

PROP 19 BRINGS SIGNIFICANT CHANGES TO CALIFORNIA PROPERTY TAX ASSESSMENTS

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On November 3, 2020, California voters approved Proposition 19 (“Prop 19”). Prop 19 brings major changes to California property tax assessments, namely (1) changes to the parent-child exclusion; and (2) changes to the base year value¹ transfer for certain property owners.

1. Prop 19 Limits the Parent-Child Exclusion

a. Current Parent-Child Exclusion Rules

In California, the general rule is that real property is reassessed for property tax purposes at its fair market value if and when there is a change in ownership² unless there is an exclusion. One of the most common exclusions is known as the parent-child exclusion.

The parent-child exclusion³ applies to changes in ownership that occur on or after November 6, 1986, and excludes from reassessment transfers between a parent and a child⁴ of two types of property: (1) a principal residence (no value limit); and (2) the first \$1 million of the full cash value of all other real property.

Simply put, if a parent transfers their principal residence to one or more children, such transfer would not trigger reassessment for property tax purposes because it is a transfer between a parent and a child (or children) of the parent’s principal residence, even though the child (or the children) could use it as a rental property or a vacation home.

[1] The base year value is the current fair market value or full cash value of real property in 1975-76, or in any subsequent year in which a change in ownership or the completion of new construction occurs. Cal. Rev. & Tax. Code §§50, 75.10(a), and 110.1(a) and (b).

[2] A change in ownership is a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest (e.g., a purchase or sale, a grant, gift or devise through inheritance or through a trust). Cal. Rev. & Tax. Code §60.

[3] The parent-child exclusion was created following the approval of Proposition 58 by the voters of California in 1986, and was implemented through the California Revenue and Taxation Code section 63.1.

[4] A child is defined very broadly in the statute. For example, any son-in-law or daughter-in-law falls under the “child” definition. Cal. Rev. & Tax. Code § 63.1(c).

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Furthermore, the same parent could transfer up to \$1 million of real property, in addition to their principal residence, to the same child or children. This exclusion essentially allows the new property owners to avoid property tax increases when acquiring from their parents or children.

b. New Parent-Child Exclusion Rules

Prop 19, which takes effect on February 16, 2021, limits the application of the parent-child exclusion. Specifically, it changes the current law by requiring that the child or children also use the property they receive as their own principal residence. Otherwise, it will be reassessed for property tax purposes. Furthermore, even if the child uses the property as his or her principal residence, it imposes a cap of \$1 million⁵ on this exclusion. For purposes of describing the new rule, this portion assumes that a parent transfers their principal residence to a child, and that the child will use it as their principal residence; therefore, the parent-child exclusion is applicable to said transfer. Under the new rule, if the fair market value of that property minus its adjusted base year value is less than or equal to the \$1 million cap, this transfer is excluded from reassessment in its entirety and the child maintains the parent's tax basis for the purposes of property taxes. However, if the fair market value of that property minus its adjusted base year value is more than the \$1 million cap, then there will be a partial reassessment with respect to the spread between the property's fair market value and \$1 million.

2. Prop 19 Expands the Base Year Value Transfer for Certain Property Owners

a. Current Rules

Under the current law⁶, any person over 55 years of age or any severely and permanently disabled person⁷ is permitted to purchase or acquire a replacement residence without reassessment for property tax purposes if: (1) the original residence is sold and reassessed to current market value; (2) the replacement residence is purchased or newly constructed within two years of the sale of the original residence; (3) the replacement residence is located in the same county as the original residence or in a county accepting base year value transfers from other counties; (4) the replacement residence is of equal or lesser value than the original residence; and (5) a claim is filed with the assessor of the county where the replacement residence is located.

[5] “[B]eginning February 16, 2023, and every other February 16 thereafter, the \$1,000,000 will be adjusted by the percentage change in the House Price Index for California for the prior calendar year, as determined by the Federal Housing Finance Agency, and such information will be released biennially by the State Board of Equalization via Letter to Assessors.” Letter to Assessors dated December 11, 2020.

[6] California Revenue and Taxation Code §69.5.

[7] Id. §74.3(b).

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b. New Rules

Prop 19, beginning on April 1, 2021, expands the class of property owners who are eligible to utilize this base year value transfer tax benefit by including victims of a wildfire or natural disaster. Also, it removes the restriction that the replacement residence be located in the same county as the old one and rather allows it to be located anywhere in California. Furthermore, it allows eligible homeowners to buy a replacement residence that is of greater value than the original residence, in which case partial relief is available.

If you have any questions about Prop 19 and its impact, please contact Justin Paik at jpaik@ferrisbritton.com.