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September 10, 1996

Attorneys at Law

Attention: Ms.

Re: Pronosition 58 Remsessment Exclusion

Dear Ms. :

This is in response to your letter to me of August 8, 1996 in which you request our opinion as to whether a "change in ownership" for property tax purposes occurred and if so, to what extent under the following facts described in your letter and set forth below. For the reasons stated hereafter, we are of the opinion that no "change in ownership" occurred.

Factual Background

The decedent died on October 20, 1994. Her estate consisted of cash and her principal residence, all held in the ABC 1993 Family Trust. The decedent resided in the real property with her son prior to her death. The son still resides in the residence.

The Trust provides that following the decedent's death, the Successor Trustee should divide the trust estate into equal shares and distribute one share to each of the decedent's two children, a daughter and a son, free of trust. In the Trust, "trust estate"* refers to "the assets listed in Schedule A and to any other property received by the Trustee." Furthermore, the Trust provides that "the Trustee is authorized to allot and make the division or distribution, pro rata or otherwise, in cash or in kind, including undivided interests in any property, or partly including undivided interest in any property, or partly in cash and partly in kind, in the Trustee's discretion." (Art. Sixth, Sec. A, p. 11.) The Trust also provides that the Trustee has the power to "encumber,

mortgage or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee.” (Art. Fourth, Sec. G, p. 7.)

The Successor Trustee believed that the Trust estate had a net worth of approximately \$322,000, with the real property valued at approximately \$310,000 and all other property valued at \$12,000. Pursuant to the Trust provisions, the Successor Trustee sought to distribute approximately \$161,000 net worth of assets to each child. On April 24, 1995, before making any distributions, the Successor Trustee obtained a loan and Deed of Trust against the Trust real property for \$160,000. The assets of the Trust then consisted of cash, including loan proceeds and the real property encumbered by the Deed of Trust.

On June 2, 1995, the Successor Trustee was ready to distribute the Trust property, and made a non pro rata distribution of \$150,000 of the Trust’s cash to decedent’s daughter. On June 22, 1995, the Successor Trustee made a non pro rata distribution of the real property to decedent’s son individually, subject to the \$160,000 loan and Deed of Trust.

On June 22, 1995, the Successor Trustee executed a proper Claim for Reassessment Exclusion for Transfer Between Parent and Child. He submitted it to the Alameda County Recorder on June 26, 1995.

The Assessor issued a Notice of Supplemental Assessment on January 12, 1996 regarding the reassessment of one-half of the real property after the death of the parent and the distribution of the real property to the decedent’s son. The property was previously on the tax roll at \$47,441. The Assessor appraised it at only \$220,000, one-half of which is \$110,000. Thus, the new assessed value is \$133,441. Subtracting the \$47,441 already taxed, the Assessor issued a Supplemental Assessment to the son of \$86,000 and a supplemental tax of 1.2990% thereon, or \$1,117.14.

The Assessor has indicated that the property was reassessed because “there was not enough money in the trust estate to equally distribute cash to [the daughter]...The Trustee obtained a cash loan to distribute cash to [the daughter] instead of a 50% interest in the above referenced property.” The Assessor relies heavily on a Letter to Assessor dated January 23, 1991, No. 91/08, entitled “Change in Ownership Consequences of Real Property in an Estate or Trust Distributed on a “Share and Share Alike” Basis” (LTA 91/08).

Law and Analysis

As you are aware, Revenue and Taxation Code’ 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.”

¹All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Section 61 provides that, subject to exceptions not here relevant, “change in ownership, as defined in section 60, includes, but is not limited to:...(g)[a]ny interests in real property which vest in persons other than the **trustor...when** a revocable trust becomes irrevocable.”

Proposition 58 added subdivision (h) to section 2 of Article XIII A of the California Constitution. Briefly, subdivision (h) excludes **from** change in ownership the purchase or transfer of the principal residence of the transferor in the case of the purchase or transfer between parents and their **children**. It also excludes the purchase or transfer of the first \$1 **million** of the **full** cash value of all other real **property** between parents **and** their children.

Subdivision (h) is implemented by section 63.1. **Section 63.1(c)(7)**, in part, defines “transfer” as including any transfer of the present beneficial ownership of property **from** an **eligible** transferor to an eligible transferee through the medium of an inter vivos trust. It seems clear, therefore, that if the transfer of the decedent’s principal residence to the decedent’s son qualifies as a transfer **from** decedent pursuant to the terms of her intervivos trust, then the transfer qualifies for exclusion from change in ownership under Proposition 58 and section 63.1.

The Board has addressed this issue in its LTA **91/08**, a copy of which is attached,-which provides in part:

“The key to whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is whether the **trust** instrument limits the trustee’s powers to distribute property.

“Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section’ 16246 which provides:

‘The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata.’ (Added by Chapter 820 of the Statutes of 1986.)

“‘The statement ‘a distribution in kind may be made pro rata or non-pro rata,’ means that the trustee has a choice in **how** he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries common ownership in all the assets of the trust estate (**pro rata**) or can allocate specific assets to individual beneficiaries (non-pro rata).

“California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McClogan (1948) 84 Cal. App.

2d 208. Thus, where the trust instrument conflicts with statutory power, the instrument controls unless a court, pursuant to Probate Code Section [162011, relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including Section 16246.

“Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rate or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer **from** parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust’s assets, the trustee has the **power to** distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may **qualify** for the parent/child exclusion under Section 63.1.”

In this case, the Trust does not limit the statutory trustee powers contained in Probate Code sections 16220 through 16249. In fact, as indicated above, Article Sixth, Section A, of the Trust provides for the Trustee’s distribution powers similar to but no less broad than those specified in Probate Code section 16246. **Also**, as indicated above, the Trustee has the power to encumber, mortgage, or pledge trust property **for** a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee. This provision is identical to Probate Code section 16228.

It is clear under LTA 91/08 discussed above that where a trustee’s powers are as broad as they are in this case and where the trust requires distribution in equal shares, a trustee may distribute a 100 percent interest in a parcel of real property to a beneficiary without triggering a change in ownership as long as the value of the parcel received by the beneficiary doesn’t exceed the value of his or her share of the trust property. Thus, where the trust property consists solely of two parcels of real property of equal value and the trust requires distribution in equal shares to the two children, the trustee may distribute one parcel to one child and one parcel to the other child without causing a change in ownership as long as the trustee’s statutory powers are not limited by the trust instrument.

Similarly, if the same trust contained one parcel of real property and cash in an amount equal to the value of the real property, no change in ownership would result from a distribution of the real property to one child and the cash to the other child.

This case is different from the latter example only in that the successor Trustee encumbered the Trust real property in order to distribute the trust estate in equal shares by distributing cash to one child and equity in the principal residence of equal value to the other

child. As indicated above, the Successor Trustee had the power to encumber the real property and to make the non-pro rata distribution. In effect, the Successor Trustee exercised his power to encumber in order to be able to exercise his non pro rata distribution power. The creation of a security interest or the substitution of a trustee under a security instrument, if that occurs, is not a change in ownership (§62(c)). Accordingly, it is our view that the distribution made by the Successor Trustee in this case does not result in a change of ownership because the distribution of the real property under the Successor Trustee's powers was a transfer from the decedent to her son "through the medium of an inter vivos...trust" within the meaning of section 63.1(c)(7) and the guidelines of LTA 91/08. The fact that the assessor valued the real property at an amount less than what the Successor Trustee believed the property was worth for purposes of encumbering the property and distributing the trust estate does not change that result. As LTA 91/08 makes clear, where a trustee's statutory powers are not limited by the trust instrument and the trust instrument requires a share and share alike distribution to children, no change in ownership resulting from a transfer between siblings occurs unless a trust beneficiary receives real property valued in excess of the value of his or her share. As pointed out in the example in LTA 91/08, where a beneficiary receives real property which is encumbered, the encumbrance must be considered in determining whether a beneficiary has received real property valued in excess of his or her trust share. In this case, the son did not receive more than his share of the trust estate and, based on the Assessor's valuation, in fact, received less than his share of the trust estate. Accordingly, there was no transfer of real property between siblings and thus, no change in ownership.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county.

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
Senior Tax Counsel

EFE:sao
Attachment

cc: Honorable John N. Scott
Alameda County Assessor

Mr. James Speed - MIC:63
Mr. Dick Johnson - MIC:64
Ms. Jennifer Willis - MIC:70

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Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

CINDY RAMBO
Executive Director

(916) 445-4588

August 6, 1990

AUG 8 1990

Assess:

Dear Mr.

This is in response to your letter of April 21, 1990 requesting advice on the application of Proposition 58 to the transfer of your father's personal residence to your brother George. I have also received a copy of your note dated June 20, 1990, to which you attached a letter written by your father on March 12, 1982, which expresses the wishes of your father as to the disposition of his estate. As we recently discussed, I have also received a copy of the letter written by your brother, George, to our Assessment Standards Division, dated May 28, 1990. This letter states that recent inquiries made by your brother to various county assessor offices has shown that there are inconsistencies from county to county in the application of Proposition 58 to parent/child transfers pursuant to will or trust where the property is left to two or more children "share and share alike".

Based on the information provided in your letter and in George's letter, I understand that your father, Grant, and his wife Ruth, had three children, Grant Jr., George, and Marylinda. Ruth passed away in 1982 and on June 3, 1983, your father executed an intervivos trust which was prepared for him by Mr. [redacted], Attorney at Law. In addition to certain stocks and bonds, Grant, as trustor, transferred to the trust a residence at Lake Almanor in Plumas County and his principal residence in Pleasant Hill, Contra Costa County. The trust was revocable until the trustor's death. It retained a life interest in the trustor and upon his death provided for distribution of the trust estate to his children, Grant, Jr., George, and Marylinda, "share and share alike".

Among the various powers expressly granted to the trustee in Exhibit A of the trust is the following:

"(p) In any case in which the Trustee is required, pursuant to the provisions of this instrument, to divide any trust property into parts or shares for the

purpose of distribution or otherwise, the Trustee is authorized, in the Trustee's discretion, to make the division and distribution in kind, including undivided interests in any property, or partly in kind and partly in money, and for this purpose to make such sales of the trust property as the Trustee may deem necessary, on such terms and conditions as the Trustee shall see fit."

Your father passed away in September of 1989. Your brother, George, is interested in acquiring sole ownership of your father's residence in Pleasant Hill. He will provide a promissory note secured by a deed of trust to the other two children as a means of financing the difference between the market value of the residence and his one-third share of the trust assets. Apparently the difference in value amounts to about 15 percent of the market value of the Pleasant Hill residence.

As the result of an inquiry from Mr. , you have been advised by Daniel M. Hallissy, Chief of the Standards Division of the Contra Costa Assessor's Office, that while the county would apply Proposition 58 to exclude the transfer of the Pleasant Hill residence to the three children from reassessment, it would treat the transfer of the property to the sole ownership of George as a reassessable transfer of a two-thirds interest of the property. You have asked that we review the terms of your father's trust and the other information supplied and provide our opinion as to the correctness of the assessor's determination. As I recently discussed with you, my conclusion, after reviewing the information supplied and the applicable authorities, is that the transfer of the Pleasant Hill residence to your brother qualifies as an excluded parent/child transfer except to the extent that the value of the property exceeds the value of his one-third share of trust assets.

Proposition 58 added subdivision (h) to section 2 of Article XIII A of the Constitution. Briefly, subdivision (h) excludes from change in ownership the purchase or transfer of the principal residence of the transferor in the case of the purchase or transfer between parents and their children. It also excludes the purchase or transfer of the first \$1 million of the full cash value of all other real property between parents and their children.

Subdivision (h) is implemented by Revenue and Taxation Code section 63.1. Section 63.1, in part, defines "transfer" as including any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an intervivos trust. It seems clear, therefore, that if the transfer of the Pleasant Hill residence

to your brother George qualifies as a transfer from your father pursuant to the terms of his intervivos trust then the transfer qualifies for inclusion under these provisions of the Revenue and Taxation Code and the California Constitution.

The provisions for distribution of your father's trust estate provide that it shall go to the three children "share and share alike." This direction indicates that the three children are to share equally in the trust estate. The question, of course, is whether the three children each receive a one-third interest in each individual trust asset. Subdivision (p) of Exhibit A of the trust grants to the trustee express authority to make distributions in kind and so forth. While I, frankly, had some difficulty in deciding whether this was a clear, broad grant of discretion to the trustee to distribute all trust property in kind, that dilemma is resolved by the provisions of the Probate Code dealing with trust administration found at Sections 16000 and following.

Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

"The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata" (added by Chapter 820 of the Statutes of 1986).

California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McColgan (1948) 84 Cal.App. 2d 208. Thus, where the trust instrument conflicts with a statutory power, the instrument controls unless a court, pursuant to Probate Code section 16201, relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including section 16246.

The powers granted to the trustee under Exhibit A of your father's trust expressly provides that they are "In addition to all other powers and discretions granted or vested in a Trustee by law." It does not appear, therefore, that any limitation on the powers conferred by statute was intended under your

father's trust. Thus, the trustee has the power to distribute the trust assets in kind on either a pro rata or non-pro rata basis. Accordingly, the distribution to your brother George of the Pleasant Hill property would be properly characterized as a transfer under the terms of the trust from your father to your brother for the purposes of Proposition 58 and section 63.1, to the extent that the value of the property did not exceed the value of your brother's one-third interest in the total trust estate. The excess, which you state is about 15% of the value of the property, could not qualify as a transfer from your father to your brother since it would exceed the direction that the three children share and share alike. To that extent, the transfer must be considered to be a transfer from the other beneficiaries pursuant to a sale of their interest to your brother George.


It must be recognized that we are dealing here with the provisions of a trust rather than a will. Under the provisions of the Probate Code, we would not necessarily reach the same result had the distribution been made pursuant to a will. Under the Probate Code provisions applicable to wills, the general rule is that a devise of property to more than one person vests the property in them as owners in common. Probate Code Section 6143 provides that unless a contrary intention is indicated by the will, "a devise of property to more than one person vests the property in them as owners in common." See also Estate of Pence (1931) 117 Cal.App. 323, at 331, holding that a devise to more than one person to "share and share alike" indicates a gift in common. See also Noble v. Beach (1942) 21 Cal.2d 91, 94; and, Estate of Russell (1968) 69 Cal.2d 200, 214-215. Of course, many wills contain provisions which grant discretion to distribute the property in kind on a pro rata or non-pro rata basis or something equivalent. In light of the general principle that the intention of the testator as expressed in the will controls the legal effect of the dispositions made in the will (Probate Code Section 6140 (a)) a clear grant of broad discretion to distribute the property in kind on a pro rata or non-pro rata basis must be given due recognition. In the absence of such a clear grant of broad discretion in the will, however, or an appropriate judicial determination of the meaning of the provisions of the will, assessors are entitled to rely on the general rule set forth in Section 6143 of the Probate Code.

As demonstrated by the above discussion, this is a difficult area of the property tax law and we are in agreement with your brother's suggestion that our Assessment Standards Division should provide guidance to assessors to assist them with these complex problems. By copy of this letter, I am requesting that the division prepare an appropriate advisory letter to county

assessors setting forth guidelines consistent with the views expressed above.

As I believe we have discussed, the opinions expressed' in this letter are advisory in nature and are not binding upon any assessor. I have, however, taken the liberty of furnishing a copy of this letter to both the Contra Costa County and Plumas County Assessors' Offices, for their information.

Very truly yours,


Richard H. Ochsner
Assistant Chief Counsel

RHO: sp
2520D

cc:

Mr. Daniel M. Hallissy
Contra Costa County Assessor's Office

Mr. Tony Exsen
Plumas County Assessor's Office

Mr. John Hager ty
Mr. Verne Walton ✓
Mr. Eric Eisenlauer



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Executive Director

January 23, 1991

TO COUNTY ASSESSORS:

No. 91/08
CORRECTIO:

CHANGE IN OWNERSHIP CONSEQUENCES OF REAL PROPERTY
IN AN ESTATE OR TRUST
DISTRIBUTED ON A "SHARE AND SHARE ALIKE" BASIS

This letter sets forth the change in ownership consequences of transfers of property from parents to children when property is distributed according to a will or trust and the language of the document directs that the assets of the estate or trust be distributed to the **children** on a "share and share alike" basis.

Currently, when an estate or trust is to be distributed on a share and share alike basis many assessors presume, for property tax purposes, that the beneficiaries of a trust or the heirs of a will have an equal interest in each and every property owned by the decedent. Consequently, in these counties a change in ownership occurs if any heir or beneficiary obtains an interest in any real property greater than his/her proportional interest in the estate or trust. For example, if property is left to four children and one child is granted a **100 percent** interest in the parent's residence, the assessor would have determined that 75 percent of the property interests transferred. Using this policy, the percentage of interests transferred is the amount that the interest in the real property exceeds the proportional interest in the estate.

Our recommendations for the change in ownership consequences of property distributed on a share and share alike basis depend on the provisions of the trust instrument or the will.

TRUSTS

The key to whether a change in **ownership occurs** when property is distributed according to a trust on a share and share alike basis is whether the trust instrument limits the trustee's powers to distribute property.

Probate Code Section 16200 provides, in part, that a trustee has not **only** the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section **16200** are a number of **provisions** conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

"The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind 'may be made pro rata or non-pro rata." (Added by Chapter 820 of the Statutes of 1986.)

The statement "a distribution in kind may be made pro rata or non-pro rata," means that the trustee has a choice in how he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries **common ownership** in all the assets of the trust estate (pro rata) or can allocate specific assets to individual beneficiaries (non-pro rata).

California trust law **recognizes** that the administration of a trust is governed by the trust instrument. -Union Bank and Trust Co. v. McColligan (1948) 84 Cal. App. 2d 208. Thus, where the trust instrument conflicts with statutory power, 'the instrument controls unless a **court**, pursuant to Probate Code Section 1620.1, relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and **those** conferred by the provisions of the Probate Code, including Section 16246.

Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rata or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis **can** be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust's assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1.

Example:

A parent leaves a trust estate with a net worth of \$500,000 to his four children on a share and share alike 'basis. Each child is to receive \$125,000 net worth of assets. The trust document does not limit the trustee's power to distribute the trust assets. Accordingly, as provided by Probate Code' Section 16246, the trustee has the power to distribute sole ownership of any asset or a fractional interest in any asset to any of the children.

In distributing the trust, the trustee decides to deed the principal residence, worth \$112,500 and no outstanding loans, to one child. In our view, this would be considered a 10.0 percent transfer from parent to child which may be excluded from change in ownership under Section 63.1 if a proper claim form is filed. This is because the net worth of the property is under the child's \$125,000 share in the estate. If the property had a net worth which was more than \$125,000, a partial change in ownership

would have occurred. The following example outlines the procedures for such a situation.

If the trustee deeds another child an investment property, with a market value of \$225,000 and an outstanding mortgage balance of \$50,000 (encumbrances in the property should be considered), then a 28.57 percent reappraisable change in ownership would occur. This is calculated as follows: equity in the **property** minus child's share of the trust estate divided by the equity in the property (\$175,000 - \$125,000/\$175,000). In this case, the equity in the property that the child receives exceeds his/her proportional share of the trust estate by 28.57 percent. In effect, this 28.57 percent interest in the property is a transfer of property between siblings. It does not qualify as a transfer from parent to child since it exceeds the direction that the children share and share alike. Therefore, a 28.57 percent change in ownership of the property has occurred while the remaining 71.43 percent may be excluded from change in ownership according to the provisions of Section 63.1 of the Revenue and Taxation Code.

In practice, assuming a 1975 factored base year value of \$75,000, the new base year value of the property would be calculated as follows:

| | | |
|------|---------------------------------------|------------------------------------|
| 1975 | Factored base year value | 375,000 x 71.43% = \$ 53,572 |
| 1990 | Market value | \$225,000 x 28.57% = <u>64,282</u> |
| | Value to be enrolled for current roll | \$117,854 |

WILLS

Whether a change in ownership occurs when a child receives a 100 percent interest in real property from a parent's estate when the estate is distributed according to a will on a share and, share alike basis depends on whether the will gives the executor a clear grant of broad discretion to distribute property in kind on a pro rata or non-pro rata basis.

Under the Probate Code provisions applicable to **wills**, the general rule is that a devise of property to more than one person vests the property in them as owners in common. Probate Code Section 6143 provides that unless a contrary intention is indicated in the will, "a devise of property to more than one person vests the property in them as owners *in common*." See also Estate of Pence (1931) 117 Cal. App. 323, at 331, holding that a devise to more than one person to share and-share alike indicates a gift in common. See also Noble v. Beach (1942) 21 Cal. 2d 91, 94; and Estate of Russell (1968) 69 Cal. 2d 200, 214-215.

Of course, many wills contain provisions which grant discretion to distribute property in kind on a pro rata or non-pro rata basis or something equivalent. Probate Code Section 6140(a) states that the intention of the testator as expressed in the will controls the legal effect of the dispositions made in the will. In light of this general principle, a clear grant of discretion to distribute the property in kind on a pro rata or non-pro

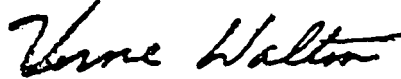
January 23, 1991

rata basis must be given due recognition. In the absence of such a clear grant of broad discretion in the will, however, or an appropriate judicial determination of the meaning of the provisions of the will, assessors are entitled to rely on the general rule set forth in Section 6143 of the Probate Code.

Therefore, if it is determined that the will clearly grants the executor broad discretion in distributing property in kind on a pro rata or non-pro rata basis, the change in ownership consequences are identical to those in the example illustrated for trusts above. If it is not certain or it has not been proved that the executor has this power, then the assessor is *correct* in allocating an equal fractional interest in each and every property owned by the parent to each child for property tax purposes. It follows that a partial change in ownership will occur if any child acquires an interest in any real property owned by the parent greater than the proportional interest in the estate. It is important to note that the taxpayer carries the burden of proving, to the assessor's satisfaction, that the will in fact grants the requisite discretionary power in distributing the property.

If you have any further questions, please feel free to contact our Real Property Technical Services Unit at (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW: sk



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Controller, Sacramento
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Executive Director

October 28, 1999

The Honorable Vince T. Minto
Glenn County Assessor/Clerk/Recorder
516 West Sycamore Street, 2nd Floor
Willows, CA 95988-2746

Attention: Ms. Sheryl J. Thur

Re: **Proper Allocation of Parent/Child Exclusion**

Dear Ms. Thur:

This is in response to your January 26, 1999 letter to Mr. Gene Palmer, in which you request our opinion on the application of the parent/child exclusion in Revenue and Taxation Code Section 63.1 to the transfer of four parcels of real property upon the death of the trustor of a revocable living trust. You are concerned that because the Trust terms required the Trust property to be distributed on a "share and share alike" basis and one of the two children received all four parcels, only 50 percent of the real property may be excluded from change in ownership as a parent/child transfer. Based on our analysis of the facts provided and for the reasons stated, we are of the opinion that 100 percent of the real property may be excluded from change in ownership, provided your office finds the applicable documents reliable. Please accept our apologies for the delay, as other matters beyond our control prevented a more timely response.

Factual Background

The decedent (Mother) died on December 12, 1997. Under the terms of the Living Trust, her son (William) and her daughter (Karen) were co-trustees of her estate (Article 1.1) and were each to receive an undivided one-half share of her estate (Article 5.2).

According to Articles 5.4 through 5.7, upon Mother's death, the Co-Trustees must divide the Trust Estate into equal shares and distribute one share to each of the decedent's two children, free of trust. Based on the "Executor's Work Sheet" submitted by William (as Co-Trustee and Executor), the "Trust Estate" refers to the assets listed on the Work Sheet, which include four parcels of real property in Glenn County and cash. Article 5.5 provides that in determining the *content* of each of the shares,

“The Trustee may make any distributions in cash, in kind, or partly in each, either pro rata or otherwise. However, notwithstanding any other provision of this Trust Instrument, if any Beneficiary is indebted to the Settlor or to the Trust, the share of such Beneficiary shall be funded in kind with such note or other debt.”

The Trust also provides that Co-Trustees have the power to “incur indebtedness, finance, or refinance Trust property, and to borrow money by any means, ... and to encumber or hypothecate Trust property by mortgage, deed of trust, pledge or otherwise; and to pay any and all such debts or obligations with Trust assets.” (Article 2.2, Sec. E.)

In making distributions of the estate following Mother’s death, the Co-Trustees apparently elected a non pro rata distribution.¹ They equalized the values of the assets each Beneficiary received from the Trust by transferring the four parcels to William and an almost equal amount of cash to Karen. The Co-Trustees indicate that the Trust estate had a net worth of approximately \$396,228, with the real property valued at approximately \$198,000 and all cash valued at \$198,228. Pursuant to Article 5.5, they distributed non pro rata all four parcels to William (deeds recorded on April 19, 1998,) and all of the cash to Karen. Upon subsequent liquidation of Mother’s estate, the Co-Trustees equalized the \$228 difference in Karen’s favor.

Summary Conclusion

In your view, the non pro rata distribution results in the following property tax consequences: 1) change in ownership of 100 percent of the four parcels deeded to William, except that William’s 50 percent interests per the Trust terms can be excluded as a parent to child transfer; and 2) reassessment of Karen’s 50 percent interest upon the April 1998 deed transfers to William. (The parent/child exclusion could prevent reappraisal of the 50 percent interests transferred from Mother to Karen on the date of Mother’s death only.) Your conclusions assume that William, in effect, received his sister’s (Karen’s) 50 percent interests, and if these were the facts, we would agree. However, based on the Trust terms and documentation regarding the Trustees’ distribution, there was only one transfer and one change in ownership of the Trust property – from Mother to her children on the date of her death. The parent/child exclusion applies to this transfer, because the value of the parcels William received from Mother did not exceed the value of his share of the Trust Estate.

Law and Analysis

The general rule is that there is only one change in ownership for property transferred in trust. This occurs either upon transfer into the trust or upon distribution to the trust beneficiaries. Following this rule, the owners of the property are construed to be the trustor, when there is no change in ownership, or the beneficiaries, when there is a change in ownership. The trustee is never considered to be the owner of the trust property for change in ownership purposes, as the trustee merely holds legal title and transfers legal title based on the trustor’s instructions in the trust instrument. (See Property Tax Rule 462.240 and Annotation No. 220.0761.)

¹ See Executor’s Work Sheet, attached, and 2/1/99

Letter, attached, from taxpayer’s attorney.

As you are aware, if a claim is properly filed and all requirements are met, Section 63.1 excludes from change in ownership transfers between parents and children including "any interests in real property which vest in persons other than the trustor...when a revocable trust becomes irrevocable," (Section 61(g)).² Section 63.1(c)(7), in part, defines "transfer" as including 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."

When the Trust became irrevocable on Mother's death, the documents here indicate that the Co-Trustees, acting for Mother, the "eligible transferor," made one transfer/distribution of all the real property (on April 13, 1998)³ and cash from the Trust to the Beneficiaries (themselves) as "eligible transferees." That transfer involved deeding all four parcels of the real property to William and, based on the Executor's Work Sheet and Letter, distributing all of the cash to Karen. As explained below, if the value of the four parcels transferred from the decedent to her son William does not exceed his "equal share" under the Trust, then the transfer qualifies for 100 percent exclusion from change in ownership under Section 63.1, assuming the claim is filed and other requirements are met.

The Board staff has addressed this issue on several occasions, as noted in the Annotation No. 625.0235 (referencing Letters to Assessors 91/08), attached. These opinions make clear that the statutory provisions in the Probate Code require the transfer and distribution of real property held in trust to be governed exclusively by the trust instrument. And where the trust does not provide restrictions or limitations on the trustee's powers to distribute, then the Probate Code controls, (allowing distribution of real property and cash in divided or undivided interests).⁴ Thus, it is necessary to examine the requirements on the trustees in making distributions of the trust assets to the beneficiaries of the trust. Where the trust states that the trust beneficiaries will receive the assets on a *share and share alike basis*, the trustee has one of two ways for the trustee to accomplish such distribution. First, the trustee can either give the beneficiaries common ownership in all the assets of the trust estate (*pro rata*) or secondly, the trustee can allocate specific assets to individual beneficiaries (*non-pro rata*).

² The principal residence of the transferor is excluded without a value limitation and the purchase or transfer of the first \$1 million of the full cash value of all other real property between parents and their children is excluded. (Article XIII A, section 2, subdivision (h) of the California Constitution.)

³ Copies of Grant Deeds recorded on April 13, 1998, show a transfer of each of the parcels from William and Karen, Successor Co-Trustees of the Living Trust to William, a single man.

⁴ "Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

'The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata.' (Added by Chapter 820 of the Statutes of 1986.)

(See LTA No. 91/08 and Annotation No. 625.0235, Eisenlauer 9/10/96.)

Whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is determined entirely on whether the trust instrument limits the trustee's powers to distribute property (and of course, whether the allocation is equalized). If there is no restriction or prohibition in the trust instrument, then the trustee has a choice, that is, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code. This means that the trustee can distribute property and cash in pro rata (undivided) or non-pro rata (divided) interests in order to adjust for any differences in valuation. (Probate Code Section 16246.) As stated in Annotation No. 625.0235 and LTA No. 91/04, page 2,

“Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust's assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1.”

Here, the Trust (Article 5.5, quoted above) contains a statement that the “Trustee may make any distributions in cash, in kind, or partly in each, either *pro rata or otherwise*.” Thus, the Co-Trustees are not limited and have a choice in how to distribute the Trust assets, both cash and real property. Where the trustees' powers are as broad as they are here, and where the trust requires distribution in equal shares, the co-trustees may distribute a 100 percent interest in the parcels of real property to one beneficiary, without triggering a change in ownership, as long as their value does not exceed the value of his share of the trust property. Accordingly, the distribution of the four parcels made by William and Karen, as the Co-Trustees, to William, as a beneficiary, can be excluded from change of ownership because the distribution of the real property under the Co-Trustees' powers was a transfer from the decedent to her son “through the medium of a testamentary trust” within the meaning of section 63.1(c)(7) that did not exceed the value of his share of the Trust property.

The fact that there was a slight value difference of \$228 (whether equalized later or not) would not change that result. Not only did the Co-Trustees have broad powers to adjust the values for purposes of making equal distributions, but William did not receive more than his share of the Trust Estate and, if anything, received slightly less than his share of the Trust Estate. Moreover, that amount of value represents a de minimis interest in the real property, excluded from change in ownership under Section 65.1 (a).

October 28, 1999

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 entity.

Very truly yours,



Kristine Cazadd
Senior Tax Counsel

KEC:jd

<h:/property/precednt/trustsle/1999/08kec>

Attachments

cc:

Mr. Dick Johnson - MIC:63
Mr. David Gau - MIC:64
Mr. Charlie Knudsen - MIC:64
Ms. Jennifer Willis - MIC:70

OCT 29 1999



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Executive Director

March 14, 2000

Re: Parent/Child – Proper Allocation of the \$1 Million Exclusion.

Dear Mr. :

This is in response to your letter of January 9, 2000, requesting our opinion as to whether the proposed distribution plan under an irrevocable trust properly allocates the assets for purposes of applying the \$1 million parent/child exclusion, thereby avoiding a change in ownership. Based on the following described facts, and for the reasons hereinafter explained, the exclusion would apply and no change in ownership will occur.

Factual Background

1. The decedent, "Mother" died on August 25, 1999. Her estate consisted of cash, securities, and five residential properties with improvements, and one unimproved lot, all located in two counties and held in Mother's 1982 Revocable Living Trust. The Trust became irrevocable upon Mother's death, and her four children were the sole present beneficiaries.
2. The Trust provided that upon the decedent's death, the Successor Trustee should divide the trust estate into equal shares and distribute one share to each of the four children free of Trust, in cash or in kind, in divided or undivided interests. (Section 5.04, p. 14 of Mother's Trust.¹)

¹ Section 5.04, p. 14 of the Trust provides that "the Trustee in its absolute discretion, may divide or distribute such assets in kind, or may divide and distribute undivided interests in such assets, or may sell all or any part of such assets and make division or distribution in cash or partly in cash and partly in kind. The decision of the Trustee, either prior to or on any division or distribution of such assets, as to what constitutes a proper division of such assets or the Trust Estate or any Trust provided for in this Declaration, shall be binding on all persons in any manner...".

3. At the time of Mother's death, each of the improved parcels in the Trust Estate had an existing mortgage; only the unimproved lot was free of debt. The entire Trust Estate had a net worth of approximately \$738,698, with the real property valued at approximately \$453,247 and all other property valued at \$497,441, less \$211,990 in debt, taxes, and other costs. Pursuant to the Trust provisions, the Successor Trustee is proposing to distribute approximately \$222,475 net worth of assets to each child, totaling \$889,900. (This amount assumes increases between the net worth on date of death and the net worth on the date of future distribution).
4. Before making any distributions however, the Successor Trustee will sell Parcel 4 in order to raise the cash needed. Thereafter, \$222,475, mixed between real property and cash, will be distributed non pro rata to each child. Each share will be funded with unequal interests in the five remaining parcels together with cash and notes, as follows:
 - To M - \$216,841 net value in Parcel 3, and \$5,634 in cash;
 - To C - \$126,082 net value in Parcel 5, and \$96,393 in cash;
 - To E - \$222,475 net value (all in cash and notes)
 - To A - \$147,750 net value in Parcel 2, \$35,809 net value in Parcel 1, \$4,500 net value in the undeveloped lot, and \$34,416 in cash.

Each of the parcels, except the unimproved lot will continue to be encumbered by a mortgage.

Your questions are: 1) Will the proposed distribution plan qualify for the parent/child exclusion and avoid change in ownership, assuming timely claims are filed; 2) Would the parent/child exclusion apply to Parcel 4, assuming a timely claim is filed prior to its sale; and 3) Is it acceptable to equalize the children's net shares by considering the outstanding mortgage balances on the properties together with cash or other assets. As explained below, the answer to all three of these questions is yes.

Law and Analysis

As you are aware, Revenue and Taxation Code² section 61 provides that, subject to exceptions not here relevant, "change in ownership, as defined in section 60, includes, but is not limited to: ". (g) [a]ny interests in real property which vest in persons other than the trustor...when a revocable trust becomes irrevocable."

² All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

The parent/child exclusion (Proposition 58) was added to section 2 subdivision (h) of Article XIII A of the California Constitution on November 6, 1986. It excludes from change in ownership the purchase or transfer of the principal residence of the transferor between parents and their children, as well as the purchase or transfer of the first \$1 million of the full cash value of all other real property *between parents and their children*. Section 63.1, which implements Proposition 58, also states in subdivision (a)(2) that the exclusion applies to "the purchase or transfer of the first \$1 million of the full cash value of all other real property *between parents and their children*." For purposes of interpreting the exclusion, Section 63.1(c)(1) states that the date of any transfer between parents and their children under a will (or trust) or intestate succession shall be the date of the decedent's death. Applied to the instant case, if the transfers of the six parcels in Mother's Trust qualified under Section 63.1, as transfers between Mother and her four children on the date of death, and if the Trustee's distribution plan merely executes such transfers based on the equal value of each child's beneficial interests received on Mother's death, then no change in ownership will occur.

1. Will the distribution plan, allocating equal shares of the Trust real property on a non-pro rata basis among the four children, qualify for the parent/child exclusion and avoid change in ownership, assuming timely claims are filed?

Yes. As we have explained in previous opinions, the property tax consequences of transferring property on a share-and-share-alike basis depend on whether the distribution plan conforms to the beneficiary provisions in the Trust instrument as of the date of death. You rely heavily on a Letter to Assessors No. 91/08, dated January 23, 1991, entitled "*Change in Ownership Consequences of Real Property in an Estate or Trust Distributed on a 'Share and Share Alike' Basis*," which sets forth this position in detail. The discussion in LTA 91/08 makes it clear that where a trustee's statutory powers over the property in an irrevocable trust are not limited by the trust instrument, and the trust instrument requires share-and-share alike distribution to children, no change in ownership occurs upon distribution, unless a trust beneficiary receives property or assets valued in excess of the value of his or her share. Regardless of the mixture of real property and assets constituting the shares ultimately distributed to each, the value of each share is the determining factor. If one sibling receives more value than the others, the result is a transfer from the other siblings to the one with the excess value. This view has been restated on numerous occasions since 1991, most notably in Annotation No. 625.0235 (attached).

The proposed distribution plan in the instant case falls squarely within the parameters of LTA No. 91/08 and Annotation No. 625.0235, in that the language of the Trust directs that all of the property and assets in the estate be distributed to the children on a share-and-share alike basis, and the Trustee's distribution plan executes this instruction by distributing to each child an

equal share in the total net worth of the assets. Each child will receive \$222,475 in net worth, mixed between real property and cash, representing one quarter of the total net worth of the Trust Estate. Since each child received one quarter of the Trust Estate on the date of Mother's death (Article 3 of the Trust), and the share to each child will be equivalent on distribution, the result is no sibling-to-sibling transfer.

2. Would the parent/child exclusion apply to Parcel 4, assuming a timely claim is filed prior to its sale?

Yes. Equalizing the shares among the children is part of the job of the Trustee. The extent of the powers given to the Trustee to perform this function depends on the language in the Trust instrument. Where the Trust instrument confers on the Trustee broad powers to sell, encumber, lease, distribute, purchase or otherwise have unfettered discretion in dealing with all of the assets in the Trust Estate, then the sale of one parcel in order to gain cash for purposes of equalizing the shares upon distribution is permissible.

The trustee enjoys both the powers conferred by the trust instrument and the broad powers conferred by the provisions of the Probate Code, including Section 16246. Thus, the critical factor is whether the trust instrument limits the trustee's powers to distribute property. As indicated on pages 2-3 of LTA No. 91/08,

"Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

"The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata."

Consistent with the broad powers described in Probate Code Section 16246, there are no express limitations Mother's Trust that would prevent the Trustee from selling Parcel 4 in order to equalize the distribution or for any other reason. Rather, Section 4.02 of the Trust provides in part, the following unlimited discretion to the Trustee:

"The Trustee shall with respect to any and all property which may at any time be held by the Trustee pursuant to this Declaration, whether such property constitutes principal or accumulated income of the Trust provided for in this Declaration, have power, exercisable in the Trustee's discretion at any time and from time to time on such terms and in such manner as the Trustee may deem advisable, to:

(a) Sell, convey, exchange, convert, improve, repair, partition, divide, allot, subdivide, create restrictions, easements or servitudes thereon, manage, operate and control;"

Based on the foregoing provisions, the Trustee's proposed sale of Parcel 4 from Mother's Trust does not prohibit the application of the parent/child exclusion to the transfer of Parcel 4 that occurred on Mother's death. Per the Trust instructions, each of the four children received a one-quarter beneficial interest in Parcel 4 at that time. Assuming a parent/child claim is filed and all of other requirements are met, that transfer will be excluded from change in ownership. If the Trustee then sells Parcel 4 in order to obtain sufficient cash to equalize the net worth of the Trust Estate into four shares (of \$222,475 each) for distribution, there is no sibling-to-sibling transfer or change in ownership, since no child will receive value in excess of the others. Accordingly, the Trustee's proposed sale of Parcel 4 will not trigger a change of ownership as of the date of Mother's death, because the sale and distribution of the proceeds from Parcel 4 is within the Trustee's powers. As such, it constitutes a transfer from Mother to her children "through the medium of an inter vivos...trust" within the meaning of section 63.1(c)(7) and the guidelines of LTA 91/08.

3. Is it acceptable to equalize the children's net shares by considering the outstanding mortgage balances on the properties together with cash or other assets?

Yes. Where the Trustee has broad powers as described above, and there is no restriction on that Trustee's authority to encumber or to retain existing encumbrances, no change in ownership results, assuming the Trustee properly considers the value of the encumbrances on the Trust real property make distributions in equal shares.

That the proposed distribution allows the Trustee to calculate the existing mortgages on the parcels in equalizing the net value of the shares to be distributed among the four children, is not a change in ownership and is consistent with advice previously stated. As pointed out in the example in LTA 91/08, where a beneficiary receives real property that is encumbered, the encumbrance must be considered in determining whether a beneficiary has received real property valued in excess of his of her trust share.

In this proposal, no child will receive more than his/her share of the Trust estate. For example, Child A will receive the most real property, (three parcels), two of which are encumbered by existing mortgages. Based on the value of the mortgages at the time of the transfer, A's share of the total Trust Estate will be exactly the same as E's share, that contains only cash and notes with no real property. Accordingly, since the value of each child's share is equal one quarter of the total Trust Estate, there will be no transfer of real property between siblings and thus, no change in ownership.

Mr.
March 14, 2000
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The views expressed in this letter are, of course, 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 upon any person or entity.

Sincerely,

/s/ Kristine E. Cazadd

Kristine E. Cazadd
Senior Tax Counsel

KEC:tr
prop/precnt/parchild/00/04kec

Attachments: LTA No. 91/08, Annotation No. 625.0235

cc:

Mr. Dick Johnson, MIC:63
Mr. David Gau, MIC:64
Mr. Charlie Knudsen, MIC:64
Ms. Jennifer Willis, MIC:70