



STATE OF CALIFORNIA

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Executive Director

January 3, 1991

Dear Mr. :

This is in response to your letter to me of December 31, 1990 (via facsimile) in which you inform us of the following modification to the facts with respect to which we issued to you a letter opinion dated November 21, 1990.

The facts are changed as follows:

1. The Partnership interests which are owned by the Irrevocable Children's Trust, representing .0388% of a limited partnership interest, are first transferred by the Irrevocable Children's Trust to each child (.0194% to each child). In other words, each child owns in his or her own name a .0194% interest, rather than that child's trust owning such interest.
2. The transfers of the real properties are made by the father directly to each child (rather than to that child's trust). A parent/child exemption under Proposition 58 is claimed for transfer between the father and the child.
3. The children and the father then transfer their shares in the real properties to the Partnership. Each child owns .0194% of each New Property, and the father owns 99.9612% of each New Property as tenants-in-common. The two children and the father then transfer their interests in each New Property to the Partnership. Both prior to and after the transfer the father owns a 99.9612% interest in the Partnership, and the children each own a .0194% interest in the Partnership as limited partners.

Based on the foregoing facts, you have requested our opinion that there would be no change in ownership for: (i) the transfer of the Partnership interests from the trust to the children; (ii) the transfer of the New Properties to the

January 3, 1991

children; and (iii) the transfer of the New Properties by the children and the father to the Partnership.

Transfer of Partnership Interests

Revenue and Taxation Code* §64(a) provides in relevant part that "the purchase or transfer of ownership interests in legal entities, such as...partnership interests, shall not be deemed to constitute a transfer of the real property of the legal entity" (unless subdivisions (c) and (d) of §64 provide otherwise).

Section 64(c) provides in relevant part that "when a corporation, partnership, other legal entity or any other person obtains...a majority ownership interest in any partnership...through the purchase or transfer of...partnership interest...such purchase or transfer of such interest shall be a change of ownership of property owned by the ...partnership...in which the controlling interest is obtained.

Section 64(d) provides in part:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of §62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the "original co-owners." Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original co-owners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of §62 shall be reappraised.

Property Tax Rule No. 462(j) (See 18 California Code of Regulations §462) provides in relevant part that:

. . . .
(3) Transfers of ownership interests in legal entities. Except as is otherwise provided in

* All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

January 3, 1991

subdivision (4), the purchase or transfer of corporate stock, partnership shares, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity.

(4) Exceptions:

(A) When any corporation, partnership, other legal entity or any person: ... (ii) obtains direct or indirect ownership of more than 50 percent of the total interest in both partnership capital and profits...

(B) When real property transferred to a corporation, partnership or other legal entity is excluded from a change in ownership pursuant to (2)(B) and the "original co-owners" subsequently transfer in one or more transactions, more than 50 percent of the total...ownership interests in the entity as defined in (4)(A). For purposes of determining whether more than 50 percent of the total...ownership interests in the entity has been transferred, transfers of such interests by the "original co-owners" shall be cumulated beginning with the time of first ownership interest transfer.

(5) Partnership

(B) Except as provided in (4)(A)(ii) and (4)(B), the addition or deletion of partners in a continuing partnership does not constitute a change in ownership of partnership property.

The proposed transfer of the Partnership interests from the Children's Trust to the children obviously would not result in any person or entity obtaining a majority ownership interest, i.e., direct or indirect ownership of more than 50 percent of the total interest in both partnership capital and profits of the Partnership. Moreover, you informed me in our recent telephone conversation regarding this matter that less than 15 percent of the ownership interests in the Partnership have been transferred since the Partnership was formed. Accordingly, §§64(c) and (d) and Rule No. 462(j)(4)(A) and (B) would not apply to the proposed transfer of Partnership interests from the Children's Trust to the children. Thus, since the Partnership is a continuing partnership (you so advised me in our recent telephone conversation regarding this matter), the proposed transfer would not be a change in ownership of Partnership property as provided by Property Tax Rule No. 462(j)(5).

January 3, 1991

Transfer of New Properties to Children

This transfer is from father to children and would thus be excluded under Proposition 58 and §63.1 subject to the limitations therein regarding value and the timely filing of a claim.

Transfer of New Properties by Father
And Children to the Partnership


Since the proportionate ownership interests in New Properties would remain the same after the transfer as they were prior to the transfer, this transfer would be excluded under §62(a)(2). Father and children would, however, be considered "original co-owners" as defined in §64(d) for purposes of determining whether a change in ownership of New Properties will occur when interests in the Partnership are subsequently transferred.

For the reasons set forth in our letter to you of November 21, 1990, we are of the opinion that the step-transaction doctrine would not apply.

The views expressed in this letter are, of course, advisory only and 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 conclusion 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,



Eric F. Eisenlauer
Tax Counsel

EFE:ta
2916D

cc: Mr. John W. Hagerty
Mr. Verne Walton



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November 21, 1990

Re: Request for Letter Response Change of
Ownership for Proposition 13 Purposes.

Dear Mr. :

This is in response to your letter of October 2, 1990 to the attention of Mr. Richard Ochsner in which you request our opinion as to whether there would be a "change in ownership" and thus a reassessment of the subject properties under the following facts and proposed transaction contained in your letter.

FACTS

A California limited partnership ("Partnership") owns existing real property located in California consisting of raw land and rental buildings. The Partnership's interests are owned 99.9612% by the Father (90% by the Father in the capacity as a general partner, and 9.9612% by the Father in the capacity as a limited partner). The remaining .0388% is owned by Father's two Children's Trusts (.0194% by each child's Trust). Father's Partnership interests are held in the name of Father's "Revocable Living Trust" under which the Father, while alive, is the sole income and principal beneficiary.

Each Child's Trust is an inter vivos irrevocable trust. Each Child's Trust provides for the accumulation of income. Principal and accumulated income from each Child's Trust is distributed to that child for the child's health, medical and educational needs, and for the support and maintenance of the child according to the child's standard of living. On the death of the child, the Trustee may allow the child to appoint property to other persons, if the Trustee deems appropriate in the Trustee's sole discretion. If such power is not exercised, then the property is distributed to that child's issue in trust.

*Prop 13 - Pina
Chad Pina*

November 21, 1990

Father presently owns outside of the Partnership other real property ("New Properties") consisting of raw land and rental buildings, which the Father desires to contribute to the Partnership for the business purpose of centralized management and estate planning. Title to these New Properties is presently held in the name of Father's Revocable Living Trust. Accordingly, the Father proposes to do the transactions described below.

PROPOSED TRANSACTION

Father proposes to transfer .0388% of the New Properties to the two Children's Trusts, after which the Father and the Trusts would transfer the entire amount of the New Properties to the Partnership as follows:

1. First, the New Properties presently in the name of Father's Revocable Living Trust by way of grant deed are gifted equally to the two Children's Trusts in the amount of .0388% (.0194% to each Child's Trust). Therefore, after the grant deed gift from Father to each Child's Trust, Father will own 99.9612% of each New Property as a tenant-in-common, and each Child's Trust will own .0194% of each New Property as a tenant-in-common. This transfer of .0388% of the New Properties represents less than \$1,000,000 of full cash value for California property tax purposes of all real property transferred by Father to the two Children's Trusts.

2. Second, Father and the Trust shall file a claim pursuant to Proposition 58 that the transfers between Father's Revocable Living Trust and each Child's Trust are excluded from being a change in ownership and reassessed due to Proposition 58 as a parent-child transfer.

3. Third, Father and the two Children's Trusts shall transfer by grant deed their entire tenancy-in-common interests of the New Properties to the Partnership. Prior to the above transaction and after this transaction, Father's Revocable Living Trust and the Children's Trusts own the identical percentage interests in the Partnership and in the New Properties, 99.9612% and .0388%, respectively.

For purposes of this opinion, we assume that transfers proposed to be made by Father will in fact be made by Father's Revocable Living Trust since title is held by the Trust and there is no mention of a proposed transfer from Father's Revocable Living Trust to Father.

November 21, 1990

LAW AND ANALYSIS

"Change in ownership" is defined by section 60 of the Revenue and Taxation Code as a:

[T]ransfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.

Section 61 provides in relevant part that except as otherwise provided in section 62, "change in ownership" as defined in section 60, includes, but is not limited to:...

(i) The transfer of any interest in real property between a corporation, partnership or other legal entity and a shareholder, partner or any other person.

Section 62(a)(2) states that a "change in ownership" does not include:

Any transfer between an individual or individuals and a legal entity or between legal entities...which results solely in a change in the method of holding title to real property and in which the proportional ownership interests of the transferors and the transferees, whether represented by stock...or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

See also Property Tax Rule 462(j)(2)(B).

As you know, the California Electorate passed Proposition 58 in November 1986 which added subdivisions (g), (h) and (i) to Section 2 of Article XIII A of the California Constitution. In part, Proposition 58 excluded from change in ownership transfers of the principal residence of the transferor and the first \$1,000,000 of the full cash value of all other real property between parents and children which were made after the effective date of the amendment (i.e., on or after November 6, 1986).

Section 63.1, which is the implementing legislation for Proposition 58, provides at subdivision (c)(7) that as used in 63.1:...

"Transfer" includes, and is not limited to, any transfer of the present beneficial ownership of property from an eligible transferor to an eligible

November 21, 1990

transferee through the medium of an inter vivos or testamentary trust.

Stats. 1987, Ch. 48 is the legislation which added section 63.1 to the Revenue and Taxation Code. Section 2 of Stats. 1987, Ch. 48 provides:

SEC. 2. It is the intent of the Legislature that the provisions of Section 63.1 of the Revenue and Taxation Code shall be liberally construed in order to carry out the intent of Proposition 58 on the November 4, 1986, general election ballot to exclude from change in ownership purchases or transfers between parents and their children described therein. Specifically, transfers of real property from a corporation, partnership, trust or other legal entity to an eligible transferor or transferors, where the latter are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, shall be fully recognized and shall not be ignored or given less than full recognition under a substance-over-form or step-transaction doctrine, where the sole purpose of the transfer is to permit an immediate retransfer from an eligible transferor or transferors to an eligible transferee or transferees which qualifies for the exclusion from change in ownership provided by Section 63.1. Further, transfers of real property between eligible transferors and eligible transferees shall also be fully recognized when the transfers are immediately followed by a transfer from the eligible transferee or eligible transferees to a corporation, partnership, trust or other legal entity where the transferee or transferees are the sole owner or owners of the entity or are the sole beneficial owner or owners of the property, if the transfer between eligible transferors and eligible transferees satisfies the requirements of Section 63.1. Except as provided herein, nothing in this section shall be construed as an expression of intent on the part of the Legislature disapproving in principle the appropriate application of the substance-over-form or step-transaction doctrine.

Section 65.1(a) states the general rule that except for a joint tenancy interest described in section 62(f), when an interest in a portion of real property changes ownership, only the interest transferred shall be reappraised except that:

November 21, 1990

A purchase or change in ownership of an interest with a market value of less than 5 percent of the value of the total property shall not be reappraised if the market value of the interest transferred is less than ten thousand dollars (\$10,000) provided, however, that transfers during any one assessment year shall be cumulated for the purpose of determining the percentage interests and value transferred.

The first step of the proposed transaction is the transfer by the Father's Revocable Living Trust of a .0194% interest in each of the New Properties to each Child's Trust. This step will qualify as a transfer between parent and child which is excluded under section 63.1 if it results in a transfer of the present beneficial ownership of the subject real property from the Father to the children as provided in section 63.1(c)(7). Since Father is the sole income and principal beneficiary of his Revocable Living Trust, a transfer by that Trust is clearly a transfer of Father's present beneficial interest in the property. While the question of whether the children receive a present beneficial interest in the property is not free of doubt because each Child's Trust provides for accumulation of income, we have taken the position that one may be a present beneficiary of a trust even though the right to receive income is discretionary so long as no one else presently has a right to income or principal. Here, the trustee is to distribute principal and accumulated income from each Child's Trust to that child for the child's health and medical needs and for the support, and maintenance of the child according to the child's standard of living. No part of the income or principal of a Child's Trust is to be distributed to anyone but the child during the lifetime of the child. Accordingly, since nobody but a child presently can receive income or principal from a Child's Trust, each child has a present beneficial interest in the property for purposes of section 63.1 in our view. Therefore, since the .0388% interest to be transferred between trusts is less than \$1,000,000 of full cash value, all of the property transferred to the Children's Trusts would be excluded from change in ownership under Proposition 58 and section 63.1.

If, for any reason, the transfers to each Child's Trust were held not to comply with the requirements of section 63.1, the de minimis rule of section 65.1(a) set forth above may apply to some, if not all, of the New Properties transferred to the Children's Trusts. This would require a further parcel-by-parcel analysis based on information which has not been provided.

November 21, 1990

The second step of the proposed transaction is the transfer by Father's Revocable Living Trust and the Children's Trusts of their respective tenancy-in-common interests in the New Properties to the Partnership. Since the proportional ownership interests of Father's Revocable Living Trust and the Children's Trusts in each of the New Properties would remain the same after the transfers of the New Properties to the Partnership as they were prior to the transfers to the Partnership, such transfers, which would result solely in a change in the method of holding title to the real property, should be excluded from change in ownership under section 62(a)(2).

However, since there clearly would be a 100% change in ownership if Father's Revocable Living Trust were to transfer New Properties directly to the Partnership without first transferring fractional interests to the Children's Trusts (Property Tax Rule 462(j)(2)(B)(ii)), a question arises as to the applicability of the step-transaction doctrine.

Generally, our position with respect to the application of the step-transaction doctrine is that where a taxpayer utilizes a series of transfers or steps to effect a transfer which might otherwise have been accomplished by fewer transfers or steps, any steps which the county assessor concludes are not supported by a business purpose other than avoiding higher property taxes should be disregarded.

An exception to the step-transaction doctrine exists where transfers are made in order to take advantage of the parent-child exclusion as indicated in section 2 of Stats. 1987, Ch. 48 set forth above. The quoted language describes a situation which closely parallels the proposed transfers described in your letter. That is, section 2 of chapter 48 refers, in part, to a parent-child transfer of real property (qualifying under Revenue and Taxation Code Section 63.1) followed by a transfer from the eligible transferees to a partnership in which the transferees are the sole beneficial owners. In the proposed transaction described in your letter, the qualified parent-child transfer would be followed by a transfer of the beneficial tenancy-in-common interests of the parent and children in the real property to the Partnership which is wholly-owned by both the parent and the children. While the Partnership is not wholly owned solely by the children and, thus, the proposed transaction does not strictly match the pattern described in section 2 of chapter 48, we are of the opinion that under the described circumstances the distinction is not sufficient to deprive the proposed transaction of the benefits of chapter 48. While the question

November 21, 1990

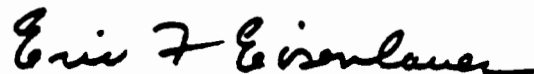
is not necessarily free of doubt, we conclude that the proposed transaction falls within the intent of the Legislature expressed in section 2 of chapter 48 and, for that reason, the step-transaction doctrine would not apply.

Accordingly, the transfers proposed should be excluded from change in ownership under sections 63.1 and 62(a)(2) and the step-transaction doctrine should not be applied. It should be noted that because of the application of section 62(a)(2), Father's Revocable Living Trust and the Children's Trusts would be considered "original co-owners" as defined in section 64(d) for purposes of determining whether a change in ownership of New Properties will occur when interests in the Partnership are subsequently transferred.

The views expressed in this letter are, of course, advisory only and 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 conclusion 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,



Eric F. Eisenlauer
Tax Counsel

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cc: Mr. John W. Hagerty
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