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February 29, 2008

No. 2008/018

TO COUNTY ASSESSORS:

REVENUE AND TAXATION CODE SECTION 63.1: PARENT-CHILD AND GRANDPARENT-GRANDCHILD EXCLUSION QUESTIONS AND ANSWERS

Since Proposition 58 (in 1986) and Proposition 193 (in 1996) were adopted, the Board of Equalization (Board) has issued several Letters To Assessors containing questions and answers regarding these two propositions (LTAs No. 87/72, dated September 11, 1987; No. 88/10, dated February 11, 1988; and No. 98/23, dated April 22, 1998). This letter supersedes these previous letters as changes in the law have occurred since the issuance of those letters.

HISTORY. On November 4, 1986, the voters of California adopted Proposition 58, which added subdivision (h) to section 2 of article XIII A of the California Constitution to provide that "purchase" and "change in ownership" do not include the purchase or transfer of (1) principal residences between parents and children, and (2) the first $1 million of the full cash value of all other real property (other than principal residences) between parents and children. Section 63.1 was added to the Revenue and Taxation Code[1] to implement the parent-child exclusion provisions of Proposition 58 and applies to any purchases or transfers between parents and children that occur on or after November 6, 1986.

On March 26, 1996, the voters of California adopted Proposition 193, which further amended section 2, subdivision (h) of article XIII A to exclude from the definition of change in ownership certain transfers from grandparents to their grandchildren. Section 63.1 was amended to reflect the grandparent-grandchild provisions.

DEFINITIONS

Section 63.1 provides various definitions, which are described briefly as follows:

1. *Principal residence* – a dwelling for which a transferor was eligible for either the homeowners' exemption or a disabled veterans' exemption as a result of the transferor's ownership and occupation of the residence. A principal residence includes only that portion of the land that consists of an area of reasonable size that is used as a site for the residence.

[1] All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

2. *Purchase or transfer between parents and their children* – any transfer of real property between a parent and a child (either way) or from a grandparent to a grandchild (one way).

3. *Children* –
    - A child born of the parent(s).
    - A stepchild or spouse of that stepchild while the relationship of stepparent and stepchild exists.
    - A son-in-law or daughter-in-law of the parent(s).
    - A statutorily adopted child, who was adopted by the age of 18.
    - A foster child of a state-licensed foster parent.[2]

4. *Grandchildren* – any children of a child of the grandparent.

5. *Full Cash Value* – as defined by section 110.1 and subdivision (a) of section 2 of article XIII A of the California Constitution just prior to the date of transfer. Section 110.1 provides that "full cash value" means the fair market value as of the 1975 lien date or the date of change in ownership, whichever occurs last, plus inflationary factoring. In other words, it is the adjusted base year value just prior to the date of transfer. Where the transferred property is restricted by a Williamson Land Conservation Act or Mills Act historical property contract or is located in a Timberland Production Zone, the excluded value is the adjusted base year value, not the restricted value.

6. *Eligible Transferor* – grandparent, parent or child of an eligible transferee.

7. *Eligible Transferee* – parent, child or grandchild of an eligible transferor.

8. *Real Property* – land and improvements as defined in section 104; it does not include any interest in a legal entity.

FILING PERIODS. In order to grant either exclusion, the county assessor must receive a claim. Claim forms are available from the county assessor. An exclusion may be granted as of the date of transfer if the claim form is received prior to the following dates:

- Within three years of the date of transfer or before a transfer to a third party.
- If a notice of supplemental or escape assessment is mailed *after* either of the above deadlines, within six months of the date of notice.
- If the notice of supplemental or escape assessment is mailed *before* the end of the three-year period, the transferee still has until the end of the three-year period to file a timely claim.

If all deadlines have expired and the transferee still owns the property, the transferee may file a claim and receive prospective relief only. Prospective relief applies to the lien date of the assessment year in which the claim is filed. The assessment year is the period between lien dates

[2] See Letter To Assessors 2007/048 for further details.

(that is, a calendar year). For example, prospective relief for a claim filed in 2006 will be applied as of the January 1, 2006 lien date for the 2006-07 fiscal year.

$1 MILLION LIMIT. These exclusions are limited to the first $1 million of the full cash value of all real property, other than the principal residence, transferred between an eligible transferor and an eligible transferee. Our opinion is that the $1 million exclusion applies only to the first $1 million of the full cash value of "other real property" for which a claim has been filed and the exclusion granted. Section 63.1 provides, in pertinent part:

> (a) Notwithstanding any other provision of this chapter, a change in ownership shall not include 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.[3]

The first sentence of subdivision (a) states that change in ownership shall not include transfers for which a parent-child claim is filed. Paragraph (2) of subdivision (a) defines one of the types of transfers to which section 63.1 applies. When read together, the plain meaning of subdivision (a)(2) is that change in ownership shall not include transfers of the first $1 million dollars of full cash value of real property *for which parent-child exclusion claims are filed*. The clear inference is that when real property is transferred between a parent and child and a claim for exclusion is *not* filed, then such a transfer is a change in ownership and will not be counted or cumulated for purposes of the $1 million exclusion limitation.

However, if parent-child claims are filed for multiple properties of which the full cash values cumulatively exceed the $1 million limit, then the *transfer date* becomes the determining factor for which properties are to receive the property tax exclusion. In other words, the first properties transferred shall receive the $1 million exclusion in this situation. If the transfer date is the same for all properties (for example, date of death), the transferees must decide which properties are to receive the $1 million exclusion. The exclusion is to be applied on a pro rata basis and not to selected portions of the appraisal unit.[4]

Example 1

In addition to his principal residence, a father owns other real property which has an adjusted base year value of $2,000,000. In 1998, the father grants a portion of real property that has an adjusted base year value of $1,000,000 to son A. In 2000, the father grants another portion of real property that has an adjusted base year value of $1,000,000 to son B.

- If both sons file for the exclusion on the $2,000,000, only the $1,000,000 to son A will qualify because the father transferred this portion of real property to son A first.

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[3] Section 63.1(a)(3) makes this provision applicable, under certain circumstances, to transfers of real property from grandparents to grandchildren.

[4] Section 63.1(d)(2).

- However, if only son B files for the exclusion, his $1,000,000 will be excluded because son A did not claim the exclusion for the property he received.

Example 2
In addition to his principal residence, a father owns four parcels of other real property with a combined adjusted base year value of $2,000,000. The father dies in 1992. His will bequeaths two parcels to son A and the other two parcels to son B. Both sons file parent-child exclusion claims for the real property. Since the transfer date is the same for all the properties, sons A and B must decide which properties are to receive the $1 million exclusion. The exclusion is to be applied on a pro rata basis and not to selected portions.

Example 3
In addition to his principal residence, a father owns four parcels of other real property with a combined adjusted base year value of $2,000,000. In 2000, the father sells one parcel with an adjusted base year value of $500,000 to his daughter. She files a parent-child exclusion claim on this property. The father dies in 2004. His will bequeaths the remaining three parcels to his children. Since only $500,000 of the father's $1 million exclusion remains, the children must decide which of the three properties that transferred upon the father's death are to receive the remainder of the exclusion.

GRANDPARENT-GRANDCHILD EXCLUSION[5]

Section 63.1, subdivision (a)(3)(A), allows certain transfers of real property from grandparents to their grandchildren to be excluded from reappraisal.

Effective Date. The date of transfer must occur on or after March 27, 1996.

Middle Generation Limitation. As of the date of transfer, the parents of the grandchild or grandchildren who qualify as the children of the grandparents, as defined in section 63.1(c)(3), must be deceased as of the date of transfer. Beginning January 1, 2006, a stepparent who is an in-law child of the grandparent does not need to be deceased in order for the grandchild to qualify.

$1 Million Limitation. The adjusted base year value of real property, other than a principal residence, that grandparents transfer to their grandchildren is applied toward the grandchild's deceased parent's $1 million exclusion.

Principal Residence Limitation. A transfer of a principal residence from a grandparent to a grandchild may be excluded as a principal residence *only if* the grandchild has not already received a principal residence from his or her parents. If the grandchild had already received a principal residence from a parent that was *eligible* to be excluded under section 63.1(a)(1), then the value of any principal residence received from a grandparent will be considered to be "other real property" subject to the $1 million limitation. This is true even if the grandchild did not file for the parent-child exclusion when the grandchild received the parent's principal residence. This is so because the parent's principal residence was still eligible for the exclusion because it was a

[5] See Letter To Assessors No. 97/32.

parent-child transfer. Thus, in situations where the child has received a principal residence from his or her parents, the adjusted base year value of the grandparent's residence has to be applied toward the deceased parent's $1 million exclusion.

Enclosed is a series of frequently asked questions and answers. I hope this information is helpful. If you have any questions, please contact our Assessment Services Unit at 916-445-4982.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:grs
Enclosure

PARENT-CHILD EXCLUSION QUESTIONS AND ANSWERS

PRINCIPAL RESIDENCES

1. Question: What is a principal residence?

   Answer: As of January 1, 2008, a principal residence is defined in section 63.1(b)(1) as the residence for which the transferor is *eligible for* either the homeowners' exemption or the disabled veterans' exemption because of the transferor's ownership and occupation of the residence.[6] Previously, this section required that either the homeowners' exemption or the disabled veterans' exemption be granted in the name of the transferor.

   A principal residence is a person's true, fixed, and permanent home and principal establishment to which the owner, whenever absent, intends to return. If the homeowners' or disabled veterans' exemption was not granted in the name of the transferor, then proof that the real property was the principal residence of the transferor must be provided. Proof of residency may include vehicle registration, voter registration, bank accounts, or income tax records.

   In addition, a principal residence includes only that portion of the land that consists of a reasonable size that is used as a site for the residence.

2. Question: How many principal residences can be transferred by an eligible transferor under Section 63.1?

   Answer: There is no limit to the number or the value of principal residences. For example, a parent sells the large family house to one child and purchases a smaller home, which becomes the parent's principal residence. After a few years, this home is too large, and the parent sells this residence to another child. Subsequently, the parent buys a condominium, which becomes the parent's principal residence. As long as both children file timely claims, both transfers qualify for the principal residence portion of the parent-child exclusion. Even if the parent transferred both principal residences to the same child, both transfers would qualify for the principal residence portion of the parent-child exclusion.

3. Question: Must the principal residence of the transferor become the principal residence of the transferee after the transfer?

   Answer: No. The residence need only be the principal residence of the transferor in order to qualify as a principal residence under section 63.1(b)(1).

4. Question: Can a principal residence consist of multiple parcels?

   Answer: Multiple parcels can be considered the principal residence if the parcels are contiguous and the residence straddles the lot line, thereby making one appraisal unit.[7] Other factors that may be considered include related miscellaneous structures (for example, a detached garage), minimum zoning requirements, physical terrain, access, actual use,

[6] Letter To Assessors No. 2007/060.
[7] Letter To Assessors No. 82/50, questions G23, S3, V3.

continuous landscaping, and fencing. For example, three one-acre parcels could be considered a principal residence if the zoning for the area is a minimum of three acres. Under these facts, the three one-acre parcels would be considered an appraisal unit because one parcel could not be sold separately without the other two.

5. Question: A parent owns two contiguous parcels. A house, which is his principal residence, sits on one parcel. The other parcel is a vacant lot. Parent wants to transfer both properties to son. Will both properties qualify as a principal residence?

   Answer: No. Only the parcel with the house that is eligible for the homeowners' exemption qualifies as a principal residence. However, the other parcel may be excluded as "other property" and counted towards the parent's $1 million exclusion.

6. Question: A parent owns an apartment complex and lives in one of the units as his principal residence. Parent wants to transfer this complex to his son. Does the entire complex qualify as a principal residence?

   Answer: No. Only the unit occupied as the principal residence qualifies for the principal residence portion of the parent-child exclusion. The remainder of the apartment complex would qualify as "other property" and apply towards the parent's $1 million exclusion.

7. Question: A parent owns a home and acreage that is restricted by a Williamson Act contract. Parent wants to transfer this property to his son. Does the entire property qualify for the exclusion? What affect will this have on the restricted value calculation?

   Answer: Yes, the property will qualify for the exclusion. The home that is occupied as the principal residence and the homesite will qualify for the principal residence portion of the parent-child exclusion. The remainder of the property qualifies as "other property" and apply towards the parent's $1 million exclusion. Where the transferred property is restricted by a Williamson Land Conservation Act or Mills Act contract or is located in a Timberland Production Zone, the excluded value is the adjusted base year value, not the restricted value.

   When property is restricted by a Williamson Land Conservation Act (open space) or Mills Act contract or is located in a Timberland Production Zone, it is annually valued by a specified income approach method, which results in a restricted value. The restricted value is compared to the factored base year value and current market value, and the lowest of the three values is enrolled. The parent-child exclusion will affect the factored base year value for the annual value comparison process.

DEFINITION OF "CHILD"

8. Question: Does an "equitable adoption" make a child eligible for the parent-child exclusion?

   Answer: No. Section 63.1(c)(3)(D) requires that a child be adopted pursuant to statute prior to the age of 18. A "statutory adoption" means an adoption in accordance with the adoption procedures contained in the Family Code. Pursuant to Probate Code section 6454, the criteria required for the establishment of a parent-child relationship for purposes of intestate

succession (i.e., an "equitable adoption") is not considered a formal adoption for purposes of this property tax exclusion. Thus, a child who is not formally adopted under the Family Code prior to the age of 18 is not considered a child for purposes of the parent-child exclusion.

9. Question: A husband and wife with two biological children divorce. After the divorce, the ex-wife remarries and her new husband formally adopts the two minor children. Do the children qualify for the parent-child exclusion for property they receive from their biological father after they were adopted?

   Answer: No. Children who are formally adopted prior to the age of 18 no longer qualify for the parent-child exclusion for property transferred to them by their former biological parent. Section 63.1(c)(3)(A) defines *children* as a child born of the parent or parents, *except* a child who has been adopted by another person or persons before reaching the age of 18. Under this situation, the adoption broke the parent-child relationship between the children and their biological father so that the transfer was not eligible for the exclusion.

STEP- OR IN-LAW RELATIONSHIP

10. Question: How long does a step- or in-law relationship exist?

    Answer: Once the marriage on which the relationship is based is terminated by divorce, then the stepparent-stepchild and in-law relationships cease to exist. However, if the marriage is terminated by death, then the stepparent and stepchild or in-law relationship continues to exist until the surviving spouse remarries. At that time, the stepparent and stepchild or in-law relationship ceases to exist.

    For example, Husband marries Wife A and has two children. Wife A dies. Husband marries Wife B who already has a child. This child becomes a stepchild of Husband. Wife B dies. Husband marries Wife C. Husband dies and leaves a separately owned property to his two natural children and Wife B's child. However, upon the marriage to Wife C, the step relationship between Husband and Wife B's child ceased to exist. Thus, the parent-child exclusion is available only to the Husband's two natural children and not to the stepchild because the stepparent relationship ceased to exist before the death of the Husband.

11. Question: A father owned real property. In 1998, the father sold property to his son and daughter-in-law, reserving a life estate for himself. In 2001, the son and daughter-in-law divorced. In 2002, the son deeded his remainder interest in the property to his ex-wife. Father died in 2004, which terminated the life estate and caused the ex-daughter-in-law's interest to become possessory. Is she eligible for the parent-child exclusion?

    Answer: No. It is the relationship as of the date of the change in ownership for property tax purposes that is relevant to the exclusion. Section 63.1(c)(3)(C) is specific in defining son-in-law or daughter-in-law of the parent and states that the relationship shall be deemed to exist until the marriage on which the relationship is based is terminated by divorce. Since the ex-daughter-in-law is not considered to be a "child" of the parent at the time of the termination of the life estate because she had already divorced the son, the parent-child exclusion is not applicable when her interest in the property became possessory.

12. Question: A father owned real property. In June 2006, father transferred real property to his daughter and her registered domestic partner. Is this transaction eligible for the parent-child exclusion?

    Answer: Yes. Transfers of real property on or after January 1, 2005 between parents and their child and that child's registered domestic partner are eligible for the parent-child exclusion.[8] Effective January 1, 2005, Family Code section 297.5(a) provides that registered domestic partners have the same rights, protections, and benefits and are subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, court rules, government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses. This section goes on to state in subdivision (j) that it does not amend or modify any provision of the California Constitution or any provision of any statute that was adopted by initiative.

    Thus, registered domestic partners are not eligible for any property tax exclusion based on an aspect of a spousal or marital relationship for which the terms *spouse* and *marriage* are defined by constitutional provision or by statute adopted by initiative. Since the definition of *child* in section 63.1 was enacted by the Legislature and not by a ballot initiative or constitutional provision, Family Code section 297.5 controls the definition of "children" in terms of the rights of registered domestic partners. Thus, beginning January 1, 2005, any relationship between parents and children established by registered domestic partnership is accorded the same treatment as if established by marriage for purposes of the parent-child exclusion.

ALLOCATION OF $1 MILLION EXCLUSION

13. Question: The purchase or transfer of the first $1 million dollars of full cash value of all other real property can be excluded under section 63.1(a)(2). Is it the current market value that is applied toward a transferor's $1 million limit?

    Answer: No. It is the adjusted base year value (also known as the Proposition 13 value) that is applied toward the $1 million limit. Section 63.1(c)(5) provides that *full cash value* means full cash value and adjustments as defined in section 110.1 and the full value of any construction in progress determined as of the date immediately prior to the date of a transfer to an eligible transferee. Section 110.1(a) identifies the point in time for which the full cash value was last determined—the 1975 lien date, the date on which a purchase or change in ownership occurs, or the date on which new construction is completed. Section 110.1(f) provides that for each lien date after the lien date for which the full cash value was determined, the full cash value must be adjusted by an inflation factor.

14. Question: How is the allocation of the exclusion to be made where the full cash value of real property exceeds the permissible exclusion?

[8] Letter To Assessors No. 2005/017.

Answer: Within any appraisal unit,[9] the exclusion can be applied only on a pro rata basis and cannot be applied to a selected portion or portions of the appraisal unit.[10]

For example, a parent died and left five parcels of "other" real property to a child. Each parcel had an adjusted base year value of $400,000 for a combined adjusted base year value of $2,000,000. The exclusion cannot be applied to only the land of each parcel. Instead, the exclusion can be applied to two parcels (total of $800,000) and half of a third ($200,000). The other half of the third parcel and the remaining two parcels must be reassessed to current market value.

15. Question: If more than one eligible transferee claims the $1,000,000 exclusion of a transferor, which transferee receives the exclusion?

    Answer: Since both section 2(b) of article XIII A of the California Constitution and section 63.1 use the term "the first one million dollars," it suggests that priority should be based on the timing of the transfers. Where simultaneous transfers are made to two or more qualifying transferees (i.e., date of death), there is no express guidance in the statute. The transferees should agree on an allocation of the exclusion (but see Q.17).

16. Question: How is the $1 million limit tracked?

    Answer: The Board monitors the $1 million limitation. The Board maintains a state-wide database of transferors who have been granted the exclusion for "other" real property. While not required to do so, county assessors are encouraged to send quarterly reports to the Board, listing the transferors, their social security numbers, the assessor's parcel numbers, and the excluded value of the parcels.[11] On a quarterly basis, the Board sends to county assessors a list of persons who have exceeded the $1 million limit.

17. Question: In February 2003, upon a parent's death, five parcels transferred to two children. Each parcel had an adjusted base year value of $400,000 for a combined adjusted base year value of $2,000,000. The transferees promptly filed a change in ownership statement and claims for the parent-child exclusion. When the Board notified the county assessor that the transferor had exceeded the $1 million limit, the assessor notified the transferees in 2004 that the limit had been exceeded and requested that the transferees determine which properties were to receive the $1 million exclusion. However, the transferees did not respond. If the transferees do not respond before the end of the four-year statutory period to enroll a supplemental assessment, can the assessor make this decision on behalf of the transferees?

    Answer: Yes. The assessor can make this decision on behalf of the transferees if they do not respond within a reasonable time. Supplemental and escape assessments for recorded transfers are subject to the four-year statute of limitations under sections 75.11(d)(1) and 532(a). If, after receiving a notice of supplemental or escape assessment, the transferees disagree with the assessor's decision, the assessor can correct the roll to reflect the

[9] Section 51, subdivision (d), defines an appraisal unit as that which persons in the marketplace commonly buy and sell as a unit.
[10] Section 63.1(d)(2).
[11] Section 63.1(f).

transferee's allocation under section 4831(a). However, roll corrections can only be made within four years after the making of the assessment that is being corrected.

18. Question: I own property in several counties and have made some partial interest transfers to my children. Do I have to contact each county to find out how much of my $1 million exclusion is available?

    Answer: No. Since the Board maintains a state-wide database to track the $1 million exclusion, you may request this information from the Board. While not required to do so, most county assessors voluntarily send quarterly reports to the Board, that list transfers of "other" real property for which the parent-child exclusion has been granted. Information in the database is confidential and available only to certain persons upon *written* request. The information will not be provided over the telephone, except in the case of an inquiry from a county assessor's office.

19. Question: Both my parents are now deceased, and I am the executor of their estate. I think they used a portion of their $1 million exclusion prior to their deaths. Can I find out how much of their exclusion is available?

    Answer: Yes. You may request this information as the executor of your parents' estate. This information is available to the transferor or transferee and their respective spouses, the transferor or transferee's legal representative, or the executor or administrator of the transferee's or transferor's estate. You may write to the County-Assessed Properties Division of the State Board of Equalization and request this information. In your letter, you must state your relationship to the transferor (e.g., trustee, executor, legal representative) and provide the transferor's name and social security number. This information will not be provided over the telephone, except in the case of an inquiry from a county assessor's office.

LEGAL ENTITIES

20. Question: What part do legal entities play in this exclusion?

    Answer: None. This exclusion applies only to transfers of real property interests between eligible parents and children. This exclusion does not apply to transfers between parents and children of ownership interests in legal entities, such as partnership interests or corporate stock.

21. Question: Mom and Dad owned real property that they subsequently proportionally transferred to their limited liability company (LLC). Because this proportional transfer was excluded from reassessment under section 62(a)(2), Mom and Dad became original coowners under section 64(d). Dad died in 2004. Upon Mom's death in 2006, two children inherited the LLC interests. The transfer of more than 50 percent of the original coowners' interests was a change in ownership under section 64(d). However, because this was a transfer between parents and children, wouldn't the transfer be eligible for the parent-child exclusion?

Answer: No. In this situation, the children inherited interests in the LLC, not real property. Section 63.1(c)(8) expressly provides that, for purposes of the parent-child exclusion, "real property" does not include interests in legal entities.

22. Question: Mom and Dad owned property through their trust and subsequently transferred the property proportionally to their family partnership, also owned by the trust. Dad died in 2004. Upon Mom's death in 2006, the trust became irrevocable and their two children became present beneficial owners of the trust. Because this was a transfer via the trust, is this transfer eligible for the parent-child exclusion?

    Answer: No. In this situation, the children inherited interests in the partnership, not real property. Property Tax Rule 462.160(b)(1)(C) provides that a change in ownership of real property held by a legal entity occurs if section 61(i), 64(c), or 64(d) applies because the change in ownership laws governing interests in legal entities are applicable regardless of whether such interests are held by a trust.

23. Question: Mom owned real property and subsequently transferred it to her single-member limited liability company. When Mom dies and her children inherit the property, will this transfer be eligible for the parent-child exclusion?

    Answer: No. Even though a single-member limited liability company may be disregarded for federal income tax purposes, its affairs are governed by all of the formalities imposed on all other legal entities (e.g., corporations, partnerships, etc.). Thus, it is treated as a separate legal entity for California property tax purposes, with transfers of membership interests subject to the provisions of section 64.[12]

STEP TRANSACTION DOCTRINE

24. Question: Does the step transaction doctrine apply to legal entity transfers between parents and children when they structure a transaction in a series of steps in order to use the parent-child exclusion?

    Answer: No, provided the transaction is consistent with the statement of legislative intent contained in the uncodified note in Chapter 48 of the Statutes of 1987 (the legislation which added section 63.1 to the Revenue and Taxation Code), which allows the parent-child exclusion for certain step transactions involving legal entities.

    For example, Corporation A (wholly owned by parents) transfers real property proportionally to parents who then transfer the same real property to their child who transfers the same real property to Corporation B (wholly owned by child). The step transaction doctrine treats a series of nominally separate transactional steps as a single transaction if the steps are, in substance, interdependent and intended for a particular result. In such circumstances, however, the step transaction doctrine would not apply, and the property may be excluded under the parent-child exclusion pursuant to the statement of legislative intent. Please note that the child must file the parent-child claim form *before* the property is transferred to Corporation B (a third party transfer).

[12] Annotation 220.0375.015.

25. Question: A mother owns real property. She transferred the property to a family partnership, in which the mother and her two children equally own partnership shares. Because the children are not receiving property directly from their mother, but rather are receiving ownership rights in the property indirectly through their ownership interests in the legal entity, such transaction would not qualify for the parent-child exclusion. However, the mother argues that the end result would have been the same if multiple steps had been taken (first, mother transfers the real property from mother to mother and children; second, both the mother and the children proportionally transfer their interests in the real property to the legal entity). Thus, the mother argues that this transaction should be treated as a single transaction under the step transaction doctrine, i.e., the transfer of real property interests from a parent to her children. Does this type of transaction qualify for the parent-child exclusion?

    Answer: No. In *Penner* v. *County of Santa Barbara* (1995) 37 Cal.App.4th 1672, the court of appeals held that the definition of "children" as set forth in section 63.1(c)(3) "includes only natural persons with a familial relationship to one another." The court acknowledged that if the mother had first transferred the real property interests to herself and the children, and, thereafter, they had transferred the same proportional interests in the partnership, the first transfer would have been excluded from change in ownership as a transfer between a parent and her children and the second transfer would have been excluded under section 62(a)(2). In response to the argument that the parent-child exclusion should apply because the end result was the same, the court refused to depart from the plain meaning of the language of the statute. The step transaction doctrine allows certain steps actually taken to be ignored; however, it does not allow a taxpayer to invent steps that never existed.

26. Question: Can a transfer from grandparent to parent, followed by a transfer from parent to child, each qualify for the parent-child exclusion?

    Answer: Yes, as long as each transfer is unrestricted. Chapter 48 of the Statutes of 1987 states that it is the intent of the Legislature to liberally construe section 63.1 to carry out the purpose of Proposition 58. Therefore, as long as each transfer is unrestricted and is otherwise eligible (e.g., between parents and children), the exclusion is applicable. However, if the parents were required to transfer the property to their child (that is, the grandchild), then the step transaction doctrine would apply and these steps would be collapsed into one transaction, i.e., a transfer from grandparent to grandchild. Since the parents are living, the grandparent-grandchild exclusion would not apply, and this transaction would not be excluded from change in ownership. The assessor can collapse the steps together under the step transaction doctrine if evidence exists that proves that the intent was for the grandchild to have the property.

TYPES OF TRANSACTIONS

27. Question: If a parent who owns real property dies and his child inherits the property, does this transfer qualify for the exclusion if the property was not purchased by the child?

    Answer: Yes. The mode of transfer is not an issue. Any transfers of real property between parents and children are eligible for the parent-child exclusion, whether by means of a sale, a

gift, a joint tenancy transfer, an inheritance, or an intestate transfer. If the child meets the family relationship requirements of section 63.1, files a claim, and the value of the property is within the $1 million limit (if applicable) or was the parent's principal residence, then the transfer qualifies for the exclusion. The parent-child exclusion applies to both voluntary and involuntary transfers and transfers resulting from a court order or judicial decree.

28. Question: My mother could not make her house payments and the bank foreclosed. If I purchase her property from the bank at the foreclosure sale, would this purchase be eligible for the parent-child exclusion?

    Answer: Yes. If a mother's primary residence is in foreclosure and the child purchases the residence at a foreclosure sale, such purchase would be considered a purchase or transfer between a parent and child under section 63.1(c)(1) if, in fact, the sale was made by the mother herself and not by an intermediary, such as a trustee in the course of a foreclosure sale.[13]

29. Question: A parent annually transfers a two percent interest in his property to two children. The market value of the four percent interest is less than $10,000. Do the children have to file for the parent-child exclusion for such small amounts?

    Answer: If the interests transferred during each assessment year have a market value of less than five percent of the value of the total property and are worth less than $10,000 in market value, then the transfers may be excluded under section 65.1(a) as a *de minimis* transfer. No parent-child exclusion claim is necessary for the *de minimis* exclusion.

    On the other hand, if the transfers during any assessment year cumulatively exceed the limit under section 65.1(a), then all the transfers will be subject to change in ownership. In this situation, then the transferees can file for the parent-child exclusion.

TRUSTS

30. Question: Are transfers of real property through the medium of a trust eligible for the parent-child exclusion?

    Answer: Yes. For property tax purposes, we look through the trust to determine who has present beneficial ownership. If the requirements of section 63.1 are otherwise satisfied, transfers to and from a trust are eligible for the exclusion.

31. Question: Parents owned property via a trust. Upon the husband's death in 1985, his interest transferred to an irrevocable trust in which his wife was the sole income beneficiary for life and also had the power to invade the principal for reasonable health, education, and support. Their children held the remainder interests. Upon wife's death in 2005, can the children file for the $1 million exclusion from both the mother and father?

[13] Annotation 625.0085.

Answer: Yes. The language and intent of section 63.1(b)(2) allow a full $1 million exclusion to each eligible transferor who has an ownership interest in real property. Thus, even though the husband predeceased the wife, husband and wife each retain a separate $1 million exclusion. Since the husband became an eligible transferor relative to his property interests when he died, the remainder interests become possessory (i.e., present beneficial interests vest in his children) upon the wife's death, making his $1 million exclusion available when the irrevocable trust for her benefit terminates.

32. Question: In 1990, a husband transferred two parcels of separate real property to his children and used his $1 million exclusion. The husband and wife jointly own other property held in a trust. Upon the husband's death in 1995, the trust was split into two trusts. The husband's interest in the real property transferred to an irrevocable Trust A in which his wife was the sole income beneficiary for life and also had the power to invade the principal for reasonable health, education, and support. The wife's interest transferred to Trust B. Their children held the remainder interests. Upon the wife's death in 1999, can the wife's $1 million exclusion apply to all the property since the husband already used his exclusion?

    Answer: No. Only the share of the property owned by the wife can be applied to her $1 million exclusion. If property was jointly owned, only the wife's share can be excluded. The husband's share would be reassessable because he already used his $1 million exclusion.

33. Question: Mom and Dad transferred real property to their trust in which they were the present beneficial owners. When Mom and Dad died, their trust became irrevocable. The trust provides that their son, daughter and nephew are the income beneficiaries for life. The trust also provides that the trustee can distribute income to any one or all of them at any time. If the trustee distributes income only to the son and daughter, is this eligible for the parent-child exclusion?

    Answer: No. Since the trust provides that the present right to receive distributions of the trust income goes to the son, daughter, and nephew, each child and the nephew are considered "present beneficial owners." Since the nephew has no exclusion and the trustee could distribute all of the trust property to him at any time, all of the property is considered to have changed ownership even if the trustee distributes the income only to the son and daughter.[14]

34. Question: A father transfers his real property into his trust, which became irrevocable upon his death. The distribution of his assets is a private matter. Can the trustee provide a certification of the trust to the assessor rather than a copy of the entire trust?

    Answer: No. A certification of the trust does not state the names of the beneficiaries or the real property interests owned by the trust—information that the assessor needs to make a determination whether the exclusion applies. The California courts have long recognized that a taxpayer is required to provide any relevant information requested by the assessor for

[14] Property Tax Rule 462.160(b)(1)(A).

property tax assessment purposes.[15] If a taxpayer fails to furnish complete information necessary to enable the assessor to make an exclusion eligibility determination, the assessor must still perform that statutory duty even if based upon incomplete evidence, which may result in a denial of the exclusion.

A claimant is required to provide information sufficient to support the claim as a condition of receiving the exclusion. Evidence about the identity and interests of the trust beneficiaries, the powers of the trustee to distribute the trust property and assets, and other terms relevant to the disposition of the trust assets is necessary for the assessor to determine whether the parent-child or the grandparent-grandchild exclusion applies. Thus, it is necessary for the trustee to provide an entire copy of the trust rather than a mere certification of the trust.

SHARE AND SHARE ALIKE

35. Question: Mom, an owner of real property, dies. Her will leaves her property jointly to her two sons. The will contains a provision that allows the executor to distribute the property in kind on a pro rata or non-pro rata basis. If the property is distributed to the sons on a non-pro rata basis, will the parent-child exclusion apply?

    Answer: Yes. If the market value of the real property does not exceed that child's share of the entire estate, then the distribution of real property to one child may be excluded under the parent-child exclusion.[16]

    Distributions of real property from an estate are not always made on a pro rata basis. Probate Code section 16246 provides that:

    > The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non pro rata, and may be made pursuant to any written agreement providing for a non pro rata division of the aggregate value of the community property assets or quasi-community property assets, or both.

    However, notwithstanding this statutory provision, the intention of the testator as expressed in the will controls the legal effect of the dispositions made in the will.[17] Thus, if the testamentary instrument does not specifically prohibit non-pro rata allocations, then it is assumed that the executor has broad discretionary powers. Thus, *for example*, Child A may receive real property and Child B may receive stocks and bonds equal in value. However, if the will specifically provides that Child A receives principal residence X and Child B receives rental property Y, then the executor has no discretion to alter the distribution scheme.

36. Question: A trust allows for non-pro rata distribution. However, the estate is composed primarily of a house and a small savings account. One child wants the real property and one

[15] See *Simms* v. *Pope* (1990) 218 Cal.App.3d 472, 477; *Domenghini* v. *County of San Luis Obispo* (1974) 40 Cal.App.3d 689, 695.
[16] Letter To Assessors 91/08.
[17] *Estate of Russell* (1968) 69 Cal 2d 200.

child wants cash. To equalize distribution, can the trust encumber the real property with a loan and will the transfer of real property still qualify for the parent-child exclusion?

Answer: Yes. When a trustee has the power to distribute trust assets on a pro rata or non-pro rata basis, the distribution of real property to one child qualifies for the parent-child exclusion if the value of the property does not exceed that child's interest in the total trust estate. A trustee who elects to make a non-pro rata distribution may equalize the value of the other beneficiaries' interests in the trust assets by encumbering the real property with a loan and distributing the loan proceeds to the other beneficiaries.[18] However, a loan cannot be made by any of the beneficiaries of the real property to the trust in order to equalize the trust interests. Such loan would be considered payment for the other beneficiaries' interests in the real property resulting in a transfer between beneficiaries rather than a transfer from parent to child, which would disqualify the transfer from the parent-child exclusion.

Example 1: M died leaving three children A, B, and C. At the time of M's death, M's residence was worth $350,000. M also owned a 50 percent interest in a warehouse valued at $200,000 and a portfolio of stocks and bonds with a value of $200,000. The executor proposes to encumber the residence with a $100,000 loan and distribute the residence to A, the portfolio plus $50,000 cash to B, and the 50 percent interest in the warehouse plus $50,000 cash to C. Since each child is receiving an equal share of M's estate ($250,000 in value) and the value of each real property does not exceed that child's share of the estate, the real properties may be excluded under the parent-child exclusion if a timely claim is filed.

Example 2: Same facts as in Example 1, however, instead of the executor encumbering the residence with a $100,000 loan, Child A, who wants to receive the residence, proposes to loan the trust the $100,000. Such loan would disqualify the transfer from the parent-child exclusion because such transaction would be considered a loan between the beneficiaries.

Example 3: Same facts as in Examples 1 and 2, however, instead of Child A providing the trust the $100,000 loan, Child C proposes to loan the trust the $100,000. Under these facts, because the child who is receiving the property with the encumbrance is not the same child making the loan to the trust, the property will qualify for exclusion.

37. Question: Mother, an owner of real property, dies, and her will leaves her properties jointly to her two sons. The court ordered the properties to be distributed jointly to the two sons. However, the two sons did not wish to jointly own property with each other. Thus, son A conveys his interest in parcel 1 to son B, and son B conveys his interest in parcel 2 to son A, resulting in son B owning parcel 1 and son A owning parcel 2. These deeds were recorded simultaneously after distribution. Would these transactions qualify for the parent-child exclusion?

Answer: No. While the distribution of parcels 1 and 2 jointly to the two sons upon the death of their mother is excludable from change in ownership under section 63.1, the subsequent transfers between the siblings would not be excluded and would be considered reappraisable events. Since the court ordered joint distribution in accordance with Mother's will, the subsequent transfers would be considered as transfers between siblings and not a redistribution of estate assets. Thus, the transfer of son A's interest in parcel 1 to son B and

[18] Annotation 625.0235.005.

the transfer of son B's interest in parcel 2 to son A would trigger a 50 percent reappraisal of each parcel.

LEASES

38. Question: A child owns real property that he has leased to his mother and his uncle for a term of 99 years. Does the parent-child exclusion apply to this situation?

    Answer: Yes. Section 61(c) provides, in part, that the creation of a leasehold interest in taxable real property for a term of 35 years or more is a change in ownership; thus, where such a leasehold is created, a change in ownership has occurred for property tax purposes. Such transfers may be excluded from change in ownership under the parent-child exclusion. Accordingly, the property subject to the lease may be excluded from change in ownership to the extent of the mother's ownership in the property within the limitations of section 63.1.

LIFE ESTATES

39. Question: A mother died. In her will she granted a life estate in real property to a friend with the remainder to the mother's children. Should the parent-child claim be filed upon the death of the mother or the termination of the life estate?

    Answer: The parent-child claim should be filed when the children's interest becomes possessory upon the termination of the mother's friend's life estate. A reappraisable change in ownership occurs when a life estate is created if it vests in a person other than the transferor, the transferor's spouse, or the transferor's registered domestic partner.[19] Similarly, another change in ownership occurs when the life estate terminates and the property transfers to the remainder person unless an exclusion applies. Thus, under these facts, a change in ownership occurred when the life estate was created because it vested in mother's friend upon mother's death. However, the children's rights in the property do not become possessory (i.e., they do not vest) until the termination of the mother's friend's life estate. Thus, the filing period for the parent-child exclusion does not begin to run until their interest becomes possessory—upon the death of the life estate holder. Assuming the parent-child claim is timely filed, the property will not be reassessed upon the termination of the life estate. It will retain the base year value determined when the life estate was created.

40. Question: An owner of real property died testate. In her will she left a residence to her sister-in-law for her life with the remainder interest to her nephew, her sister-in-law's son. Eight years later, the sister-in-law transfers her life estate to her son by quitclaim deed. Is the sister-in-law's transfer to her son excluded from change in ownership by the parent-child exclusion?

    Answer: Yes. In this situation, the sister-in-law's transfer of her life estate to her son resulted in a merger of the life estate and the remainder interest. Since the merged interest is considered to have been received from the life tenant (his mother), the parent-child exclusion applies.[20]

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[19] Property Tax Rule 462.060(a).
[20] Annotation 220.0372 and 220.0372.015.

41. Question: A mother recorded a deed in which she transferred ownership of her real property to three of her four children, but reserved a life estate for herself. The three children gave 25 percent of their remainder interest to their sibling, the fourth child. Upon the death of the mother, is the entire property eligible for the parent-child exclusion?

    Answer: No. Only the interest that passed to the three children from their mother is eligible for the parent-child exclusion. The 25 percent that the fourth child received was granted by the siblings, not the mother. Thus, that 25 percent is subject to reassessment as a sibling-to-sibling transfer.

LIFE ESTATE – DISCLAIMER

42. Question: Grandfather records a deed in which he gives a life estate to his grandson with the remainder to the grandfather's son. If the grandchild disclaims any interest in the grandparent's property, can the transfer of real property qualify for the parent-child exclusion?

    Answer: Yes. Probate Code section 265 defines a "disclaimer" as any writing which declines, refuses, renounces, or disclaims any interest that would otherwise be taken by a beneficiary. "Beneficiary" means the person entitled, but for the person's disclaimer, to take an interest (Probate Code section 262). A properly executed and filed disclaimer results in the interest disclaimed descending and being distributed as though the disclaimant had predeceased the creator of the interest. Being treated as deceased and being deceased are not the same. Thus, under this scenario, if the grandson disclaims his life estate interest, then the property will pass from grandfather to grandfather's son, and would be eligible for the parent-child exclusion.

DATE OF CHANGE IN OWNERSHIP

43. Question: A mother died in 1985. After a lengthy probate, her estate was distributed to her surviving children in 2006. What is the date of change in ownership for purposes of this exclusion?

    Answer: Generally, the date of death is the date of change in ownership.[21] However, under *Larson* v. *Duca* (1989) 213 Cal.App.3d 324, the date of a judicial decree of distribution can be considered the date of change in ownership for purposes of applying the parent-child exclusion when the decedent parent or child died prior to November 6, 1986 and the judicial decree of distribution of the court in which the decedent's estate was probated occurred after November 6, 1986. Only under these circumstances will the change in ownership occur on the date of distribution of the property in probate proceedings rather than on the date of death. *Larson* does not apply to properties held in trust or joint tenancy because these types of estate plans avoid probate upon the date of death.

[21] Property Tax Rule 462.260(c).

CLAIMS

44. Question: When must a claim for exclusion be filed?

Answer: To receive property tax relief as of the date of the transfer of real property, claims must be filed within three years after the date of the transfer or prior to the transfer of the real property to a third party, whichever is earlier. If the assessor mails a notice of supplemental or escape assessment after the expiration of either of these filing periods, a claim is considered timely if it is filed no later than six months after the date of mailing of notice of supplemental or escape assessment. If a claim is *not* filed timely, relief can be granted prospectively only if the property is still owned by the transferee.

45. Question: What is a transfer to a third party?

Answer: A transfer to a third party is a transfer that is subject to reassessment and not otherwise excluded by the parent-child exclusion. Section 63.1(e)(4) expressly provides that a transfer to a parent or child of the transferor is not considered a transfer to a third party.[22]

For example, a mother bequeathed her home to her adult daughter. The daughter did not know of the parent-child exclusion and had, in turn, transferred the property to her own child (the mother's grandchild). The filing period for the first transaction is not foreclosed by the subsequent transfer to the grandchild, since this transfer is not considered a transfer to a third party. However, until the daughter files a claim, the base year value that is set as of the date the daughter acquired the property would remain intact.

Meanwhile, in order to receive retroactive relief, the grandchild's filing period is within three years of the second transfer or before a transfer to a third party, whichever is earlier, or within six months of a notice of supplemental or escape assessment on the second transfer. If both the parent *and* the grandchild file claims, then both transfers may be excluded from change in ownership as long as the grandchild has not transferred the property to a third party who is not eligible for the parent-child exclusion. Finally, the grandchild may file for prospective relief on the transfer from the parent at any time, provided the grandchild has not transferred the property to a third party who is not eligible for the parent-child exclusion.

46. Question: A mother's real property was held in a trust when she died in 2002. More than three years has passed and the trustee has not yet distributed the property to mother's son, the sole beneficiary. Thus, the three-year statutory period in which to apply for the parent-child exclusion has passed. Does the son have to wait to file the claim until after he receives a notice of supplemental or escape assessment (i.e., the beginning of the six-month filing period)? Or, can the assessor's office accept a filing of the parent-child exclusion form as timely before processing corrections and opening the six-month window for filing?

Answer: The assessor can accept a completed form as timely before officially beginning the six-month filing period. The Legislature added paragraph (C) to section 63.1(e)(1) to extend the filing period for claimants who otherwise would have been ineligible under the previous requirements.[23] Under paragraph (C), a claim filed after either the transfer-to-a-third-party

[22] See Letter To Assessors 2000/005.
[23] See Letter To Assessors 94/21.

deadline or the three-year deadline, as applicable, will nevertheless be timely if the filing is made *no later than* six months after the mailing of a notice of supplemental assessment required by section 75.31 or the notice of escape assessment required by section 534.

47. Question: What is meant by "prospective relief?"

    Answer: If a claim is filed after the conclusion of the specified filing periods described above, the exclusion may be granted as of the year that the claim is filed, but will not be back-dated to the date the transfer actually occurred. Section 63.1(e)(2) provides that any exclusion granted for a claim that is filed subsequent to the expiration of the filing periods shall apply commencing with the lien date of the assessment year in which the claim is filed. *For example*, untimely claims filed in 2006 shall apply as of the 2006 lien date (January 1, 2006) for the 2006-07 fiscal year, but not for any prior years.

48. Question: In 2003, a father gave his son real property that the father had owned. The son filed a preliminary change of ownership report that indicated a parent-child transfer had occurred. No parent-child exclusion claim was filed. Subsequently, the assessor reassessed the property and the son received a supplemental assessment property tax bill. Isn't this exclusion automatic? Wouldn't the preliminary change in ownership report be sufficient to grant the exclusion?

    Answer: No. Section 63.1(d)(1) requires that a claim be filed before the exclusion can be granted and that both the transferor and transferee must certify under penalty of perjury as to the parent-child relationship. Section 63.1(e)(1) requires that the Board prescribe the form for claiming eligibility. The preliminary change in ownership report is not sufficient because it does not contain the proper certification for the parent-child exclusion.

49. Question: The claim form for the parent-child exclusion is a Board-prescribed form. Why isn't it on the Board's website?

    Answer: If a form is prescribed by the Board, this means the Board sets the language to be used by all 58 counties; however, we do not create the document. Rather, the county assessor adds the county name and address to the form, and creates the claim form for use by taxpayers within his or her county. The claim form may be available from a county assessor's website. A list of county assessors and links to their websites (if available) is contained on the Board's website at www.boe.ca.gov/proptaxes/assessors.htm.

CLAIMS - SIGNATURE REQUIREMENTS

50. Question: Who can sign the claim form?

    Answer: Section 63.1(d)(1)(A) and (B) specifically requires written certification attesting to the parent-child relationship under penalty of perjury from both the transferee and the transferor, or the executors of their estates or their legal representatives. (A legal representative is one who has been duly authorized and has been given appropriate power.) In instances where there are multiple transferees, section 63.1(d)(1)(D) allows one transferee to sign on behalf of the other transferees. However, there is no similar language for

transferors. Thus, if there is more than one transferor, *each* transferor must sign the claim form.[24]

If the property is in a trust, the trustee can sign on behalf of the transferor because the trustee has the legal obligation to carry out the terms of the trust. If the property is in bankruptcy, the trustee assigned by the bankruptcy court may sign the form on behalf of the transferor.

51. Question: A father transferred real property to his son and now refuses to sign the claim form. Can the son provide proof of the relationship in lieu of the father signing the claim form?

Answer: In this regard, it is important to note that the exact language of the statute does not require the transferor's signature on the claim, but rather requires that the transferee shall submit "A copy of written certification by the transferor...made under penalty of perjury that the transferor is a parent...of the transferee." Section 63.1(d) requires the transferee to file the claim; and section 63.1(d)(1)(B) requires written certification as to parenthood and certification that the property transferred is the transferor's principal residence. The transferor's signature on the claim form is the standardized method approved by the Board for the assessor to obtain such written certification required by the statute. The lack of the transferor's signature would not preclude an assessment appeals board from determining whether there is sufficient independent evidence to satisfy the statute. If, for example, there are other forms or writings, deeds, court documents, tax returns, etc., signed under oath or penalty of perjury, which indicate the parent-child relationship, then such documentation could satisfy the requirement of "written certification by the transferor." Similarly, other documents might be used to certify that the property was the principal residence of the parent. The weighing of such evidence, of course, and the ultimate conclusion to which it leads are questions of fact entirely within the purview of the assessment appeals board.

Obsolete language - See LTA 2003/018

RESCISSION

52. Question: May an assessor allow a claimant to rescind a parent-child or grandparent-grandchild claim for exclusion?

Answer: Yes, even though there is no express statutory authorization for such action. Under the basic principles of tax law, the taxpayer has the right to elect whether to claim a tax benefit or not, and if the benefit is voluntary, the taxpayer is not forced to take it. However, both parties to the transaction must agree to the rescission. Thus, if one of the parties is now deceased, then the rescission cannot be granted because the deceased party cannot agree to the rescission.

In addition, if the change in ownership occurred more than four years prior to the rescission request, the assessor can only issue escape assessments for four years under section 532, the statute of limitations period for escape assessments.

[24] Letter To Assessors 2003/018.

GRANDPARENT-GRANDCHILD EXCLUSION QUESTIONS AND ANSWERS

1. Question: Can any transfer of real property between grandparent and grandchild qualify for exclusion from change in ownership?

Answer: No. Not all transfers of real property between grandparent and grandchild qualify. Such transfers may be excluded only under certain circumstances. In fact, only transfers from a grandparent to a grandchild may qualify (and not vice versa) if all other specified circumstances are met (i.e., transfers from a grandchild to a grandparent do not qualify for exclusion). Other requirements that must be met is that all of the parents of the eligible transferees who qualify as "children" of the grandparents have died or, in the case of an in-law, have divorced or remarried. Thus, the exclusion applies where the parent of the grandchild has predeceased the grandparents and the in-law either remarried after the death of the spouse or was divorced from the deceased prior to death. However, beginning January 1, 2006, an in-law who is a stepparent of the grandchild need not be deceased.

2. Question: Why is the grandparent-grandchild exclusion so limiting?

Answer: The application of the grandparent-grandchild exclusion is consistent with the intent of Proposition 193. The vehicle which put Proposition 193 on the ballot was Assembly Constitutional Amendment 17, carried by Assemblyman Knowles. In the California Ballot Pamphlet, Assemblyman Knowles stated in the "Argument in Favor of Proposition 193" that this proposition was authored to allow taxpayers to decide "whether to permit property to be transferred from grandparents to their own grandchildren *only in cases where both parents are deceased*, so that California families who are caught in this unfortunate situation are not punished due to mere oversight in the law." Assemblyman Knowles noted further: "It will be an uncommon family to whom this new tax provision will apply, and therefore this measure will have minimal revenue consequence on state or local governments."

PRINCIPAL RESIDENCE

3. Question: How many principal residences can be transferred by a grandparent to a grandchild under section 63.1?

Answer: Just as with the parent-child exclusion, there is no limit to the number or the value of principal residences transferred from a grandparent to a grandchild so long as the grandchild has not received a principal residence from his parent that was excludable under section 63.1. If the grandchild received a principal residence from a parent that was excludable under section 63.1, then any principal residence received from a grandparent would be considered "other real property" and counted against whatever is remaining from the grandchild's deceased parent's $1 million exclusion.

$1 MILLION EXCLUSION TRACKING

4. Question: The application for the grandparent-grandchild exclusion does not ask for the grandparent's tax identification number. Is this an oversight?

Answer: No. Because the grandparent-grandchild exclusion is an extension of the parent-child exclusion, real property excludable under the grandparent-grandchild exclusion is counted against the grandchild's deceased parent's $1 million exclusion. If the parent used his or her entire $1 million exclusion while alive, then no exclusion is available for the grandparent-grandchild transfer.

MIDDLE GENERATION LIMITATION

5. Question: A grandfather died and left real property to his grandson. The grandfather's daughter has been declared mentally incapacitated and is in a care home. The daughter has never been married. Is the grandson eligible for the grandparent-grandchild exclusion?

   Answer: No. The grandparent-grandchild exclusion from change in ownership is available only when all of the parents of the eligible transferees who qualify as "children" of the grandparents have died or, in the case of an in-law, have divorced or remarried. Since his mother (grandfather's daughter) is alive, the grandson is not eligible for the exclusion.

6. Question: A daughter had a son. After the son was born, the daughter married a prison inmate who was not the son's father. Several years later, the daughter died. Thereafter, on August 1, 2006, the grandfather died and left real property to his grandson (daughter's son). The daughter's husband had not remarried. Is the grandson eligible for the grandparent-grandchild exclusion?

   Answer: Yes. The daughter's husband is a stepfather to her son. Commencing January 1, 2006, the provisions that require a parent who is a child of the grandparent to be deceased do not apply to an in-law child who is a stepparent of the grandchild.

IN-LAW CHILD

7. Question: A grandfather died and left real property to his grandson. The grandfather's daughter (grandson's mother) was legally separated from her husband (grandson's father) at the time of her death. Would that be the same as divorced for this purpose?

   Answer: No. Section 63.1(c)(3)(C) specifically states that an in-law is a child of the parent until the marriage on which that relationship is based is terminated by divorce. Legally separated is a temporary situation that may or may not end in divorce. A divorce decree is a final judgment that terminates a relationship. Until the divorce is final, the in-law relationship still exists.

MISSING PARENT

8. Question: Can a transfer of real property between grandparent and grandchild qualify for exclusion from change in ownership if the whereabouts of the parent of the grandchild is unknown?

   Answer: Yes, if the date of death of the parent is established. When a person has been missing for over five years, the estate may be administered as that of a decedent by invoking the presumption of death from five-years absence created by Evidence Code section 667. A

person may file a petition in court pursuant to Probate Code sections 1804 et seq., which provides a procedure for the final distribution of property of an absent person without recourse by him if he has been missing for the requisite period of time.

DISCLAIMER

9. Question: Can a transfer of real property between grandparent and grandchild qualify for exclusion from change in ownership if the parent disclaims any interest in the grandparent's property?

   Answer: No. Probate Code section 265 defines a "disclaimer" as any writing which declines, refuses, renounces, or disclaims any interest that would otherwise be taken by a beneficiary. "Beneficiary" means the person entitled, but for the person's disclaimer, to take an interest (Probate Code section 262). A properly executed and filed disclaimer results in the interest disclaimed being distributed as though the disclaimant had predeceased the creator of the interest. However, being treated as deceased for purposes of a disclaimer and being deceased are not the same. Thus, for purposes of the grandparent-grandchild exclusion, the parent must actually be deceased prior to the transfer in order for the transfer of real property from the grandparent to the grandchild to qualify for exclusion.

ADOPTION

10. Question: Does a natural grandchild qualify as an eligible transferee of her natural grandmother if the grandmother's daughter (grandchild's mother) was legally adopted as a minor by another mother and father?

    Answer: No. Based on the definition in section 63.1(c)(4), a "grandchild" means any child of the child of the grandparent. For purposes of the grandparent-grandchild exclusion, the grandchild's mother ceased to be the "child of the grandparent" when she was legally adopted by another set of parents.

11. Question: A son predeceased his mother (grandmother). At the time of his death, the son was divorced from his son's (grandson) mother and had not remarried. The son's ex-wife had remarried and after her ex-husband's death, her new husband formally adopted her child (grandson) at age 19. The paternal grandmother left real property to the grandson. Does he qualify for the grandparent-grandchild exclusion?

    Answer: Yes. Section 63.1(c)(4) defines "grandchild" as "any child of the child of the grandparent." At the time of the son's death, the son was a child of the grandmother and the grandson was a child of the son. The marriage on which the daughter-in-law's relationship with the grandparent was based, ceased to exist when, after her husband's death, she remarried. Furthermore, the adoption by the new husband was of no effect because, under subdivision (c)(3)(D), the term "child" is defined as any child adopted by the parents *if under the age of 18*. Since the grandson was adopted at age 19, the adoption did not erase the biological relationship between the son and the grandson for purposes of the grandparent-grandchild exclusion. Thus, the transfer from the grandparent to the grandson qualifies because as of the date of transfer, the grandson was a child of the son, the grandmother's son was deceased, and his ex-wife did not meet the qualification of "child"

under section 63.1(c)(3)(C) because the relationship of parent and daughter-in-law was terminated by his death and her remarriage.

STEP GRANDCHILD

12. Question: A grandfather had a son who married a woman who already had two children (son's stepchildren). The son passes away. Wife (stepchildren's natural mother) does not remarry and passes away. Subsequently, the grandfather dies and leaves real property to his deceased son's stepchildren. Will transfers of real property from a grandfather to his step grandchildren qualify for exclusion?

    Answer: Yes. Under section 63.1(c)(3)(B), a "child" is defined as "any stepchild of the parent or parents and the spouse of that stepchild while the relationship of stepparent and stepchild exists…[T]he relationship of stepparent and stepchild 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 stepparent." In this case, the criterion for the grandparent-grandchild exclusion was met on the date of the transfer. That is, all of the "parents" of the grandchildren who qualify as the "children" of the grandparents were deceased.[25] The grandchildren are thus qualified for this exclusion.[26] Even though the stepchildren are no longer considered children of the stepfather because the step relationship terminated with stepfather's death, they are still considered grandchildren of the stepfather's parents because the step relationship was not terminated by remarriage.

13. Question: A grandmother owns real property. The grandmother's daughter married a man with a son (stepson). The daughter died and her husband remarried, breaking the in-law relationship with her mother (grandmother). Can grandmother transfer her property to her ex-son-in-law's son and qualify for grandparent-grandchild exclusion?

    Answer: No. Under section 63.1(c)(3)(B), a "child" is defined as "any stepchild of the parent or parents and the spouse of that stepchild while the relationship of stepparent and stepchild exists…[T]he relationship of stepparent and stepchild 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 stepparent." In this case, the transfer of property from the grandmother to her daughter's stepson would not qualify for the grandparent-grandchild exclusion because the father had remarried after the daughter's death. When the father remarried, the in-law relationship ceased to exist.[27]

GREAT-GRANDCHILD

14. Question: Is a great-grandchild eligible for the grandparent-grandchild exclusion?

    Answer: No. The exclusion under section 2(h) of article XIII A of the California Constitution and section 63.1 applies to transfers of real property (1) between parents and children, and (2) from grandparents to grandchildren under limited circumstances. A

[25] Section 63.1(c)(2).
[26] Section 63.1(c)(3)(B).
[27] Section 63.1(c)(3)(C).

great-grandchild does not meet the definition of "child" or "grandchild" under section 63.1(c)(3) or (c)(4).

LIFE ESTATE

15. Question: Does the grandparent-grandchild exclusion apply when a grandchild receives the remainder interest upon the termination of a life estate granted to his/her parent who qualified as the "child" of the grandparent/trustor?

    Answer: Yes, as long as the limitations of the grandparent-grandchild exclusion are met. If the facts indicate that the grandparent is the grantor of lifetime interests, and she designates that the remainder interest in the trust property shall transfer to her grandchildren upon the death of the lifetime beneficiaries, she is the "eligible transferor" to her grandchildren for purposes of this exclusion. Whether the grandchildren qualify as "eligible transferees" under the exclusion depends in each case on whether all of their parents who qualify as "children" of the grandparent are deceased at the time of the transfer. This requires a factual determination to be made by the assessor based on the facts submitted by the taxpayer on the claim form (and other documentation).

LARSON V. DUCA

16. Question: A grandmother died in 1985. After a lengthy probate, her estate was distributed to her surviving children and grandchildren in 1997. Since the only parent of the grandchildren predeceased the grandmother, will the property inherited from the grandmother qualify for the exclusion under *Larson* v. *Duca*, 213 Cal. App. 3d 324 (1989)?

    Answer: No. This is a grandparent-grandchild exclusion and not a parent-child exclusion. The *Larson* v. *Duca* court case is a very narrow decision which is limited to the facts of the case. The court stressed that it intended only to deal with parent-child benefits (Proposition 58). Thus, an assessor should apply the holding of this case only to parent-child cases that fall within the described facts of this case—the decedent parent or child died prior to November 6, 1986, and the judicial decree of distribution of the court in which the decedent's estate was probated occurred after November 6, 1986. *Only* under these circumstances will the change in ownership occur on the date of distribution of the property in probate proceedings rather than on the date of death. *Larson* does not apply to properties held in trust or joint tenancy.

STEP TRANSACTION

17. Question: Parents formed a family limited partnership (LP1) to which they transferred real property, maintaining the same percentage of ownership so that such transfer was excluded under section 62(a)(2). Subsequently, the parents gave 49 percent of the LP1 ownership interests to their children and grandchildren. Next, the family dissolves LP1 and transfers the real property proportionally to the parents, children, and grandchildren. Then, the parents give a two percent interest in the real property to their children and file for the parent-child exclusion. The parents, children, and grandchildren now want to form a new family limited partnership (LP2) and transfer the real property to LP2. Will these transfers be subject to the step transaction doctrine?

Answer: No. The statement of legislative intent, contained in the uncodified note in Chapter 48 of the Statutes of 1987 (the legislation which added section 63.1 to the Revenue and Taxation Code), allows the parent-child exclusion for certain step transactions involving legal entities. This statement of intent was amended, effective January 1, 2007,[28] to include transfers involving grandchildren.

[28] Stats. 2006, Ch. 224 (SB 1607).