equal to the value of a fee interest. Change in ownership includes a transfer of any interest in real property between a legal entity and a shareholder, partner, or any other person, unless an exclusion applies. (Rev. & Tax. Code, § 61, subd. (j).) In addition, change in ownership includes transfers of real property into and out of a trust, unless an exclusion applies. (Property Tax Rule<sup>4</sup> 462.160, subd. (a).) Moreover, the termination of a trust, or a portion thereof, results in a change in ownership of any trust real property at the time of such termination. (Rule 462.160, subd. (c).) The lifetime right to income from real property creates a life estate in such property. (See Annotation 220.0364.005 (August 18, 2004).) The transfer of a life estate in real property results in a change in ownership. (See Rule 462.060, subd. (a).) The transfers by the Dean Trusts of the cotenancy interests to the Company could result in a change in ownership under these general provisions, unless an exclusion applies.

As you point out, there is a potential exclusion from change in ownership under the proportional ownership rules. Section 62, subdivision (a)(2), and Rule 462.180, subdivision (b)(2), exclude from change in ownership a transfer of real property between legal entities or between an individual and a legal entity that results solely in a change in the method of holding title and in which the proportional ownership interests in each and every piece of real property transferred remains the same after the transfer.

To determine whether a transfer is proportional for purposes of section 62, subdivision (a)(2), it is necessary to determine who holds the ownership interest before and after the transfer. You correctly point out that section 62, subdivision (a)(2) applies to transfers of interests in real property between individuals and legal entities, and does not specifically mention transfers between trusts and legal entities. We have consistently taken the position that trusts are not considered separate entities for change in ownership purposes. Since trusts are not considered separate entities for this analysis, we determine who has the present beneficial ownership interest in the trust corpus by disregarding the trustee's legal title. This is referred to as "looking through a trust." The party with the present beneficial ownership interest in the trust corpus after looking through the trust is considered the "owner" of the trust property for purposes of section 62, subdivision (a)(2).

#### **Beneficial Owner of the Marital Trust Property**

For change in ownership purposes, the present beneficiary of an irrevocable trust is considered the owner of the present beneficial interest in the trust corpus. (See *Reilly v. City and County of San Francisco* (2006) 142 Cal.App.4th 480; see also Rule 462.160.) Under this rule, as the present beneficiary of a lifetime interest in the income from the trust property, D is considered the owner of the Marital Trust's cotenancy interests.

#### **Beneficial Owner of the Survivor's Trust Property**

For change in ownership purposes, the trustor of a revocable trust is considered to be the owner of the present beneficial interest in the trust property. (See Section 62, subd. (d); Rule 462.160, subd. (b)(2).) Therefore, as the trustor of a revocable trust, D is considered the owner of the Survivor's Trust's cotenancy interests.

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<sup>4</sup> Cal. Code Regs., tit. 18, § 462.180, subd. (b)(2). All rule references are to sections of title 18 of the California Code of Regulations.

**Beneficial Owner of the D Trust Property**

The D Trust provisions require the accumulated income be distributed to D "in monthly or other convenient installments, not less frequently than annually." As discussed above, we interpret this as making D the sole present income beneficiary of the trust property. In addition, in his capacity as sole present income beneficiary, he has a power of appointment to direct the trustee to pay any of the trust principal or accumulated income to certain other named beneficiaries, which includes his children, his spouse, and his children's descendants. As we mentioned above, we respectfully disagree with your interpretation that D has "a limited power of appointment" in his capacity as trustee.

We have taken the position that if a trust beneficiary has a general power of appointment under the terms of the trust, he or she is considered the owner of the trust property. (Annotation 220.0818 (December 26, 1990).) Under California Probate Code section 611, subdivision (a), a power of appointment is "general" only to the extent that it is exercisable in favor of the donee, his estate, his creditors, or the creditors of his estate, whether or not it is exercisable in favor of others, and under subdivision (d), a power of appointment that is not "general" is "special." The D Trust specifically provides that the power of appointment D has is not a general power of appointment. As quoted more fully above, Article IV, Section A of the trust provides that "this power of appointment shall on no account be exercised in favor of himself, his estate, his creditors or the creditors of his estate." Since this power of appointment is not general, the general rule that the trust beneficiary with a general power of appointment is the owner of the trust property is inapplicable here.

Even though D's power of appointment is not general (and thus our interpretation with respect to general powers of appointment is inapplicable here), for property tax purposes we still interpret D as being the sole owner of the trust property because he is the sole *guaranteed* present income beneficiary. Annotation 220.0369 (June 30, 1983) involved the creation of a life estate that could have been defeased if the life tenant failed to personally live at the residence or failed to maintain the property (among other conditions). We opined that the creation of this life estate resulted in a change in ownership (and hence the life tenant was the owner of the property for property tax purposes) in spite of the fact that the life tenant could have lost the estate prior to the end of her life. Similarly, D has a guaranteed right to all of the accumulated trust income, which may be defeased in the future only if he decides to exercise his power to direct the trustee to pay any of the accumulated income, or any portion of the trust principal, to the other named beneficiaries. Thus, as we opined in the annotation with respect to the life tenant, D as the sole guaranteed present income beneficiary of the trust corpus is the owner of the trust for property tax purposes despite the fact that his interest could be subject to defeasance at any time.

Because we conclude that D is the owner of the D Trust for property tax purposes, and therefore D is considered the owner of the D Trust cotenancy interests in the properties at issue, we respectfully disagree with the statement in your letter that D "apparently would not be considered as beneficial owner of 100% of the property in the D Trust because of the limited sprinkle power."

**Section 62, subdivision (a)(2) Proportionality**

Section 62, subdivision (a)(2) requires that the ownership interests remain proportional in each and every piece of real property transferred. Therefore, we analyze whether the cotenancy interests owned by the Dean Trusts prior to their transfers to the Company are proportional to the Dean Trusts' ownership interests in capital and profits of the Company after the transfers.

Before the proposed transaction, D is considered the owner of 100 percent of the Dean Trusts' cotenancy interests for purposes of change in ownership. After the transaction, the Company would own 100 percent of the C Properties and the D Properties, and would be a cotenant with the Charles Trusts of the A Properties and the B Properties. As the owner of all of the Dean Trusts' trust property even after the transaction, D will be considered the owner of 100 percent of the Company ownership interests even though such interests will actually be owned by the Dean Trusts. Accordingly, in our opinion, proportionality under section 62, subdivision (a)(2) in each and every cotenancy interest transferred is satisfied, as long as (as your letter represents): (i) each of the Dean Trusts receives a membership interest in the Company with an initial capital account balance equal to the aggregate value of the respective cotenancy interests contributed and a percentage interest in profits and losses of the Company based upon the relative value of that trust's capital contribution as compared to the aggregate value of all contributions, and (ii) the Company's operating agreement provides that income, loss and distributions are to be made pro rata in accordance with each member's percentage interest in the Company.

D will be an "original co-owner" under section 64, subdivision (d) with respect to the Company ownership interests. Whenever more than 50 percent of the total Company ownership interests are transferred by the Dean Trusts in one or more transactions, a change in ownership will occur with respect to 100 percent of the C Properties and the D Properties, and with respect to the interests in the A Properties and the B Properties the Company owns in cotenancy with the Charles Trusts.

The views expressed in this letter are advisory in nature only; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

*/s/ Matthew F. Burke*

Matthew F. Burke  
Tax Counsel

MFB:cme

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