

November 16, 2020

Beware of Proposition 19 Property Tax Increases— Planning Opportunities Still Exist for a Brief Window

Proposition 19, which was marketed as a provision to benefit homeowners who are over 55, the disabled, and wildfire/disaster victims, actually contained major property tax increases. The increased property taxes will be paid by children and grandchildren that receive California real estate (primary residences and all other properties) from their parents and grandparents. "These increases could be in the tens of millions of dollars per year," according to the Legislative Analyst. The new law goes into effect on February 16, 2021. There is a brief window of time for generational property tax planning that could save substantial property taxes for the next generation or generations.

How Proposition 19 Will Raise Property Taxes?

Proposition 58 - The law until February 15, 2021:

The current law allowed many transfers of properties between parents and children without triggering an increase in property taxes. The Proposition 58 rules also applied to the transfers of property from grandparents to grandchildren in limited circumstances. Under Proposition 58:

- A parent may transfer the assessed value of their primary residence to a child or children without any limitations on the fair market value of the residence.
- Each parent may transfer to a child or children real property (such as rental property, commercial property, or vacation homes) of up to \$1,000,000 of assessed property tax value without triggering an increase in property taxes.

Proposition 19 - The law on February 16, 2021 and thereafter:

The ability to transfer property to children is completely lost in all cases other than principal residences:

- Proposition 19 limits the exclusion from reassessment for transfers from a parent to a child of up to \$1 million of fair market value (where it used to be of *unlimited* value) AND the transferee child has to use the property as his or her primary residence within one (1) year of the transfer.
- The following are examples of the application of Proposition 19:

A parent dies and leaves his or her children a ten-unit apartment house held for many years with a fair market value of \$5,000,000 and an assessed value of \$950,000. Under Proposition 19, upon the date of the death of the parent, the property will be reassessed and the assessed value increased to the \$5,000,000

fair market value. The children will be subject property taxes based on this new assessed value. Whereas, under Proposition 58, the children would have retained the \$950,000 property tax assessed value.

A parent dies owning a house worth \$4,000,000, leaving one child. The house was the parent's principal residence. Under Proposition 19, the value that the child can exclude from reassessment is capped at \$1,000,000 fair market value plus the assessed value of the deceased parent's home which was \$700,000. The child has to make the parent's house his or her primary residence within one (1) year of the parent's death. The value of the home in excess of \$1,700,000 will be subject to reassessment. Under Proposition 58, the full \$4,000,000 value of the parent's house would have been protected from reassessment.

A parent dies and leaves the children a principal residence held for many years with a fair market value of \$800,000 and an assessed value of \$150,000. The children decide that none of the children will live in the house as a principal residence and they will lease the residence to an unrelated person. Under Proposition 19 the children will pay property taxes based on the fair market value on the date of the parent's death of \$800,000. Under Proposition 58, the children would have kept their parent's assessed value of \$150,000 while they owned the house.

The statistics on the elimination of much of Proposition 58 (the Parent Child Exclusion from Reassessment) are staggering. Jeff Olson from the San Diego County Assessor's Office estimates that the San Diego County Assessor's Office approved 7,000 parent child exclusions from reassessment in 2019. He further estimates with the passage of Proposition 19, at least 3,500 of those parent child exclusions would not have qualified.

When Will Proposition 19 Be Effective?

The provisions of Proposition 19 that increase property taxes go into effect on February 16, 2021. This creates a very short planning opportunity for property tax savings under the current tax law (Proposition 58).

What Can Be Done to Save Property Taxes?

Gifts and sales of real property to children, outright, into trusts or into entities may allow clients to take advantage of the current Proposition 58 Parent Child Exclusion before it is gone. These Proposition 58 plans can be developed and implemented in late 2020 and early 2021, before the start of the scheduled Proposition 19 property tax increases.

Major property tax savings may be available. Under Proposition 58, the \$1,000,000 Parent-Child Exclusion from Reassessment is per parent! A couple can transfer to their children a total of \$2,000,000 of assessed value in real property.

For those who have not made major gifts, the Federal Estate and Gift Tax Exemption of \$11,580,000 per donor is available in 2020. This allows many property owners to gift properties to their children without the imposition of federal gift tax. California does not have a state gift tax.

Please note that the Federal Estate and Gift Tax Exemption, which is currently set to expire on December 31, 2025, may be reduced by an act of Congress signed by the President in as early as 2021. The best time for gift planning may be 2020.

Gift planning involves several financial and tax issues, including income tax basis. Property transferred by gift takes a carry-over basis while property transferred at death, under current law, receives a step up in income tax basis. Don't let the property tax tail wag the dog. A parent may rely on the income being produced by real estate for living expenses. Children may ultimately want to liquidate property after the parent dies. If children acquire carry over basis property received from a lifetime gift, they lose the step up in basis at the death of the parent, subjecting them to capital gain taxes on sale of the property. A careful analysis needs to be completed before gifts are made to save property taxes.

If you have an interest in discussing planning, including property tax planning for using the current Parent-Child Exclusion from Reassessment of Property Taxes, please call or email your contact at Buchalter, or call or email any of the undersigned. Time is of the essence. Clients are encouraged to contact us as early as possible as many attorneys will stop taking on clients for this issue in early 2021.



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