State of California

Board of Equalization
Legal Division

220.0398

Memorandum

To: Mr. Verne Walton -- MIC:64

Date: April 26, 1994

From: Eric Eisenlauer

Subject: Letter from Shasta County Dated September 7, 1993

This is in response to your memo of February 17, 1994 to Mr. Richard Ochsner in which you ask that we review the documents submitted with the above-referenced letter and provide you with our opinion with respect to the following questions:

1. Do the documents create a trust estate?

2. If so, will transfers of real property to the organization be a change in ownership?

3. Will subsequent transfers to similarly created organizations be treated as transfers to a trust and eligible for the parent-child exclusion?

The documents submitted here include a contract between Steven McMillan designated as the "Creator" and Echo Moran, designated as the "Exchanger." The contract purports to create an organization called Crescent Investment (Crescent) which is characterized by the contract as a Pure Trust Organization or Unincorporated Business Organization (UBO). The contract expressly provides that the organization "is not a partnership or corporation, but a separate legal entity having its own common law identity."

Under the contract, which is irrevocable, the Exchanger transferred a promissory note and seven parcels of real property to Crescent in exchange for a trust certificate for 60 certificate units (TCUs) of an authorized 100 TCUs. The TCUs entitle the holder to his or her proportionate share of all distributions made by the Trustees. At the same time, the Creator appointed Robert Messick as first Trustee of Crescent. The contract permits the first Trustee to appoint a second Trustee and the two may jointly appoint one or more additional Trustees. The Trustees are authorized to exclusively manage, administer and control the trust estate (the assets of Crescent). At no time shall more than half of all Trustees be related to or subordinate to any person holding more than fifty percent of the outstanding certificates. The contract provides that the Trustees shall hold legal <u>and</u> equitable title to all assets. Ownership of TCUs <u>shall not</u> entitle the holder to any legal or equitable title in the company or the trust estate, nor to any undivided interest therein, nor management thereof.

The stated purpose of the contract is "to create a common law contractual company,...for receiving, conveying or holding property in fee simple, and for providing prudent management of such property, and for conducting any legitimate business through appointed Trustees for the benefit of certificate holders."

The organization, unless terminated earlier as provided in the contract, is to continue for 25 years. The life of the company may, however, be extended for an additional 25 years, subject to a unanimous vote of the board of Trustees at least 30 days prior to each termination date.

After the initial transfers of the seven parcels to Crescent, Crescent transferred the seven parcels to five UBOs (which, for purposes of this letter, we assume to be identical to Crescent). Two were transferred to Gold Enterprises, two to Sunset Investments, one to Diamond Investments, one to Crystal Investments and one to Shemrock Investments. Echo Moran was the Trustee for each of those five UBOs. In exchange for each transfer, Crescent received 60 TCU's from the transferee UBO.

<u>Do the Documents Create a Trust Estate?</u>

In *Goldwater v. Oltman* (1930) 210 Cal. 408, the California Supreme Court discussed organizations resembling those in this case beginning at page 416:

> Generally stated, a trust of this nature is created wherever several person transfer the legal title in property to trustees, with complete power of management in such trustees free from the control of the creators of the trust, and the trustees in their discretion pay over the profits of the enterprise to the creators of the trust or their successors in interest. As thus defined it is apparent that such a trust is created by the act of the parties and does not depend on statutory law for its validity. In the case of *Hecht v. Malley*, 165 U. S. 144, 146 [68 L. Ed. 949, 44 Sup. Ct. Rep. 462, 463], Mr. Justice Sanford referred to such organizations as follows:

> "The 'Massachusetts trust' is a form of business organization, common in that state, consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may from time to time be the holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest in the property is divided. These certificates, which resemble certificates for shares of stock in a corporation and are issued and transferred in like manner, entitle the holders to share ratably in the income of the property, and, upon termination of the trust, in the proceeds.
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> "Under the Massachusetts decisions these trust instruments are held to create either pure trusts or partnerships, according to the way in which the trustees are to conduct the affairs committed to their charge. If they are the principals and are free from the control of the certificate holders in the management of the property, a trust is created; but if the certificate holders are associated together in the control of the property as principals and the trustees are merely their managing agents, a partnership relation between the certificate holders is created."

The court went on to adopt the foregoing view as California law. Thus, if the Trustee or Trustees in this case are free from the control of the TCU holders in the management of the property, a trust is created. Otherwise, a partnership is created among the TCU holders.

It is clear under the contract provisions here that the Trustees and not the TCU holders have the full management control of the trust estate. The organization in this case, therefore, can properly be characterized as a "Massachusetts trust" or business trust rather than a partnership. Such trusts, however, are distinguishable from ordinary or traditional trusts. (*Koenig v. Johnson* (1945) 71 Cal.App.2d 739, 749-750; see also 88 ALR 3d §5, pp. 720-722.) Accordingly, we have taken the position that such trusts should be treated as legal entities rather than as ordinary or traditional trusts for property tax purposes. The contract in this case is consistent with that treatment in that it provides (1) that the organization is a separate legal entity having its own common law identity; (2) that the Trustees shall hold both legal and equitable title to the property of the organization; and (3) that the ownership of TCU's, which are in the nature of shares of stock, shall not entitle the holder to any legal or equitable title or any undivided interest in the property of the organization.

Such characteristics distinguish Crescent from traditional or ordinary trusts. For example, it is a rudimentary principle of trust law that the creation of a trust divides title by placing legal title in the trustee and equitable title in the beneficiaries. (*Gonsalves v. Hodgson* (1951) 38 Cal.2d 91, 98.)

Consequently, although Crescent can reasonably be characterized as a Massachusetts or business trust rather than a partnership, it should, in our view, still be treated as a legal entity rather than a traditional or ordinary trust for property tax purposes.

Will Transfers of Real Property to the Organization be a Change in Ownership?

As you know, a change in ownership as defined in Revenue and Taxation Code section 60 includes the transfer of any interest in real property to a legal entity. (Rev. & Tax. Code §61, subd. (i); Property Tax Rule 462 (j)(1).)

There are, however, two possible exceptions to this general rule. One is when the transfer is between affiliated corporations (Rev. & Tax. Code §64, subd. (b); Property Tax Rule 462(j)(2)(A).) The other is when the transfer results solely in a change in the method of holding title and in which the proportional ownership interests remain the same after the transfer. (Rev. & Tax. Code §62, subd. (a)(2); Property Tax Rule 462(j)(2)(B) and (m)(5).)

The first exception clearly does not apply here because none of the transfers are between affiliated corporations.

With respect to the second exception, the transfer of several parcels to Crescent by Echo Moran in exchange for 60 TCU's of Crescent appears to be solely a change in the method of holding title and since Echo Moran holds all of the issued and outstanding ownership interests in Crescent in the form of 60 TCUs the proportional ownership interests in the property remain the same after the transfer. Accordingly, the transfer of the seven parcels to Crescent would be excluded from change in ownership under Revenue and Taxation Code section 62, subdivision (a)(2) and Property Tax Rules 462(j)(2)(B) and (m)(5). Even if Crescent were to be treated as an ordinary trust rather as a separate legal entity, the transfers would be excluded for the same reason pursuant to Property Tax Rule 462(i)(2)(E).

Similarly, the transfers from Crescent to the five identical UBOs would also be excluded from change in ownership pursuant to Revenue and Taxation Code section 62, subdivision (a)(2) and Property Tax Rules 462 (j)(2)(B) and (m)(5) assuming the transfer in each case was in exchange for all of the outstanding TCUs of the transferee UBO which appears to be the case from the information submitted. In that event such transfers would also be excluded from change in ownership under Property Tax Rule 462 (i)(2)(F) if the UBOs were treated as ordinary trusts rather than separate legal entities.

Will Subsequent Transfers to Similarly Created Organizations be Treated as Transfers to a Trust and Eligible for the Parent-Child Exclusion?

As indicated above, it is our view that the UBOs in this case should be treated as separate legal entities rather than ordinary trusts. As you know, transfers to legal entities, as distinguished from transfers through the medium of an ordinary trust, do not constitute transfers between parents and children for purposes of Proposition 58. (LTA 87/72.)

Similarly, TCUs do not constitute real property for purposes of the parent child exclusion. (Rev. & Tax. Code §63.1, subd. (c)(6).) Accordingly, transfers of TCUs between parents and children will not qualify for the parent-child exclusion.

Moreover, the holders of the TCUs received in exchange for the transfers to the UBOs excluded from change in ownership pursuant to Revenue and Taxation Code section 62, subdivision (a)(2) are "original coowners" for purposes of determining whether a change in ownership will occur upon subsequent transfers of such TCUs. (Rev. & Tax. Code §64, subd. (d); Property Tax Rules 462 (j)(2)(B) and (m)(5).)

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cc: Ms. Jennifer Willis -- MIC:70
Mr. John Hagerty -- MIC:63