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October 10, 2012

Re: Application for Parent-Child Exclusion: Family Trust
Assignment No.: 12-126

Dear Mr. :

This is in response to your May 25, 2012 letter regarding an exclusion from reassessment for a transfer of real property held by the Family Trust from a parent to a child. As explained below, it is our opinion that a 50 percent change in ownership of the subject real property should be excluded from reassessment.

Factual Background

On May 15, 1991, Charles (Charles) and Phyllis (Phyllis), husband and wife, executed the Family Trust (Trust), as both trustors and trustees. The Trust provided that upon the death of either trustor, survived by the other trustor, the trustee would divide the trust estate into two shares, Trust A and Trust B. Trust A was to consist of certain designated property, and Trust B was to consist of the balance of the trust estate.

Paragraph 2.5.2 of the Trust provides that the surviving trustor was to "have the absolute power . . . to appoint any part of the principal and any undistributed income of TRUST A in favor of himself, his estate or any person." Paragraph 3.3 of the Trust provides that "Upon the death of either Trustor, this trust shall become irrevocable and may not be subject to alteration or amendment except as may be provided under the terms of TRUST A." Additionally, paragraph 5.3 of the Trust provides that "[i]ncome accrued or held undistributed by the Trustee at the termination of any interest or estate under this trust shall go to the beneficiaries entitled to the next eventual interest in the proportions in which they take such interest This provision shall not apply to TRUST A."

Charles died on August 21, 1995, and the assets of the Trust estate were divided into Trust A and Trust B.

On September 22, 2009, Phyllis, as surviving trustor, executed a Notice of Exercise of Power of Appointment, stating that she appointed "at the time of [her] death the entire principal and undistributed income of Trust A" as follows:

1. The real property located at _____ Lane, _____, California (subject property) to be distributed as follows:
 - a. 50 percent to her daughter, N _____ H _____ (Ms. H _____), and
 - b. 50 percent to her granddaughter, N _____ P _____, and her grandson, D _____ H _____. (N _____ P _____ and D _____ H _____ are the children of Charles and Phyllis' predeceased daughter and son-in-law, P _____ H _____ and J _____ H _____.)
2. The residue of Trust A was to be distributed to Ms. H _____.

Phyllis died on March 13, 2011.

On October 21, 2011, Ms. H _____, as successor trustee of the Trust, entered into a Distribution Agreement (Agreement) with herself, N _____ P _____, and D _____ H _____. The Agreement stated that the assets of Trust A consisted of the subject property worth \$1,800,000, subject to an encumbrance of \$450,000, a _____ investment account worth approximately \$500,000, and a cash account worth approximately \$450,000.

According to the Agreement, the assets listed above were to be distributed as follows:

1. To N _____ H _____ : _____ Lane, _____, California.
2. To N _____ P _____ : cash and securities in the sum of \$450,000.
3. To D _____ H _____ : cash and securities in the sum of \$450,000.
4. The remainder of Trust A to be distributed to N _____ H _____.

Ms. H _____ filed a Claim for Reassessment Exclusion for Transfer Between Parent and Child for the subject property. The Assessor for the County of San Diego approved the application for the parent-child exclusion only for Ms. H _____'s 50 percent portion in accordance with Phyllis' exercise of her power of appointment, on the grounds that the Trust limited the trustee's discretionary powers to distribute the assets listed in the power of appointment, and that the current distribution is based on an agreement among the beneficiaries and not pursuant to provisions of the now irrevocable Trust. The Assessor stated that this was a transfer from niece/nephew to aunt, for which there is no exclusion available.

You requested our opinion on this matter, stating that the Trust instrument did not limit the use of a distribution agreement, and that the distribution agreement and the application for the exclusion carry out the public policy supporting the exclusion from reassessment of transfers from parent to child.

As explained below, we believe the exclusion should apply to Ms. H _____'s 50 percent portion of the property because such transfer was specifically set forth by Phyllis in the exercise of her power of appointment, which must be given effect before the distribution agreement.

Law and Analysis

Section 60 of the Revenue and Taxation Code¹ 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 equivalent to the value of the fee interest. Section 63.1, which implements the parent-child and grandparent-grandchild exclusions, excludes from change in ownership the transfer, between parents and children, and grandparents and grandchildren, of any number of principal residences and the first \$1 million of full cash value of other real property. (Rev. & Tax. Code, § 63.1, subd. (a)(1) and (2).)

An eligible parent-child or grandparent-grandchild transfer includes, but is not limited to, 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. (Rev. & Tax. Code, § 63.1, subd. (c)(9).)

The administration of a trust is governed by the trust instrument. (*Union Bank and Trust Co. v. McColgan* (1948) 84 Cal.App.2d 208.) Probate Code section 21102, subdivision (a) provides that, in construing a trust or other dispositive instrument, "the intention of the transferor as expressed in the instrument controls the legal effect of the dispositions made in the instrument." Thus, the trust instrument controls unless a court, pursuant to Probate Code section 16201, relieves the trustee of the restriction in the instrument.

In this instance, Phyllis was given a general power of appointment over the property in Trust A. The exercise of a general power of appointment is a change in ownership unless an exclusion applies and the holder of the power is considered the transferor. (Property Tax Annotation² (Annotation) 220.0818 (December 26, 1990).) In 2009, Phyllis executed a document exercising her power of appointment, effective upon her death, giving the subject property to Ms. H and N P and D H. Therefore, when Phyllis died, the property transferred to Ms. H, N P and D H and a change in ownership occurred, absent any exclusion.

Unless the trust instrument states otherwise, non pro rata distributions can be made. (Letter to Assessors (LTA) 91/08, (January 23, 1991); Annotation 625.0235 (September 10, 1996).) In that case, the trustee is not required to give the beneficiaries common ownership in all the assets of the trust (pro rata), but may allocate certain specific assets to some beneficiaries and not to others (non pro rata). (Annotation 625.0235.020 (December 16, 2009).) We have advised that so long as there are sufficient trust assets to equalize the distributions to all other beneficiaries, the trustee may distribute real property to an eligible transferee and other assets to other beneficiaries, and the transfer to the eligible transferee will be deemed directly from the trustor and entirely excluded from reassessment under section 63.1. (LTA 91/08.)

What differentiates this situation from a share and share alike provision described above, however, is that the document exercising Phyllis' power of appointment states that a specific

¹ All further statutory references are to the California Revenue and Taxation Code, unless otherwise specified.

² Property tax annotations are summaries of the conclusions reached in selected legal rulings of State Board of Equalization counsel published in the State Board of Equalization's Property Tax Law Guide. (See Cal. Code Regs., tit. 18, § 5700 for more information regarding annotations.)

parcel of real property, the subject property, was to be divided among the three beneficiaries in specific percentages, and that the residue of the Trust assets was to be distributed to Ms. H . Based on the specific percentage allocations of a specific property to three particular individuals, it is our opinion that Phyllis intended to make a specific gift of the subject property. (Prob. Code, § 21117, subd. (a).) A recipient of a specific gift has the rights to the property as of the time of the transfer. (Prob. Code, § 21133.) Further, once property becomes distributable pursuant to a power of appointment, the exercise of the power of appointment becomes irrevocable. (Prob. Code, § 695, subd. (b).) Therefore, at the time of Phyllis' death on March 13, 2011, Ms. H was the 50 percent present beneficial owner of the subject property, and N P and D H were the other 50 percent beneficial owners.

A change in ownership of the property occurred at that time. We assume the transfers would be eligible for the parent-child exclusion and the grandparent-grandchild exclusion if claims were timely filed. The subsequent Agreement to distribute the subject property entirely to Ms. H would result in a transfer of a 50 percent interest in the property from N P and D H to Ms. H . Since no exclusion applies to niece/nephew to aunt transfers, the 50 percent interest must be reassessed. (Rev. & Tax. Code, § 65.1; Annotation 625.0216 (February 21, 1989); LTA 2008/018 (February 29, 2008) at p.12, Question 37.)

Your letter states that although the San Diego Assessor states that the Trust instrument limited the beneficiaries from entering a distribution agreement, you believe the Trust instrument did not limit the use of a distribution agreement. However, paragraph 3.03 of the Trust states that upon Charles' death, the Trust became irrevocable and was not subject to alteration or amendment except under the terms of Trust A. The terms of Trust A provide in paragraph 2.5.2 that the surviving spouse, Phyllis, was to have "absolute power" to distribute the assets in Trust A. Additionally, paragraph 5.3 of the Trust provides that even if some accrued income were to be proportionately distributed to the next eventual beneficiary, such distribution scheme was distinctively not to be applied to Trust A, presumably because of the specific instructions already in place for Trust A.

Phyllis then went on to grant a specific distribution of the assets in Trust A, pursuant to the general power of appointment granted to her in paragraph 2.5.2. As stated above, her intentions as trustor, as expressed in the exercise of her power of appointment, control the legal effect of the dispositions. (Prob. Code, § 21102, subd. (a).) Further, Probate Code, section 21120 states that "the words of an instrument are to receive an interpretation that will give every expression some effect, rather than one that will render any of the expressions inoperative." Additionally, Probate Code, section 21121 states that "all parts of an instrument are to be construed in relation to each other and so as, if possible, to form a consistent whole." Thus, although the Trust instrument does not preclude the beneficiaries from entering into an independent distribution agreement, it grants no authority for such an agreement among the beneficiaries to override the trustor's exercise of her power of appointment according to the original Trust terms. Any distribution agreement would have to take effect after the terms of the power of appointment have been met.

Because Phyllis specifically distributed the real property in Trust A half to her daughter and half to her two grandchildren, and distributed the cash and securities in the Trust to Ms. H , there is no indication that Phyllis intended to give the trustee the authority to override these bequests; and beneficiaries may not unilaterally modify the terms of the trust,

except upon petition to the court, even if the beneficiaries are in agreement. (See Prob. Code, §§ 15403, subd. (a), 15409, subd. (a).)

Finally, you state that the Distribution Agreement carries out the public policy supporting the parent-child exclusion from reassessment. However, any such policy cannot be interpreted in such a manner as to be directly contradictory to the statutory and case law described above, which mandates that the administration of a trust be governed by the trust instrument.

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

Sincerely,

/s/ Sonya S. Yim

Sonya S. Yim
Tax Counsel III (Specialist)

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cc: Ms.

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