



Winter 2021 Bulletin

UPDATE ON PROPOSITION 19

EXTREMELY IMPORTANT – PLEASE READ

Unfortunately, the text of Proposition 19 raised a number of important questions that were not answered by the Proposition but are critical to Proposition 19's proper implementation and administration. The Board of Equalization ("BOE") is charged with the statutory responsibility and authority to "prescribe rules and regulations for local boards of equalization, and County Assessors". Therefore, BOE is required to analyze and interpret Proposition 19 and issue guidance to County Assessors so that its provisions can be uniformly administered. Pursuant to its mandate, BOE issued a memorandum on January 8, 2021, which clarified certain sections of Proposition 19, but left many questions unanswered.

In the Memorandum, BOE began by stating the intent of Proposition 19 is "to limit property tax increases: (1) on primary residences by removing unfair location restrictions on homeowners who are severely disabled, victims of wildfires or other natural disasters, or seniors over 55 years of age that need to move closer to family or medical care, downsize, find a home that better fits their needs, or replace a damaged home and limit damage from wildfires on homes through dedicated funding for fire protection and emergency response; and (2) on family homes used as a primary residence by protecting the right of parents and grandparents to pass on their family home to their children and grandchildren for continued use as a primary residence, while eliminating unfair tax loopholes used by East Coast investors, celebrities, wealthy non-California residents, and trust fund heirs to avoid paying a fair share of property taxes on vacation homes, income properties, and beachfront rentals that they own in California".

Following the intent of Proposition 19, BOE answered the following questions regarding Proposition 19. This Bulletin will focus on questions regarding the parent-child exclusion. **Q1:** Proposition 19 makes the previous parent-child exclusion operative for purchases or transfers that occur on or before February 15, 2021. Since February 15, 2021 is a state holiday, are purchases or transfers that occur on February 16, 2021 eligible for the previous parent-child exclusion?

A1: Yes, except for transfers of property by inheritance.

Q2: Proposition 19 requires that a family home continue as the family home of the transferee. Must the family home continue as the family home of *all* transferees?

A2: No, only one transferee needs to maintain the family home as his or her principal residence.

The qualifying phrase, "if the property continues as the family home of the transferee" is unclear. Taken literally, a family home could only be transferred to one child and qualify for this exclusion; however, the exclusion explicitly applies to transfers of a family home between "parents and their children", strongly implying that more than one child can receive a family home and the home still qualify for the exclusion.

Although the language is ambiguous, the legislative intent is to limit property tax increases for family homes that continue to be used as a primary residence by their children, while eliminating tax loopholes that allow what was a family home to be used as rental property. Based on this intent, BOE states that more than one child may be the recipient of the family

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home, and as long as one child maintains the family home as his or her principal residence, the family home may qualify for this exclusion; however, all transferees must be eligible transferees.

Q3: Prop 19 requires that a family home continue as the family home of the transferee. By what date must a transferee establish the family home as his or her family home?

A3: The transferee must establish the family home as his or her family home within one year of the purchase or transfer of the family home. Based on the language of Proposition 19 and its intent, BOE believes that a family home need not be the family home of the transferee immediately at the time of purchase or transfer. Instead, it must become a transferee's primary residence within one year of the purchase or transfer of the family home.

Q4: Proposition 19 requires that a family home continue as the family home of the transferee. How long must a transferee maintain the property as her family home for continued exclusion?

A4: The exclusion applies only as long as the transferee or another transferee maintains the property as his or her family home.

As cited above, Proposition 19 requires that a family home "continues as the family home of the transferee" in order to qualify for exclusion. This language is ambiguous. It is susceptible to mean that the family home must continue to be the family home of the transferee at the time of the transfer, or to mean the family home must be the family home of the transferee at the time of transfer and must continue to be the family home of the transferee.

The legislative intent is to limit property tax increases for family homes that continue to be used as a primary residence by their children while eliminating tax loopholes that allow family homes to be used as rental property. Proposition 19 will protect family transfers, when a family member is going to treat the new property as a primary residence. It would close the loophole for vacation homes and other uses that do not include a primary residence. Based on this intent, BOE states that the family home must be maintained as a family home by a transferee, whether by the transferee that initially used the family home as a primary residence or another eligible transferee that received the property from an eligible transferor.

In the event the family home is no longer used as the primary residence of a transferee, the property should receive the factored base year that applies had the family home not qualified for exclusion at the time of purchase or transfer. This is because at the time the family home is no longer the primary residence of a transferee, there is no transfer of the property and therefore, there can be no change in ownership on that date. At the time the family home is no longer the primary residence of a transferee, the change in ownership exclusion that applied at the initial transfer of the family home is lost. Therefore, the property is not reassessed, and instead should be taxed at the factored base year value that the property would have if the parent-child exclusion not been applied.

Q5: Proposition 19 makes the parent-child exclusion applicable to family farms. What familial relationship will establish a farm as a "family farm"?



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A5: The "family farm" is the farm that is transferred between parents and children (or when applicable, between grandparents and grandchildren).

Proposition 19 provides that the parent-child and grandparent-grandchild exclusion shall also apply to the purchase or transfer of a family farm. Any reference to a "family home" in the parent-child and grandparent-grandchild exclusions shall be deemed to instead refer to a "family farm".

A "family farm" is defined as any real property which is under cultivation or which is being used for pasture or grazing, or that is used to produce any agricultural commodity, as that term is defined in Section 51201 of the Government Code as that Section reads on January 1, 2020.

There is, however, no definition of "family" or any indication of the type of relationship that would make a farm a "family farm". The operative provision makes clear that a family farm qualifies for exclusion, if the family farm is transferred between parents and children. Therefore, the issue is not whether the farm is a "family" farm, but rather is the farm (as defined in Proposition 19 transferred between parents and children. If it does (and it meets all other qualifications), the farm is a family farm.

Q6: Proposition 19 makes the parent-child exclusion applicable to family farms. Must a family farm also be the principal residence of the transferee?

A6: No, the family farm does not need to be the principal residence of the transferee to qualify for the parent-child exclusion.

Proposition 19 provides, "paragraphs (1) and (2) [the operative provisions of the parent-child and grandparent-grandchild provisions] shall also apply to the purchase or transfer of a family farm". It then directs how the parent-child and grandparent-grandchild exclusions are to be applied to family farms. It explains, "for purposes of this paragraph, any reference to a 'family home' in paragraph (1) or (2) shall be deemed to instead refer to a 'family farm'".

For purposes of the Proposition, the terms "purchased" and "change in ownership" do not include the purchase or transfer of a *family farm* of the transferor in the case of a transfer between parents and their children, as defined by the Legislature, if the property continues as the *family farm* of the transferee.

The definition of "family farm" contains no requirement that it be the principal residence of the transferor or transferee. Therefore, the only explicit requirements for qualification are that: (i) the family farm is used in the manner described in the Proposition; (ii) the family farm be transferred between parents and children; and (iii) the family farm continues to be used as a family farm by a transferee. There is no requirement that a family farm be the primary residence of the transferor or transferee, unless there is clarifying legislation to the contrary.

Q7: Under Proposition 19, if you inherit your parent's family home and move into it and establish it as your principal residence, must you live continually in the home to receive the parent-child exclusion? What happens if you move somewhere else?

A7: At least one eligible transferee must continually live in the property as his or her



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family home for the property to maintain the exclusion. If the property is no longer your family home, it will receive a new taxable value. The new taxable value will be the fair market value of the home on the date you inherited it, adjusted each year for the inflation factor, which is published by the BOE annually.

Q8: Does Proposition 19 apply to a transfer of a rental home?

A8: No, Proposition 19 limited the parent-child exclusion to a transfer of a family home that is the principal residence of the transferor and becomes the principal residence of the transferee.

Q9: Will I lose the parent-child exclusion if the value of the family home is greater than \$1 million dollars?

A9: The value limited under Proposition 19 is the sum of the factored base year value plus \$1 million. If the market value exceeds this limit, partial relief is available. The amount exceeding the excluded amount will be added to the factored base year value.

For example, a family home has a factored base year value (FBYV) of \$300,000 and a fair market value of \$1,500,000. The excluded amount under Proposition 19 is $\$300,000 + \$1,000,000 = \$1,300,000$. The difference, $\$1,500,000 - \$1,300,000 = \$200,000$. Thus, the adjusted base year value is \$500,000 (FBYV \$300,000 + difference of \$200,000).

Q10: If a parent died prior to the February 16, 2021 operative date and the Assessor does not become aware of the death until a year later and reassesses the property as of the date of death, are the parent-child exclusion provisions applied under Proposition 58 or Proposition 19?

A10: The date of death is the date of change of ownership. The law in effect as of the date of death will apply. Proposition 19 is clear that Proposition 58 applies to transfers that occur on or before February 15, 2021, and Proposition 19 applies to transfers that occur on or after February 16, 2021.

Q11: How is a property held in a trust affected by Proposition 19?

A11: The administration of a trust is governed by the trust instrument itself. For properties held in trusts, the Revenue and Taxation Code provides that a change in ownership occurs when any interests in real property vest in persons other than the trustor or the trustor's spouse or registered domestic partner when a revocable trust becomes irrevocable. This typically occurs upon the death of the trustor. Thus, the date of death is considered to be the date of change in ownership. Proposition 19 is clear that Proposition 58 applies to transfers that occur on or before February 15, 2021, and Proposition 19 applies to transfers that occur on or after February 16, 2021.

Proposition 19 will apply to any transfer of California real property after February 15, 2021, whether by a lifetime gift or a transfer at death. It will apply to any irrevocable trust (such a Qualified Personal Residence Trust or a trust created for your benefit by a predeceased spouse) that owns California real property and that will pass to your children from that trust in the future. If it is important to you to keep a current low assessed value and low property taxes for your children when you transfer real property to them, you should consider whether you want to transfer a property now to take



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advantage of the current parent-child exclusion. Any current transfer would involve many factors besides property taxes, and you should consult your estate planning attorney promptly to discuss what options might be available to you.

In the next bulletin, which you will receive within a day, we will discuss planning techniques.