



## STATE BOARD OF EQUALIZATION

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August 19, 2013

**Re: Parent-Child Transfers  
Assignment No.: 13-059**

Dear Mr. \_\_\_\_\_ :

This is in response to your letter requesting an advisory opinion concerning whether certain transfers of real properties constitute a change in ownership. As explained below, we agree with you that the transfers will not result in any changes in ownership assuming the facts you have provided to us are correct.

**Factual Background**

Husband and Wife own four properties in a joint revocable trust (Original Trust). The four properties are Husband and Wife's community property. The Original Trust provides that upon death of first spouse, three sub-trusts are created consisting of a Survivor's Trust, Bypass Trust, and Marital Trust.

The Survivor's Trust is a revocable trust holding one-half of Husband and Wife's community property for the benefit of the surviving spouse which provides as much principal and interest as spouse determines he or she needs in the spouse's own discretion. The Bypass Trust holds an amount equal to the deceased spouse's lifetime exclusion under federal estate tax law and is funded out of the deceased spouse's share of community property. The surviving spouse is the sole lifetime beneficiary, and is to receive the amount of income and/or principal necessary for the spouse's health, support, maintenance and education. The Marital Trust is funded with any share of the deceased spouse's community property not allocated to the Bypass Trust. The surviving spouse is the sole lifetime beneficiary and will receive all of the income as well as the amount of income and/or principal necessary for spouse's health, support, maintenance and education.

Husband (Deceased Spouse or Husband) dies and is survived by Wife (Surviving Spouse or Wife). The properties are then allocated in accordance with the trust terms discussed above. Parcel A is allocated to the Survivor's Trust, Parcel B is allocated to the Bypass Trust, and Parcel C and D are allocated to the Marital Trust. After being transferred to the Marital Trust, Parcel C is sold to an irrevocable trust (Gifting Trust) whose sole lifetime beneficiaries are Husband and Wife's children (Children). The Gifting Trust provides that the Children will receive so much of

the income and principal necessary for their health, support, maintenance, and education. Upon the death of Surviving Spouse, Parcel D will be distributed from the Marital Trust to the Children in separate trusts with each trust having a child as its sole income and principal beneficiary during each child's lifetime.

### **Law & Analysis**

Revenue and Taxation Code<sup>1</sup> section 60 provides that a change in ownership is "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." Section 61, subdivision (h) provides that change in ownership includes "[a]ny interests in real property that vest in persons other than the trustor (or, pursuant to Section 63, his or her spouse) when a revocable trust becomes irrevocable."

Section 61, subdivision (g) provides that a change in ownership includes:

Any 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.

As explained below, changes in ownership may occur upon both the creation and termination of life estates (upon the transfer to the life tenant and again upon transfer to the remainderpersons), unless an exclusion applies. Subdivision (a) of Property Tax Rule<sup>2</sup> (Rule) 462.060, which interprets and implements section 61, subdivision (g), provides that:

The creation of a life estate in property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse. However, the subsequent transfer of such 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.

Upon termination of a life estate at the death of the life tenant, there occurs a vesting of the remainder. The grantor of a life estate and the remainder that vests upon the termination of that estate is considered the transferor of both interests for change in ownership purposes unless the life tenant holds a general power of appointment.<sup>3</sup> However, where the life tenant transfers her life estate prior to her death, Property Tax Annotation<sup>4</sup> (Annotation) 220.0372 (4/13/1992) clarifies that the transfer of a life estate by the life tenant during his or her lifetime is considered to be a transfer by the life tenant rather than the grantor of the remainder interest.

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<sup>1</sup> All section references are to the Revenue and Taxation Code unless otherwise specified.

<sup>2</sup> All references to Property Tax Rules or Rules are to title 18 of the California Code of Regulations.

<sup>3</sup> See Property Tax Annotation 220.0372.010 (3/6/2006).

<sup>4</sup> 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.)

As relevant herein, section 63, provides that a change in ownership does not include any interspousal transfer, including, but not limited to:

- (a) Transfers to a trustee for the beneficial use of a spouse, or the surviving spouse of a deceased transferor, or by a trustee of such a trust to the spouse of the trustor;
- (b) Transfers which take effect upon the death of a spouse.

Additionally, section 63.1 excludes from a change in ownership specified purchases or transfers of real property between parents and their children for which a valid and timely claim is filed. Section 63.1, subdivision (c)(9) specifically provides that "'Transfer' includes, and is not limited to, any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust."

### **Survivor Trust**

After Husband's death, the transfer of Parcel A from the Original Trust to the Survivor's Trust is excluded from change in ownership. Pursuant to section 62, subdivision (d) and Rule 462.160, subdivision (b)(2), transfers by a trustee of a revocable trust to a trustor or a trustor's spouse are excluded from change in ownership. Here, Wife was a trustor of the Original Trust and the sole present beneficiary of the Survivor's Trust so her interest in Parcel A did not change ownership. Further, Husband's interest in Parcel A passed to Wife, his spouse, and was also excluded from change in ownership.

### **Bypass Trust**

Upon the death of Husband, the transfer of Parcel B from the Original Trust to the Bypass Trust creates a life estate in Wife which is a change in ownership unless an exclusion applies. (Rule 462.060, subd. (a).) Here, the transfer is a transfer between spouses and is therefore excluded from change in ownership pursuant to section 63, subdivisions (a) and (b). As stated above, Parcel B was allocated to the Bypass Trust which is for the benefit of Wife during her lifetime with the remainder to Children. At Husband's death, a remainder interest in Parcel B was created for Children. At Wife's death the remainder will vest in the Children and that transfer will be eligible for the parent-child exclusion under section 63.1. As well, because Parcel B had been a community property asset before its transfer into the Original Trust, and had been owned by both Husband and Wife, Husband and Wife will both be considered transferors of Parcel B for purposes of the parent-child exclusion.<sup>5</sup> (Back up letter to Annotation 625.0120 (9/30/1993).)

### **Marital Trust**

Upon Husband's death, Parcels C and D are transferred to the Marital Trust.<sup>6</sup> Wife is the sole beneficiary of the Marital Trust for her lifetime, with a remainder to the Children. Again this transfer constitutes a transfer between spouses and is therefore excluded from change in ownership pursuant to section 63, subdivisions (a) and (b).

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<sup>5</sup> We note that you state that the Bypass Trust was to be funded by Husband's portion of the community property. However, the entirety of Parcel B, including Wife's community property interest, was allocated to the Bypass Trust. We assume the trustee had the discretion to make such an allocation.

<sup>6</sup> Again, we assume that the trustee had the discretion to make this allocation.

The sale of Parcel C from the Marital Trust to the Gifting Trust, an irrevocable trust whose lifetime beneficiaries are Children, is also eligible for the parent-child exclusion. In this case, Wife would be the transferor of Parcel C since she is the holder of the present beneficial interest at the time of the sale. (Annotation 220.0372.) Therefore, this transfer may be excluded from change in ownership because it is a transfer to which the parent-child exclusion applies, assuming a timely claim is filed and all other requirements are met.

Upon Wife's death, the transfer of Parcel D from the Marital Trust to the Children in separate trusts for their benefit will be a change in ownership pursuant to section 61, subdivision (g), unless excluded from change in ownership. As with the property in the Bypass Trust, because Parcel D had been a community property asset before its transfer into the Original Trust, and had been owned by both Husband and Wife, Husband and Wife will both be considered transferors of Parcel B for purposes of the parent-child exclusion. (Back up letter to Annotation 625.0120.)

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, and are not binding on any person or public entity.

Sincerely,

/s/ Daniel Pal

Daniel Paul  
Tax Counsel III (Supervisor)

DMP:yg

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