

W surrendered the #1 Certificate Evidencing Shares of Beneficial Interest (Certificate) at that meeting, "in exchange for membership on [the] Board of Trustees," and received the #2 Certificate with ten shares of "beneficial interest." The meeting minutes then state that the "balance" of the 100 shares were issued to the following "Trustees": Certificate #3 to B for no shares, Certificate #4 to W for one share, and Certificate #5 to L for one share. (May 30, 1983 Minutes of the Board of Trustees (Meeting minutes), ¶ 19.) Additionally, six separate Certificates are attached to the meeting minutes, dated the same day as the meeting itself, each conferring five shares to six individuals who you believe to be W's children. It is uncertain because the Trust instrument and meeting minutes do not make reference to such additional Certificates.

The Certificates state that they do "not confer any interest in or to the Trust assets, or in any management or control thereof," and that they are "non-transferable." They are also irrevocable except by death, resignation, or removal of the holder by the Board of Trustees.

The meeting minutes, after paragraph 19, dedicate a space to identifying the beneficiaries, but that space is left blank. Nevertheless, the Trust provides that any income accruing to a minor beneficiary is to be used to promote their educational or cultural progress, and later their family and estate. (Trust, ¶ 12.) However, no beneficiary may enforce a demand for any accounting or report from the Trustees relating to management of the Trust or any other action taken or performed in their capacity as Trustee. (Trust, ¶ 19.) On their part, the Trustees "accept[ed] the control over, and the wise preservation of, the assets conveyed to this Trust for the benefit of the Beneficiaries of this Trust...they pledge[d] their best efforts and interest in protecting and preserving the assets of this Trust." (Trust, ¶ 2.)

The Trustees are authorized to "do anything and perform any act that would be legal for an individual, ... and that by their Minutes may set forth their own general powers and authority as conferred upon them in this Contract of Trust." The Trust confers limited liability on the trustees, creator, and beneficiaries (Trust, ¶ 23), and the death or bankruptcy of a trustee, or transfer of a Certificate of Beneficial Interest will not affect the operation of the Trust. (Trust, ¶ 26.) The Trustees may terminate the Trust at any time by unanimous decision for "good and sufficient reasons," at which time the assets must be liquidated and the proceeds distributed to the beneficiaries on a pro-rata basis. (Trust, ¶ 22.) The Trustees are also authorized to issue Shares of Beneficial Interest as replacements and to new Trustees, (Trust, ¶ 7) and "may disburse all or any portion of the net income" and the corpus of the Trust "at their discretion". (Trust, ¶ 10.)

Law and Analysis

Business Trusts

We understand that the subject Trust has been assessed as a business trust.¹ Whether trusts fall into the business trust or the non-business, or "ordinary" or "traditional" trust, category is generally a question of fact. (6-44A Powell on Real Property § 44A.02, *supra*, at section 1.)

¹ By definition, a business trust is an entity created by a declaration of trust, by the terms of which property is transferred to trustees, to be held and managed by them for the benefit of persons holding transferable certificates representing the beneficial interest in the trust estate and assets. (6-44A Powell on Real Property (2012) Business, Security and Voting Trusts and Other Trusts Involving Real Property, § 44A.02; 88 A.L.R.3d 704 (2009), section 3.)

Pertinent facts that courts consider in determining whether a trust is a business trust or a traditional trust² are set forth below.

First, business trusts "differ[] from the common-law [traditional] trust in that the purpose of the traditional trust is to conserve property, with incidental powers of sale and investment, while the acknowledged goal of the business trust is to carry on a business enterprise for profit."³ In this case, the _____ and _____ Trust fails to identify any explicit purpose at all. The Trust instrument does state that the Trustees "pledge[d] their best efforts and interest in protecting and preserving the assets of this Trust," (Trust, ¶ 2), which we understand to be a residence. Other than periodic references to "income" that could accrue from no specified source, there is no indication in the Trust instrument of any business enterprise or profit motivation with which the Trust is engaged. Without a business purpose, the Trust cannot qualify as a business trust.

Additionally, a business trust is formed by the voluntary, consensual act of the parties, and is based upon contract. (6-44A Powell on Real Property § 44A.02, *supra*, section 8; *Berry v. McCourt* (1965) 1 Ohio App.2d 172, 177-178.) In contrast, the beneficiaries of ordinary trusts do no more than accept the benefits thereof by gift from the settlor, and are not the voluntary planners or creators of the trust arrangement. (26 C.F.R. 301.7701-4(a); 88 ALR.3d 704 (2009), p. *5; *Plymouth Secur. Co. v. Johnson* (1960, Mo.) 335 S.W.2d 142, 149.) In the case at hand, although the documents are labeled, "Trust Contract" and "Contract of Trust," there is no indication that the beneficiaries (if any exist; see discussion *infra*) of the Trust gave any voluntary, mutual consent to enter a contractual relationship, contributed any capital, made any investment in the Trust res, negotiated an agreement, or provided any consideration for any interests they are purportedly to receive. Rather, the beneficiaries did no more than accept the benefits thereof by gift from the settlor, and are not the voluntary planners or creators of the trust arrangement. This weighs against the subject Trust qualifying as a business trust.

Furthermore, "[t]he certificates representing shares of beneficial interest in a business trust resemble shares in a corporation and are issued and transferred in a similar manner. Holders are entitled to share ratably in the income of the trust and, upon termination of the trust, in the proceeds of the business." (6-44A Powell on Real Property § 44A.02, *supra*, section 18; 88 A.L.R.3d 704 (2009), p. 3; *Goldwater, supra*, at p. 416-417; *Bernesen v. Fish* (1933) 135 Cal.App. 588, 599-600.)

² Notably, comparing a business trust to a traditional trust is a discussion distinct from, and should not be confused with, comparing a business trust to a business association (such as a partnership or corporation). For example, a body of law exists which discusses application of the "control test," wherein if the trustees, vested with title to the property, possess the exclusive right to manage the property and conduct its business affairs free from the control of the certificate holders/beneficiaries, the organization is treated as a "business trust," but if the certificate holders actually control the property and the trustees are subject to their control as their managing agents, the organization is treated as a partnership or business association. (*Goldwater v. Oltman* (1930) 210 Cal. 408; *Engineering Service Corp. v. Longridge Inv. Co.* (1957) 153 Cal.App.2d 404.) In this case, to the extent that the Trustees of the _____ Trust are vested with title and possess exclusive rights to manage the property free from control of the certificate holders, this only shows that it is not a business association; it does not show that, or even address whether, it is a valid business trust. Whether it is a valid business trust is otherwise addressed throughout this letter.

³ (6-44A Powell on Real Property § 44A.02, *supra*, at section 8; Rev. & Tax. Code § 23038(b)(1); *In re Sung Soo Rim Irrevocable Intervivos Trust* (1995) 177 B.R. 673; *In re Treasure Island Land Trust* (1980) 2 B.R. 332; *Morrissey v. Commissioner* (1935) 296 U.S. 344, 357 [providing examples of various purposes of business trusts].)

In this case, the Certificates do not resemble shares of corporate stock, primarily because they are not transferrable. They are irrevocable and do not entitle the holders to share ratably in the income of the Trust, or, for that matter, to "any interest in or to the Trust assets, or in any management or control thereof." (*See* Certificates.) (Emphasis added.) They also state that the Certificate becomes immediately null and void upon the death of a holder, and are "preferably" to be re-issued to the Creator's family or relatives. Certificate holders are also subject to "removal" by the Board of Trustees. There are no indications of the value of each Certificate, or provisions for any consideration to be given in exchange for the Certificate.

In a valid business trust, the holders of certificates of beneficial interest have the same right to examine the records of the trustee as do shareholders in a corporation, and "the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust." (*Wallace v. Malooly* (1954) 4 Ill.2d 86, 95; *Strauss v. Superior Court of Los Angeles County* (1950) 36 Cal.2d 396, 401-402.) However, the subject Trust states that no beneficiary is empowered to enforce a demand for any accounting from the Trustees relating to any action taken by the Trustees in their capacity as Trustees. (Trust, ¶ 19.) This provision is contrary to legal principles involving the rights of beneficiaries and duties of trustees, regardless of the type of trust at issue. This weighs against finding the Trust to be a valid trust at all. (See discussion of Traditional Trusts, *infra*.)

Further, a court will examine the "economic realities of the situation," such as the business activity in which the trust is actively engaged, the economic byproducts that customarily result from the conduct of business such as trade creditors or other debts, and compliance with registration requirements of the securities laws. (*In re Treasure Island Land Trust* (1980) 2 B.R. 332, 334-335.) In this case, there is no indication of any business activity in which the Trust is actively engaged. It is unknown whether the Trust has any trade creditors or other debts that customarily result from the conduct of business, whether the Trust has complied with securities laws, registered with the state of California as any type of business entity, complied with California's fictitious name statutes, or filed income tax returns such as IRS Form 1041 (United States Income Tax Return for Estates and Trusts).⁴ If the Trust is actually engaging in any business activities, that would weigh in favor of finding the Trust to be a business trust. However, we currently have no information that it is engaging as such, but rather that the Trust consists of residential property. Based on the foregoing reasons, we do not believe the Trust is a valid business trust.

If, however, the Trust in this case was a valid business trust, it would be regarded as a legal entity for property tax law purposes. (See Property Tax Rule 462.160(e); see also, for example, Property Tax Annotations⁵ 220.0398 (April 26, 1994) and 220.0399 (January 13, 1998).) Therefore, the legal entity rules governing transfers of property to and from legal entities would apply. (See Rev. & Tax Code, § 64 and Rule 462.180.)

⁴ The Trustees apparently desire not to disclose the Trust document itself and its assets, as they stated in their Board Meeting Minutes, "NOTE—The SCHEDULE OF TRUST ASSETS AND THE AFFIDAVIT [transferring the personal property and assets to this Trust] are NOT to be recorded!" (emphasis in original.) (Meeting minutes, ¶ 7.) The Minutes also state at ¶ 17: "NOTE—If the IRS asks for a copy of the TRUST CONTRACT, all they are to receive is a copy of Page 1."

⁵ Property tax annotations are summaries of the conclusions reached in selected legal rulings of State Board of Equalization counsel published in the State Board of Equalization's Property Tax Law Guide. (See Cal. Code Regs., tit. 18, § 5700 for more information regarding annotations.)

Section 61, subdivision (j) of the Revenue and Taxation Code,⁶ provides that a change in ownership as defined in section 60 includes the transfer of any interest in real property to or from a legal entity. (See also Property Tax Rule 462.180, subd. (a).) However, if the transfer is between affiliated corporations, or 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, exclusions may apply. (Rev. & Tax. Code § 64, subd. (b); Property Tax Rule 462.180, subd. (b)(1); Rev. & Tax. Code § 62, subd. (a)(2); Property Tax Rule 462.180, subd. (b)(2) and 462.180, subd. (d)(4).)

The transfers into and out of the Trust did not occur between affiliated corporations. Instead,⁷ a transfer of real property from the Trust, whose shares of beneficial interest were apparently held by seven individuals,⁸ was made to W and B B as joint tenants. Upon execution of the Grant Deed, six individuals no longer had any interest in the Trust property, and B B became a new joint tenant with W B. For that reason, the exclusion contained in section 62, subdivision (a)(2) is not applicable, and the transfer would constitute a change in ownership, subjecting the entire property to reassessment. (See also, Property Tax Annotation 220.0399 (January 13, 1998) p. 1-2.) If this trust was a valid business trust, the same analysis would apply to the Warranty Deed dated June 11, 2012, wherein the same property was deeded from W and B B as joint tenants, to the Trust. We have no information as to the status of the Certificates as of that date, but if the beneficial interests in the property after the transfer were not identical to the interests prior to the transfer, then the transfer of the property would cause a change in ownership, subject to 100 percent reassessment.

Traditional Trusts

We turn to the question of whether the Trust is an ordinary, traditional trust, since we do not believe it is a business trust. In order to constitute a valid trust there must be, in addition to the existence of a trustor, trustee, and property in the trust, a fiduciary relationship, as well as a purpose and beneficiary, which are to be "indicat[ed] with reasonable certainty" in the declaration of trust. (*Reagh v. Kelley* (1970) 10 Cal.App.3d 1082, 1089; Prob. Code § 15200-15207; Rest.3d Trusts, (2003) § 2.) "If the language [of the trust] is so vague, general, or equivocal that any of these necessary elements of the trust is left in real uncertainty, then the trust must fail." (*Union Trust & Sav. Bank v. Ishkanian* (1919) 45 Cal.App. 347, 349, citing *Wittfield v. Forster* (1899) 124 Cal. 418.)

In this case, the Trust documents identify the Trustor, Trustees, and property. However, the Trust does not identify beneficiaries or establish a purpose or a fiduciary relationship with reasonable certainty, and we believe it lacks economic substance. For these reasons, we do not believe the Trust is a valid trust.

⁶ All further statutory references are to the California Revenue and Taxation Code, unless otherwise specified.

⁷ The Trust documents are unclear on how the property was placed into the Trust and how the shares of beneficial interest were distributed, so we are not commenting on the property tax consequences of a possible change in ownership at the initiation of the Trust in 1983.

⁸ It is unknown whether any transfers of the shares of beneficial interest were made during the life of the Trust, but based on the documents in our possession, our most current information is that W owned 10 shares and six other individuals owned 5 shares each. We therefore base our opinion on this information.

"[I]f property is transferred upon an intended private trust and no definite or validly ascertainable beneficiaries are provided, no express trust is created." (Rest.3d Trusts, *supra*, § 2; *Reagh, supra*, at p. 1092.) For example, in *Limbaugh v. Department of the Treasury* (N.D.Cal., August 18, 1998, No. C97-2040 TEH) 1998 U.S. Dist. LEXIS 13157, the court held that the trust at issue was invalid, in part because it failed to designate or identify any beneficiaries in the trust, but rather "only provides for Certificates of Beneficial Ownership divided into one hundred units which are 'non-assessable, non-taxable..., non-negotiable but transferable.'" (*Limbaugh, supra*, at p. 6.) The Court also found the trust to be invalid because the Certificate owners were given no beneficial interest over the res, the trustees had unbridled discretion over the management of the trust property without fiduciary obligations, and the trustees retained both legal title and all beneficial interest in the trust res. (*Id.* at p. 6-16.) (See also *United States v. Geissler* (1993) 94-1 U.S. Tax Cas. (CCH) P50,060, at p. 20-21; *Markosian v. Commissioner* (1980) 73 T.C. 1235, 1242.)

In this case, the Trust fails to identify any beneficiaries in the Trust instrument, despite designating space during the Trustees' first meeting on the same day the Trust was created to do so, and fails to make any reference to the "Certificates evidencing Shares of Beneficial Interest." However, even if the Trust did make such reference, the Certificates convey no interest in the Trust assets, management, or control thereof. To the extent that Certificate holders could be deemed beneficiaries, nowhere in the Trust instrument or any of the attached documents are they given any beneficial interest over the res. Thus, there are no ascertainable beneficiaries, and for that reason, no express trust can be created.

Lack of Economic Substance

"[I]f [a] Trust has no economic substance, then any transfer to it ... will be disregarded because the trust is a sham." (*United States v. Geissler, supra*, at p. 18; *Zmuda v. Commissioner* (1984) 731 F.2d 1417, 1421; *Neely v. United States* (9th Cir. 1985) 775 F.2d 1092, 1094.) "[W]hen the settlor is trustee and the beneficiaries are the settlor and his family, such trust arrangements must be closely scrutinized for economic substance." (*Markosian, supra*, at p. 1245.) The Tax Court in *Markosian* set forth four factors used to determine whether the trust in question lacked economic substance: (1) the grantor's relationship to the property did not differ materially before and after creation of the trust; (2) there was no independent trustee to prevent the trustees from acting in derogation of the interests of the other beneficiaries; (3) no economic interest passed to other beneficiaries of the trust; and (4) the trust imposed no substantial restriction on the trustee's use of the trust property. (*Markosian, supra*, at p. 1243-1245.)

Applying these four factors, it appears the Trust lacks economic substance. First, we have no information as to whether the grantor's (W's) relationship to the property, such as beneficial use or payments made, materially differed before and after creation of the Trust. Second, there was no independent trustee to prevent the Trustees from acting in derogation of the interests of the other beneficiaries. Third, there is no indication that any economic interest passed to other beneficiaries of the Trust. The Trust does not identify any beneficiaries, and to the extent that Certificate holders can be construed as beneficiaries, such holders are not conveyed any rights. Finally, the Trust imposes no substantial restriction on the Trustees' use of the Trust property.

If the subject Trust, however, were a valid ordinary trust, we would analyze whether a change in ownership occurred according to section 60 and other rules pertaining to trusts. Section 60 defines a *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. Property Tax Rule 462.160 states that for irrevocable trusts, "The transfer of real property by the trustor to a trust in which the trustor-transferor is the sole present beneficiary of the trust [does not constitute a change in ownership]. However, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor are or become present beneficiaries of the trust unless otherwise excluded from change in ownership." (Rule 462.160, subd. (b)(1)(A).)

In this case, no beneficiaries are named in the Trust. If, however, the certificate holders are considered to be the beneficiaries, a change in ownership would have occurred to the extent that the six individuals other than the trustor-transferor, W B , became present beneficiaries of the trust. However, there would be no change in ownership if the beneficiaries were otherwise excluded from change in ownership.⁹ The same analysis would apply when the property is transferred out of the Trust and deeded to W and B B as joint tenants, and upon execution of the Warranty Deed dated June 11, 2012, deeding the property from W and B B back into the Trust.

If the Trust was a valid revocable trust, there would be no change in ownership consequences because in a revocable trust, the Trustors remain as the beneficial owners of the property due to their power to revoke, while the beneficiaries merely have future beneficial interests. Therefore, the Trustors could transfer the property in and out of the trust, and there would be no change in ownership consequences.

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.

Sincerely,

/s/ Sonya S. Yim

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J:/Property/Precedent/Changeownshp & Trusts/2012/12-075

cc: Mr. David Gau MIC:63
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⁹ Since you have mentioned that the certificate holders may be W B 's children, it is possible that this transaction could have been excluded from change in ownership under the parent-child exclusion.