

# Proposition 19: How it affects property taxes on inherited real estate

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## Daniel J. Wilson

Attorney at Law

California State Board Certified Specialist

Estate Planning, Trust, and Probate law

Master of Laws in Taxation

11665 Avena Place, Suite 108

San Diego, CA 92128

858-485-1990

DanielWilson@TrustLaw.us



## Chuck Ebersole

CLU®, ChFC®, CFP®, CAP®, AEP®

Senior Wealth Advisor/Legacy Coach

9350 Waxie Way, Suite 500

San Diego, CA 92123

(916)588-2960

chuck.ebersole@hoylecohen.com



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# California Proposition 19 (2020)

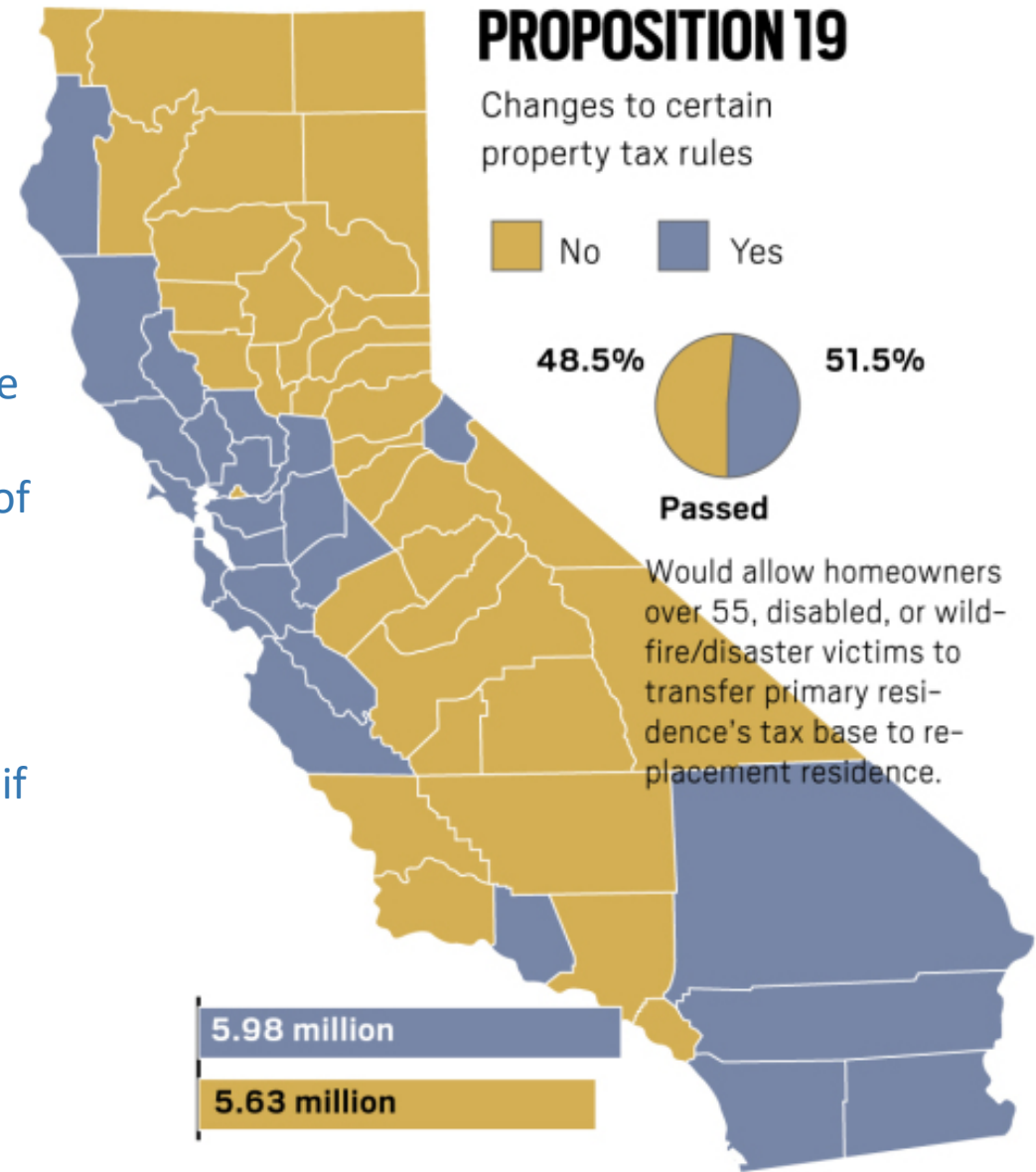
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- California Real Property Owners
- Affects Property Taxes
- Historic Change to California Constitution



# Ballot Summary

- Permits homeowners who are over 55, severely disabled, or whose homes were destroyed by wildfire or disaster, to transfer their primary residence's property tax base value to a replacement residence of any value, anywhere in the state.
- Limits tax benefits for certain transfers of real property between family members.
- Expands tax benefits for transfers of family farms.
- Allocates most resulting state revenues and savings (if any) to fire protection services and reimbursing local governments for taxation-related changes.



# California Proposition 13 (1978)

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- 1970's Inflation
- High Property Taxes
- Jarvis Taxpayer Revolt



# California Prop 13 (1978) – Limit on Annual Increases

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- Property assessed at 1% of market value upon a Change of Ownership (Sale, Gift, and Death)
- Annual Property Tax Increase capped at 2%/yr
- Property Taxes fully reassessed if “Change of Ownership” – Unless an Exclusion applies



# California Prop. 58 (1986): Residence Exclusion

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- No Change of Ownership to Children upon inheriting Parent's Principal Residence
- This is an unlimited exclusion, no matter the value of the Principal Residence



# California Prop. 58 (1986): \$1M Other Property Exclusion

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- No Change of Ownership to Children upon inheriting \$1 million of assessed value of other property
- Each Parent can leave this \$1 million of other property to their children - \$2m total





# Parent-Child Exclusion (Old)

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No reassessment of property taxes on transfers of real estate from parents to children on:

- Parent's principal residence; AND
- \$1 million of assessed value of other property

# Parent-Child Exclusion (New)

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No reassessment of property taxes on transfers of real estate from parents to children on:

- Parent's principal residence, if the child maintains this property as their own principal residence
- Only the first \$1 million over assessed value is excluded from reassessment

Starting after **February 15, 2021!**

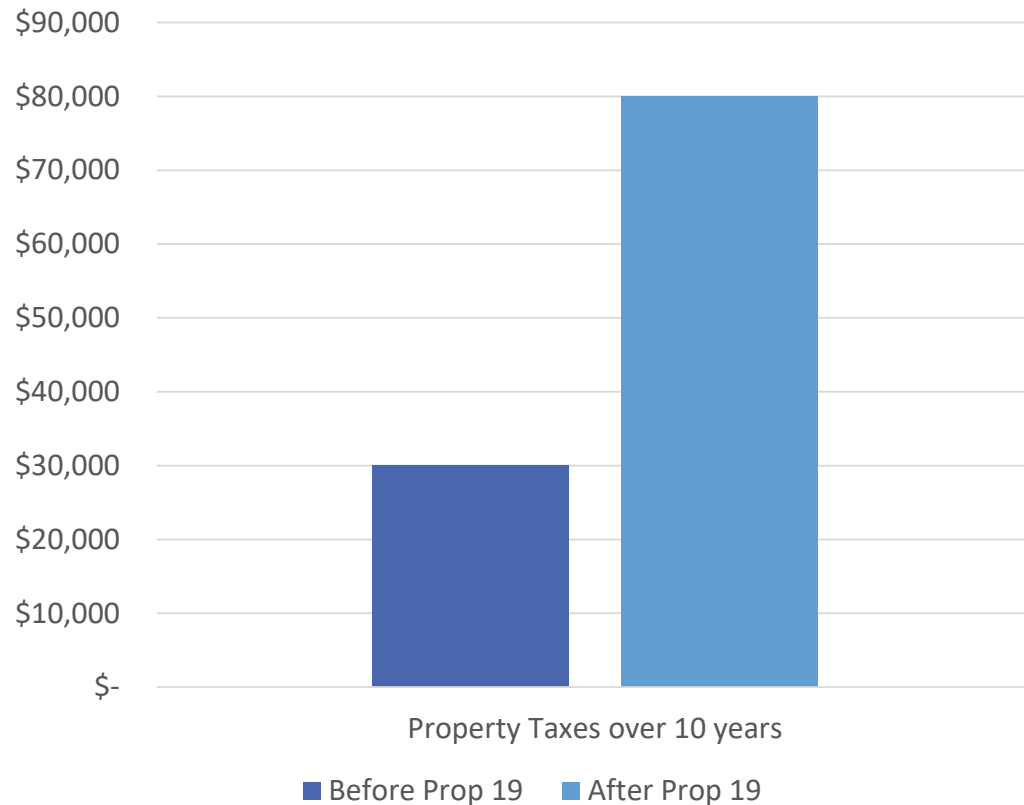
# California Prop. 19 – **GONE**: \$1M Other Property Exclusion

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- **NO** \$1M Exclusion of other real estate
  - Any rental property passing from a parent to children will be fully reassessed upon death
  - Any vacation or 2<sup>nd</sup> home passing from a parent to children will be fully reassessed upon death



# Proposition 19 – Principal Residence

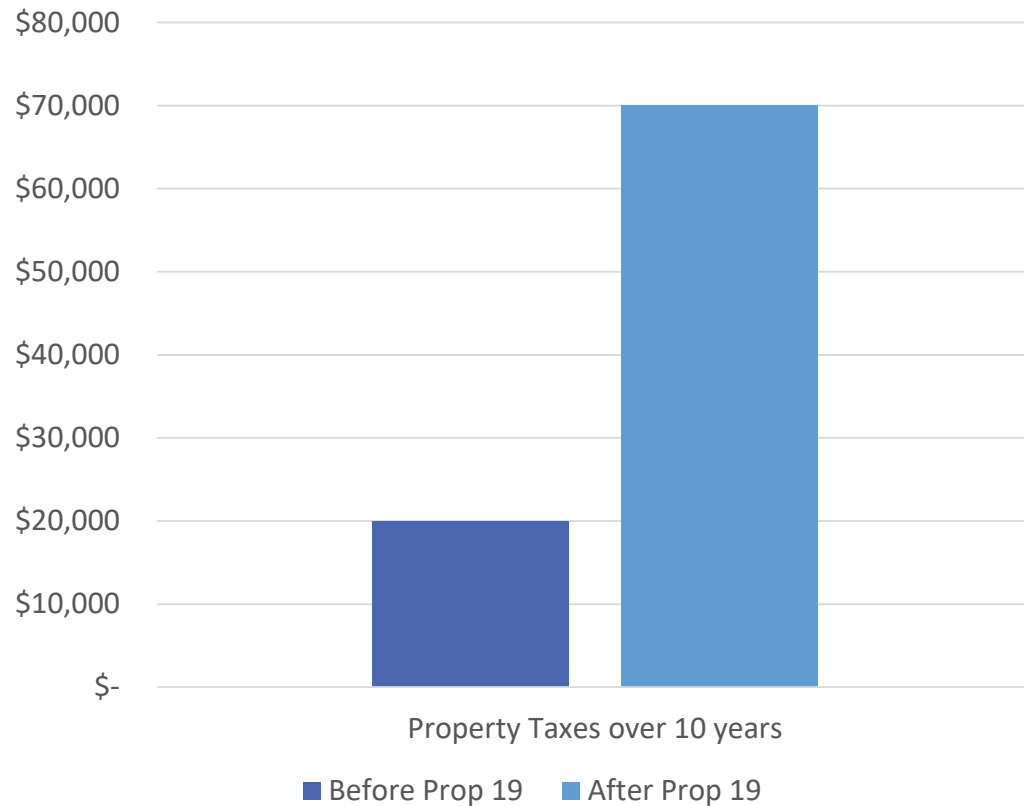


Mom buys home in 1990 for \$200,000. Property taxes are about \$3,000 per year. If Mom dies when the property is worth \$800,000, then:

- Before Prop 19, children could inherit home and continue to pay \$3,000 per year.
- After Prop 19, if no child makes this home their principal residence, the property taxes will increase to about \$8,000 per year.

Over ten years, the children pay \$50,000 **more** in property taxes

# Proposition 19 - Rental Property



Mom also has a rental property from 1980, which she bought for \$100,000 and is now worth \$700,000.

Property taxes are about \$2,000 per year. If Mom dies when the property is worth \$700,000, then:

- Before Prop 19, children could inherit the rental property and continue to pay \$2,000 per year.
- After Prop 19, it will be fully reassessed and the children would pay \$7,000 per year.

Over ten years, the children pay \$50,000 **more** in property taxes

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# Proposition 19 – Limit on Exclusion

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**The Parent-Child Exclusion is limited to the first \$1 million over the assessed value**

- Excess market value is added to the excluded assessed value

For Example: A property with an assessed value of \$500,000 and a market value of \$2.5 million is given an assessed value of \$1.5 million after transfer, even if the Parent-Child Exclusion applies.



# Proposition 19 Planning

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First Question to ask: Do the kids want to keep the property?



OR



# Proposition 19 Planning – Considerations

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## Trade-Offs on Transferring Property before 2/15/2021

- Stepped-Up Basis at Death v. Carry-Over Basis on a Gift
- Loss of ability to exclude property from estate for Estate Tax purposes
- Loss of Rental Income on Rental Properties
- Loss of new depreciation schedule at death
- Possible trigger of a due on sale clause, if mortgage
- Loss of Income Tax Benefits of Owning Real Estate
- Uncertainty of property tax law in the future

The interplay of these trade-offs makes this an individualized analysis.





# Proposition 19 Planning – Capital Gains

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- $\text{Basis} = \text{Purchase price} + \text{Capital Improvements} - \text{Depreciation}$

- $\text{Capital Gains} = \text{Sales Price} - \text{Basis}$

At death, property gets a “stepped-up” basis at death. Meaning the basis becomes the value as of the date of death.



# Proposition 19 – Planning before 2/16/2021

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- Death before 2/16/2021
  - The Change of Ownership date is the date of death. Even if the property has not been transferred to the child until after 2/16/2021, then the old rules applies
- Outright Gift of Property
- Creation of LLC coupled with an outright gift to children
  - Parent would gift partial interest in real property to child. Parent and Child transfer their interests into a newly created LLC. On Parent's death, their interest passes to Child, however, only the portion passing to Child is reassessed.
- Irrevocable Trusts?
  - Trust with a “2038 Power” to use disappearing parent-child exclusion and cause estate inclusion for Stepped-Up Basis.
  - Sale to an “Intentionally Defective Grantor Trust” (IDGT)

# Proposition 19 – Planning before 2/16/2021

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## Outright Gift



- Pros: Simple, low cost, can be accomplished before 2/16/2021
- Cons: **Carryover Basis**, Loss of control, subject to child's divorce or creditors, loss of rental income, no access to equity if needed

# Commonly Asked Questions about Prop. 19

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- What does “Family Home” Mean?: Home that qualifies for Homeowners’ Exemption
  - “To help you determine your principal residence, consider (1) where you are registered to vote, (2) the home address on your automobile registration, and (3) where you normally return after work. If after considering these criteria you are still uncertain, choose the place at which you have spent the major portion of your time this year.”
  - Link to San Diego Homeowners’ Exemption Form:  
<https://arcc.sdcounty.ca.gov/Documents/266HOXCLAIM.pdf>
- Does having my home in a Trust prevent a reassessment? No, your family living trust does not protect against Prop 19.
- What if I add my children as co-trustees to my Trust? No, a “Change of Ownership” has not occurred by doing this.

# Unanswered Questions about California Prop. 19

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- How long does child have to live in the residence to establish as his or her Family Home?
- May only one person claim the “Family Home”?
- What if the “Family Home” is left as residue to three children and only one of the children live in the “Family Home”? Is qualification made?
- When does the child have to move into the “Family Home” to qualify or does the child have to be residing in the “Family Home” at the time of the transfer?
- The State Board of Equalization will be busy propounding regulations; uniformity is important.

# Proposition 19 – Planning in the future

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## Include a “Right of First Refusal” in your Trust

- If one child would like to retain the residence and qualify for the parent child exclusion, but there are not sufficient assets to “buy out” the other siblings, a “Right of First Refusal” allows the flexibility for the child who is receiving the property to purchase the property from the Trust.

# Proposition 19 – Planning in the future

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## Use an LLC to purchase property

- If an LLC is the original purchaser of property, then the LLC can avoid any future reassessment for so long as there is no “change of control” for property tax purposes



# QUESTIONS?



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