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TIME SENSITIVE – READ IMMEDIATELY

January 12, 2021

Re: **TAX CONSEQUENCES OF PROPOSITION 19 FOR CA REAL ESTATE OWNERS -- SHORT TIME FRAME TO ACT!**

Dear Pierce King Client:

For those who own real estate in California, there will be a change in *your heirs'* property taxes as a result of Proposition 19. If you choose to make any changes, the property deeds must be signed, notarized, and recorded with the County Recorder **by February 11, 2021**, so you don't have much time to act, if you desire to do so.

PLEASE READ THIS LETTER, SPEAK WITH YOUR CPA, THEN CONTACT ME (Julie King) **with your questions**. Since this involves taxes, be sure your accountant is in the loop!

High Level Summary of Proposition 19

Proposition 19 was officially named "The Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfires or Natural Disasters Act." Although the law helps the people listed in the title of Prop 19, it also makes a second change: it raises property taxes when children inherit California real estate from a parent (and in some cases a grandparent.) This letter only addresses the changes for inherited property.

Before I go any further, please know that this new law *only* deals with property tax. **It is important to look at *all* implications of your decisions**, including gift tax, capital gains tax, franchise tax, and estate tax -- as well your own financial and estate plan. Don't let the tail wag the dog. You may not want to pay more taxes now, just so your children have lower property tax later. Or maybe you do. Each person is different, so this letter does not address anyone's specific estate plan. Instead, this is for general information purposes only.

Current Law (only for another month)

When children inherit their parent's primary residence in California, the children pay the same property tax rate as their parents regardless of the value of the primary residence. Other property such as vacation homes, rental property, commercial, and investment properties can be transferred between parents and children without reassessment subject to a lifetime limit of $1,000,000 of assessed value *per parent*.

New Law (Starting February 16, 2021)

Here is how Proposition 19 will change the current law:

1. For A Parent's "Other Property". If the inherited property is not the parent's primary residence or a family farm with a principal residence, the property *will be reassessed* when your child inherits it, and the child's property taxes will go up.

2. For A Parent's Primary Residence. Your child's property taxes may or may not go up when they inherit your primary residence. The answer depends on the following:

- If your child (1) moves into the residence, (2) records with the County a document swearing under penalty of perjury that the home is *their primary residence,* and (3) records that document within one year of the parent's death, then a formula will be used to determine if the property taxes will go up. I will call this the "Primary Residence Formula" for purposes of this letter. [More on that in a second.]

- If your child does *not* do all three of the things noted in the bullet point above, the property will be taxed as if it were not the parent's primary residence, meaning the property value will be reassessed and property taxes will go up.

- Now, the Primary Residence Formula. The Assessor will compare the home's *assessed value* with the home's *market value*.

    - For purposes of this letter, the *assessed value* of property is defined as the value the Assessor uses to calculate property taxes. When someone buys property, the Assessor generally calculates property tax based on the price paid for the property. Due to Proposition 13 (from 1978), property taxes in California can only go up 2% per year. However, the *market value* of property (what you could sell it for) can go up or down 4% or more in a year. So, the *market value* of property is not the same as the *assessed value*.

    - After February 16th, the Assessor will examine the difference between the assessed value *plus $1 million* and the market value.

EXAMPLE 1:

The assessed value of parent's primary residence is $400,000 at second parent's death. The market value at that time is $800,000. If the child moves in, makes it her primary residence, and files the appropriate paperwork within one year, the calculation will be:

- The $400,000 assessed value + $1m = $1.4m

- Take the FMV of $800,000 and subtract the $1.4m = <$600,000> [negative $600k]

- Since the result is a *negative* number, there is no reassessment, and the child keeps the second parent's same property tax value.

The next example was given by the Los Angeles County Assessor.

EXAMPLE 2:

The assessed value of parent's home is $400,000 at second parent's death. The market value at that time is $2 million. If the child moves in, makes it her primary residence, and files the appropriate paperwork within one year, the calculation will be:

- The $400,000 assessed value + $1m = $1.4m
- Take the FMV of $2m and subtract the $1.4m = $600,000 [a positive number]
- The positive number is referred to as an "overage"

- Add the overage of $600,000 to the current assessed value ($400,000) to get the *new assessed value* for the child = $1,000,000.

Although the child in this second example will pay higher property tax than her parents, she is still paying lower property tax than someone who, on the date of the parent's death, buys the property next door for the same market value ($2m).

Child/Primary Resident	-	Assessed value of $1m
New buyer next door	-	Assessed value of $2m

Note: the dollar amount that is added to the assessed value ($1m in 2021) will be adjusted annually.

THERE ARE A LOT OF HOLES (UNANSWERED QUESTIONS) IN PROP 19. Unfortunately, lawyers, CPAs, and even the Assessors themselves have no way to answer many questions because the law does not address them. Until we receive more guidance from the state, please know it's possible we won't have an answer to some of your questions.

What Can Be Done?

There are a variety of strategies people can take, depending on their unique situation. Some people will transfer property to their children today to take advantage of current laws, especially if the children will keep the property for the long haul. [But the children could get angry at the parent and kick the parent out.] Other people will set up two limited liability companies (LLCs) and transfer real estate to the LLCs. **Whatever you consider doing, it is important to consider *all* tax consequences (not just property tax), and your estate and financial plans.** For example, if you have rental property and you depend on the rent as income during retirement, you may determine that keeping the rental income is more important than your children paying higher property tax – especially since the tax the children will be paying is still lower than if they had purchased the property themselves and the children can always sell the property if the tax is too high for them.

Final Note

Although Pierce King does not normally provide legal updates on the many changes in the law that occur each year due to the wide variety of our clients' situations, we thought this information would be useful and of general interest to many of you.

If you would like to discuss how Proposition 19 might impact your California real estate, please speak with your accountant, and call or email my Administrative Assistant Carol to set up a time to talk with me. Carol is at (831) 275-1002 x2 or Carol@PierceKingLaw.com.

Take care and stay healthy!

Julie

Disclaimer*: Proposition 19's requirements are complicated and were simplified for purposes of this letter. Due to the generality of this information, it is not applicable in all situations. This information should not be acted upon without appropriate professional tax and legal advice based upon the particular facts in each person's circumstances. The information in this letter is* ***not intended to be considered legal advice and should not be acted upon as such without such professional advice.***

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