

California
Proposition 19
Passes,
Now What?



On November 3, 2020, California voters narrowly approved Proposition 19 (“Prop. 13”). The bad news for those that own real estate in California is that it came with significant property tax changes that go into effect February 16, 2021. The good news is that you are reading this before that date and you still have time (although just barely) to determine if Prop. 19 helps or hurts you and implement a good solution if necessary.

The two main impacts are as follows:

1. Property transfers between parents and children (and grandparents and grandchildren in some limited circumstances) will only avoid property tax reassessment in very limited circumstances - most transfers after February 15, 2021 will now trigger a property tax reassessment and thus a higher tax bill.
2. Homeowners who are age 55 years or older, disabled, or victims of a wildfire or natural disaster to preserve will be able to transfer the Prop 13 base year assessed value of their primary residence to a replacement primary residence.

As is the case with most changes in the law, Prop. 19 has its pros and cons. While some homeowners who can qualify will benefit from the expanding property tax “portability” available in certain situations, it will certainly be harmful for those parents or grandparents planning to keep property in the family and transfer it to later generations like adult children or even grandchildren. Let us explain.

What Is Proposition 13?

Passed by voters in 1978, Proposition 13 (“Prop. 13”) taxes California properties based on their assessed value (also known as the base year value or taxable value) rather than their fair market value. Assessed value is generally determined by including the purchase price and cost of improvements, plus an increase of no more than 2% per year unless and until there is a change in ownership.



Because California real estate, on average, has appreciated in value at a rate higher than 2% per year, the longer a property is held, the greater the difference is between its assessed value and its fair market value, and thus the greater the difference will be between the amount of property tax its owner pays as compared to the owner of a newly purchased property of equivalent value.

That is why if a property is sold or transferred, the property taxes can sometimes increase dramatically as a result. However, as explained below, if the sale or transfer is between parents and their children, or from grandparents to their grandchildren, under limited circumstances, the property will not be reassessed if certain conditions are met and the proper application is timely filed.

Proposition 13 will remain the current law even after Proposition 19 goes into effect. The impact will be to these the exceptions called the “parent-child exclusion” and “grandparent-grandchild exclusion” and the significant tax benefits they provide.

Current Law on Reassessment Exclusions

Under current California law, new property owners avoid property tax increases when acquiring property from their parents or children or from their grandparents. The new owner’s taxes are calculated on the established Proposition 13 factored base

year value, instead of the current market value when the property is acquired. For that reason, these exclusions are create a very favorable tax benefit to families that have long-held California real estate with low Prop 13 assessed values.

Proposition 58 is commonly referred to as the “parent-child exclusion” because it excludes from reassessment transfers of real property between parents and children of the transferor’s:

- (a) Primary residence, regardless of value, and
- (b) \$1 million of assessed value of any other real property (such as vacation homes, second homes, rental properties, etc.) per property owner which means, two parents together could transfer to their children up to \$2 million of assessed value.

Proposition 193 is commonly referred to as the “grandparent-grandchild exclusion” and operates similarly to Proposition 58. In order to be applicable, however, all of the receiving grandchild’s parents who can be claimed as a child of the grandparent who is transferring the property must be deceased. Otherwise, a transfer from grandparent to grandchild currently triggers a property tax assessment.

As an example, a 60-unit apartment complex in the San Francisco Bay Area purchased by a married couple in 1979 may have an assessed value just under \$2 million, although the fair market value of the building is \$20 million. Under Proposition 58, the couple could transfer this property to their children without reassessment. (Each parent can transfer property with \$1 million of assessed value, and together they can transfer property with \$2 million of assessed value.) In addition, the couple could transfer their primary residence to their children without reassessment, regardless of the assessed value.

The New Rules Under Proposition 19

Proposition 19 replaces Propositions 58 and greatly limits the scope of the parent-child and grandparent-



grandchild exclusions.

Beginning on February 16, 2021, the following changes will occur:

- the ability to transfer a primary residence between a parents/grandparents and a child/grandchild (and grandparent and grandchild) without reassessment will no longer apply unless two conditions are met:
 - (1) the parent’s primary residence must also become the recipient’s primary residence within one-year, and
 - (2) the fair market value of the primary residence at the time of transfer does not exceed the parent’s assessed value by more than \$1 million.
- Property that is not the parent/grandparent’s primary residence will be reassessed upon transfer to anyone, thus eliminating the former \$1 million exclusion for these types of non-primary residence properties

This means that any transfers of a primary residence to children/grandchildren will trigger a property tax reassessment if they do not live in the home and the fair market value is \$1 million more than the current Prop 13 assessed value.

In those situations where the fair market value is over \$1 million more than the current assessed value, then the new assessed value will be the fair market value less \$1 million.

However, if the parent/grandparent's primary residence does not become the child/grandchild's primary residence, then the property will be reassessed to its fair market value.

Likewise, the property will be reassessed to current fair market value if the property is not the parent/grandparent's primary residence. This will create problems for parents/grandparents that have property they wish to sell, gift, or bequest in their will or trust such vacation homes, second homes, rental properties, and/or commercial properties.

For an additional visual comparison, see the chart on the California Board of Equalization's website for a side-by-side comparison of the parent-child exclusion pre- and post-Proposition 19:
<https://www.boe.ca.gov/prop19/>

Solutions

Planning done between now and February 15, 2021, can lock in the current parent-child exclusion rules. However, the true deadline is **February 11, 2021** due to county office closures for Lincoln's Birthday and President's Day.

This is a complex situation involving tax, trust and estate, and real estate law. There is no one-size fits all remedy, and solutions are very situational and will need to be tailored to each family's unique needs.

This is especially important for:

- (1) parents and grandparents who expect or want their children or grandchildren to keep rather than sell their California property.
- (2) anyone who has transferred California real property to a qualified personal residence trust (QPRT) that has not yet terminated as the property held in a QPRT is not protected from Proposition 19.



- (3) Any trust or estate of a deceased parent or grandparent that transferred property or bequests property and the updates to title along with filing the proper exclusion claim forms have not yet been completed.

Because of the fast-approaching deadline to do this planning, property owners who wish to transfer their California real property to their children without property tax reassessment should contact legal counsel as soon as possible to discuss their current options.

If you are interested in determining appropriate solutions and want to take the next steps quickly, contact us to schedule a Prop 19 Strategy Meeting or click below to schedule online.

**Schedule a Prop 19
Strategy Meeting Today!**

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