220.0781 **Trusts.** The transfer of real property by a trustee to a partnership owned by the trust followed by transfers of partnership interests to the beneficiaries as they reach ages specified in the master trust instrument do not constitute changes in ownership. The transfer to the partnership constituted a change in the manner in which title to the property was held, and the distributions to the beneficiaries were transfers of legal title to the beneficial owners of the property. C 1/23/89.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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Executive Director

January 23, 1989

Dear

This is in response to your letter of November 29, 1988, to Mr. Kenneth McManigal in which you request our opinion that the proposed transactions set forth in your letter and described below will not result in a change in ownership for property tax purposes.

Facts

Your clients are the trustees of four irrevocable trusts. The trusts are governed by one trust instrument, a copy of which, with names and other identifying data deleted, was provided to us. Except for the identity of the primary beneficiary of each trust, the trusts are identical.

The provisions that apply to each primary beneficiary's separate trust are as follows:

Until the primary beneficiary attains the age of 21 years, the trustees have discretion to accumulate net income and add it to principal or distribute net income to the primary beneficiary, as the trustee deems proper and desirable. After the primary beneficiary reaches the age of 21 years, the trustees are directed to pay to or expend for the direct or indirect benefit of the primary beneficiary all of the annual net income of the beneficiary's separate trust. The trustees are authorized to distribute to the primary beneficiary whatever amounts of the principal of the beneficiary's trust the trustees deem proper or necessary for the comfortable support, maintenance, education, establishment or continuation of a business, or to meet any emergency need of the beneficiary.

When a primary beneficiary attains the age of 25 years, one-third of the beneficiary's separate trust is to be distributed to the beneficiary. When the primary beneficiary attains the age of 30 years, one-half of the assets remaining

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in the separate trust is to be distributed to the beneficiary. At age 35 years, the remaining balance of the primary beneficiary's separate trust is to be distributed to the beneficiary. If a beneficiary dies before the age of 35, the trustees are to administer the beneficiary's share as a trust for the benefit of the beneficiary's lineal descendants and spouse. If the deceased beneficiary has no lineal descendants or spouse, the beneficiary's share is to be added in equal shares to the trust estates that are administered for the other primary beneficiaries. If all beneficiaries die before final distribution, then at the death of the last survivor, all of the estate not then disposed of is to be distributed to the trustee's heirs at law.

The trustees of the four trusts own one large commercial building and land in California as tenants in common; each trust owns an equal undivided one-fourth interest in the two properties. The trustees of each trust also own securities and cash.

The trustees intend to create a general partnership ("the partnership") in which the trustees of the four trusts will be general partners, each owning a 25 percent interest in the partnership capital and profits. The large commercial property currently owned by the trustees of the four trusts will be transferred to the partnership. The other trust assets will not be transferred to the partnership.

It is further contemplated by the trustees that as the primary beneficiary of a separate trust reaches age 25, the trustees will distribute to the beneficiary a fractional part of the partnership interest owned by the trustees of that beneficiary's separate trust. At age 30, another fractional part of the partnership interest will be distributed to the beneficiary and at age 35, the remainder of the partnership interest will be distributed to the beneficiary (if all of the partnership interest has <u>not</u> already been distributed to the beneficiary at ages 25 and 30). The fractional part of the partnership interest to be distributed by the trustees of a beneficiary's trust to the beneficiary at age 25 will be determined so that the value of the fractional partnership interest that is distributed to the beneficiary at that time is equal to one-third of the total value of the assets. The fractional part of the partnership interest to be distributed to the beneficiary at age 30 will be determined so that the value of the fractional partnership interest that is distributed to the beneficiary at that time is equal to one-half of the total value of the assets of the beneficiary's trust.

For purposes of this legal opinion, the provisions of Section J of Article FOURTH can be ignored; no additional children were born within the ten year period described in Section J, so no additional trusts were created other that the original four trusts.

As indicated above, you have requested our opinion that the following transactions will not result in a change of ownership under Revenue and Taxation Code* section 60 of any real property currently held by the trust and subsequently transferred to the partnership by the trustees of the trusts:

1. The transfer to the partnership by the trustees of each of the four trusts of the trusts' California real property.

2. The distributions by the trustees of each of the four trusts of fractional parts or all of the trusts' partnership interest to the primary beneficiary of the trust at ages 25, 30 and 35, respectively.

Legal Analysis

I. The Transfer of the Trusts' Real Property by the Trustees to the Partnership is Not a Change of Ownership.

Section 60 defines "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."

Section 61 provides in relevant part that "[e]xcept as otherwise provided in Section 62, change in ownership, as defined in Section 60 includes, but is not limited to: . . . [¶](i) [t]he transfer of any interest in real property between a . . . partnership, . . . and a . . . partner. . . ."

Section 62(a)(2) provides, in relevant part however, that a change in ownership shall not include "[a]ny transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every

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

piece of real property transferred, remain the same after the transfer." 18 Cal. Code Reg. section 462(j)(2)(B) provides that a transfer of an interest in real property to a partnership is not a change in ownership of the real property, if it is a transfer "of real property between separate legal entities or by an individual(s) to a legal entity (or

vice-versa), which results solely in a change in the method of holding title in which the proportional ownership interests remain the same after the transfer."

At the present time, the trustees of the four trusts own the trusts' real property as tenants in common. The trustees of each trust own an undivided 25 percent interest in the trusts' real property. After the transfer of the four trusts' assets to the partnership, the trustees of each trust, as partners, will own a 25 percent interest in both partnership capital and profits.

Thus, although the proposed transfers are of interests in real property between the trusts and the partnership, they would result solely in a change in the method of holding title to the real property in which the proportional ownership interests would remain the same after the transfers. Accordingly, the proposed transfers would not result in a change in ownership.

II. <u>The Distribution of Partnership Interests from the Trustees to the Beneficiaries Will Not Constitute a Change in Ownership</u>.

Section 64(a) provides in relevant part that "[e]xcept as provided in subdivision . . . (d) of this section, the purchase or transfer of ownership interests in legal entities, such as . . . partnership interests, shall not be deemed to constitute a transfer of real property of the legal entity."

Subdivision (d) provides that "[i]f property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the 'original coowners.' Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised." 18 Cal. Code Reg. section 462(i)(4)(E)

provides, however, that the termination of a trust, or portion thereof, does not constitute a change in ownership at the time of the termination if the "termination results in the transfer to the beneficiaries who receive the same proportional interests in the property as held before the termination of the trust."

After the creation of the partnership, the trustees of each separate trust will each own a 25 percent interest in partnership capital and profits (a "25 percent partnership interest"). The distributions of partnership interests from the trustees to the beneficiaries will occur periodically as each beneficiary of a separate trust reaches the ages 25, 30 and 35. Prior to the distributions of partnership interests to a beneficiary, the primary beneficiary of a separate trust would be the sole beneficial owner of the 25 percent partnership interest held by the trustee of the separate trust. After the distribution of fractional parts or all of the trust's partnership interests to the primary beneficiary, as the case may be at ages 25, 30 and 35, the primary beneficiary will remain as the sole beneficial owner of the 25 percent partnership interest. The termination of each trust, or portion thereof, that results as the trustees periodically distribute partnership interests to the primary beneficiaries of the trusts will merely result in a transfer to each beneficiary of the same proportional interest in the partnership interest as the beneficiary held before the distribution. Thus, the transfer of the partnership interests from the trustee to the beneficiaries will not result in the change of ownership under section 64(d).

The conclusion reached above is supported by the 1983 California Court of Appeal decision, Allen v. Sutter County Board of Equalization (1983) 138 Cal.App.3d 887. In the Allen case, two grandparents in 1961 conveyed real property to their son as trustee for their four grandchildren. The trust, which was irrevocable, provided that the property was "to be divided into four (4) equal undivided parts . . . ." Until each beneficiary reached the age of 21, income was to be accumulated or paid to each "in the amounts and at times as the trustee shall in his sole discretion deem advisable." Once each beneficiary reached 21, the trustee was required to pay the beneficiary his or her share of the income until he or she attained the age of 25. At that time, the trustee was directed to distribute to each beneficiary his or her share of the trust estate. The trust also provided that if any beneficiary were to die before the age of 25 the trustee was to distribute the balance of that beneficiary's share to his or her surviving issue. Absent issue, the balance was to be "added equally to the shares of the trust estate set aside for the benefit of the

remaining beneficiaries, . . ." If all beneficiaries died before final distribution of the trust assets, then at the death of the last survivor, all of the estate not then disposed of was to be distributed to the trustee's heirs at law.

The Allen court concluded that the termination of the trust in 1978 by the distribution of the trust's real property to the four grandchildren, after they each reached the age of 25, did not constitute a change of ownership. The court stated: "In effect, the only real change in 1978 was in the name of the holder of legal title. The beneficial ownership remained the same." 139 Cal.App.3d 890 (emphasis added). Although the case was ultimately decided by an analysis of the meaning of "change in ownership" under Article XIII A, section 2 of the California Constitution, the court in dicta stated that it would have reached the same conclusion under both the recently enacted legislation, namely Revenue and Taxation Code section 60, and the State Board of Equalization's own regulations, namely 18 Cal. Code Reg. section 462(i)(4)(E).

The facts of the Allen case are remarkably similar to the facts here. The trusts at issue here are separate trusts rather than separate shares of one trust, and beneficiaries of the separate trusts receive distributions of principal at ages 25, 30 and 35, rather than just one distribution of principal at age 25. These differences, however, do not affect the conclusion that all that will occur, as partnership interests are distributed to beneficiaries at ages 25, 30 and 35, are changes in the name of the holder of legal title, not changes in the beneficial ownership of the partnership interests. For the same reasons that the Allen court concluded that the transfer of real property interests to the trust beneficiaries upon the termination of the trust did not constitute a change in ownership, the transfer of partnership interests by the trustees to the beneficiaries of the separate trusts as those beneficiaries reach age 25, 30 and 35 will not constitute a change in ownership.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

If we can be of further assistance in this matter, please let us know.

Very truly yours,

Eric F. Eisenlauer
Tax Counsel

EFE:cb/1777D
cc: Gelmer, Gottfried, Miller