

# California Proposition 19: Impact on Wealth Transfer Planning



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December 2020

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California narrowly passed the controversial Proposition 19 into law during the November 2020 elections. While the proposition expanded property tax exclusions for seniors, the disabled, and those affected by wildfires and other natural disasters, it put limits on generous historical tax exclusions for parent-to-child transfers of residential and non-residential real property. The new limits take effect **February 16, 2021**. If you own California real property, the new law may warrant a review of your wealth planning objectives and structures.

Under current law, a parent can transfer a personal residence of unlimited value and other real property of up to \$1M to their children without mandatory reassessment for property tax purposes. The transferee child assumes the parent's taxable value, which is often considerably less than the appreciated market value. This exclusion allows families to pass appreciated residential property to the next generation, where it could be converted into vacation or rental property and still maintain the benefit of significantly lower property taxes.

***The new law eliminates the parent-to-child non-residential real estate exclusion and effectively caps the benefit on residential property to current appraised value +\$1M.*** Any incremental appreciation in excess of the \$1M will be added to the child's property tax assessment value. Additionally, in order to qualify for the \$1 M cap benefit, the transferee child must use the home as their personal residence.

As a result, any near-term or contemplated future intra-family transfers of real property should be re-examined as soon as possible. Parents should consider whether the future long-term property tax savings of accelerating a gift may outweigh the comfort and convenience of retaining ownership and possession. And while gifting the home now may cause the loss of step-up in tax basis at the parents' death, this may have minimal impact if the family intends to keep the home for multiple generations.

***This change will also impact any existing Qualified Personal Residence Trusts (QPRTs) terminating after February 15, 2021.*** These trusts are commonly created to transfer personal residences to the next generation in a gift tax-efficient manner. By retaining the right to occupy the home for a term of years, the home's value is substantially discounted for gift tax planning purposes. Once the trust term ends, the home transfers to the children, at which time the parents must either vacate or become renters at market value.

Both contemplated and existing QPRT planning requires immediate attention. Since the title is not transferred until the QPRT terminates, the new law would appear to trigger property tax reassessment at that time. Additionally, plans which contemplated transferor parents renting from transferee child upon trust termination need to be re-examined as the new more limited parent to child exclusion is not applicable unless the transferee child uses the home as their personal residence.

While the specific implications and administration of Proposition 19 may take years to fully materialize, we strongly recommend clients with California real property consult with their planning attorney as soon as possible.

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