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June 6, 2006

Re: Section 69.5 Base Year Value Transfer of Life Estate Interest in Real Property

Dear Mr. _____ :

We apologize for the delay in responding to your correspondence dated May 31, 2005, regarding the property tax consequences of certain transactions involving a life estate interest in real property. You ask whether the transfer of a life estate interest in real property from a husband to a wife, upon his death, constitutes a "change in ownership" that is subject to reassessment. As discussed in detail below, we conclude that the grant of the life estate interest by husband to his wife does not constitute a change in ownership. You also ask whether the wife can transfer the base year value of a 90 percent interest in real property to a replacement property. We further conclude that the wife can transfer the base year value of her life estate to a replacement property.

Background and Facts

According to your letter, husband (H) owned a property which was used as the principal residence for H and his wife (W). H transferred an undivided 10 percent interest in that principal residence to his children prior to his death. Upon his death, the remaining 90 percent interest in the principal residence (Y) was placed in an irrevocable trust for the benefit of W for life. The remainder interest in Y was left to H's children.

Applicable Law and Analysis

1. Whether H's creation of a life estate for W upon his death constitutes a change in ownership of the property that is subject to reassessment.

A change in ownership occurs upon the 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. (Rev. & Tax. Code, § 60.) The transfer of real property by a trustor to an irrevocable trust is a change in ownership unless the trustor is the sole present beneficiary of the trust or the transfer is otherwise excluded from the definition of change in ownership. (Cal. Code Regs., tit. 18, § 462.160, subd. (b)(1)(A).) Furthermore, the creation of a life estate interest

in real property constitutes a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse.

(Cal. Code Regs., tit. 18, § 462.060, subd. (a).) Thus, the holder of a life estate is the beneficial owner of the real property for property tax purposes. (Property Tax Annotation 200.0075.) Finally, a change in ownership does not include an interspousal transfer of real property which takes effect upon the death of a spouse. (Rev. Tax. Code, § 63, subd. (b).)

In this case, our understanding is that H transferred Y to an irrevocable trust for the benefit of W for life upon his death. Since the trust created a life estate interest in Y for the benefit of W, H's spouse, no change in ownership results. (See also Cal. Code Regs., tit. 18, § 462.060, subd. (a).) Additionally, since the transfer of the life estate from H to W occurs between spouses upon H's death, the transfer is excluded from the definition of change in ownership as an interspousal transfer. (See Rev. & Tax. Code, § 63.) Therefore, H's transfer of a life estate to W upon his death does not constitute a change in ownership.

2. Whether W can transfer 100 percent of the base year value of her principal residence to a replacement property.

Article XIII A, section 2, subdivision (a) of the California Constitution provides for a transfer of the base year value of an original property to a replacement dwelling under specific circumstances. The Legislature set forth those circumstances by adopting section 69.5 of the Revenue and Taxation Code.¹ Under that statute, any person over the age of 55 years who resides in property eligible for the homeowners' exemption may transfer the base year value of that original property to any replacement dwelling of equal or lesser value subject to certain conditions and limitations.

Subdivision (b)(1) of section 69.5 requires that the claimant be an "owner" and occupy the original property as her principal residence either at the time of its sale or within two years of the purchase or new construction of the replacement dwelling. Subdivision (b)(4) requires that at the time of claiming the relief, the claimant be an "owner" of the replacement dwelling and occupy it as her principal residence. The holder of a life estate is considered to be an "owner" under section 69.5. (See Property Tax Annotation 200.0075.)

A claimant that is a co-owner or tenant in common of the original property is entitled to the benefit provided under section 69.5. (See Rev. & Tax. Code, subd. (d).) If a single replacement dwelling is purchased or newly constructed by all of the co-owners and each co-owner retains an interest in the replacement dwelling, claimant is eligible for the benefit under section 69.5. (Rev. & Tax. Code, § 69.5, subd. (d)(1).) Additionally, if only one replacement dwelling is purchased in the sole name of only one eligible claimant, that claimant is eligible for a base year value transfer. (Rev. & Tax. Code, § 69.5, subd. (d)(3).) Furthermore, in order to qualify for a base year value transfer under section 69.5, the full cash value of the original property must be equal to or greater than the full cash value of the replacement property. (See Rev. & Tax. Code, § 69.5, subd. (a)(1).) To calculate the value of the original property as compared to the replacement property where the property is co-owned, the full cash value of the entire original property will be compared to the full cash value of the entire replacement

¹ Unless otherwise specified, all section references are to the Revenue and Taxation Code.

property, regardless of the claimant's partial ownership interest in either or both. (See Property Tax Annotation 200.0010.)

In this case, the original property is W's principal residence. W, as the life tenant, has the present beneficial ownership of 90 percent of the property and H's children own the remaining 10 percent interest. Our understanding is that the co-tenants agree to sell W's principal residence and purchase a replacement property which W will occupy as her principal residence. If the ownership interest in the replacement property will remain the same as the original property, that is, H's children will own 10 percent of the replacement property, and as to the remaining 90 percent interest, W will be a life tenant, with the remainder interest in H's children. Under these circumstances, the base year value of the original property may be transferred to the replacement property if all of the other requirements of section 69.5 are satisfied. Alternatively, if the replacement home is purchased by W as the sole owner, the base year value may still be transferred to the replacement property because W is an eligible claimant under section 69.5. (See Rev. & Tax. Code, § 69.5, subd. (d)(3).)

Lastly, since the full cash value of the replacement property must be equal to or less than the full cash value of the original property, 100 percent of the full cash value of W's original property will be compared to 100 percent of the full cash value of the replacement regardless of the fact that W only holds a 90 percent ownership interest in the original property. If the full cash value of W's replacement property is equal to or less than that of the original property, W can transfer the base year value of the original property to the replacement property.

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.

Very truly yours,

/s/ Dana Flanagan-McBeth

Dana Flanagan-McBeth
Tax Counsel

DFM:eb
Prec/BYV/06/05-418.df-m

cc: Honorable
County Assessor

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Mr. Dean Kinnee, MIC:64
Ms. Mickie Stuckey, MIC:62
Mr. Todd Gilman, MIC:70