



STATE BOARD OF EQUALIZATION

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August 13, 2013

**Re: Request for Opinion on Reassessment
Assignment No.: 13-012**

Dear Ms. :

This is in response to your letter requesting an advisory opinion concerning whether the transfer of real property to an irrevocable trust constitutes a change in ownership. As explained below, it is our opinion that the transfer will result in a change in ownership.

Factual Background

Husband dies, survived by his wife and three children, but no grandchildren. California commercial real estate is transferred into a trust titled the Exempt Family Trust.¹ As of the date of transfer, there remain three children and no grandchildren. The relevant terms of the Exempt Family Trust provide:

1(a) During the survivor's life, the trustee shall pay to any one or more of the survivor and our descendants so much or all of the income and principal in such proportions as from time to time is necessary for their respective support, health and education, giving priority to the survivor. In addition, during the survivor's life, the trustee shall pay to any one or more of the survivor and our descendants so much or all of the income and principal in such proportions as the independent trustee, if any, from time to time decides is advisable for their respective best interests and welfare, giving priority to the survivor. It is our wish, without imposing any legal obligation, that payments to our children and their respective descendants pursuant to the immediately preceding sentence be made equally so that each child (and their respective descendants) receives an equal share of the trust property.

You ask 1) whether the transfer of real estate into the Exempt Family Trust qualifies for the parent-child exclusion and 2) whether reassessment will be triggered as of the date of birth of a grandchild even if the trustee never makes any distributions to such grandchild.

¹ Although your letter does not state, we assume that the trust is irrevocable.

Law & Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a change in ownership. A change in ownership is defined in Revenue and Taxation Code² section 60 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."

Proposition 58, approved by the voters on November 4, 1986, added subdivision (h) to section 2 of article XIII A of the California Constitution. Subdivision (h) provides, in part, that the terms "purchased" and "change in ownership" shall not include the purchase or transfer between parents and their children of either a principal residence or the first \$1 million of the full cash value of all other real property.

Section 63.1 provides the statutory implementation of Proposition 58. Subdivision (a)(1)(A) of section 63.1 states that a change in ownership shall not include "The purchase or transfer of real property which is the principal residence of an eligible transferor in the case of a purchase or transfer between parents and their children." The term "transfer" is defined in subdivision (c)(9) of section 63.1 as "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."

A trust provision which gives the trustee total discretion to distribute the trust income or property to a number of potential beneficiaries is called a "sprinkle or spray power." When a trust contains a sprinkle or spray provision, all of the persons included as beneficiaries under that provision must have an exclusion in order to avoid a change in ownership and reassessment. If even one person included as a beneficiary is not excludable, then 100 percent of the trust property is subject to change in ownership. (Property Tax Annotation³ (Annotation) 625.0236 (July 18, 2001); Annotation 220.0821 (July 22, 2002).)

This principle is described in Property Tax Rule⁴ (Rule) 462.160, subdivision (b)(1)(A) as follows:

Where a trustee of an irrevocable trust has total discretion ("sprinkle power") to distribute trust income or property to a number of potential beneficiaries, the property is subject to change in ownership, because the trustee could potentially distribute it to a non-excludable beneficiary, unless all of the potential beneficiaries have an available exclusion from change in ownership.

Thus, a trust which provides that the trustee may exercise a sprinkle power to a group of beneficiaries that includes some persons to whom exclusions are available and some to whom no exclusions are available is treated as though no exclusions were available. This is because the trustee may distribute any or all income to some beneficiaries and omit other beneficiaries. (Annotation 625.0236 (July 18, 2001).)

² All section references are to the Revenue and Taxation Code unless otherwise specified.

³ 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.)

⁴ All references to Property Tax Rules are to sections of title 18 of the California Code of Regulations.

According to your letter, the current "descendants" apparently only consist of husband and wife's direct children. However, naming "descendants" as potential beneficiaries grants the trustee power to potentially transfer trust assets to a non-excludable beneficiary since the term "descendants" could include grandchildren that do not qualify for the grandparent-grandchild exclusion. Annotation 220.0821 analyzes a trust provision similar to the one at issue here. In that annotation, a trust provided a trustee power to sprinkle income or principal to any present or future descendants of the trustor. Because the class of potential beneficiaries included beneficiaries not excludable under the parent-child or grandparent-grandchild exclusion, it opined that pursuant to Rule 462.160, subdivision (b)(1)(A), a change in ownership occurred at the time of trustor's death. We also note that Annotation 625.0236 states that if the trust provided that any beneficiary, present or future, could receive trust income or income and principal, a change in ownership of all of the trust property would occur. (Annotation 625.0236 (July 18, 2001) at p. 4.)

In this case, since the group of beneficiaries potentially includes some persons to whom exclusions are available and some to whom no exclusions are available, there is no guarantee that the property will be transferred to excludable beneficiaries. Therefore, pursuant to Rule 462.160, subdivision (b)(1)(A), and Annotations 220.0821 and 625.0236, it will be treated as though no exclusions were available, and the entire portion of the trust property that was transferred into the Exempt Family Trust should be reassessed at the time of transfer into the Exempt Family Trust. Because the reassessment occurs at the time of the transfer, there will be no additional reassessment when any grandchildren are born.

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. Should you have any additional questions, please feel free to contact me.

Sincerely,

/s/ Daniel Paul

Daniel Paul
Tax Counsel III (Supervisor)

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