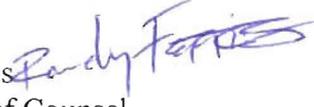


## Memorandum

To: Honorable Jerome E. Horton, Chairman  
Honorable Michelle Steel, Vice Chair  
Honorable Betty T. Yee, First District  
Senator George Runner, Second District  
Honorable John Chiang, State Controller

Date: April 13, 2011

From: Randy Ferris   
Acting Chief Counsel

Subject: **Board Meeting, April 27, 2011**  
**Chief Counsel Matters – Item J – Rulemaking**  
**Petition to Amend the Following Property Tax Rules Related to Change in Ownership:**  
**462.060 (Life Estates and Estates for Years), 462.100 (Leases), 462.160 (Trusts),**  
**462.180 (Legal Entities), and 462.260 (Date of Change in Ownership)**

On March 21, 2011, the Legal Department received Mr. Stephen Bennett's (petitioner's) petition, pursuant to Government Code section 11340.6, to amend Property Tax Rules<sup>1</sup> 462.060, 462.100, 462.160, 462.180, and 462.260.<sup>2</sup> The petition seeks to amend these Rules to "prohibit assessors from violating the due process rights of real property taxpayers who acquired their interest in real property prior to the enactment of Part 0.5 of the Property Tax Division [titled *Implementation of Article XIII A of the California Constitution*, and referred to throughout this memorandum as Part 0.5] of the Revenue & Taxation Code."<sup>3</sup>

This matter is scheduled for the Board's consideration at the April 27, 2011 meeting on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition in its entirety because, as explained below, petitioner's requested amendments are based on an incorrect understanding of basic tenets of California property

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<sup>1</sup> References to "Rule" or "Rules" are section references to title 18 of the California Code of Regulations.

<sup>2</sup> Government Code section 11340.7 requires a response to a rulemaking petition within 30 days. In this case, petitioner refused to waive the 30-day deadline, necessitating the Legal Department to take "other action" as provided in Government Code section 11340.7, subdivision (b) and inform petitioner before the April 20, 2011 deadline that his petition will be heard on the April 27, 2011 Chief Counsel Matters Agenda.

<sup>3</sup> Petition, at p. 1. Petitioner also "separately petition[s] BOE to compel its legal staff to depublish all annotations that apply Part 0.5 retrospectively," and specifically lists Property Tax Annotations 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780 and 220.0786 in his petition. The Legal Department will respond to petitioner's requests for depublication separately under Rule 5700.

tax law and they are contrary to judicial precedent and longstanding interpretations of Board staff. Furthermore, petitioner's requested amendments are effectively repetitive of the amendments the petitioner requested be made to Rule 462.160 by petition dated December 31, 2010, which were unanimously denied by the Board on January 27, 2011. Nothing in the current petition supports a different result.

This memorandum sets forth: (1) a general background of property tax law as it pertains to the petition; (2) a discussion of the petition; and (3) staff's recommendation.

### **I. General Background - Proposition 13**

Proposition 13 added Article<sup>4</sup> XIII A to the California Constitution by voter-approved initiative adopted June 6, 1978, effective July 1, 1978.<sup>5</sup> Article XIII A, section 2 changed California's ad valorem property taxation scheme from one based on annual fair market value assessment to one based on a property's "full cash value," with reassessment allowed only upon new construction or a "change in ownership." By its own terms, Article XIII A, section 2 set the beginning "full cash value" of all property to be a property's assessed value as shown on the 1975-1976 tax bill.<sup>6</sup> The value shown on the 1975-1976 tax bill was set as of the 1975 lien date, which was March 1, 1975. Therefore, effective July 1, 1978, all property in California subject to Proposition 13 had a full cash value determined as of March 1, 1975.<sup>7</sup>

To implement Proposition 13, including defining "change in ownership," Part 0.5 was added to Division 1 of the Revenue and Taxation Code effective July 10, 1979.<sup>8</sup> As relevant here, the statutes contained in Part 0.5 that define "change in ownership" and exclusions therefrom, are sections<sup>9</sup> 60, 61, 62 and 64. Rules 462.060, 462.100, 462.160, 462.180, and 462.260 interpret these statutes.

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 equivalent to the value of the fee interest." Section 61, subdivision (g) provides that a change in ownership occurs upon "[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63." Section 62, subdivision (d) excludes from change in ownership:

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<sup>4</sup> Unspecified references to "Articles" are to the California Constitution.

<sup>5</sup> Assem. Com. on Rev. & Tax., Property Tax Assessment (Oct. 29, 1979), at p. 5.

<sup>6</sup> The definition of "full cash value" is codified at Revenue and Taxation Code section 110.1, which is located in Division 1, Part 1 of the Revenue and Taxation Code, not Part 0.5.

<sup>7</sup> Certain exceptions not relevant to this memorandum are enumerated in Revenue and Taxation Code section 110.1.

<sup>8</sup> We note that the petition fails to consider that, between July 1, 1978 and July 10, 1979, a different statutory and regulatory scheme implemented Proposition 13. The petition also fails to consider that Part 0.5 consists of multiple sections of the Revenue and Taxation Code, which were added at different times and, therefore, have different potential effective dates.

<sup>9</sup> All further section references are to the Revenue and Taxation Code unless otherwise specified.

Any transfer by the trustor, or by the trustor's spouse or registered domestic partner, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the trustor retains the reversion and in which the interest of others does not exceed 12 years duration.

Section 63 excludes interspousal transfers from change in ownership. Section 61, subdivision (h) states that a change in ownership occurs when "[a]ny interests in real property" vest in persons other than a trustor or trustor's spouse and the trust becomes irrevocable. Rule 462.160 interprets these provisions as they apply to real property held in revocable and irrevocable trusts.

Section 62, subdivision (e) excludes from change in ownership "[a]ny transfer by an instrument whose terms reserve to the transferor an estate for years or an estate for life," but provides that the termination of such a life estate or estate for years is a change in ownership except as provided in section 62, subdivision (d) and section 63. Rule 462.060 interprets this statute.

Section 61, subdivision (c) provides that a change in ownership includes the creation of a leasehold interest in taxable real property for a term of 35 years or more, the termination of a leasehold interest that had an original term of 35 years or more, or the transfer of a lessor's interest subject to a lease with a remaining term of less than 35 years. Section 62, subdivision (g) excludes from change in ownership any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term of 35 years or more. Rule 462.100 interprets these provisions.

Section 61, subdivision (j) provides that any transfer of real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person is a change in ownership. However, section 62, subdivision (a)(2) excludes from change in ownership proportional ownership interest transfers. If such a transfer occurs on or after March 1, 1975, the owners of the legal entity immediately after the transfer become "original co-owners" with respect to their interests in the transferee legal entity. (Section 64, subd. (d).) Rule 462.180 interprets these provisions.

Rule 462.260 provides dates to be used "for purposes of reappraising real property as of the date of change in ownership" for transfers involving sales, leases, inheritance by will or intestate succession, and trusts.

## **II. Discussion of Petition**

The petition seeks rule amendments to "prohibit assessors from violating the due process rights of real property taxpayers who acquired their interest in real property prior to the enactment of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code."<sup>10</sup>

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<sup>10</sup> Petition, at p. 1.

However, the petition provides no explanation of how the due process rights of such owners were infringed upon, nor does it provide any specific authority to support its position.

The only explanation given is the following:

Respectfully, petitioner contends that BOE legal staff erroneously interprets *Steinhart*. [¶] . . . [¶] BOE must accept the findings in *Steinhart* as correct. BOE should realize that it can no longer contend that a remainderman's taking of actual possession constitutes a reassessable change in ownership. Why? ***Two reassessments of the remainderman's interest on two different dates*** violates the remainderman' [sic] constitutional right to due process as codified by our legislature's ban on "double taxation" in R&T §102.<sup>11</sup> (Emphasis added.)

Based on the petition and legal staff's numerous emails and conversations<sup>12</sup> with petitioner, staff believes that petitioner seeks the same result as he sought in his December 31, 2010 petition to amend Rule 462.160, and that petitioner is arguing from a premise that is fundamentally contrary to California property tax law. For these reasons the petition should be denied.

In his first petition, petitioner essentially argued that as a result of *Steinhart*,<sup>13</sup> a "vesting" of a remainder interest caused a change in ownership of that interest, and thus could not be reassessed again when that vested interest became possessory.<sup>14</sup> However, as explained fully in the Chief Counsel Memorandum dated January 14, 2011 (which is attached and incorporated by reference), petitioner's interpretation of *Steinhart* was clearly in error because it directly contradicted the interpretation of *Steinhart* set forth in *Phelps v. Orange County Assessment Appeals Bd. No. 1 (Phelps)*.<sup>15</sup> In *Phelps*, a trustor died in 1947, at which time the trustor's three children and widow each received a lifetime income interest in the trust property, with a remainder to the grandchildren. One of those children (Wilson) died in 2002. Pursuant to the terms of the trust, Wilson's life estate terminated and his children received the right to a one-third lifetime income interest in the property. The Court of Appeal upheld the reassessment of the one-third interest stating that:

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<sup>11</sup> Petition, at p. 3.

<sup>12</sup> The Board's legal staff met with petitioner after the January 27, 2011 meeting and explained the basis for the January 14, 2011 Chief Counsel Memorandum. At that time, staff also received for informal consideration petitioner's request for depublication of certain annotations. Petitioner sent staff twenty additional emails between February 2 and March 17, 2011, each with additional arguments or annotations to be considered. Staff discussed these emails extensively by telephone with petitioner on March 22, 2011, and, as of April 4, 2011, staff has received several additional emails containing additional arguments, citations, and demands for Board action. As previously mentioned, petitioner's request for the depublication of certain annotations is being handled separately by the Legal Department pursuant to Rule 5700.

<sup>13</sup> *Steinhart v. County of Los Angeles* (2010) 47 Cal.4th 1298.

<sup>14</sup> See petitioner's December 31, 2010 Petition, Section IV, Proposed Amendments to Rule 462.160, at pp. 7-12.

<sup>15</sup> (2010) 187 Cal.App.4th 653. We also note that, as he did in his first petition, petitioner fails to address *Phelps* at all in this petition.

Although a change in ownership occurred in 1947 [when the trust became irrevocable and when the grandchildren's remainder interest vested], another ownership change occurred in 2002, when Wilson's entire equitable [present beneficial] interest in the real property passed to Wilson's children. Plaintiff's focus on identifying a single "transfer" or transferor finds no support in *Steinhart*.<sup>16</sup>

In this petition, petitioner argues that "two reassessments of the remainderman's interest on different dates" is illegal. This is the same argument, at least in substantive effect, petitioner made in his first petition since petitioner, again, seeks to restrict property passed via irrevocable trust to only one change in ownership regardless of how many times the present beneficial interest in the property is transferred. However, as explained in the response to his first petition, *Phelps* clearly holds to the contrary. Thus, petitioner essentially asks this Board again to contravene *Phelps* by amendments to Rules 462.060, 462.160, and 462.260.<sup>17</sup> For this reason alone, the petition should be denied. Notwithstanding this fact, we briefly address what we understand to be petitioner's fundamental misunderstanding of the law.

Petitioner's fundamental misunderstanding is his assumption that, under any facts similar to *Phelps*, a change in ownership is being determined "retrospectively" against those whom he refers to as "Pre-Enactment Owners." Such is never the case, however, because section 60 and Rule 462.260 require a change in ownership to be determined as of the date of the transfer of a present beneficial interest. A change in ownership occurring on the date of a transfer of a present beneficial interest is never an assessment on a past or future interest.

This can best be illustrated using the facts in *Phelps*. Petitioner's assumption is that, in *Phelps*, Part 0.5 is applied in 2002 to an event (i.e., the vesting of the remainder interest) that occurred in 1947, thus making it a "retrospective" application of Part 0.5 against the remainder beneficiaries. Petitioner fails to understand, however, that it is not the remainder interest received in 1947 upon which a change in ownership determination is being made. Rather, as *Phelps* held, and as required by sections 60 and 61, and Rules 462.060, 462.160, and 462.260, a change in ownership determination is made upon the receipt by the remainderman of the present beneficial interest (what *Steinhart* and *Phelps* refer to as the "equitable interest") in 2002. It is the transfer of the present beneficial interest, originally held by Wilson, to the remainder beneficiaries in 2002 that causes the change in ownership.

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<sup>16</sup> *Phelps, supra*, 187 Cal.App.4th 653, at p. 666.

<sup>17</sup> *Phelps* came before the California Court of Appeal a second time after its first decision was vacated by the California Supreme Court and remanded for further consideration in light of *Steinhart*. (*Phelps v. Orange County Assessment Appeals Board No. 1* (2009) 175 Cal.App.4th 448, judg. vacated and cause remanded for further consideration in light of *Steinhart* (2010) 47 Cal.4th 1298.) Upon reconsideration, the Court of Appeal reached the same conclusions and also explained how its decision was not inconsistent with *Steinhart*. Phelps again petitioned the California Supreme Court and his petition for review was denied. (*Phelps, supra*, 187 Cal.App.4th 653, cert. den. 2010 Cal.LEXIS 12265.) On March 1, 2011, Phelps filed a petition for certiorari to the United States Supreme Court; on March 30, 2011, Orange County waived its right to make a response. The petition is scheduled for consideration on April 22, 2011.

There is no 2002 assessment of the vesting of a 1947 remainder interest based on law that became effective in 1979 as petitioner believes.<sup>18</sup>

Also, for this reason, there is no “double taxation” within the meaning of section 102. The California Supreme Court has held that “double taxation occurs only when ‘two taxes of the same character are imposed on the same property, for the same purpose, by the same taxing authority within the same jurisdiction during the same taxing period.’”<sup>19</sup> Clearly, there is no double taxation when a separate real property interest is being assessed at a different time (e.g., the remainderman’s 2002 present beneficial interest versus the 1947 event where the trust becomes irrevocable and the remainderman’s interest vests).<sup>20</sup>

Petitioner also requests amendment to Rule 462.100 to provide that the termination, transfer or assignment of a long-term lease should not be reassessed as a change in ownership if the term of the lease commenced prior to the effective date of Part 0.5. Again, no explanation for this request is given. However, it appears that petitioner objects to Board legal staff opinion letters in which the portion of the lease term effective prior to the effective date of Part 0.5 is counted in determining whether or not a lease is a long-term lease (i.e., 35 years or longer) under section 61, subdivision (c) and section 62, subdivision (g).<sup>21</sup> However, those opinion letters are consistent with the plain language of the statutes that require the counting of the “original term” or the “remaining term” of the lease. Nothing in those statutes suggests that a lease is exempt from Part 0.5 if it was entered into prior to the effective date of Part 0.5. Furthermore, if taken to its logical conclusion, petitioner’s position could result in such property being reassessed any time there is a termination, transfer, or assignment of such a lease whether or not the lease is 35 years or longer, since the protection afforded to leases for terms of less than 35 years would then not apply.

Petitioner also requests amendment of Rule 462.180 to provide that “original co-owner”<sup>22</sup> status should not attach if real property is transferred to a legal entity prior to the effective date of Part 0.5. In this case, there is no need for an amendment. Both section 64, subdivision (d) and Rule 462.180, subdivision (d)(2) provide, by their own terms, that original co-owner status is only obtained for transfers of real property that occur on or after March 1, 1975.<sup>23</sup>

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<sup>18</sup> By email dated March 24, 2011, petitioner requested that an article by Robert R. Gunning entitled *Back from the Dead: The Resurgence of Due Process Challenges to Retroactive Tax Legislation* (2009) 47 *Duquesne Law Review* 291 be included in consideration of his petition. Because the Rules that petitioner requests to be amended are not applied to periods prior to the effective date of Part 0.5 (i.e., the Rules in question have not been and are not applied retrospectively), the analysis proffered by this article does not support petitioner’s arguments.

<sup>19</sup> *Assoc. Home Builders etc., Inc. v. City of Walnut Creek* (1971) 4 Cal.3d 633, 613 [citations omitted].

<sup>20</sup> Petitioner also fails to realize that a remainder interest can never be reassessed since, as a future interest, it does not meet the section 60 definition of change in ownership. Furthermore, the 1947 remainder interest could not be reassessed even in 1947 since Proposition 13 did not exist at that time.

<sup>21</sup> These opinion letters are the basis for several annotations requested to be republished by petitioner.

<sup>22</sup> On page 16 of the Petition, petitioner mistakenly uses the term “original transferor,” which is a status that only applies in the context of a joint tenancy. We assume he meant “original co-owner.”

<sup>23</sup> As explained in Part I, although the effective date of Part 0.5 is July 10, 1979, Article XIII A, section 2 and section 110.1 make clear that the full cash value of property is first determined as of the 1975-1976 tax year for which March 1, 1975 was the lien date.

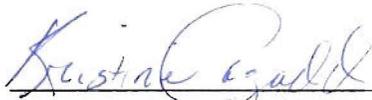
### **III. Staff's Recommendation**

By these requested amendments to Property Tax Rules, petitioner effectively asks the Board to disregard the 2010 judicial decisions in *Steinhart* and *Phelps*. Despite the extensive judicial attention received by Proposition 13 since its adoption in 1978, we have not found any due process challenges along the lines of petitioner's contentions as presented in this petition, and we do not believe such challenges would be successful.

Staff recommends that the Board deny the petition because the current versions of Property Tax Rules 462.060, 462.100, 462.160, 462.180, and 462.260 conform to the applicable statutes as applied in *Steinhart* and *Phelps*. The petition should also be denied because it is, in substance, duplicative of the petition that the Board denied on January 27, 2011.

If you need more information or have any questions, please contact Christine Bisauta, Acting Assistant Chief Counsel, at (916) 323-2549 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved:

  
Kristine Cazadd  
Interim Executive Director

Attachment: Chief Counsel Memorandum dated January 14, 2011

RMF:bk:yg

J:/Chief Counsel/Finals/Board Memo – Item J – Petition to Amend CIO – 462.060 462.100 462.160 462.180  
460.260 – 04-12-2011.doc  
J:/Prop/Finals/Monthly CC Agenda Items/2011/11-053.Memo.doc

cc:	Ms. Kristine Cazadd	MIC: 73
	Ms. Christine Bisauta	MIC: 82
	Mr. Richard Moon	MIC: 82
	Ms. Carole Ruwart	MIC: 82

## Memorandum

To: Honorable Betty T. Yee, Chairwoman  
Honorable Jerome E. Horton, Vice Chair  
Senator George Runner, Second District  
Honorable Michelle Steel, Third District  
Honorable John Chiang, State Controller

Date: January 14, 2011

From: Randy Ferris   
Acting Chief Counsel

Subject: **Petition for Amendment of Property Tax Rule 462.160**  
***Change in Ownership – Trusts***  
**January 27, 2011 Board Meeting – Chief Counsel Matters – Item J – Rulemaking**

On January 3, 2011, the Legal Department received Mr. Stephen Bennett's petition, pursuant to Government Code section 11340.6, to amend Property Tax Rule<sup>1</sup> 462.160, *Change in Ownership - Trusts*. In his petition, Mr. Bennett seeks to amend Rule 462.160 to "clarify" the change in ownership consequences when certain property interests terminate. He states that a recent California Supreme Court decision, *Steinhart v. County of Los Angeles (Steinhart)*,<sup>2</sup> raised two questions that should be clarified by Rule 462.160.

This matter is scheduled for the Board's consideration at the January 27, 2011, meeting<sup>3</sup> on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition because, as explained in detail below, the questions raised in the petition have been answered by *Steinhart* and a recent California Court of Appeal decision, *Phelps v. Orange County Assessment Appeals Board No. 1 (Phelps)*.<sup>4</sup> Furthermore, Mr. Bennett's proposed amendments to Rule 462.160 are contrary to *Phelps*.

This memorandum sets forth: (1) a general background of change in ownership law as it pertains to real property held in trusts; (2) a discussion of the petition and the requested amendments; and (3) staff's recommendation.

<sup>1</sup> All "Property Tax Rule" or "Rule" references are to title 18 of the California Code of Regulations.

<sup>2</sup> (2010) 47 Cal.4th 1298.

<sup>3</sup> Under Government Code section 11340.7, the Board has 30 days from receipt to take action on the petition. Petitioner states in his petition that he does not waive this deadline.

<sup>4</sup> (2010) 187 Cal.App.4th 653.

## **I. General Background – Change in Ownership and Trusts**

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a “change in ownership.” This section has been implemented by statutes enacted by the Legislature and Property Tax Rules promulgated by the Board of Equalization. As relevant here, such authorities regarding trusts include Revenue and Taxation Code section<sup>5</sup> 60, section 61, subdivisions (g) and (h), section 62, subdivision (d), and Rule 462.160.

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 equivalent to the value of the fee interest.” This is often referred to as a three-part test. To meet the test, there must be: (1) a transfer of a present interest; (2) that includes beneficial use; (3) the value of which is substantially equivalent to the value of the fee. Section 61, subdivision (g), provides that a change in ownership occurs upon “[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.” Section 62, subdivision (d) excludes from change in ownership:

Any transfer by the trustor, or by the trustor’s spouse or registered domestic partner, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the trustor retains the reversion and in which the interest of others does not exceed 12 years duration.

Section 63 excludes interspousal transfers from change in ownership. Section 61, subdivision (h) states that a change in ownership occurs when “[a]ny interests in property” vest in persons other than a trustor or trustor’s spouse and the trust becomes irrevocable.

Rule 462.160 interprets change in ownership statutes as they apply to transfers involving trusts. It explains in subdivisions (a) and (c) that, generally, both the creation and termination of trusts will result in a change in ownership of trust real property. Rule 462.160, subdivisions (b) and (d) provide a number of exceptions to these general rules.

## **II. Discussion of Petition**

The petition states that its genesis was the Supreme Court’s decision in *Steinhart*. In *Steinhart*, a trustor (Helfrick) created a revocable trust with herself as the sole beneficiary, and transferred a residence to the trust. Upon Helfrick’s death in 2001, the trust became irrevocable and under its terms, Helfrick’s sister, plaintiff Lorraine Steinhart (Steinhart), received a life estate in the residence with the remainder to Helfrick’s heirs. The Los Angeles County Assessor reassessed the residence since the transfer of the life estate to Steinhart caused a change in ownership.

Steinhart argued that the residence should not have been reassessed because no change in ownership occurred upon her receipt of the life estate in the residence based on the contention

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<sup>5</sup> Section references are to the Revenue and Taxation Code unless otherwise indicated.

that her life estate was not “substantially equivalent to the fee” as required by section 60.<sup>6</sup> The Supreme Court disagreed, stating that Steinhart’s error was in focusing on the interest that she had received rather than on what interest was transferred by Helfrick. Because Helfrick, upon her death, had transferred the life estate and the remainder, she was left with no interest and thus had transferred the entire fee itself, not just an interest that was “substantially equivalent to the fee.”<sup>7</sup> The Court did not find it necessary to determine whether the transfer of a life estate alone would result in a change in ownership, nor did it address whether there would be a subsequent change in ownership when Helfrick’s heirs obtained the remainder interest in the residence.<sup>8</sup>

The petition requests that the Board amend Rule 462.160 to provide three examples and several definitions (proposed by new subdivision (f)) that would purportedly answer the following two questions raised by the *Steinhart* decision.

1. Did the receipt by Lorraine Steinhart of her life estate in Helfrick’s residence on Helfrick’s death trigger a reassessable change in ownership?
2. Will Steinhart’s future death then trigger a reassessable change in ownership of the same residence?

We first note that *Steinhart* directly answers Question 1, and *Phelps*, which petitioner does not discuss, answers Question 2.

A. Question 1

Petitioner requests amendment of Rule 462.160 to clarify the application of section 61, subdivision (g) to his Question 1. However, no amendment to Rule 462.160 is necessary to answer petitioner’s Question 1 because section 61, subdivision (g) is unnecessary to answer it, and as explained in *Steinhart*, Rule 462.160 provides an answer. *Steinhart* held that sections 60, 61, subdivision (h), and 62, subdivision (d), and Rule 462.160 lead to the conclusion that a change in ownership of trust property occurs when a trust becomes irrevocable and the trustor transfers the entire equitable estate in the property. In fact, the Court goes through a detailed analysis of its conclusion beginning with section 2, subdivision (a), of Article XIII A of the Constitution, explaining how the relevant statutes are consistent with this constitutional provision, and finally explaining how the Board’s Rule 462.160 properly interprets those statutes. In this regard, the Court explained as follows:

The State Board of Equalization, through an implementing regulation, has also expressly addressed section 2, subdivision (a)’s [of Article XIII A of the California Constitution] application to transactions involving trusts. That regulation begins by stating a “[g]eneral [r]ule” that, for purposes of section 2, subdivision (a), “[t]he transfer by the trustor . . . of real property into a trust is a change in ownership . . . at the time of the transfer.” (Cal. Code Regs., tit. 18, § 462.160, subd. (a).) The regulation then specifies a list of “[e]xceptions” to the general rule—i.e., “transfers” involving trusts that “do not constitute changes in

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<sup>6</sup> *Steinhart*, *supra*, 47 Cal.4th at pp. 1323-1325.

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

ownership”—including, as here relevant: (1) “[t]he transfer of real property by the trustor to a trust in which the trustor-transferor is the sole present beneficiary of the trust” (*id.*, § 462.160, subd. (b)(1)(A)); and (2) “[t]he transfer of real property . . . by the trustor to a trust which is revocable by the trustor” (*id.*, § 462.160, subd. (b)(2)). [Fn. Omitted.] Regarding revocable trusts, the regulation further provides that “a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or becomes the sole present beneficiary or unless otherwise excluded from change in ownership.” (*Id.*, § 462.160, subd. (b)(2).)

We generally accord “great weight” to the statutes the Legislature has passed and the regulations the State Board of Equalization has promulgated to implement article XIII A. (*Amador, supra*, 22 Cal.3d at p. 246.) **Under both the express language of, and the underlying justification for, section 61, subdivision (h), section 62, subdivision (d), and the administrative regulation discussed above, it is clear that upon Helfrick’s death, a “change in ownership” under section 2, subdivision (a), occurred in this case.** Notably, Steinhart does not even argue otherwise, conceding in her brief that under “a literal application of” section 61, subdivision (h)’s language, “a change in ownership occurred” when Helfrick died, “the revocable trust became irrevocable,” and her (Steinhart’s) “life estate vested.”<sup>9</sup> (Emphasis added.)

As noted by petitioner, in reaching this conclusion, the Court did not discuss section 61, subdivision (g). Such a discussion was unnecessary. The case was decided based on section 60, section 61, subdivision (h), section 62, subdivision (d), and Rule 462.160 because the event at issue was the transfer of a life estate to Steinhart as a result of Helfrick’s death and the trust becoming irrevocable. The Court’s omission of section 61, subdivision (g), in its analysis is consistent with the position that section 61, subdivision (g), becomes relevant only upon Steinhart’s death, when the remainder interests of Helfrick’s heirs become possessory. Rule 462.160 addresses petitioner’s Question 1 in subdivision (b)(1), which explains that a change in ownership of trust property occurs when a revocable trust becomes irrevocable, unless the trustor-transferor remains or becomes the sole present beneficiary or an applicable exclusion applies, which was not the case under the facts of *Steinhart*. Therefore, petitioner is incorrect in his implication that Rule 462.160 needs amendment to clarify the meaning of section 61, subdivision (g), to address his Question 1.

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<sup>9</sup> *Steinhart, supra*, 47 Cal.4th at pp. 1322-1323.

## B. Question 2

To provide an answer to his Question 2, petitioner requests amendment of Rule 462.160 to add three examples and several definitions.<sup>10</sup> In each of the examples, A creates a trust which becomes irrevocable upon A's death, at which time B receives a lifetime interest in income (a life estate) in real property. Upon B's death, C and D receive the remainder interest.<sup>11</sup> In such a situation, as explained above, *Steinhart* makes clear that a change in ownership occurs upon A's death. Petitioner asserts that Rule 462.160 needs to be amended to clarify whether a change in ownership occurs upon B's death. However, section 61, subdivision (g), Rule 462.160, and *Phelps* already make clear that a second change in ownership does in fact occur upon B's death. Petitioner's Examples 7 and 8 are contrary to these authorities.<sup>12</sup> In those examples, petitioner puts forth the analysis that since C's and D's remainder interests vested at the time of A's death, upon B's death, there is not a change in ownership. This is the same argument made by the plaintiff and rejected by the court in *Phelps*.

Relevant to this petition, in *Phelps*,<sup>13</sup> a trustor died in 1947 at which time the trustor's three children and widow each received a lifetime income interest in the trust property. One of those children (Wilson) died in 2002, and pursuant to the terms of the trust, Wilson's life estate terminated and his children received the right to a one-third lifetime income interest in the property. The plaintiff argued that because all vested interests in the property were transferred in 1947, nothing was transferred when Wilson died in 2002, and that, therefore, no change in ownership of the property could occur in 2002.<sup>14</sup> The Court disagreed stating that Proposition 13 tracks "real ownership of real property, which *Steinhart* determined followed the equitable estate."<sup>15</sup> Thus, a change in ownership occurred in 2002 when Wilson no longer continued to own the property.<sup>16</sup>

Implicit in the court's reasoning is its analysis that Wilson possessed all three elements required to meet the three-part section 60 definition of change in ownership.<sup>17</sup> In other words Wilson held a life estate which gave him (1) a present interest, (2) from which he derived beneficial use,

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<sup>10</sup> Because petitioner's definitions are intended to buttress his examples and the examples conflict with existing law, we do not specifically address the proposed definitions other than to state that their inclusion would also conflict with existing law.

<sup>11</sup> In his examples, petitioner includes additional facts, including that B has a general or special power of appointment that is either exercised or not exercised, as well as certain provisions of the trust regarding allocation of income and principal. None of the additional facts change the conclusion that a change in ownership occurs upon A's death and again upon B's death.

<sup>12</sup> While petitioner's proposed Example 5 is consistent in result with Board staff interpretations, this example would not improve the clarity of Rule 462.160 because its analysis is flawed.

<sup>13</sup> *Phelps* came before the California Court of Appeal a second time after its first decision was vacated by the California Supreme Court and remanded for further consideration in light of *Steinhart*. (*Phelps v. Orange County Assessment Appeals Board No. 1* (2009) 175 Cal.App.4th 448, judg. vacated and cause remanded for further consideration in light of *Steinhart* (2010) 47 Cal.4th 1298.) Upon reconsideration, the Court of Appeal reached the same conclusions and also explained how its decision was not inconsistent with *Steinhart*. *Phelps* again petitioned the California Supreme Court and his petition for review was denied. (*Phelps, supra*, 187 Cal.App.4th 653, cert. den. 2010 Cal.LEXIS 12265.)

<sup>14</sup> *Phelps, supra*, 187 Cal.App.4th 653 at p. 666.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> *Phelps, supra*, 187 Cal.App.4th 653 at pp. 658-666.

and (3) the value of that use was substantially equivalent to the value of the fee. When Wilson died, his life estate terminated, a life estate interest passed to his children, and his children received all three elements previously held by Wilson, necessitating a change in ownership of their interest in the property.

The petition to amend Rule 462.160 fails to recognize that, upon the termination of a life estate in these examples, all three requirements necessary for a change in ownership are met. Petitioner's Examples 7 and 8 seem to concede that the second and third parts of the three-part test are met but ignore the present interest requirement of the first part of the test. The Examples state that no change in ownership occurs upon B's death because C's and D's remainder interests already vested upon A's death. Petitioner's analysis, however, fails to consider that a remainderman does not have present enjoyment of the property until the precedent estate has terminated. Until the remaindermen obtain the present enjoyment of the property, their interests are "future" interests that are to be protected from reassessment by section 60's present interest requirement.<sup>18</sup> This is true even if the remainder interest becomes "vested" at an earlier time (i.e., upon grantor's death). Furthermore, this conclusion is supported by Rule 462.160, subdivision (d)(1), which states:

Prior Change in Ownership. Termination results in the distribution of trust property according to the terms of the trust to a person or entity who received a present interest (either use of or income from the property) when the trust was created, when it became irrevocable, or at some other time. However, a change in ownership also occurs when the remainder or reversionary interest *becomes possessory* if the holder of that interest is a person or entity other than the present beneficiary unless otherwise excluded from change in ownership. (Emphasis added.)

In petitioner's Examples 7 and 8, at B's death, a present interest in the property is transferred because B's interest terminates and C's and D's interests then become possessory. And, because C and D also have the beneficial use of the property, and their interest in the property is substantially equivalent to the value of the fee, all three parts of the section 60 definition of change in ownership are met at B's death. Therefore, contrary to petitioner's proposal, pursuant to *Phelps* and Rule 462.160, subdivision (d)(1), the property must be reassessed at that time.

The plaintiff in *Phelps* also argued, and petitioner also appears to be arguing, that *Steinhart* limited section 61, subdivision (g), to retained life estates and nonsuccessive remainder interests. *Phelps* rejected this argument and concluded that section 61, subdivision (g), supported its conclusion that a change in ownership occurred upon Wilson's death:

Plaintiff [Phelps, the trustee of the trust] notes that under section 61, subdivision (g), a change of ownership includes, "Any vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63." He observes "the section appears to state that every time a life estate ends and the remainder

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<sup>18</sup> Assem. Com. on Rev. & Tax., Report of the Task Force on Property Tax Administration (Jan. 22, 1979) at p. 39.

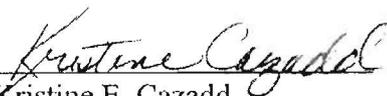
interest vests in another, this is an assessable change in ownership.” He contends *Steinhart* limits section 61, subdivision (g), to retained life estates and nonsuccessive remainder interests. *Steinhart* did not involve successive transfers or vesting of remainder interests under a trust, and the court did not discuss section 61, subdivision (g), in this context. [Citation omitted.] Cases are not authority for propositions not considered. (*Silverbrand v. County of Los Angeles* (2009) 46 Cal.4th 106, 127 [92 Cal. Rptr. 3d 595, 205 P.3d 1047].) **Section 61, subdivision (g), however, supports our conclusion the vesting of property rights in Wilson’s children upon termination of Wilson’s life interest effected a change of ownership.**<sup>19</sup> (Emphasis added.)

Therefore, the petition should be denied because the proposed amendments directly contradict section 61, subdivision (g), and *Phelps*. Additionally, the appellate court’s analysis in *Phelps* is consistent with Rule 462.160, subdivision (d)(1) and inconsistent with the Rule amendments proposed by petitioner.

### **III. Staff’s Recommendation**

Staff recommends that the Board deny the petition because the current version of Rule 462.160 conforms to the applicable statutes as applied in *Steinhart* and *Phelps*. In staff’s opinion, the requested regulatory change is contrary to these authorities.

If you need more information or have any questions, please contact Christine Bisauta, Acting Assistant Chief Counsel, at (916) 323-2549 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved:   
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RF:bk  
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<sup>19</sup> *Phelps, supra*, 187 Cal.App.4th at p. 667.