STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
TELEPHONE (916) 445-5580
FAX (916) 323-3387
www.boe.ca.gov

August 4, 2003

Honorable Stephen L. Vagnini,
Assessor, Monterey County
P.O. Box 570
Courthouse
Salinas, CA 93902
Attn: Steve Vilcone, Appraiser

Re: Trust Property Transfers – Application of Parent-Child Exclusion to Non ProRata Distribution

Dear Mr. Vagnini:

This is in reply to your letter of April 22, 2003 in which you relate questions from Mr. requesting an opinion concerning the application of the parent-child exclusion to the distribution of real property from a trust to beneficiaries who are the children of the settlor in which the trustee proposes to make non prorata distribution of the property. The trustee proposes to obtain a loan in order to equalize the dollar value of distributed interests to the beneficiaries. For purposes of applying the exclusion, you ask whether the loan to the trust may be obtained from the beneficiary to whom the real property will be distributed rather than from a third-party lender. For the reasons set forth below, a loan made by the beneficiary would be considered payment for the other beneficiary's interest in the trust property distributed to the lender which would constitute a transfer of that interest, in effect, constituting a "purchase" by the lender/beneficiary from the other beneficiary. Thus, the parent-child exclusion would not be applicable to exclude the transfer of the other beneficiary's interest in the real property from a change in ownership.

Facts Presented

A trust has a single asset, a piece of real property called Blackacre, worth $100,000 that is to be distributed equally to the two beneficiaries who are the children of the trustor. The trustee has the power under the terms of the trust instrument to make non prorata distributions of the trust property. In order to make a non prorata distribution of the property to A, it is proposed that the trustee will obtain a $50,000 unsecured loan from A. The trustee will distribute the $50,000 to B and Blackacre to A encumbered by the obligation to repay the loan. Alternatively, A would lend the trust the $50,000 secured by a note and deed of trust on Blackacre. The trustee then distributes the $50,000 to B and Blackacre to A subject to the note.

Law and Analysis

Revenue and Taxation Code section 63.1 implements section 2, subdivision (h) of article XIIIA of the California Constitution and generally provides for an exclusion from change in ownership for certain transfers of real property between parents and their children. Subdivision (c)(9) defines "transfer" to include "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". Therefore, if the transfer of the decedent's property to the decedent's son qualifies as a transfer from the decedent pursuant to the terms of his trust, then the transfer qualifies for exclusion from change in ownership under section 63.1.

Unless the trust instrument specifically states otherwise, the trustee has the power under Probate Code section 16246 to distribute the trust assets in kind on either a pro rata or non prorata basis. A trustee with the power to distribute the trust property on a non prorata basis may allocate specific assets to individual beneficiaries so long as the value of their shares are equal. Thus, the transfer of an undivided interest in real property is considered a direct transfer from the trustor to the beneficiary to the extent that the value of the property interest does not exceed the value of the beneficiary's share of the trust estate. Accordingly, such a distribution from a trustor-parent to a beneficiary-child constitutes a transfer of real property that may qualify for the parent/child exclusion under Section 63.1. (Letter to Assessors No. 91/08.)

Under the facts presented, the trustee also has the power to encumber the trust property by using the property as security for a loan. It is our view that a trustee who elects to make a non-prorata distribution of trust properties which are not of equal value, may encumber property by securing a loan and distribute the proceeds of the loan to the other beneficiary or beneficiaries in order to equalize the values of the shares of distributed property. (See Annotated Letter No. 625.0201, enclosed) Additionally, the encumbrance on the property must be considered in determining the value of the share of the beneficiary who receives that property.

However, a money contribution by a beneficiary of the trust in order to equalize the shares of the beneficiaries for the purpose of trust distribution constitutes payment for the interest of the other beneficiary, in effect, a "purchase," even though it may be characterized as a loan. "A loan transaction contemplates a debtor-creditor relationship with an obligation of the 'debtor' to repay the amount of the loan to the creditor." *Ghirardo v. Antonioli* (1994) 8 Cal.4th 791 (quoting 4 Miller & Starr, supra, § 10:3, p. 651.). A security transaction in real property creates an interest in realty to secure the performance of an obligation. 3 Witkin, Summary of California Law sections 1, p 515. Thus, a security transaction involves at least two parties in which a debtor gives a creditor a lien on the debtor's property as security for an obligation owed to the creditor. Witkin section 5, p 517.

Under first scenario, the trust borrows $50,000 from beneficiary A which is secured by a note and deed of trust in Blackacre. The trust distributes Blackacre to A subject to the note and gives the $50,000 to beneficiary B. The transfer does not constitute a secured loan transaction because it involves only one party, A. Moreover, no interest is created in Blackacre to secure the performance of an obligation because A is the obligor on the note.

Under the second scenario, A makes an unsecured loan of $50,000 to the trust. The trustee distributes the $50,000 to B and the Blackacre to A with the obligation to repay the loan.

The transfer from A does not constitute an unsecured loan transaction because A is both debtor and creditor and, of course, has no obligation to repay a loan to himself.

Thus, A's contribution of money to the trust is not a loan transaction because it does not create a debtor-creditor relationship whereby a B either assumes an obligation to repay the debt or gives A, security interest in the debtor's property. Instead, the money tendered by A would be paid directly to B and in exchange A will receive the real property interest of B, in effect, constituting a purchase of B's interest by A. The transfer of B's interest to A in exchange for A's payment results in a change in ownership for which the parent-child exclusion under section 63.1 is not applicable.

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.

Very truly yours,

/s/ Kristine Cazadd for L. Ambrose

Lou Ambrose
Supervising Tax Counsel

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cc: Mr. David Gau, MIC: 63
Mr. Dean Kinnee, MIC: 64
Ms. Jennifer Willis, MIC: 70

State of California

Board of Equalization
Legal Department - MIC:82
Telephone: (916) 324-2646

M e m o r a n d u m

To: Mr. Dean Kinnee (MIC:64)
Chief, County-Assessed Properties Division

Date: September 5, 2007

From : Daniel Paul
Tax Counsel

Subject: ***Parent-Child Exclusion – Non Prorata Trust Distributions***
Assignment No. 07-279

This is in reply to an e-mail dated July 12, 2007, from Ms. -------- -------- of your staff in which she requested our opinion regarding Property Tax Annotation 625.0235.005. As she stated in her e-mail, a recent estates and trusts publication has offered advice contrary to the backup letter to Annotation 625.0235.005. This memorandum serves to reiterate the position of the Legal Department in this area.

Annotation 625.0235.005 and the publication address the parent-child exclusion under Revenue and Taxation Code[1] section 63.1 as it applies to trust distributions. In each situation, the trust instrument requires that the beneficiaries (trustor's children) receive equal shares in the trust property, and allows the trustee to make non prorata distributions. Issues arise when a single real property is the only trust asset. The Legal Department has taken the position that the trustee may encumber the property with a loan and distribute the loan proceeds to one beneficiary, and the encumbered property to the other, so long as the cash distribution is equal to the value of the equity in the real property and the loan to the trust is not obtained from the beneficiary to whom the real property will be distributed. (See Annotation 625.0201; see also backup letter to Annotation 625.0235.005.)

The publication in question states that an alternative method of encumbering the property is to have the beneficiary receiving the property execute a note and deed of trust in favor of the trust in exchange for the property. This advice is inconsistent with the conclusion set forth in the backup letter to Annotation 625.0235.005, which provides that:

> a money contribution by a beneficiary of the trust [receiving the property] in order to equalize the shares of the beneficiaries for the purpose of trust distribution constitutes payment for the interest of the other beneficiary, in effect, a 'purchase,' even though it may be characterized as a loan.

In other words, both the back-up letter to Annotation 625.0235.005 and the publication have the same critical disqualifying fact, that is, the lender-beneficiary is the beneficiary to whom the property will be distributed. Simply stated, it is irrelevant whether the loan proceeds are in the form of cash or a note. The result remains the same because the trustee is encumbering trust

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

property to secure repayment for a loan from the lender-beneficiary to whom the property will be distributed.

Due to some confusion on this issue, two points bear repeating. First, only the trustee may encumber the property. If a beneficiary obtains a loan and secures the repayment of the loan by encumbering the property, 100 percent interest in that property is considered to be distributed to him or her. Any subsequent transfer of an interest in the property to the other beneficiary will result in a change in ownership as a sibling transfer for which the parent-child exclusion under section 63.1 is not applicable.

Second, the beneficiary receiving the property may not make a loan to the trust to equalize the distribution by either providing cash or a note secured by the trust property. In both instances the beneficiary receiving the property is providing consideration (cash or a note) for the purchase of the property interest from the other beneficiary. Therefore, both transactions are considered a purchase of the interest of the other beneficiary. The loan must be made by a third party lender, or, alternatively, by the beneficiary not receiving the property.

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cc: Mr. David Gau MIC:63
Mr. Todd Gilman MIC:70

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www.boe.ca.gov

February 19, 2009

Honorable Gary W. Freeman
San Joaquin County Assessor
24 South Hunter Street, Room 303
Stockton, CA 95202-3273

Attn: , Chief of Standards/Recorder-County Clerk

Re: Parent-Child Exclusion under Will – "Share and Share Alike"
Assignment No.: 08-194

Dear Ms. :

This is in response to your letter to Chief Counsel Kristine Cazadd dated September 12, 2008, requesting an opinion as to whether a non pro rata distribution of the decedent-mother's real property to one of her three surviving children, where the terms of the decedent's will allocated equal shares in her property to her surviving children, results in a change in ownership. In our opinion, a two-third interest in the property is subject to reassessment because one child-beneficiary (C) provided consideration (cash) to the estate in order to equalize the shares of the beneficiaries for the purpose of distribution of the property under the will, constituting payment for the interests of the others beneficiaries (i.e., a purchase of the other siblings' interests in the property). (Property Tax Annotation (Annotation) 625.0235.005.)

Facts and Contentions

The real property at issue is located at (property). The previous owner of the property, N , died testate on August 22, 2006. The third paragraph of Ms. N 's will, which you provided for our review, states that "I give all my jewelry, clothing, household furniture and furnishings, personal automobiles, books and other tangible articles of a personal nature together with any insurance on such property to my surviving children, *in equal shares,* as they may select on the basis of valuation." (Emphasis added.) The fourth paragraph of her will states that "I give the residue of my estate to my issue, who survive me, by right of representation." Although this paragraph four does not specifically state that the surviving children were entitled to receive a distribution of the real property held in the estate *in equal shares,* we consider this to be a reasonable and valid

interpretation of the language in the will.[1] Ms. N was survived by her three children, A , B and C .

A , as executor of the will, filed a change of ownership statement dated January 25, 2007, which identified transfer of the property equally to each of the three children (i.e., one-third interest in the property transferred to A , B and C). She also filed a parent-child exclusion claim for transfer of the entire property dated January 25, 2007, identifying Ms. N as the transferor and all three children as transferees of the property. Your letter indicates that you allowed the parent-child exclusion as of the date of Ms. N 's death, which we understand to mean that you concluded that the entire transfer of the property was subject to the parent-child exclusion.

Before probate closed, C encumbered another piece of property that he owned, and contributed $140,000 to the estate, which was the appraised value of his mother's real property to be distributed under the will. The executor then distributed the estate equally amongst the three siblings, giving the real property to C , solely, and distributing the remaining assets (including the money contributed by C to the estate) to the other siblings. A grant deed for the property was executed in the name of C and M , as Trustees of The N Family 2000 Revocable Trust, on June 8, 2007. C filed a preliminary change in ownership form for the property dated June 29, 2007, in which he stated that he purchased the property from his mother's estate for $133,000.

In light of the new information provided to you, you concluded that C acquired a one-third interest in the real property from his mother and a two-third interest in the real property from his siblings as the date of distribution based on your finding that, pursuant to the guidance provided in LTA 91/08, the executor was not explicitly given discretion under the will to distribute assets on a non pro rata basis. Consequently, you determined that a change in ownership occurred of the two-third interest in the property that C purchased from his siblings, which was then subject to reassessment. C and his attorney assert that the parent-child exclusion is applicable to the entire property, and any reliance upon LTA 91/08 is inappropriate because Probate Code section 6143, which is discussed in this letter as support for the guidance provided, has been repealed. There is no formal appeal involved and this matter is not before the local Assessment Appeals Board.

Legal Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership." Revenue and Taxation Code[2] section 63.1 provides an exclusion from change in ownership for certain purchases or transfers of real property between

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[1] Probate Code section 21102 provides guidance on interpreting the testator's intent. (See cases in Deering's Ann. Prob. Code, § 21102 (2009 supp.), under headings Decision under Current Prob. C § 21102, In General, & Decisions under Former Prob. C § 6140, Giving Reasonable Meaning to Will; Common Sense Consideration of Language.) Probate Code section 21102 replaced former Probate Code section 6140, and pursuant to Probate Code section 2, "a provision of the Probate Code, insofar as it is substantially the same as a previously existing provision relating to the same subject matter, shall be construed as a restatement and continuation thereof and not as a new enactment." (14 Witkin Sum. Cal. Law Wills § 47.)

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

parents and their children on or after November 6, 1986; namely, the transferor's principal residence and up to $1,000,000 of other real property. (Rev. & Tax. Code, § 63.1, subd. (a)(1) & (2).)

Here, the property was transferred to C and thus, a change in ownership of the entire property occurred unless an exclusion applies. Subdivision (c)(9) of section 63.1 defines "transfer" to include 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." Therefore, if the transfer of the property is from Ms. N to her son, C , then the transfer *may* qualify for exclusion from change in ownership under section 63.1.[3]

C contributed $140,000 to the estate in order to receive a 100 percent interest in the property, rather than a one-third interest. We have advised that when a beneficiary makes a money contribution to a trust in order to equalize the shares of the beneficiaries for the purpose of a trust distribution, that this constitutes payment for the interest of the other beneficiary and in effect constitutes a purchase of that interest from that beneficiary. (Annotation 625.0235.005.) Applying this guidance to the facts here, we consider C 's contribution of money to the estate in exchange for a two-third interest in the property to be a purchase of the other siblings' interest in the property, with the other siblings being the transferors of the property. As such, transfer of two-thirds interest in the property does not qualify for the parent-child exclusion and is subject to reassessment.

Your letter indicates that the assessor and the property owner disagree on the application of LTA 91/08 to the facts here. As our analysis above indicates, a change in ownership occurred because C provided consideration to the estate in exchange for his siblings' interest in the property as discussed in Annotation 625.0235.005; and our conclusion is not based on LTA 91/08. However, we would like to address the property owner's assertion that LTA 91/08 is outdated due to the repeal of Probate Code section 6143.

LTA 91/08 states, in part, that when a will distributes real property interests from parent to children on a "share and share alike" basis, the children are assumed to hold the property as tenants in common pursuant to Probate Code section 6143. LTA 91/08 further provides that, pursuant to the general principle set forth in Probate Code section 6140, subdivision (a), if the will clearly grants the executor broad discretion in distributing property in kind on a pro rata or non-pro rata basis, then there will be a change in ownership to the extent that any child acquires an interest in any real property owned by the parent that is greater than the child-beneficiary's equal proportionate share in the property. Also, if it is not certain that the executor has this discretion, then for property tax purposes, there is a distribution of an equal fractional interest in each and every property owned by the parent to each child.

Probate Code section 6143 was repealed in 1994 in the same legislation in which a similarly worded statute, Probate Code section 21106,[4] was enacted.[5] Probate Code section

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[3] As you noted, for purposes of determining whether the transfer qualified for the parent-child exclusion, there is also the issue of whether the executor had the authority to distribute the estate property in a non pro rata basis, as discussed in LTA 91/08.

[4] Former Probate Code section 6143 stated that "[u]nless 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." Whereas, former Probate Code

21106 is historically derived from Probate Code section 6143,[6] and was later repealed in 2002 because it was considered less complete than, and the equivalent to, Civil Code section 686.[7] Civil Code section 686 states that:

> **§ 686. What interests are in common**
>
> *Every interest created in favor of several persons in their own right is an interest in common*, unless acquired by them in partnership, for partnership purposes, or unless declared in its creation to be a joint interest, as provided in Section 683, or unless acquired as community property. (Emphasis added.)

Civil Code section 686 is consistent with the statement in LTA 91/08 that any devise of property to more than one person vests the property in those persons as tenants in common *unless* a contrary intention is indicated in the will. It also bears mentioning that *Estate of Pence* (1931) 117 Cal. App. 323, which is cited in LTA 91/08 as holding that a devise to more than one person to share and share alike indicates a gift in common, also analyzes Civil Code section 686 in support of its conclusion. Based on the foregoing, and considering that we are not aware of any authority or indication that a substantive change of Probate Code section 6143 was intended by its repeal, we believe that the guidance set forth in LTA 91/08 concerning the change in ownership consequences of real property in an estate distributed on a "share and share alike" basis is correct, irrespective of the fact that Probate Code section 6143 has been repealed.[8]

Moreover, as stated above, LTA 91/08 also refers to former Probate Code section 6140, subdivision (a), which was replaced by Probate Code section 21102, subdivision (a), which states that: "[t]he intention of the transferor as expressed in the instrument controls the legal effect of the dispositions made in the instrument."[9]

Consequently, we believe that the guidance set forth in LTA 91/08 with respect to wills remains valid irrespective of the fact that Probate Code sections 6140 and 6143 have been repealed.

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section 21106 stated that "[a] transfer of property to more than one person vests the property in them as owners in common."

[5] Stats 1994 chap. 806 § 21 (AB 3686).

[6] See Historical Derivation, Deering's Ann. Prob. Code § 21106 (2008 supp.).

[7] Legislative history regarding the repeal of Probate Code section 21106 is located at http://www.leginfo.ca.gov/pub/01-02/bill/asm/ab_1751-1800/ab_1784_cfa_20020620_162326_sen_floor.html (Jan. 15, 2009).

[8] See Prob. Code, § 2, subd. (a).

[9] The 1994 enactment of Section 21102 extended former Section 6140 (wills) to trusts and other instruments. (See fn.1, *supra*, & Amendments, Deering's Ann. Prob. Code § 21102 (2009 supp.).)

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/ Kiren K. Chohan

Kiren Kaur Chohan
Tax Counsel III

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cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70