STATE OF CALIFORNIA

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February 14, 1995

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Re: Request for Opinion on Parent/Child Transfer

Please excuse our delay in responding to your letter of October 5, 1994 to the Board's Chief Counsel. Other matters requiring our attention have made such delay unavoidable.

You have requested our opinion with respect to the facts and proposed transactions described in your letter and set forth below.

Your client, a widow with two adult children, has a total estate of approximately $450,000 of which her residence accounts for $350,000. She wishes to leave the residence to her son and the balance of the estate to her daughter on the condition that her son pay her daughter an amount that will equalize the two distributions, using a value of the real property at the date of her death.

1. If her will leaves the property outright to her son and the balance to the daughter but makes a provision for the son to pay the daughter from his personal funds to equalize the distribution, will the property be exempt from reassessment as a parent to child transfer?

Response: Article XIIIA, section 2, subdivision (h) of the California Constitution provides that "the terms 'purchased' and 'change of ownership' shall not include the purchase or transfer of the principal residence of the transferor in the case of a purchase or transfer between parents and their children...and the purchase or transfer of the first $1,000,000 of the full cash

value of all other real property between parents and their children...." Revenue and Taxation Code section 63.1, which implements the constitutional provision, is to the same effect and makes clear that transfers by will are included for purposes of the parent-child exclusion. (Rev. & Tax. Code §63.1, subd. (c)(1).) Although the term "transfer" is not defined in the foregoing or related provisions, the term "purchase" is defined by section 67 as "a change in ownership for consideration."

The question you have raised is whether the additional provision in the will "for the son to pay the daughter from his personal funds to equalize the distribution..." somehow negates the parent-child transfer for property tax purposes, e.g., that part of the property is being purchased by the son from the daughter. The nature of such a transaction is discussed by the court in *Woodley v. Woodley* (1941) 47 Cal.App.2d 188 at page 191 as follows:

> But we are satisfied that there is no trust involved, but that the rights of the parties rest upon an "equitable charge." The distinction between these relations is clearly drawn in Scott on Trusts, vol. 1, section 10, as follows: "If a testator devises or bequeaths property subject to the payment of certain sums of money to third persons, he thereby creates an equitable charge, not a trust. An equitable charge is like a trust in that in each case the legal title to property is vested in one person and an equitable interest in the property is given to another. <u>The interest which the equitable encumbrancer has, however, is different from the interest of a beneficiary of a trust. The equitable encumbrancer has only a security interest in the property; the beneficiary of a trust is, to the extent of his beneficial interest, the equitable owner of the trust property.</u> If a devisee subject to an equitable charge fails to pay the equitable encumbrancer the sum to which he is entitled, the latter's remedy is a suit in equity to obtain a decree for the sale of the land to pay the charge; if a trustee fails to perform his duties under the trust, the remedy of the beneficiary is a suit in equity to compel specific performance or redress of the breach of trust." (Emphasis added.)

Under the foregoing case, the nature of the relationship created by the proposed transaction would appear to be that of an equitable charge. The effect of that would be that the son would be the legal <u>and</u> beneficial owner of the property subject to a

security interest in the daughter of the payment of the equalizing payment to her by the son of $125,000. Such a transaction would be similar to a sale of the property by the mother to the son in exchange for the son's promissory note for the purchase price secured by a deed of trust on the property.

The latter transaction, a "purchase" because of the consideration paid, could clearly be excluded from change in ownership between parent and child because the son would have the legal and beneficial ownership of the property and the mother would have only a security interest. (See 3 Witkin Summary of Cal.Law (9th ed. 1987 §6, p. 518, 519.) In either case, the son would be the transferee of the legal and beneficial ownership of the property from his mother subject to a security interest in another. Accordingly, since the son would acquire his entire ownership of the property from his mother, we see no reason why the proposed transaction could not be excluded from change in ownership as a parent-child transfer provided the other requirements of section 63.1 are satisfied.

2. If the above condition is omitted from the will, but it is informally agreed among the three that the son will make gifts from his own funds to his sister in order to equalize the distribution from the mother, will the transfer be exempt?

Response: Since the first proposed transfer would qualify as a parent-child transfer from mother to son in our view, the second proposed transfer would also qualify since it is less formal than the first and there is no apparent intent or attempt to even make the property security for the equalizing payment.

3. Suppose that the mother were now to sign a promissory note to the daughter in the amount of $125,000 (total estate of $450,000 divided by 2 = $225,000 for each share minus the $100,000 balance of the estate distributed to daughter), with the note carrying a market rate of interest and stating that all interest shall be accrued until payment of principal which shall be upon the death of the mother and the promissory were secured to the property by deed of trust so that when the son inherited the property it was encumbered by a deed of trust to his sister that he would be obligated to pay immediately. Would the transfer to the son be exempt?

Response: Since the mother would devise the property to son subject to the deed of trust in favor of the daughter, the son would receive the legal and beneficial ownership in the property and the daughter would have only a security interest in the property as explained under the response to question 1 above. The transfer, therefore, could also qualify for the parent-child

exclusion as a transfer between the mother and the son assuming the requirements of section 63.1 are otherwise satisfied, e.g., timely filing of a claim, etc.

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

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,

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