ATE OF CALIFORNIA

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February 8, 1999

Attorney at Law

In re: Revised Change in Ownership Opinion: Transfers among Five Trust Beneficiaries – Termination and Transfer of Each Life Estate.

Dear Mr. :

This is in further response to your December 2, 1997 communication and your February 11, March 31 and June 2, 1998 letters, in which you requested our opinion concerning the change in ownership consequences of transfers of life income interests in properties under a Mother's irrevocable trust to her five sons and re-transfers of such interests upon each son's death to the surviving sons, until the death of the fourth son, at which time the trust properties were distributed one half to the last surviving son and one half to the Mother's grandchildren. Upon reconsideration, this letter constitutes a revision and a superseding analysis of our previous letters dated December 19, 1997, April 14, 1998, and June 24, 1998, and restatement of questions 2 and 3 of our previous letters.

This analysis is based on the following set of circumstances involving an irrevocable trust and five beneficiaries with lifetime interests in the trust properties:

1. Mother ("M"), by a 1953 will, provided for the transfer of her properties into a spendthrift testamentary trust, which directed that after her death all income (but no part of the principal) from the properties would be distributed semi-annually to her five sons in equal shares, and that the beneficial interest of each son would cease upon his death to be re-allocated in equal shares to the surviving sons until only one son remained. Upon the death of the fourth son, the trust was to cease and the trust properties were to be distributed one-half to the surviving son and one-half in equal shares to M's grandchildren. M died in 1962.

2. At all times, the trust properties have been subject to a lease of less than 35 years, which granted to the lessee the right to extract sand, gravel and rock, and granted to the trust the right to receive royalties representing its entire net income. Over the years, several sales and exchanges of trust properties occurred, which reduced the number of parcels originally placed in the trust to two. There are eight other parcels (hereinafter "other parcels"). The death of each son and the transfer or contemplated transfer of his respective share to the surviving sons and grandchildren occurred as follows: A died in 1974, B died in 1986, C died in 1988, D died in 1995, and E died in 1997.

3. No change in ownership statement was ever filed following the death of each son. After D died in 1995, E as Trustee met with the Assessor's staff and reviewed trust documents to determine the need for filing change in ownership statements; E was advised that no statement was required. Following D's death in 1995, no deeds transferring title to the trust properties either to E or to M's grandchildren were executed.

4. As of the date of E's death, both parents of some of the grandchildren had predeceased E, and these grandchildren have not received the maximum benefit of the parent/child exclusion under Proposition 58.

Based on the foregoing, you ask three questions, which results in a revision and a superceding analysis of our previous December 19, 1997, April 14 and June 24, 1998 letters. First, you question whether the death of each beneficiary/son triggered a change in ownership of his percentage income interest in the trust properties. Secondly, you question whether change in ownership statements should have been filed and if so, whether penalties may be imposed. Thirdly, you question whether the grandparent/grandchild exclusion may be applied to the transfer by will to E's heirs at the time of his death in 1997.

For the reasons hereinafter explained, the answer to all three questions is yes, except to the extent that the parent/child or grandparent/grandchild exclusion in Section 63.1 apply.

Question 1.

Did the death of each beneficiary/son trigger a change in ownership of his percentage income interest in the trust property?

Answer: Yes, except to the extent that the Section 63.1 exclusion applies.

In general, there is only one change in ownership[1] for real property transferred in trust, and that occurs either upon the creation of a trust (such as a transfer to an irrevocable trust in which the trustor/transferor is not the beneficiary) or upon the termination of a trust (when the trustor dies and the property transfers to the beneficiaries). Subject to certain exceptions under Property Tax Rule 462.160 (a), the transfer of real property into an irrevocable trust, or the date that a revocable trust becomes irrevocable, is a change in ownership of the trust property. In addition, under Section 61(g), any vesting of the right to possession or enjoyment of a remainder interest, which 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, is a change in ownership. Where, as here, the trustor grants to the trust beneficiaries life estates in the trust property, changes in ownership may occur upon both the creation and termination of the life estates (upon transfer to the remainder persons), unless an exclusion applies.

Under Rule 462.060, the creation, transfer, or termination of a life estate is a change in ownership, apart from the application of an exclusion.

[1] Under Section 60, a change in ownership constitutes any "... 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."

> (a). LIFE ESTATES. The creation of a life estate in real 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 a 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.

Under the life estate exclusion of Section 62(e), if the transfer is to the transferor or the transferor's spouse, then transfer of an estate for life does not constitute a change in ownership.[2] Alternatively, if the transfer of the life estate is to the children of the grantor/transferor, then the parent/child exclusion under Section 63.1 may apply. Further, if the beneficiaries of the life estate (the life tenants) are the children of the transferor, and the ultimate beneficiaries are remainder persons who qualify as the grandchildren of the transferor, then both the parent/child exclusion and the grandparent/grandchild exclusion under Section 63.1 may apply. In that case, both the creation and the termination of the life estate (including the vesting in the remainder persons) could be excluded from change in ownership.

A life estate is defined as an estate whose duration is *limited to the life of a person* holding it, or to the life of some other person. Estate of Smythe (1955) 132 Cal.App.2d 343. A life estate can be granted or reserved by deed, created by will, trust or by any other written instrument. No particular language is required to create a life estate. It is any reservation of a lifetime interest (estate) in a recorded instrument creating a right or privilege for the benefit of the grantor or others in the land and withholding that right or privilege from the operation of the grant. By the reservation, the grantor reserves something in himself or others which is newly created by the grant. Victory Oil Co. v. Hancock Oil Co. (1954) 125 Cal.App.2d 222.

This definition is consistent with the rationale for the exclusion adopted by the Legislature in Section 62 (e). That rationale, stated in Implementation of Proposition 13, Vol. I, Property Tax Assessment, by the Assembly Revenue and Taxation Committee, October 29, 1979, page 29, is as follows:

> (3)...Transfers with a retained life estate are not ownership changes until the life tenant dies. The life tenant has the dominant or primary interest under the value equivalence element of the general change in ownership definition, and there is no transfer of the present interest in the property until the life tenant dies and the property vests in the remainder. At that time, the provisions of trusts and interspousal transfers permitting, a change in ownership shall be deemed to have occurred (Section 62(e)).

Based on the facts here, Mom's properties transferred in equal shares to five beneficiaries (her sons) through the trust which became irrevocable when she died in 1962. There would have been a change in ownership of the properties at that time, except that the transfer was before the adoption of Proposition 13. Each son became a sole present beneficiary, therefore the owner, of 20% of the trust property at that time. The fact that their interests were held as "income" beneficiaries, rather than in possession or "use," does not alter the fact that they each held present beneficial ownership in the property to the extent of their percentage interest. Whether the beneficiary makes a present use of his percentage interest in the property, or whether he receives the income produced by his percentage interest in the property, he is considered the

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[2] The decision in *Pacific Southwest Realty Co. v. County of Los Angeles* (1991) 1 Cal.4th 155 does not alter the conclusion that each of the five sons, as beneficiaries with lifetime income interests under the trust, owned present beneficial interests in the trust properties per Section 60. There is no inconsistency between that case and the Eisenlauer Memorandum, 7/28/89, Annotation No. 220.0780.

"owner" and proper assessee of that percentage interest for property tax purposes. (See Eisenlauer Memorandum, 7/28/89, Annotation No. 220.0780, Enclosed).

The primary question is whether additional changes in ownership of the trust property occurred during the ensuing years as the result of the death and termination of the life estate of each son, B, C, D, and E. (There was no change in ownership in 1974 when A died, since it was before the adoption of Proposition 13.) In our previous opinion letters to you, we answered this question affirmatively, because the termination of a life estate resulting from the death of a life tenant with a vesting in another person constitutes a change in ownership, and the parent/child exclusion did not apply since the transfer was made by each son. However, overlooked was our longstanding position regarding transferors: where a life estate terminates as a result of the death of the life tenant, the transfer to the remainderman is from the transferor of the remainder interest, not from the life tenant. (See Annotation Nos. 220.0372 and 220.0373, enclosed.) This is because the statutory language in Section 61(g), Section 61(h) and Section 62(d) always identifies the grantor of a life estate as the "transferor" of the remainder or reversionary interest. The only "exception" occurs when the life tenant has not died, but transfers his interest during his lifetime to the remainder person or to a third party, in which case the life tenant is the "transferor." (See Annotation No. 220.0372, Enclosed.)

In the instant case, Mom, as grantor/trustor, directed that on the date of each son's death, his interest would transfer to her surviving sons in equal shares. Under the trust instrument, when each son died, his life estate terminated and his percentage interest transferred by order of Mom's trust to the other sons. Thus, Mom was the "transferor," not the deceased life tenant (son). Since Mom was the transferor, the parent/child exclusion and/or the grandparent/grandchild exclusion in Section 63.1 would apply to exclude from change in ownership the termination of each life estate, providing that the filing and other requirements are met. If for some reason, any one of these transfers does not qualify for the exclusion, (e.g., if the 1986 termination of B's life estate and transfer to C, D, and E, occurred before the effective date of the parent/child exclusion (Proposition 58) on November 6, 1986), then the change in ownership would not be excluded, and the trust property would be reappraised to the extent of the interest transferred (e.g., B's former interest would be reappraised).

Based on the foregoing, the following consequences occurred on the death of sons A, B, C, D, and E, assuming that the parent/child exclusion or the grandparent/grandchild exclusion applied:

1. No change in ownership in 1974 when A died, since it was before the adoption of Proposition 13; however, when the life estate terminated, surviving sons, B, C, D, and E, received through Mom's trust one-quarter of A's 20% interest, resulting in each owning a 25% interest in the trust property.

2. Change in ownership of B's 25% when his life estate terminated in 1986 and each of the surviving sons, C, D, and E received through Mom's trust one-third of his 25% interest, except that the transfer is excluded under parent/child in Section 63.1. C, D, and E each owned a 33.33% interest in the trust property.

3. Change in ownership of C's 33.33% when his life estate terminated in 1988, and each of the surviving sons, D and E, received through Mom's trust one-half of his 33.33% interest, except that the transfer is excluded under parent/child in Section 63.1. D and E each owned a 50% interest in the trust property.

4. Change in ownership of D's 50% on the termination of his life estate in 1995. Mom's trust terminated, and D's interest transferred to the remainder persons (Mom's grandchildren), with the result that each grandchild received an interest in 50% of the trust property previously owned by D. The grandparent/grandchild exclusion would not apply to the extent of the interests received by D's grandchildren, since it was not adopted until March 26, 1996 (Proposition 193). (No interests transferred to E who retained his 50%.)

5. Change in ownership of E's 50% interest when he died in 1997, because the trust terminated and E's interest transferred to the remainder persons, Mom's grandchildren, with the result that each grandchild received an interest in 50% of the trust property previously owned by E. However, the grandparent/grandchild exclusion may apply.

Question 2.

Were change in ownership statements required to be filed on the death of each son?

Answer: **Yes.**

The language of Sections 480 and 482 clearly provides that Sections 480, 480.1 and 480.2 apply to all changes in ownership subject to their terms and requires statements to be filed for all such changes in ownership "occurring on or after March 1, 1975..." . In regard to trust transfers, Section 480 (b) states (since September 30, 1994) that "the change in ownership statement or statements shall be filed by the trustee (if the property was held in trust) or the transferee with the county recorder or assessor in each county in which the decedent owned an interest in real property within 150 days after the date of death."

Prior to September 30, 1994, the statute was silent regarding the specific duty of a trustee to file a change in ownership statement where the property was held in trust. However, the basic filing requirements were substantially the same in that any transferee of real property or mobilehome subject to local property tax had to file a change in ownership statement. Thus, where the death of a grantor caused or causes a transfer of the beneficial interests in property, the trustee's or transferee's failure to file a change in ownership statement results in escape assessments, interest, and penalties.

Section 482 expressly provides that a change in ownership statement is to be filed, even if the transfer reported did not result in a change in ownership or was excluded from change in ownership under another provision of law. When a transfer does not constitute a change in ownership or is excluded, the penalty for failure to file a change in ownership statement is ten percent of the current year's taxes. Thus, a change in ownership statement should have been filed on the death of each beneficiary son, even if the termination of his life estate was excluded from change in ownership as a parent/child transfer from Mom to the surviving sons or as a grandparent/grandchild transfer from Mom to the grandchildren. Specifically, change in ownership statements should have been filed within 45 days of the death of B in 1986, within 45 days of the death of C in 1988, within 150 days after the death of D in 1995, and within 150 days after the death of E in 1997.

Penalties for failure to file a change in ownership statement may not be imposed, however, unless a person or legal entity fails to do so within 45 days from the date of a written request by the assessor, regardless of whether a change in ownership has actually occurred. (Section 482 and 482.1.) If a written request was made by the assessor and the person failed to file the statement, the consequences of failing to timely file are three-fold.

First, Section 482.1 authorizes the imposition of the penalty described in Section 482, in the amount of either $100, or 10 percent of the taxes applicable to the new base year value reflecting the change in ownership (or current year's taxes if no change in ownership occurred), whichever is greater, but not to exceed $2,500. Second, until the change in ownership statement is filed, the assessor's time limits for making supplemental and escape assessments do not commence (Sections 532 (b) and 75.11(d)). This provision delays the commencement of the statute of limitations period for all escape and supplemental assessments that occur prior to the time the statement is filed. After the statement is filed, there is no further delay, and the limitations period in Section 532(a) and 75.11(d) apply. (This provision does not limit the number of escape assessments made, but sets the time period in which they must be enrolled. See Letter to Assessors No. 95/35, p 5, attached.)

The third consequence is that escape assessments made as the result of a person's failure to file a change in ownership statement are subject to the 25% penalty assessment imposed under Section 504 and the 9 percent interest charge authorized by Section 506. As set forth in Section 531.2, the penalty provisions of Article 3 commencing with Section 501 apply to any "real property which escaped assessment " (including property which has since been transferred to a bona fide purchaser or become subject to a lien) as a result of an unrecorded change in ownership," for which a statement required by Section 480 was not filed. As further set forth in Sections 532 and 75.11(d), the 25% penalty in Section 504 shall be added in the case where real property has escaped taxation or has been underassessed following an unreported change in ownership. (See LTA No. 95/35, p 3, attached.) Interest, as provided in Section 506 at the rate of three-fourths of 1 percent per month (9 percent annual) must also be added.

Once the required change in ownership statements are filed for the transfers occurring on the death of sons B, C, D, and E, the assessor is required to reappraise the portion of the property transferred and levy escape and supplemental assessments as may be appropriate.[3] Thus, if the parent/child exclusion was not in effect on B's death in 1986, escape assessments would apply to B's 25% interest in all trust property on the date of his 1986 death, excluding any parcels transferred to third parties before such date and including all parcels in trust on that date. Since the grandparent/grandchild exclusion was not in effect on the date of D's 1995 death, escape assessments would apply to D's 50% interest in all trust property, excluding any parcels transferred to third parties before such date and including any parcels in Trust on that date.

[3] As an example, if change in ownership statements are filed in January 1998, and the assessor determines that B's death in 1986 triggered a change in ownership of 25% of the property, a new 1986 base year value will be enrolled for each parcel the trust held in 1986. In addition, that value would be factored forward to 1998 for each parcel the trust still held in 1998, and that value for the other parcels would be factored forward from 1986 for each year until the parcels were transferred to others. Escape assessments would then be made for 1987 through 1998 on all parcels not transferred to others at the time and on any parcels which were transferred to others, but only up to the date of the particular transfer. Supplemental assessments would also be made as described in LTA No. 95/35. Simple interest of 9% under Section 506 and a penalty of 25% in Section 504 would also apply.

Question 3.

Does the grandparent/grandchild exclusion apply to the transfer by will to E's heirs at the time of his death in 1997?

Answer: **Yes.**

As explained in our December 19, 1997 letter, the grandparent/grandchild exclusion in Section 63.1(a) and (c) is applicable to the transfer of remainder interests in trust to M's grandchildren, providing that all other requirements are met. You indicated that both of the parents of some of the grandchildren predeceased E, and that these grandchildren did not previously receive the maximum benefit under Proposition 58 from their parents. This fact leads to the conclusion that such grandchildren may be eligible for the grandparent/grandchild exclusion. The result would be to exclude from change in ownership some or all of E's 50% interest in trust property that transferred to M's grandchildren on his 1997 death.

Assuming the occurrence of the death of the parents of some of the grandchildren, the 1997 transfer on E's death would be from M to her eligible grandchildren and would comply with the narrow requirements of the exclusion (which requirements state that it applies "between grandparents and their grandchild or grandchildren," only if "all of the parents of that grandchild or those grandchildren, who qualify as the children of the grandparents, are deceased as of the date of the purchase or transfer.") You are correct in assuming that under such facts the intent of the constitutional amendment (paragraph (2)(A)(B), subdivision (h), Article XIII A), to allow taxpayers the grandparent/grandchild exclusion up to the amount of the parent's $1 million (under the parent/child exclusion), if taxpayer's parents are "deceased," and if taxpayer has not already received the maximum property tax benefit of Proposition 58 from his or her parents, is met. (See Letter to Assessors No. 97/32, attached.)

As stated in our December 19, 1997 letter, this is the same analysis we have provided regarding trusts with an intervening lifetime beneficiary. Since the enactment of Proposition 58 and Section 63.1, the parent/child exclusion has been applicable to transfers through the medium of a trust, provided that the eligible transferee (child) is the beneficiary of the trust. It has further been our position that one may be the present beneficiary of a trust even though the right to receive the income from the trust property lasts only for a beneficiary's lifetime or someone else's lifetime. However, once the lifetime interest of that beneficiary ceases, we have long applied Section 61(g) and Rule 462.060(a) stating that there is a change in ownership at that time, because the entire right to property has then become possessory and has vested in the remainder persons. In effect, when the lifetime beneficiary dies, his or her life estate terminates and the property transfers by prior directive of the trustor/transferor to the remainder persons. Until the adoption of Proposition 193 in 1996, we consistently held in situations such as this, that where the trustor/transferor is a grandparent, the lifetime beneficiaries are the children, and the remainder persons are the grandchildren, the parent/child exclusion does not apply when the grandchildren's remainder interests become possessory, because the "transferor" is the grandparent, not the parents who simply held the intervening life estate.

Now that the grandparent/grandchild exclusion is available, there is no reason why it should not apply in these situations. Since the facts indicate that the grandparent (Mom) is both the trustor (or trustor's spouse) of the trust property and the grantor of the lifetime interests, and since she provided that the remainder interests in the trust properties would transfer to her grandchildren upon the death of the lifetime beneficiaries, she is the "eligible transferor" to her grandchildren for purposes of this exclusion. The grandchildren will qualify as "eligible transferees" under the exclusion in each case in which all of their parents who qualify as the "children" of the grandparent (Mom) are deceased at the time of the

they did not already receive the maximum benefit of the exclusion from their parents under Proposition 58. (See LTA No. 97/32.)

The views expressed herein are, of course, advisory only and are not binding on any person or entity. This is a staff opinion which is based on the existing law and the facts as we understand them, and should not be cited as representing the views of the elected Board or any of its Members.

Sincerely,

Kristine Cazadd
Senior Tax Counsel

Attachments

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cc: Honorable Claude Parrish
Third District Board Member

The Honorable
County Assessor

Mr. Dick Johnson
Mr. David Gau
Ms. Jennifer Willis