

# Prop 19: Big Property Tax Changes

Presented by:

The San Bernardino  
County Bar Association  
Probate Section

December 11, 2020





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# Slide Presentation Materials

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# Agenda

- Current Law: Prop13, Prop 58, and Prop 193
- New Law: Prop 19
- Important Consideration: Gift Tax Basis
- Property Tax Planning Opportunities

Current Law: Prop  
13, Prop 58, and  
Prop 193  
(Until Feb. 15, 2021)

# Prop 13 (1978)

## Article XIII A of the California Constitution

Creates a base year value for each parcel of real property

Annual Property tax = 1% of assessed value (Cal. Const. Art. XIII A Sec. 1(a))

Local taxing jurisdictions can (and do) levy additional ad valorem property tax (Rev. & Tax. Code §§ 93 and 100)

Assessed value increases maximum of 2% per year, unless reassessment

# Prop 13 When can a property Reassessed?

Property may be reassessed upon:

- Reduction in the market value (Prop 8)
- Additions and New Construction
- A “change in ownership” (Rev. & Tax. Code § 60)
  - Sale
  - Gift
  - Death (Inheritance)

# What is a Change in Ownership?

A “change in ownership” (Rev. & Tax. Code § 60)

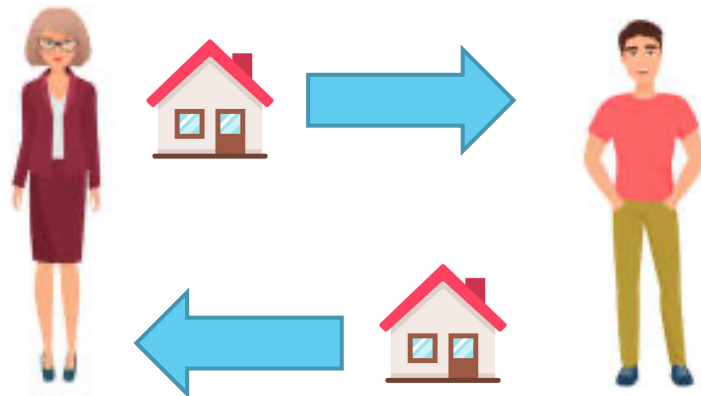
1. Transfer of a present interest in real property,
2. Transfer of the beneficial use
3. The value of which is substantially equal to the value of the fee interest



# Prop 58 (1986) Parent Child Exclusion

## Rev. & Tax. Code § 63.1(a)(1)&(2)

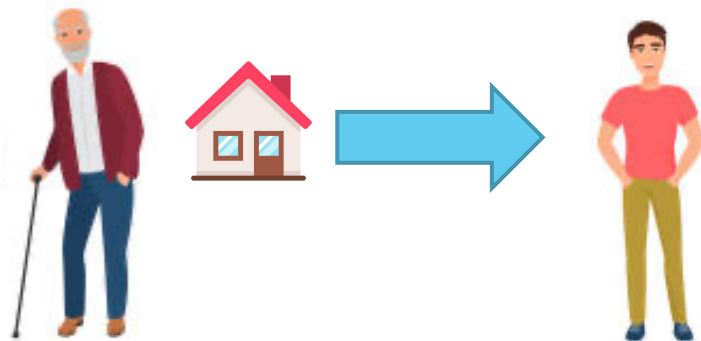
- Excludes certain transfers between Parent-Child from “change in ownership,” thus, NO reassessment
- Can be either from Parent to Child, or from Child to Parent
- Can be transferred directly, by inheritance, or through a trust
- Transfer cannot be through a legal entity (LLC/Corp/Partnership)



# Prop 193 (1996) Grandparent Grandchild Exclusion

## Rev. & Tax. Code § 63.1(a)(3)

- Excludes certain transfers between Grandparent-Grandchild from reassessment
- All parents of grandchild must be deceased
- Only goes from Grandparent to Grandchild (NOT Grandchild to Grandparent)



# Who is a Child?

A “child” includes (Rev. & Tax. Code § 63.1(c)(3)):

- Any child born of the parent(s) (unless adopted out)
- Any stepchild when the relationship of stepparent and stepchild exists
- Any son-in-law or daughter-in-law of the parent(s), unless
  - (1) divorce, or
  - (2) death of child and SIL/DIL remarries
- Any adopted child who was adopted before age 18
- A foster child

# Who is a Grandchild?

A “grandchild” includes (Rev. & Tax. Code § 63.1(c)(4)):

- Any child of parent(s) who qualify as children of the grandparents as of the date of the transfer
- Look to the broad definition of “child”

# How Much Assessed Value is Excluded?



Principal Residence : no value limit

A dwelling with either:

- Homeowner's Exemption, or
- Disabled Veteran's Residence Exemption

Includes only land underlying the principal residence of reasonable size that is used as a site for the residence



Other Real Property: first \$1M of assessed value

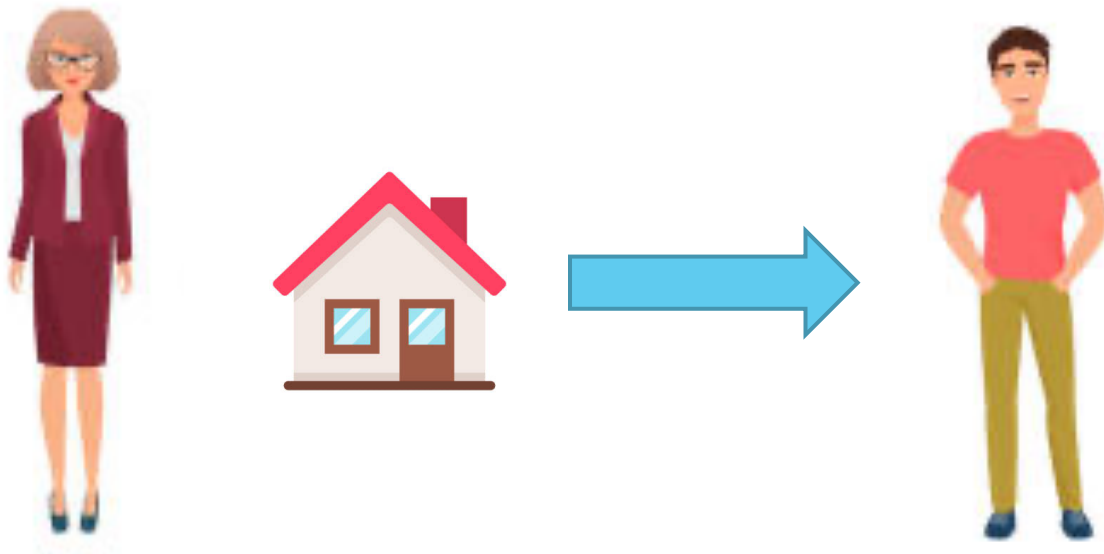
# Current Law: Example #1 Principal Residence

Mother transfer 100% of Principal Residence to her son.

Assessed value = \$2,600,000

FMV = \$7.3 million

No reassessment. Unlimited exclusion for Principal Residence.



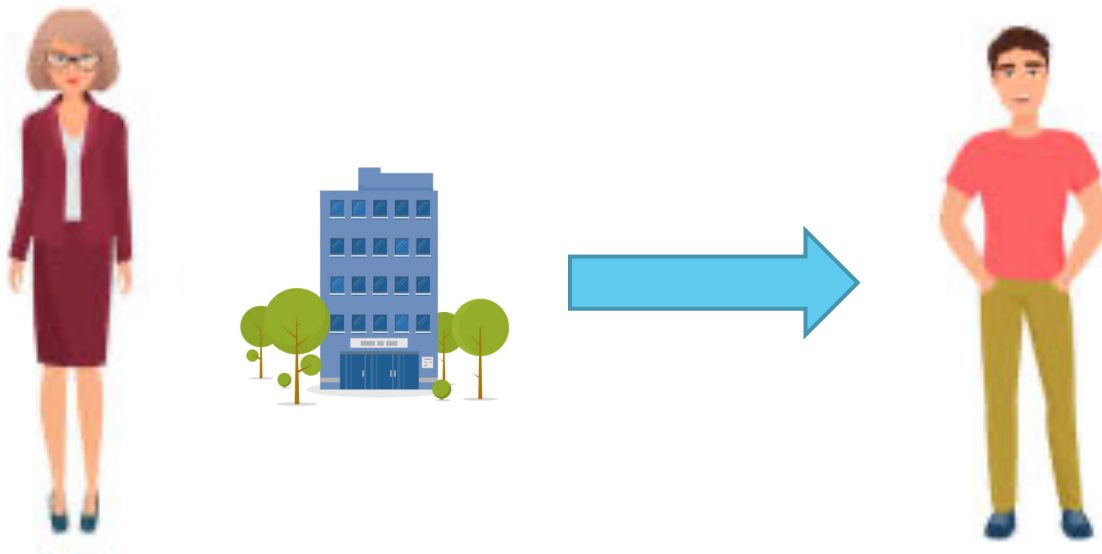
# Current Law: Example #2 Other Real Property

Mother transfer 100% of Office Building to her son.

Assessed value = \$400,000

FMV = \$1.3 million

No reassessment. \$400,000 of Mother's \$1M exclusion is used.



# Attorney Requests \$1M Exclusion Remaining

Attorney can request without the client's written authorization

Fax on law firm letterhead to:

BOE: County Assessed Properties Division, MIC: 64

Fax: (916) 285-0134

- A statement that explains your relationship to the client
- If parent is deceased, explain the child's capacity: trustee/executor, etc. in the trust or estate
- Your client's name
- Your client's social security number
- A return fax number



# How to Claim the Exclusions

Parent Child Exclusion:

Claim for Reassessment  
Exclusion for Transfer  
Between Parent and  
Child, Form BOE-58-AH

Grandparent -  
Grandchild Exclusion:

Claim for Reassessment  
Exclusion for Transfer  
Between Grandparent  
and Grandchild, Form  
BOE-58-G

# Deadline to Claim the Exclusions

For exclusion retroactive to the date of transfer, file a claim at the earliest of the following:

- Within 3 years of the transfer
- Prior to transferring to a third party

Otherwise, exclusion would only be prospective from the date of filing the claim

## Resources on Current Law

California Constitution Article XIII A

Rev. & Tax. Code § 63.1

BOE Letter to County Assessors No.  
2008/018 dated 02/29/2008

Assessor's Handbook Section 401  
"Change in Ownership"

# Prop 19: Big Property Tax Changes



# Prop 19 (2020)

## Amendment to Article XIII A of the California Constitution

### Section 2.1:

- Allows transfer of assessed value for a replacement principal residence within California for seniors, severely disabled and wildfire and natural disaster victims.
- **Changes Parent-Child and Grandparent-Grandchild Exclusions.**

### Section 2.2 - Creation of the CA Fire Response Fund

### Section 2.3 - Establishment of the County Revenue Protection Fund

# Prop 19 Sec. 2.1 (a) and (b)

## Transfer of Assessed Value

Starting April 1, 2021, allows transfer of assessed value for a replacement principal residence for:

- Seniors 55+ (up to 3 times )
- Severely Disabled (up to 3 times )
- Wildfire and Natural Disaster Victims

Replacement principal residence can be anywhere in California

Requires filing of an application to transfer the assessed value

Must claim Homeowner's Exemption or Disabled Military Exemption within 2 years of the sale of the original principal residence

# Prop 19 Sec. 2.1 (a) and (b)

## Transfer of Assessed Value

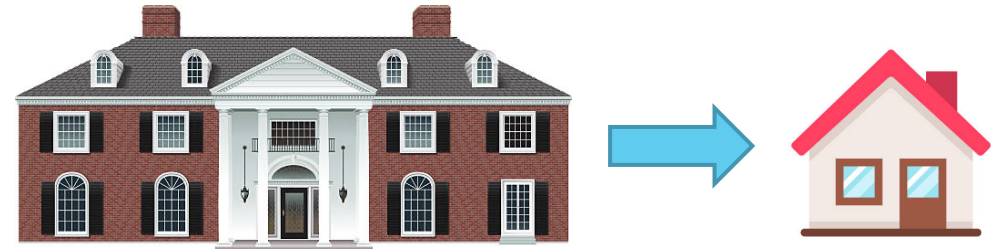
What's different from old rule?

1. Anywhere in the state (within 10 counties before)
2. Can buy more expensive home (previously, equal value or less)
3. Up to 3 times in lifetime, unless wildfire (previously, was only once)

# Prop 19 Sec. 2.1 (a) and (b)

## Assessed Value of Replacement Principal Residence

If buy less expensive replacement principal residence: lower assessed value of replacement principal residence is used



If buy more expensive replacement residence: transfer the original principal residence assessed value to the replacement principal residence + difference in FMV





# Example #1

## More Expensive Replacement Principal Residence

Mrs. Jones is 68 years old

Her home in Rancho Cucamonga is worth \$1M

She wants to sell it and buy a Pismo Beach condo for \$1.2M

\$400,000 Current assessed value  
+ \$200,000 difference ( $\$1.2M - \$1M$ )  
= \$600,000 Replacement assessed value



# Example #2

## Less Expensive Replacement Principal Residence

Mr. Davis is 70 years old

His home in Costa Mesa is worth  
\$800,000

He wants to sell it and buy a Running  
Springs cabin for \$300,000

\$200,000 Current assessed value

+ \$0 difference ( $\$300,000 - \$800,000$ )

= \$200,000 Replacement assessed value



# Prop 19 Sec. 2.1 (c)

## Property Tax “Fairness” for Family Homes

Takes effect Feb. 16, 2021 (Feb. 15 is a national holiday: President’s Day)

Transfer from Parent to Child or Grandparent to Grandchild

Replaces Prop 58 and Prop 193 - Current Law will be changed

Parent “family home” and/or “family farm”

Child must identify the family home as his/her principal residence within 1 year

Must file for homeowner’s exemption or disabled veteran’s residence exemption within 1 year of the transfer

MAXIMUM = current assessed value + up to \$1M of FMV

# Prop 19 Sec. 2.1 (c) What Properties Are Included?



“Family Home” = Principal residence

Must claim either:

Homeowner’s Exemption, or

Disabled Veteran’s Exemption



“Family Farm” = Any real property which is:

- Under cultivation
- Being used for pasture or grazing
- Used to produce any agricultural commodity

# Prop 19 Sec. 2.1 (c) What Properties Are Excluded?

The current law that allows for up to \$1 million for non-principal residence property is eliminated

Under Prop 19: No Parent-Child (Grandparent-Grandchild)

Exclusion available for:

- Retail, Commercial & Industrial Real Property
- Vacation or Second Home
- Vacant Land
- Rental Property
- Time Share
- Oil, Gas, & Mineral Rights

# Prop 19 Example #1

## Example 1: Assessed Value and FMV Under \$1M

Mother transfers 100% of Principal Residence to Son.

Son then uses property as his Principal Residence.

Principal Residence assessed value = \$300,000

FMV = \$800,000

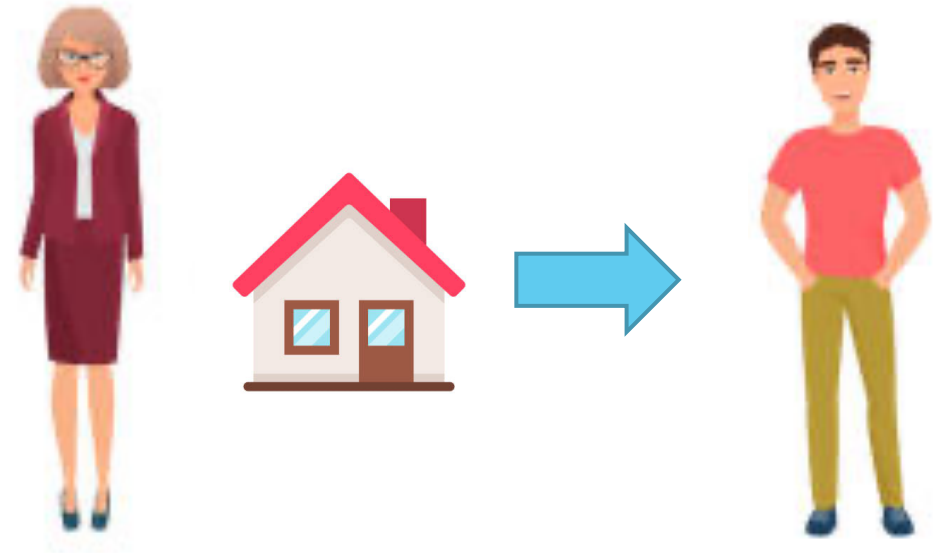
Prop 19 will exclude \$500,000 of FMV

Thus, assessed value to Son:

\$300,000 current assessed value

+ \$0 excess FMV ( $\$800\text{K FMV} - \$300\text{K Current} - \$1\text{M Exclusion}$ )

= \$300,000 assessed value to child



## Prop 19 Example #2

### Example 2: Assessed Value Under \$1M and FMV Over \$1M

Mother transfers 100% of Principal Residence to Son.

Son then uses property as his Principal Residence.

Principal residence assessed value = \$300,000

FMV = \$1,700,000

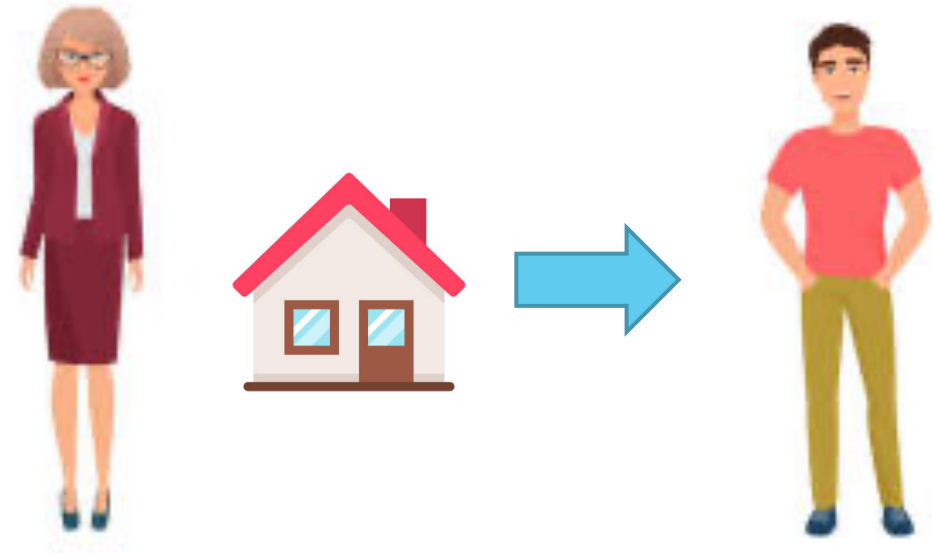
Prop 19 will exclude the first \$1,000,000 of FMV

Thus, assessed value to child:

\$300,000 current assessed value

+ \$400,000 excess FMV ( $\$1.7 \text{ FMV} - \$300\text{K Current} - \$1\text{M Exclusion}$ )

= \$700,000 assessed value to child



# Prop 19 Example #3

## Example 3: Assessed Value and FMV Over \$1M

Mother transfers 100% of Principal Residence to Son.

Son then uses property as his Principal Residence.

Principal residence assessed value = \$1,200,000

FMV = \$2,400,000

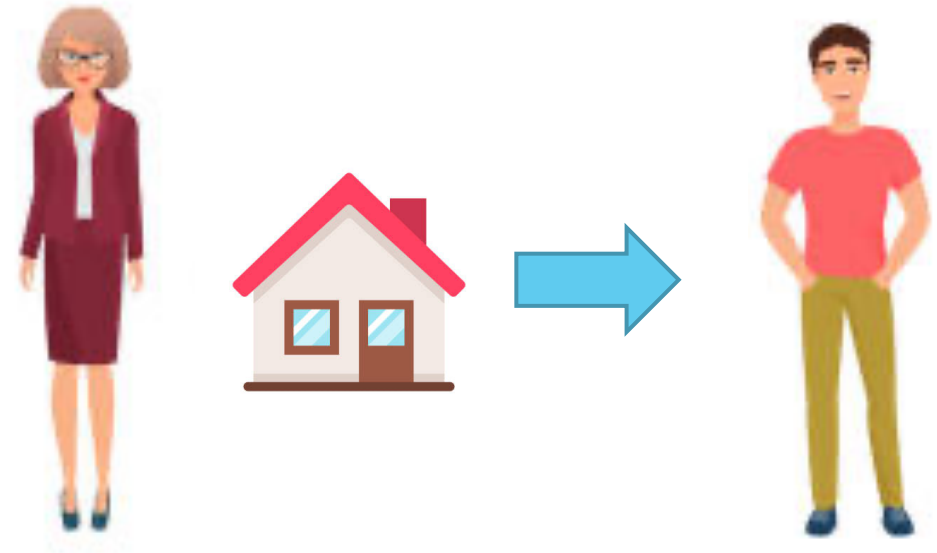
Prop 19 will exclude the first \$1,000,000 of FMV

Thus, assessed value to child:

\$1,200,000 current assessed value

+ \$200,000 excess FMV (\$2.4 FMV - \$1.2 Current - \$1M Exclusion)

= \$1,400,000 assessed value to child





# Prop 19 Example #4

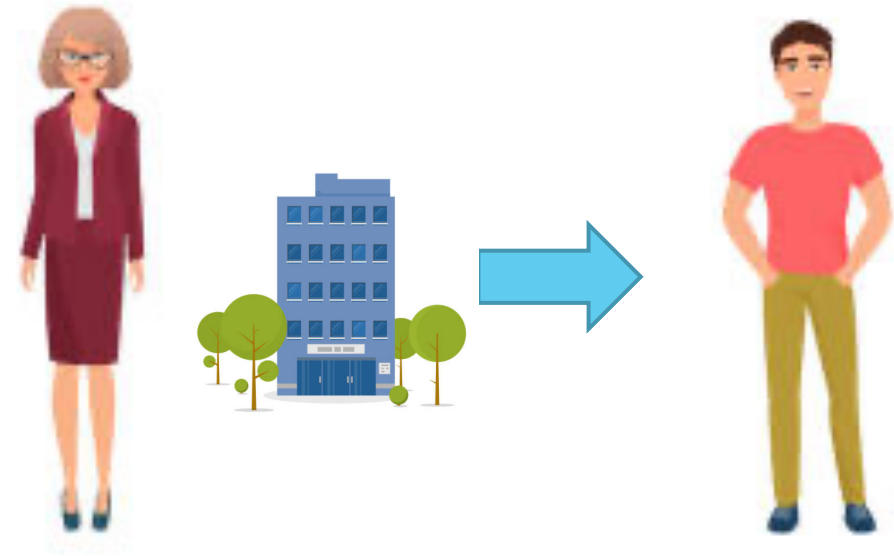
## Example 4: Not Principal Residence

Mother transfers 100% of Commercial Property to Son.

Neither Mother nor Son used property as Principal Residence.

No parent-child exclusion applies.

The Commercial Property is reassessed at FMV.



# Current Law / New Law Comparisons

	Current Law	Prop 19
Principal Residence	<ul style="list-style-type: none"><li>• Principal residence of transferor only</li><li>• No value limit</li><li>• Residence and homesite (excess land may be excluded)</li></ul>	<ul style="list-style-type: none"><li>• Principal residence of transferor and transferee</li><li>• Value limit of current assessed value plus up to \$1M</li><li>• Family Homes &amp; Family Farms</li></ul>
Other Real Property	<ul style="list-style-type: none"><li>• Transferor lifetime limit of \$1M of current assessed value</li></ul>	<ul style="list-style-type: none"><li>• Only family Home and Family Farm</li></ul>
Filing Period	<ul style="list-style-type: none"><li>• File claim within 3 years or before transfer to third party</li></ul>	<ul style="list-style-type: none"><li>• Child files for homeowner's exemption or disabled veteran exemption within 1 year</li></ul>
Important Dates	<ul style="list-style-type: none"><li>• Through February 15, 2021</li></ul>	<ul style="list-style-type: none"><li>• Effective February 16, 2021</li></ul>

# Property Tax Planning Opportunities

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# What to do Before Feb. 16, 2021

- Do Nothing
- Transfer to Preserve Current Property Tax Assessed Value, but Transferred Basis for Income Tax Purposes
- Sell property to child, Preserve Current Property Tax Assessed Value, and get basis of FMV as of date of Transfer
- Transfer to Preserve Current Property Tax Assessed Value, and Get Step-Up in Basis on Death of Parent for Income Tax Purposes

# Planning Issue: Step-Up in Basis

## IRC § 1014: Basis of Property Acquired from a Decedent

- FMV as of the date of death
- (there's some exceptions - but let's not worry about that now)
- There is talk in the Biden administration of eliminating step-up in basis and instead using carryover basis

# Do Nothing

Parent's Principal Residence

Child's Principal Residence, or will be Child's Principal Residence within 1 year of transfer

No other real estate

Don't Want Any Adverse Income Tax Effects from a Lifetime Gift

If the property will be sold after death of the Parent, then there is no point in trying to get a lower property tax base after death

# Gift of Entire Property to Child (1 of 3)

Parent gifts property to Child on or before February 15, 2021

## Income Tax Basis Issues

Gift of Appreciated Property: Basis = Transferred Basis

Gift of Depreciated Property:

Sold at a loss: Basis = FMV

Sold at a gain: Basis = Transferred Basis

Sold in between FMV and Transferred Basis: No gain or loss

No step up in basis on the death of the transferor

# Gift of Entire Property to Child (2 of 3)

Gift Tax Issues - file Gift Tax return

(\$11.58M gift tax exemption for 2020)

(\$11.7M gift tax exemption for 2021)

Generation Skipping Transfer Tax Issues - file GST Tax Return

(\$11.58M GST tax exemption for 2020)

(\$11.7M GST tax exemption for 2021)



# Gift of Entire Property to Child (3 of 3)

Example:

Parent purchase property for \$300,000

Property current FMV = \$700,000

Property taxes are \$3,000 per year

## Gift to Child:

Transferred basis of \$300,000

On a sale, gain of \$400,000

Capital Gain Tax @15% = \$60,000

Property taxes = \$3,000/year

Savings = \$4,000/year in prop. tax

## Inheritance to Child:

Step-Up basis of \$700,000

On a sale, gain of \$0

Capital Gain Tax @15% = \$0

Property taxes are \$7,000/year

Savings = \$60,000 in cap. gains tax

# How to Gift Property From Parent to Child

Complete all steps by Feb. 15, 2021:

## The “Two-Step” Dance

Uses up to \$1M of assessed value of the property(ies)

1. Parent transfers 100% of title to property to child by a Deed
2. Then, file for parent-child exclusion

# How to Gift Property From Parent to Child

Complete all steps by Feb. 15, 2021:

## The “Three-Step” Dance

Uses up to \$1.96M of assessed value of the property(ies)

1. Parent transfers 51% of property to Child by Deed (Qualifies for Parent - Child Exclusion)
2. Parent owns 49% and Child owns 51% of property - which is then transferred to an LLC in which Parent owns 49% and Child owns 51% of the LLC interests (Qualifies for proportional interest exclusion - Rev. & Tax. Code § 62(a))
3. Parent transfers 49% of LLC to Child (qualifies for less than control of entity exclusion - Rev. & Tax. Code § 64)

# How to Gift Property From Parent to Child

Complete all steps by Feb. 15, 2021:

## “Gangnam Style”

Uses up to \$50M of assessed value of the property(ies)

1. Parent transfers 100% of property to LLC1 owned 100% by parent (proportional interest exclusion - R&T §62(a))
2. Parent transfer a 49% interest of LLC1 to Child (less than control of entity exclusion - R&T § 64)
3. LLC1 transfers property by deed as 51% to Parent and 49% to Child (proportional interest exclusion - R&T §62(a))
4. Parent gifts 2% of the property by deed to Child by Deed (Parent - Child Exclusion R&T 63.1)
5. Parent transfers 49% and Child transfers 51% of property by deed to LLC2 owned 49% by Parent and 51% by Child
6. Parent transfers 49% interest in LLC2 to Child

# Parent Sells Property to Child

Parent sells rental property to Child on or before February 15, 2021

Triggers capital gain on sale (no step-up in basis on death of parent)

Sell as an installment sale - spreads capital gain over multiple years

May do interest only payments

Can forgive by gift \$15,000 per year (\$30k for married couple)

Parent must report interest income each year

Any balance of note at death of parent is IRD

Can still get Parent-Child Exclusion for sale - keep low property tax base

Child's basis in property is FMV as of date of transfer

No gift tax or GST tax issues, so long as sold for FMV

# Have Your Cake and Eat It Too?

Parent transfers rental property to IDGT for Child on or before February 15, 2021

The idea:

- Transfer from parent to child is a “change of ownership” that qualifies for the parent-child exclusion
- Incomplete gift for gift tax purposes
- Included in the parent’s estate for estate tax purposes
- Eligible for a step up in basis on the parent’s death

Parent Creates Irrevocable Trust with child as current beneficiary

Parent retains some power that keeps the property in the Parent’s estate for estate tax purposes (power to borrow without adequate security? IRC § 675(3))

There is a step up in basis on the death of the parent

Have a “change in ownership” that qualifies for the parent-child exclusion

# Questions and Discussion



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