



STATE BOARD OF EQUALIZATION

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DEC 14 1990

Reg.

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Third District, San Diego

PAUL CARPENTER
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GRAY DAVIS
Controller, Sacramento

CINDY RAMBO
Executive Director

December 14, 1990

Mr.

Re: Our Letter to Assessor of Sutter County,
Dated June 19, 1987/K Application
For Parent/Child Exclusion

Dear Mr. :

Thank you for providing us with copies of the K Family Trust and the I Living Trust. Based on those documents and the materials provided with your letter to me of November 5, 1990, you have requested our clarification of the above-captioned letter (the "Shubat letter") with respect to the following facts.

Facts

The K Family Trust was established by I and R K as of December 17, 1969. The I Living Trust was established as of July 4, 1982. After R's death, prior to the effective date of Proposition 58, the K Family Trust allocated the assets in the trust 50% to the "A" Trust and 50% to the "B" Trust. All subsequent references to the "A" Trust and to the "B" Trust refer to the "A" Trust and the "B" Trust referred to in the K Family Trust. I K died on April 7, 1988. The K Family Trust held legal title to certain San Diego property as of I's date of death.

Under the terms of the K Family Trust, I held a general power of appointment (i.e., the power to appoint to himself, his estate or any person) over the "A" Trust and a special power of appointment (i.e., the power to appoint to one or more of his issue) over the "B" Trust. If the powers were not exercised, the assets of both trusts passed to I's children in trust.

In the I Living Trust, I exercised his general power of appointment over the assets in the "A"

Trust of the K Family Trust and his special power of appointment over the assets in the "B" Trust of the K Family by requiring that all assets of the "A" Trust and the "B" Trust be distributed to the I Living Trust. Pursuant to I 's direction, however, the assets of the "B" Trust could not be distributed to the I Living Trust until the death of I .

On June 23, 1988, S , Trustee of the K Family Trust, signed a deed transferring title to a 50% undivided interest in certain San Diego County real property ("San Diego property") from the K Family Trust to H and S , the Trustees of the I Living Trust. On January 4, 1989, S , Trustee of the K Family Trust, signed a deed transferring all the trust's interest in the San Diego County property from the K Family Trust to H and S , the Trustees of the I Living Trust.

From the time of R 's death, I : had the right to all the income from both the "A" Trust and the "B" Trust. In addition, the Trustees of the K Family Trust had the right to invade principal for I 's benefit pursuant to Article II, Paragraph 8 of the K Family Trust. Until I died, the issue of the K 's had no right to any assets under the K Family Trust.

Under the terms of the I Living Trust, I : 's two daughters (Sh. and F.) became the sole present beneficiaries of the trust with respect to the San Diego property upon the death of I . Upon the death of the first daughter, the surviving daughter will be the sole present trust beneficiary with respect to the San Diego property. Upon the death of the survivor of the two daughters, the San Diego property will go to I 's grandchildren.

Based on the foregoing, you have requested our opinion as to whether a separate \$1 million exclusion is available for each parent for purposes of Proposition 58 and Revenue and Taxation Code* section 63.1.

Law and Analysis

Section 60 defines "change in ownership" as "a transfer 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."

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

Section 63.1 provides in relevant part:

(a) Notwithstanding any other provision of this chapter, a change in ownership shall not include either of the following purchases or transfers for which a claim is filed pursuant to this section:

...

(2) The purchase or transfer of the first one million dollars (\$1,000,000) of full cash value of all other real property of an eligible transferor in the case of a purchase or transfer between parents and their children.

(b)

...

(2) For purposes of paragraph (2) of subdivision (a), the one million dollar (\$1,000,000) exclusion shall apply separately to each eligible transferor with respect to all purchases by and transfers to eligible transferees on and after November 6, 1986, of real property, other than the principal residence, of that eligible transferor.

...

(c) As used in this section:

(1) "Purchase or transfer between parents and their children" means either a transfer from a parent or parents to a child or children of the parent or parents or a transfer from a child or children to a parent or parents of the child or children.

...

(4) "Eligible transferor" means a parent or child of an eligible transferee.

(5) "Eligible transferee" means a parent or child of an eligible transferor.

(7) "Transfer" includes, and is not limited to, 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.

...

(f) This section shall apply to purchases and transfers of real property completed on or after November 6, 1986, and shall not be effective for any

change in ownership, including a change in ownership arising on the date of a decedent's death, which occurred prior to that date.

From the foregoing provisions, it is clear that a \$1,000,000 exclusion is available with respect to real property of an eligible transferor, i.e., property which is owned by an eligible transferor. In this case, I received a general power of appointment over the property of the "A" Trust at the death of R. Since a donee of a general power of appointment may exercise it in his own favor, in legal effect such a power gives him an absolute ownership (Estate of Kuttler (1959) 160 Cal. App. 2d 332,338); Morgan v. CIR (1940) 309 U.S. 78,81 (person who can appoint to his own estate or creditors has "as full dominion over the property as if he owned it"). Thus, when I exercised his general power of appointment over the "A" Trust by having all of the "A" Trust assets transferred to the I Living Trust, such act was legally equivalent to transferring his own property to his living trust.

Since I in legal effect became the owner of the assets of the "A" Trust (he was the sole income beneficiary of the "A" Trust as well as the donee of a general power of appointment over the "A" Trust) at the death of R and since he was the sole income beneficiary of the I

Living Trust and had the power to revoke such trust, there was no transfer of a present beneficial interest in the "A" Trust or the assets of the "A" Trust to I's children and thus no transfer to I's children for purposes of section 63.1 until I died on April 7, 1988. See section 63.1(c)(7) and pages 5 and 6 of the Shubat letter which predates the addition of subdivision (c)(7) to section 63.1.

At that time, there was a transfer of the present beneficial ownership of the property of the "A" Trust from I to his two daughters through the medium of the I Living Trust which constituted a "transfer" under section 63.1(c)(7) for which a \$1,000,000 exclusion is applicable pursuant to section 63.1(a)(2) providing a timely claim is filed.

At R's death, the assets of the K Family Trust were divided equally into the "A" Trust and the "B" Trust with the "A" Trust property including the community property interest of I and the "B" Trust property including the community property interest of R.

At R's death, I received a life income interest in the "B" Trust as well as a special power of appointment over the "B" Trust. This transfer to I from

R was excluded from change in ownership as an interspousal transfer pursuant to section 63. Although the remainder in the "B" Trust was given to the three children and their issue in trust subject to I's limited power of appointment by R in the K Family Trust, such disposition did not constitute "transfers" to the children within the meaning of section 63.1 because they were not transfers of a present beneficial ownership of property as required by section 63.1(c)(7). See also, the Shubat letter, pp. 5 and 6.

As was the case with the "A" Trust, there was no transfer of a present beneficial interest in the property of the "B" Trust to the children until the death of I.

In the Shubat letter, we concluded that there was a transfer from Mr. Doe to his children as of the date of death of Mrs. Doe after the effective date of Proposition 58 because Mr. Doe had given his children equitable remainders in trust and Mrs. Doe an equitable life estate interest when he died in 1984. A \$1,000,000 exclusion would therefore be applicable to Mr. Doe's transfer even though he died prior to the effective date of Proposition 58. The rationale for that conclusion is that it was the property of Mr. Doe and not Mrs. Doe which the children received when the trust terminated.

The principal difference between Mr. Doe's property in the Shubat letter and the "B" Trust in this case is that the surviving spouse had a special (i.e., a nongeneral) power of appointment over the "B" Trust in this case which the surviving spouse did not have in the Shubat letter.

As indicated above, the donee of a general power of appointment in legal effect is the owner of the property over which he holds the power. The same is not true, however, with respect to the donee of a special power of appointment.

This distinction is recognized in federal gift tax law. As observed by one commentator:

Section 2514 [Internal Revenue Code] sets out the gift tax consequences of an exercise, release, or lapse of a post-1942 general power of appointment, but is silent about the treatment of nongeneral (or "special") powers, such as power to appoint among the holder's children. Although the exercise or release of a nongeneral power can shift the beneficial interests in the property subject to the power from one person to another, the resulting change is not a "gift" by the person holding the power, because he does not own or have a beneficial interest in the

Mr.

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December 14, 1990

affected property; and since the power is not a "general" power as defined by IRC section 2514(c), the holder's action is not deemed to be a transfer by IRC section 2514(b). (5 Bittker, Federal Taxation of Income, Estates and Gifts (1984) p. 121-50.)


The same distinction (i.e., to treat the person holding a general power but not a special power like an outright owner) is recognized in federal estate tax law (IRC section 2041(a)(2)); see also, 5 Bittker, supra, at p. 128-4).

Based on the foregoing, it is our view that since section 63.1 contemplates transfers of property owned by an eligible transferor, this distinction is appropriate for purposes of applying section 63.1. Thus, I 's possession and exercise of his special power of appointment does constitute ownership of the property of the "B" Trust and does not distinguish this case from our conclusion in the Shubat letter. Accordingly, since R and not I owned the property in the "B" Trust, we believe that R and not I should be treated as the eligible transferor of the real property in the "B" Trust for purposes of section 63.1(a)(2) as of the date of I 's death.

The views expressed in this letter are advisory only and are not binding upon the assessor of any county. You may wish to consult the San Diego County Assessor in order to confirm that the subject 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

EFE:ta
2845D

cc: Mr. John W. Hagerty
Mr. Verne Walton
Hon. Gregory J. Smith
San Diego County Assessor



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PAUL CARPENTER
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GRAY DAVIS
Controller, Sacramento

CINDY RAMBO
Executive Director

January 3, 1991

Re: Letter Dated December 14, 1990 Regarding,
Application for Parent/Child Exclusion

Dear Mr. :

Thank you for your letter of December 28, 1990 in which you suggest that there is a slight typographical error in the second sentence of the second full paragraph of the last page of the above-referenced letter. You are correct! The word "not" was inadvertently omitted between the word "does" and the word "constitute" of that sentence. The sentence should, therefore, read as follows: "Thus, I 's possession and exercise of his special power of appointment does not constitute ownership of the property of the "B" Trust and does not distinguish this case from our conclusion in the Shubat letter."

Please accept our apologies for any inconvenience caused by this oversight.

Very truly yours,

Eric F. Eisenlauer
Tax Counsel

EFE:ta
2910D

cc: Mr. John W. Hagerty
Mr. Verne Walton
Hon. Gregory J. Smith
San Diego County Assessor

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DOUGLAS D. BELL
Executive Secretary

April 5, 1988

Dear Mr. _____:

Re: Proposition 58 and Chapter 48 of the Statutes of 1987

This is in response to your letter of March 4, 1988 to the Legal Staff of the State Board of Equalization in which you ask the following questions about revocable trusts wherein the settlor, trustee, and lifetime beneficiary typically are the same person.

1. Regardless of who is trustee, as long as the beneficiary is the parent of the transferee through a sale, lifetime gift or death bequest, does the transfer qualify (assuming it is the principal residence or the first \$1,000,000 of the beneficiary's property transferred where the exemption is claimed) under Proposition 58?

Response: Your question is unclear because neither a "sale, lifetime gift or death bequest" is involved in the typical revocable trust in which the parent is the lifetime beneficiary and the child the remainder beneficiary. A transfer to which Proposition 58 would be applicable would not typically occur until the parent died and the child's remainder became possessory (Rev. and Tax. Code* §§ 61(f), 61(g), 62(d) and 62(e)).

If your question is whether Proposition 58 and section 63.1 apply equally to transfers during lifetime, at death and for or without consideration, the answer is yes (§§ 63.1(a), 67 and Prop. Tax Rule 462(a)(2) (18 Cal. Admin. Code § 462); see also Question 8 of the Board's letter to County Assessors dated September 11, 1987 of which you have a copy).

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

April 5, 1988

2. If the beneficial title holder parent is not the trustee or not the sole trustee, must the trustee deed the property to the parent and then the parent deed the property to the child (assuming it is the principal residence or the first \$1,000,000 of the beneficiary's property transferred where the exemption is claimed) under Proposition 58?

Response: No. As indicated in Question 9 of the Board's Letter to County Assessors dated September 11, 1987, the creation of a trust involving real property places the legal title in the trustee and the beneficial title in the beneficiaries. In the typical inter vivos trust you referred to, the present beneficial interest passes from the parent (income beneficiary) to the child (remainder beneficiary) when the parent dies. But for the application of Proposition 58 and section 63.1 a change in ownership would occur at the death of the parent. The subsequent conveyance by the trustee to the child is excluded from change in ownership not under Proposition 58 and section 63.1 but because it conveys only legal title which is not a change in ownership (section 60, 62(b), Property Tax Rules 462(i)(3)(E) and 462(m)(1), Parkmerced Co. v. City and County of San Francisco (1983) 149 Cal.App.3d 1091; Allen v. Sutter County Board of Equalization (1983) 139 Cal.App.3d 887; see also our letter of June 19, 1987 to Honorable Emil G. Shubat a copy of which is enclosed).

3. Many revocable inter vivos trusts that are for a husband and wife provide that upon the death of the first spouse all property remains in trust and only after the surviving spouse's death is the property transferred to the children. During the surviving spouse's life, the surviving spouse is entitled to all of the income and beneficial use of the property. In these circumstances, does the transfer of the property after the surviving spouse dies allow the children transferees to claim a total of \$2,000,000 plus principal residence assuming that no prior transfers to the children have been made where the exclusion is claimed?

Response: Yes (section 63.1(b)(2)).

- 3(a). If the answer is yes, then I assume that the \$1,000,000 plus principal residence per parent would be reduced to the extent of any prior claim of exclusion by the transferee.

April 5, 1988

Response: Yes, the combined \$1,000,000 exclusions for parents cannot exceed \$2,000,000 as indicated above. However, there is no limit with respect to the exclusion for principal residence (see Question 1 of the Board's Letter to County Assessors dated September 11, 1987).

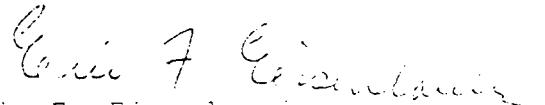
4. In the circumstances described in question number 3 and in the circumstances of a trust for only one parent, if there is a delay in distributing property to the children until they reach an age designated in the trust agreement, will the transfer to the children at the time they reach the designated age by a nonparent trustee allow the children transferees to claim the exclusion to the extent remaining after prior claims of exclusion?

Response: Yes, see the response to Question 2 above.

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 conclusions stated above.

If you have further questions regarding this matter, please let us know.

Very truly yours,



Eric F. Eisenlauer
Tax Counsel

EFE:cb
0989D

Enclosure

cc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson
Mr. Verne Walton