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October 27, 2010

Ms.
Assessment Manager
San Luis Obispo County Assessor's Office
County Government Center
1055 Monterey St., Ste. D360
San Luis Obispo, CA 93408

Re: Community Property and R&T 62(a)(2) Transfer Question
Assignment No.: 10-068

Dear Ms. :

This is in response to the first question from your letter to the State Board of Equalization's Legal Department dated April 14, 2010, wherein you requested our opinion regarding legal entity interests owned as community property. As explained below, it is our opinion that interests in any type of legal entity may be owned either as separate property or community property, and that interests owned in the name of one spouse are presumed to be separate property unless it is shown by clear and convincing evidence that the spouses intended to hold the interests as community property.

Factual Background

In your letter you ask the following questions to assist you in determining the treatment of legal entity interests held by spouses for the purposes of Revenue and Taxation Code, section 62, subdivision (a)(2):

> What role does community property play in proportional distributions into and out of legal entities?
>
> First, there are at least two annotations that identify corporations as a separate legal entity, and in which shares held by one spouse can not be considered community property of the other spouse. Therefore, if, for example, the shares in a corporation are owned solely by wife, and the corporation distributes to both the husband and wife, the transfer is not proportional, and there is a 100% reassessment. [See Annotations 220.0278, 220.0267]
>
> Both of these annotations qualify the statements regarding community property by saying that the interest *could* be considered community property interest if the presumption of the stock vesting is rebutted by 'clear and convincing evidence.' Federal tax returns, joint possession, joint collection of rents, and affidavits by the spouses are not considered 'clear and convincing evidence.' What would be some

documentary examples of 'clear and convincing evidence' that would rebut the presumption, and would show the interest in the corporation was actually community property?

The letter dated May 14, 1993 states in part:

> Thus, the Declaration of ownership signed under penalty of perjury by Wife and the incorporation forms filed by Wife are conclusive evidence of the existence of the corporation. (15 Cal.Jur. III, Corporations, Section 80.) The corporate entity may be disregarded only when two conditions are met: 1) where there is such a unity of interest and ownership that the separate personalities of the corporation and individual no longer exist; and 2) where the failure to disregard the corporate entity results in a grave injustice to a third party.

Are there any documents that assessment staff could accept that would satisfy either of these two conditions, or must such a decision be made by a judge?

Second, in a partnership (and LLC?), interest may be held by one spouse, but may be either separate or community property interest. So, for example, a transfer from a partnership held by A, B, and C as individuals, may be distributed to A and spouse, B and spouse, and C and spouse, and might be considered proportional. This would assume that A, B, and C owned their partnership interests as community property. [Annotations 220.0388, 220.0483, 220.0505] However, this may not always be the case. [Annotation 220.0274, 220.0279]

Based on these various annotations, it appears that interest held by a spouse in a corporation is not community property, so that transfers into and out of a corporation must always be proportional. However, for a partnership, LLC, and other legal entity, interest held by a spouse in his/her individual name may be either separate or community interest. Is this correct?

If this is true, what documents should assessment staff request to document whether interest in a non-corporate legal entity is either separate or community property for purposes of determining proportionality? A complete discussion of the community property interest in a non-corporate legal entity would be very helpful, as well as what questions we should be asking and/or what assumptions we can make based on normal entity agreements and/or statements.

Law & Analysis

Except as otherwise provided by statute, all property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in California is community property. (Fam. Code, § 760.) The definition of "community property" in the Family Code includes all types of real and personal property, including interests in limited liability companies, partnerships and corporations.

During the marriage, each spouse has a present, existing and equal interest in community property. (Fam. Code, § 751.) Either spouse may exercise management and control of community property. (Fam. Code, §§ 1100, subd. (a); 1102, subd. (b).) Typically, both spouses are identified on the deed or other instrument as holding the property as community property. However, in some cases, during the course of a marriage property is acquired in the name of only one spouse without reference to the other spouse.[1] This implicates the deed presumption, i.e., that the owner of the legal title to property is presumed to be the owner of the full beneficial title unless rebutted by clear and convincing evidence. (Evid. Code, § 662.) The interplay between these two presumptions is discussed in *In re Marriage of Brooks & Robinson* (2008) 169 Cal.App.4th 176, 186-187:

> The relationship between the general community property presumption and the form of title presumption was discussed in *In re Marriage of Lucas* (1980) 27 Cal.3d 808 [Citation]. The *Lucas* court stated: 'The presumption arising from the form of title is to be distinguished from the general presumption set forth in [Family Code section 760] that property acquired during marriage is community property. *It is the affirmative act of specifying a form of ownership in the conveyance of title that removes such property from the more general presumption*'. [Citation.]. . . Thus the mere fact that property was acquired during marriage does not. . . rebut the form of title presumption; to the contrary, the act of taking title to property in the name of one spouse during marriage with the consent of the other spouse effectively removes that property from the general community property presumption. In that situation, the property is presumably the separate property of the spouse in whose name title is taken.

Therefore, the specific title presumption overrules the general community property presumption and property that is acquired in the name of one spouse is presumed to be separate property of that spouse. As explained above, the separate property presumption can be rebutted by clear and convincing evidence that there was an agreement or understanding between the spouses that the property was to be held as community property. (Evid. Code § 662; *In re Marriage of Brooks & Robinson*, *supra*, 169 Cal.App.4th 176, 189.)

The courts define "clear and convincing proof" as evidence "so clear as to leave no substantial doubt in the mind of the trier of fact," and as evidence "sufficiently strong to command the unhesitating assent of every reasonable mind." (*Tannehill v. Finch* (1986) 188 Cal.App.3d 224, 228; *Lillian F. v. Superior Court* (1984) 160 Cal.App.3d 314, 320; *Sheehan v. Sullivan* (1899) 126 Cal. 189, 193.)

Property Tax Rule[2] (Rule) 462.200, subdivision (b) interprets Evidence Code, section 662 in the context of determinations made by county assessors. Subparagraphs (1) and (2) of subdivision (b) describe examples of extrinsic types of evidence that rebut the presumption of ownership:

> (b) Deed presumption. When more than one person's name appears on a deed, there is a rebuttable presumption that all persons listed on the deed have

[1] This letter addresses the acquisition of property by a spouse from a third party, and not transmutation of community property, which is a separate issue governed by different rules.

[2] References to "Property Tax Rules" or "Rules" are section references to title 18 of the California Code of Regulations.

ownership interests in property, unless an exclusion from change in ownership applies.

In overcoming this presumption, consideration may be given to, but not limited to, the following factors:

(1) The existence of a written document executed prior to or at the time of the conveyance in which all parties agree that one or more of the parties do not have equitable ownership interests.

(2) The monetary contribution of each party. The best evidence of the existence of any factor shall be an adjudication of the existence of the factor reflected in a final judicial finding, order, or judgment. Proof may also be made by declarations under penalty of perjury (or affidavits) accompanied by such written evidence as may reasonably be available, such as written agreements, canceled checks, insurance policies, and tax returns.

In the case of *In re Marriage of Brooks & Robinson*, *supra*, 169 Cal.App.4th 176, 190-191, the Court found that the husband failed to provide clear and convincing evidence of an agreement to hold the property as community property:

Brooks testified that the money used for the downpayment toward the purchase price came from his employment earnings and that Robinson did not contribute money toward the purchase. As stated above, however, the form of title presumption cannot be overcome by simply tracing the source of the funds used to purchase the property. He further testified that he believed the Property belonged to him and Robinson. Such a unilateral belief, however, is likewise insufficient to establish the existence of an agreement or understanding between the spouses as to ownership of the Property. There is no evidence in the record that Robinson held a similar understanding regarding ownership of the property. Indeed, Robinson's subsequent sale of the Property to ECG without seeking Brooks's consent indicates that she understood that the Property was her separate property.

Brooks is not helped by his testimony that the purpose of taking title in Robinson's name was to facilitate financing for the Property. This merely explains why Brooks was willing to allow Robinson to have sole title to the Property. Having a reason for allowing title to be taken solely in Robinson's name does not diminish the inference that the parties intended the Property to be Robinson's separate property. Indeed, it supports the conclusion that the form of title was not inadvertent, but rather that the parties expressly intended such a result. Most significantly, the proffered reason does not constitute evidence of an agreement between the spouses that the Property be community property.

Based on the Court's analysis, the presumption of Evidence Code, section 662 may not be rebutted simply because the spouse not named on the deed believed that the property was community property, especially where the other spouse sold the property without consulting the spouse not named on the deed. Further, the presumption cannot be rebutted solely by evidence

that title was taken in a particular manner merely to obtain a loan, or by evidence that the funds used to purchase the property were community funds.

We note that whether the presumption is rebutted is ultimately a factual determination which must be made by the county assessor based upon the evidence submitted for his or her review. With regards to ownership interests in legal entities acquired during the course of a marriage in the name of one spouse only, it is our opinion that clear and convincing evidence establishing that the spouses intended to hold the legal entity interests as community property is required to rebut the presumption that the interests are separate property. As explained above, spouses have a present, existing and equal interest in community property and either spouse may exercise management and control of community property. (Fam. Code, §§ 751, 1100, subd. (a), 1102, subd. (b).) Therefore, the assessor should request evidence of the intent that each spouse had an equal interest in the legal entity interests and that each spouse had the power of management and control over the interests, or that the power of management and control was specifically delegated to or relinquished by one of the spouses. This should be shown by documentary evidence such as the examples listed in Rule 462.200, subdivision (b), particularly contemporaneous written agreements, corporate records, tax returns, etc.

The backup letter to Property Tax Annotation (Annotation) 220.0278, dated May 14, 1993, addressed a situation where a husband and wife contributed community real property to a corporation wholly owned by the wife. It was our opinion that the spouses failed to produce clear and convincing evidence that the voting stock of the corporation was intended to be held as community property, despite the fact that the husband and wife both continued in possession of the condominium; continued to collect rent on the property; continued to treat the property as their own for income tax purposes; and continued to pay the property taxes and other property expenses. Though some of these factors fall in the category of proof that may constitute clear and convincing evidence, it was our opinion that the totality of the evidence was insufficient. While the backup letter to Annotation 220.0278 did not expound on its analysis, it appears that the evidence presented related to the use of the real property, and did not sufficiently indicate an agreement that the voting stock specifically was intended to be community property. Also, the evidence was not prior to or contemporaneous with the transfer of the property to the corporation.

Furthermore, the May 14, 1993 letter also indicated that the husband and wife were attempting to deny the existence of the corporation. It is our opinion that it is not necessary to disregard the corporate entity to determine that voting stock held in the name of one spouse is community property. As explained above, the presumption is overcome by clear and convincing evidence of an agreement to hold the stock as community property.

The above analysis is consistent with our previous opinions, including our advice contained in Annotation 220.0040. That annotation explained two precepts: 1) in the event that spouses obtain legal entity interests as community property, then each spouse has ownership of one-half of the interests, and 2) the fact of marriage cannot be used to attribute ownership of one spouse's community property interest to that of the other so as to find that one spouse has directly or indirectly acquired more than 50 percent ownership in a legal entity. Therefore, if husband is the record owner of 100 percent of the voting stock of a corporation, but the deed presumption has been overcome and it has been established that he and his wife intended to own the stock as community property, then husband and wife are each considered owners of 50 percent of the stock. The fact that they are married cannot be used to attribute one spouse's interest to the other

to find that either has control of the entity. The transfer of real property to such a corporation will be proportional for the purposes of Revenue and Taxation Code, section 62, subdivision, (a)(2) if, prior to the transfer, the husband and wife owned the property as community property or otherwise were equal co-owners.

If, on the other hand, a spouse is the record owner of 100 percent of the voting stock of a corporation and the deed presumption has not been rebutted, a transfer of community real property to that corporation is not proportional and will result in a change in ownership pursuant to section 61, subdivision (j). Similarly, a transfer of property from the corporation to the spouses as community property or other co-equal joint ownership will result in a change in ownership. The interspousal exclusion will also not apply in either case since the transfers are not between spouses, but rather between individuals and legal entities. (Annotations 220.0274, 220.0278.)

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, and are not binding on any person or public entity.

Sincerely,

/s/ Daniel Paul

Daniel Paul
Tax Counsel

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