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Dear Clients and Friends of David A. Nearon, APLC,

As you may be aware, in November 2020, California voters passed Proposition 19, which makes substantial and significant changes to the real property reassessment exclusions between a parent and child as well as grandparent and grandchild. This element of Proposition 19 will take effect on **February 16, 2021**.

In California under Proposition 13 (1977) the "Assessed Value" (AV) of real property for real property tax purposes may not increase more than 2% per year. Given the steady and rapid appreciation of real property in California, over time the "Fair Market Value" (FMV) of real property will be substantially higher than its AV. As a result, longtime owners usually enjoy significantly lower real property taxes compared to those who purchase more recently.

When there is a "change of ownership" the county assessor will "reassess" the property to its FMV usually resulting in substantially higher property taxes. A sale, a gift, and death of the owner all result in a change of ownership and reassessment by the county assessor. There is no reassessment event between spouses even at death.

**Current law** [before February 16, 2021]

In 1986, California voters passed Proposition 58, which allows for reassessment exclusion for change of ownerships between a parent and child. A parent is able to transfer his/her primary residence of unlimited value *and* non-residence properties [second homes, investment properties, commercial, etc.] up to $1 million of AV without reassessment provided certain requirements are satisfied and a timely filed application is submitted to the county assessor. The voters later provided this same exclusion between a grandparent and grandchild although with limitations.

For example, at death mom can will her primary residence with an AV of $100,000 with a FMV of $2 million; her Lake Tahoe home with an AV of $400,000 with a FMV of $2.5 million; and her retail property with an AV of $500,000 with a FMV of $3 million to one of more children without reassessment of any of the properties. The residence is unlimited and the combined AVs of the two non-residence properties is less than $1 million.

**New Law** [February 16, 2021]

The reassessment exclusion between parent and child as well as grandparent and grandchild will be eliminated with one important exception described below. Beginning February 16, 2021, any transfer of real property to a child or grandchild whether by sale, gift or inheritance will be reassessed to FMV. Children that desire to retain real property with low AV after the death of the parent will be paying substantially higher annual property taxes.

Proposition 19 does make an exception for the *primary* residence [which must have elected and qualified for the "Homeowner's Exemption"]. A parent may sell, gift, or will that primary residence to a child without reassessment provided the child uses that property as her primary residence. However, it is limited to $1 million above the AV. Using my example above, mom can transfer her $2 million residence to her child but only $1,100,000 is excluded with the difference being reassessed.

**What to do between now and February 16, 2021**

For those clients who own one or more real properties with low AV and who have children that desire to retain such properties after the death of their parents, they have tough choices to make over the next few weeks.

The parent can give that Lake Tahoe home outright to her children and if recorded before the deadline, the children would be able to retain the parent's AV. The rules are such that if the parent continues to reside or use the gifted property the parent must pay the child FMV rent. If the gifted property generates rental income the donor parent may not retain that income. These are factors that must be considered as many parents are in no position to pay rent and cannot afford to give up the income.

A major tax disadvantage to making a lifetime gift is the loss of the "step-up" in "cost basis" for capital gain tax purposes. Under current tax law if an individual dies holding on an appreciated asset its cost basis is stepped-up to FMV thereby eliminating the unrecognized gain. For example, if mom's Lake Tahoe property has a cost basis of $600,000 and at her death it is valued at $2.5 million, the cost basis is stepped up to $2.5 million. This means that the mom's children could sell shortly after her death paying no capital gains taxes. On the other hand, if mom gifts the Lake Tahoe property to her children while she is alive that basis of $600,000 transfers to them, so if they later sell they will then recognize substantial capital gain.

Between now and February 15, 2021, families need decide whether the step-up or the property tax AV transfer is more valuable. We cannot make specific recommendations in this letter as every situation and family is entirely unique.

Therefore, it is important that if you have questions on this matter that you speak directly with an attorney.

**Logistical challenges**

Even if a parent or grandparent decides that she wants to make a complete gift prior to the deadline, the usual logistical challenges of simply getting the transfers completed by the deadline are heighted as a result of the current shelter-in-place due to COVID-19.

Although it is long-standing law that a change of ownership occurs at the delivery of a deed as opposed to the recording date, a couple of counties have declared that a deed must be duly recorded before February 16, 2021, in order to benefit from the current law. While I disagree with that position on legal grounds, clearly you want to record before that date. To complicate things, all the various recorder offices are closed to the public due to the COVID-19 shelter-in-place orders. Moreover, many counties are struggling to process deeds received due to operational challenges posed by COVID-19.

Most Bay Area county recorders are not open to walk-in business and have installed "drop boxes". Mail is our usual method of delivery. Earlier this week on January 12, 2021, I received an email from the Santa Clara County Clerk-Recorder's office that stated that it is taking them 5 to 10 days to process deeds upon receipt. I am told that Los Angeles County is taking several weeks. As we approach the deadline there is an increasing risk that such a deed may not be recorded on time.

We have never used an electronic recording service but are looking into it. Given this COVID-19 environment we simply cannot guarantee that a deed will be recorded by February 16, 2021, irrespective of which manner it is submitted for recording.

**Concluding thoughts**

The purpose of this letter is to offer basic information and is not intended to give specific legal advice or make a recommendation. We encourage you to contact one of our attorneys to discuss your particular situation. There may be techniques or strategies not discussed here that could be useful to you and your family.

Proposition 19 and the limited window to potentially take action is a challenge for all of us. Thank you for allowing us to serve you.

David A. Nearon, Jr.
Phillip Greenan