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February 26, 1997

Dear Mr.

This is in response to your December 17, 1996 letter to Mr. James Speed, in which you request our opinion concerning the application of the grandparent/grandchild exclusion (Proposition 193) to the following set of circumstances:

1. Husband ("H") and Wife ("W") transferred commercial real property into their revocable family trust ("Trust") in 1983. When H died on August 4, 1991, the commercial property was allocated to three subtrusts ("Subtrusts") each of which became irrevocable at H's death.

2. Each Subtrust named W as the sole beneficiary during her lifetime and the four grandchildren of H and W as the remainder beneficiaries. W retained a special power of appointment over Subtrust 1. However, W has authority to transfer property out of Subtrust 2 and recently obtained a court order to transfer property out of Subtrust 3, the recipients to be the four remainder beneficiaries, grandchildren.

3. The mother of the transferees/grandchildren died in April 1992, and the father of the transferees/grandchildren, was divorced from mother in 1983. It is also contemplated that the transfers might be made from the Subtrusts to a Limited Liability Company (LLC) owned by the grandchildren.

Based on the foregoing, you wish to know first, whether the grandparent/grandchild exclusion is applicable to exclude the transfers to grandchildren where one parent is deceased and the other parent is a divorced ex-son-in-law, and secondly, whether the exclusion would be applicable if grandparents (Subtrusts) transfer the commercial property directly to the LLC owned by the Grandchildren, rather than to the Grandchildren individually. For the reasons hereinafter explained, the answers to these questions are as follows: 1) The grandparent/grandchild exclusion is available where all of the parents of the eligible transferees,

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who qualify as the "children" of the grandparents, have died or, in the case of a son-in-law, divorced; and 2) The exclusion is not available for transfers of property to a legal entity (LLC), since only the grandchildren of eligible transferors are "eligible transferees."

Summary of Law:

The grandparent/grandchild exclusion, adopted by the voters of California in Proposition 193 on March 26, 1996, is fairly narrow and contains two conditions which are directly relevant to the facts here. Paragraph (2)(A), which amends subdivision (h) of Article XIII A of the California Constitution, states that the exclusion applies "between grandparents and their grandchild or grandchildren," if "all of the parents of that grandchild or those grandchildren, who qualify as the children of the grandparents, are deceased as of the date of the purchase or transfer." Paragraphs (2)(A) and (B) limit the exclusion to a one way transfer "between grandparents and their grandchild," and eliminate the possibility of the transferee being a legal entity. All of these provisions were included in the recent implementing legislation, SB 1827, Chapt. 1087, Stats.1996, a copy of the pertinent portions of which is enclosed.

As you will note, the Legislature incorporated the new exclusion into the existing parent/child exclusion in Revenue and Taxation Code Section 63.1, primarily in subsections (a) and (c). The language in these subsections conforms almost exactly to the language set forth in Proposition 193 in three respects: 1) Section 63.1 (c)(2) requires "a purchase or transfer on or after March 27, 1996, from a grandparent or grandparents to a grandchild or grandchildren, if all of the parents of that grandchild or those grandchildren who qualify as the children of the grandparents are deceased as of the date of the transfer." 2) Section 63.1 (c)(4) requires that the "grandchildren" shall be only those persons as defined therein (encompassing section 63.1 (c)(3) and not including legal entities), and 3) (c)(6) and (7) add the terms "grandparent" and "grandchild" as "eligible transferors" and "eligible transferees", respectively, for purposes of the exclusion.

Question 1: Is the grandparent/grandchild exclusion applicable when one parent who qualifies as the "child" of the grandparents is deceased and the other parent (ex-son-in-law) is divorced?

Yes.

Both the language in the Constitution and the statutory language include the condition requiring that all of the parents of the grandchildren/transferees, who are the children of the grandparents/transferors, must be deceased or, in the case of a son-in-law, divorced at the time of the transfer. Thus, the exclusion clearly applies in situations where the parent of the transferees (Grandchildren) has predeceased the grandparents and the former husband/son-in-law was divorced from the deceased child prior to her death.

In identifying the "parents who qualify as the children of grandparents," reliance on the definition of the term "children" in Section 63.1(c)(3) is required. This definition states in

subparagraph (C) that "children" includes "Any son-in-law or daughter-in-law of the parent or parents," and establishes that the relationship of the son-in-law or daughter-in-law "shall be deemed to exist until the marriage on which the relationship is based is terminated by divorce or, if the relationship is terminated by death, until the remarriage of the surviving son-in-law or daughter-in-law." Thus, a son-in-law is deemed to be a "child" of his wife's parents, until he either divorces his wife, or until his wife dies and he remarries.

This is exactly the situation in the facts you describe. Both parents who qualify as the "children of the grandparents," are not deceased, but the son-in-law was divorced from his wife (the Daughter) at the time of her death. The circumstance of the divorce terminated his status as a "child" at that time, and as an ex-son-in-law disqualified him from being considered a "child of the grandparents" for purposes of the grandparent/grandchild exclusion or for some purposes under the parent/child exclusion. (e.g., An ex-son-in-law is not an "eligible transferee" under Section 63.1 for property received from his ex-wife's parents after the divorce.) Assuming that the Daughter had not remarried after the 1983 divorce, she was the only parent of the Grandchildren who qualified as the "child of the grandparents" at the time of her death. Therefore, based on the facts you submitted, the condition that all the parents of the transferees (Grandchildren) who qualify as the "children of the grandparents" are deceased (or divorced) at the time of the transfer has been satisfied. If the Daughter had remarried however, then her second husband (the grandchildren's stepfather) would be the new son-in-law and therefore, the "child of the grandparents." In that case, the exclusion would not apply unless the stepfather was also deceased at the time of the transfer. [1]

Question 2: Is the exclusion available for transfers of property to a legal entity (LLC) owned by the grandchildren?

No.

By its express terms, Proposition 193 incorporated into Section 2(h) of Article XIII A as paragraph (2), including two subparagraphs (A) and (B), limits the extent of the exclusion as follows: "(2)(A) Subject to subparagraph (B), commencing with purchases or transfers that occur on or after the date upon which the measure adding this paragraph becomes effective, the exclusion established by paragraph (1) also applies to a purchase or transfer of real property between grandparents and their grandchild or grandchildren, as defined by the Legislature,...". The statutory provisions adopted by the Legislature have defined the terms "grandchild" and "grandchildren" in Section 63.1(c)(4), and encompassing section 63.1 (c)(3). There are no legal entities included within the definition of "grandchild" and "grandchildren" or within any terms pertaining to "grandchild" and "grandchildren." This is consistent with the parent/child exclusion which limits its application to transfers between parents and their children only, and

[1] Interestingly, under the statutory language, the exclusion would apply even if the natural father of the grandchildren was still alive (providing the natural mother and the step-father were deceased), because he would not be considered a "child of the grandparents" at the date of the transfer.

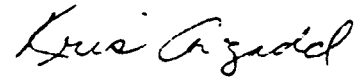
states in Section 63.1(c)(8) that it applies exclusively to "real property" and that real property does not include any interest in a legal entity.

In addition, the Legislature amended Section 63.1(c)(6) and (7) to add the terms "grandparent" and "grandchild" to the definitions of "eligible transferor" and "eligible transferee", respectively, found in these paragraphs. The intent and effect of such amendments is to require that in each case an eligible transferor (Grandparent) must transfer real property to an eligible transferee (Grandchildren) in order to qualify for the exclusion. Since an LLC is defined as a legal entity for property tax purposes (Section 64(a)), and since assessors are prohibited from granting the grandparent/grandchild exclusion to a legal entity or any other person except an " ligible transferee"/grandchild, the exclusion will not be available if W transfers to an LLC, rather than to the Grandchildren.

Finally, we note that where the grandparent/grandchild exclusion is applicable, the filing requirements for claims, the amount of the exclusion available from each grandparent/transferor, the allocation of the exclusion among grandchildren/transferees, and numerous other requirements pertaining to its proper administration are found in the provisions of Section 63.1, and it will be the determination of the county assessor as to whether all the prerequisites have been met.

The views expressed herein are, of course, advisory only and are not binding on the assessor of any county. Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions to help us accomplish that objective are appreciated.

Sincerely,



Kristine Cazadd
Senior Staff Counsel

KEC:ba
Attachments

cc: Mr. James Speed - MIC:63
Mr. Dick Johnson - MIC:64
Ms. Jennifer Willis - MIC:70

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