California Property Tax and Proposition 19

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Agenda

I. Overview of Proposition 13

II. Summary of Laws Under Propositions 58 & 193

III. Filing Deadlines for Transfers before February 16, 2021

IV. Comparison of Laws Now Under Proposition 19 to Prior Law

PARENT-CHILD & GRANDPARENT-GRANDCHILD EXCLUSION

	Proposition 58/193 (Former Law)	Proposition 19 (Current Law)
Principal Residence	→ Principal residence of transferor → No value limit → Residence and homesite (excess land may be excluded as "other property")	→ Principal residence of transferor and transferee → Value limit of current taxable value plus $1,000,000 (as biennially adjusted) → Family homes and farms
Other Real Property	→ Transferor lifetime limit of $1,000,000 of factored base year value	→ Eliminates exclusion for other real property other than the principal residence
Grandparent-Grandchild Middle Generation Limit	→ Parent(s) of grandchild, who qualifies as child(ren) of grandparent, must be deceased on date of transfer	→ No change: parent(s) of grandchild, who qualifies as child(ren) of grandparent, must be deceased on date of transfer
Filing Period	→ File claim within 3 years or before transfer to third party	→ File for homeowners' exemption within 1 year of transfer → File claim for exclusion within 3 years or before transfer to third party
Implementing Statute	→ Revenue & Taxation Code section 63.1 (implements Propositions 58/193)	→ Revenue and Taxation Code section 63.2 (implements Proposition 19)
Important Dates	→ Through February 15, 2021	→ Effective February 16, 2021

BASE YEAR VALUE TRANSFER – PERSONS AT LEAST AGE 55/DISABLED

	Propositions 60/90/110 (RTC Section 69.5)	Proposition 19 (RTC Section 69.6)
Type of Property	→ Principal residence	→ Principal residence
Timing	→ Purchase or newly construct residence within 2 years of sale	→ Purchase or newly construct residence within 2 years of sale
Location of Replacement Home	→ Same county → County with intercounty ordinance (10 counties)	→ Anywhere in California
Value Limit	→ Equal or lesser value → 100% if replacement purchased/newly constructed prior to sale → 105% if replacement purchased/newly constructed in first year after sale → 110% if replacement purchased/newly constructed in second year after sale	→ Any value → No adjustment to transferred base year value if the replacement property is of equal or lesser value than the original property's market value. "Equal or lesser value" means: → 100% if replacement purchased/newly constructed prior to sale → 105% if replacement purchased/newly constructed in first year after sale → 110% if replacement purchased/newly constructed in second year after sale → Amount above "equal or lesser value" is added to transferred value
How many transfers?	→ One time → Exception: After using once for age, second time for subsequent disability	→ Three times
Implementing Statute	→ Revenue & Taxation Code section 69.5 (implements Propositions 60/90/110)	→ Revenue and Taxation Code section 69.6 (implements Proposition 19)
Important Dates	→ Replaced by Proposition 19 (Revenue and Taxation Code section 69.6)	→ Effective April 1, 2021

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Proposition 13 and Property Taxation in California

- With the passage of Proposition 13 in June 1978, base year values were established for all properties in California. For people who owned property on March 1 1975, the base year was established as of that date. Subsequent base years were established whenever property changed ownership or there was new construction.
  - What does this mean for California taxpayers?
- As time went on and property values increased, base year values established in later years were substantially higher than earlier base year values. People who bought or built property understood that their taxes would be higher than the prior owner's taxes.
  - The two events that will cause property taxes to go up are (1) changes of ownership (whole property), and (2) new construction (only on new parts)

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Changes in Ownership Under Proposition 13

- Events that cause property taxes on an entire property to go up, or property to be "reassessed," are called "changes in ownership"
  - A transfer can be a sale or purchase, but it also can be a gift or inheritance. Transfers that constitute a change in ownership may occur by any means, including, but not limited to, transfers that are voluntary, involuntary, or occurs by operation of law; transfers by grant, gift, devise, inheritance, trust, contract of sale, addition or deletion of an owner, or property settlement. Payment or consideration for the property is not required.
- There are some types of transfers that are exempt from "change in ownership" treatment, these include but are not limited to:
  - Proportional transfers (ex: partition of a tenancy in common, transfer to proportionally owned legal entity) – this is very exact (Estate Planning Ex: transfer of 100% property interest to client's single member LLC for liability or future gifting purposes)
  - Interspousal transfers and transfers between domestic partners occurring on or after January 1, 2006 (Estate Planning Ex: an individual adding her spouse to title, funding a joint revocable trust, retitling property in connection with marital dissolution)
  - Transactions to correct bare legal title (ex: name change upon marriage)
  - Transfers that create a joint tenancy where the transferor remains as one of the joint tenants
  - Transfers of property to a revocable trust – looking through to beneficial owner (Estate Planning Ex: funding a client's new revocable trust)

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Changes in Ownership Under Proposition 13

- In addition, transfers of interests in legal entities that own property in California are typically <u>not</u> reassessable events, with a couple exceptions:
- First, whenever there is a "change in control" of the legal entity, there is a reassessment of 100% of the property held by the entity – this happens when any party obtains greater than 50% ownership of an entity
  - (Estate Planning Ex: parents own single member LLC, then gift 51% membership interest to one child → 100% reassessment)
- Second, whenever an entity with property that was previously excluded under the proportional transfer exclusion has over 50% of its ownership interests transferred, there will be a reassessment of 100% of the excluded property.
  - (Estate Planning Ex: parents transfer 100% of property into New LLC , then gift 20% membership interests to three children (60% total gifted) → 100% reassessment)

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The Inception of the Parent-Child Exclusion

- While those engaged in third-party transfers of their property knew their tax bases would go up, children or grandchildren who inherited real property from their parents/grandparents would also see the taxes double or triple on the inherited property because, by law, this was a change in ownership. Therefore, their parents'/grandparents' lower base year value disappeared.
- In order to encourage continuing family ownership of property, California voters passed Proposition 58 in November 1986 and Proposition 193 in March 1996.

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Summary of Laws under Propositions 58 & 193

- Propositions 58 and 193 are constitutional provisions that provide property tax relief by excluding from reassessment the transfer of (1) a principal residence, and (2) up to one million dollars ($1,000,000) of base year value of other real property between parents and children or from grandparent to grandchild.
  - Principal residence rules only require the parent to use it as their primary residence (take the homeowner's exclusion)
  - This $1,000,000 is base year value, not market value
- In order to qualify for the exclusion from reassessment, the transfer of the property must have occurred on or before February 15, 2021 and requirements for exclusion must be met.
- Unlike the exclusions discussed earlier which are automatic exclusions, for the parent-child exclusion, a **claim must be filed**, generally, within three years of the date of transfer to receive the full benefit of the exclusion.

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Eligible "Children" for Transfers

- A "child" for purposes of Proposition 58 includes:
    - Any child born of the parent(s).
    - Any stepchild while the relationship of stepparent and stepchild exists.
    - Any son-in-law or daughter-in-law of the parent(s).
    - Any adopted child who was adopted before the age of 18.
- Spouses of eligible children are also eligible until divorce or, if terminated by death, until the remarriage of the surviving spouse, stepparent, or parent-in-law.
- A person adopted after reaching the age of 18 is not considered a "child" for purposes of the parent-child exclusion.
- An eligible "grandchild" for purposes of Proposition 193 is any child of deceased parent(s) who qualify as child(ren) of the grandparents as of the date of transfer. (This type of exception is unidirectional)

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Odds n' Bits for Parent-Child Transfers

- Transfers of interests in legal entities or to/from legal entities do not qualify for parent-child exclusion treatment
  - For example: If mom owns a legal entity that owns real property, and mom passes the legal entity to her child via a transfer of interests in the legal entity, the resulting change in control of the legal entity is not excluded
- Trust documents must be examined carefully, particularly funding and distribution clauses
  - Breaking up real property and other property when the assets are not equal
  - California looks through trusts to the beneficial owner, so the date of transfer is not necessarily the date of distribution
  - Review trust agreement for "sprinkle" and non pro rata funding clauses
- When should I not make this claim?
  - Declining value
  - Choosing properties to claim and ordering claims
  - Consider 1014 (step up at death) and 1015 (carry over for gift) basis tradeoffs, if applicable
  - Note that if property was leased to parents under the Prop 13 rules, ensure compliance with lease

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Transfers of Base Year Value – Over 55 – Laws Under Propositions 60 and 90

- Propositions 60/90 amended the California Constitution to allow a person who is over age 55 to sell his or her principal place of residence and transfer its base year value to a replacement dwelling of equal or lesser value that is purchased or newly constructed within two years of the sale.
- Proposition 60 allows for the transfers of a base year value within the same county (intracounty). Proposition 90 allows for the transfers of a base year value from one county to another county in California (intercounty) if the county has authorized such a transfer by an ordinance.
  - Intercounty base year transfers allowed: Alameda, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, Santa Clara, Tuolumne, and Ventura (these would be the counties in which the replacement dwelling is located because that is the county granting the transfer)
- This is another type of transfer that requires a claim form to be filed
  - Each county has their own – look for BOE-60-AH in the county where the replacement dwelling is located

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Transfers of Base Year Value – Over 55

- Claimant:
  - You, or a spouse residing with you, must be at least 55 years of age when the **<u>original property is sold</u>**.
    - You do not qualify is you were shy of 55 on the sale of the original but turn 55 prior to purchase of the replacement dwelling – you are not eligible
    - You do qualify if you were 54 when you purchased the replacement dwelling but turned 55 before selling the original property
  - This is a one-time only benefit. Once you have filed for and received this tax relief, neither you nor your spouse who resides with you, can ever file again, even upon your spouse's death or if the two of you divorce. However, if you become disabled after receiving this tax relief, you may transfer the base year value of your personal residence a second time due to the disability, which involves a different claim form
  - There are "rescission" options under very specific circumstances
    - Basically, you must have vacated the replacement property as principal place of residence within 90 days from when the original claim was filed
- If two divorcing spouses sell the "original property" only one of them may take the base year value

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Transfers of Base Year Value – Over 55

- Original Property
  - Your original property must eligible for the Homeowners' Exemption or Disabled Veterans' Exemption either at the time it was sold or within two years of the purchase or construction of the replacement property.
  - The original property must be subject to reappraisal at its current fair market value at the time of sale. (so no double-dipping here with an excluded transfer to a child)
  - In addition, there must be a sale of the original property and a purchase of the replacement property – a gift of the original property will not qualify

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Transfers of Base Year Value – Over 55

- Replacement Property
  - The replacement property must be your principal residence and must be eligible for the Homeowners' Exemption or Disabled Veterans' Exemption
  - The replacement property must be of "equal or lesser value" than the original property. In general, equal or lesser value means:
    - 100% or less of the market value of the original property if a replacement property were purchased or newly constructed before the sale of the original property, or
    - 105% or less of the market value of the original property if a replacement property were purchased or newly constructed within the first year after the sale of the original property, or
    - 110% or less of the market value of the original property if a replacement property were purchased or newly constructed within the second year after the sale of the original property.
    - If the replacement primary residence is partly purchased and partly constructed, then the full cash value for both land and improvements is determined as either the date of purchase or the date of completion of new construction, whichever occurs last.
  - Note: When making the "equal or lesser value" test calculation, it is important to understand that the market value of a property is not necessarily the same as the sale or purchase price → there is no wiggle room on this requirement
  - The replacement property must be purchased or built within two years (before or after) of the sale of the original property
  - The date of completion of a newly constructed replacement home shall be the date that the property has been inspected and approved for occupancy by the local building department, or, if there is no such inspection and approval procedure, the date when the prime contractor has fulfilled all of the contractual obligations. If inspection and approval procedures are non-existent and there is no prime contractor, the date of completion is when outward appearances clearly indicate it is immediately usable for the purpose intended.
  - The construction on replacement property must be completed within two years of the sale of the original property to qualify for Proposition 60/90 tax relief. The replacement lot may be purchased any time, but completion of the construction on the lot must occur within two years of the sale of the original property. In addition, the market value of the lot and new constructed home on date of completion of construction must meet the equal or lesser value test.

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Transfers of Base Year Value – Over 55

- Some Examples:
  - A few years ago, I inherited a residence from my mother and moved into it as my primary residence, can I now sell it and transfer my mother's property tax base to a replacement dwelling?
    - Yes, as long as you meet the other requirements
  - If I have a multi-unit property and intend to use more than one unit as my principal place of residence, can I transfer my original base year value to all these units?
    - Only one unit is eligible for the base year transfer – the transfer here would be granted only if physical construction is undertaken to convert the multiple units into a single merged unit. This new construction would need to be completed within two years of the sale of the original property.
  - My Registered Domestic Partner and I sold a home and purchased a replacement property in 2008. My Partner transferred the base year value under Proposition 60. Since we are registered domestic partners, was I also considered a claimant? If not, will this affect my ability to use the exclusion later?
    - As a registered domestic partner, you were not considered a claimant. The fact that your partner used the exclusion will not affect your ability to transfer the base year value later. Proposition 60 provides that "any person over the age of 55 years" includes a married couple one member of which is over the age of 55 years. Since a registered domestic partnership is not a married couple, the registered domestic partner of a claimant is not a spouse and is not considered to have used his/her one-time-only exclusion under section 69.5.

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Filing Deadlines for Transfers Prior to Feb 16, 2021

- Claim for Reassessment Exclusion for Transfer Between Parent and Child, Form BOE-58-AH
- Claim for Reassessment Exclusion for Transfer Between Grandparent and Grandchild, Form BOE-58-G
- Each county has its own Exclusion Form that must be filled out and filed by the earlier of:
  - Three years from the date of the transfer, or
  - Prior to transferring to a third party.
  - However, if a notice of supplemental or escape assessment is mailed after the deadline for either of these periods has passed, then the transferee has an additional six months from the date of the notice to file a claim.

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Filing Deadlines for Transfers Prior to Feb 16, 2021 (cont.)

- Can I still be granted the exclusion if I file after the 3-year filing period?
  - Effective January 1, 1998, if the transferee has not transferred the property to a third party, applications may still be filed at any time after the three-year deadline; however, those filed after three years will only become effective for the lien date in the assessment year in which they are filed and will not be retroactive to the date of transfer. Therefore, the first year's enrolled value would be the base year value as of the year of transfer, factored for inflation plus any additional value which has been enrolled because of new construction.

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Filing Deadlines for Transfers Prior to Feb 16, 2021 (cont.)

- Claim for Transfer of Base Year Value to Replacement Primary Residence for Persons At Least Age 55 Years – BOE-19
  - Assuming you meet all the qualifications for a Proposition 60/90 base year value transfer, the base year value is transferred as of the ***latest*** qualifying date:
    - The date the original property sold; or
    - The date the replacement property is purchased; or
    - The date the new construction of the replacement property is completed.
- Base Year Value Transfers – Over 55
  - To receive retroactive relief from the date of transfer, you must file your claim within three years of:
    - The purchase date of the replacement property; or
    - The new construction completion date of the replacement property.
  - If a claim is filed after the three-year period, relief will be granted beginning with the calendar year in which the claim was filed.

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Proposition 19 Changed the Laws Substantially

- Adjustments were made to which kinds of transfers qualified for exclusion from reassessment under the parent-child rules (operative February 16, 2021)
- Adjustments were also made to the base year value transfer rules for those over 55 or disabled (operative April 1, 2021)
    - As long as one transaction occurs on or after April 1, 2021, and the original home is sold within two years of the purchase of the replacement home, the base year value of the original home can be transferred to the replacement home under Proposition 19.

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Proposition 19 Changes to Parent-Child Transfers

- First, the only type of property eligible for the exclusion now is a principal residence
  - The additional $1,000,000 in other real property exclusion no longer exists
- Second, the property must be the principal residence of both the transferor and the transferee
  - The transferee must make the home their principal residence within 1 year of the date of transfer
  - If a home is gifted to two children, as long as at least one of the children who were gifted the family home resides in the residence and applies for either the homeowners' or disabled veterans' exemption within one year of the transfer, and all other requirements have been met, then the parent-child (intergenerational) transfer exclusion should be allowed.
  - At least one eligible transferee must continually live in the property as their family home for the property to maintain the exclusion. Thus, once the property is no longer your principal residence, it will receive a new taxable value as of the lien date following the date you no longer occupy the property as your principal residence. The new taxable value will be the fair market value of the home on the date you inherited it, adjusted each year after for the inflation factor, and enrolled as of the lien date following the date you moved out.

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Proposition 19 Changes to Parent-Child Transfers

- Third, there is a value limit to the exclusion
  - The value limit under Proposition 19 is the sum of the factored base year value plus $1 million. If the market value exceeds this limit, the amount exceeding the value limit will be added to the factored base year value. Thus, as long as all other qualifications have been met, you are still entitled to the exclusion, with an adjusted taxable value to account for the excess over the value limit.
  - For example, a family home has a factored base year value (FBYV) of $300,000 and a fair market value of $1,500,000. The excluded amount under Proposition 19 is $1,300,000 ($300,000 + $1,000,000 = $1,300,000). The difference of $200,000 ($1,500,000 - $1,300,000 = $200,000) is added to the property's FBYV. Thus, the adjusted base year value is $500,000 (FBYV $300,000 + difference of $200,000).
- Estate Planning Takeaway: Prop 19 substantially limited the opportunity to transfer primary and secondary residences to children for estate planning purposes. Depending on the circumstances, income tax basis (step up at death) may now be the more important tax consideration.

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Proposition 19 Changes to Base Year Value Transfers

- Under Proposition 19, three transfers will be allowed for homeowners who are over age 55 or physically and permanently disabled, regardless of whether a property owner previously transferred a base year value under Propositions 60/90 and Proposition 110.
- If the replacement home is of equal or lesser value than the original home, then the original home's factored base year value may be transferred to the replacement home without any value adjustment. In general, "equal or lesser value" means:
  - 100% or less of the full cash value of the original home if a replacement home is purchased or newly constructed before the sale of the original home, or
  - 105% or less of the full cash value of the original home if a replacement home is purchased or newly constructed within the first year after the sale of the original home, or
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Proposition 19 Changes to Base Year Value Transfers

- This rule, however, is a bit more lenient than prior law when it comes to value of replacement dwellings
- If the full cash value of the replacement home is greater than the adjusted full cash value of the original home, the base year value of the original home may still be transferred to the replacement home, but with any excess value above the adjusted full cash value of the original home added on. Thus, the new taxable value of the replacement home would be the sum of the adjusted base year value of the original home plus the difference between the full cash values of the original home, as described above, and the replacement home.
- For example, an original home was sold and had a full cash value of $400,000 and a factored base year value of $100,000 at the time of sale. If a replacement home is purchased in the first year after the sale for a full cash value of $600,000, then 105 percent of the full cash value of the original home is compared to the full cash value of the replacement home. The original home's adjusted full cash value equals $400,000 X 105% = $420,000. The difference between the full cash value of the replacement dwelling ($600,000) and the adjusted full cash value of the original property ($420,000) is added to the factored base year value ($600,000 - $420,000 = $180,000 + $100,000 = $280,000). Thus, the replacement home will have a taxable value of $280,000.

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Filing Deadlines for Transfers On or After Feb 16, 2021

- Claim for Reassessment Exclusion for Transfer Between Parent and Child, Form BOE-19-P
- Claim for Reassessment Exclusion for Transfer Between Grandparent and Grandchild, Form BOE-19-G
- Each county has its own Exclusion Form that must be filled out and filed by the earlier of:
  - Three years from the date of the transfer, or
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  - However, if a notice of supplemental or escape assessment is mailed after the deadline for either of these periods has passed, then the transferee has an additional six months from the date of the notice to file a claim.

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Filing Deadlines for Transfers On or After Feb 16, 2021 (cont.)

- Claim for Transfer of Base Year Value to Replacement Primary Residence for Persons At Least Age 55 Years – BOE-19-B
    - Within 3 years of the date a replacement dwelling is purchased, or new construction of a replacement dwelling is completed.

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Questions?

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