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450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
916-324-2623 • FAX 916-323-3387
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February 2, 2005

Honorable Tom J. Bordonaro, Jr.
San Luis Obispo County Assessor
County Government Center, Room 100
San Luis Obispo, CA 93408-2070

Attention:

**Re: *Change in Ownership: Transfer of Life Estate to Corporation Owned Exclusively by
Remainder Interest Holders***

Dear :

This is in response to your letter dated September 5, 2003, requesting our opinion as to the change in ownership consequences of a transfer of a life estate in real property by the life tenant during the life tenant's lifetime to a corporation owned exclusively by individuals, including the life tenant, who also held the remainder interests in the property. Following this transfer, the remainder interest holders/shareholders, excluding the life tenant, sold their stock in the corporation to third-party individuals. The four remainder interest holders/shareholders claim that no change in ownership of the real property occurred as a result of the transfers. Your office, however, determined that a 100 percent change in ownership occurred. For the reasons discussed below, we conclude your determination is correct and that a 100 percent change in ownership occurred.

Factual Background

Anna was the sole owner of real property. At her death, the provisions of her will created a life estate in the property for her daughter, Charlotte ("Charlotte"). Upon termination of the life estate, the remainder interest would pass 50 percent to Charlotte and 16.66 percent to each of Anna's three sons, Charles, James, and Michael. A parent-child claim was properly filed thereby excluding the creation of the life estate in Charlotte from change in ownership.

Charlotte, Charles, James, and Michael ("the four siblings") formed the T Corporation on April 11, 2001, and owned all the outstanding shares of the corporation. The four siblings then quitclaimed all their interests in the property to the corporation. Specifically, Charlotte quitclaimed to the corporation her life estate and 50 percent remainder interest, and Charles, James, and Michael each quitclaimed to the corporation their 16.66 percent remainder interests. In the meantime, Charles, James, and Michael also each entered into a stock purchase agreement to sell their shares of stock in the T Corporation to Leon and Boyd for \$25,000. Following the recording of the quitclaim deed, your office determined that a 100 percent change in ownership occurred with respect to the property. The four siblings disagree and claim Revenue and Taxation Code section 62, subdivision (a)(2),¹ excluded from change in ownership their transfer of the property to the corporation, and section 64, subdivision (a),

¹ All section references are to the Revenue and Taxation Code unless stated otherwise.

excluded a change in ownership of the property on the sale of corporate stock from Charles, James, and Michael to Leon and Boyd .

Applicable Law and Analysis

Section 60 defines a change in ownership as (1) a transfer of a present interest in real property, (2) including the beneficial use thereof, (3) the value of which is substantially equal to the value of the fee interest. Section 63.1 sets forth the parent-child exclusion from change in ownership and provides that change in ownership does not include the purchase or transfer of the principal residence of the transferor or the first \$1 million of full cash value of all other real property in the case of transfers between parents and their children.

With respect to the creation, transfer, and termination of a life estate, section 61, subdivision (g), provides that a change in ownership includes “[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.” Section 62, subdivision (e), provides that a change in ownership shall not include “[a]ny transfer by an instrument whose terms reserve to the transferor an estate for years or an estate for life. However, the termination of such an estate for years or estate for life shall constitute a change in ownership, except as provided in subdivision (d) and in Section 63.”

The regulation that interprets and implements section 62, subdivision (e), Property Tax Rule 462.060, provides in subsection (a):

“The creation of a life estate in real property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor of the transferor’s spouse. However, the subsequent transfer of such a life estate by the transferor or the transferor’s spouse to a third party is a change in ownership. Upon termination of such a reserved life estate, the vesting of a right to possession or enjoyment of a remainderman (other than the transferor or the transferor’s spouse) is a change in ownership.”

Applying the above rules to the facts presented, Property Tax Rule 462.060 makes it clear that the creation of the life estate in Charlotte at the death of Anna constituted a change in ownership of the property. Charlotte received the present beneficial interest in the property the value of which was substantially equal to the value of the fee interest. However, the creation of the life estate also constituted a transfer between a parent and child and thus was excluded from change in ownership pursuant to section 63.1 upon the timely filing of a proper claim form. This conclusion does not end our inquiry, however.

Section 61, subdivision (j), provides that a change in ownership includes a transfer of any interest in real property between a corporation and a shareholder or any other person. Section 62, subdivision (a)(2), excludes from a change in ownership, however, any transfer of real property between individuals and a legal entity, such as a corporation, resulting solely in a change in the method of holding title to the real property and in which the proportional ownership interests of the transferor and the transferee in each piece of real property remain the same after the transfer.

Subsequent to the creation of the life estate and during her lifetime, Charlotte transferred her life estate and 50 percent remainder interest in the property to the T Corporation. Charles, James, and Michael also transferred their combined 50 percent remainder interests to the corporation. At the time of the transfer, Charlotte, Charles, James, and Michael held stock in the corporation in the same percentages as their remainder interests in the property. As a result, they contend that the quitclaim conveyances of the life estate and remainder interests to the corporation were excluded from change in ownership

pursuant to section 62, subdivision (a)(2). We note that the letter provided to you by the taxpayers' attorney states:

“The subject property was formerly owned by Anna . Upon her death, and pursuant to a Nunc Pro Tunc Order Amending Order on Petition for Final Distribution and For Instructions to Administer with Will Annexed filed in the San Luis Obispo County Superior Court on March 5, 2001, a copy of which I am enclosing for your reference, the real property was transferred to her children, Charlotte , Charles , aka Bud , Michael , and James . Charlotte received a fifty percent (50%) interest in the property. Her brothers each received an undivided 16.66% interest in the real property.”

The attorney makes no reference to the creation of the life estate in Charlotte and the remainder interests in Charlotte, Charles, James, and Michael. The order referred to by the attorney, however, clearly states on pages 2, 3, and 4 that Charlotte received a life estate and a 50 percent remainder interest and Charles, James, and Michael each received a 16.66 percent remainder interest. If, as the attorney seems to state in his letter, Charlotte received only a 50 percent present beneficial interest in the property and Charles, James, and Michael each received a 16.66 percent present beneficial interest in the property, then the four siblings' contention that the transfer of the property to the corporation was excluded pursuant to section 62, subdivision (a)(2), would be correct. The attorney's statement in the letter, however, is clearly incorrect.

Charlotte owned a life estate in the property. For purposes of change in ownership, she held the primary ownership interest in the entire property because a creation of a life estate meets the definition of section 60 as a transfer of the present beneficial interest in the property with a value substantially equal to the value of the fee interest. Charles, James, and Michael did not hold primary ownership interests in the property because they held future interests, not present interests in the property that vested upon termination of the life estate. As the life tenant, Charlotte was the primary owner of the entire property during her lifetime and by transferring her life estate the corporation became the primary owner of the entire property for change in ownership purposes. Pursuant to section 60, section 61, subdivision (j), and Property Tax Rule 462.060, Charlotte's transfer of her life estate to the corporation resulted in a 100 percent change in ownership of the property. The transfer of her life estate to the corporation was not excluded from change in ownership under section 62, subdivision (a)(2), because the proportional interests of the transferor and transferees did not remain the same. Charlotte held 100 percent of the interests in the property as the primary owner before the transfer and she held only a 50 percent interest in the property through her ownership interests in the corporation after the transfer. (See also Property Tax Rule 462.180, sub. (b)(2), ex. 2 & 3.)

In addition to transferring Charlotte's life estate to the corporation, the recorded quitclaim deed also transferred the four siblings' remainder interests in the property to the corporation. Pursuant to the doctrine of merger, whenever a greater estate (remainder fee interest) and a lesser estate (life estate) in the same parcel of real property are held by the same person,² without an intermediate interest or estate, the lesser estate generally merges into the greater estate and is terminated. (30 Cal.Jur.3d (1987) Estates, §§ 8, 22; 4 Miller & Starr, Cal. Real Estate (3d ed. 2000) § 10.41, pp. 138-139.) When the quitclaim deed was recorded, the entire title to the property, both legal and equitable, united in the same legal entity, the corporation. The result was the merger of the life estate into the remainder interest causing a termination of the life estate and a change in ownership of the property pursuant to section 61, subdivision (g). (See enclosed Ochsner letter, Sept. 26, 1990.) This change in ownership, however, occurred at the same time as the change in ownership caused by Charlotte's transfer of her life estate to the corporation. Therefore, a separate change in ownership occurrence would not be recognized.

² Revenue and Taxation Code section 19 and Corporations Code section 5065 define “person” to include a corporation.

At the same time that Charles, James, and Michael formed the T Corporation with Charlotte and quitclaimed their remainder interests in the property to the corporation, each also agreed to sell his stock in the corporation to Leon and Boyd pursuant to a stock purchase agreement. The shares of stock transferred by the three brothers totaled 50 percent of the outstanding shares of the corporation. Thus, pursuant to section 64, subdivision (a), no change in ownership of the property occurred on the sale of the stock.

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. Therefore, they are not binding on any person or public entity.

Very truly yours,

/s/ Reed Schreiter

Reed Schreiter
Senior Tax Counsel

RS:eb

Prec/LifeEstates/05/01-rs

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| cc: | Mr. David Gau | MIC:63 |
| | Mr. Dean Kinnee | MIC:64 |
| | Ms. Mickie Stuckey | MIC:62 |
| | Mr. Todd Gilman | MIC:70 |