



## STATE BOARD OF EQUALIZATION

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December 5, 2014

Mr.

**Re: *Change in Ownership – Trusts***  
***Assignment No.: 14-135***

Dear Mr. :

This is in response to your request for a legal opinion regarding the change in ownership consequences when real property is transferred upon a trustor's death to the trustor's wife for a period of 18 months, then subsequently sold, with the proceeds distributed among remainder beneficiaries. As explained below, it is our opinion that the value of the fee equivalent interest transferred to the remainder beneficiaries at the trustor's death.

**Factual Background**

B K and M K, a married couple (collectively, Trustors), are the trustors of their living trust (Trust). B K (B ) owned real property located in County, California (Property), as his separate property, and which was used as the Trustors' principal residence. B transferred the Property to the Trust, where it remained his separate property.

The Trust provides that upon B 's death, the Property remains in the Trust for the benefit of his wife, M K (M ), for a period of 18 months. At the end of the 18-month period, the Trust directs the trustee to sell the Property, with the proceeds of the sale to be distributed to remainder beneficiaries as follows:

- (1) \$5,000 to J (J ) (B 's grandson);
- (2) \$5,000 to D (D ) (B 's grandson);
- (3) \$5,000 to B (B ) (B 's grandson);
- (4) \$100,000 to M ; and
- (5) Any remaining proceeds to S (S ) and R K (R ) (B 's daughters and M 's stepdaughters).

Prior to the sale of the Property, R proposes to transfer her interest in the proceeds of the sale of the Property to M . Subsequent to R 's transfer, S intends to purchase the Property from the Trust for fair market value, which you indicate is approximately \$800,000.

### **Law and Analysis**

Article XIII A, section 2 of the California Constitution provides that real property must be reassessed whenever a change in ownership occurs. A change in ownership is defined at Revenue and Taxation Code<sup>1</sup> section 60 defines "change in ownership" as a single test with three elements as follows:

A "change in ownership" means a transfer of [1] a present interest in real property, including [2] the beneficial use thereof, [3] the value of which is substantially equal to the value of the fee interest.

Section 62, subdivision (d) specifies that a change in ownership shall not include any transfer by a trustor into a revocable trust, or a trust for which the transferor is the present beneficiary. Complementary to that provision is section 61, subdivision (h), which specifies that a change in ownership includes any interests in real property that vest in persons other than the trustor (or, pursuant to section 63, his or her spouse) when a revocable trust becomes irrevocable. When a revocable trust becomes irrevocable upon the death of a trustor, the date of the change in ownership is the date of death of the decedent. (Property Tax Rule<sup>2</sup> (Rule) 462.260, subd. (d)(1).)

Section 63.1, which implements the parent-child and grandparent-grandchild exclusions, excludes from change in ownership transfers between parents and their children of any number of principal residences and the first \$1 million of full cash value of other real property of an eligible transferor. (Rev. & Tax. Code, § 63.1, subs. (a)(1) & (2).) The \$1 million exclusion applies separately to each eligible transferor. (Rev. & Tax. Code, § 63.1, subd. (b)(2).) An eligible transferor means a grandparent, parent, or child of an eligible transferee and an eligible transferee means a parent, child, or grandchild of an eligible transferor. (Rev. & Tax. Code, § 63.1, subs. (c)(6) & (7).) A "child" under section 63.1 includes any stepchild of the parent while the relationship of stepparent and stepchild exists. If the marriage on which the stepparent-stepchild relationship is based is terminated by death, the relationship is deemed to exist until remarriage of the surviving stepparent. (Rev. & Tax. Code, § 63.1, subd. (c)(3)(B).)

Rule 462.060, subdivision (b) provides that the creation of an estate for years for a term of 35 years or more in real property is a change in ownership, unless an exclusion applies. Conversely, the creation or transfer of an estate for years for less than 35 years is not a change in ownership.

Here, the transfer of the Property by B into the Trust, of which he was a present beneficiary at the time of the transfer, did not constitute a change in ownership. (Rev. & Tax. Code, § 62, subd. (d).)

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<sup>1</sup> All further statutory references are to the California Revenue and Taxation Code, unless otherwise indicated.

<sup>2</sup> All subsequent references to "Rules" are to the Property Tax Rules promulgated under title 18 of the California Code of Regulations.

### Change in Ownership Consequences at B's Death

Upon B's death, M's receipt of the right to live in the Property is the creation of an estate for years for a term of 18 months. The Trust provides that after the 18-month estate for years, the Property be sold and the proceeds distributed to various beneficiaries as listed above. Pursuant to section 60, based on these facts, a change in ownership of the property results upon B's death, as there is 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. In *Steinhart v. County of Los Angeles*,<sup>3</sup> the California Supreme Court held that the transfer of a life estate and remainder interests upon the death of the trustor of a revocable trust was a change in ownership because the total of the present and future interests transferred upon the death of the trustor was the entire equitable estate in the property. The Court expressly rejected the plaintiff's interpretation of section 60 that a change in ownership only occurs when the value of the present interest received by any one person is substantially equivalent to the value of the fee interest. Therefore, in this case, because the transferor retained no interest in the property, the section 60 change in ownership test is met. Although the interest transferred from B's estate is divided between an estate for years to M, and the remainder interest to the remainder beneficiaries, the entirety of B's interest in the Property was transferred at his death. As such, the Property underwent a change in ownership at B's death.

The issue here, of course, is whether the "fee equivalent interest" transferred from B's estate to M, or from B's estate to the remainder beneficiaries. Pursuant to Rule 462.060, subdivision (b), which provides that the creation or transfer of an estate for years for less than 35 years is not a change in ownership, M, who receives an estate for years for the period of 18 months, is not the recipient of the fee equivalent interest at B's death. Therefore, necessarily, it is the remainder beneficiaries who receive the fee equivalent interest.

We believe the remainder beneficiaries should be deemed partial owners in relation to their respective interests in the proceeds. For purposes of reappraising property for change in ownership purposes, the date used for property in a revocable trust is the date at which the trust becomes irrevocable. (Rule 462.260, subd. (d)(1).) Here, the Trust became irrevocable at B's date of death. As such, the value of the Property as of B's date of death should be used to determine the partial ownership percentages of the remainder beneficiaries. We assume that the fair market value of the Property as of B's date of death is \$800,000 as you have stated. Based on this assumption, as stated in your letter, the ownership of the Property at B's death is as follows:

J	0.625 %
D	0.625 %
B	0.625 %
M	12.5 %
S	42.8125 %
R	42.8125 %

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<sup>3</sup> (2010) 47 Cal.4th 1298.

As to the 0.625 percent interests transferred each to B's grandchildren, J, D, and B, a change in ownership occurred upon B's death. The transfers to B's grandchildren do not qualify for the grandparent-grandchild exclusion, as you indicate that the parents of the grandchildren are not deceased. (Rev. & Tax. Code, § 63.1, subd. (a)(3)(A).) The 12.5 percent interest transferred to M, as a remainder beneficiary, is excluded from change in ownership, pursuant to the interspousal exclusion. (Rev. & Tax. Code, § 63, subd. (b).) Finally, as to the 42.8125 percent interests transferred each to B's daughters, R and S, the parent-child exclusion would be available, assuming all other requirements are met. (Rev. & Tax. Code, § 63.1, subd. (a)(1)(A).) Because the Property was B's principal residence, the transfer to R and S would not be counted towards his \$1 million exclusion for property that is not his principal residence. (Rev. & Tax. Code, § 63.1, subs. (a)(1) & (2).)

#### Change in Ownership Consequences if M Purchases the Property

You ask in your letter whether the above-discussed conclusion would change if M purchased the Property from the Trust during her 18-month estate for years.<sup>4</sup> Generally, the doctrine of merger stands for the proposition that whenever a greater estate (remainder fee interests) and a lesser estate (estate for years) in the same parcel of real property are held by the same person, without an intermediate interest or estate, the lesser estate merges into the greater estate and is terminated. (Annotation<sup>5</sup> 220.0372.015 (November 7, 2006).) Here, upon B's death, M received an 18-month estate for years, as well as a 12.5 percent remainder interest in the sales proceeds of the Property. If M purchases the Property, her estate for years would merge with her remainder interest. Therefore, as to her 12.5 percent interest, no change in ownership occurs upon the sale of the Property. However, M's purchase would be a purchase of the interests of the other remainder beneficiaries.

As discussed above, the transfers from B to each of his grandchildren upon B's death result in a change in ownership, for which the grandparent-grandchild exclusion is unavailable. Thus, if M purchases the grandchildren's interests, another change in ownership results from the transfer of those interests. Again, because the grandchildren's parents are still living, this would not be an excludable transfer under section 63.1. As to the transfers from B to his daughters upon B's death, the parent-child exclusion would be available. (Rev. & Tax. Code, § 63.1, subd. (a)(1)(A).) If M purchases the daughters' interests in the Property, such transfer would again result in a change in ownership, for which the exclusion under section 63.1 would be available as a transfer from children to parent. If the Property was not the daughters' principal residence, the transfer of their interests to M would count towards each of their \$1 million exclusions. (Rev. & Tax. Code, § 63.1, subs. (a)(1) & (2).)

#### Change in Ownership Consequences of R's Transfer of Her Interest to M

Prior to the sale of the Property, R proposes to transfer her interest in the sales proceeds to M. You indicate that R is M's stepdaughter and meets the qualifications of a "child" as described in section 63.1, subdivision (c)(3)(B). As such, we agree that the

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<sup>5</sup> 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.)

parent-child exclusion would be available for this transfer, provided that a timely claim is filed. If the Property is not R's principal residence, the value of the share transferred would count against the \$1 million exclusion pursuant to section 63.1, subdivision (a)(2).

Change in Ownership Consequences Upon S's Purchase of the Property

Subsequent to R's transfer of her interest to M, as discussed above, the ownership of the Property would be as follows:

J	0.625 %
D	0.625 %
B	0.625 %
M	55.3125 %
S	42.8125 %

If S purchases the Property at the end of M's 18-month estate for years, for the reasons discussed above, the sale would be considered a transfer to S from the remainder beneficiaries. As such, we agree with your analysis of the change in ownership consequences under this premise. The parent-child exclusion would be available for M's transfer of her 55.3125 percent interest to S, her stepdaughter, pursuant to section 63.1, subdivision (c)(3)(B), assuming a timely claim is filed. If the Property serves as M's principal residence at the time of transfer, the transfer to S would not count towards M's \$1 million exclusion pursuant to section 63.1, subdivision (a)(2).

You also indicate that S is the mother of J, D, and B. As such, the parent-child exclusion would be available for the transfer of the interests held by J, D, and B to S. Further, if the Property is not their principal residence, the transfer would be counted towards each of J, D, and B's \$1 million exclusions pursuant to section 63.1, subdivision (a)(2).

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/ Leslie Ang*

Leslie Ang  
Tax Counsel

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- cc: County Assessor
- Mr. David Gau MIC:73
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