“CHANGE IN OWNERSHIP” UNDER PROPOSITION 13:

Understanding and Avoiding Property Tax Reassessment

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1. SUMMARY

1.1 Outline Topics. This outline focuses on the property tax “change in ownership” rules encountered most by estate planners. Specifically, this outline will analyze the rules concerning Tenancies in Common, Joint Tenancies, Leases, Trusts, Legal Entities, and particular rules concerning Excluded Transfers, including Proportional Interest, Interspousal, Domestic Partner, and Parent-Child transfers.

1.2 Opinions of State Board of Equalization. This outline discusses written and oral opinions expressed by the State Board of Equalization (the SBOE) about the change in ownership rules. The opinions are usually provided by SBOE counsel in letters to county assessors or taxpayers or in telephone conversations. Letters issued by the SBOE, along with property tax statutes, rules, and other information, can be found at www.boe.ca.gov. Although SBOE opinions provide useful guidance, county assessors are not bound by a position taken by the SBOE. County assessors may disagree with the SBOE’s interpretation of a statute or regulation and may challenge an SBOE interpretation in court.

1.3 Background

1.3.1 Property Tax Rates. The property tax imposed on California real property is equal to 1% of the property’s “assessed value,” plus any local ad valorem taxes or special assessments approved by a two-thirds vote. [Cal. Const. art XIII A, §1 and §3.] Most tax rates are in the range of 1.00% to 1.25%.

1.3.2 Determination of Assessed Value. Generally, the assessed value is equal to the fair market value of the property as of the date there is a “change in ownership,” plus a yearly increase in value based on inflation. [Cal. Const. art XIII, §1 and art XIII A §2.] Proposition 13 mandates that the yearly increase does not exceed 2% of the prior year’s value, unless there is a change in ownership which triggers a reassessment. [§51(a)(1)(D).] The assessed value may also increase upon completion of new construction, and the assessed value may decrease if the property’s value declines, but this outline considers only change in ownership issues.

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1 Except as otherwise indicated, all code section references refer to the California Revenue and Taxation Code and all rule references refer to the Property Tax Rules (also referred to as Regulations) of the SBOE, unless otherwise noted. References are also made to the Property Taxes Law Guide Annotations published by SBOE. The Annotations are derived from SBOE letters to county assessors and taxpayers and from Attorney General Opinions that provide interpretations of statutes, rules, and court cases.

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Property Tax Outline GG.wpd 1
1.4 Change in Ownership Defined

1.4.1 Definition. 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.”

1.4.2 Three Part Test. The change in ownership definition provides a three part test:

(a) Present Interest. Is the transferred property interest a present interest (e.g., a contingent interest in a revocable trust is not a present interest)?

(b) Beneficial Use. Does the transfer include the right to the beneficial use of the property? This question focuses on who is the beneficial owner of the property (e.g., a beneficial owner is not a bank with a security interest in real property or a trustee who holds legal title only).

(c) Substantially Equivalent to Fee Value. The value of the interest transferred must be substantially equivalent to the fee value of the property (e.g., a leasehold interest of 35 years or more (including renewal options) is considered substantially equivalent to the fee value. [Rule 462.100(a) and (d).]

1.4.3 Includes All Types of Transfers. Under Rule 462.001, a change in ownership is broadly defined to include transfers that are voluntary, involuntary, by operation of law, grant, gift, devise, inheritance, trust, contract of sale, addition or deletion of an owner, property settlement, or any other means.

2. TENANCIES IN COMMON - Rule 462.020

2.1 General Rule. A tenancy in common interest that is transferred is reassessed, unless an exclusion applies. [Rule 462.020(a).]

2.1.1 Example: A and B each own a 1/2 undivided interest in Property as tenants in common. If A transfers his interest to C, the 1/2 interest transferred to C is reassessed. The interest of B is not reassessed.

2.2 Exclusions. Four main exclusions (discussed in more detail in paragraph 7 of this outline) apply to transfers of tenancy in common interests:
2.2.1 Proportional Interest Exclusion. A transfer in which there is a change in the method of holding title to the real property transferred without changing the proportional interests of the beneficial owners is not considered a change in ownership. If the beneficial ownership interests are the same before and after the transfer, there is no change in ownership. [§62(a) and Rule 462.020(b)(1).]

(a) Example. A and B own Property equally as tenants in common. A and B transfer to each other as joint tenants. There is no change in ownership.

2.2.2 Interspousal Exclusion. A transfer of real property to a spouse does not constitute a change in ownership. [§63, Rule 462.220.]

2.2.3 Domestic Partner Exclusion. A transfer of real property to a registered domestic partner occurring on the death of a domestic partner. [Rule 462.240(k).]

2.2.4 Parent-Child (and Grandparent-Grandchild) Exclusion. Certain transfers of real property between a parent and child or grandparent and grandchild are excluded from change in ownership. [§63.1.]

2.2.5 De Minimis Exclusion. Transfers of property representing less than 5% of the property and valued at less than $10,000 are excluded from change in ownership. [§65.1; 462.020(b)(2).]

3. JOINT TENANCIES - §§ 62(f) and 65, Rule 462.040

3.1 General Rule. The creation, transfer, or termination of a joint tenancy interest is a change in ownership of the interest transferred, unless an exclusion applies [Section 65(a) and Rule 462.040(a).]

3.1.1 Examples

(a) A and B acquire Property as joint tenants. B dies and A becomes sole owner. There is a 50% change in ownership unless an exclusion applies. [Rule 462.040, Example 3.]

(b) A and B hold Property as joint tenants. A and B transfer to C and D as joint tenants. There is a 100% change in ownership unless an exclusion applies. [Rule 462.040, Example 2.]

3.2 General Exclusions. The primary exclusions that apply to tenancy in common transfers also apply to joint tenancy transfers (i.e., proportional interest transfers, interspousal
transfers, domestic partner transfers, parent-child transfers, and de minimis transfers). [See paragraph 7 and Rule 462.040(4),(5),(6), and (7).]

3.3 “Original Transferor” Exclusion

3.3.1 Basic Rule. Section 65(b) excludes joint tenancy transfers where all of the transferors are among the remaining joint tenants:

“There shall be no change in ownership upon the creation or transfer of a joint tenancy interest if the transferor or transferors, after such creation or transfer, are among the joint tenants. Upon the creation of a joint tenancy interest described in this subdivision, the transferor or transferors shall be the ‘original transferor or transferors’ for purposes of determining the property to be reappraised on subsequent transfers.”

(a) Examples

(1) One Original Transferor. A transfers Property to A and B as joint tenants. There is no change in ownership, and A becomes an original transferor. [Rule 462.040, Example 5.]

(2) No Limit to Number of Transfers. A and B transfer Property to A, B, C, and D as joint tenants. There is no change in ownership, and A and B become original transferors. [Rule 462.040, Example 5.] If then A, B, C, and D transfer to A, B, C, D, X, and Y, there is no change in ownership, and C and D become original transferors. [Note that the step transaction doctrine (discussed in part 8) will apply if the transaction is set up only to avoid a change in ownership and not to hold the property as joint tenants.]

(3) No Remaining Original Transferor. A transfers Property to B and C as joint tenants. Because A is not a joint tenant after the transfer, the original transferor exclusion does not apply and there is a 100% change in ownership. B and C are not original transferors.

(4) All Joint Tenants Must Transfer. A and B as joint tenants transfer Property to B, C, and D. Because A is not a transferee, the transfer does not qualify for the original transferor exclusion, and the 66 2/3% interest that is transferred to C and D is reassessed. B, C, and D are not original transferors. [Rule 462.040, Example 8.]

(b) Spouse of Original Transferor Can Become an Original Transferor. If a spouse of an original transferor acquires an interest in the joint tenancy property either during the period that the original transferor holds an interest or by means of a transfer
from the original transferor, the spouse is also considered to be an original transferor. [Rule 462.040(b)(1).]

(1) Example. A and B are joint tenants, and A is an original transferor. C is A’s spouse. A and B transfer to A, B, and C as joint tenants. C is an original transferor. [Rule 462.040, Example 7-3.]

(c) Other Than Original Transferors. All other joint tenants, regardless of when they acquire their interests, are considered to be “other than original transferors.” [Rule 462.040(b)(1).]

3.3.2 Reappraisal on Transfer of Last Remaining Original Transferor’s Interest. After the creation or transfer of a joint tenancy with “original transferors,” the interests held in joint tenancy will not be reappraised until the transfer of the last remaining original transferor’s interest or the termination of the joint tenancy. Upon the transfer or termination of the last remaining original transferor’s interest, there is a change in ownership and the portion of the property that was excluded from reassessment under the original transferor exclusion is reassessed. [§65(c); Rule 462.040(b)(2).]

(a) Examples:

(1) A and B transfer Property to A, B, C, and D as joint tenants. There is no change in ownership, and A and B become original transferors. If A dies, there is no change because B remains as a joint tenant. If later B dies, 100% of Property is reassessed because the last remaining original transferor has transferred her interest. [Rule 462.040, Examples 10 and 11.]

(2) A transfers Property to A and B as joint tenants. There is no change in ownership, and A becomes an original transferor. If B dies first, there is no change in ownership because A is the last remaining original transferor and he has not transferred his interest. However, if A were to die first, there is a 100% change in ownership.

3.3.3 Reappraisal on Termination of Joint Tenancy to Extent Property Vests in Other than Original Transferors. On the termination of a joint tenancy with original transferors, any interest in the property held by anyone other than an “original transferor” is reassessed.

(a) Example. A transfers Property to A and B as joint tenants. There is no change in ownership, and A becomes an original transferor. If the parties terminate joint tenancy so that A and B hold property as tenants in common, B’s 1/2 interest is reassessed. [See SBOE letter to taxpayer dated January 19, 1994, Property Taxes Law Guide Annotation No. 220.0305.]
3.3.4 No Third Party Required - New Rule. Under the prior joint tenancy
rules, a joint tenancy transfer was excluded only if the joint tenancy included at least one new
joint tenant. Under a recent amendment to this Rule (effective November 13, 2003), a new joint
tenant is not required. [Rule 462.040(b)(1).]

(a) Example. A and B own Property equally as tenants in common.
A and B transfer Property to A and B as joint tenants. Both A and B become “original
transferors.” [Rule 462.040, Example 4.] (Under the old Rule, A and B would become “original
transferors” only if they added a third party when they created the joint tenancy - i.e., A and B
needed to transfer to A, B, and at least one more joint tenant.) A dies terminating the joint
tenancy. The joint tenancy interest passes to B without a change in ownership because B is an
original transferor. [Rule 462.040(b)(3).] After the transfer from A, B ceases to be an original
transferor [Rule 462.040(b)(3).]

3.3.5 Transfer to Trust - New Rule. The revised Rule (effective November
13, 2003) also provides that a joint tenant may become an “original transferor” if the joint
tenant transfers his or her interest to other joint tenants through his or her trust, if the trust
instrument names the other joint tenants as the beneficiaries. [Rule 462.040(b)(1).]

(a) Example 4(a) provided in New Rule. “A and B purchase
property as joint tenants. Later A and B transfer their property interests to each other as joint
tenants through their respective trusts. A and B are transferors who are among the joint tenants
and are, therefore, considered to be ‘original transferors.’” [Rule 462.040, Example 4-1.]

(b) SBOE Interpretation. The new Rule and new example are
confusing because it is not clear how the joint tenants can “transfer their property interests to
each other as joint tenants through their respective trusts.” In its Letter to County Assessors No.
2004/042 dated July 6, 2004, the SBOE provides a lengthy discussion of how the new Rule
should be interpreted. The following are a few of the issues addressed in the Letter to County
Assessors:

1. Three Part Test. The Letter to County Assessors advises
that there are three parts that must be satisfied in order for a property owner to obtain original
transferor using a trust:

(A) Joint Tenancy. The real property must be held in
joint tenancy at the time of the transfers to a revocable trust.

(B) Recorded Instrument. The instrument
transferring a joint tenant’s interest into the trust must be recorded on or after November 13,
2003. The SBOE refers to a deed in its explanation of this part, but the SBOE later notes that
“the term ‘recorded’ for purposes of this rule means recordation of the trust or deed to the trust.”
(C) Name All Other Joint Tenants. The trust must name all other joint tenants as the present beneficiaries.

1) Present Beneficiary. The SBOE states that for purposes of Rule 462.040, a present beneficiary is a person who receives the property held in a revocable trust when the trustor dies.

(2) Additional SBOE Comments. The following are additional excerpts of SBOE’s Letter to County Assessors No. 2004/042 concerning the new Rule:

(A) Trust Must be Revocable. The word “trust” in the new Rule is intended by the SBOE to mean a revocable trust. A transfer to an irrevocable trust will be deemed to sever the joint tenancy.

(B) Change in Beneficiary Severs Joint Tenancy if Recorded. Where original transferor status has been obtained under the new rule, a change in the trust beneficiary to a third party will sever the joint tenancy if the trust amendment is recorded. Upon the severance of a joint tenancy, the parties will hold as tenants in common, which may trigger a change in ownership. The joint tenancy is not severed if the trust amendment changing the beneficiary is not recorded because without recordation the joint tenants’ survivorship rights would not be severed.

(C) One Person Transfer. The new Rule does not require that all joint tenants transfer their property interests into trust.

1) Example. A owns Property. A deeds Property to A and B. There is no change in ownership and A becomes an “original transferor.” B does not acquire “original transferor” status. With the new Rule, B can become an original transferor if B transfers her interest to a revocable trust naming A as the present beneficiary. A is not required to transfer his interest to a revocable trust for benefit of B in order for B to take advantage of the new Rule.

(D) Life Estate or Income Interest in Trust Sufficient. In order to satisfy the requirements of the new Rule, the revocable trust agreement is not required to provide for an outright transfer of the settlor’s interest in the property to the other joint tenants on the settlor’s death. Instead, the revocable trust agreement may provide for the other joint tenants with life estates or comparable income interests in the trust, with remainders to other beneficiaries. However, if there is more than one joint tenant, their interests under the revocable trust agreement must be fixed and equal. A transfer to a sprinkling trust for the benefit of the other joint tenants will be treated as a severance of the joint tenancy, which may result in a change of ownership.
1) **Planning Opportunity for Unmarried Couples.** The use of a life estate or income interest in a trust provides unmarried couples with the ability to leave property to the surviving partner on the death of the first partner, and to have the property transferred to the children of each partner on the death of the second partner to die.

2) **Examples**

   a) A and B acquire Property as joint tenants. Neither A nor B is an original transferor. A deeds his interest in Property to a revocable trust providing that on A’s death B will be the beneficiary for life, with remainder to A’s children. B deeds her interest in Property to a revocable trust providing that on B’s death A will be the beneficiary for life, with remainder to B’s children. No change in ownership. A and B become original transferors.

   A dies. There is no change in ownership because an interest in the property continues to be held by an original transferor.

   B dies. A’s children receive A’s 50% interest in Property under the terms of A’s revocable trust and B’s children receive B’s 50% interest in Property under the terms of B’s revocable trust. No change in ownership if the requirements of the parent-child exclusion are satisfied.

   Note that the example above is based on examples set forth in the SBOE’s Letter to County Assessors No. 2004/42, but the conclusions we have drawn are not discussed in the SBOE examples. However, SBOE counsel Lou Ambrose has indicated verbally that the conclusions are consistent with the SBOE’s interpretation of the new Rule.

   b) A owns Property. A deeds Property to A, B, and C. B transfers her interest to a revocable trust, which provides that on B’s death her interest in the property will be administered in a sprinkling trust for A and C for their lives, with remainder to B’s children. Because the distributions to A and C under the trust may be unequal, the joint tenancy is severed, resulting in a 1/3 change in ownership.

   (E) **Proof of Agreement.** Because the trust is not recorded the taxpayer will have the burden of proving to an assessor that she became an original transferor by executing an appropriate revocable trust.

   (c) **New Rule Based on Conclusion that Transfer to Appropriate Revocable Trust Not Treated as a Severance of a Joint Tenancy.** The new rule appears to be based on the conclusion that a transfer of a joint tenant’s interest to a revocable trust leaving that interest to the other joint tenant(s) on the transferring joint tenant’s death, does not sever the joint tenancy. Under Civil Code section 683.2, a joint tenancy is severed if a joint tenant transfers his interest to a third person. The SBOE assumes that such a revocable trust is not a third person.
SBOE counsel acknowledges that it has no statutory or case authority for its position. The SBOE came to its conclusion based on a "common sense" approach that relied on some estate planning attorneys who advised the SBOE that a transfer to a revocable trust would not terminate a joint tenancy. Although the definition of a joint tenancy under Civil Code section 683 does include joint interests in title created "when granted or devised to executors or trustees as joint tenants," it is unclear whether a court would treat a transfer to a revocable trust as a transfer to a third person.

(d) Alternative Method of Becoming Original Transferors. Instead of relying on the new transfer by trust Rule, it is possible for joint tenants to become original transferors by deeding the property to themselves as tenants in common and then re-deeding the property to themselves as joint tenants. [This option is suggested on SBOE Board Member Carole Migden's web site; SBOE counsel confirmed that this method generally is acceptable, but cautioned that the step transaction doctrine will apply if the parties do not intend to hold the property as joint tenants and create the joint tenancy merely to avoid a change in ownership.]

3.3.6 Recommended Methods to Obtain "Original Transferor" Status.
Under the new rule, parties may obtain the benefits of "original transferor" status (and hold property as joint tenants) by taking the following steps.

(a) Acquiring Property. Parties acquiring a property should take title as tenants in common and then deed the property to themselves as joint tenants.

(h) Property Currently Held in Joint Tenancy. If property is currently held by the parties as joint tenants (and neither is an original transferor), the parties should deed the property to themselves as tenants in common and then deed the property back to themselves as joint tenants.

(1) Alternatively, each party could deed his or her interest in the property to a revocable trust for the benefit of the other party or parties.

(c) Only One Current Property Owner. If the property is currently held by A only, A should deed the property to A and B as joint tenants, and then B should deed her interest in the property to a revocable trust naming A as the present beneficiary.

(1) Note that for gift tax purposes the transfer from A to A and B would be treated as a gift of a one-half interest in the property.

3.4 "Original Transferors" Do Not Include Legal Entities. The recent amendment to the joint tenancy rules also states that the purpose of the "original transferor" rules was to protect family interests and therefore "original transferors" do not include legal entities. [Rule 462.040(e).]
3.5 Benefit of Rule for Estate Planning Only; Step-Transaction. SBOE states that an assessor may apply the step-transaction doctrine to a transaction using the original transferor exclusion rules (the step-transaction doctrine is discussed in article 8) if the transfer was made only to avoid a change in ownership and not for any estate planning purposes. [Rule 462.040 Example 9; Letter to County Assessors No. 2004/042 dated July 6, 2004.]

4. LEASES - Rule 462.100

4.1 Change in Ownership - 35 Years or More. The following transfers of interests in real property constitute a change in ownership of that property under Rule 462.100(a):

4.1.1 The creation of a leasehold interest in real property for a term of 35 years or more.

(a) Lessee Treated as Owner. If a lessee holds a leasehold interest of 35 years or more, the lessee is considered the owner of the property for property tax purposes. [SBOE letter to taxpayer dated June 22, 1982, Property Taxes Law Guide Annotation No. 220.0330.]

4.1.2 The transfer, sublease, or assignment of a leasehold interest in real property with a remaining term of 35 years or more.

4.1.3 The termination of a leasehold interest which had an original term of 35 years or more.

(a) Comment. A lease that is restated by the parties may constitute a termination of the pre-existing lease and trigger a change in ownership if the terms of the original lease are materially and fundamentally changed. [SBOE letter to taxpayer dated September 26, 1990, Property Taxes Law Guide Annotation No. 220.0327.] In the September 26, 1990 letter, the SBOE states that the question of whether a lease is effectively terminated is determined by the facts of each case. The letter cites changes to the premises description, percentage rent, a performance option, and renewal terms as specific material provisions that changed in the taxpayer’s lease; however, the SBOE letter did not offer an opinion concerning whether the particular facts actually constituted a termination of the lease.

4.1.4 The transfer of a lessor’s interest in real property subject to a lease with a remaining term of less than 35 years.

4.1.5 The transfer of a lessor’s interest in real property subject to multiple leases, one or more of which is for a remaining term of less than 35 years and one or more of which is for a remaining term of 35 years or more, in which case there is a change in ownership of the portion of the property subject to the lease(s) with a remaining term of less than 35 years.
4.2 No Change in Ownership. The following transfers of interests in real property do not constitute a change in ownership of such real property under Rule 462.100(b):

4.2.1 The creation of a leasehold interest in real property for a term of less than 35 years.

4.2.2 The transfer, sublease, or assignment of a leasehold interest in real property with a remaining term of less than 35 years (regardless of the original term of the lease).

4.2.3 The termination of a leasehold interest which had an original term of less than 35 years.

4.2.4 The transfer of a lessor’s interest in real property subject to a lease with a remaining term of 35 years or more, whether to the lessee or another party.

4.3 Options Counted. The calculation of the term of a lease includes written renewal options. [Rule 462.100(d).]

4.3.1 Right of First Refusal Not an Option. A right of first refusal to extend a lease is not considered a renewal option. [SBOE letter dated January 5, 1987, Property Tax Law Guide Annotation No. 220.0342.]

4.4 Reappraisal of Entire Property. Once a change in ownership of real property subject to a lease is deemed to have occurred, the entire property subject to the lease is reappraised (i.e., both the lessee’s interest and the reversion). [Rule 462.100(c).]

5. TRUSTS - §§ 61(h) and 62(d); Rule 462.160

5.1 Revocable Trust General Rule. The transfer of real property to a revocable trust is not a change in ownership because no present interest is transferred. When a revocable trust becomes irrevocable a change in ownership occurs unless an exclusion applies. [Rule 462.160(b)(2).]

5.2 Irrevocable Trust General Rule. The transfer of real property to or from an irrevocable trust is a change in ownership unless an exclusion applies. [Rule 462.160(a) and (c).]

5.3 Change in Beneficial Ownership. Any change in the beneficial ownership of property held in an irrevocable trust is a change in ownership unless an exclusion applies. [Rule 462.160(d)(1).]

5.4 Determination Based on Beneficial Ownership. Analysis regarding whether a transfer to or from an irrevocable trust is a change in ownership is based on the “beneficial
ownership" of the beneficiaries rather than the "legal ownership" of the trustee. [See SBOE letter to taxpayer dated February 29, 1988, Property Taxes Law Guide Annotation No. 220.0790.] However, see paragraph 6.2.2(b)(2)(B) below where a trustee is deemed to have control of corporate stock held by a trust for purposes of section 64(c).

5.4.1 Only Current Beneficiaries Considered. In determining who has a beneficial interest in trust real property, only current beneficiaries are considered. [SBOE Change in Ownership Workbook, p. 24-26.]

5.5 Settlor of Trust Remains Transferor. When the interest of one trust beneficiary terminates and the trust property is distributed to (or retained in trust for) another beneficiary, the person who originally transferred the property into trust continues to be the transferor. [See SBOE letter to taxpayer dated August 5, 1991, Property Taxes Law Guide Annotation No. 220.0777.]

5.5.1 Example. Settlor transfers property in trust for benefit of his Daughter for life, remainder to Daughter’s children. Upon death of Daughter, there is a transfer from Settlor to Daughter’s children (rather than a transfer from Daughter to her children). Unless the requirements of the grandparent-grandchild exclusion (which are described in paragraph 7.5.4 of this outline) are satisfied, there will be a 100% reassessment on Daughter’s death.

5.6 Powers of Appointment

5.6.1 General Power of Appointment Constitutes Beneficial Ownership. A grant of a general power of appointment is treated as being equivalent to a grant of absolute ownership. [See Estate of Thorndike (1979) 90 Cal.App.3d 468, 473.] Upon the death of a trust beneficiary holding a testamentary general power of appointment, the beneficiary is treated as the transferor for purposes of determining whether there is a change in ownership. [SBOE letter to taxpayer dated December 26, 1990, Property Taxes Law Guide Annotation No. 220.0771.]

(a) Example. Settlor transfers property in trust for benefit of his Daughter for life and provides Daughter with a testamentary general power of appointment. Under Daughter’s Will, Daughter transfers all of her interest in trust property to her husband and children in equal shares. Because Daughter holds a testamentary general power of appointment, at Daughter’s death there is a transfer from Daughter to her husband and her children (rather than a transfer from Settlor), and the transfers may qualify for the interspousal and parent/child exclusion. [SBOE letter to taxpayer dated December 26, 1990, Property Taxes Law Guide Annotation No. 220.0771.]

5.6.2 Limited Power of Appointment Does Not Constitute Ownership. A grant of a limited power of appointment is not treated as being equivalent to a grant of absolute ownership. When a trust beneficiary exercises a limited power of appointment, the trustor remains the transferor for purposes of determining whether there is a change in ownership.
5.7 Exclusions

5.7.1 Beneficiary Excluded. Property transferred to an irrevocable trust will not constitute a change in ownership if the beneficiary who is treated as receiving the transferred interest qualifies for an exclusion. [Rule 462.160(b).] Similarly, property transferred from an irrevocable trust will not constitute a change in ownership if the recipient qualifies for an exclusion. [Rule 462.160(d).] The following is a brief summary of the rules concerning qualifying and non-qualifying beneficiaries:

(a) Potentially Qualifying Beneficiaries. Beneficiaries who potentially qualify for an exclusion include (a) transferor [Rule 462.160(b)(1)(A)], (b) transferor’s spouse [Rule 462.160(b)(3) and (d)(4)], (c) transferor’s domestic partner [Rule 462.240(k)], and (d) transferor’s parent, child, or grandchild [Rule 462.160(b)(4) and (d)(5)].

(b) All Beneficiaries Qualify. If property is transferred to a trust in which all the beneficiaries qualify for an exclusion, then there is no reassessment.

(1) Example. Upon Father’s death, Property is transferred to a trust for the benefit of Wife and Child 1/2 each. There is no change in ownership if the interest passing to Child qualifies for the parent-child exclusion discussed in paragraph 7.5 below.

(c) Non-Qualifying Beneficiary. If the trustee has no discretion as to who receives the beneficial interest, and there are beneficiaries who do not qualify for an exclusion, only the portion held for non-qualifying beneficiaries is reassessed. [Rule 462.160(b)(1)(A) Example 3.]

(1) Example. Upon Husband’s death, Property is transferred to a trust for the benefit of Wife, Child, and Niece 1/3 each. The 1/3 interest in Property passing to Niece does not qualify for any exclusion and is reassessed.

(d) “Sprinkle Power.” If the trustee has discretion as to who receives the beneficial interest (i.e., a “sprinkle power”), and the beneficiaries include non-qualifying beneficiaries, then 100% of the property is reassessed. [Rule 462.160(b)(1)(A) Example 2.]

(1) Example. Upon Husband’s death, Property is transferred to a trust for the benefit of Wife, Child, and Child’s descendants. Trustee has discretion over distributions of trust income and principal. If Child is living and has descendants, then 100% of Property is reassessed because trustee could pass all of the beneficial interest to Child’s descendants, who do not qualify for any exclusion.
(2) Disclaimer. However, if property is transferred to a sprinkling trust that includes both qualifying and non-qualifying beneficiaries, a change in ownership can be avoided if the non-qualifying beneficiaries disclaim their interests. [See SBOE letter to taxpayer dated December 14, 1993, Property Taxes Law Guide Annotation No. 220.0774.]

(3) Claiming Parent-Child Exclusion. If the trustee has a sprinkle power to distribute among a spouse and children, there will be no change in ownership to the extent the interest passing to the children qualifies for the parent-child exclusion and the Claim for Reassessment Exclusion form is timely filed (see Paragraph 7.5 for timing requirements). [Rule 462.160(b)(1)(A) Example 2.] According to counsel for the SBOE, the children must assume for purposes of filing the claim form that they are receiving 100% of the property.

(A) Example. Upon Husband’s death, Property (other than H’s principal residence) with an assessed value of $1 million is transferred to Trust for benefit of Wife and Child, and trustee has a sprinkle power. Child must claim the $1 million exclusion to avoid a change in ownership. If the assessed value were $10 million, then there would be a reassessment of the 90% interest in Property that does not qualify for an exclusion. As noted above, this situation may be avoided if Child disclaimed her interests.

5.7.2 Proportional Interest Exclusion. If the transfer is to or from a trust, and the beneficial owners of the property remain the same before and after the transfer, there is no change in ownership. [Rule 462.160(b)(5).]

(a) Example. Property is held in Trust with A and B as equal beneficiaries. Trust terminates and Property transferred to A and B as tenants in common with each holding a 50% interest in Property. There is no change in ownership.

5.7.3 Reversionary Interest Exclusion. If the transferor or transferor’s spouse retains reversionary interest and the beneficial interest does not exceed twelve years, there is no change in ownership. [§ 62(d); Rule 462.160(b)(1)(B).]

5.7.4 Transfer Between Trusts Exclusion. A transfer from one trust to another trust is excluded if the transfer qualifies based on one of the other exclusions. [Rule 462.160(b)(6).]

5.7.5 Transfer From Trust to Present Beneficiary. When a trust transfers trust property to the beneficiary who was the current beneficial owner of the property prior to the transfer, there is no change in ownership. [Rule 462.160(d)(1).]
5.8 Deemed Transfers Among Beneficiaries Under Will or Trust

5.8.1 Specifically Devised Property. If property is specifically devised under a will or trust to one or more beneficiaries and is distributed from the estate or trust in a different manner (i.e., in different proportions or to different beneficiaries), there is a deemed transfer of any interest in the property that was distributed to a different recipient than was specified under the will or trust.

(a) Example: Property (which is Parent's principal residence) is specifically devised to Son and Daughter equally. On distribution of Parent's estate, Son receives Property and Daughter receives other assets of equal value. Daughter is treated as having transferred a 1/2 interest in Property to Son. Because no exclusion applies to the deemed transfer, 1/2 of Property is reassessed.

5.8.2 Property Not Specifically Devised. Property that is not specifically devised under a will or trust may be allocated among beneficiaries without a deemed transfer occurring unless a beneficiary receives property with a value in excess of his or her share of the estate or trust. [See SBOE letters to taxpayer dated August 6, 1990 and September 10, 1996 as amended, Property Taxes Law Guide Annotation No. 220.0767.]

(a) Examples

(1) Parent's will leaves her estate equally between Son and Daughter. Parent's estate consists of Property worth $500,000 and securities worth $500,000. If Son receives Property and Daughter receives the securities on distribution of Parent's estate, there will be no deemed transfer from Daughter to Son and the parent-child exclusion may be claimed for 100% of Property.

(2) Same as in prior example except the securities are worth only $400,000. There will be a deemed transfer from Daughter to Son of a 1/10 interest in Property, resulting in reassessment of a 1/10 interest in Property.

(b) How to Handle Real Property that Exceeds Value of Other Property. Where the value of the real property being distributed exceeds the beneficiary's share of the estate or trust as in the example above, the fiduciary making the distribution may avoid reassessment by placing debt on the property to adjust the value of the assets distributed to the various beneficiaries.

(1) Example. Parent's will leaves her estate equally between Son and Daughter. Parent's estate consists of Property worth $500,000 and securities worth $400,000. Before distribution the personal representative borrows $50,000, secured by a deed of trust against property. On distribution, Son receives Property subject to the deed of trust and Daughter receives securities worth $400,000 and cash of $50,000 for an equal division. Because
each beneficiary has received his or her pro-rata share of the estate there is no change in ownership. [Handout and lecture of Kristine Cazadd, Assistant Chief Counsel SBOE, March 3, 2004.] According to SBOE counsel Kristine Cazadd, an alternative method in this situation is to have the Son execute a promissory note in favor of the estate prior to the Property distribution, and then have the estate transfer the note along with the securities to the Daughter.

6. LEGAL ENTITIES - §64; Rule 462.180

6.1 Transfer of Real Property to or from Entity

6.1.1 General Rule. Transfer of real property to or from an entity is a change in ownership of the property transferred, unless an exclusion applies. [Rule 462.180.]

6.1.2 Exclusions

(a) Transfer between affiliated corporations. See Rule 462.180(b)(1).

(b) Proportional Interest Exclusion - Into and Out of Entities. If there is only a change in the method of holding title and the proportional interests of the beneficial owners remain exactly the same, there is no change in ownership. [§62(a)(2); Rule 462.180(b)(2).] This rule applies to transfers into and out of entities.

(1) Examples

(A) Transfer into Entity. A and B own Property equally as tenants in common. Each transfers his interest in Property to LLC in exchange for a 50% membership interest. There is no change in ownership.

(B) Transferring Two Properties Out of Entity. Corporation owns Blackacre and Whiteacre. A and B each own a 50% of stock in Corporation. If Corporation transfers Blackacre to A and Whiteacre to B, then 100% of both properties are reassessed. However, if Corporation transfers half of each property to both A and B, then there is no change in ownership for either property. [Rule 462.180 Example 4.]

(C) Classes. A owns Property. A transfers property to Corporation owned by B. If Corporation creates special class of shares that is deemed to own Property, and A receives 100% of the special class of shares, then there is no change in ownership. [Handout and lecture of Kristine Cazadd, Assistant Chief Counsel SBOE, March 3, 2004.]
6.1.3 Single Member LLC Treated as Separate Legal Entity. SBOE takes the position that a single member LLC must be treated as a separate legal entity for property tax purposes, with transfers of property and membership interests subject to the entity rules. [SBOE internal memorandum dated February 15, 2000, Property Taxes Law Guide Annotation No. 220.0375.015.]

6.2 Transfers of Ownership Interests in Legal Entities

6.2.1 General Rule - Section 64(a). Transfers of ownership interests in entities holding real property generally are not treated as changes in ownership, unless an exception applies.

6.2.2 Exceptions that Trigger Change in Ownership

(a) Transfers by Original Coowners - Section 64(d): If original coowners transfer, cumulatively, more than 50% of the ownership interests in an entity, then 100% of the property is reassessed. An owner is deemed an “original coowner” if the beneficial interest held by the owner was excluded from a change in ownership when the owner’s interest was transferred into an entity because of the proportional interest transfer exclusion of section 62(a)(2).

(1) Example. A owns Property. A transfers Property to single member LLC. There is no change in ownership under the proportional interest exclusion, but A becomes an original coowner. A transfers 50% membership interest to B. There is no change in ownership because there has not been a transfer of more than 50% of the original coowner’s interests. A then transfers 1% interest to C. There is a 100% reassessment.

(2) Must Consider Underlying Owners of Trusts and Entities. When a trust or legal entity is an original coowner, analysis of any transfer requires an examination of the underlying owners of the trust or entity.

(A) Trust. When a trust is an original coowner, the present beneficiary of the trust is treated as the owner for purposes of section 64(d). If the present beneficiary of the trust changes, the interest passing to the new beneficiary is considered a transfer by an original coowner. [Letter to County Counsel of San Luis Obispo County dated August 10, 2000, Property Tax Law Guide Annotation No. 220.0793.]

(i) Example. Property is held by Partnership. Partnership is owned equally by A and Trust, and both are original coowners. Parent is the sole beneficiary of Trust during Parent’s life, and upon Parent’s death the interest transfers to Parent’s children. When Parent dies, there is a transfer of 50% of the Partnership interests for purposes of 64(d).
(B) Entity. According to SBOE counsel the SBOE takes the position that when an entity is an original coowner, the interests held by that entity are attributed to the owners of that entity and any ownership changes within the entity are treated as a transfer by an original coowner.

(i) Example. Property is held by Corporation. Corporation is owned equally by A and LLC, and both are original coowners. LLC is owned by B. If B transfers 48% of his interest in LLC to C, there is a transfer of a 24% interest in the Corporation for purposes of section 64(d).

(3) Certain Transfers Not Counted. The following transfers are not counted for purposes of calculating the percentage of interest transferred: interspousal transfers, transfers to revocable trusts or trusts where the trustor is the present beneficiary, proportional interest transfers, and transfers that have already been counted. [Rule 462.180(d)(2).]

(4) Examples

(A) A, B, C, and D own Property as equal tenants in common. They transfer Property to LLC, with each receiving a 25% membership interest in LLC. There is no change in ownership under the proportional interest exclusion.

A then transfers her 25% membership interest to her daughter E, and B transfers her 25% membership interest to her husband F. For purposes of section 64(d), only 25% has been transferred. B’s transfer is excluded under the interspousal exclusion. A’s transfer is not excluded because the parent-child exclusion applies only to transfers of real property, not entity interests.

C then transfers her 25% membership interest to Corporation X of which C is the sole shareholder, D transfers her 25% membership interest to her brother G, E transfers her 25% membership interest to H, and F transfers his 25% membership interest to his revocable trust. Only D’s transfer counts. E’s transfer does not count because E was not an “original transferor” and the membership interest held by E has already been counted. F’s transfer does not count because it was made to a revocable trust. At this point, only 50% of the membership interests in LLC have been transferred so there is not yet a change in ownership.

Corporation X then transfers a 1% membership interest to Z. The cumulative transfers of the original coowners total 51%, and 100% of Property will be reassessed.

(B) H transfers Property to LLC, of which H is sole member. There is no change in ownership under the proportional transfer exclusion, and H becomes an original coowner for purposes of §64(d).
H then transfers the membership interests in LLC to an irrevocable trust (which is not a sprinkling trust). The current beneficiaries of Trust are H’s spouse and children in equal shares. If no children are living at the time of the transfer, there is no change in ownership because the interspousal exclusion would apply.

If a child is born, the child is considered the beneficial owner of 50% of the membership interests. There is no change in ownership. However, there has been a change 50% of the membership interests because the child may not use the parent-child exclusion with the transfer of entity interests. If later a second child is born, the children would be deemed to hold 2/3 of the beneficial interests in LLC. Under §64(d), Property is reassessed because more than 50% of the interests in LLC have been transferred.

(C) Same as previous example, except the irrevocable trust is a sprinkling trust for the benefit of H’s spouse and children. There would be a 100% reassessment on the birth of the first child under Rule 462.160(b)(1)(A) because the trustee has discretion to distribute 100% of membership interests to child (who does not qualify for an exclusion).

(b) Change in Control - Section 64(c). If an individual or entity acquires control of an entity, then 100% of any real property owned by that entity is reassessed.

(1) Control. Control is defined as (a) direct or indirect ownership or control of more than 50% of the stock in a corporation, and (b) direct or indirect ownership of more than 50% of capital and profits interests in a partnership or LLC. [Rule 462.180(d)(1).]

(A) Example. LLC owns Property. A and B each own 50% interest in LLC. A transfers 5% interest to B. A now holds 45% and B holds 55% of the membership interests. Property is reassessed because there has been a change in control. [Section 64(c).]

(2) Ownership Interests Held in Trust

(A) Interests Attributed to Beneficiary. When a trust holds an ownership interest, the present beneficiary of the trust is treated as an owner for purposes of determining change in control under section 64(c). [See Letter to County Counsel of San Luis Obispo County dated August 10, 2000, Property Tax Law Guide Annotation No. 220.0793.]

(B) Interests Attributed to Trustee

(i) Corporation. If a trustee has the power to vote stock in a corporation that is held by a trust, the trustee (in addition to the beneficiary) is
deemed to have “control” of that stock for purposes of determining whether there is a change in control under section 64(c). [See Property Tax Annotation 220.0105 concerning SBOE letter to taxpayer dated April 11, 1983 and SBOE letter to taxpayer dated December 11, 1991, Property Taxes Law Guide Annotation No. 220.0769.]

(ii) **Partnership.** The rule is different for partnerships. When evaluating a partnership only the parties’ ownership interests (and not voting “control”) are considered for purposes of section 64(c); the trustee’s control over partnership interests is irrelevant. The present beneficiaries of a trust, and not the trustee, are treated as the owners of the trusts’ partnership interests. [See SBOE letter to taxpayer dated December 11, 1991, Property Taxes Law Guide Annotation No. 220.0769.]

(3) **Entity: Attribution Rules for Tiered Entities.** According to counsel for SBOE, the SBOE takes the position that where an entity (a second tier entity) holds an ownership interest in another entity, a party who owns more than 50% of the second tier entity is deemed to have control of that second tier entity, and all the ownership interests held by the second tier entity are attributed to the controlling party.

(A) **Example.** Property held by Partnership, which is owned equally by A, B, and LLC. LLC is owned by B 51% and A 49%. B is considered to be in control of the 1/3 interest in Property held by LLC, and therefore controls 2/3 of Partnership.

(4) **Acquiring Minority Interest.** Under Section 64(c)(1), a change in ownership occurs when the acquiring party “obtains” control. If the acquiring party held more than 50% ownership interests prior to acquiring all or part of the remaining interest in an entity, then there is no change in ownership. [see SBOE letter to taxpayer dated May 18, 1989, Property Taxes Law Guide Annotation No. 220.0525; see also SBOE Change in Ownership Workbook, example at pages 36-37.]

(5) **Examples**

(A) Corporation owns Property. The stock in corporation is owned by A 52%, B 24%, and C 24%. B transfers his 24% interest to A. There is no change in ownership because A already had control. [Section 64(a) and 64(c)(2); SBOE Change in Ownership Workbook, p. 36-37; confirmed in conversations with SBOE counsel.]

(B) Property is owned by Partnership. A and LLC each own 50% of Partnership. C and D each own 50% of LLC. C transfers a 9% LLC interest to A. There is no change in ownership because A does not gain control of Partnership. If instead C and D each transfer a 26% LLC interest to A, then there would be a change in ownership of Property, because A is deemed to have control of both LLC and Partnership. [See SBOE letter to taxpayer dated January 22, 1999, Property Taxes Law Guide Annotation No. 220.0501.]
Property held by Partnership, which is owned equally by A, B, and LLC. LLC is owned by B 51% and A 49%. If B transfers 2% of her interest in LLC to A, A would gain control of LLC, and therefore would be deemed to control 2/3 of Partnership, which would trigger a full reassessment.

6.2.3 No Parent-Child Exclusion for Transfer of Entity Interests. The parent-child exclusion applies only to transfers of real property, not to transfers of interests in entities. [Section 63.1(c)(8).]

(a) Example. Parent transfers a 100% interest in Property to LLC and then immediately transfers a 51% membership interest in LLC interest to Child. There is a 100% reassessment even though transaction would have been exempt if Parent had first transferred 51% tenant in common interest in Property to Child, and then Child and Parent each transfer their respective interests in Property to LLC.

6.2.4 Statutory Merger and Conversion. A statutory merger or conversion does not constitute a transfer resulting in a change in ownership as long as the proportional interests of the entity owners remain the same. Any persons who were original coowners in the converting or merging entity remain original coowners, but new original coowners are not created. [Rule 462.180(d)(4).] This rule is significant in situations where there are no original coowners before the transfer because a transfer of real property by deed (instead of by conversion) from one entity to another would result in each of the owners being treated as an original coowner after the transfer.

(a) Example. A and B are equal partners in General Partnership. A and B convert General Partnership into an LLC, with each holding a 50% membership interest in LLC. There is no change in ownership. If General Partnership had original coowners, LLC will have the same original coowners. If General Partnership did not have original coowners, LLC will not have original coowners.

6.3 Lessons

6.3.1 Acquire Property in Entity. Persons acquiring real property should consider acquiring property in an entity in order to avoid reassessment on future transfers of entity interests. Under section 64(d), property owners become “original coowners” if the owners transfer their property interest into an entity in exchange for proportional ownership interests, thus avoiding reassessment under the proportional interest exclusion of section 62(a)(2). However, if the property is acquired in an entity, the entity owners do not have the taint of “original coowner” status and there is no limit on the percentage of ownership interests that may be transferred, provided that no owner acquires “control” as defined under section 64(c).
6.3.2 Acquire Entity Interests rather than Property. If the property is already in an entity and there are no original coowners, a change in ownership may be avoided if the buyers acquire the interests in the entity rather than the property if no one person or entity acquires control.

6.3.3 Examples

(a) New Owners, but Nobody Gains Control. LLC owns Property. A (who is not an original coowner) owns 100% of LLC. A transfers his 100% membership interest equally to his children B, C, and D. There is no change in ownership under section 64(d) because A is not an original coowner, and there is no change in ownership under section 64(c) because no person has gained control of the LLC. As long as no person acquires more than 50% of the membership interests, there will never be a change in ownership, regardless of how many entity interest transfers occur. [Section 64(a).]

(b) Community Property Acquisition of 100% Membership Interests Does Not Trigger Reassessment Under §64(c). LLC owns Property. H and W acquire 100% of membership interests of LLC as community property from current owners, who are not original coowners. H and W are each treated as acquiring 50% of the membership interests, and there is no change in ownership. [Example 7 of new Rule 462.180, effective October 15, 2003.]

6.4 Legal Title: Substance over Form. If the relationship of the parties is treated as a partnership under state law, then the entity Rules apply for purposes of determining whether there has been a change in ownership. Note that it may be difficult to determine whether a partnership was formed. [Rule 462.180(c).]

6.4.1 Example. If title to Property is held by A and B as tenants in common, but A and B file partnership income tax returns and otherwise act as partners, then the change in ownership rules for entities should apply.

7. EXCLUSIONS

7.1 Proportional Interest Transfers - §62(a). Section 62(a) excludes a transfer in which there is a change in the method of holding title to the real property transferred without changing the proportional interests of the beneficial owners. The proportional interest exclusion applies both to transfers of real property and to transfers of entity interests. [See Rule 462.180(b)(2) and (d)(4).]
7.1.1 Examples

(a) A & B own Property equally as tenants in common. Each transfers her 50% interest in Property to LLC in exchange for a 50% membership interest. There is no change in ownership.

(b) Corporation owns Property. A and B each own 50% of the outstanding stock of Corporation. A transfers all of his stock to LLC, which is owned 100% by A. There is no change in ownership because A was merely changing his method of holding title.

7.2 De Minimis Transfers - §65.1; 462.020(b)(2) - tenancies in common; 462.040(b)(6) - joint tenancies. Transfers of real property representing less than 5% of the property and valued at less than $10,000 are excluded from a change in ownership. The de minimis transfer exclusion applies only to transfers of real property, and not to transfers of entity interests. Transfers within the same calendar year are aggregated.

7.3 Interspousal Transfers - §63, Rule 462.220

All interspousal transfers, including both transfers of real property and transfers of ownership interests in legal entities, are excluded from change in ownership. Spouses may make the following transfers (during lifetime or at death) without a change in ownership:

7.3.1 transfer of real property to spouse
7.3.2 transfer of entity interests to spouse
7.3.3 transfer to trustee of trust for benefit of spouse
7.3.4 transfer to former spouse in connection with legal separation
7.3.5 distribution of legal entity’s property to a spouse or former spouse in connection with legal separation

7.4 Domestic Partners - Rule 462.240(k)

7.4.1 New Rule

(a) Under SBOE’s new Rule that became effective November 13, 2003, property that passes to a registered domestic partner on the death of the other partner by intestate succession will be excluded from reassessment. The new Rule applies to transfers occurring on or after July 1, 2003.
(b) In its proposed form, the new Rule also excluded transfers made at death to a registered domestic partner by will or trust, but this language was removed when the Rule was finalized. Despite the removal, the SBOE has taken the position that the new rule will apply to transfers at death by will, trust, joint tenancy, etc., as well as by intestate succession. [SBOE Letter to County Assessors No. 2004/023 dated April 26, 2004.] The SBOE’s decision to allow transfers through a will or trust provides a significant opportunity for domestic partners to transfer real property without reassessment.

(c) An assessor could challenge the SBOE’s position in court, and if a court held that transfers made by will or trust do not qualify for the exclusion, the new Rule would be of very limited usefulness. Registered domestic partners who wish to take advantage of the new Rule would not be able to leave property to each other by will or trust, and would be forced to rely on the intestate succession provisions contained in California Probate Code section 6401. Under California Probate Code section 6401, a surviving domestic partner will not receive the entire estate of a deceased domestic partner if the deceased domestic partner leaves any surviving issue, parent, brother, sister, or issue of a deceased brother or sister. As a result, in most instances the new Rule would not permit a transfer of a deceased domestic partner’s entire interest in real property to a surviving domestic partner without a change in ownership.

7.4.2 Persons Eligible. The exclusion will cover only those domestic partners registered with the California Secretary of State. The state defines eligible partners as same-sex partners of any age who register with the Secretary of State, and registered heterosexual couples, in which at least one partner is over 62 and is entitled to old-age Social Security insurance benefits. [Family Code §297.]

7.4.3 Different than Interspousal Exclusion

(a) Not Applicable to Lifetime Transfers. Unlike the interspousal exclusion, the new Rule does not apply to lifetime transfers; it only applies to transfers on death.

(b) Not Applicable to Transfers of Entity Interests. Unlike the interspousal exclusion, the domestic partner exclusion applies only to the transfer of real property and not to the transfer of entity interests.

7.5 Parent-Child Transfers - §63.1

7.5.1 Rule. A parent may transfer to his or her children the following real property without a change in ownership [§63.1(a).]:

(a) a principal residence,

(b) up to $1 million of the full cash value of real property, other than the principal residence.
7.5.2 Defined terms

(a) “Principal Residence” is a dwelling for which a homeowner’s exemption or a disabled veterans residence exemption has been granted in the name of the eligible transferor. The definition includes only that portion of the land underlying the principal residence that consists of an area of reasonable size that is used as a site for the residence. [§63.1(b)(1).]

(b) “Transfer” may be from parent to child or from child to parent. [§63.1(c)(9).]

(c) “Children” includes stepchild and spouse of stepchild, adopted child, and son-in-law and daughter-in-law (until marriage terminates by divorce, or if the marriage terminates by death, until the in-law remarries). [§63.1(c)(3).]

(d) “Full Cash Value” is the assessed value of the property at the time of the transfer. [§63.1(c)(5).]

7.5.3 Not Entity Interests. The parent-child exclusion does not apply to transfers of entity interests. [§63.1(c)(8).]

(a) Example. LLC owns Property. H owns 100% of LLC. If H transfers his entire membership interest to Daughter, there would be 100% reassessment because Daughter has gained control of LLC. The parent-child exclusion does not apply.

7.5.4 Grandparent-Grandchild - §63.1(a)(3). A grandparent may transfer property to a grandchild on similar terms as a parent if all parents of the grandchild who qualify as children of the grandparent are deceased.

(a) Examples

(1) Grandparent has Son, Daughter-in-Law, and two Grandchildren. Son dies before Grandparent. On Grandparent’s death, Grandparent leaves Property to Grandchildren. If Daughter-in-Law is alive and has not remarried, there will be a 100% change in ownership on Grandparent’s death. The transfer to Grandchildren is not excluded because Daughter-in-Law is considered a child of Grandparent.

(2) Grandparent has Son, Daughter-in-Law, and two Grandchildren. Grandparent transfers property in trust for benefit of Son for life, remainder to Grandchildren. Upon Son’s death, there is a transfer from Grandparent to Grandchildren (rather than a transfer from Son to his children). If Daughter-in-Law survives Son and was married to him at the time of his death, there will be a 100% change in ownership on Son’s death. The
transfer to Grandchildren is not excluded because Daughter-in-Law is considered a child of Grandparent.

(b) Limitations. Some limitations apply to the grandparent-grandchild exclusion, including:

(1) the grandchild may not transfer to a grandparent;

(2) the grandchild may not receive a personal residence if the grandchild has received a residence from a parent; and

(3) the value of a personal residence passed to a child from parents is included when calculating the grandchild’s $1 million limit. [§63.1(a)(3)(B).]

7.5.5 Must File Form - §63.1(e). To qualify for the parent-child or grandparent-grandchild exclusion, the property owner generally must file a Claim for Reassessment Exclusion form within three years of date of transfer, or before a transfer to a third party, whichever is earlier. However, the claim form is considered to be timely if it is filed within six months of a notice of supplemental or escape tax.

7.5.6 Notes from SBOE April 22, 1998 letter to County Assessors

(a) Not limited. The parent-child exclusion is not limited to one principal residence and can apply to the transferor of any property that is the transferor’s principal residence at the time of the transfer.

(b) Transferee. The transferee does not need to make the transferred property his or her principal residence.

(c) Allocation. The parent-child exclusion applies to first $1 million of full cash value of property other than a principal residence. If more than $1 million of full cash value is transferred at the same time, then the transferees must agree on the allocation of the exclusion.

(d) Trusts. The transfers through the medium of a trust are eligible for the parent-child exclusion.

(e) Transfer from Grandparent to Parent to Child. A transfer from grandparent to parent immediately followed by a transfer from parent to child is excluded from a change in ownership provided that the transfer to the parent is unrestricted. Both transfers may take advantage of the parent-child exclusion.
(f) **Pre-deceased Parent.** Each parent is entitled to a $1 million parent-child exclusion. It is SBOE’s opinion that children may claim an exclusion from the first parent after the second parent dies if property interest of first parent to die is held in trust for the surviving parent for life, with remainder to children as in the following example.

(1) **Example:** Husband dies in 1985 leaving Property to an irrevocable trust in which wife is the sole income beneficiary for life and has the power to invade the principal for reasonable health, education, and support. Their children hold the remainder interests. Upon wife’s death in 1995, the children can claim a $1 million exclusion from husband. [See SBOE Letter to County Assessors, April 22, 1998.]

(2) **Comment.** SBOE counsel has confirmed that the SBOE opinion applies even in situation (as in example above) where first parent died prior to enactment of parent-child exclusion in 1986. Also, although the SBOE example concerns only transfers occurring at death, the same analysis should apply to comparable transfers made during lifetime.

8. **STEP-TRANSACTION DOCTRINE**

8.1 **Doctrine.** In considering whether a change of ownership has occurred assessors do not limit their evaluation to a single transaction or event. Under the step-transaction doctrine, an assessor will consider the substance of a multiple step-transaction, rather than the form of each individual transaction. Although each individual step in a series of transactions may avoid triggering a reassessment, an assessor may determine the tax consequences by viewing each step as part of a multiple step transaction. (See Examples under sections 3.5 and 8.3.)

8.1.1 **Tests.** In applying the step-transaction doctrine, the SBOE has instructed assessors to consider the three tests set forth in the cases *Shuwa Investments Corp. v. County of Los Angeles*, 1 Cal.App.4th 1635 (1991), and *McMillin-BCED/Miramar Ranch North v. County of San Diego*, 31 Cal.App.4th 545, mod. 32 Cal.App.4th 264a (1995). In its Letter to County Assessors No. 2004/042 dated July 6, 2004, the SBOE describes the three tests as follows:

(a) **End Result Test.** Separate steps may be condensed into a single transaction when it appears they were all part of an ultimate result intended from the outset. This test also appears to require all the parties to have been pursuing a related intent throughout the steps taken.

(b) **Interdependence Test.** An analysis of the relationship between the steps results in a reasonable interpretation that the steps are so interdependent that taking one step would be fruitless without the completion of the series of steps.

(c) **Binding Commitment Test.** A requirement that if one step is taken, there is a binding commitment to take the remaining steps. This test, like the end result
test, appears to require the parties to have been pursuing a related intent throughout the steps taken.

(d) **Other.** The court in *McMillin* also determined that time between the steps was a factor to consider for the step transaction doctrine, only one of the three tests needs to be met, and the step transaction doctrine may apply even though the steps may have legitimate business purposes.

8.2 **Step-Transaction Doctrine Applied to Joint Tenancies.** If unrelated property owners use the joint tenancy rules merely to avoid a change of ownership in the transfer of property, an assessor may collapse the steps.

8.2.1 **Example.** The following is taken from an example in the SBOE Letter to County Assessors No. 2004/42 dated July 6, 2004.

In 1987, A and B acquire Property as joint tenants.

In late 2003, A and B transfer Property to their respective revocable trusts with the other as the beneficiary. A and B become original transferors.

In January 2004, A and B transfer Property to A, B, C, and D as joint tenants. C and D are not related to A and B. No change in ownership because A and B are original transferors.

In February 2004, C and D transfer Property to their respective revocable trusts with A, B, C, and D as beneficiaries. C and D become original transferors.

In March 2004, A and B sell their interest to C and D. Technically, the Property would not be reassessed because C and D are original transferors. However, when the steps are collapsed it appears the transaction was designed to disguise a sale between unrelated parties in order to avoid a reassessment. Thus, there would be a 100% change in ownership.

8.3 **Step-Transaction Doctrine Applied to Legal Entities**

8.3.1 **Example.** Partnership owns the Ferry Building and the Transamerica Building. A and B each own 50% of Partnership. A and B would like to dissolve partnership and transfer 100% of the Ferry Building to A and 100% of the Transamerica Building to B, but they know this will trigger a reassessment because the A and B are not retaining a proportional 50% interest in each property. In an attempt to avoid reassessment, A and B make the following transfers:
Partnership transfers to each of A and B a 50% tenant in common interest in Ferry Building and Transamerica Building. The transfers are proportional with no change in beneficial ownership and there is no reassessment.

A transfers to B a 1% tenant in common interest in Transamerica Building and B transfers a 1% tenant in common interest in Ferry Building to A. The ownership interest in the Ferry Building is A 51% and B 49% and the ownership interest in the Transamerica Building is B 51% and A 49%. There is a reassessment of a 1% interest in each property.

A and B transfer their interest in Ferry Building to Ferry Partnership and their interest in Transamerica Building to Transamerica Partnership. The ownership interest in the Ferry Partnership is A 51% and B 49% and the ownership interest in the Transamerica Partnership is B 51% and A 49%. The transfers are proportional with no change in beneficial ownership and there is no reassessment.

A now transfers a 49% partnership interest in Transamerica Partnership to B and B transfers a 49% partnership interest in Ferry Partnership to A. Although A owns 100% of Ferry Partnership and B owns 100% of Transamerica Partnership, there does not appear to be a reassessment because there has been no change in control.

In applying the step-transaction doctrine, an assessor may collapse the series into one multi-step transaction, and when viewed as one transaction an assessor may decide to reassess the 50% beneficial ownership interest in each property that has been transferred.

8.4 Step Transaction Doctrine Does Not Apply to Parent-Child Transfers. The SBOE takes the position that the step transaction doctrine does not apply to parent-child transfers based on the following uncodified language of section 63.1. [See SBOE letter to County Assessors dated April 22, 1998, and diagrams of SBOE.]

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

8.5 Transfers In and Out of Entities for Benefit of Children. According to an SBOE letter to County Assessors dated April 22, 1998, diagrams prepared by SBOE, and our conversations with SBOE counsel, through proper planning a parent may transfer property far in excess of $1,000,000 of assessed value to children without triggering a reassessment.

8.5.1 Example. H and W, husband and wife, own Property (not their principal residence) with an assessed value of $10 million. Neither H nor W has made any prior transfers chargeable against the $1,000,000 exclusion.

H and W transfer Property to LLC with each receiving a 50% interest in LLC. There is no change in ownership under proportional interest exclusion. H and W become original coowners.

H and W each transfer a 24.5% membership interest to C, their child. There is no change in ownership because there is no change in control and there has not been a transfer of more than 50% of the membership interests by the original coowners.

H, W, and C dissolve LLC, and LLC transfers Property 25.5% to H, 25.5% to W, and 49% to C. There is no change in ownership under the proportional interest exclusion.

H and W each deed a 1% interest in Property to C so that C holds a 51% interest in Property, and H and W each hold a 24.5% interest in Property. Each 1% transfer qualifies for the parent-child exclusion and uses $100,000 of H or W’s $1 million exclusion amount.

H, W, and C deed Property to LLC-2, with C owning 51%, H 24.5%, and W 24.5%. There is no change in ownership under proportional interest exclusion.

Upon H and W’s death, all interests in LLC-2 transfer to C. There is no change in ownership because there is no change in control under section 64(c) and no transfer of more than 50% of the membership interests of original coowners under section 64(d).

8.5.2 Technique not Available for Transfers to Other Persons. The planning described above is possible because the step-transaction doctrine does not apply to parent-child transfers. If the above steps were taken by business partners, an assessor might apply the step-
transaction doctrine to collapse the steps of this transaction, and reassess the entire property based on the transfer in and out of entities, which when viewed as a single transaction would be considered a change in control under section 64(c) and a transfer of more than 50% interests of the original coowners under section 64(d).