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March 18, 1991

Re: Request for Ruling on "Change of Ownership"
of Real Property Incident to Distributions
in Reorganization of a Testamentary Trust

Dear

This is in response to your letter of January 24, 1991, to Mr. Richard Ochsner in which you request our opinion with respect to the following facts which you have provided us and which are set forth below.

I

Facts

Elmer S. died testate in 1973. At date of death his estate was valued at approximately \$1,130,000. The estate consisted of Elmer's interest in a residence located in Pasadena, California (hereinafter referred to as "the Pasadena Property") valued at \$75,000 plus various other assets (cash, securities, receivables and other real properties (which have since been sold)) valued at approximately \$1,055,000.

Elmer's Will provided that substantially all of his estate, after certain minor gifts of personal property, be distributed to a testamentary trust (hereinafter referred to as the "Trust under the Will of Elmer S. ").

The trustee of the Trust under The Will of Elmer S. was, and is, Elmer's son, Donald. The beneficiaries of the testamentary trust are Elmer's four grandchildren: John, James and Paul (the three sons of Elmer's deceased son, Elmer, Jr.), and Susan (the daughter of Elmer's son, Donald). All four grandchildren were minors at the time the testamentary trust was created in 1973. The grandchildren's beneficial interests in the trusts were as follows: John 1/6th, James 1/6th, Paul 1/6th and Susan 1/2.

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Pending the time each grandchild reaches age 21, the income of the trust set aside for such grandchild is accumulated and added to principal. After a grandchild reaches age 21, he or she is entitled to receive the income of his or her share during his or her lifetime, and is given a limited power of appointment over the principal of said share, exercisable at his or her death. Failing exercise of such appointment, a deceased grandchild's share of principal will pass, by right of representation, to his or her issue, to remain in trust for the maximum further time permitted by the rule against perpetuities, at which time the principal will vest free and clear of trust.

The terms of the Trust under the Will of Elmer S. state that, with respect to the beneficial interests of each of Elmer's four grandchildren, "each such part shall constitute a separate and distinct trust."

Article Four of the Trust under the Will of Elmer S. also vests in the trustee the following powers:

. . . .
d. Upon any partial or final distribution of the trust estates, to distribute the trust estates in undivided interests or in kind, or partly in money and partly in kind, according to such method or procedure as the Trustees may deem necessary to make distribution.

. . . .
f. I hereby direct that each share set aside for a child of mine and each part of a share set aside for a grandchild or a great-grandchild of mine or issue more remote shall constitute a separate and distinct trust and shall be held, managed and distributed as such.

g. Notwithstanding the fact that upon the various divisions into shares and parts separate and distinct trusts are created for each share or part, I expressly authorize the Trustees in the exercise of their sole discretion to maintain and administer the assets of all trusts created by this Will as a unit until such time as the Trustees are required to make distribution therefrom as herein provided, but in any event separate accounts shall be kept for each trust to which shall be assigned appropriate undivided

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interests in the property constituting the trust estates of the various trusts. (Emphasis added.) Within the discretion of the Trustees, funds of the separate trusts created hereunder available for investment may be combined for investment purposes with any other trust created herein or at any time by me or by my wife or by any of my issue. In such event, separate accounts shall be kept for each trust to which the Trustees may assign appropriate undivided interests in the property constituting the trust estate of each such trust.

For purposes of administrative convenience, however, during the period from 1973 until the present time, the trustee has held all trust assets (including the Pasadena Property) in a single undivided pool, and has not made physical segregation of the trust estate's assets into separate 1/6th, 1/6th, 1/6th and 1/2 portions. For accounting and income tax reporting purposes, the trustee has made the appropriate allocations between the respective grandchildren, but record title to the various assets (including the Pasadena Property) remains in one single trust, known as the "Trust under the Will of Elmer S."

The value of the corpus of the Trust under the Will of Elmer S. at this time is approximately \$2,500,000. This consists of the Pasadena Property, having a current market value of approximately \$600,000, plus cash, securities, and other assets having a value of \$1,900,000.

At this time the four grandchildren have all reached age 21, and have expressed interest in having their respective shares of the trust estate segregated or partitioned into separate parts or trusts for their own individual benefit - consistent with the language of the original trust document (quoted above) which provides for "separate and distinct" trusts. Similarly, the trustee, Donald, is interested in retiring from the office of trustee and appointing a successor trustee or trustees to serve as trustee for the separate trusts for the four adult grandchildren.

The trustee could partition the existing "old" trust into four separate and distinct parts ("new" trusts) by dividing cash, securities and real property - all in kind - into 1/6th, 1/6th, 1/6th and 1/2 shares, and conveying 1/6th, 1/6th, 1/6th and 1/2 undivided shares as tenants in common to each of such partitioned assets to the respective "new" trusts. However, for personal and non-tax-motivated purposes (including the fact that the Pasadena Property is being used as the personal residence of Susan) it is desirable to allocate 100% of the

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Pasadena Property to the "new" trust for Susan. The other beneficiaries have agreed in principle to having the Pasadena Property allocated 100% to the "new trust for Susan, with a commensurately greater share of cash and securities allocated to the other three "new" trusts to make up for the disproportionate share of the Pasadena property allocated to Susan's trust (i.e., Susan's "new" trust would receive a conveyance of 100% title to the Pasadena Property (with a value of \$600,000), plus cash and securities with a value of \$650,000; the other three "new" trusts would receive cash and securities only, having an aggregate value of \$1,250,000).

II Question

You have asked whether a conveyance of title to the Pasadena Property from the Trust under the Will of Elmer S. to a "new" Trust under the Will of Elmer S. for the benefit of Susan S. constitutes, in whole or in part, a "change of ownership" within the meaning of Revenue and Taxation Code, Section 60, et seq.

III Law and Analysis

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 equivalent to the value of the fee interest.

You assert three arguments why no change in ownership would occur as a result of the proposed transfer.

First, you contend that the interest transferred would be equivalent to a life estate with a remainder over to the beneficial transferees' heirs and that such an estate would have a value significantly less than the value of the fee interest in the Pasadena Property and thus would not be a change in ownership as defined by section 60.

Property Tax Rule (18 Cal. Code Regs.) 462(d)(1), however, provides that the creation of a life estate (except by reservation) or the transfer of a life estate in real property is a change in ownership.

Thus, the fact that the interest transferred would be equivalent to a life estate does not mean that such transfer is not a change in ownership.

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You next argue that no beneficiary's interest would be altered as a result of the transfer because no beneficiary has a vested interest either legal or equitable in the Pasadena Property. Instead, it is your position that each beneficiary has an undivided interest in the assets as a whole.

Under Probate Code, section 16000, the trustee must administer the trust according to the express terms of the trust instrument. As indicated above, the express terms of the Trust under the Will of Elmer S. direct that "separate accounts shall be kept for each trust to which shall be assigned appropriate undivided interests in the property constituting the trust estates of the various trusts". Since the beneficiary of a testamentary trust has an equitable estate in the trust property vesting at the time of death of the testator (Estate of Feureisen (1971) 17 Cal. App. 3d 717) and since each separate trust for a beneficiary must, under the terms of the Trust under the Will of Elmer S., be assigned an appropriate undivided interest in the trust property, we are of the opinion that the beneficiaries do have vested equitable interests in the Pasadena Property (i.e., John 1/6th, James 1/6th, Paul 1/6th and Susan 1/2). Accordingly, a transfer of the Pasadena Property to Susan's separate trust would, in our view, be a change in ownership as to an undivided one-half interest in that property.

Your final argument is that Donald, as Trustee, could simply carve out 1/2, 1/6th, 1/6th and 1/6th pieces of each and every asset in the trust corpus, in kind, in order to make separate parts in accordance with the terms of the decedent's Will. (In our view, the Will compels this.) However, he is entitled under State law to make non pro-rata distributions with respect to particular trust assets in order to effect a total plan of partitioning of the trust corpus, so long as the net effect of such a plan is fair and equitable to all beneficiaries. Accordingly, Donald would be making an initial division into four separate trusts in the manner proposed. Although the division would be made in 1991, it would be, in effect, a nunc pro tunc division, dating back to the creation of the Trust in 1973. As such, it would pre-date the enactment by initiative of California Constitution, Article XIII A and there would be no "change in ownership" issue presented.

We agree that State law (Probate Code §16246) entitles the trustee to make non pro-rata distributions. As indicated above, decedent's Will also permits non pro-rata distributions "[u]pon any partial or final distribution of the trust estates". The transfer proposed, however, is not a partial or final distribution of the trust estates. Instead, it is

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purportedly part of the funding of the separate trusts created under the decedent's Will. Moreover, your argument ignores the fact that decedent's Will requires that each separate trust "be assigned appropriate undivided interests in the property". As concluded above, that results in each beneficiary having a vested equitable interest in the Pasadena Property so that the proposed transfer would result in a 50% change in ownership in the Pasadena Property.

The views expressed in this letter are advisory only and are not binding upon the assessor of any county. You may wish to consult the Los Angeles County Assessor in order to confirm that the subject property will be assessed in a manner consistent with the conclusion stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,

Eric F. Eisenlauer

Eric F. Eisenlauer
Tax Counsel

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