



STATE BOARD OF EQUALIZATION

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May 27, 1993

Mr.

Dear Mr. :

This is in response to your letter of April 9, 1993, to Mr. Richard Ochsner in which you request our opinion whether the following proposed transaction described in your letter would result in a change in ownership for property tax purposes.

The parties involved in the transaction will be a father who is also a surviving spouse, a daughter, a son, and the testamentary trust created on the death of the mother of the two children.

Under the terms of the trust, the father has a life estate (he is the sole income beneficiary of the trust for his lifetime) with the remainder being divided equally by the children as remaindermen on his death.

Previously the father and daughter purchased as joint tenants a residence from a third party. The daughter currently occupies the residence.

The proposal is for the father and daughter to transfer the residence into the trust that was created by the deceased spouse of the father. The market value of the residence is \$220,000. There is a deed of trust against the residence which secures a note with a balance due of \$50,000.

The purpose of the proposed transaction is to place the residence into the trust in order to cancel a debt owed to the trust by the father and to provide a method for the payment of the loan on the residence since the daughter is only a part-time employee for this period during which she is provided a home for her infant child.

In this regard, the daughter is to receive a note from the trust for her equity in the residence which will be used to offset her rental obligation.

Revenue and Taxation Code¹ section 60 defines "change in ownership" to mean "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."

Section 61 provides in relevant part that "[e]xcept as otherwise provided in section 62, change in ownership as defined in section 60, includes, but is not limited to: ... (d) [t]he...transfer, or termination of any joint tenancy interest.... (f) [a]ny vesting of the right to possession or enjoyment of a remainder...interest which occurs upon the termination of a life estate or other similar precedent property interest.... [and] (i) [t]he transfer of any interest in real property between a...legal entity...or any other person."

Section 62, however, provides in relevant part that "[c]hange in ownership shall not include... (d) [a]ny transfer by the trustor...into a trust for so long as (1) the transferor is the present beneficiary of the trust...."

The Board has interpreted section 60, 61² and 62 as they relate to trusts in Property Tax Rule 462(i).

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

²Rule 462(i) provides in relevant part:

(1) Creation. Except as is otherwise provided in subdivision (2) the transfer by the trustor, or any other person, of real property into a trust is a change in ownership of such property at the time of the transfer.

(2) Exceptions. A transfer to a trust is not a change in ownership upon the creation of or transfer to a trust if:

(A) Trustor-Transferor Beneficiary Trusts. The trustor-transferor is the sole present beneficiary of the trust; provided, however, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor are present beneficiaries of the trust.

None of the foregoing provisions reflect the effects of Proposition 58. As you know, Proposition 58 amended Article XIII A of the California Constitution to provide among other things that the terms "purchase"³ and "change in ownership" do not include the purchase or transfer of the principal residence and the first \$1 million of the full cash value of other real property between parents and children. Section 63.1 is the implementing legislation for Proposition 58. For purposes of the parent-child exclusion, a "transfer" is defined by section 63.1(c)(7) to include "any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust."

Since the transfer into the trust involves a transfer of an interest in real property by both the father and the daughter, the consequences of the proposed transaction must be analyzed from the standpoint of each person.

(B) Revocable Trusts. The transfer of real property or an ownership interest(s) in a legal entity by the trustor(s) to a trust which is revocable by the trustor(s); provided, however, a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or becomes the sole present beneficiary.

(C) Trustor Reversion Trusts. The trustor-transferor retains the reversion, and the beneficial interest(s) of person(s) other than the trustor-transferor does not exceed 12 years in duration.

(D) Interspousal Trusts. The exemption afforded interspousal transfers is applicable; provided, however, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor's spouse are beneficiaries of the trust.

(E) Proportional Interests. The transfer is to a trust which results in the proportional interests of the beneficiaries in the property remaining the same before and after the transfer.

(F) Other Trusts. The transfer is from one trust to another and meets the requirements of (A), (B), (C), (D), or (E).

³The term "purchase" is defined by section 67 to mean "a change in ownership for consideration."

Since the father is the sole income beneficiary of the trust for his lifetime, he is the sole present beneficiary of the trust. The only other beneficiaries are the daughter and the son who, as remaindermen, hold future rather than present interests in the trust. The transfer by father of his interest in the real property would, therefore, be excluded from change in ownership under section 62(d) and Property Tax Rule 462(i)(2)(A) as a transfer into a trust in which the transferor is the sole present beneficiary of the trust.

Although the daughter's transfer of her interest in the residence would not be excluded by section 62(d) or Rule 462(i), it would nevertheless be excluded under section 63.1 (subject to its requirements and limitations) as a transfer between a child and a parent through the medium of a trust because her father, as a result of the transfer, would receive present beneficial ownership for life in the real property interest transferred into the trust by the daughter. (§63.1(c)(7); see also Allen v. Sutter County Board of Equalization (1983) 139 Cal.App.3d 887, 890.)

The father, as transferee, would, of course, have to file a timely claim with the assessor as required by section 63.1(d) in order to obtain the exclusion.

Thus, assuming a timely claim is filed and subject to the limitations contained in section 63.1, there would be no change in ownership as a result of the transfer of the residence into the trust by the father and daughter.

At the death of the father, there would be, but for the application of section 63.1, a change in ownership as to the interest he transferred into the trust under section 61(f). Since the right of possession in that interest will vest in either the daughter or son or both at father's death, the parent-child exclusion will be applicable at that time subject to the requirements of section 63.1. The interest transferred by the daughter, however, would not be excluded from change in ownership under section 63.1 or any other provision. There would be, therefore, a change in ownership under section 61(f) as to that one-half interest in the residence at the time of the father's death.

As discussed in our recent telephone conversation, however, we believe the result would be different if, as an alternative, the father first purchased the daughter's interest in the residence. Such purchase would be excluded under section 63.1 as a parent-child purchase or transfer providing a timely claim is filed by the father. To be timely under section 63.1(d), we

believe the claim should be filed prior to the father's transfer to the trust. The father's subsequent transfer of his total interest in the residence into the trust would be excluded from change in ownership under section 62(d) and Property Tax Rule 462(i)(2)(A) as explained above. The transfer of the property occurring on father's death would be excluded under section 63.1 as a transfer from parent to children subject to timely claim filing and other requirements of section 63.1.

Since this alternative involves one more step than the first alternative and produces a more favorable tax result, a question arises as to the applicability of the step-transaction doctrine. Section 63.1 was added by Statutes 1987, chapter 48, section 1, pages 121-123. Section 2 of that legislation is not codified but provides in relevant part at pages 123-124 that:

It is the intent of the Legislature that the provisions of Section 63.1 of the Revenue and Taxation Code shall be liberally construed in order to carry out the intent of Proposition 58 on the November 4, 1986, general election ballot to exclude from change in ownership purchases or transfers between parents and their children described therein. Specifically, transfers of real property from a corporation, partnership, trust, or other legal entity to an eligible transferor or transferors, where the latter are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, shall be fully recognized and shall not be ignored or given less than full recognition under a substance-over-form or step-transaction doctrine, where the sole purpose of the transfer is to permit an immediate retransfer from an eligible transferor or transferors to an eligible transferee or transferees which qualifies for the exclusion from change in ownership provided by Section 63.1. Further, transfers of real property between eligible transferors and eligible transferees shall also be fully recognized when the transfers are immediately followed by a transfer from the eligible transferee or eligible transferees to a corporation, partnership, trust, or other legal entity where the transferee or transferees are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, if the transfer between eligible transferors and eligible transferees satisfies the requirements of Section 63.1. Except as provided herein, nothing in this section shall be construed as an expression of intent on the part of the Legislature disapproving in principle the appropriate application

May 27, 1993

of the substance-over-form or step-transaction doctrine."

Since the alternative proposal falls squarely within the second example quoted above, all of the steps would be fully recognized for property tax purposes and neither the substance-over-form nor the step-transaction doctrine would be applicable in our view.

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.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

Very truly yours,



Eric F. Eisenlauer
Senior Tax Counsel

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cc: Mr. John Hagerty
Mr. Verne Walton