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## Community property and spousal transfers

**A long-awaited BOE letter addresses this issue.**

By Cameron L. Hess, CPA, Esq.  
*Guest Contributor*

The 2014-year decision by the California Supreme Court in *In re Marriage of Valli*, 58 Cal.4th 1396 (*Valli*) changed how assessors must decide which spouse/partner owns

real property or a legal entity as to interests acquired during marriage (or a domestic partnership). The BOE has issued Letter No. 2018/014, which provides that the BOE will look to the nature of the ownership in real property rather than how the property is titled. This letter is important to understand in order to avoid an unexpected property tax reassessment where spouses transfer property into or out of a legal entity.

### **Background**

For property tax purposes, Property Tax Rule 63<sup>1</sup> provides owners an exclusion from reassessment for any transfers of property between spouses ("direct transfers") and any transfers between spouses of interests in legal entities, i.e., partnerships, LLCs and corporations, that hold real estate ("indirect transfers").

While the foregoing exclusion seems liberal, unfortunately the interspousal exclusion does not apply to transfers between individuals and legal entities. Accordingly, whether property acquired during marriage was separate or community property may trigger reassessment traps for unwary spouses where the percentage ownership in the legal entity is not the same as held by the spouses.<sup>2</sup> This meant that for transfers between entities and spouses, spouses were encouraged to do "double deeding" or legal entity corrections to clean up title so that the proportionate transfer applied.

### **Life before *Valli***

Before *Valli*, the BOE and assessors advocated that legal title held by just one spouse, even if acquired during their marriage, would not be treated as community property owned "50/50" with the other spouse absent contrary "clear and convincing evidence."<sup>3</sup> Assessors generally relied solely on title documents (such as a grant deed) to determine ownership for both real property held by spouses and legal entities, absent the spouses providing a written agreement or other recorded document clearly showing that the property or legal entity remained community property between the spouses/domestic partners.

### **Enter the *Valli* decision**

In 2014, the California Supreme Court ruled that life insurance titled with just one spouse as owner should be treated as community property because it had been acquired during marriage. The court specifically rejected that the documented title ownership would overcome the recognition of 50/50 community property ownership, which was presumed by law. The BOE notified assessors that the old method should no longer be followed.<sup>4</sup>

What was critical is that the court rejected prior law and found that even if one spouse "consents" to having only one spouse on title, there must be a writing, signed by the adversely affected spouse, that "expressly state[s] that the character or ownership of the property at issue is being changed." Absent that statement, the policy remained community property.

### **Expanded assessor requests**

While for estate planning purposes, we have been warning clients for years that simply changing title in property and legal entities does not in California convert community property into separate property, the *Valli* decision affirms this warning is of equal concern for property taxes.

Because they cannot rely on title documents or partnership, LLC, or corporate ownership documents to determine between spouses whether property is separate or community, or transfers to legal entities should be reassessed, assessors now must make intimate divorce court-like inquiries to determine if ownership is in fact 50/50 as community property to determine whether the interspousal exclusion applies.

Accordingly, there are likely to be more situations where the assessors will find for spouses and domestic partners that the proportionate transfer rule applies to avoid a reassessment. Examples of documents that may be requested include legal entity formation proof, marriage certificates and domestic partnership registrations, proof whether spouses/partners were California domiciled, and copies of any private written transmutation agreements between spouses.

### Property tax planning

There is a plethora of property tax planning connected to BOE Letter No. 2018/14.

#### No more double deeding?

First, while the trend will be for more intimate inquiries, the fact that title to property is held in one spouse alone will no longer be as conclusive with the Assessor as to whether property is separate or community property. If property is shown to be acquired during marriage, assessors generally must accept the community property presumption in reviewing transfers absent evidence of a transmutation agreement.

Second, while the proportionate transfer rule avoids reassessment between individuals and legal entities where the proportional ownership interests remain the same after the transfer, the issue remains whether one should undertake "double deeding."<sup>5</sup> For contributions to a legal entity, double deeding involves an initial "extra" deed to clean up property title to match the ownership in the legal entity title. Double deeding may still be a good idea, and while not necessarily required for spouses, if the community property presumption applies, it may clean up title to conform with intent. It may also be used for parent-child transfers that may qualify for exclusion, wherein only direct deeding to a child may qualify for an exclusion. Once completed, the second deed must match ownership in the legal entity so that interests remain proportionate.

#### Other concerns

While the BOE letter focused principally on transfers between individuals and legal entities, the *Valli* decision has extensive property tax planning implications. In California, property tax planning is a required element to undertaking any tax planning. The application to avoid reassessment or to apply reassessment exclusions requires careful review and analysis.

#### About the author

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<sup>1</sup> R&TC §63

<sup>2</sup> See Annotations 220.0274, 220.0278

<sup>3</sup> BOE Letter dated October 27, 2010; BOE Letter dated May 14, 1993; Property Tax Annot. 220.0044 and 220.0278

<sup>4</sup> Letter No. 2018/014

<sup>5</sup> Property Tax Rule 62(a)(2)

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