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January 17, 2001

In Re: Change in Ownership - Section 62(a)(2) Exclusion for Transferring Trust Property to a Limited Liability Company.

Dear Mr. & Mrs. :

This is in response to your April 3, 2000 letter to the Los Angeles County Assessor, that was several months later forwarded to the State Board of Equalization for analysis. You request our opinion regarding the change in ownership consequences and applicable exclusions relative to a proposed transfer of Los Angeles County real property held in your revocable living trust to a Limited Liability Company (LLC) owned 100% by the Trust. For the reasons hereinafter explained, the transfer of real property by the present beneficiaries of a trust to a legal entity, such as an LLC owned by the trust beneficiaries, is excluded from change in ownership under Revenue and Taxation Code Section 62(a)(2).

The details of the proposed transaction set forth in your letter are as follows:

- A. Husband ("H") and Wife ("W") are the sole present beneficiaries of Family Living Trust ("Trust"), which is the record owner of property in Los Angeles County. Since the Trust is revocable, H and W are the settlors, trustees, and the present beneficiaries.
- B. Through the Trust, H and W propose to transfer the property to an LLC owned by the Trust, in exchange for which the Trust will receive 100% of the capital and profits interests of the LLC.

Change in Ownership Concepts

Revenue and Taxation Code Section 60 defines "change in ownership" 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."

Within that definition is the provision of Section 61(j) which include as a change in ownership:

* * *

(j) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

However, an important exclusion applicable to transfers to legal entities is found in Section 62(a)(2), which provides that a change in ownership shall not include:

Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

This statutory exclusion is interpreted by Property Tax Rule 462.180 in subdivision (b)(2), (18 California Code of Regulations 462.180), which provides specifically with regard to legal entities - including LLCs, the following relevant language:

(b) EXCEPTIONS.

* * *

(2) Transfers of real property between separate legal entities or by an individual to a legal entity (or vice versa), which result solely in a change in the method of holding title and in which the proportional ownership interests in each and every piece of real property transferred the property remain the same after the transfer. (The holders of the ownership interests in the transferee legal entity, whether such interests are represented by stock, partnership shares, or other types of ownership interest, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer of the ownership interests in the legal entity.) * * *

One example of a transfer excluded from change in ownership, set forth in the first part of Example 2 of subdivision (b)(2), is similar to the proposed transaction in the instant case:

Example 2: A transfer of real property from A and B, as equal co-tenants, to Corporation X where A and B each take back 50 percent of the stock. No change in ownership. * * *

Based on the foregoing, the transfer proposed here would be excluded from change in ownership. The reason is that both before and after the transfer to the LLC, the property will be

owned 50 percent by H and 50 percent by W as the sole present beneficiaries of their Trust. The only change will be their method of holding title to the property – that is, after the transfer, H and W, through the Trust, will each own 50 percent of the membership interests in the LLC that holds title to the property.

This determination – that the transfer would be proportional - rests upon the fact that the property is currently held in the typical living trust, in which the trustors/settlors (H and W) have the power to revoke and are therefore considered to be the “owners” of the trust property.¹ We have consistently taken the position since the inception of Proposition 13 that trusts are merely an estate-planning tool considered as substitutes for a will, and should not be treated as a separate entities for purposes of determining change in ownership.

Therefore, to determine the present beneficial ownership of the trust property - and whether or not a transfer of property held in trust is proportional - it is necessary to “look through the trust.” Under the general trust statute Section 62(d), the “owner” of the property in trust is always the trustor (or transferor, sometimes called “settlor”) 1) if the trustor can revoke the trust, or 2) is the beneficiary, if the trustor is the sole present beneficiary or an irrevocable trust. (See *Report of Task Force on Property Tax Administration to Assembly Revenue and Taxation Committee*, January 22, 1979, p. 43-44.) Neither the trustee, nor the trust itself is ever viewed as the “owner” of the trust property for change in ownership purposes, even though “legal title” is recorded in the trustee’s or the trust’s name. (Rules 462.160 and 462.240.) Since both the trustors and the present beneficiaries here are said to be H and W, H and W are considered to be equal co-tenants owning the property through the Trust. Similarly, if H and W form an LLC in the name of the Trust, H and W are treated as though they each own 50 percent of the LLC membership interests. (There is no attribution of interests held in a legal entity by a husband and wife, Annotation No. 220.0040, copy enclosed.)

It is important to note however that where – as here - the application of the exclusion in Section 62(a)(2) occurs, and a transfer into a legal entity is excluded from change in ownership, the transferors (H and W) become the “original coowners.” Under the provisions of Section 64(d), if the “original coowners” should in the future transfer cumulatively more than 50 percent of the interests in the legal entity (LLC), there is a change in ownership and reappraisal of all of the property previously transferred into the entity (LLC) under the Section 62(a)(2) exclusion. Section 64 (d) states the following:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in that legal entity immediately after the transfer shall be considered the "original co-owners."

¹ However, we have not been provided with a copy of the trust instrument.

Whenever shares or other ownership interests representing cumulatively **more than 50 percent of the total interests** in the entity are **transferred** by any of the **original co-owners** in one or more property transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property that was previously excluded from change in ownership under the provisions of Section 62(a)(2) shall be reappraised.

The date of reappraisal shall be the date of the transfer of the ownership interest representing individually or cumulatively more than 50 percent of the interests in the entity.

Rule 462.180(d)(2) is the pertinent rule provision which interprets Section 64(d) and explains how and when it is to be applied:

(d) EXCEPTIONS.

* * *

(2) When on or after March 1, 1975, real property is transferred to a partnership, corporation, limited liability company, or other legal entity and the transfer is excluded from change in ownership under Section 62(a)(2) of the Revenue and Taxation Code, and the "original co-owners" subsequently transfer, in one or more transactions, cumulatively more than 50 percent of the total control or ownership interests, as defined in subdivision (d)(1), in that partnership, corporation, limited liability company or legal entity, there is a change in ownership of only that property owned by the entity which was previously excluded under Section 62(a)(2). However, when such transfer would also result in a change in control under Section 64(c) of the Revenue and Taxation Code, then reappraisal of the property owned by the corporation, partnership, limited liability company, or other legal entity shall be pursuant to Section 64(c) rather than Section 64(d).

Thus, most transfers of interests in a legal entity (LLC) by the "original coowners" must be "cumulated" or counted as a "transfer" for purposes of determining a future change in ownership under Section 64(d). When and if the cumulative "transfers" by original coowners exceed 50 percent of the total interests in the LLC, the real property previously excluded from change in ownership by Section 62(a)(2) would be removed from the benefits of the exclusion and undergo reassessment.

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The views expressed in this letter are, of course, 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.

Very truly yours,

/s/ Kristine Cazadd

Kristine Cazadd
Supervising Tax Counsel

KEC:tr
prop/prec/lc/01/01kec

Attachments: Report of Task Force, pp. 43-44
Annotation 220.0040

cc: Honorable Rick Auerbach
Los Angeles County Assessor

Mr. Dick Johnson, MIC:63
Mr. David Gau, MIC:64
Mr. Charlie Knudsen, MIC:62
Ms. Jennifer Willis, MIC:70