

Issue Paper Number 06-005



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

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## AMENDMENT OF PROPERTY TAX RULE 462.040

### I. Issue

Should the Board authorize publication of proposed amendments to Property Tax Rule 462.040, *Change in Ownership—Joint Tenancies*, to eliminate the potential of obtaining "original transferor" status by transferring joint tenancy interests into trusts?

### II. Staff Recommendation

Staff recommends that the attached proposed amendments to Property Tax Rule 462.040 be adopted and authorized for publication (Attachment A).

### III. Other Alternative(s) Considered

None

### IV. Background

On August 10, 2006, the California Assessors' Association (CAA) filed a petition to amend Property Tax Rule 462.040, *Change in Ownership—Joint Tenancies* (rule). Subsequently, CAA agreed to limit its petition to solely request amending the rule to delete the creation of "original transferor" status for joint tenants who have transferred their joint tenancy interests into a trust for the benefit of the other joint tenant.

#### *General Statutory Law on Joint Tenancy*

Real property is reassessed at its current fair market value upon a "change in ownership." Revenue and Taxation Code sections<sup>1</sup> 60 and 65 detail the change in ownership law applied to the creation, transfer, or termination of joint tenancy interests in property. Subdivision (b) of section 65 excludes from change in ownership, the creation or transfer of a joint tenancy interest if, after such creation or transfer, the "transferors are among the joint tenants." After such a creation or transfer of a joint tenancy interest, the transferors who are also transferees become "original transferors" -- and a subsequent transfer or termination of a joint tenancy interest does not result in a change in ownership -- if the interest vests entirely or in part in an original transferor. When the last original transferor's interest terminates, there is a change in ownership of the entire property.

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<sup>1</sup> All section references are to the Revenue and Taxation Code unless otherwise indicated.

### ***Current Joint Tenancy Rule 462.040 – Trusts***

Effective November 13, 2003, Property Tax Rule 462.040, subdivision (b)(1) provides that joint tenants may become "original transferors" if they transfer their joint tenancy interest to their respective trusts for the benefit of the other joint tenant or joint tenants. For purposes of the rule, such conveyances are considered to be a transfer of the joint tenancy interests within the meaning of section 65, subdivision (b) discussed above. In other words, the rule recognizes that trustors transferring their joint tenancy interests into their respective trusts are "transferors among the joint tenants," and thus, obtain "original transferor" status.

### ***CAA Petition to Amend Property Tax Rule 462.040 - Trusts***

In its petition, the CAA states that unanticipated and unintended administrative problems have resulted from the creation of original transferor status by the transfer of joint tenancy interests into trusts. In response to the petition, Board staff advised interested parties of the proposed amendment to Property Tax Rule 462.040 in Letter To Assessors (LTA) No. 2006/038, September 5, 2006. Interested parties were provided with a draft of the staff's proposed amendment. The LTA solicited comments and suggestions regarding the proposed amendments and announced the September 22, 2006 interested parties meeting to discuss the proposed amendment. In addition to the county assessors and the Board's list of interested parties, the LTA was distributed to several sections of the California State Bar and interested parties from the 2003 rulemaking process that resulted in the amendments to the rule effective November 13, 2003.

### ***September 22, 2006 Interested Parties Meeting***

On September 22, 2006, an interested parties meeting was held in Sacramento to discuss the proposed rule amendment, as well as alternative language proposed by the interested parties. Attendees included representatives of the CAA and assessors from the counties of Los Angeles, Placer, Sacramento, San Luis Obispo, and Santa Clara, and an estate planning attorney.

At the meeting, the following administrative difficulties resulting from the creation of original transferor status upon the transfer of joint tenancy interests into trusts were discussed: (1) difficulty in determining whether the trust document substantiates the creation of original transferor status; (2) trust provisions could be amended after the joint tenancy interest transfer is recorded; and (3) difficulty in determining, on the death of a property owner, which document substantiates the transfer of the property to an original transferor. The estate planning attorney who attended the interested parties meeting opposed any changes to the existing rule 462.040 because property owners are using the current version as a means of obtaining original transferor status for properties held in joint tenancy. To prevent those who have relied on the current version of the rule from being adversely impacted by these amendments, the interested parties agreed that if the proposed rule amendments are made, they should have only prospective application.

## **V. Staff Recommendation**

Staff recommends that the Board adopt the attached proposed amendments to Property Tax Rule 462.040 and authorize the amended rule for publication (Attachment A). Consensus on the staff's proposed amendment to the rule by the interested parties representing the CAA and the county assessors who participated in the interested parties process has been reached.

### **A. Description of the Staff Recommendation**

The attached proposed amendments to the rule reflect revisions made in response to comments received from interested parties. In general, the amendments limit the grant of original transferor status for transfers of joint tenancy interests into trusts from November 13, 2003 (the effective date of the prior amendment of the rule) to the effective date of the newly proposed rule amendment at issue.

### **B. Pros of the Staff Recommendation**

The proposed rule amendments will eliminate the county assessors' unanticipated and unintended administrative problems resulting from the creation of original transferor status by transferring joint tenancy interests to trusts. By amending the rule on only a prospective basis, taxpayers who have structured their estate planning in reliance on the current rule will not be negatively impacted.

### **C. Cons of the Staff Recommendation**

The proposed amendment will eliminate the ability to obtain original transferor status by transferring joint tenancy interests into trusts as an estate planning tool for persons who hold property in joint tenancy.

### **D. Statutory or Regulatory Change**

Action by the Board to amend the rule will amend Title 18 of the California Code of Regulations, Chapter 1, Subchapter 4, section 462.040.

### **E. Administrative Impact**

None.

### **F. Fiscal Impact**

#### **1. Cost Impact**

Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.

#### **2. Revenue Impact**

See attached Revenue Estimate.

### **G. Taxpayer/Customer Impact**

Taxpayers will not be negatively impacted by the proposed rule amendments because the amendments will be prospective.

**H. Critical Time Frames**

None

**VI. Alternative 1**

**A. Description of the Alternative**

There is no alternative.

Prepared by: Legal Department, Tax and Fee Programs Division

Current as of: September 27, 2006

**Rule 462.040 CHANGE IN OWNERSHIP – JOINT TENANCIES.**

*Authority Cited:* Section 15606, Government Code.

*Reference:* Sections 60, 61, 62, 63, 63.1, 65, 65.1, 67, Revenue and Taxation Code; Section 662, Evidence Code.

(a) The creation, transfer, or termination of a joint tenancy interest is a change in ownership of the interest transferred.

Example 1: The purchase of property by A and B, as joint tenants, is a change in ownership of the entire property.

Example 2: The transfer from A and B, as joint tenants, to C and D, as joint tenants, is a change in ownership of the entire property.

Example 3: The subsequent transfer from C and D, as joint tenants, to C, as sole owner, is a change in ownership of 50% of the property.

(b) The following transfers do not constitute a change in ownership:

(1) The transfer creates or transfers any joint tenancy interest, ~~including an interest in a trust,~~ and after such creation or transfer, the transferor(s) is one of the joint tenants. Such a transferor(s) is also a transferee(s) and is, therefore, considered to be an "original transferor(s)" for purposes of determining the property to be reappraised upon subsequent transfers. If a spouse of an original transferor acquires an interest in the joint tenancy property either during the period that the original transferor holds an interest or by means of a transfer from the original transferor, such spouse shall also be considered to be an original transferor. For the transfer of a joint tenancy interest into trust from November 13, 2003 to [the date before the effective date of the proposed regulatory change], Any joint tenant may also become an original transferor by transferring his or her joint tenancy interest to the other joint tenant(s) through his or her trust if the trust instrument names the other joint tenant(s) as the present beneficiary or beneficiaries. All other initial and subsequent joint tenants are considered to be "other than original transferors."

Example 4: A and B own property as tenants in common and transfer the property to A and B as joint tenants. A and B are both "original transferors."

Example 4-1: A and B purchase property as joint tenants. ~~Later On December 12, 2004,~~ A and B transfer their property interests to each other as joint tenants through their respective trusts. A and B are transferors who are among the joint tenants and are, therefore, considered to be "original transferors." If A and B had transferred their interests into trust before November 13, 2003 or after [one day before the effective date of the proposed regulatory change], neither A nor B would be considered "original transferors" as a result of the transfer into trust.

Example 5: A and B, as joint tenants, transfer to A, B, C, and D as joint tenants. No change in ownership because A and B, the transferors, are included among the transferees and are, therefore, "original transferors." (C and D are "other than original transferors.") Likewise, if A, as the sole owner, had transferred to A, B, C, and D as joint tenants, no change in ownership. A would be an "original transferor" and B, C, and D would be "other than original transferors."

Example 6: A and B, as joint tenants, transfer to A, B, C, D and E as joint tenants. E is B's wife. No change in ownership because A and B, the transferors, are included among the transferees and are, therefore, "original transferors." E is also an "original transferor." (C and D are "other than original transferors.")

Example 7-1: A, B, and C are joint tenants and A is an "original transferor." A dies. B and C transfer to B, C, and D as joint tenants. D is A's husband. D does not become an original transferor because he did not acquire his interest during the period that A held an interest in the joint tenancy.

Example 7-2: A and B, as joint tenants, transfer to B and C, as joint tenants, and C is A's spouse. C is an original transferor because he was the spouse of an original transferor and he acquired an interest by means of a transfer from A.

Example 7-3: A and B are joint tenants and A is an "original transferor." C is A's spouse. A and B as joint tenants transfer to A, B, and C. C is an original transferor.

Example 8: A and B, as joint tenants, transfer to B, C and D, as joint tenants. 66 2/3% change in ownership of the transferred interests because A is not one of the transferees.

Example 9: A and B purchase property as joint tenants, ~~and transfer their joint tenancy interests to each other through their respective trusts. A and B become "original transferors."~~ On August 13, 2003, A and B sell a 50% interest to C and D, with the deed showing A, B, C and D as joint tenants. A and B become "original transferors." On December 13, 2003, C and D then transfer their joint tenancy interests to each other through their trusts, so that both become "original transferors." On January 13, 2004, A and B then sell their remaining 50% to C and D, and go off title. Under circumstances where application of the step-transaction doctrine to

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disregard the form of the transaction would be appropriate due to their intent to avoid a change in ownership, ~~A, B,~~ C, and D do not become "original transferors" as the result of their transfers to each other.

(2) The transfer terminates an original transferor's interest in a joint tenancy described in (b)(1) and the interest vests in whole or in part in the remaining original transferor(s); except that, upon the termination of the interest of the last surviving original transferor, there shall be a reappraisal of the property as if it had undergone a 100 percent change in ownership.

Example 10: A and B transfer to A, B, C, and D as joint tenants. A dies or grants his interest to the remaining joint tenants, B, C, and D. No change in ownership because B, an original transferor, remains as a joint tenant.

Example 11: Following the example set forth in Example 10 (above), B dies or grants his interest to C and D. 100 percent change in ownership because both A's and B's interests had previously been excluded from reappraisal and B was the last surviving original transferor.

(3) The transfer terminates a joint tenancy interest held by other than an original transferor in a joint tenancy described in (b)(1) and the interest is transferred either to an original transferor, or to all the remaining joint tenants, provided that one of the remaining joint tenants is an original transferor. The original transferor status of any remaining joint tenants ceases when a joint tenancy is terminated.

Example 12: Following the example set forth in Example 10 (above), C, not an original transferor, grants his interest to B and D. No change in ownership because C grants to the remaining joint tenants, B and D, and B is an original transferor.

Example 13: A owns real property and transfers a 50% interest to B as a tenant in common resulting in a change in ownership of that 50% interest. They subsequently transfer to themselves in joint tenancy and, as a result, become "original transferors." A dies and A's joint tenancy interest passes to B by operation of law without a change in ownership because B is an "original transferor." Upon A's death, the joint tenancy is terminated and B ceases to be an "original transferor."

(4) For other than joint tenancies described in (b)(1), the transfer is between or among co-owners and results in a change in the method of holding title but does not result in a change in the proportional interests of the co-owners, such as:

(A) a transfer terminating the joint tenancy and creating separate ownerships of the property in equal interests.

(B) a transfer terminating the joint tenancy and creating a tenancy in common of equal interests.

(C) a transfer terminating a joint tenancy and creating or transferring to a legal entity when the interests of the transferors and transferees remain the same after the transfer. (Such transferees shall be considered to be the "original co-owners" for purposes of determining whether a change in ownership occurs upon the subsequent transfer(s) of the ownership interests in the property.)

(5) The transfer is one to which the interspousal exclusion applies.

(6) The transfer is of a joint tenancy interest of less than five percent of the value of the total property and has a value of less than \$10,000; provided, however, that transfers of such interests during any one assessment year (the period from January 1 through December 31) shall be accumulated for the purpose of determining the percentage interest and value transferred. When the accumulated interests transferred during any assessment year equals or exceeds five percent of the value of the total property or \$10,000, exclusive of any interest transferred to a spouse or other exempt transfer, only that percentage of the property represented by the transferred accumulated interests shall be reappraised. For purposes of this subsection, the "accumulated interests transferred" shall not include any transfer of an interest that is otherwise excluded from change in ownership.

(7) The transfer is one to which the parent-child or grandparent-grandchild exclusion applies, and for which a timely claim has been filed as required by law.

(c) For purposes of this section, for joint tenancies created on or before March 1, 1975, it shall be rebuttably presumed that each joint tenant holding an interest in property as of March 1, 1975, shall be an "original transferor." This presumption is not applicable to joint tenancies created after March 1, 1975.

(d) For purposes of this section, the assessor may consider persons holding joint title to property, such as tenants in common, to be joint tenants and "original transferors" if there is "reasonable cause" to believe that the parties intended to create a joint tenancy and each person was a transferor among the persons holding title. "Reasonable cause" means a deed, Affidavit of Death of Joint Tenant, a trust, will, or estate plan indicating that a joint tenant was a transferor among the joint tenants, unless circumstances causing the application of the step transaction exist.

**Example 14: A and B jointly purchase their primary residence and title is recorded as tenants in common. The sales contract states that A and B intended to take title as joint tenants. ~~Subsequently, A and B each execute revocable living trusts transferring their respective interests in the property to their trusts for the benefit of each other. The assessor may determine that the sales contract and trust instruments establishes that A and B intended to hold title as joint tenants upon purchase, and that each subsequently became an "original transferor."~~**

BOARD OF EQUALIZATION  
**REVENUE ESTIMATE**

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**ISSUE # 06-005**  
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PROPERTY TAX RULE 462.040**Issue**

Should the Board authorize publication of proposed amendments to Property Tax Rule 462.040, *Change in Ownership—Joint Tenancies*, to eliminate the potential of obtaining "original transferor" status by transferring joint tenancy interests into trusts?

**Staff Recommendation**

Staff recommends that the proposed amendments to Property Tax Rule 462.040 be adopted and authorized for publication

**Other Alternative(s) Considered**

None.

**Background, Methodology, and Assumptions**

Real property is reassessed at its current fair market value upon a "change in ownership." Revenue and Taxation Code sections 60 and 65 detail the change in ownership law applied to the creation, transfer, or termination of joint tenancy interests in property. Subdivision (b) of section 65 excludes from change in ownership, the creation or transfer of a joint tenancy interest if, after such creation or transfer, the "transferors are among the joint tenants." After such a creation or transfer of a joint tenancy interest, the transferors who are also transferees become "original transferors"—and a subsequent transfer or termination of a joint tenancy interest does not result in a change in ownership—if the interest vests entirely or in part in an original transferor. When the last original transferor's interest terminates, there is a change in ownership of the entire property.

Effective November 13, 2003, Property Tax Rule 462.040, subdivision (b)(1) provides that joint tenants may become "original transferors" if they transfer their joint tenancy interest to their respective trusts for the benefit of the other joint tenant or joint tenants. For purposes of the rule, such conveyances are considered to be a transfer of the joint tenancy interests within the meaning of section 65, subdivision (b) discussed above. In other words, the rule recognizes that trustors transferring their joint tenancy interests into their respective trusts are "transferors among the joint tenants," and thus, obtain "original transferor" status.

The proposed amendments, in general, limit the grant of original transferor status for transfers of joint tenancy interests into trusts from November 13, 2003 (the effective date of the prior amendment of the rule) to the effective date of the proposed rule amendments.

A transfer would be affected under the proposed changes if:

- 1) the transferee is a joint tenant who does not have "original transferor" status when the joint tenants transfer their joint tenancy interests to their respective trusts for the benefit of the other joint tenant(s);
- 2) the transfer of their joint tenancy interests to their respective trusts for the benefit of the other joint tenant(s) occurs after the effective date of the proposed rule amendments.

In Sacramento County, there have been approximately 100 transfers that were not reassessed because of the original transfer status granted the transferee by a preceding transfer of a joint tenancy interest into trust. The estimated assessed value loss for these is \$14,776,800. In San Luis Obispo County, there have been about 50 such transfers with an estimated assessed value loss of \$4.75 million. These two counties represent 5.36 percent of reappraisable transfers statewide for 2004-05. Applying this percentage to both the number of transfers and the estimated assessed value loss yields the following statewide estimates:

$$\begin{aligned} \text{Number of transfers: } & 150 / 5.36\% = 2,799 \\ \text{Assessed value loss: } & \$19,526,800 / 5.36\% = \$364,305,970 \end{aligned}$$

Taking into account the interval between the transfers of the joint tenancy interests into trusts and the subsequent transfer to the surviving transferee(s), assume that these are for a two-year period. The annual figures for these are then:

$$\begin{aligned} \text{Annual number of transfers: } & 2,799 / 2 = 1,400 \\ \text{Annual assessed value loss: } & \$364 \text{ million} / 2 = \$182 \text{ million} \end{aligned}$$

However, the number of transfers of joint tenancy interests into trusts has steadily increased since November 13, 2003. Assuming the numbers that would be affected are 10 percent higher than the above estimates yields:

$$\begin{aligned} \text{Estimated annual number of affected transfers: } & 1,400 \times 1.10 = 1,540 \\ \text{Estimated annual assessed value change: } & \$182 \text{ million} \times 1.10 = \$200 \text{ million} \end{aligned}$$

Assuming the average annual reassessable transfer rate is seven percent for subsequent transfers, the increase in assessed values for these properties over the first five years can be estimated as follows:

		Increase in assessed value	Cumulative
Year 1		\$200,000,000	\$200,000,000
Year 2	x 93%	\$186,000,000	\$386,000,000
Year 3	x 93%	\$172,980,000	\$558,980,000
Year 4	x 93%	\$160,871,400	\$719,851,400
Year 5	x 93%	\$149,610,402	\$869,641,802

## **Revenue Summary**

The estimated revenue impact of the proposed amendments to rule 462.040 at the basic one percent property tax rate over the first five years is:

	Property tax at 1% rate
Year 1	\$2,000,000
Year 2	\$3,860,000
Year 3	\$5,589,800
Year 4	\$7,198,514
Year 5	\$8,696,418

## **Qualifying Remarks**

No adjustment for transfers that might also qualify for a parent/child change-in-ownership exclusion was made since that breakdown is not available.

## **Preparation**

This revenue estimate was prepared by Aileen Takaha Lee, Research and Statistics Section and reviewed by Mr. Bill Benson, Jr., Research and Statistics Section. For additional information, please contact Aileen Takaha Lee at (916) 445-0840.

Current as of October 2, 2006