T. Chiu Law
A PROFESSIONAL CORPORATION

HOW PROPOSITION 19 MIGHT AFFECT YOUR FAMILY

Proposition 19 was passed in California during the November 2020 election. The proposition was characterized as a law that would benefit seniors, severely disabled, families and wildfire victims, but many legal professionals are doubtful about positive impacts on many of their clients.

Disclaimer: This notice is not intended to be tax or legal advice. Rather, this notice is intended to inform clients and colleagues of T. Chiu Law about the potential effect Prop 19 has on them or their clients. If further questions arise, T. Chiu Law may be engaged to render estate planning advice in connection with Prop 19. The regulations to enforce and clarify this law are being drafted by the California Board of Equalization ("BOE") and are not currently available. Each family's circumstances will determine the best planning option for you. Information on Proposition 19 is available on the BOE website at https://www.boe.ca.gov/prop19.

Background

Proposition 19 affects our property taxes. Property taxes are based on the assessed value of your property, which is determined by your County Assessor. In 1976, Prop 13 was passed to limit increases to the *assessed value* of your home to no more than 2% per year. As a result, your property taxes (usually somewhere slightly above 1% of the assessed value depending on your county) should only increase by a marginal amount (if any) every year.

The county can reassess a property every time there is a *change in ownership*, which in California, typically results in a higher assessed value because of the ever-appreciating nature of real estate. There are exceptions to reassessment, and in 1986, Proposition 58 came into effect *excluding transfers between parent and child* from reassessment. As a result, many parents can leave their family home to their children, and because the change in ownership from parent to child is an exception to reassessment, the children inherit the property without experiencing an unaffordable increase in their property tax bill. In California, Prop 58 has allowed many children to keep homes they may not otherwise be able to afford if the property was reassessed to the fair market value of the home at the time they inherited it.

Overview of Prop 19

In short, Proposition 19 severely restricts the *parent to child exclusion* in the following ways:

<u>*Principal Residence*</u>. If you pass your principal residence to your children, then only the first $1,000,000 of taxable value can be excluded from reassessment.

Example. John and Jane purchased their family home in 1970 in Orange County for $80,000. They raised 2 children, Jack and Jill, in the home and welcomed grandchildren and great-grandchildren into the home before John passed in 2025. Jane passed 5 years later in 2030. The *assessed value* at the time Jane passed was $400,000 and her corresponding property tax was $4,800 (assuming a 1.2% property tax of the assessed value). The fair market value in 2030 was $2,000,000.

When Jack and Jill inherit the home, a change in ownership occurs and the county can reassess the property to its fair market value at the time of the transfer. However, because of the *parent-child exclusion* under Prop 58, the property is excluded from reassessment, and Jack and Jill pay the same lower property tax for their parents' principal residence.

Under Prop 19, Jack and Jill will pay much more in property tax. IF EITHER (BOTH?*) CHILD USES THE FAMILY HOME AS HIS/HER OWN PRINCIPAL RESIDENCE, the calculation of property tax on their family's home is roughly as follows:

Assessed Value in 2020	$400,000
$1,000,000 exclusion from reassessment	$400,000 - $1,400,000
Fair Market Value	$2,000,000
Added Taxable Value	$2,000,000 - $1,400,000 = $600,000
Total Assessed Value	$400,000 + $600,000 = $1,000,000
New Annual Property Tax Under Prop 19	<u>**$12,000 (assuming the same 1.2% property tax rate)**</u>

If neither Jack nor Jill uses the property as his/her principal residence but keeps it as a rental property, then the entire property is reassessed (with no $1,000,000 exclusion) and the resulting property tax based on the $2,000,000 assessed value is <u>**$24,000 (1.2% property tax rate X $2,000,000 assessed value increased to fair market value)**</u>.

<u>*Other Real Property*</u>. Under current law, the parent-child exclusion also applies to other real property (not only principal residences), but the exclusion is capped at $1,000,000. If the property described in the above example was NOT John and Jane's principal residence, the property tax should be $12,000.

*It is unclear how the assessed value will be calculated if parents had more than one child, the children inherit equally, but only one child uses the property as his/her principal residence.

Under Prop 19, assuming the property described was NOT John and Jane's principal residence, the parent-child exclusion is entirely eliminated. When the kids inherit the property, it is reassessed to $2,000,000 and the kids pay a corresponding property tax of **<u>$24,000</u>**.

Does Prop 19 Affect My Family?

It depends on the answers to the following questions (and likely, many more):

Do you intend to leave your home to your kids? Or is it possible that you will inherit property from your parents?

Do you own other property that you intend to leave to your kids?

How old are your kids?

Will your kids keep the property once inherited or will they sell it?

How long have you owned the property?

What is the current assessed property value? What is the fair market value of the property?

Conclusion

Proposition 19 goes into effect on February 16, 2021. Transfers of property between parent and child must be recorded before then in order to qualify for the parent-child exclusion and lock-in the property tax rate. If you are considering a transfer, it is taking 4-5 weeks to have a deed recorded.

NOTE THAT THERE ARE OTHER ISSUES TO CONSIDER. In many cases, a present transfer of property to children is NOT the solution. Please contact T. Chiu Law to schedule an appointment to assess your individual situation. To start, we will need the following documents:

- ☐ Current property tax bill
- ☐ Adjusted basis for your property
- ☐ Estimated fair market value of your property
- ☐ Previously filed gift tax returns