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June 26, 2000

Honorable William G. Copren, Assessor  
County of Sierra  
P.O. Box 8  
Downieville, CA 95936

JAMES E. SPEED  
Executive Director

RE: Change in Ownership for Transfer to a California Land Trust

Dear Mr. Copren:

This is in reply to your letter to Senior Tax Counsel Kristine Cazadd dated February 29, 2000 regarding the possible reappraisal of real property transferred to the Land Trust (PRLT) and information regarding a California Land Trust.

As discussed further below, it is our opinion that the PRLT is an Illinois land trust and that the transfer of real property to this trust would be excluded from change in ownership.

Factual Background

As detailed in your letter and the accompanying trust document (1) the sole owner of real property transferred the property into the PRLT, an irrevocable trust, (2) the transferor is the beneficiary of the trust, and (3) legal title to the property in trust is held by a third party as trustee. The provisions of the trust provide, however, that the trustee shall not act unless instructed to do so by the trust beneficiary and that the trustee shall not manage nor operate the trust properties.

Law and Analysis—Overview of Business Trusts & California Land Trusts (Illinois Land Trusts)

It is quite likely that you will come across trusts other than ordinary, inter vivos revocable trusts. Such other trusts include both Massachusetts business trusts (generally known as “business trusts”) and California land trusts (generally known as “Illinois land trusts”). Both of these types of trusts are reviewed separately below. Neither business trusts nor Illinois land trusts are in wide use, and Illinois land trusts are the less common of the two.

Persons utilizing business trusts and Illinois land trusts may seek to accomplish some of the same goals and results as persons utilizing inter vivos revocable trusts. These trusts are distinguishable from inter vivos revocable trusts, however, as inter vivos revocable trusts provide for the separation of legal title (held by the trustee) and equitable title (held by the beneficiary(ies)) of the trust property. Legal title and equitable title of the trust property, however,

are generally held by one party, the trustee, in business trusts and Illinois land trusts. As will be discussed further below, however, while the trustee of an Illinois land trust may hold legal and equitable title to the trust property, management and control of the trust and trust property are held by the beneficiary(ies) of the trust.

## BUSINESS TRUSTS

The California Supreme Court in Goldwater v. Oltman, 210 Cal. 408 (1930), discussed entities similar to those at issue here. The Court, at pages 416-417 of the opinion, stated:

Generally stated, a trust of this nature is created wherever several persons transfer the legal title in property to trustees, with complete power of management in such trustees free from the control of the creators of the trust, and the trustees in their discretion pay over the profits of the enterprise to the creators of the trust or their successors in interest. As thus defined it is apparent that such a trust is created by the act of the parties and does not depend on statutory law for its validity. In the case of Hecht v. Malley, 265 U.S. 144, 146 . . ., Mr. Justice Sanford referred to such organizations as follows:

“The ‘Massachusetts trust’ is a form of business organization, common in that state, consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may from time to time be the holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest in the property is divided. These certificates, which resemble certificates for shares of stock in a corporation and are issued and transferred in like manner, entitle the holders to share ratably in the income of the property, and, upon termination of the trust, in the proceeds.

“Under the Massachusetts decisions these trust instruments are held to create either pure trusts or partnerships, according to the way in which the trustees are to conduct the affairs committed to their charge. If they are the principals and are free from the control of the certificate holders in the management of the property, a trust is created; but if the certificate holders are associated together in the control of the property as principals and the trustees are merely their managing agents, a partnership relation between the certificate holders is created.”

The Court then went on to adopt the foregoing view as California law. Thus, if trustees are free from the control of certificate holders in the management of trust property, a trust is created. Otherwise, a partnership is created among the certificate holders.

If trustees have the management control of a trust estate, such an organization can properly be characterized as a “Massachusetts trust” or a business trust rather than a partnership. Such trusts, however, are distinguishable from ordinary or traditional trusts (Koenig v. Johnson, 71 Cal.App.2d 739 (1945)). The Board has taken the position that such trusts should be treated as legal entities rather than as ordinary or traditional trusts for property tax purposes.<sup>1</sup>

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<sup>1</sup> Property Tax Rule 462.160(e) states “For purposes of this rule, the term “trust” does not include a Massachusetts business trust or similar trust, which is taxable as a legal entity and managed for profit for the

The characteristics of a business trust generally include the following: (1) the operation of the trust as a business entity (as opposed to the mere holding and conservation of property); (2) characterization of the ownership interests in the entity as personal property; (3) broad powers given to the trustee(s); (4) the centralization of management in the trustee(s); (5) the holding of both legal and equitable title of the trust property by the trustee(s); (6) the continuation of the entity uninterrupted by the death of beneficial owners; (7) the ownership of certificates or units, similar in nature to shares of stock, to provide the means for the transfer of beneficial interests; and (8) the limitation of personal liability by the participants in the undertaking.

### ILLINOIS LAND TRUSTS

There appears to be only two California cases which review land trusts: (1) a case involving the inclusion of a deceased Californian's interest in an out-of-state land trust in the valuation of the decedent's estate for inheritance tax purposes (Estate of Tutules v. Cranston, (1962) 204 Cal.App.2d 481) and (2) a case involving the specific performance of a land contract by a trustee, with California beneficiaries, California real property, and a California trust (Walgren v. Dolan, (1990) 226 Cal.App.3d 572).

In Walgren v. Dolan, the duties of the trustee, according to the terms of the trust, were exercisable only pursuant to the written instructions of the beneficiaries. The Court of Appeal, at pages 576-578, stated:

The beneficiary of an ordinary trust is empowered to convey only his ordinary interest in the trust property. . . . Since the beneficiary holds only equitable title, the legal title residing in the trustee, the beneficiary has no power to convey absolute ownership of trust property. . . . The Dolan trust [the defendant's trust in the case] was not, however, an ordinary trust. The beneficiary had retained absolute control over trust property, having . . . the complete power to direct the trustee to purchase or sell realty. It would seem inequitable, indeed, to permit one with absolute power over title to realty to decline to perform an agreement for sale of the realty because bare legal title was held in the name of a trustee.

. . . Where . . . a party holds the equitable title to realty and has the power to "call for" legal title, it is established that specific performance is available. . . .

. . .

Surprisingly, in these times of great use of inter vivos trusts, most of which contain powers of direction reserved to the trustor beneficiaries, there is no case in California directly on point. We find, however, applicable authority from the Appellate Courts of Illinois. A device called the "Land Trust" appears widely in use in Illinois. While the trustee is vested with legal and record title, full powers of management and control are

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holders of transferable certificates which, like stock shares in a corporation, entitle the holders to share in the income of the property. For rules applicable to Massachusetts business trusts or similar trusts, see Section 64 of the Revenue and Taxation Code and Rule 462.180, which address legal entities."

reserved to the beneficiary. . . . Such trusts are, therefore, the practical equivalent of the Dolan trust [the defendant's trust].

The power specifically to enforce an agreement by the beneficiary of such trust to sell realty of the trust was explained in Seaberg v. American Nat. Bank and Trust Co. of Chicago, (1976) 35 Ill.App.3d 1065, 1069-70, . . . as follows:

“ . . . The beneficiary of a conventional land trust, as used in Illinois, may under appropriate circumstances enter into a valid contract to convey title to the trust property. He may do so not as agent of the trustee but in his capacity of beneficiary. This right is limited to situations in which the trust agreement vests in him the sole right to direct the trustee to convey title. Such a contract will be mutually enforceable by the beneficiary as seller and the buyer where it expressly, or by reasonable construction, provides for exercise by the beneficiary of the power to direct conveyance.” . . . .

We believe the Illinois authority to be in point and correct. We therefore conclude that specific performance (assuming all other requisites of the remedy are established) is available in California to a vendee who has an agreement to purchase realty executed by the holder of beneficial interest in a trust which is legal titleholder, where the beneficiary has the power under the terms of the trust to require a conveyance by the trustee.

Unfortunately, the case does not discuss whether the trust at issue was considered to be a separate legal entity.

The characteristics of a land trust generally include the following: (1) the holding of both legal and equitable title of the trust property by the trustee; (2) management and control reserved to the beneficiary (or any person designated in writing by the beneficiary); (3) the beneficiary vested with the right to direct the trustee to convey title; and (4) the interest of the beneficiary is personal property.

As a result, business trusts and Illinois land trusts have some characteristics in common such as the holding of legal and equitable title of the trust property by the trustee and the characterization of ownership interests in the entity as personal property. However, there is one significant difference between the entities: broad management powers are given to the trustee of a business trust to manage the entity while management and control of an Illinois land trust are reserved to the beneficiary or beneficiaries of the trust. Thus, who controls the management of the entity, the trustee or the beneficiary, is the most significant characteristic in determining whether a business trust or an Illinois land trust has been created.

Law and Analysis—Characterization of the PRLT and Assessability of the Real Property Transfer to the Trust

CHARACTERIZATION OF THE PIKE RIDGE LAND TRUST

With the above as a background, a determination can be made regarding the classification of the Land Trust (PRLT). Section 1 (Purpose of the Land Trust) of the Declaration of Trust states

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The purpose of this Trust shall be to hold title to the trust properties and to protect and conserve them until sale or liquidation. The Trustee shall not manage or operate the trust properties; nor undertake any activity not strictly necessary to the attainment of the foregoing objects and purposes; . . .

Thus, the PRLT is not being operated as a business entity but rather, for the holding and conservation of property. In addition, neither broad powers nor centralization of management have been given to the trustee. Also, while not necessarily dispositive of the true characterization of the trust, Section 1 also states that a trustee shall not “. . . transact business regarding trust properties which may be, or which may create the existence of a Massachusetts Business Trust . . .”

In addition, Section 4 (Powers and Duties of the Trustee) of the Declaration of Trust states “. . . It is . . . understood that the Trustee shall deal with said property only when authorized in a letter of direction to do so . . .” And finally, Section 8 (Non-Liability of the Trustee) of the Declaration of Trust states

\* \* \*

The Trustee shall not be called upon to do anything with respect to the management or control of trust properties, . . . except on written direction of the Beneficiary(ies) as provided herein . . .

Based upon the provisions of Sections 1, 4, and 8 of the Declaration of Trust, it is clear that the management of the trust rests in the hands of the trust's beneficiary and that the trustee may act only when instructed to do so by the beneficiary. Despite the statement in Section 4 that the trustee is the owner of record of trust property and the statement in Section 11 (Interests of Beneficiaries as Personalty) that the beneficiary of the trust holds neither legal or equitable title to trust properties,<sup>2</sup> as the Court of Appeal held in Walgren v. Dolan, the trustee in reality merely holds bare legal title to the trust property, as the management and control of the trust estate lies squarely in the hands of the trust beneficiaries. Based upon the above, the PRLT appears to be an Illinois land trust.

#### ASSESSABILITY OF THE REAL ESTATE TRANSFER TO THE PRLT

As mentioned above, the Court of Appeal in Walgren v. Dolan did not discuss whether the trust at issue was a separate legal entity. The Hecht v. Malley case, discussed above, indicates the proper characterization of a business trust. The Court concluded that if trustees are free from the control of the certificate holders in the management of the trust property, a trust is created; the Board has concluded that such a trust should be treated as a legal entity. Here, on the other hand,

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<sup>2</sup> Section 11 states in part “. . . No Beneficiary now has, or shall hereafter at any time have, any right, title, or interest in or to any proportion of said real estate as such, either legal or equitable, or in any other trust properties . . .”

management of the PRLT remains with the beneficiary; such a trust is more in character with ordinary or traditional trusts. This characterization is in line with the fundamental principles of trust law, in that the creation of a trust divides title by placing legal title in the trustee and equitable title in the beneficiaries.

Revenue and Taxation Code section 60<sup>3</sup> 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.”

Subdivision (d) of section 62 provides in part that a change in ownership shall not include “[a]ny transfer by the trustor, or by the trustor’s spouse, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust . . .” Section 1 of the Declaration of Trust states in part that

When the Trustee takes title to any property conveyed by the Beneficiary(ies) as Settlor(s), the Trustee shall hold it and any proceeds, profits, and avails thereof received, in trust, for the ultimate use and benefit of the Beneficiary(ies) and any successor(s) or assign(ees).

As a result, since the trustors are the present beneficiaries of the trust, subdivision (d) of section 62 would apply to exclude the transfer of real property into the trust from change in ownership.

If the PRLT were construed to be a business trust, such a trust would be considered a legal entity. Subdivision (j) of section 61 provides that “[t]he transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person” shall be a change in ownership. However, there are two possible exceptions to this general rule. One is when the transfer of real property is between affiliated corporations (subsection (b) of section 64). The second exception is when the transfer results solely in a change in the method of holding title and in which the proportional ownership interests remain the same after the transfer (subdivision (a)(2) of section 62<sup>4</sup>). Here, the proportional ownership interest of the beneficiary in the real property transferred to the PRLT remains the same after the transfer. As a result, if the PRLT were considered to be a business trust, the transfer of real property into the trust could be excluded from change in ownership under subdivision (a)(2) of section 62.

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,

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<sup>3</sup> All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

<sup>4</sup> Subdivision (a)(2) of section 62 states in part that a change in ownership shall not include “Any transfer between an individual or individuals and a legal entity or between legal entities . . . that 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 piece of real property transferred, remain the same after the transfer. . . .”

Anthony S. Epolite  
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ASE:jd

precednt/trustsle/00/02ase

cc: Mr. Richard Johnson, MIC:63  
Mr. David Gau, MIC:64  
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