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December 16, 2009

Honorable Tom Bordonaro, Jr.  
San Luis Obispo County Assessor  
1055 Monterey Street, Suite D360  
San Luis Obispo, CA 93408-2070

**Att: Assessment Manager**

**Re: Parent/Child Exclusion  
Assignment No.: 09-097**

Dear Ms. :

This is in response to your letter of June 9, 2009, wherein you requested a written opinion concerning the property tax implications of a trustee transferring assets from one trust to another and using those assets to equalize the distribution of real property to certain beneficiaries. As explained below, it is our opinion that such assets cannot be used to equalize the distribution.

**Factual Background**

According to your letter and the attached documents from the trust attorney, Husband and Wife transferred real property to their revocable trust in 1989. The first spouse died in 1999. According to the trust document, two trusts were established at the death of the first spouse, Trust A and Trust B. Pursuant to the terms of the trust, the real property was transferred to Trust A, a revocable trust for the benefit of the surviving spouse. Trust B, an irrevocable trust for the benefit of the surviving spouse, was never funded. The surviving spouse died in 2008. Pursuant to the trust document, \$4,250 in special bequests is to be paid from Trust A assets. The beneficiaries of the residue of Trust A are B (daughter of the trustors) for 50 percent, J (son of the trustors) for 25 percent, M (granddaughter of the trustors and daughter of B ) for 15 percent and R <sup>1</sup> (husband of B ) for 10 percent. The trust beneficiaries of Trust B are B for 40 percent, J for 35 percent and M for 25 percent.

Trust A contains the real property, valued at \$450,000<sup>2</sup> and \$1,071.00 of other assets. The remaining, unfunded, assets total \$420,709.13. These assets are referred to as "Trust B

<sup>1</sup> The taxpayer's attorney's letter states that R is "now deceased." For the purposes of this letter, it is assumed that both trustors predeceased R . If this is not the case, our opinion may be different.

<sup>2</sup> This figure assumes that there is no encumbrance on the property.

assets," though Trust B has not yet been funded. The attorney proposes to make the \$4,250 in special bequests from Trust B assets. The attorney also proposes to fund Trust A with \$62,000 of Trust B assets. The property would be distributed to B, J and R, in unspecified shares. The \$62,000 would be distributed to M in satisfaction of her 15 percent interest in the Trust A assets.

### Law

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership," unless an exclusion from change in ownership applies. A change in ownership is defined in 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."

Property Tax Rule<sup>3</sup> 462.160, subdivision (a), provides the general rule that a transfer of real property into a trust is a change of ownership of such property at the time of transfer. Section 62, subdivision (d) states, in part, that the following transfers involving trusts are excluded 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. (Emphasis added.)*

Rule 462.160, subdivision (b)(2), further explains that a change in ownership does not occur upon the transfer of real property *by the trustor* to a trust which is *revocable by the trustor*. However, a change in ownership does occur at the time the *revocable trust become irrevocable* unless the *trustor-transferor* remains or becomes the sole present beneficiary or unless otherwise excluded from change in ownership. As indicated by section 62, subdivision (d) and Rule 462.160, not all transfers to or from revocable trusts are excluded from change in ownership; transfers are only excluded if made by or for the benefit of certain parties.

As relevant herein, section 63 provides that a change in ownership does not include any interspousal transfer, including, but not limited to:

- (a) Transfers to a trustee for the beneficial use of a spouse, or the surviving spouse of a deceased transferor, or by a trustee of such a trust to the spouse of the trustor; and
- (b) Transfers which take effect upon the death of a spouse.

Additionally, section 63.1 excludes from a change in ownership specified purchases or transfers of real property between parents and their children for which a valid and timely claim is filed. Section 63.1 also provides that transfers from grandparent to grandchild may be excluded from reassessment, but only if all of the parents of the grandchildren who qualify as children of

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<sup>3</sup> All subsequent references to "Rules" are to the Property Tax Rules promulgated under title 18 of the California Code of Regulations.

the grandparents are deceased. (Rev. & Tax. Code, § 63.1, subd. (a)(3)(A).) Section 63.1, subdivision (c)(9) specifically provides that "'Transfer' includes, and is not limited to, any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust."

When, as here, a trust document does not indicate a certain percentage interest that the beneficiaries have in each piece of property, but rather gives them an undivided interest in the whole of the trust estate, and allows non pro rata distributions, the trustee may allocate certain properties to some beneficiaries and not to others. As such, if there are sufficient trust assets, a trustee may distribute real property to an eligible transferee and other assets to other beneficiaries and the transfer to the eligible transferee will be deemed directly from the trustor. However, to the extent that the value of the real property received exceeds the value of the beneficiary's share of the trust estate it will be considered a transfer from the other beneficiaries and subject to reassessment. (Letter to Assessors (LTA) 91/08). To accomplish an equal distribution, the trustee may encumber the property with a loan so long as the loan proceeds are not provided by the beneficiary receiving the property. (Property Tax Annotation 625.0235.005.)

### Analysis

The transfer of the property by Husband and Wife to the trust did not result in a change in ownership because the trust was revocable for their lifetime. (Rev. & Tax. Code, § 62, subd. (d).) The transfer of the property to Trust A upon the death of the first spouse also did not result in a change in ownership of the property. (Rev. & Tax. Code, §§ 62, subd. (d); 63, subd. (b).)

When the surviving spouse died, Trust A became irrevocable and B, J, M and R became the present beneficiaries. Each beneficiary was given a percentage interest in the entire residue of trust estate, which included the real property. B, J and R were eligible transferees for the parent-child exclusion. (Rev. & Tax. Code, § 63.1.) M was not eligible for the grandparent-grandchild exclusion since her mother, B, was still alive. (Rev. & Tax. Code, § 63.1, subd. (a)(3)(A).) It does not appear that M is eligible for any other change in ownership exclusions.

Because the trust gives the beneficiaries interests in the entire residue and the trustee has not yet distributed the property, the change in ownership consequences are still unknown. Because M is not eligible for any exclusion, if the trustee distributes any interest in the property to her then a change in ownership of that interest will occur. (Rev. & Tax. Code, § 60.) Further, to the extent that B, J or R receives an interest in the property with a value greater than the value of their share of the residue, it will be considered a transfer from the other beneficiaries, and the amount transferred will undergo a change in ownership. (LTA 91/08.)

As explained above, to determine if any transfer has occurred that does not qualify for the parent-child exclusion, it is necessary to compare the value of the real property received by each beneficiary to the value of that beneficiary's share of the trust estate. In this case, the question is whether the \$62,000 in Trust B assets should be included in calculating the total residue and each beneficiary's share thereof. For the reasons set forth below it is our opinion that it should not be included.

First, the value of the total residue should be determined as of the date the trust became irrevocable, not as of the date of distribution. Where property is, as here, held in a trust that becomes irrevocable on the death of the trustor, beneficial ownership of the real property held in the trust passes to the beneficiaries as of the date of death of the trustor. (Rule 462.260, subd. (d)(1).) The property will be reassessed, if necessary, as of the date of death. (Rev. & Tax. Code, § 110.1, subd. (a)(2)(A).) Therefore, for property tax purposes, the value of any interest that passes to the children must be determined as of the date of death. This is true even though the trustee might not distribute the property until some time after the death of the trustor. Even in such a case, the transfer of beneficial interest and any corresponding change in ownership will be deemed to have occurred at the date of death. Because the \$62,000 in Trust B assets were not part of the Trust A estate as of the date of the death of the surviving spouse, they should not be included in determining the total Trust A residue and each beneficiary's share thereof.

In the past, we have advised county assessors to take into account encumbrances put on the property after the date of death when calculating the trust estate and each beneficiary's share thereof. (Annotation 625.0235.005.) Such encumbrances are offset by the corresponding loan proceeds and therefore do not diminish or increase the net trust estate. In this case, with the transfer of \$62,000 from Trust B to Trust A, there will be no corresponding encumbrance placed on the property. Since the addition of assets from Trust B will increase the value of the net trust estate for Trust A beyond what it was at the date of death of the trustor, such assets should not be included in determining the residue and each beneficiary's share thereof.

According to the letter from the trustee's attorney, Trust A contains the real property, valued at \$450,000 and \$1,071.00 of other assets for a total of \$451,071. Based on their percentage interests, the value of each beneficiary's share of the trust estate is as follows:  
 B - \$225,535.50, J - \$112,767.75, M - \$67,660.65 and R - \$45,107.10.  
 Upon distribution, to the extent that the value of the real property interest received by any beneficiary exceeds the value of his or her share of the trust estate it will be considered a transfer from the other beneficiaries and subject to reassessment.

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.

Sincerely,

/s/ Daniel Paul

Daniel Paul  
 Tax Counsel

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cc: Mr. David Gau MIC:63  
 Mr. Dean Kinnee MIC:64  
 Mr. Todd Gilman MIC:70