

# RED Group – December 16, 2020 Meeting

RED Group – Welcome!

Upcoming Meetings

## Hot Topics

- PPP Loans – Update
  - Rev Ruling 2020-27. (PPP loan expense deductibility)
  - Sales/Merger of Business
- Biden Tax Proposals

Main Program- Proposition 19, What Hath We Wrought? (Cameron L. Hess)



# PROPOSITION 19: WHAT HATH WE WROUGHT?

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# OVERVIEW OF PROPOSITION 19

This program is for educational use. It does not cover all provisions of Proposition 19 or current law. This program assumes some understanding of Proposition 13 basics.

## Slides are Color Coded:

- **Yellow Caption Slides** – Current Law - Before Proposition 19 Effective
- **Green Caption Slides** – Proposition 19
- **Charts** – Compare Old Law and New Law
- **Blue Caption Slides** – Planning—Before/After Proposition 19 Effective

# OVERVIEW OF PROPOSITION 19

Approved November 3, 2020

Makes Changes to Proposition 13 (Amends Ca Constitution)

- Expands *some* exemptions; mostly limits others.
- Does not eliminate Prop 13 “basics” (Prop 15 failed)

Effective Date for Changes:

- Base-Year Value – Transfers – 4/1/21 and Later
- Parent-Child or Grand-Parent-Child – 2/16/21 and Later

# PROP 60/90 (1986/1988) — Ending 3/31/21

## Transfers of Base-Year Value for “Seniors” (One-Time)

*Current (Pre-Prop 19): aka “Downsizing for Seniors”*

- One-time transfer base-year value to new home if 55-years or older
- Required: Principal Residence + Eligible for HO or Disabled Exemption
- New Home: Located same county or a *Prop 90* Reciprocal County\*
- New Home: (i) Already own or (ii) acquired/built within 2-year.
- Effect: Transfers same base-year value from old to new home.

\*Reciprocity: Only 10 of 58 Counties. ☹️

Expiring Provision:

# PROP 60/90 (1986) — Ending 3/31/21

## Claim: Within 3-Years of Acquiring New Home

Old Home's FMV: ANY AMOUNT

New Home's FMV: (Pass/Fail Test):

- If already own: **FMV of New Home** = or < *FMV Old Home*
- If purchase/build later: 105% - 1<sup>st</sup> Year; 110% - 2<sup>nd</sup> Year

### Special considerations

- Lots of situations, like a pending marriage

***Prop 110: also allowed for Severely/Permanently Disabled (one-time)***

*All ends 3/31/21 (can not use Prop 60/90 on later replacement.)*

# Prop 19— Senior Base-Year Transfers-4/1/21+

## **Claim: (3-years? Of) Acquiring New Home**

Transfer base-year value to new home if 55-years or older

Old Home FMV: Any amount (no change)

**NEW:** May claim 3 Times (4th home) – *unclear* – *old transfers too?*

**NEW:** New Home FMV (\$0/Partial Exemption):

- If New Home  $\leq$  FMV Old Home: *Base-Year Value Carries (no change)*
- If  $>$  FMV Old Home: *Partial reassessment – increased FMV reassessed*

**NEW: Intercounty Transfers Allowed** – Anywhere (58 Counties!)

**Effective 4/1/2021** - Unclear: *old home pre 4/1, new home 4/1+*

# Prop 19— Seniors Base-Year Transfers-4/1/21+

## Claim: (3-years? Of) Acquiring New Home

### Severely/permanently disabled

- New law is same as seniors: Right to transfer base-year 3 times.
- Expect BOE to set up database to track for all counties.
- *Six Transfers Allowed? – 3 for disability & 3 for over 55? – **Maybe.***

As a Constitutional Amendment – no statute/forms yet:

- California legislation (R&T Code) will be forthcoming later
- *BOE will issue forms for counties use later*



**CHART #1****BASE YEAR VALUE TRANSFER – PERSONS AT LEAST AGE 55/DISABLED**

	<b>Current Law</b>	<b>Proposition 19</b>
Type of Property	•Principal residence	•Principal residence
Timing	•Purchase or newly construct residence within 2 years of sale	•Purchase or newly construct residence within 2 years of sale
Location of Replacement Home	•Same county • <u>County with intercounty ordinance (10 counties)</u>	•Anywhere in California
Value Limit	•Equal or lesser value <ul style="list-style-type: none"> <li>• 100% if replacement purchased/new construction prior to sale</li> <li>• 105% if replacement purchased/new construction in first year after sale</li> <li>• 110% if replacement purchased/new construction in second year after sale</li> </ul>	•Any value •Amount above 100% is added to transferred value
How many transfers?	•One time •Exception: After using once for age, second time for subsequent disability	•Three times
Implementing Statute	•Revenue & Taxation Code section 69.5 (implements Propositions 60/90/110)	•To be determined

# PROPS 3 & 10- [CALAMITY – ENDING 3/31/21]

## Base-Year Value Carry-over For

- Eminent Domain/Inverse Condemnation – **NO CHANGE.** 😊
- **Substantial Destruction (50% FMV loss) – Current rules end 3/31/21**
  - **Any Real Property** (home, rental, business) – One Time Right
- Replace: 5-Years Substantial Destruction – similar size, use, function.
- Claim Exemption “anytime” (timely - first 4-years retroactive)
- New Property FMV – Carryover rule (ending 3/21/21)
  - If FMV New Property < 120% FMV Old Property: Base-year carry-over (100%)
  - If FMV New Property > 120% higher, reassess only increase > 120%.

# PROPS 3 & 10- CALAMITY — ENDING 3/31/21

Eminent Domain/Inverse Condemnation

- may replace in any California county.

Formally Declared Disaster (State)

- replace only in same county or in a reciprocating county.

# Prop 19— Limiting Calamity Relief — 4/1/21

## ***Simple Explanation:***

***If your business/rental burns down in a disaster area, you may no longer rebuild somewhere else in the county and get property tax relief on the replacement.***

***If your principal residence burns down in a disaster area, you may buy another for any value. If new house has a higher value, it will be partly reassessed (for FMV increase). You only have 2-years to replace.***

# Prop 19— Limiting Calamity Relief

*Replace principal residence within 2-years of sale*

**Gone – All Other Property!** – No Base-Year Transfer to New Property

**New Limit:** Can only transfer to new principal residence

- Calamity Definition – same 50% value decline; Some terms slightly different.
- Primary Residence + HO Exemption or Disabled Veterans
- Replacement: ~~5 years from calamity~~ 2-years from sale.

**Gone: 120% Protection**

- *If New Home > FMV Old Home Calamity – partial reassessment*
- *Inter-county Transfer is okay – Anywhere (58 Counties!)*

**Effective 4/1/2021** - Unclear: old home pre 4/1, new home 4/1+

# Prop 19— Limiting Calamity Relief

*No change: Property lost to eminent domain, inverse  
condemnation.*

*These are still under the old rules.*

## BASE YEAR VALUE TRANSFER – INTRACOUNTY DISASTER RELIEF

	Current Law	Proposition 19
Type of Property	<ul style="list-style-type: none"> <li>•Any type of property</li> </ul>	<ul style="list-style-type: none"> <li>•Principal residence</li> </ul>
Timing	<ul style="list-style-type: none"> <li>•Purchase or newly construct property within 5 years of disaster</li> </ul>	<ul style="list-style-type: none"> <li>•Purchase or newly construct residence within 2 years of sale</li> </ul>
Location of Replacement Property	<ul style="list-style-type: none"> <li>•Within same county</li> </ul>	<ul style="list-style-type: none"> <li>•Anywhere in California</li> </ul>
Value Limit	<ul style="list-style-type: none"> <li>•Any value</li> <li>•Amount above 120% is added to transferred value</li> </ul>	<ul style="list-style-type: none"> <li>•Any value</li> <li>•Amount above 100% is added to transferred value</li> </ul>
Type of Disaster	<ul style="list-style-type: none"> <li>•Disaster for which the Governor proclaims a state of emergency</li> </ul>	<ul style="list-style-type: none"> <li>•Wildfire, as defined, or natural disaster as declared by the Governor</li> </ul>
Implementing Statute	<ul style="list-style-type: none"> <li>•Revenue &amp; Taxation Code section 69 (implements Proposition 50)</li> </ul>	<ul style="list-style-type: none"> <li>•To be determined</li> </ul>
Important Dates	<ul style="list-style-type: none"> <li>•Through March 31, 2021</li> </ul>	<ul style="list-style-type: none"> <li>•Effective April 1, 2021</li> </ul>

BASE YEAR VALUE TRANSFER – INTERCOUNTY DISASTER RELIEF		
	Current Law	Proposition 19
Type of Property	•Principal residence	•Principal residence
Timing	•Purchase or newly construct principal residence within 3 years of disaster	•Purchase or newly construct principal residence within 2 years of sale
Location of Replacement Home	• <a href="#"><u>County with intercounty ordinance (13 counties)</u></a>	•Anywhere in California
Value Limit	<ul style="list-style-type: none"> <li>•Equal or lesser value <ul style="list-style-type: none"> <li>• 105% if purchased/new construction in first year after disaster</li> <li>• 110% if purchased/new construction in second year after disaster</li> <li>• 115% if purchased/new construction in third year after disaster</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>•Any value</li> <li>•Amount above 100% is added to transferred value</li> </ul>
Type of Disaster	•Disaster for which the Governor proclaims a state of emergency	•Wildfire, as defined, or natural disaster as declared by the Governor
Implementing Statute	•Revenue & Taxation Code section 69.3 (implements Proposition 171)	•To be determined



# Calamity Change - Why do We Care?

2017-Year (10,280 Structures)

- Sonoma Complex Fire

2018-Year (24,266 Structures)

- Camp Fire (Butte County – 18,800 structures)

2019-Year (732 Structures.

- Sandalwood Fire (Riverside County)
- Saddle Ridge Fire (Los Angeles County)
- Kincade Fire (Sonoma County – 174 homes)

2020-year (10,488 Structures)

- LNU Lightning Complex Fire (8/17/20 – 10/2/20)

Need to Clarify: **Which** set of rules apply? **[Prediction: Based on replacement (?)]**



# Calamity Change - Planning

## Property Not a Personal Residence

- ***Example: Rental or business property***
- ***Section 170, disaster value reduction still permitted (same property)***
- ***Section 194.1, deferral of first installment still permitted (same property)***
- ***May replace by different property on or before 3/31/2021***



# Parent-Child Transfer Excl'n (Prop 58)-2/15/21

Transfer Base-Year Value to Children (1986)

Claim later of: i) 3-yrs or 6 mths from supplemental

- Any personal residence if qualified for HO exclusion (No limit on #)
  - Child receiving *not* required to live there.
- Other real property. **Limit:** \$1 million *total lifetime* (estate) “base-year” transfers. (No portability.) BOE tracks everyone and every transfer.

# Parent-Child Transfer Excl'n (Prop 58)-2/15/21

## Right to Transfer Base-Year Value to Children

### Old Rule

- Sale, gift or bequest okay – any transfer
- Extended to grandparent-grandchild (Prop 193, 1996)
- Preamble: Step-transaction doctrine won't apply
- *Lots of planning opportunities – business, rentals.*
- *Ends 2/15/2021.*

# Prop 19— Parent-Child Transfer Limited

Parent-Child Exclusion: Claim is limited & 1-Year from Transfer

## Principal Residence - Changed

- No Change: Principal residence “eligible” for HO or Disabled Veterans Exemption
- New: Must “Continue as the family home of the transferee”.
  - Family Farm – must contain a principal residence.

## Partial Reassessment New – avoid only first \$1M reassessment

- No Reassessment: If FMV is less than “Factored Value + \$1 million.
- Reassessment. Excess supplemental/escape assessment > \$1 million is reassessed.
- Example - \$200,000 Base-Year Value; \$1.5 million FMV.

If qualified, new base-year will be \$500K (\$200K + \$300K (\$1.5 - \$1.2))

# Prop 19— Parent-Child Transfer Limited

## \$1 million “exclusion”

- Indexed annually beginning 2/1/2023 for CPI for prior calendar year.

## Family Farm

- Real property under cultivation for pasture or grazing or used to produce an Agricultural Commodity
- Allowed same limited protection.
- No other business is protected.

Ex: 200 Acre Nut Family Farm, with Shop/Office/Building.  
\$800,000 assessed value (\$8,000 Tax). FMV \$4 million. At death, will be reassessed to \$3 Million (\$30,000 Tax) (800K + \$4M - \$1.8M)

PARENT-CHILD & GRANDPARENT-GRANDCHILD EXCLUSION

	Current Law	Proposition 19
Principal Residence	<ul style="list-style-type: none"> <li>•Principal residence of transferor</li> <li>•No value limit</li> <li>•Residence and homesite (excess land may be excluded as "other property")</li> </ul>	<ul style="list-style-type: none"> <li>•Principal residence of transferor and transferee</li> <li>•Value limit of current taxable value plus \$1,000,000 (as annually adjusted)</li> <li>•Family homes and farms</li> </ul>
Other Real Property	<ul style="list-style-type: none"> <li>•Transferor lifetime limit of \$1,000,000 of factored base year value</li> </ul>	<ul style="list-style-type: none"> <li>•Eliminates exclusion for other real property other than the principal residence</li> </ul>
Grandparent-Grandchild Middle Generation Limit	<ul style="list-style-type: none"> <li>•Parent(s) of grandchild, who qualifies as child(ren) of grandparent, must be deceased on date of transfer</li> </ul>	<ul style="list-style-type: none"> <li>•No change: parent(s) of grandchild, who qualifies as child(ren) of grandparent, must be deceased on date of transfer</li> </ul>
Filing Period	<ul style="list-style-type: none"> <li>•File claim within 3 years or before transfer to third party</li> </ul>	<ul style="list-style-type: none"> <li>•File for homeowners' exemption within 1 year of transfer</li> </ul>
Implementing Statute	<ul style="list-style-type: none"> <li>•Revenue &amp; Taxation Code section 63.1 (implements Propositions 58 / 102)</li> </ul>	<ul style="list-style-type: none"> <li>•To be determined</li> </ul>

# Planning Strategies

## Transfer Property Under Old Rules Before they Expire

- Deed real property for family business (Non-Ag) to children.
  - ACE hardware, restaurant space, if property tax increase will “kill” business”.
  - Warning – Must directly own property. If held in corporation/LLC planning won’t work..
  
- Options:
  - Gift (But No-Step-up)
  - Sale – Installment Sale of Property to Children
    - Problem – Cash Flow
    - Problem – SCIN may result in capital gain in situation where there was no estate tax. (No substitution of taxes.)



# Planning Strategies

## LLC Planning

- If Proportionate Transfer Rule Used. Re-distribution of ownership – transfer out proportionately, make gifts to children, recontribute property back-in. Extend life of partnership.
- If PTR Never Used – LLD Buyer. The “Dell” Planning. Avoid heir getting 51% ownership.
- Fraction out interests.

## Still Works?

- “Freshen up Ownership in LLC to Avoid Cumulative Transfer Rule.
- 3 Owners 1/3<sup>rd</sup> each in LLC. – After One Person Dies, his Children become owner.
- Terminate LLC after death, transfer property out (Proportionate Transfer Rule), then recontribute to new LLC or LP Proportionately. Claim NEW START\*
  - **\*STEP TRANSACTION RISK? – BUSINESS PUROSE; DELAY RECONTRIBUTION.**

# Failed Planning

## Qualified Personal Residence Trusts (QPRTs)

- Problem: When Income Interest of Parents Ends – after 2/15/21, the property held will be reassessed if parent's stay in property.
- Option: **Break Trust Now** – Pass Assets to Children, claim parent-child exclusion and have parents rent.
  - Parents will have to pay rent sooner.

# Further Sources of Guidance

<https://www.boe.ca.gov/proptaxes/pdf/Ita20061.pdf>

*December 11, 2020 BOE Guidance to Assessors*

<https://vig.cdn.sos.ca.gov/2020/general/pdf/topl-prop19.pdf>

*Text of Prop 19*

# Thank You

## **RED Group – What Happens Here Goes Everywhere!**

- Next Meeting – TBA – February 2020.



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