

Stay Ahead of the Curve: California Property Tax Developments and Practice Pointers for the Everyday Practitioner

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Proposition 13:

California Constitution Article XIII A

- ▶ Limited Annual Increases in Assessed Value of Real Property to an Inflation Factor, Not to Exceed 2% Per Year (“Trended Base Year Value”)
- ▶ Prohibited Reassessment of a New Base Year Value except upon:
 - a) Change in Ownership or
 - b) Completion of New Construction

Proposition 8

- ▶ Provides Property will be assessed at the “Trended Base Year Value” or the Fair Market Value as of January 1 (Revenue & Taxation Code §51(a)(2)).

Appeal Deadlines

- ▶ Regular Assessment
 - *September 15 or November 30 (depends on the county)*
- ▶ Supplemental Assessment
 - *60 days from the mailing of the notice or bill (depends on the county)*
- ▶ Escape Assessment
 - *60 days from the mailing of the notice or bill (depends on the county)*

Definition of Change in Ownership: Revenue & Taxation Code § 60

- ▶ Three Elements:
 1. Transfer of a present real property interest;
 2. Including the beneficial use thereof; and
 3. The value of the interest is substantially equal to the value of the fee.

Proposition 19 - Overview

- ▶ In the November 2020 election, California voters passed Proposition 19 by a 51.1% majority
- ▶ Prop. 19 (with variations) had been on prior years' ballots but did not receive enough votes
- ▶ Major selling point was that tax dollars would go towards wildfire response

Proposition 19 - Overview

- ▶ Prop 19 was put forth by California realtors to increase sales and therefore commissions for realtors.
- ▶ The virtual elimination of the Parent-Child Exclusion and the extension of the Over 55 Base Year Transfer will likely increase sales volumes.

Parent-Child Exclusion (Prior Law)

- ▶ Revenue & Taxation Code §63.1 provides that a change in ownership does not include the transfer between parents and children (in either direction) of:
 1. A Principal residence; and
 2. The first \$1 million of Trended Base Year Value of all other real property

Revenue & Taxation Code § 63.1(a)(1)(A), (2)

Parent-Child Exclusion

- ▶ “Principal residence” means a dwelling for which a homeowner’s exemption or a disabled veterans’ residence exemption has been granted in the name of the eligible transferor
- ▶ “Principal residence” includes only that portion of the land underlying the principal residence that consists of an area of reasonable size that is used as a site for the residence

Revenue & Taxation Code § 63.1(b)(1)

Parent-Child Exclusion

- ▶ “Child” generally means:
 1. Any child born of the parents except a child who has been adopted by another person;
 2. Any stepchild of the parents and the spouse of the stepchild;
 3. Any son-in-law or daughter-in-law of the parents until divorce or death of the child and re-marriage of the son/daughter-in-law; or
 4. Any child adopted by the parents other than a child adopted after the age of 18.

Revenue & Taxation Code § 63.1(c)(3)

Parent-Child Transfers

Prior Law Example 1:

- ▶ Mother transfers 100% of Blackacre to child and Blackacre is the mother's principal residence
- ▶ The assessed value is \$3,500,000
- ▶ The fmv of Blackacre is \$8 million
- ▶ No reassessment

Parent-Child Transfers

Prior Law Example 2:

- ▶ Mother transfers 100% of Blackacre to child and Blackacre is not a principal residence
- ▶ The assessed value is \$350,000
- ▶ The fmv of Blackacre is \$1.2 million
- ▶ No reassessment. \$350,000 of the mother's \$1 million exclusion is used.

Prop. 19 Parent-Child Transfers

- ▶ Now, the parent-child exclusion remains in a limited fashion
 - For transfers on and after February 16, 2021, the parent-child exclusion applies for the transfer of a parent's (or child's) principal residence to a child (or parent), who uses it as his or her principal residence (the child must move in within one year of the transfer and file for the homeowner's exemption).
 - The exclusion is further limited to the house's base year value plus one million dollars, as adjusted annually by the State Board of Equalization.

Revenue & Taxation Code § 63.2(a), (d);

See also, California Constitution, Article XIII A, Section 2.1(c)(4)

Prop. 19 Parent-Child Transfers

- ▶ Now, the parent-child exclusion remains in a limited fashion
 - The \$1 million for non-principal residence property is eliminated.

Prop. 19 Parent-Child Transfers

Example 1:

- ▶ Mother transfers 100% of Blackacre, her principal residence, to child, and child uses Blackacre as his principal residence
- ▶ At that time, the assessed value is \$350,000, and the adjusted \$1 million exclusion is \$1.1 million
- ▶ The fmv of Blackacre is \$1.2 million
- ▶ No reassessment because Blackacre's fmv is less than the assessed value plus the exclusion

Prop. 19 Parent-Child Transfers

Example 2:

- ▶ Same facts except the fmv of Blackacre is \$2 million.
- ▶ Reassessment results in \$900,000 valuation

Example 3:

- ▶ Same facts (\$1.2m fmv) except child does not use Blackacre as his principal residence.
- ▶ Reassessment results in \$1,200,000 valuation

Prop. 19 Parent-Child Transfers

- ▶ The eligible transferee has one year to move in and claim the homeowner's exemption.
- ▶ When the transferee moves out, the exclusion is removed and the property value is "recalculated."
- ▶ If another eligible transferee moves in within 1 year of the prior eligible transferee's exit, no recalculation.

Revenue & Taxation Code § 63.2(a)(1)(B)

Prop. 19 Parent-Child Transfers

Example 1:

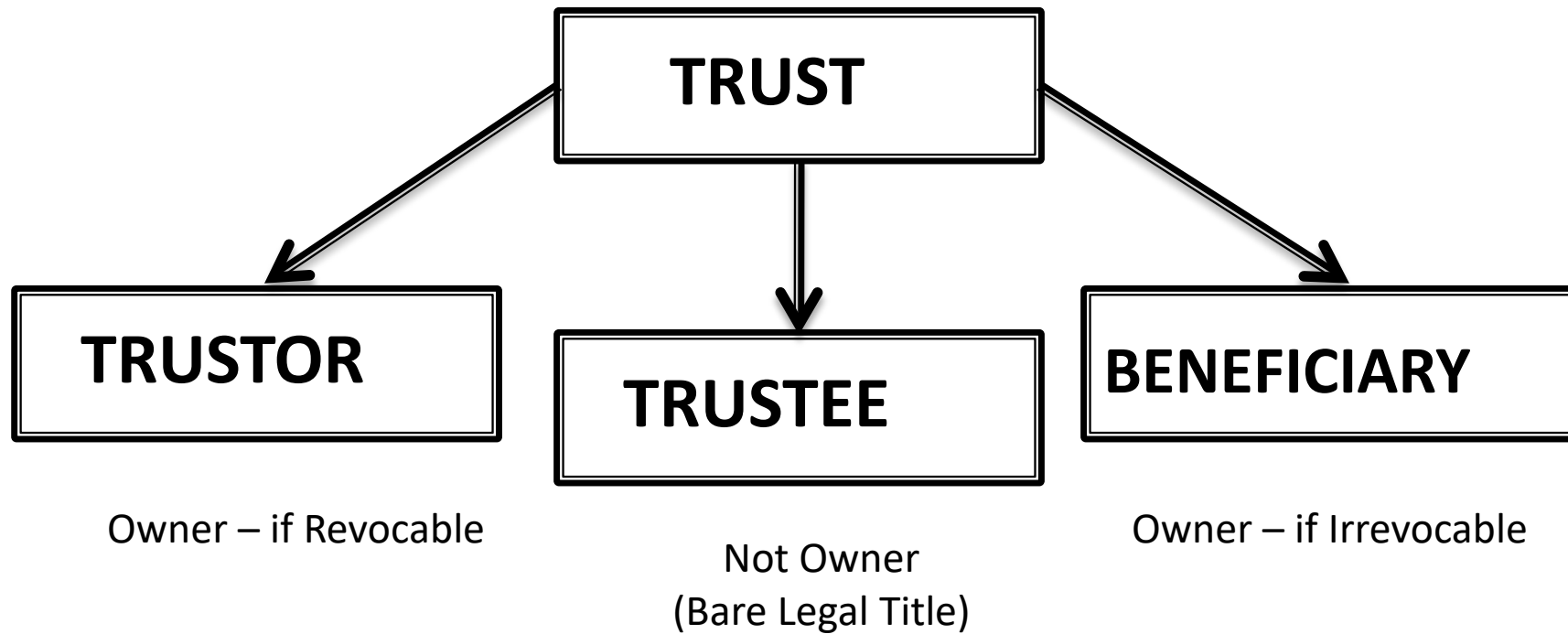
- ▶ Mother transfers Home to Son who lived there for 3 years, then moved and rented it out.
- ▶ When Son moved in, the assessed value was \$150,000, and fmV was \$800,000.
- ▶ When Son moved out, the property is reassessed at \$848,966 (assuming 2% trend factor), even if the current fmV is higher.

Parent-Child Exclusion

- ▶ “Principal residence” means a dwelling that is eligible for a homeowner’s exemption or a disabled veterans’ residence exemption
 - Revenue & Taxation Code § 63.2(e)(5)
- ▶ Other terminology remained substantially similar to prior version (e.g., “Child”).
 - Revenue & Taxation Code § 63.2(e)
- ▶ Filing deadlines remained substantially similar.
 - Revenue & Taxation Code § 63.2(f)

§ 62(d) - Any Transfer by a Trustor, or by the Trustor's Spouse, or by both, into a Trust:

- ❑ Excluded if Transferor is Present Beneficiary of Trust

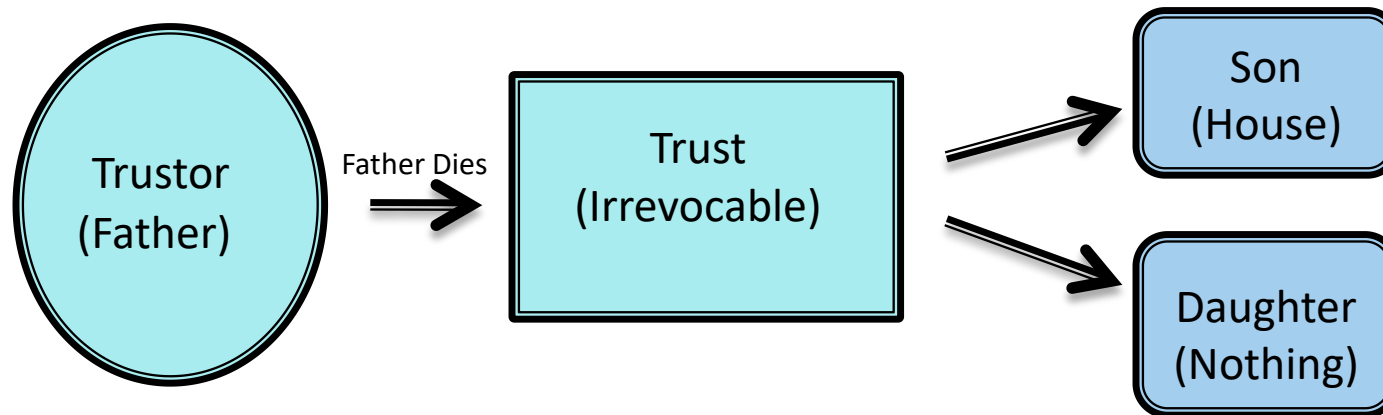


Parent to Child Transfer Via Trust

Non-Pro Rata Distribution

Taxpayer Problem – Single Property Only Trust Asset

- ❑ Trust Property: House \$500,000 FMV with no DOT and no cash.
- ❑ Trustee distributes house to Son.
- ❑ Son encumbers house with a loan and gives loan proceeds to Daughter.
- ❑ Result: Change in ownership of 50% of the house. At distribution, Son received more than his equal share. The Daughter's share is deemed to have transferred to Son.



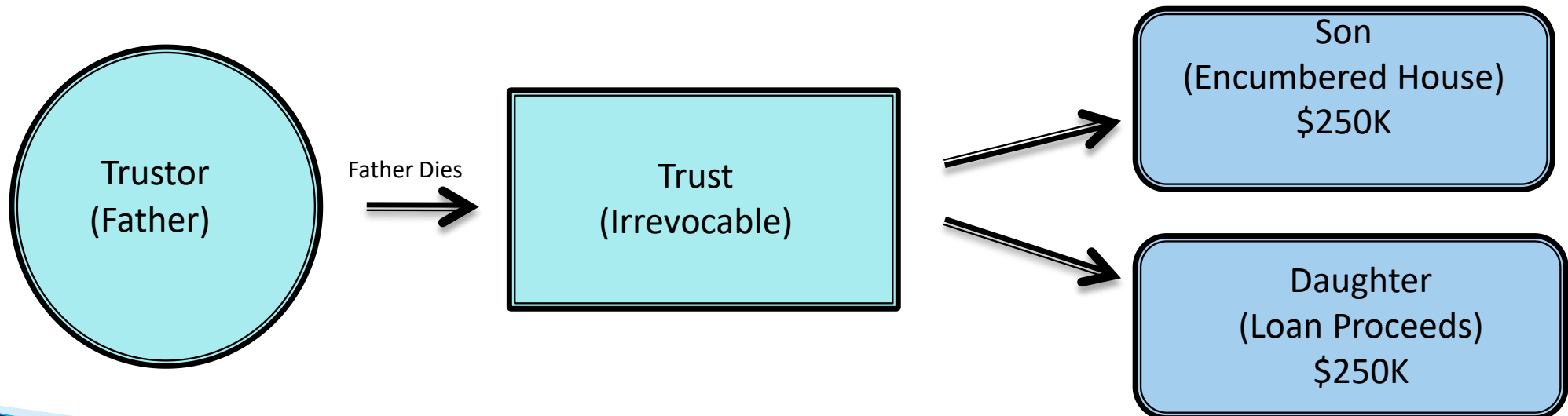
Property Tax Rule 462.160

Parent to Child Transfer Via Trust

Non-Pro Rata Distribution - Redone

Taxpayer Solution – Trustee Encumbers Property Before Distribution

- ❑ Trust Property: House \$500,000 FMV with no DOT and no cash.
- ❑ Trustee encumbers the property with a loan for \$250,000 (Loan cannot be made by beneficiary receiving the property).
- ❑ Trustee distributes the property subject to the loan to Son and the loan proceeds to Daughter.
- ❑ Result: 100% of House subject to PC exclusion.



Prop. 19 Parent-Child Transfers

- ▶ There may be ways to plan around the limitations imposed on the parent-child transfer exclusion by Proposition 19 (using legal entity rules, joint tenancy rules, etc.). However, all planning must be prior to death.
- ▶ Proper documentation, proactive planning, and timely submissions are critical to ensure application of the parent-child exclusion or to avoid a change in ownership altogether

Proportional Transfers

- ▶ Revenue & Taxation Code §62(a)(2) excludes from a change in ownership “Any transfer between an individual or individuals and a legal entity or between legal entities... that results solely in a change in the method of holding title to real property and in which proportional ownership interests of the transferors and transferees... remain the same after the transfer.”

Legal Entity CIO - Overview

- ▶ §64(a) provides the general rule that transfers of legal entity interests are not reassessable changes in ownership.
- ▶ Trusts are generally not legal entities for property tax change in ownership purposes.
- ▶ Ownership of LLCs and Partnerships is measured by capital and profits interests.
- ▶ Ownership of corporations, for Section 64 purposes, is measured by voting stock.

Joint Tenancy Rules

- ▶ Joint tenancy is form of concurrent ownership in real property held by any number of co-owners with rights of survivorship
 - Civil Code § 683; Assessor's Handbook ("AH") 401, Ch. 2, p. 15
- ▶ Generally, creation, transfer, or termination of a joint tenancy interest is a change in ownership.
 - Revenue & Taxation Code § 61(e)
- ▶ Only the interest portion that has undergone a change in ownership is reassessed.
 - Revenue & Taxation Code § 65(a)

Joint Tenancy Rules

Example 1 (Creation):

- ▶ When Z, as sole owner, transfers Blackacre to X and Y, as joint tenants, there is a 100% change in ownership.

Example 2 (Transfer):

- ▶ When X and Y, as joint tenants, transfer Blackacre to A and B, as joint tenants, there is a 100% change in ownership.

Example 3 (Termination):

- ▶ When A and B, as joint tenants, transfer Blackacre to A, as sole owner, there is a 50% change in ownership (assuming no original transferor status).

Joint Tenancy Rules

- ▶ There are three primary exceptions to the general rule:
- ▶ (1) Original Transferor Exception;
- ▶ (2) Proportional Ownership Interest Transfer Exception;
and
- ▶ (3) Qualifying Parent-Child and Grandparent-Grandchild Transfers (Under Current Law)

Joint Tenancy Rules

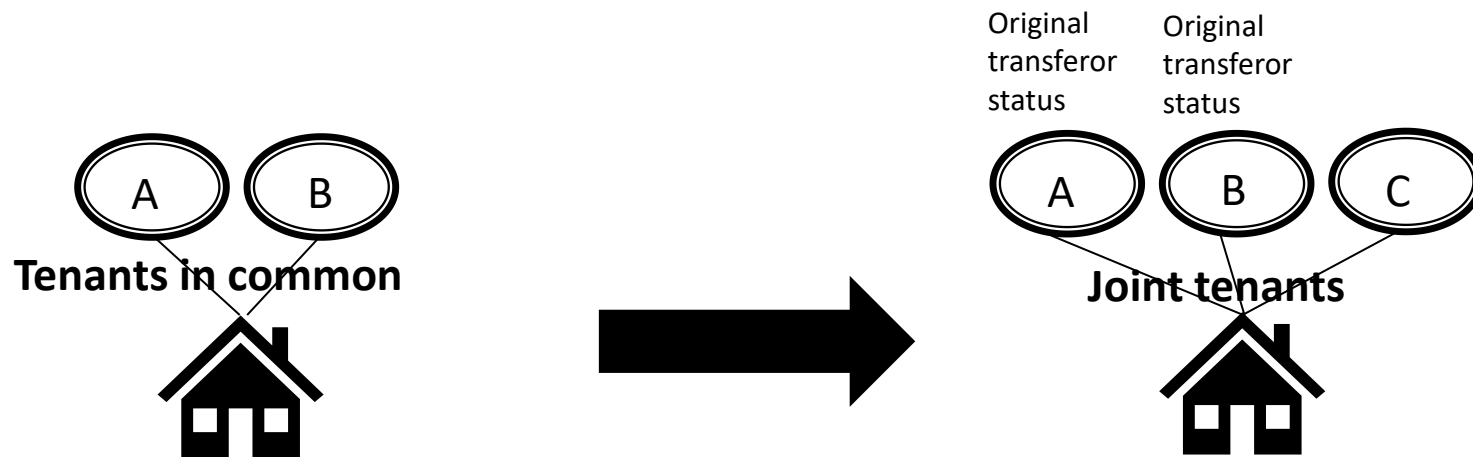
(1) Original Transferor Exception

- ▶ Transfers creating or transferring a joint tenancy interest where all the transferors are “original transferors”
- ▶ An “original transferor” is a person who creates a joint tenancy by transferring real property to others and remains among the joint tenants.
- ▶ Where there is a transfer that terminates the property interest of a joint tenant **without** original transferor status, there is no reassessment so long as that interest vests in the remaining joint tenants and one such tenant is an original transferor.
- ▶ However, transfers that terminate the joint tenancy interest of the last surviving original transferor result in a 100% change in ownership.

Revenue & Taxation Code §§ 62(f), 65(b);
Property Tax Rule 462.040(b)(1)

Joint Tenancy Rules

- ▶ A and B own Blackacre, as tenants in common. A and B deed the property to A, B and C, as joint tenants. C is unrelated to A and B.



- ▶ No change in ownership results because A and B are original transferors. C is not an original transferor.

Joint Tenancy Rules

- ▶ If A and B die, 100% change in ownership
- ▶ If C dies, no change in ownership.
- ▶ If A, B, and C transfer the property to A, no change in ownership since A is an original transferor.

Joint Tenancy Rules

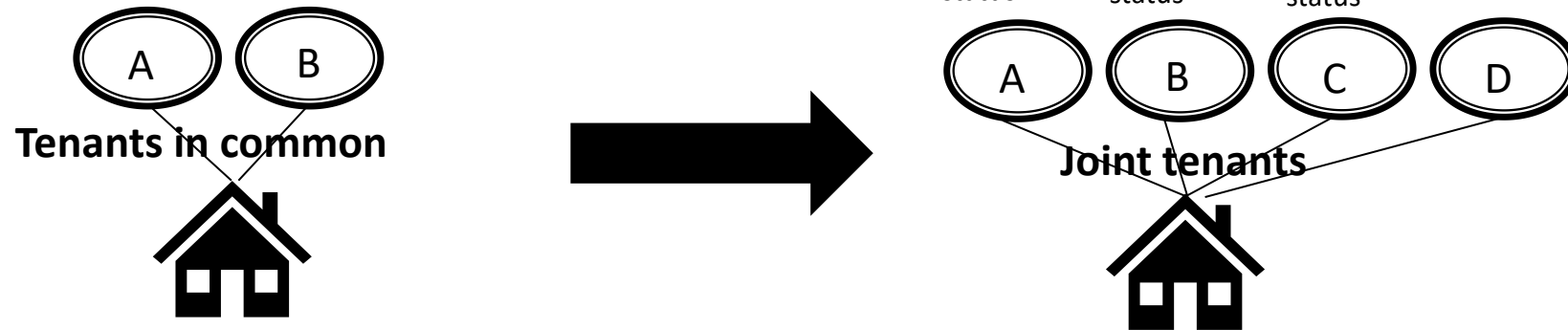
- ▶ **Spouse of Original Transferor**
- ▶ A spouse of an original transferor who acquires an interest in joint tenancy property during the time the original transferor owns the property will also be considered an original transferor.

Revenue & Taxation Code § 65(b);
Property Tax Rule 462.040(b)(1)(A)

Joint Tenancy Rules

Example 1:

- ▶ A and B are joint tenants, and they transfer Blackacre to A, B, C, and D as joint tenants. C is B's spouse, and D is unrelated to all



- ▶ No change in ownership because the Original Transferor Exclusion applies. A, B, and C are original transferors (C by marital status), and D is not an original transferor.

Joint Tenancy Rules

- ▶ **(2) Proportional Interest Transfer Exclusion**
- ▶ For all joint tenancies other than those to which the Original Transferor Exclusion applies, a transfer among co-owners where there is a change in the method of holding title but does not change the proportional interests of the co-owners does not result in a change in ownership.

Revenue & Taxation Code § 62(a)(2)

Joint Tenancy Rules

- ▶ **(3) Parent-Child and Grandparent-Grandchild Exclusions (Under Current Law)**
- ▶ Due to the joint tenancy rules under property tax law, there may be ways to plan around the restrictions on the parent-child transfer implemented under Proposition 19.
- ▶ Planning around joint tenancy rules is highly fact specific and also requires the clear expressed intent to create a joint tenancy.

Over Age 55 Transfers (Prior Law)

- ▶ Section 69.5 allows for a transfer of base year value for any person age 55 and older who resides in property eligible for the homeowner's or veteran's exemption.
- ▶ The section 69.5 transfer can only be done once unless a person becomes severely and permanently disabled.
- ▶ The new home must be of "equal or lesser value."

Over Age 55 Transfers (Prior Law)

- ▶ “Equal or lesser value” means:
 1. 100% of the value of the original property if the new home is purchased or newly constructed prior to the date of sale of the original property;
 2. 105% if the new home is purchased within one year following the date of sale of the original property; or
 3. 110% of the amount of the value of the original property if the new home is purchased within the second year following the date of sale of the original property.

Revenue & Taxation Code § 69.5(g)(5)

Over Age 55 Transfers (Prior Law)

- ▶ If the replacement dwelling is purchased and, in part, newly constructed, the relevant date is the latter of the purchase date or the completion of construction.
 - Revenue & Taxation Code § 69.5(g)(5)
- ▶ The new home must be in the same county as the original home or a county that has reciprocity.
 - Revenue & Taxation Code § 69.5(a)(1), (2)

Prop. 19 Special Transfers

- ▶ Effective 4/1/2021, such transfers are expanded greatly
 - Applicable to homeowners age 55 and older, disabled homeowners, and natural disaster victims
 - The transfer is permitted three times, not just once
 - The new home can be in any CA county so long as it is purchased or newly constructed within two years of the sale of the old home

Revenue & Taxation Code § 69.6(a), (b)

Prop. 19 Special Transfers

- ▶ No longer limited to new homes of “equal or lesser value”
- ▶ If the new home’s assessed value is equal to or less than the old home’s assessed value, the base year value transfers over
 - Revenue & Taxation Code § 69.6(e)(2)
- ▶ If the new home’s assessed value is greater than the old home’s assessed value, the new base year value is increased by the difference in fmv
 - Revenue & Taxation Code § 69.6(e)(3)

Prop. 19 Special Transfers

Example 1:

- ▶ Homeowner, 56 years old, has a home with an assessed value of \$150,000.
- ▶ Homeowner sells old home for \$500,000, and purchases new home for \$400,000.
- ▶ New home's assessed value will be \$150,000.

Measure ULA

City of Los Angeles “Mansion” Tax

Documentary Transfer Tax

- ▶ Revenue & Taxation Code § 11911 states that the DTT is imposed on each deed, instrument, or writing by which lands, tenements, or other realty sold within the county shall be granted, assigned, transferred or otherwise conveyed to, or vested in, the purchaser...when the consideration or value of the interest or property conveyed exceeds \$100.

Documentary Transfer Tax

- ▶ The transfer tax is an “excise” tax for the privilege of transferring realty.
- ▶ The documentary transfer tax is not a property tax, but rather a tax on the exercise of the privilege of conveying property. (*City of Huntington Beach v. Superior Court* (1978) 78 Cal.App.3d 333, 340-341).

Documentary Transfer Tax

- ▶ One uncoded provision (Stats. 1967, ch. 1332, §2) is particularly significant, “no city or county shall directly or indirectly impose a tax on transfers of real property which is not in conformity with this part [the Transfer Tax].”
- ▶ As used in this section, “city” does not include a chartered city and “county” does not include a city and county.

Measure ULA: Mansion Tax?

- ▶ Advertised as the “Mansion Tax” designed for the rich to pay their fair share.
- ▶ Increased the Documentary Transfer Tax rate based on real estate consideration or value sold or transferred by an additional:
 - Greater than \$5 million = 4% of consideration or value transferred.
 - Greater than \$10 million = 5.5% of consideration or value transferred.

Measure ULA: Mansion Tax?

- ▶ Not limited to a specific property type
 - Does exempt transfers to some non-profits, community land trusts, and limited equity housing cooperatives
- ▶ Became effective April 1, 2023
 - Thresholds are adjusted annually (every July 1) based on CPI index.
 - Currently at \$5,300,000 and \$10,600,000.
- ▶ Graduated rates are on top of the 0.45% base rate on all LA City transfers.

Documentary Transfer Tax: Compliance

- ▶ Declaration on the face of the Deed
 - Legal Entity Transfer Tax Events
 - County specific Declaration
- ▶ Review County and City Municipal Codes
 - LA is not only city with graduated tax
 - Santa Monica, San Mateo, San Jose, San Francisco, Culver City, etc.
- ▶ Include debt?
- ▶ Rounded value?
- ▶ Reporting Deadlines?
- ▶ Penalties and interest?