State of California

Memorandum

To : Mr.

Date : March 27, 1987

From :

Subject: Interspousal Transfers

On February 5, 1987, responding to Mr. advised that a transfer by a husband or his separately owned real property to a general partnership in which the husband would have a 95% interest and his wife would have a 5% interest could not be equated with an inter- spousal transfer and did not qualify for a change in ownership under section 63 of the Revenue and Taxation Code. You have questioned that conclusion and asked that we reconsider our position.

Attached for your convenience are copies of the provisions in the California Constitution, the Revenue and Taxation Code, and Rule 462, dealing with interspousal transfers. A comparison of these provisions indicates that they are all quite similar in text. The language of Rule 462 contains some additional wording in the third and fifth paragraphs of the subdivision. These slight variations do not appear to be material, however, to the discussion of the issue before us.

I have reviewed this issue with , as well as I think it's fair to say that all four of us agree that has reached the right conclusion. Further, neither nor , who have had the longest experience in change in ownership questions, felt that this conclusion was inconsistent with prior advice.

While we all agree that the provisions of the code and regulation should be given a liberal construction to provide the benefit of the exclusion to all "interspousal" transfers, we also agree that the transfer described here was not a transfer between spouses. I know we have all heard about people who are married to their jobs but I don't believe the term "spouse" can be interpreted to include a corporation, partnership or other legal entity. The language in the first paragraph of the first constitutional provision refers to "transfer of real property between spouses." It is difficult

to believe that either the Legislature or the electors who voted for Proposition 58 intended this language to mean "transfer of real property between spouses or between a spouse and a legal entity in to which the spouse or spouses have an ownership interest." Such an interpretation greatly expands the impact of this provision.

I recognize that the fifth paragraph of the exclusion refers to the distribution of property from a legal entity to a spouse or former spouse, in exchange for that spouses interest in the legal entity, in connection with a property settle agreement or dissolution of marriage. This is a very limited provision, however. It has very narrow application and does not suggest to me an intent to exclude all transfers between spouses and legal entities in which the spouse has an interest. If the Legislature had intended such a broad exclusion, it could have easily so provided. The fact that broader language was not used indicates an intent to create only a narrow provision. I am sure that it was recognized that this type of transfer would not ordinarily qualify as an "interspousal" transfer and, therefore, it was necessary to create an express provision to cover the situation. These conclusions are based upon the language used. Unfortunately, the discussion of these provisions in the Proposition 13 Task Force Report and the Assembly Revenue and Taxation Committee Report are not enlightening on this question.

Our review of this question also considered the effect of an alternative interpretation. Consideration needs to be given to the effect upon transfers involving third-party interests. The legal entity referred to in the fifth paragraph of the exclusion may involve many other parties. If distributions to or from such an entity outside the narrow limits of the language of that provision is to be considered an "interspousal" transfer, then we will have created a potential loophole in the change of ownership provisions. If A wishes to sell his property to Corporation X and avoid reappraisal, he merely has his spouse buy a few shares in the Corporation prior to the sale. Since this transfer would then qualify as "interspousal," the entire transfer would be excluded from change in ownership. I am sure there are many other examples of how this could be a problem where third party interests are involved.

Perhaps we could avoid these problems if we limited our interpretation to legal entities in which only the spouses held an interest. Once we buy the legal entity concept, however, I am not sure that we can limit it since its obvious that the term "legal entity," as used in the fifth paragraph, extends to

third party situations. Certainly such an interpretation would be extremely difficult to support without either an amendment of the statute or at least an amendment of our regulation, which I don't recommend.

After you have reviewed these materials, I would like an opportunity to sit down and discuss this matter with you. I would like to do that as soon as possible since, in light of your objection, we are holding our response to another opinion request involving a similar issue. This problem involves the purchase by a husband of a residence from his deceased wife's estate for a sum which was fixed pursuant to a prenuptial option agreement. We have preliminarily concluded that the purchase of the residence from the estate is not an "interspousal" transfer. The purchase of the property from the estate is, in effect, a purchase from the residual heirs and cannot be considered a purchase from the spouse. Perhaps this conclusion will have to be changed, however, if we take a more liberal interpretation of the term "interspousal."

RHO:cb
0435D

cc: