



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	04/19/05	Bill No:	SB 333
Tax:	Property	Author:	Campbell
Related Bills:			

BILL SUMMARY

This bill would provide that a purchase of a life estate in residential property by a person who is over the age of 55 years old as their dwelling is not a change in ownership.

Summary of Amendments

The amendments since the previous analysis: (1) increase the age threshold from 50 to 55 years, (2) limit the provisions to residential property, and (3) require the life estate interest to consist solely of the right for the purchaser to occupy the property as his or her dwelling until death and does not include any right to sell or otherwise transfer the interest to someone else.

ANALYSIS

Current Law

Under existing law, property is reassessed to its current fair market value after a “change in ownership.” Revenue and Taxation Code Section 60 defines change in ownership to mean a transfer of present interest in real property including the beneficial use thereof the value of which is substantially equal to the value of the fee interest. The creation of an estate for years or a leasehold interest in real property is not a change in ownership if the agreement is less than 35 years.¹ In contrast, the creation of a life estate is generally a change in ownership regardless of the potential number of years the life estate may last. The major exception is a conveyance in which the transferor reserves a life estate in himself or herself or his or her spouse.²

Proposed Law

This bill would add subdivision (p) to Section 62 of the Revenue and Taxation Code to exclude from change in ownership the purchase of a life estate interest in residential real property by a person over the age of 55 years if:

- The purchaser does not hold a reversionary interest in the property; and

¹ Property Tax Rules 462.060(b) and 462.060, respectively.

² Property Tax Rule 462.060(a).

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- The life estate interest consists solely of the right by the purchaser to occupy the property as his or her dwelling for a period that ends on or before that person's date of death, and does not include any right to sell or otherwise transfer that interest.

This bill includes Legislative findings and declarations that such a purchase does not constitute a change in ownership because the value transferred is not substantially equal to the value of a fee interest in the property.

This bill would take effect immediately as a tax levy.

In General

Proposition 13 provided that property will be reassessed to current market value when there is a "change in ownership," it did not define the phrase. The Assembly Revenue and Taxation Committee appointed a special Task Force to recommend the statutory implementation of Proposition 13 including its change in ownership provisions. The Task Force was a broad-based 35-member panel that included Legislative Committee staff, Board of Equalization staff, Department of Finance staff, county assessors, attorneys in the public and private sectors, and trade associations. The Task Force's findings are published in **Report of the Task Force on Property Tax Administration**³ and a second report, **Implementation of Proposition 13, Volume 1, Property Tax Assessment**,⁴ provides additional insight into the change in ownership laws in force today.

In defining change in ownership, the Task Force's goal was to distill the basic characteristics of a "change in ownership" and embody them in a single test, which could be applied evenhandedly to distinguish between "changes" and "non-changes." It ultimately concluded that a change in ownership is a transfer which has all three of the following characteristics:

- It transfers a present interest in real property
- It transfers the beneficial use of the property
- The property rights transferred are substantially equivalent in value to the fee interest.

Of relevance to this discussion, the Task Force created the concept of property interests that are "substantially equal to the value of a fee interest" and deemed all life estates to meet this element. The element of substantial equivalence is addressed beginning on page 39 of the **Report of the Task Force**. It reads:

Value Equivalence. The "value equivalence" test is necessary to determine who is the primary owner of the property at any given time. Often two or more people have interests in a single parcel of real property. Leases are a good example. The landlord owned the reversion; the tenant, the leasehold interest.

³ California State Assembly Publication 723, January 22, 1979.

⁴ California State Assembly Publication 748, October 29, 1979, prepared by the Assembly Revenue and Taxation Committee.

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Suppose the landlord sells the property subject to the lease and the lessee assigns the lease. Which sale or transfer is the change in ownership?

The example illustrates that in determining whether a change in ownership has occurred it is necessary to identify but one primary owner. Otherwise assessors would be forced to value, and account for separate base year values for landlords and tenants on all leases, and for other forms of split ownership. This would enormously complicate the assessor's job.

A major purpose of this third element, therefore, is to avoid such unwarranted complexity by identifying the primary owner, so that only a transfer by him will be a change in ownership and when it occurs the whole property will be reappraised. If the hypothetical lease previously mentioned was a short term lease (the landlord owned the main economic value), the landlord's sale, subject to the lease would count. If, on the other hand, the lease was a long term lease (the lease's interest was the main economic package), the lease assignment would count. In either case the entire fee value of the leased premises would be reappraised.

The Task Force recommends that its general definition of change in ownership (proposed Section 60 Rev & Tax Code) should control all transfers, both foreseen and unforeseen. The Task Force also recommends the use of statutory 'examples' to elaborate on common transactions. Lay assessors and taxpayers would otherwise have difficulty applying legal concepts such as 'beneficial use' and 'substantially equivalent.' Thus, common types of transfers were identified and concrete rules for them were set forth in proposed Sections 61 and 62.

It is important that the specific statutory examples be consistent with the general test. The entire statutory design would be destroyed by providing statutory treatment for specific transfers which are inconsistent with the general test. In that case, the general test would be overruled by the specific rules and the entire statutory design might be held invalid because of the lack of any consistent, rational interpretation of the constitutional phrase "change in ownership."

Specific Statutory Examples.

1. Leases. Leases are a good illustration of the necessity of concrete statutory examples. Both taxpayers and assessors need a specific test – rather than the broad 'value equivalence' test - to determine the tax treatment of leases. The specific test however, must be consistent with the 'value equivalence' rule and have a rational basis. Lenders will lend on the security of a lease for 35 years or longer. Thus 35 years was adopted as the concrete dividing line.⁵

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5. Retained Life Estates. Transfers with a retained life estate are not ownership changes until the life tenant dies. The life tenant has the dominant or primary interest under the 'value equivalence' element of the general change in

⁵ Related to leases, a discussion of the evolution of the 35 year bright line test is found on page 25 of **Implementation of Proposition 13.** "Leases. A long-term lease is a means of conveying the substantial equivalent of a fee interest in property. The Legislature felt leases had to be termed a change in ownership, but the issue was how long a lease term has required to constitute 'value equivalence.' In SB 154, the term was set at 10 years. This brought protests that so low a threshold was arbitrary and unadministerable. In considering this issue the Task Force opted for 35 years, based on the practice of financial institutions which will lend on the security of a lease for 35 years or longer. Although the implementing legislation for some time carried a 50, rather than 35 year test, the number 35 was eventually amended into AB 1488 ..."

ownership definition, and there is no transfer of the present interest in the property until the life tenant dies and the property vests in the remainder.

Background

In 2002, the Board received a request to amend [Property Tax Rule 460.060](#) which interprets and implements statutory change in ownership law applicable to life estates and estates for years. The requested amendment was similar to this bill and would have provided that:

“The creation of a life estate based upon the life of one or more persons who are all 55 years of age or older is not a change in ownership if the life estate is purchased from the transferor and the transferor reserves the remainder estate in the transferor.”

After discussions with interested parties it was determined that the rule would not be amended, in part due to the concerns that the amendment lacked statutory authority, such as this bill provides.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author to reduce the amount of property taxes paid by a person over the age of 55 who purchases a life estate in residential real property because such a purchase would not result in a change in ownership and reassessment of the property to its current fair market value.
2. **The April 19 amendments** increase the age threshold from 50 to 55 years and limit the exclusion to residential property where the life estate interest consists solely of the right by the purchaser to occupy the property as his or her dwelling until death and does not include any right to sell or otherwise transfer the interest to someone else.
3. **Proponents of this bill state that these purchases should be treated the same as the creation of a leasehold interest or an estate for years for a period of less than 35 years.** The rationale is that the actuarial life expectancy for a person over the age of 55 is also less than 35 years.
4. **Change in ownership exclusions.** While Proposition 13 provided that a “change in ownership” would trigger reassessment, the phrase was not defined. Statutory language defines the term “change in ownership” and details various transfers that are to be included or excluded from the definition. This includes the provision for leases whereby the creation of a lease for more than 35 years is considered a change in ownership triggering reassessment to current market value, but a lease of less than 35 years is not. Therefore, statutory amendments such as this bill proposes, could modify the definitions and examples initially established.
5. **Related Assessment Appeals.** The assessment of condominiums in communities with minimum age restrictions located in La Jolla and Dana Point have been subject to assessment appeals at the local level in San Diego and Orange Counties. In these senior-oriented projects, units were offered for sale in a fee basis and as a life

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estate interest. The purchase of a life estate interest resulted in a change in ownership and, thus, would be assessed for property tax purposes as if owned in fee rather than at the purchase price paid for the life estate. Taxpayers who purchased life estate interests have contended that a “change in ownership” has not occurred. If the change in ownership exclusion for life estates had been existed at the time of sale of these units, then in practical application this means:

- for units purchased as a life estate interests, the value for property tax purposes would be based on the builder/owners value at the time construction was completed on the units⁶
- for those purchased in fee, the value would be based on current fair market value at the time of purchase by the owner.

The assessment appeals boards in these counties have reached different conclusions, with Orange County finding that a change in ownership did not occur and San Diego County finding the opposite.

6. **Related court case.** In *Leckie v. County of Orange* (1998) 65 Cal.App. 4th 334, the 4th District Court of Appeal held that the transfer of a life estate results in a change in ownership because “[t]he transferee receives a present interest in the property, the beneficial use of the property and the primary interest under the value equivalency test, which qualifies as a change of ownership under section 60.” In reaching its conclusion, the court cited the Task Force's finding that “[t]he life tenant has the dominant or primary interest under the 'value equivalence' element of the general change in ownership definition . . .” In that case, the transferee was 58 years old at the time of the vesting of the life estate that resulted in the change in ownership.
7. **Does this bill intentionally apply only purchases?** If a life estate is not purchased but gifted, then presumably the exclusion would not apply. If this is not the intent, the phrase a “purchase or transfer” could be substituted. Of course, a life estate would then likely be purchased for a nominal sum to meet the conditions of this bill.
8. **This bill could allow unmarried persons to avoid a reassessment that currently occurs upon the granting of a life estate to a non-spouse.** For example, a person who owns a home he or she shares with a partner could sell a life estate interest in the property to their partner for a nominal sum upon their death and then after the surviving partner's death leave the property to his or her children or other family member as in the *Leckie* case. In that case, a man left a life estate to his unmarried partner of many years in the home they shared but he owned. Upon her eventual death, the home would then be left to his children.

⁶ In general, for other types of property in which a life estate interest is purchased, the property tax value would remain unchanged and would therefore be based upon the fair market value of the property the last time it was purchased.

9. **Is this bill retroactive?** Would the exclusion apply to purchases that occurred prior to the effective date of this bill? It does not appear that this bill is retroactive and there is no statement that this bill is declaratory of existing law. However, if enacted, there would be an expectation by affected condominium owners that their assessments should be reduced, resulting in possible disagreements between tax practitioners and life estate holders.
10. **A sale of the transferor's reversionary interest would trigger a change in ownership of life estate units.** The sale of the entire condominium project from the builder/developer to another investor would result in a change in ownership of the units sold as life estates which would be reassessed to current fair market value at that time.

COST ESTIMATE

The Board would incur some insignificant absorbable costs in informing and advising local county assessors, the public, and staff of the law changes as well as addressing ongoing implementation questions and issues.

REVENUE ESTIMATE

The number of people over the age of 55 that annually purchase life estate interests is unknown. However, as an order of magnitude, let us assume that 100 taxpayers in California meet the age criteria and purchase a life estate interest. According to the California Association of Realtors (CAR), in 2004 the median home price in California for all single-family homes, for both detached homes and condominium/townhouses was \$450,990. The average assessed value of properties receiving homeowner exemptions was \$233,533 in 2004.

For the purpose of this estimate, we assume the average assessed value of properties receiving a homeowner exemption is equal to the builder/owners value at the time the units were constructed. The average property tax rate was 1.119% in FY 2003-04. Therefore, on average, the property tax revenue loss for each property qualifying for a life estate change in ownership exclusion under this bill amounts to \$2,433 [(\$450,990 - \$233,533) x 1.119%]

If 100 taxpayers in California over the age of 55 purchase a life estate interest, the resulting local property tax revenue loss amounts to \$243,300 (100 x 2,433).

Analysis prepared by:	Rose Marie Kinnee	916-445-6777	04/25/05
Revenue estimate:	Bill Benson	916-445-0840	
Contact:	Margaret S. Shedd	916-322-2376	
mcc			0333-2rk.doc

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