



STATE BOARD OF EQUALIZATION

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Executive Director

March 6, 2006

Re: Revenue and Taxation Code Section 63.1 - Termination of Life Estate

Dear Ms. :

This is in response to your letter dated September 23, 2005, requesting our opinion concerning the change in ownership consequences of a transfer of the life income interest in a property under the parents' irrevocable trust to their three children and a re-transfer of such interests upon each child's death to that child's issue, or if none, to the surviving children under the principle of representation. The County Assessor's office has notified your client that a re-transfer of the property from a deceased child to a sibling does not qualify as a parent to child transfer under Revenue and Taxation Code¹ section 63.1 because the transferee is not a parent or child of the transferor. Your position is that the parents of the siblings, not the deceased child, are the transferors. For the reasons stated below, we agree that the parents are the transferors, and therefore, the transfer is excluded from change in ownership provided that all of the requirements of section 63.1 are met.

Relevant Facts

The facts are based on your letter and copies of the county's denial of the parent-child exclusion claim, a death certificate, a quitclaim deed, and the irrevocable H Living Trust.

1. On December 11, 1990, Mr. and Mrs. H, trustors, created the H Living Trust (Trust), and the H Exempt Trust No. 1, a subtrust of the Trust, to minimize federal estate taxes by creating a generation-skipping trust that would not be taxed on the death of a child.
2. Mr. and Mrs. H had three daughters: JH, MMH and GP. The Trust provided that upon the surviving spouse's death, the Trust estate would be divided into equal shares for each of the children, and that any subsequent share allocated to a child would continue in the subtrust for such child. The Trust directed that all income of the subtrust be paid to the child in quarterly or more frequent installments during the child's lifetime, and at any time, discretionary payments of principal could be distributed. Upon the death of a child, the Trust directed that the entire remaining balance of the subtrust estate be distributed to the child's then living descendants, according to the principle of representation. If the child had no such descendant, the trustee was to distribute the property equally to Mr. and Mrs. H's surviving children, according to the principle of representation.

¹ All section references are to the Revenue and Taxation Code, unless otherwise noted.

3. At the death of the surviving parent, MMH had a life estate in the MMH Exempt Trust No. 1 that consisted of a one-third interest in the Trust estate. On October 30, 2003, MMH died without living descendants; thus, on her death the subtrust property was divided equally between the surviving child, JH, and the four children (J, D, C and A) of GP, a predeceased child.
4. On February 28, 2005, the successor trustee of the MMH Exempt Trust No. 1 filed a quitclaim deed transferring the one-third real property interests in equal shares to JH (one-sixth) and to GP's four children (one-sixth in equal shares). A parent/child claim was filed for the transfer to JH. On July 28, 2005, the assessor's office denied the claim on the basis that the "transferee was neither the parent nor the child of the transferor, as defined by revenue and Taxation Code § 63.1."

Law and Analysis

"Change in ownership" is defined by section 60 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." There is excluded from the definition of change in ownership any transfer of real property that is the principal residence of the eligible transferor and the first million dollars of full cash value of all other real property of each eligible transferor in the case of parents and their children. (Rev. & Tax. Code, § 63.1, subd. (a).)

Subject to certain exceptions under Property Tax Rule 462.160, subdivision (b), the transfer of real property into an irrevocable trust, or the date that a revocable trust becomes irrevocable, is a change in ownership of the trust property. In addition, under section 61, subdivision (g), any vesting of the right to possession or enjoyment of a remainder 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, is a change in ownership. Where, as here, the trustors grant to the trust beneficiaries life estates in the trust property of an irrevocable trust, changes in ownership may occur upon both the creation and termination of the life estates upon transfer to the remainderpersons, unless an exclusion applies.

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

Where a life estate terminates as a result of the death of the life tenant, the transfer to the remainderperson is from the transferor of the remainder interest, not from the life tenant. This is because the statutory language in section 61, subdivision (g), section 61, subdivision (h), and section 62, subdivision (d) identifies the grantor of a life estate as the "transferor" of the remainder or reversionary interest. (See Property Tax Annotation 220.0786, enclosed.) The only "exception" occurs when the life tenant has not died, but transfers his interest during his

lifetime to the remainder person or to a third party, in which case the life tenant is the "transferor." (See Property Tax Annotation No. 220.0372, enclosed.)

In the instant case, Mr. and Mrs. H, as grantors/trustors, granted each child a life estate and directed that on the date of the child's death, her interest would transfer to that child's descendants, and if none, to the surviving siblings. Under the trust instrument, when each child died, her life estate terminated and her percentage interest transferred, by order of the Trust, to that child's descendants, or if none, to the other surviving siblings, according to the principle of representation. Thus, Mr. and Mrs. H were the "transferors," not the deceased child life tenant, MMH. Since the parents were the transferors, the parent/child exclusion and/or the grandparent/grandchild exclusion under section 63.1 would apply to exclude from change in ownership the termination of each life estate, provided that all of the filing requirements are met.

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/ Shirley Johnson

Shirley Johnson
Tax Counsel

SJJ:jlh

Enclosure

Prec/LifeEstate/06/05-739.SJJ.doc

Prec/ParChild/06/05-739.SJJ.doc

cc: Honorable
County Assessor's Office

Mr. David Gau, MIC: 63
Mr. Dean Kinnee, MIC: 64
Ms. Mickie Stuckey, MIC: 62
Mr. Todd Gilman, MIC: 70