
ALERT

Proposition 19 Impacts Estate Planning

Recently passed Proposition 19 (“Prop 19”) includes two (2) relevant changes in California property tax assessments that may impact your estate planning. In order to ensure you are not unaware of or adversely impacted by these changes, we have prepared this summary for your review.

Changes to Parent-Child Exclusion

Prop 19 limits the availability of the parent-child exclusion for purposes of real estate tax assessments. Prop 19 takes effect on February 16, 2021.

Under current law, when a parent transfers ownership of his or her principal residence to a child, the property’s value for tax assessment purposes is not reassessed. Under current law, the child or children could even use the residence as a vacation home or a rental property. Finally, under current law and in addition to the principal residence exclusion, each parent can transfer to their children up to \$1 million of any non-principal residence property (e.g., commercial property, second home, rental property, etc.) without triggering a reassessment.

Prop 19 changes this by requiring that the child or children use the principal residence as their own principal residence or it will be reassessed. Also, even if the child uses the principal residence as his or her own principal residence, there is a cap of \$1,000,000 on the exclusion. Prop 19 eliminates the non-principal residence property exclusion (i.e., up to \$1 million) for non-principal residence property.

Prop 19 poses a particular dilemma for clients who created a Qualified Personal Residence Trust (“QPRT”) which has a fixed term that extends beyond February 16, 2021. A QPRT allows the transfer of a residence to a trust while the residence is still occupied for a fixed number of years. The parent(s) continue(s) to live in the residence as their primary residence, and at the end of the fixed number of years, the residence transfers to someone else (generally their children or a trust for their benefit). Most parents who establish QPRTs want to continue living in the house after the fixed term expires. They may do so, but they need to pay rent to the trust or their children, depending on who owns the residence at the end of the fixed term.

Under existing law, when the children become the owners they would qualify for the parent-child exclusion. However, once Prop 19 takes effect, the children would need to use the residence as their primary residence or trigger reassessment. They could not rent it back to the parent, and if siblings are entitled to the residence at the end of the fixed term, they would need to move in together and share a household to qualify for the exemption. If parents have QPRTs with fixed terms that end on or after February 16, 2021, the value of their home may be reassessed to its current value. This could lead to a large property tax increase, though it may be possible to mitigate this. Those with an established trust that hold a residence and names their children as remainder beneficiaries, or those planning a transfer of a home to their children outright or in trust, should contact your estate or tax counsel before the effective date of this new law. It is critical that he/she review your estate planning documents and recommend any necessary changes.

If your home has increased in value significantly from its taxable value, Prop 19 adds certain limitations that could result in an increased assessment. This new rule will apply to outright transfers and to transfers in trusts, such as the QPRT transfer discussed above. If the increase in

value is less than or equal to \$1,000,000, no adjustment is made. If the increase in value is more than \$1,000,000, the increase in value after the first \$1,000,000 is added to the tax assessed value. For example, assume a parent's home has a taxable value of \$1,000,000. Because the parent purchased the home many years ago, its value is now \$5,000,000. In other words, it has increased by \$4,000,000. The new reassessed value if the parent gifts the home to her child will be \$4,000,000. Note that there are inflation adjustments that apply to the \$1,000,000 increase limitation for later years.

Changes to the Transfer of Taxable Value for Certain Property Owners

The other relevant change in Prop 19 is generally beneficial to homeowners. Prop 19 expands the class of people who qualify for a transfer of their taxable value from their current home to a new property.

Under existing law, only homeowners over 55 years of age or certain disabled persons may make use of this benefit. And they can do so only if (1) their new home is in the same county as their old home; and (2) the value of their new home is less than or equal to the value of their old home.

The new law, which takes effect on April 1, 2021, expands the class of homeowners who are able to transfer their taxable value to include victims of wildfire or other natural disasters, regardless of age or disability status. The new law also removes the restriction that the replacement home must be in the same county as the old home. Now such replacements must simply be in the state of California. The new law also allows homeowners to buy a replacement home that is worth more than their old home; provided, however, that the increase in value is added to the transferred taxable value of the old home. For example, assume a homeowner is over 55. Her house has a taxable value of \$5,000,000. She sells it for \$15,000,000. If she buys a new home anywhere in California for \$15,000,000 or less, she can transfer her \$5,000,000 taxable value to the new home. This will be its taxable value. However, if she wants to upgrade to a \$20,000,000 home, her new home's taxable value will be \$10,000,000 – the taxable value of her old home transferred (\$5,000,000) plus the upgrade value (\$20,000,000 - \$15,000,000.)

No real planning needs to be done in connection with this change, but the new rules that apply to transferring taxable value are something of which homeowners should be aware. Additionally, the ability to transfer such taxable value is not automatic, and homeowners who wish to make use of the benefit must apply for the benefit by filing a claim with the assessor that provides certain information required by the statute.

Please contact our office if you have any questions or concerns regarding your specific estate plan and/or the impacts of Prop 19.



Author

[Thomas G. Blomberg, Jr.](#)
T 925.944.9700
tblomberg@brotherssmithlaw.com



Author

[J. Wesley Smith](#)
T 925.944.9700
wsmith@brotherssmithlaw.com

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addressed herein.

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2033 North Main Street, Suite 720
Walnut Creek, California 94596
T 925.944.9700 F 925.944.9701

www.brothersmithlaw.com

