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December 14, 1993

Honorable Eric J. Sonquist  
Assessor of Santa Barbara County  
105 East Anapamu Street, Room 204  
San Barbara, CA 93101-2062

Attn: Karen M. Stein  
Senior Appraiser

Re: Parent/Child Exclusion - R&T Sec. 63.1, Transfer Between  
Parent and Children - By-Pass Trust

Dear Mr. Sonquist:

This is response to your letter to me of September 29, 1993 in which you request our assistance as to the applicability of the parent-child exclusion under the following circumstances.

passed away February 5, 1993. At her death, her property passed into a trust for the benefit of her spouse - ( ), her children Jr. and ( ) and her grandchildren ( ) and ( ).

At issue here is the property tax treatment of decedent's property passing into Trust B, a By-Pass or Exemption Equivalent Trust. During the life of the surviving spouse, the income and principal of Trust B is to be distributed as follows:

a. Income and Principal:

The trustee shall pay to or apply for the benefit of the surviving Settlor as much of the net income and principal of Trust B as the trustee, in the Trustee's discretion, shall deem necessary for the survivor's proper health, support and maintenance, after taking into consideration, to the extent the Trustee shall deem advisable, any other income or resources of the surviving Settlor known to the Trustee.

Payments of principal for the benefit of the surviving Settlor shall be made first out of Trust C, and then out of Trust A, until both of such Trusts are exhausted, and

thereafter out of Trust B; provided, however, that all or any part of such payments may be made from Trust B for the benefit of the surviving Settlor, without first exhausting Trusts A and C, if for any reason the Trustee deems this advisable.

b. Sprinkle Power:

The Trustee may also pay to or apply for the benefit of the issue of Settlers as much of the net income or principal of Trust B as the Trustee, in the Trustee's discretion, deems appropriate for their proper health, support, maintenance, and education. So long as any beneficiary of this trust is serving as sole Trustee, however, the power of such beneficiary to pay or apply income or principal to himself or for his own benefit may not be exercised without the consent of \_\_\_\_\_, or if she is then deceased or otherwise unable to confer consent, then the consent of \_\_\_\_\_ shall be required; or if both \_\_\_\_\_ and \_\_\_\_\_ are then deceased or otherwise unable to confer consent, then the consent of any beneficiary of the trust other than the beneficiary then serving as Trustee shall be required.

c. Intent:

In exercising these discretionary powers to sprinkle income and invade principal, the Trustee shall be mindful of the fact that the primary concern of Settlers in the establishment of this Trust is the welfare of the surviving Settlor, and the interests of others in the trust are to be subordinate thereto. Payments of any sum from principal shall not create rights in any other person under any trust created herein, and such payments need not be restored to principal of the trust estate.

Under the foregoing provisions, any one of decedent's surviving spouse, children and grandchildren could receive some, all or none of the income and/or principal of Trust B depending upon the discretion of the Trustee.

Prior to the adoption of the parent-child exclusion, we considered similar trust provisions for purposes of determining the applicability of the interspousal exclusion under Revenue and Taxation Code section 63. In a letter dated August 31, 1981 (copy enclosed) the legal staff concluded:

- (1) It is only required that the surviving spouse be the sole present beneficiary of the life estate. It is not necessary that the surviving spouse have a special power of appointment over the trust assets in order to so qualify. If the surviving spouse is the sole present beneficiary, there will be no reappraisal upon the death of the first spouse. Upon the death of the second spouse, the property will be subject to reappraisal.
- (2) It is permissible for the trustee to have the discretion to distribute or accumulate income. There is no requirement that the income be distributed annually so long as the surviving spouse is the sole present beneficiary.
- (3) If the trustee has the power to sprinkle income among persons other than the surviving spouse, the surviving spouse is not the sole present beneficiary of the trust and such property cannot qualify for the interspousal exclusion. Board Rule 462(i)(2)(D).

We have taken the same approach with respect to the parent-child exclusion. That is, if children are the sole present beneficiaries of a trust, we would view the transfer in trust by a parent as a transfer for purposes of the parent-child exclusion notwithstanding the fact that the trustee has the discretion as to whether or not to distribute income and/or principal to them. If however, the trustee has discretion to distribute income and/or principal to both children and grandchildren, we would view the transfer in trust as not being a transfer for purposes of the parent-child exclusion because the children would not be the sole present beneficiaries of the trust.

From the foregoing, it would follow that the transfer of property into Trust B by the decedent would not be excluded under the interspousal exclusion because the surviving spouse is not the sole present beneficiary nor would it be excluded under the parent-child exclusion because the children are not the sole present beneficiaries.

In the event, however, that valid disclaimers pursuant to the Probate Code were filed so that only the surviving spouse or only the children were present trust beneficiaries, the Assessor could, in our view, recognize such valid disclaimers and apply either the interspousal exclusion or parent-child exclusion as appropriate.

The views expressed in this letter are, of course, advisory only.

Honorable Eric J. Sonquist

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December 14, 1993

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  
Staff Counsel III

EFE:jd  
precednt/parchild/93014.efe

Enclosure

cc: Mr. John Hagerty, MIC:63  
Mr. Verne Walton, MIC:64