



STATE OF CALIFORNIA

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TO COUNTY ASSESSORS:

No. 89/16

PROPOSITION 58 CLEAN-UP LEGISLATION - 1988
(ASSEMBLY BILL 3020)

Chapter 769 of the Statutes of 1988 (Assembly Bill 3020), effective on January 1, 1989, provides the clean-up legislation for Proposition 58, the parent-child exclusion found in Revenue and Taxation Code Section 63.1. Because Chapter 769 (see Section 5 of this bill) is double joined with Chapter 700 of the Statutes of 1988 (SB 1736) only Sections 3 and 4 of Chapter 769 are operative. The major revisions of Section 63.1 are summarized below.

1. Subdivision (b)(2) is amended to state that the \$1 million exclusion shall not apply to any property in which the eligible transferor received his/her interest through a transfer excluded from change in ownership by either Section 62(f) or Section 65(b) unless the eligible transferor qualifies as an "original transferor" under Section 65(b).

Section 65(b) defines an "original transferor" as a transferor who creates or transfers a joint tenancy interest and who remains as one of the joint tenants after the creation or transfer of the interest. Any other transferee after the creation of such a joint tenancy is considered "other than an original transferor." In this statutory provision, the "original transferor" is considered to possess all the interest held by the joint tenancy.

In other words, as of the date of the transfer which qualifies for the Section 63.1 exclusion, if the transferors are joint tenants, then the assessor must first determine who are the "original transferor(s)." The next determination is whether the "original transferor" is an eligible transferor. Finally, the entire interest held by the joint tenancy is considered held by the "original transferor" and it is this interest that is under consideration for purposes of applying the \$1 million exclusion.

Example 1:

A is the sole owner of a property.

A adds B, his sister, as a joint tenant.

B transfers her interest in the property to her parents.

She cannot apply the \$1 million exclusion to her interest, since she received her property interest through a transfer excluded from the change in ownership provisions of Section 65(b) and she is not an "original transferor."

Example 2:

A is the sole owner of a property.

A adds B, his brother, as a joint tenant.

A and B, as joint tenants, transfer the property to their parents.

A's interest of 100% as an "original transferor" in the property can qualify for the \$1 million exclusion from the change in ownership provisions under Section 63.1, since A is the "original transferor."

Since B received an interest through a transfer excluded from change in ownership by the joint tenancy provisions of Section 65(b) and B does not qualify as an "original transferor," Section 63.1(b)(2) prevents B's interest from qualifying for the \$1 million exclusion.

This revision prevents escalation of the amount of the \$1 million exclusion through utilization of the change in ownership provisions applicable to joint tenancies. For example, a child who wishes to transfer a \$5 million property to a parent could first transfer the property to him or herself and four other brothers or sisters as joint tenants and have the transfer excluded under prior sections. Each child could then transfer \$1 million in value to the parent under Section 63.1 thereby expanding the \$1 million exclusion to a \$5 million exclusion. This change is designed to deny the exclusion under Section 63.1 to any joint tenant, with the exception of original transferors, whose property interest was received through a transfer excluded from change in ownership under the joint tenancy provisions. Only the interest held by the original transferor(s) can qualify. It should be noted that this will not interfere with interspousal joint tenancy transfers since a spouse is deemed to be an original transferor under the express terms of Section 65(b).

2. The other changes to subdivision (b)(2) clarify three interpretive problems. They are:

- a. The prior language literally said that upon electing to combine exclusions, the transferors "may jointly sell or transfer property with a full cash value..." Obviously, transferors do not need statutory authority to sell or transfer their property. The change makes clear the original intent by stating that the combined amount of the separate exclusions will be applied to a joint transfer.

b. There was also a question of the intended effect of the election to combine exclusions. In many areas of the law, tax elections are permanent and the present law could be interpreted this way. That permanency does not appear to be appropriate here, however, and the amendment makes clear that the combined exclusions only apply to property jointly transferred.

c. There was also a problem as to the effect of the combined exclusion and whether it can be used to exclude the transfer of an interest from one individual in excess of the \$1 million limit. For example, if A and his former spouse B own property with a \$2 million full cash value as tenants in common holding 90 percent and 10 percent interests, respectively, application of the full \$2 million combined exclusion to the transfer of the property from A and B to their child would result in a \$1.8 million exclusion for A. In order to prevent the granting of an exclusion which would exceed the \$1 million limit required by Proposition 58, subdivision (b)(2) limits the amount of the exclusion, as to any one eligible transferor, to the amount of that transferor's separate unused exclusion as of the date of the transfer. Therefore, in our example, if neither A nor B ever used their exclusion previously, then the exclusion should be treated as follows:

A:	\$2,000,000 X .90 = \$1,800,000	
	Unused exclusion = \$1,000,000	
	Exclusion	\$1,000,000
B:	\$2,000,000 X .10 = \$ 200,000	
	Unused exclusion = \$1,000,000	
	Exclusion	<u>\$ 200,000</u>
Total exclusion		\$1,200,000

Reappraised: Unexcluded/Total Taxable Value
 $\$800,000/\$2,000,000 = 40\%$

3. Subdivision (c)(2)(B) is amended to clarify that the stepchild-stepparent relationship is deemed to exist until the marriage on which the relationship is based is terminated by divorce, or if terminated by death, until remarriage of the survivor.

The change to subdivision (c)(2)(B) was intended to clarify when the stepchild-stepparent relationship ceases to exist for purposes of the definition of "children." Once the marriage on which the relationship is based is terminated by divorce then the relationship of stepparent and stepchild ceases to exist. However, if the relationship is terminated by death, then the relationship of stepparent and stepchild continues to exist until the remarriage of the surviving stepparent.

Subdivision (c)(2)(C) was changed to parallel paragraph (B), thus affording the same treatment to sons-in-law and daughters-in-law as is provided to stepchildren.

4. Subdivision (c)(3) modifies the definition of "full cash value" to include the value of new construction in progress.

"Full cash value" is used for purposes of applying the \$1 million exclusion. The term is defined as the adjusted base year value of the property just prior to the date of transfer. The prior definition failed to recognize that the property transferred could include new construction in progress which has not yet received a base year value because construction has not yet been completed. This means that there is no exclusion applicable to new construction in progress and that property could be transferred to an eligible transferee without the application of the \$1 million limitation. Revenue and Taxation Code, Section 71 provides that new construction in progress shall be valued on a lien date at its full value. This subdivision now requires that the full value of any new construction in progress be considered for purposes of applying the \$1 million exclusion. In other words, the market value of the construction in progress, as of the date of transfer, is included in the definition of "full cash value" in this section.

It should be recognized, however, that once the construction in progress is completed then another reappraisable event has occurred. Under Section 75.10, a new base year value must be established for the completed new construction, including the previously excluded construction in progress and a supplemental assessment is required.

5. Subdivision (d)(2)(C) is amended to require that where the available amount of the \$1 million exclusion is less than the full cash value of the property transferred than the exclusion shall be applied to any appraisal unit on a pro rata basis.

Subdivision (d)(2)(C) addresses objections raised as to the authority of the transferee to allocate the exclusion where the value of the property transferred exceeds the amount of the available exclusion. There have been concerns that within a single appraisal unit, a transferee may attempt to allocate the exclusion to specific properties. For example, the exclusion may be allocated to just the land or to certain of the improvements on the land. These types of allocations can create very difficult appraisal problems for the assessor. It may be fairly simple to determine the value of a house and lot but difficult to accurately allocate the value between the land and the improvement.

Subdivision (d)(2)(C) prevents this by requiring that the exclusion be applied to the entire appraisal unit, as determined in accordance with Section 51(e), on a pro rata basis. This will greatly simplify the administrative problems of this part of the statute.

6. Subdivision (d) also adds a standard administrative requirement that any claim for the Section 63.1 benefit must be filed within three years after the purchase or transfer.
7. Subdivision (f) is amended to state that Section 63.1 is not effective for any change in ownership which occurred prior to November 6, 1986, including a change in ownership arising on the date of a decedent's death.
8. Section 4 of the bill specifies that the changes made to Section 63.1, except for paragraph (7) of subdivision (c), apply retroactively to purchases and transfers of real property which occurred on or after November 6, 1986.

In order to treat all taxpayers similarly situated equally, it is important that these amendments have retroactive effect. This provision avoids the problem of having different rules for Section 63.1 depending upon when a transfer occurred or the benefit was claimed. Therefore a review of all prior claims is necessary, especially regarding the parent-child relationships and the allocations of the exclusion. Once the required changes have been made, appropriate refunds and escaped assessments should be processed.

9. Subdivision (c)(7) deals with the transfer of property through the medium of a trust. It includes "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." This is basically a restatement of the Board's position and current practice among the assessors.

I hope this information proves helpful. If you have any questions, please feel free to contact our Real Property Technical Services Unit at (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW:wpc
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