ORANGE COUNTY BAR ASSOCIATION

REAL ESTATE LAW
SECTION MEETING

What You NEED to Know About Proposition 19 and Its Looming February Deadline

Tuesday, January 26, 2021

PROTECT YOUR KIDS' INHERITANCE!

How Prop 19 Effects Taxes on Inherited Real Estate

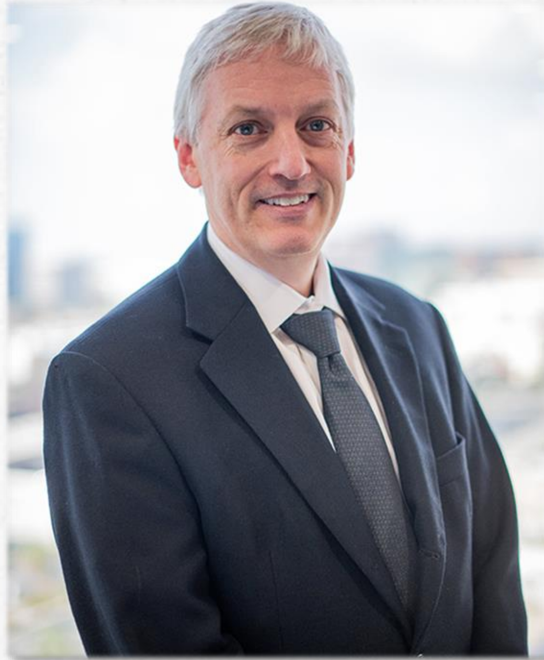
Zebulon Law, Esq.

LAW & STEIN LLP

SPEAKER BIO

BACKGROUND

- Partner at Law & Stein, Irvine, CA
- Estate Attorney 30 years
- Adjunct Professor at Chapman University Fowler School of Law since 2007
- Published in numerous legal publications
- Frequent speaker in various areas of law



Zebulon Law, Esq.

AREAS OF PRACTICE

- Estate Planning
- Trust & Business Litigation
- Business & Tax Planning

EDUCATION

J.D., American University, Washington College of Law, Washington, DC

LL.M., Georgetown University, Washington, DC

B.A., Long Island University, C.W. Post College, Brookville, NY

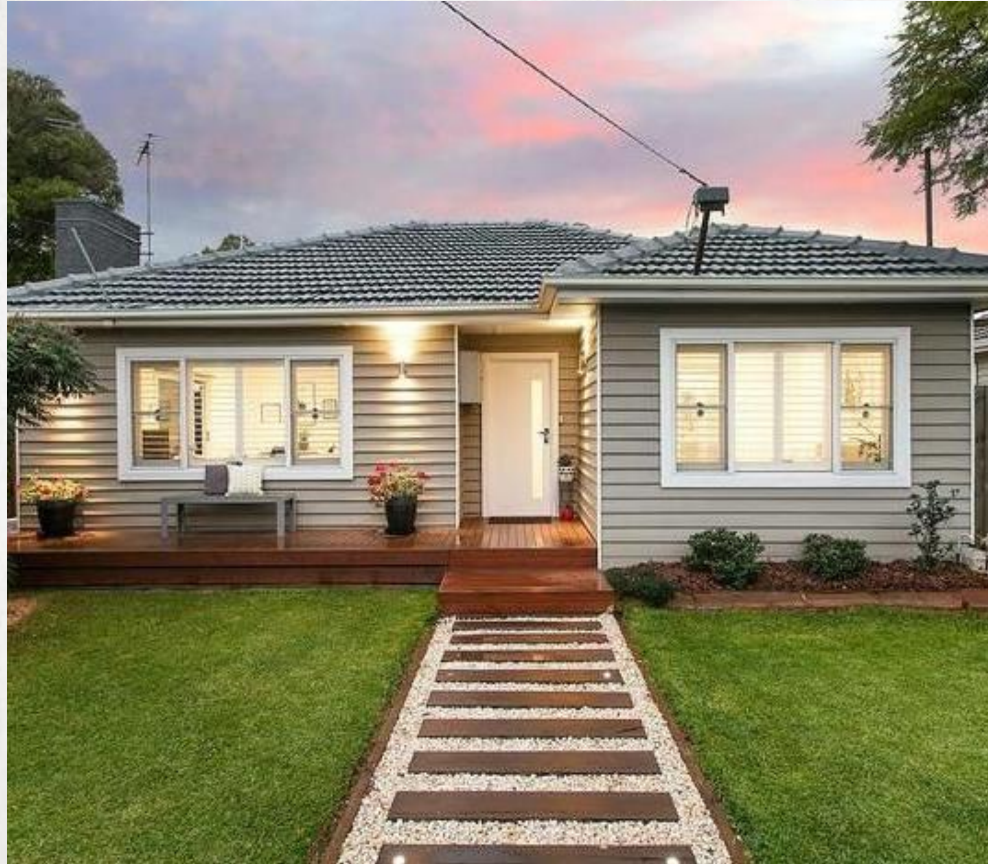
AGENDA

- Prop. 19 planning between now and Feb 11 with trusts
- Long term LLC planning
- Income Tax, Gift/Estate Tax, Property Tax

ESTATE/GIFT/INCOME TAX

- Top capital gains bracket is 20% federal, and 13.3 state
- Possible 3.8% tax on tax on investment income (capital gains).
- No more SALT deduction, so the blended rate is generally 33-35% for capital gains
- Could go up?
- Gift and estate tax rate is 40%
- Gift/Estate exemption is $11.7 million in 2021
- Property received from a decedent gets a step up at death under Code §1014

PROP 13…



- Mom & Dad buy home in Newport Beach for $400,000
- Property now worth $4.6M
- Property assessed at $600,000 (includes the 2%/year increases)
- Taxes are $7,000 ***per year…that's Prop 13***
- ***After Prop. 19, tax will go to $40,000/year***

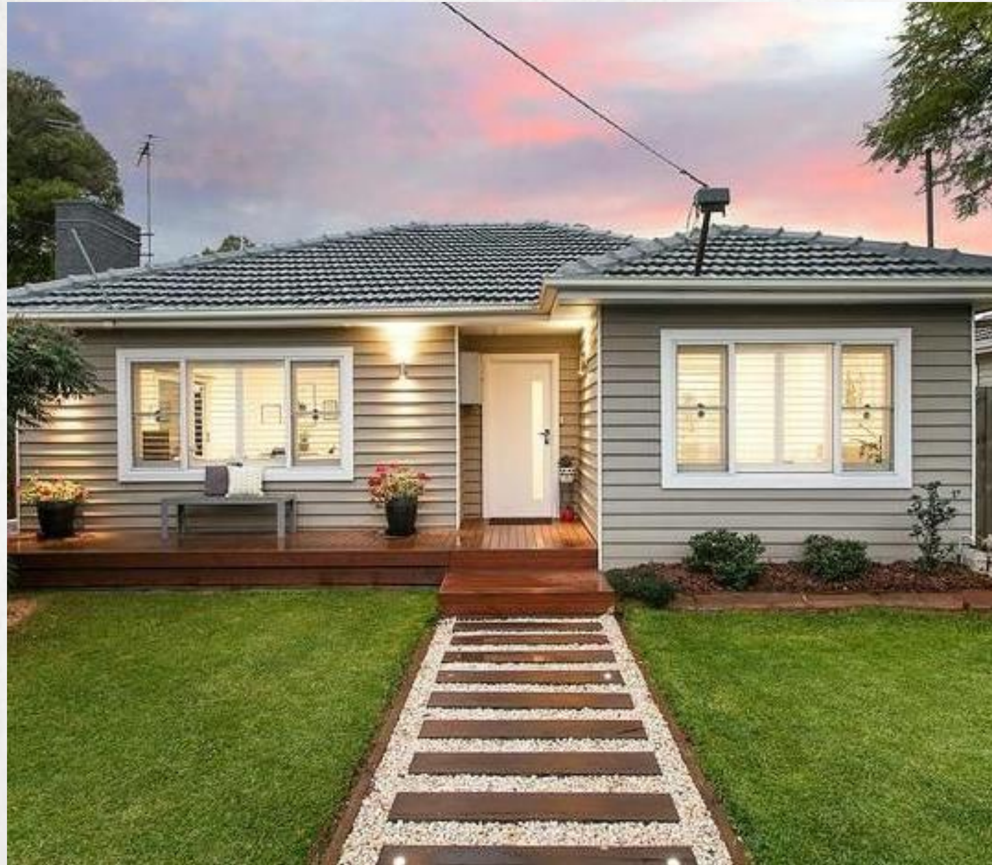
INITIAL PLANNING CONSIDERATIONS (FROM AN ESTATE PLANNER'S PERSPECTIVE)

- Is the parent's estate over $11.7 million? If so, there are estate tax considerations
- Estate exemption is currently $11.7 million per person.   Drops in half in 2026.
- Any property tax planning must also take into account the (future) estate tax consequences and the (future) income tax consequences.
- Example, parents can give properties to children now to come under the Pre-Prop. 19 rules, but there are gift tax consequences, and the children receive carry-over basis.

CURRENT PROPERTY TAX STRUCTURE: PROP 13

- Property assessed at 1% of market value at a "Change in Ownership" (CIO) R&T Code §60
- CIO is roughly any deed transferring property. It includes sale, gift and DEATH transfers.
- After a CIO, property base value (and tax) increases by the California Consumer Price Index – capped at 2%
- 2% annual cap on increase in taxes… but real estate values have actually increased annually at 4%, 6% or 8% ***or more***
- Long term owners of CA real estate have lower property tax bills than newer owners
- ***PROP 13 is effectively a tax cap!***

IN 1980's, THE EXEMPTIONS EXPANDED



- Prop 58 (1986) lets the kids KEEP the parents' Prop 13 taxes when a "Change in Ownership (CIO)"!
- And the kids' kids can keep those taxes too! … that's Prop 13+58!
- My client with NB house got to keep his parents property tax base year figure
- If it was reassessed, property taxes would increase by $30,000/year!

PARENT CAN GIVE PROP 13 TAX BASE TO CHILD (BEFORE PROP 19)

- Property is reassessed when a "Change in Ownership" (CIO) occurs UNLESS an "exclusion from reassessment" applies. R&T Code §62.
- Parents can transfer (by sale, gift, death) a home of ANY value to children and no reassessment. R&T Code §63.1(a)(1)(A).
- Parents can leave $1M EACH in ***assessed value*** to children ($2M total) on properties other than the home. R&T Code §63.1(a)(2).

R&T CODE §60: STATUTE AND CASES

- A "change in ownership" means 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.
- Pacific Southwest Realty v. County of Los Angeles, 1 Cal.4th 155, 2 Cal. Rptr. 2d 536, 820 P.2d. 1046 (unanimous re: long term leases are CIOs)
- Steinhart v. County of Los Angeles, 47 Cal.4th 1298, 223 P.3d 57, 104 Cal. Rptr. 3d 195 (2010) (unanimous re: termination of life estate is CIO)
- So all of the plans where mom/dad give house to kids or to a trust, but keep lving there, the assessor or BOE will argue parent retained a life estate, and will trigger a CIO when the parents die.

SIX PLANNING PROBLEMS WITH CIO

1. When parent retains lifetime right of occupancy CIO at parent's death (life estate/lifetime right of occupancy)

2. When parent retains an estate for years CIO at end of estate for years (QPRT)

3. When a parent retains a life estate CIO at death of (other) parent (spousal life estate)

4. When a parent retains right to rents, CIO when that right ends

5. When a parent deeds from parent to "parent and child as joint tenants" no CIO at creation, CIO at death of parent

6. If parent holds a general power of appointment in an irrevocable trust over real property a CIO occurs when the power is released (at death), whether exercised or not

PROP 19 PLANNING

- So how do we get around these problems?
- 1. Prop. 19 trust
- 2. LLC

BEFORE WE START- REMIND THE CLIENT

- No planning needed if the properties will be sold before or shortly after death
- Don’t plan on transferring the house, if the parent can’t pay rent.
- If the family can’t “respect the structure” and keep a set of books for the trust, and make sure the trust pays the bills, etc. don’t do it!
- Don’t use fancy trust if the parent really wants the 55 and over exclusion.
- If someone other than a child gets the property, no exemption available.

PROP 13 TRUST

- Irrevocable trust. Sole beneficiary(ies) are children.
- Transfer property by deed to trust ***NOW*** and use the parent to child exclusion. Deed the property to the trust before February 16th.
- Parent is the Grantor, children are beneficiaries, and a Change of Ownership occurs NOW (but we use parent to child).
- Consider whether client wants an adjusted cost basis (step up) at death (will discuss).
- Each plan is highly dependent on many facts.

PROPOSITION 13 TRUST: BASIC ELEMENTS

- Grantor Trust for income tax purposes. Code §672-675
- Power to borrow without adequate security (avoid swap powers and power to add charitable beneficiary)
- Completed gift upon transfer, file 709. If the house is included in estate (to get the step up), it may also require 706.
- Include power to delay so property comes back into estate under IRC §2038 (to get a step up in basis- case specific planning)
- Under 26 CFR 25.2511-2(d) (cessation of dominion and control) the power of the Grantor to delay enjoyment does NOT make the gift incomplete
- LPOA might be dangerous unless limited to the power to appoint in a manner that does not cause a change in ownership under R&T §60

PROPOSITION 13 TRUST: GIFT APPROACH

- To the extent the Grantor occupies the property (like a personal residence) then grantor ***must pay fair market rent.***
- ***Always run the numbers!***

PROPOSITION 13 TRUST: CONSIDER SALE TO IDGT

- If the parent wants to get cash back one day from the real estate, the parent should consider a “sale” to the DGT.
- Parent must seed trust with 10%.
- Parent carries back a note for the rest.
- This way, as the trust receives rent (or sells the house), there is money in the trust to pay back the note.

BE MINDFUL OF REVENUE & TAXATION CODE §60

- A "change in ownership" means 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 … you might be asking "what's a fee?"
- Transfers between spouses, original owners, life estates, leases less than 35 years not CIO
- Transfers of LLC interest sometimes not CIO
- Property reassessed when a CIO occurs unless a Reassessment Exclusion applies

PROP 19 PLAN

- 1. Start with analysis of what happens if parent does NOTHING. That sets the baseline for what can happen with planning.
- Example, assume assessed value is $600,000, but fair market value is $4.6 million. Parent does nothing
  - Estate tax is $___________ (maybe zero, if overall estate is less than $11.7 million)
  - Capital gains tax after death is $0 (because of basis adjustment at death)
  - Property tax increase of $33,000/year (from $600,000 to $4.6 million).

PROP. 19 PLAN

- Then show the client what might happen under the plan:
  - 1. Estate tax is _____________ (zero?)
  - 2. Capital Gains tax is substantial (because of carry over basis with a DGT)
  - 3. Property tax stays the same

Note: It is possible to get a step up in basis at death with a properly drafted trust.

BENEFITS OF USING TRUSTS

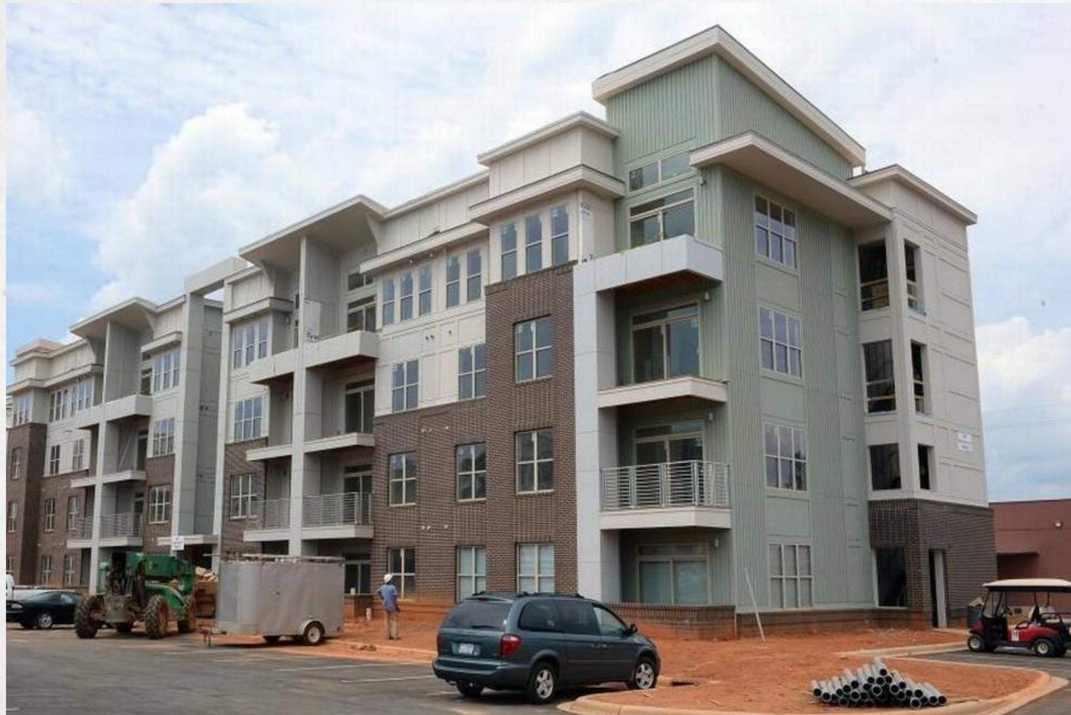
- Can parents just give property to their children now? Yes, but it greatly increases the risk of adverse tax consequences and creditor/dispute issues.

- Example: Parents give their house to their children within the next couple of weeks. In order to obtain a CIO, the parents must give up possession or the beneficial use of the house (which means the parents must rent the house). The children have rental income, and the parents don't get a deduction, since the rent is personal.
  - Note- at lease one attorney in the estate lecture circuit has suggested the kids can "forgive" the rent as a gift to the parents. I haven't found any direct authority, but in my opinion, that won't work.
  - The attorney also noted that the transaction won't be audited by the assessor after the initial deed gets recorded. Any strategy that depends on "flying under the radar" is not a good strategy.
  - Also, a direct gift will mean no step up at parent's death.
  - Finally, what if the kids boot the parents out of the house? In the estate world, we see things like that all the time…

USE OF A TRUST

- Benefits of using a trust include:
- 1. The trust can be drafted so there is a CIO now.
- 2. The trust can be drafted to "steer" the income tax consequences back to the grantors. For example, mom and dad can continue to get the property tax deduction.
- 3. The trust can be drafted so that there is a step up in basis at death.
- 4. A defective grantor trust (which is invisible for income tax purposes) can be set up so the parents can carry back a note, and get money back out of the trust, if they want (with NO income tax consequences).
- 5. Finally, the parents can retain some level of control over the trust, you can prevent the "kids booting mom and dad out of the house" scenario.

LLC PLAN STILL WORKS



- Form a Limited Liability Company (LLC)
- LLC buys Multi-family (MF) for $1.4M
- Three children EACH acquire a 1/3 interest in the entity
- NO CHANGE IN OWNERSHIP provided no one person gets more than 50% or has control
- Planning is based on Ocean Avenue v. County of Los Angeles 227 Cal.App.4th 344 (2014).

LLC AND A TRUST

- A plan involving an LLC and a special trust will continue to be possible even after February 16. But only for property other than a house

- Example– Parents own commercial property in an LLC.
  - Step 1- Parents give/sell 49% of the LLC to an IDGT. No CIO.
  - Step 2- Take the property out of the LLC. 51% to parents, and 49% to DGT. No CIO.
  - Step 3- Parents convey 1% undivided interest in property to children. After Feb. 15, this 1% will be reassessed.
  - Step 4- Parents and DGT re-form a new LLC. 50% parents and 50% DGT. No CIO.
  - When parents die, they bequeath 50% of this new LLC. Per Cal. Reg. 462.180(d)(1)(A), since no party has obtained "control" (***more than*** 50%) in the transfer of the parents' 50% interest, there is no CIO. Also, see page 1 on Forms 565 (partnership) and 568 (LLC).
  - NOTE- we don't know if the rules will be changed after Prop. 19 takes effect.

PROPOSITION

19 CHANGES CERTAIN PROPERTY TAX RULES. LEGISLATIVE CONSTITUTIONAL AMENDMENT.

OFFICIAL TITLE AND SUMMARY

PREPARED BY THE ATTORNEY GENERAL

The text of this measure can be found on the Secretary of State's website at *voterguide.sos.ca.gov.*

- Permits homeowners who are over 55, severely disabled, or whose homes were destroyed by wildfire or disaster, to transfer their primary residence's property tax base value to a replacement residence of any value, anywhere in the state.
- Limits tax benefits for certain transfers of real property between family members.
- Expands tax benefits for transfers of family farms.
- Allocates most resulting state revenues and savings (if any) to fire protection services and reimbursing local governments for taxation-related changes.

SUMMARY OF LEGISLATIVE ANALYST'S ESTIMATE OF NET STATE AND LOCAL GOVERNMENT FISCAL IMPACT:

- Local governments could gain tens of millions of dollars of property tax revenue per year. These gains could grow over time to a few hundred million dollars per year.
- Schools could gain tens of millions of dollars of property tax revenue per year. These gains could grow over time to a few hundred million dollars per year.
- Revenue from other taxes could increase by tens of millions of dollars per year for both the state and local governments. Most of this new state revenue would be spent on fire protection.

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FINAL VOTES CAST BY THE LEGISLATURE ON ACA 11 (PROPOSITION 19)
(RESOLUTION CHAPTER 31, STATUTES OF 2020)

Senate:	Ayes 29	Noes 5
Assembly:	Ayes 56	Noes 5

ANALYSIS BY THE LEGISLATIVE ANALYST

BACKGROUND

Local Governments Tax Property. California cities, counties, schools, and special districts (such as a fire protection district) collect property taxes from property owners based on the value of their property. Property taxes raise around $65 billion each year for these local governments.

How Is a Property Tax Bill Calculated? Each property owner's annual property tax bill is equal to the taxable value of their property multiplied by their property tax rate. The typical property owner's property tax rate is 1.1 percent. In the year a new owner takes over a property, its taxable value typically is its purchase price. Each year after that, the property's

taxable value is adjusted for inflation by up to 2 percent. When a property changes ownership again, its taxable value is reset to its new purchase price.

Property Taxes Increase When a Property Changes Ownership. The taxable value of most properties is less than what they could be sold for. This is because the price most properties could sell for grows faster than 2 percent per year. Because of this, when a property changes ownership its taxable value often resets to a higher amount. This leads to a higher property tax bill for that property. This means people who move usually end up paying higher property taxes for their new home than they paid for their old home.

Special Rules for Some Homeowners. In some cases, special rules allow existing homeowners to move to a different home without paying higher property taxes. These special rules apply to homeowners who are over 55 or severely disabled or whose property has been impacted by a natural disaster or contamination. We refer to these people as "eligible homeowners." An eligible homeowner can move within the same county and keep paying the same amount of property taxes if their new home is not more expensive than their existing home. Also, certain counties allow these rules to apply when an eligible homeowner moves to their county from another county. Homeowners who are over 55 or severely disabled generally can use these special rules only once in their lifetime. This limit does apply to properties impacted by a natural disaster or contamination.

Special Rules for Inherited Properties. Special rules also allow properties to pass between parents and children without an increase in the property tax bill. These rules also apply to grandparents and grandchildren if the grandchildren's parents are deceased. We call properties passed between parents and children or grandparents and grandchildren "inherited property." The rules apply to a parent's or grandparent's home and a limited amount of other types of property.

Counties Manage the Property Tax. County assessors determine the taxable value of property. County tax collectors bill property owners. County auditors distribute tax revenue to local governments. Statewide, counties spend about $800 million each year on these activities.

Schools Funding Comes From Both Local Property Taxes and State Taxes. Schools receive funding from both local property taxes and state taxes. State law says that schools must receive a minimum amount of total funding from these two sources.

PROPOSAL

The measure makes changes to the special rules for eligible homeowners and inherited properties.

Expanded Special Rules for Eligible Homeowners. Starting April 1, 2021, the measure expands the special rules for eligible homeowners. Specifically, the measure:

- ***Allows Moves Anywhere in the State.*** Eligible homeowners could keep their

lower property tax bill when moving to another home anywhere in the state.

- ***Allows the Purchase of a More Expensive Home.*** Eligible homeowners could use the special rules to move to a more expensive home. Their property tax bill would still go up but not by as much as it would be for other homebuyers.
- ***Increases Number of Times a Homeowner Can Use the Special Rules.*** Homeowners who are over 55 or severely disabled could use the special rules three times in their lifetime.

Narrows the Special Rules for Inherited Properties. Starting February 16, 2021, the measure narrows the special rules for inherited properties. Specifically, the measure:

- ***Ends Special Rules for Properties Not Used as a Home or for Farming.*** The special rules would apply only to two kinds of inherited property. First, the rules would apply to properties used as a primary home by the child or grandchild. Second, the rules would apply to farms. Properties used for other purposes could no longer use the special rules.
- ***Requires Tax Bill to Go Up for High Value Inherited Homes and Farms.*** The property tax bill for an inherited home or farm would go up if the price the property could be sold for exceeds the property's taxable value by more than $1 million (adjusted for inflation every two years). In this case, the tax bill would go up but not as much as it would if the property were sold to someone else.

Dedicates Certain Money for Fire Protection. The measure could make new funding available to the state. We discuss this new funding in the next section. The measure requires that most of the new funds be spent on fire protection. In addition, the measure requires that a smaller part of the new funds be given to certain local governments.

FISCAL EFFECTS

Increased Property Taxes From Narrowed Rules for Inherited Properties. Narrowing the special rules for inherited properties would lead to higher property taxes for some inherited properties. This would increase property taxes for local governments and schools.

Reduced Property Taxes From Expanded Rules for Eligible Homeowners. Expanding the special rules for eligible homeowners could change property tax collections in a few ways. Most importantly, more homeowners could get property tax savings when moving from one home to another. This would reduce property taxes for local governments and schools.

Overall, More Property Taxes for Local Governments and Schools. Some parts of the measure would increase property taxes. Other parts would decrease them. Overall, property taxes for local governments and schools probably would increase. In the first few years,

ANALYSIS BY THE LEGISLATIVE ANALYST CONTINUED

local governments could gain tens of millions of dollars per year. Over time, these revenue gains could grow to a few hundred million dollars per year. Schools could receive similar property tax gains.

Possible Reduction in State Costs for Schools in Some Years. In limited situations, total school funding from property taxes and state taxes could be about the same in some years despite schools' property tax gains. This is because existing state law could cause state funding for schools to decrease by about the same amount as their property tax gains. If this happens, the state would get cost savings in those years. These savings would be a similar amount to school property tax gains. The measure says most of these savings would have to be spent on fire protection.

Other Smaller Changes in Tax Collections. The measure allows more people to buy and sell homes without facing an increased property tax bill. Because of this, the measure probably would increase the number of homes sold each year. This would increase money going to the state and local governments from a number of other taxes collected on the sale of a home. These increases could be in the tens of millions of dollars per year. The measure says most of this increase in state tax revenue would have to be spent on fire protection.

Higher Costs for Counties. Counties probably would need to hire new staff and make computer upgrades to carry out the measure. This would increase costs for counties by **tens of millions of dollars per year**.

Visit *http://cal-access.sos.ca.gov/campaign/measures/* for a list of committees primarily formed to support or oppose this measure.

Visit *http://www.fppc.ca.gov/transparency/top-contributors.html* to access the committee's top 10 contributors.

If you desire a copy of the full text of this state measure, please call the Secretary of State at (800) 345-VOTE (8683) or you can email *vigfeedback@sos.ca.gov* and a copy will be mailed at no cost to you.

vote in any primary or special election that occurs before the next general election in which the citizen would be eligible to vote if at least 18 years of age.

PROPOSITION 19

This amendment proposed by Assembly Constitutional Amendment 11 of the 2019–2020 Regular Session (Resolution Chapter 31, Statutes of 2020) expressly amends the California Constitution by adding sections thereto; therefore, new provisions proposed to be added are printed in *italic type* to indicate that they are new.

PROPOSED AMENDMENTS TO ARTICLE XIII A

First—This measure shall be known, and may be cited, as the Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfire or Natural Disasters Act.

Second—That Section 2.1 is added to Article XIII A thereof, to read:

SEC. 2.1. (a) Limitation on Property Tax Increases on Primary Residences for Seniors, the Severely Disabled, Wildfire and Natural Disaster Victims, and Families. It is the intent of the Legislature in proposing, and the people in adopting, this section to do both of the following:

(1) Limit property tax increases 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.

(2) Limit property tax increases 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 they own in California.

(b) Property Tax Fairness for Seniors, the Severely Disabled, and Victims of Wildfire and Natural Disasters. Notwithstanding any other provision of this Constitution or any other law, beginning on and after April 1, 2021, the following shall apply:

(1) Subject to applicable procedures and definitions as provided by statute, an owner of a primary residence who is over 55 years of age, severely disabled, or a victim of a wildfire or natural disaster may transfer the taxable value of their primary residence to a replacement primary residence located anywhere in this state, regardless of the location or value of the replacement primary residence, that is purchased or newly constructed as that person's principal residence within two years of the sale of the original primary residence.

(2) For purposes of this subdivision:

(A) For any transfer of taxable value to a replacement primary residence of equal or lesser value than the original primary residence, the taxable value of the replacement primary residence shall be deemed to be the taxable value of the original primary residence.

(B) For any transfer of taxable value to a replacement primary residence of greater value than the original primary residence, the taxable value of the replacement primary residence shall be calculated by adding the difference between the full cash value of the original primary residence and the full cash value of the replacement primary residence to the taxable value of the original primary residence.

(3) An owner of a primary residence who is over 55 years of age or severely disabled shall not be allowed to transfer the taxable value of a primary residence more than three times pursuant to this subdivision.

(4) Any person who seeks to transfer the taxable value of their primary residence pursuant to this subdivision shall file an application with the assessor of the county in which the replacement primary residence is located. The application shall, at minimum, include information comparable to that identified in paragraph (1) of subdivision (f) of Section 69.5 of the Revenue and Taxation Code, as that section read on January 1, 2020.

(c) Property Tax Fairness for Family Homes. Notwithstanding any other provision of this Constitution or any other law, beginning on and after February 16, 2021, the following shall apply:

(1) For purposes of subdivision (a) of Section 2, the terms "purchased" and "change in ownership" do not include the purchase or transfer of a family home 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 home of the transferee. This subdivision shall apply to both voluntary transfers and transfers resulting from a court order or judicial decree. The new taxable value of the family home of the transferee shall be the sum of both of the following:

(A) The taxable value of the family home, subject to adjustment as authorized by subdivision (b) of Section 2, determined as of the date immediately prior to the date of the purchase by, or transfer to, the transferee.

(B) The applicable of the following amounts:

(i) If the assessed value of the family home upon purchase by, or transfer to, the transferee is less than the sum of the taxable value described in

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subparagraph (A) plus one million dollars ($1,000,000), then zero dollars ($0).

(ii) If the assessed value of the family home upon purchase by, or transfer to, the transferee is equal to or more than the sum of the taxable value described in subparagraph (A) plus one million dollars ($1,000,000), an amount equal to the assessed value of the family home upon purchase by, or transfer to, the transferee, minus the sum of the taxable value described in subparagraph (A) and one million dollars ($1,000,000).

(2) Paragraph (1) shall also apply to a purchase or transfer of the family home between grandparents and their grandchildren if all of the parents of those grandchildren, who qualify as children of the grandparents, are deceased as of the date of the purchase or transfer.

(3) Paragraphs (1) and (2) shall also apply to the purchase or transfer of a family farm. 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."

(4) Beginning on February 16, 2023, and every other February 16 thereafter, the State Board of Equalization shall adjust the one million dollar ($1,000,000) amount described in paragraph (1) for inflation to reflect the percentage change in the House Price Index for California for the prior calendar year, as determined by the Federal Housing Finance Agency. The State Board of Equalization shall calculate and publish the adjustments required by this paragraph.

(5) (A) Subject to subparagraph (B), in order to receive the property tax benefit provided by this section for the purchase or transfer of a family home, the transferee shall claim the homeowner's exemption or disabled veteran's exemption at the time of the purchase or transfer of the family home.

(B) A transferee who fails to claim the homeowner's exemption or disabled veteran's exemption at the time of the purchase or transfer of the family home may receive the property tax benefit provided by this section by claiming the homeowner's exemption or disabled veteran's exemption within one year of the purchase or transfer of the family home and shall be entitled to a refund of taxes previously owed or paid between the date of the transfer and the date the transferee claims the homeowner's exemption or disabled veteran's exemption.

(d) Subdivision (h) of Section 2 shall apply to any purchase or transfer that occurs on or before February 15, 2021, but shall not apply to any purchase or transfer occurring after that date. Subdivision (h) of Section 2 shall be inoperative as of February 16, 2021.

(e) For purposes of this section:

(1) "Disabled veteran's exemption" means the exemption authorized by subdivision (a) of Section 4 of Article XIII.

(2) "Family farm" means 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 read on January 1, 2020.

(3) "Family home" has the same meaning as "principal residence," as that term is used in subdivision (k) of Section 3 of Article XIII.

(4) "Full cash value" has the same meaning as defined in subdivision (a) of Section 2.

(5) "Homeowner's exemption" means the exemption provided by subdivision (k) of Section 3 of Article XIII.

(6) "Natural disaster" means the existence, as declared by the Governor, of conditions of disaster or extreme peril to the safety of persons or property within the affected area caused by conditions such as fire, flood, drought, storm, mudslide, earthquake, civil disorder, foreign invasion, or volcanic eruption.

(7) "Primary residence" means a residence eligible for either of the following:

(A) The homeowner's exemption.

(B) The disabled veteran's exemption.

(8) "Principal residence" as used in subdivision (b) has the same meaning as that term is used in subdivision (a) of Section 2.

(9) "Replacement primary residence" has the same meaning as "replacement dwelling," as that term is defined in subdivision (a) of Section 2.

(10) "Taxable value" means the base year value determined in accordance with subdivision (a) of Section 2 plus any adjustment authorized by subdivision (b) of Section 2.

(11) "Victim of a wildfire or natural disaster" means the owner of a primary residence that has been substantially damaged as a result of a wildfire or natural disaster that amounts to more than 50 percent of the improvement value of the primary residence immediately before the wildfire or natural disaster. For purposes of this paragraph, "damage" includes a diminution in the value of the primary residence as a result of restricted access caused by the wildfire or natural disaster.

(12) "Wildfire" has the same meaning as defined in subdivision (j) of Section 51177 of the Government Code, as that section read on January 1, 2020.

Third—That Section 2.2 is added to Article XIII A thereof, to read:

SEC. 2.2. (a) Protection of Fire Services, Emergency Response, and County Services. It is the intent of the Legislature in proposing, and the people

in adopting, this section and Section 2.3 to do both of the following:

(1) Dedicate revenue for fire protection and emergency response, address inequities in underfunded fire districts, ensure all communities are protected from wildfires, and safeguard the lives of millions of Californians.

(2) Protect county revenues and other vital local services.

(b) (1) The California Fire Response Fund is hereby created within the State Treasury.

(2) The County Revenue Protection Fund is hereby created within the State Treasury. Moneys in the County Revenue Protection Fund are continuously appropriated, without regard to fiscal year, for the purpose of reimbursing eligible local agencies that incur a negative gain, and paying the administrative costs of the California Department of Tax and Fee Administration, in accordance with Section 2.3. Moneys in the fund shall only be expended as provided in Section 2.3.

(c) For purposes of the calculations required by Section 8 of Article XVI, moneys in the California Fire Response Fund and the County Revenue Protection Fund shall be deemed to be General Fund revenues which may be appropriated pursuant to Article XIII B.

(d) The Director of Finance shall do the following, as applicable:

(1) On or before September 1, 2022, and on or before each subsequent September 1 through September 1, 2027, calculate the additional revenues and savings that accrued to the state from the implementation of Section 2.1, including, but not limited to, any increase in state income tax revenues and net savings to the state arising from any reduction in the state's funding obligation under Section 8 of Article XVI, during the immediately preceding fiscal year ending on June 30. In making the calculation required by this paragraph, the Director of Finance shall use actual data or best available estimates where actual data is not available. The calculation shall be final and shall not be adjusted for any subsequent changes in the underlying data. The Director of Finance shall certify the results of the calculation to the Legislature and the Controller no later than September 1 of each year.

(2) On or before September 1, 2028, and each subsequent September 1 thereafter, calculate the additional revenues and savings that accrued to the state from the implementation of Section 2.1, including, but not limited to, any increase in state income tax revenues and net savings to the state arising from any reduction in the state's funding obligation under Section 8 of Article XVI during the immediately preceding fiscal year ending on June 30 by multiplying the amount from the immediately preceding fiscal year ending on June 30 by the rate of increase in property tax revenues allocated to local agencies in that fiscal year. In making the calculation required by this paragraph, the Director of Finance shall use actual data or best available estimates where actual data is not available. The calculation shall be final and shall not be adjusted for any subsequent changes in the underlying data. The Director of Finance shall certify the results of the calculation to the Legislature and the Controller no later than September 1 of each fiscal year.

(e) No later than September 15, 2022, and each subsequent September 15 thereafter, the Controller shall do both of the following:

(1) Transfer from the General Fund to the California Fire Response Fund an amount equal to 75 percent of the amount calculated by the Director of Finance pursuant to subdivision (d) for the applicable year.

(2) Transfer from the General Fund to the County Revenue Protection Fund an amount equal to 15 percent of the amount calculated by the Director of Finance pursuant to subdivision (d) for the applicable year. Moneys transferred to the County Revenue Protection Fund pursuant to this paragraph shall be used to reimburse eligible local agencies with a negative gain, as provided in Section 2.3.

(f) Moneys in the California Fire Response Fund shall be appropriated by the Legislature in each fiscal year exclusively for the purposes of this section and, except as otherwise provided in subdivision (g), shall not be appropriated for any other purpose. Moneys in the California Fire Response Fund may be used upon appropriation without regard to fiscal year and shall be used to expand fire suppression staffing, as set forth in paragraphs (1) to (4), inclusive, and not to supplant existing state or local funds utilized for those purposes.

(1) Twenty percent of the moneys in the California Fire Response Fund shall be appropriated to the Department of Forestry and Fire Protection to fund fire suppression staffing.

(2) Eighty percent of the moneys in the California Fire Response Fund shall be deposited in the Special District Fire Response Fund, which is hereby created as a subaccount within the California Fire Response Fund, and appropriated to special districts that provide fire protection services in accordance with the following criteria:

(A) Fifty percent of the amount described in this paragraph shall be used to fund fire suppression staffing in underfunded special districts that provide fire protection services, were formed after July 1, 1978, and employ full-time or full-time-equivalent station-based personnel who are immediately available to comprise at least 50 percent of an initial full alarm assignment.

(B) Twenty-five percent of the amount described in this paragraph shall be used to fund fire suppression staffing in special districts that provide fire protection

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services, were formed before July 1, 1978, are underfunded due to a disproportionately low share of property tax revenue and an increase in service level demands since July 1, 1978, and employ full-time or full-time-equivalent station-based personnel who are immediately available to comprise at least 50 percent of an initial full alarm assignment.

(C) Twenty-five percent of the amount described in this paragraph shall be used to fund fire suppression staffing in underfunded special districts that provide fire protection services and employ full-time or full-time-equivalent station-based personnel who are immediately available to comprise at least 30 percent but less than 50 percent of an initial full alarm assignment.

(3) In determining whether a special district that provides fire protection services is underfunded for purposes of paragraph (2), the Legislature shall take into account the following factors, in order of priority:

(A) The degree to which the special district's property tax revenue is insufficient to sustain adequate fire suppression, as measured against the population density, size of the service area, and number of taxpayers within the boundaries of the special district.

(B) Whether the special district, upon formation, received a property tax allocation in accordance with Chapter 282 of the Statutes of 1979.

(C) Geographic diversity.

(4) The allocation of moneys to a special district that qualifies pursuant to paragraph (2) shall be in the form of grants, with a term of not less than 10 years, in order to ensure that the special district can engage in responsible budgeting and sustain adequate fire suppression services over the long term.

(g) Notwithstanding subdivision (f), if in any fiscal year after the first fiscal year for which moneys are transferred from the General Fund to the California Fire Response Fund pursuant to this section the amount transferred exceeds the amount transferred in the previous fiscal year by more than 10 percent, the Controller shall not transfer the amount in excess of that 10 percent, which shall be available for appropriation from the General Fund for any purpose.

Fourth—That Section 2.3 is added to Article XIII A thereof, to read:

SEC. 2.3. (a) Each county shall annually, no later than the date specified by the California Department of Tax and Fee Administration by regulations adopted pursuant to this section, determine the gain for the county and for each local agency in the county resulting from implementation of Section 2.1 by adding the following amounts:

(1) The revenue increase resulting from the sale and reassessment of original primary residences for outbound intercounty transfers pursuant to subdivision (b) of Section 2.1.

(2) The revenue decrease, which shall be expressed as a negative number, resulting from the transfer of taxable values of original primary residences located in other counties to replacement primary residences located within the county for inbound intercounty transfers pursuant to subdivision (b) of Section 2.1.

(3) The revenue increase resulting from subdivision (c) of Section 2.1.

(b) A county or any local agency in the county that has a positive gain determined pursuant to subdivision (a) shall not be eligible to receive reimbursement from the County Revenue Protection Fund. A county or any local agency in the county that has a negative gain determined pursuant to subdivision (a) shall be deemed to be an eligible local agency entitled to a reimbursement from the County Revenue Protection Fund.

(c) The California Department of Tax and Fee Administration shall determine each eligible local agency's aggregate gain every three years, based on the amounts determined pursuant to subdivision (a) for each of those three years, and provide reimbursement to each eligible local agency with a negative gain from the moneys in the County Revenue Protection Fund equal to that amount. If there are insufficient moneys in that fund to cover the total amount of reimbursements under this section, the California Department of Tax and Fee Administration shall allocate a pro rata share of the moneys in the fund to each eligible local agency based on the amount of the eligible local agency's reimbursement relative to the total amount of reimbursements under this section.

(d) At the end of each three-year period described in subdivision (c), after the California Department of Tax and Fee Administration has reimbursed each eligible local agency that has experienced a negative gain during that three-year period, the Controller shall transfer the remaining balance, if any, in the County Revenue Protection Fund to the General Fund, to be available for appropriation for any purpose.

(e) The California Department of Tax and Fee Administration shall promulgate regulations to implement this section pursuant to the rulemaking provisions of the Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code), as may be amended from time to time by the Legislature, or any successor to those provisions.

(f) For purposes of this section and Section 2.2, an "eligible local agency" is a county, a city, a city and county, a special district, or a school district as determined pursuant to subdivision (o) of Section 42238.02 of the Education Code as it read on January 8, 2020, that has a negative gain as determined pursuant to this section.

STATE OF CALIFORNIA

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State Controller

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Executive Director

No. 2013/021

TO COUNTY ASSESSORS:

CHANGE IN OWNERSHIP EXCLUSION - COTENANTS

Effective September 29, 2012, Assembly Bill 1700[1] adds section 62.3 to the Revenue and Taxation Code[2] to provide that *change in ownership* does not include a transfer of real property from one cotenant to the other that takes effect upon the death of one transferor cotenant. Section 62.3(e) specifically states that its provisions apply to transfers that occur on or after January 1, 2013.

This exclusion applies if all of the following conditions are met:

- Two cotenants must together own 100 percent of the property as tenants in common or joint tenants.
- The two cotenants must be owners of record for the one-year period immediately preceding the death of one of the cotenants.
- The property must have been the principal residence of both cotenants for the one-year period immediately preceding the death of one of the cotenants.
- The transfer must occur due to the death of one of the cotenants, and the surviving cotenant must obtain a 100 percent ownership interest in the property.
- The surviving cotenant must sign an affidavit under penalty of perjury affirming that he or she continuously resided at the residence for the one-year period immediately preceding the transferor cotenant's death.

If one of the above conditions is not met, the exclusion does not apply. Following is a discussion of these points, and answers to questions that we received from assessors' staff regarding the implementation of the cotenancy exclusion.

FORM OF OWNERSHIP

The property must be held in a tenancy in common or joint tenancy form of ownership by the cotenants, with no other individual holding title to the property. Specifically, two individuals must own 100 percent of the real property as either joint tenants or tenants in common.

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[1] Stats. 2012, ch. 781.
[2] All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Question 1: If there are other cotenants, does this disqualify the cotenant from filing an affidavit for the exclusion?

Yes. Pursuant to section 62.3(a)(1), the exclusion only applies to property owned 100 percent by two individuals.

RECORDED OWNERSHIP

Both cotenants must be owners of record of the property for the one-year period immediately preceding the transferor cotenant's death. The exclusion will not apply if the surviving cotenant was not on title to the property for at least a year prior to the decedent's date of death.

Question 2: Does the cotenancy apply only to property acquired by two individuals?

Section 62.3 is silent on how the property is acquired by the cotenants. Section 62.3(a)(3) requires that the two cotenants be owners of record for the one-year period immediately preceding the transferor cotenant's death.

Question 3: Is it required that the cotenants take title at the same time in order to consider the title as a cotenancy?

Pursuant to section 62.3(d)(1), a *cotenancy interest* is a term that describes an interest in real property held only as tenants in common or joint tenants. The two cotenants do not have to take title together at the same time to create a cotenancy interest. They merely have to be on title together as tenants in common or joint tenants for the one-year period prior to the time that the cotenancy exclusion is claimed.

Question 4: If the decedent was an original transferor and the surviving cotenant was not an original transferor, does the exclusion apply as long as the surviving cotenant was added by a recorded document at least one year prior to the death of the original transferor?

Yes. The exclusion applies as long as the cotenants both have been on title for at least a year prior to the date of death. Additionally, section 62.3(a) provides that qualifying transfers are not changes in ownership "Notwithstanding any other provision in this chapter... ." Therefore, notwithstanding the fact that such a transfer would normally be a change in ownership pursuant to section 65(c), it would be excluded by section 62.3, assuming all of the conditions of that section are met.

Question 5: Does it matter what gender the cotenants are?

No. Section 62.3 does not mention gender.

PRINCIPAL PLACE OF RESIDENCE

The property must be the principal residence of both cotenants immediately preceding the transferor cotenant's death. Both cotenants must have continuously resided at that residence for the one-year period immediately preceding the date of death of one of the cotenants. Section 62.3(d)(2) provides that a *principal residence* means a dwelling eligible for either the Homeowners' Exemption or the Disabled Veterans' Exemption.

In order to qualify for either exemption, the dwelling must be established as the owner's principal place of residence as of 12:01 a.m. on the lien date (January 1). If new to the property and not yet domiciled at the property through a lien date, the exemption may be claimed by a qualified individual on the supplemental assessment resulting from a change of ownership or completion of new construction on or after January 1.

One of the foremost factors in granting the homeowners' exemption or the disabled veterans' exemption is determining what constitutes a dwelling as a principal place of residence. For property tax purposes, the relative definition of a principal place of residence is the same as, or closely parallels to, the legal doctrine of domicile. Under this doctrine, a person's domicile depends on two factors: *physical presence* and *intention*. The combination of both factors should be used to make the final determination of a claimant's primary residence.

Physical Presence Factor

Physical presence is the place where:

- A person is physically present and makes his or her home.
- A person customarily returns after work and between trips or absences due to work, pleasure, or otherwise, even if the absence is extended. A member of the armed services who is on active military service outside of California does not lose their residency under the Servicemembers Civil Relief Act.[3]
- Clothes and personal belongings are kept.
- Housekeeping (preparing meals, sleeping, bathing, entertaining) is set up.
- The person files income tax returns as a resident.
- A driver's license is issued.
- The person has listed for voter registration.

For the physical presence factor, the individual facts as they relate to each other as a whole should be reviewed in each claim, as not all elements listed are necessary to satisfy this requirement.

Intention Factor

Intention factor is the intent of the claimant to remain at the residence and not the intent to stay there only for a temporary purpose and return to a legal domicile elsewhere. Of the two factors, intention is essential and required.

If the Homeowners' Exemption or the Disabled Veterans' Exemption was not granted in the name of both cotenants, then proof that the real property was their principal residence must be provided. Proof of residency may include vehicle registration, voter registration, bank accounts, or income tax records.

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[3] 50 Appendix U.S.C.A. 501-594.

Question 6: Does "continuously resided at the residence for one year" mean 12 months? Can one year be interpreted to mean a period other than 365 days?

A *year* is defined[4] as a period of 365 days (leap year is 366 days) divided into 12 months. Section 62.3(a)(5) requires the transferor and the transferee to have continuously resided at the residence for the one-year period preceding the transfer. We take this to mean the prior one-year period immediately preceding the death of the transferor. For example, if a transferor died on March 10, 2013, the one-year period would be the period from March 11, 2012 through March 10, 2013.

Question 7: Is there any other way to verify continuous residency?

Once residency is established, it is presumed that residency will be continuous until another property becomes the principal residence (similar to the Homeowners' and Disabled Veterans' Exemptions). Whether the transferor and the transferee actually continuously resided at a residence for the one-year period preceding a transfer is a question of fact for the assessor to determine on a case-by-case basis if evidence indicates otherwise. As such, no particular number of days will establish continuous residence, but rather the intentions and actions of the parties should control. Further, temporary absences should be treated as they are for the purposes of the Homeowners' Exemption.

Question 8: How does the assessor verify that the property was the principal place of residence for both parties in cases where there is a Homeowners' Exemption but only under one social security number?

Section 62.3(d)(2) defines a *principal residence* as one that is eligible for the Homeowners' Exemption or the Disabled Veterans' Exemption. Therefore, in a situation where the social security number of a cotenant is not on file, the person claiming the exclusion must provide evidence that he or she was eligible to receive the Homeowners' Exemption or the Disabled Veterans' Exemption on the transferred property and not receiving an exemption on another property. In-state presence, vehicle registration, voter registration, bank accounts, and state income tax filings are among the factors to be considered.[5]

DATE OF TRANSFER

A transfer must occur due to the death of one cotenant in order for the cotenancy exclusion to apply. Property Tax Rule 462.200(c)[6] provides that the *date of death* is the date of change in ownership. Thus, pursuant to section 62(e), these provisions only apply to dates of death that occur on or after January 1, 2013.

Question 9: Does the date of death, not just the transfer of property, also have had to occur on or after January 1, 2013 for the cotenancy exclusion to apply? Currently, there are many transfers pending resolution of probate – some pending for many years.

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[4] *Webster's Dictionary*, Third College Edition.
[5] Annotation 505.0078 (11/20/84) [http://www.boe.ca.gov/proptaxes/pdf/505_0078.pdf] .
[6] Title 18, Public Revenues, California Code of Regulations.

Pursuant to Rule 462.260(c), the date of change in ownership is the date of death of the decedent. Therefore, the exclusion only applies to those transfers that occurred as a result of the death of a cotenant where he or she dies on or after January 1, 2013.[7]

ACQUISITION METHODS

Upon the death of the transferor cotenant, the surviving cotenant must obtain a 100 percent ownership interest in the property via the transferor cotenant's will or trust, intestate succession, or by operation of law.

The cotenancy exclusion does not apply if any other provision in the Revenue and Taxation Code provides a change in ownership exclusion. Applicable exclusions may include the interspousal, registered domestic partner, parent-child, or the joint tenancy exclusion where the surviving joint tenant has original transferor status.

Question 10: ***In cases of tenancy in common, does the assessor exclude the change in ownership from reassessment upon the death with the assumption that the transferee will ultimately receive title (for example, through probate) simply based on the affidavit? Or should the assessor reassess and hold the affidavit pending confirmation that the transferee actually receives the decedent's interest?***

On the date of death, the beneficial interest in the property transfers to the heirs, beneficiaries, or others entitled to the property.[8] It is not necessary to wait for legal title to be transferred to process a change in ownership. Similarly, it is not necessary to wait for legal title to be transferred to claim an exclusion from change in ownership. Assuming the taxpayer can show, by providing a copy of the will, trust, or other document, that he or she owns the beneficial interest in the property, then the assessor should grant the exclusion. If someone other than the cotenant ultimately inherits the property, then the assessor should reassess the decedent's interest as of the date of death (unless another exclusion applies).

Question 11: ***Does marital status matter?***

Yes. Section 62.3(c) provides that the "exclusion provided by this section shall not apply to any transfer of real property interests for which a separate exclusion in this chapter applies." If the cotenants are spouses or registered as domestic partners with the California Secretary of State, then the exclusion under sections 63 or 62(p) would apply instead of section 62.3.

Question 12: ***What happens to the cotenancy exclusion if the cotenant, through a court order or trust, becomes a life tenant for a 50 percent interest inherited and the remainder of future interest is designated?***

The cotenancy exclusion of section 62.3 only applies to transfers by and between two cotenants. A transfer of a remainder interest upon the termination of a life estate is considered to be from

[7] The Appellate Court ruling in *Larson v. Duca,* (1989) 213 Cal.App.3d 324, opined that the date of change in ownership is the date of a judicial decree of distribution does not apply to exclusions under section 62.3 as that decision specifically limits itself to specific circumstances for purposes of applying the parent-child exclusion under section 63.1.

[8] Probate Code section 7000; Property Tax Rule 462.260(c) and (d).

the creator of the life estate and not the life tenant.[9] Therefore, in a situation where a cotenant obtains a life estate in the residence from a third party, when the remainder ultimately vests in the other cotenant it will be a transfer from the third party and the exclusion of section 62.3 will not apply.

Alternatively, if a property is owned 100 percent by two cotenants, and one cotenant at his or her death transfers a life estate in the property through his or her will or trust to the surviving cotenant giving the surviving cotenant 100 percent of the present interest in the property, then the exclusion would apply.

Question 13: How can a cotenant inherit via trust if title can only be held in joint tenancy or tenancy in common?

According to section 62.3(b), the transfer may occur pursuant the transferor cotenant's trust. Subdivision (d)(1) defines a *cotenancy interest* as "an interest in real property held only as tenants in common or joint tenant." This does not prohibit legal title from being held by a trust while equitable title is held by the cotenants as beneficiaries of the trust. To conclude otherwise would render subdivision (b)(1) contradictory to subdivision (d)(1) and would be in direct conflict with Board staff's longstanding opinion regarding property held in trust.[10] Further, "Where a trust is created for several beneficiaries, the beneficiaries may be tenants in common or joint tenants of the beneficial interest to the same extent to which they might be tenants in common or joint tenants of a legal interest." [11]

AFFIDAVIT

The surviving cotenant must sign an affidavit under penalty of perjury affirming that he or she continuously resided at the property for the one-year period immediately preceding the cotenant's death. On December 19, 2012, the Board of Equalization approved BOE-58-H, *Affidavit of Cotenant Residency*. This form has been transmitted to county forms coordinators.

Question 14: Is there any filing period for the affidavit?

There is no filing period specified in section 62.3.

Question 15: Will there be a late-filing fee for the cotenancy exclusion, similar to the fee for the parent-child exclusion in section 63.1?

Since section 62.3 does not contain any filing deadline, there can be no penalty for failure to meet a filing deadline that does not exist. Moreover, section 62.3 does not authorize a filing fee of any type.

The *Affidavit of Cotenant Residency* is not a change in ownership statement. If an assessor mails the affidavit in lieu of the *Change in Ownership Statement*, the filing period and penalty under section 482 do not apply.

Question 16: When the death of a transferor cotenant is not discovered timely, is the exclusion retroactive to the date of death, or from the filing date of the affidavit

[9] Annotation 220.0372 (4/13/92) [http://www.boe.ca.gov/proptaxes/pdf/220_0372.pdf] .
[10] Annotation 220.0761 (07/14/80) [http://www.boe.ca.gov/proptaxes/pdf/220_0761.pdf] .
[11] *Restatement of the Law (2d) of Tr*usts, American Law Institute, Section 113, com. c.

forward? If retroactive, how far back can assessors go to correct prior rolls, and how many years can be refunded?

Pursuant to section 62.3(a), a transfer that meets the conditions of section 62.3 is excluded from change in ownership. A transfer by operation of death causes a change in ownership upon the date of death of the decedent. Therefore, if property is reassessed upon the death of a cotenant and the assessor later learns that the transfer met the requirement of section 62.3, then the assessor must correct that assessment, since no change in ownership occurred. An assessor should correct the base year value pursuant to section 51.5(a) whenever the error is discovered and process roll corrections pursuant to section 4831. Refunds may be generated by the county auditor pursuant to section 5097.

Question 17: What is considered a "complete" affidavit? If some of the data elements are missing and cannot be determined, how should the assessor proceed—approve or deny the exclusion?

Section 62.3(a)(6) provides that in order for the exclusion to apply the "transferee has signed, under penalty of perjury, an affidavit affirming that he or she continuously resided with the transferor at the residence for the one-year period immediately preceding the transfer."

As such, to meet with the requirements of subdivision (a)(6), an affidavit must:

(1) Be signed by the transferee under penalty of perjury;

(2) Identify the transferee and transferor;

(3) Identify the residence; and

(4) Contain affirmations such that the assessor can conclude that the transferor and transferee continuously resided with the transferor at the residence for the one-year period immediately preceding the transfer.

If an affidavit does not contain all of the above information, then it is incomplete and the exclusion does not apply until a complete affidavit is provided to the assessor. As noted above, once a complete affidavit is provided, then, assuming all other requirements are met, the exclusion is retroactive to the date of the death.

Question 18: Would the filing of a Preliminary Change of Ownership Report or a Change in Ownership Statement be sufficient to grant the cotenancy exclusion?

No. Signing and filing a *Preliminary Change of Ownership Report* or a *Change in Ownership Statement*[12] is not sufficient to meet the requirement to sign an affidavit affirming continuous residency since neither form contains the required residency language.

[12] BOE-502-A and BOE-502-AH, respectively.

A copy of section 62.3 is enclosed. If you have any questions regarding this change in ownership exclusion, please contact the County-Assessed Properties Division at 1-916-274-3350.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:grs
Enclosure

Section 62.3 as added to the Revenue and Taxation Code:

62.3. (a) Notwithstanding any other provision in this chapter, a change in ownership shall not include a transfer of a cotenancy interest in real property from one cotenant to the other that takes effect upon the death of the transferor cotenant if all of the following conditions apply:

(1) The transfer is solely by and between two individuals who together own 100 percent of the real property in joint tenancy or as tenants in common.

(2) As a result of the death of the transferor cotenant, the deceased cotenant's tenancy in common or joint tenancy interest in the real property is transferred to the surviving cotenant, which results in the surviving cotenant holding a 100-percent ownership interest in the real property immediately after the transfer, thereby terminating the cotenancy.

(3) For the one-year period immediately preceding the transfer, the real property was coowned by the transferor and the transferee, and both cotenants have been the owners of record of that real property.

(4) The real property constituted the principal residence of both cotenants immediately preceding the transferor cotenant's death.

(5) The transferor and the transferee continuously resided at that residence for the one-year period immediately preceding the transfer.

(6) The transferee has signed, under penalty of perjury, an affidavit affirming that he or she continuously resided with the transferor at the residence for the one-year period immediately preceding the transfer.

(b) A transfer of cotenancy interest in real property from one cotenant to the other shall take effect upon the death of the transferor cotenant under any of the following circumstances:

(1) Pursuant to the transferor cotenant's will or trust, upon the death of the transferor cotenant.

(2) Through intestate succession from the transferor cotenant.

(3) By operation of law, upon the death of the transferor cotenant.

(c) The exclusion provided by this section shall not apply to any transfer of real property interests for which a separate exclusion in this chapter applies.

(d) For purposes of this section, both of the following apply:

(1) "Cotenancy interest" means an interest in real property held only as tenants in common or joint tenants.

(2) "Principal residence" means a dwelling eligible for either the homeowners' exemption or the disabled veterans' exemption.

(e) This section shall only apply to transfers that occur on or after January 1, 2013.

State of California

Board of Equalization
Legal Department - MIC:121
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Memorandum

To: Honorable Antonio Vazquez, Chair
Honorable Mike Schaefer, Vice Chair
Honorable Ted Gaines, First District
Honorable Malia M. Cohen, Second District
Honorable Betty T. Yee, State Controller

Date: January 8, 2021

From: Henry D. Nanjo
Chief Counsel

Subject: ***Proposition 19 – Initial Interpretational Questions and Answers***[1]

This is in response to your request for a legal opinion on a number of questions raised regarding the interpretation of Assembly Constitutional Amendment Number 11 (ACA 11) – presented to and approved by voters at the November 3, 2020 general election as Proposition 19 (Proposition 19 or Prop 19). Prop 19 is entitled, "The Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfire or Natural Disasters Act," and added, as relevant here, section 2.1 to article XIII A of the California Constitution (hereafter Section 2.1).[2]

Unfortunately, the text of Prop 19 leaves a number of significant questions unanswered that are critical to Prop 19's proper implementation and administration. The Board of Equalization (Board) is charged with the statutory responsibility and authority to "[p]rescribe rules and regulations to govern local boards of equalization when equalizing, and assessors when assessing ...." (Gov. Code, § 15606, subd. (b).) The Board must also, "Prepare and issue instructions to assessors designed to promote uniformity throughout the state and its local taxing jurisdictions in the assessment of property for the purposes of taxation." (Gov. Code, § 15606, subd. (e).) Therefore, the Board is required to analyze and interpret Prop 19 and issue guidance to assessors so that its provisions can be uniformly administered.[3]

In interpreting Prop 19, we are required, first and foremost, to ascertain the intent of the Legislature in proposing and the people in adopting Prop 19 to effectuate the purpose of the law. (*Select Base Materials v. Board of Equalization* (1959) 51 Cal.2d 640, 645.) The text itself is the first and best indicator of intent. (*Kwikset Corp. v. Superior Court* (2011) 51 Cal.4th 310, 321.) Therefore, we are guided by Prop 19's explicit, stated intent:

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[1] This memorandum, including questions and answers, represent the initial thoughts of the legal department and may be subject to change.

[2] ACA 11 also added section 2.2 and 2.3 to Article XIII A of the California Constitution. Section 2.2 instructs how funds derived from section 2.1 are to be used and section 2.3 directs the California Department of Tax and Fee Administration to track the effects of section 2.1. The full text of ACA 11 is at <http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200ACA11> [as of December 2, 2020].

[3] We recognize that many of Prop 19's unclear provisions are susceptible to more than one reasonable interpretation. This memorandum represents the view of the Legal Division in the absence of clarifying legislation. If, and when, any clarifying legislation is enacted, our opinion, of course, may change.

> (1) Limit property tax increases 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.
>
> (2) Limit property tax increases 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 they own in California.

(Cal. Const., art. XIII A, § 2.1, subd. (a).)

Proposition 19 - Summary

In addition to the legislative intent as expressed in subdivision (a) of section 2.1 of article XIII A, cited above, four additional subdivisions, as follows, make up the remainder of Section 2.1:

Subdivision (b) – Base year value transfers
Subdivision (c) – New parent-child exclusion
Subdivision (d) – Parent-child exclusion contained in Article XIII A, section 2, subdivision (h) made inoperative
Subdivision (e) – Definitions

Subdivision (b) creates a base year value transfer provision for certain classes of people that operates differently from existing base year value transfer provisions authorized under Article XIII A, section 2 of the California Constitution (hereafter Section 2). Section 2 was amended by Propositions 60, 90, and 110[4] and Propositions 50 and 171[5] (together, the previous base year value transfer provisions), and implemented by Revenue and Taxation Code (RTC) sections 69, 69.3, and 69.5.

Subdivision (c) modifies the existing parent-child exclusion while subdivision (d) explicitly provides that the parent-child exclusion authorized under Article XIII A, section 2, subdivision (h) of the California Constitution (the previous parent-child exclusion) becomes inoperative as of February 16, 2021. Therefore, section 2, subdivision (h) and Revenue and Taxation Code section 63.1, which implements that provision are of no effect on dates on and after February 16, 2021.

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[4] Proposition 60 amended Section 2 to authorize the Legislature to allow the transfer of a base year value from a principal residence to a replacement dwelling within the same county by homeowners age 55 or over. Proposition 90 authorized county boards of supervisors to adopt ordinances allowing base year value transfers authorized under Proposition 60 between different counties. Proposition 110 extended these provisions to apply to severely disabled persons of any age.

[5] Proposition 50 amended Section 2 to authorize the Legislature to provide that the base year value of property substantially damaged or destroyed in a Governor-declared disaster may be transferred to a replacement property located within the same county. Proposition 171 extended these provisions to transfers to another county that has adopted an ordinance that allows such transfers.

(See *Professional Engineers in California Government v. Kempton* (2007) 40 Cal.4th 1016, 1037-1039 [Voter initiative allowing state to contract with private architects and engineers impliedly repealed prior law restricting the state's authority to enter such private contracts].)

Proposition 19's Effect on Existing Parent-Child Exclusion and the Previous Base Year Value Transfer Provisions Authorized in Article XIII A, section 2 of the California Constitution

Section 2.1 explicitly makes inoperative the previous parent-child exclusion. (See art. XIII A, § 2.1, subd. (h).) However, Section 2.1 does not explicitly render inoperative the previous base year value transfer provisions. The initial question, therefore, that must be answered is whether Section 2.1, subdivision (b) impliedly repealed some or all of the previous base year value transfer provisions.

Although there is no explicit language making any aspect of the previous base year value transfer provisions inoperative, Section 2.1, subdivision (b) is made operative on and after April 1, 2021 "[n]otwithstanding any other provision of this Constitution or any other law," ensuring that no previous constitutional provision or law nullifies any part of Section 2.1, subdivision (b). The previous base year value transfer provisions contain numerous differences with Section 2.1, subdivision (b), some of which are in direct contravention to it.[6] Therefore, in our view, Section 2.1 did not intend the simultaneous operation of the previous base year value transfers related to primary residences. However, because Prop 19 is clear that its base year value transfer provisions apply only to primary residences, Prop 19's effect on RTC sections 69 and 69.3 are not entirely clear.

The questions below have been identified by County-Assessed Properties Division and the California Assessors' Association as questions necessary to answer for the proper implementation and administration of Proposition 19.[7] In answering these questions, we employ well-settled canons of statutory construction (*Persky v. Bushey* (2018) 21 Cal.App.5th 810, 818–819 [rules of statutory construction also apply to interpretation of constitutional provisions]), which fundamentally seeks to ascertain the intent of the Legislature so as to effectuate the purpose of the law.' (*Select Base Materials v. Board of Equal*. (1959) 51 Cal.2d 640, 645.) The first and best indicator of intent is the text itself. (*Persky v. Bushey, supra,* 21 Cal.App.5th at pp. 818–819; *People v. Knowles* (1950) 35 Cal.2d 175, 182, cert. den. 340 U.S. 879.) If the language is ambiguous, extrinsic evidence of the enacting body's intent may be consulted, which may include the analysis by the Legislative Analyst and the ballot arguments for and against the initiative. (*Silicon Valley Taxpayers Assn., Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 444-445.) Because Prop 19's text does not explicitly answer many questions or is ambiguous, a number of the answers here are based on the perceived intent of the Legislature and voters. Therefore, the Legislature should make clear the answer to these and other questions in follow-up legislation as contemplated by by subdivision (b)(1) of Section 2.1 which states that the Legislature will enact legislation detailing "procedures and definitions".

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[6] For a detailed summary of the substantive differences between the previous base year value transfer provisions property tax changes made by Proposition 19, see <https://www.boe.ca.gov/prop19/>.

[7] This memorandum does not answer all of the questions raised. It attempts to addresses those that are most pressing. Staff expects to issue guidance in the future addressing additional questions.

Base Year Value Transfer Provisions Related Questions

> **Q1**: Must both the sale of the primary residence and the purchase of a replacement primary residence be completed on or after April 1, 2021?
>
> **A1**: No, the operative requirement is that *the transfer* of the base year value must be on or after April 1, 2021, and not the purchase or sale of either the original or replacement property.

Subdivision (b) of Section 2.1 provides the following:

> Property Tax Fairness for Seniors, the Severely Disabled, and Victims of Wildfire and Natural Disasters. Notwithstanding any other provision of this Constitution or any other law, *beginning on and after April 1, 2021*, the following shall apply:
>
> (1) Subject to applicable procedures and definitions as provided by statute, an owner of a primary residence who is over 55 years of age, severely disabled, or a victim of a wildfire or natural disaster *may transfer the taxable value of their primary residence to a replacement primary residence* located anywhere in this state, regardless of the location or value of the replacement primary residence, *that is purchased or newly constructed as that person's principal residence within two years of the sale of the original primary residence*.

(Emphasis added.)

Subdivision (b) of Section 2.1 makes clear that if the *transfer* of the base year value from a primary residence to a replacement primary residence occurs on or after April 1, 2021, its provisions will apply. Thus, the event that must occur on or after April 1, 2021 is the transfer of the base year value. It is not the date of sale of the primary residence or the date of purchase of the replacement primary residence that must occur on or after April 1, 2021, although related. Subdivision (b) also requires the replacement primary residence be purchased or newly constructed within two years of the sale of the original primary residence without specifying that either transaction – the sale or the purchase or new construction – must come first. Therefore, if the replacement primary residence is purchased or newly constructed on or after April 1, 2021, the primary residence may be sold either two years prior to or after the purchase or new construction of the replacement primary residence and qualify. Alternatively, if the primary residence is sold on or after April 1, 2021, the replacement primary residence may be purchased or newly constructed either two years prior to or after the sale of the primary residence.

We note that what constitutes the date of the actual "transfer" is not specified in Prop 19. However, we believe the transfer should be processed as of the later of the date of the sale of the primary residence or the date of the purchase or new construction of the replacement primary residence, whichever applies, regardless of when the application for transfer was actually submitted.[8]

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[8] This assumes, of course, that the submitted application met whatever filing deadline the legislature may set.

> **Q2**: Must a claimant be "severely disabled" or "severely *and permanently* disabled" under Prop 19?
>
> **A2**: Prop 19 requires that a claimant be "severely disabled," not "severely and permanently disabled".

Section 2, subdivision (a) of Article XIII A provides, in relevant part, that, "The Legislature may extend the provisions of this subdivision relating to the transfer of base year values from original properties to replacement dwellings of homeowners over the age of 55 years to *severely disabled* homeowners...." (Emphasis added.) However, Revenue and Taxation Code (RTC) section 69.5, subdivision (a)(1) requires that a person be "severely and permanently disabled". "Severely and permanently disabled" is defined at RTC section 69.5, subdivision (g)(12) to mean any person described in RTC section 74.3, subdivision (b). RTC section 74.3, subdivision (b) defines "a severely and permanently disabled person" as any person who has a *physical* disability or impairment.

Subdivision (b) of Section 2.1 makes its provisions applicable to "an owner of a primary residence who is over 55 years of age, *severely disabled*, or a victim of a wildfire or natural disaster". However, "severely disabled" is not defined. For that reason, unless the Legislature includes a definition in a statute describing procedures and definitions as required by Section 2.1, subdivision (b)(1), the common meaning of "severely" and "disabled" should apply. (See *Mercer v. Department of Motor Vehicles* (1991) 53 Cal.3d 753, 763 [plain meaning of words in a statute interpreted through the use of dictionary definition].) Merriam Webster's dictionary defines "disabled" as "impaired or limited by a physical, mental, cognitive, or developmental condition," and defines "severe" as "of a great degree". Therefore, in our view, "severely disabled" is more broad than "severely and permanently disabled" as defined in RTC section 74.3, subdivision (b) and as required by RTC section 69.5, and is not limited to a physical disability.

> **Q3**: On what date is the value of the original and replacement primary residences determined for purposes of calculating the transferrable taxable value?
>
> **A3**: The value of the original and replacement primary residences are determined for purposes of calculating the transferrable taxable value as of the date of sale or the date of purchase or completion of new construction, respectively.

Section 2.1, subdivision (b)(1) states, in relevant part:

> (1) Subject to applicable procedures and definitions as provided by statute, an owner of a primary residence [meeting certain conditions] may transfer the *taxable value* of their primary residence to a replacement primary residence ... regardless of the location or *value* of the replacement primary residence....

(Emphasis added.)

While "taxable value" is defined in subdivision (e)(10) of Section 2.1, "value" is undefined. However, Section 2.1 subdivision (b)(2)(B) provides that the taxable value transferred to a replacement primary residence of greater value than the original primary residence, is calculated by adding the difference of the full cash value of the original primary residence and the full cash value of the replacement primary residence to the taxable value of the original primary residence.

For purposes of Proposition 13, "full cash value" is defined at RTC section 110.1, subdivision (a)(2) as the fair market value of property as of the date on which a purchase or change in ownership occurs or the date on which new construction is completed. Therefore, the determination of the fair market value of the original primary residence for purposes of calculating the transferable taxable value, must be as of the date of the sale of the original property because the date of sale is the date of change in ownership as required by RTC section 110.1. (See also Property Tax Rule[9] 462.260.) Similarly, the date on which the full cash value of the replacement primary residence must be determined is the date of purchase or date of the completion of new construction of the replacement primary residence.

Q4: How many times may spouses transfer an original primary residence pursuant to Prop 19?

A4: Each spouse may transfer a base year value up to three times.

Subdivision (a) of Section 2 provides that, "For purposes of this section, 'any person over the age of 55 years' includes a married couple one member of which is over the age of 55 years." This provision has been interpreted to treat spouses as a single claimant if the spouse is also a record owner of the replacement dwelling. (See Letters to Assessors No. (LTA) 2006/010 (dated February 6, 2006), Questions and Answers A2 & B1.)

Section 2.1, however, has no specific requirement or limitation as regards base year value transfer claims from spouses. For this reason, and because constitutional provisions that restrain the legislative power (here, the power to tax) are to be construed liberally , we believe each spouse can transfer base year values pursuant to Section 2.1, subdivision (b) a maximum of three times each as explicitly stated in subdivision (b)(1). Further, we are of the opinion that a transfer completed pursuant to the previous base year value transfer provisions do not count toward the Section 2.1 three transfer maximum.

Parent-Child Exclusion[10] Related Questions

Q1: Prop 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.

Subdivision (d) of Section 2.1 provides,

> Subdivision (h) of Section 2 shall apply to any purchase or transfer that occurs on or before February 15, 2021, but shall not apply to any purchase or transfer

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[9] All references to Property Tax Rule or Rules are to sections of title 18 of the California Code of Regulations.

[10] These questions and answers also apply to the grandparent-grandchild exclusion where applicable even if not explicitly stated.

> occurring after that date. Subdivision (h) of Section 2 shall be inoperative as of February 16, 2021.

Government Code (GC) section 6700, subdivision (a)(5) identifies the third Monday in February as a state holiday. In 2021, that date is February 15. GC sections 6706 and 6707 provide that an act that is to be performed on a holiday may be performed with the same effect on the next business day, and that when the last day for filing any instrument with a state agency falls on a holiday, such act may be performed on the next business day with the same effect.

Because subdivision (c) of Section 2.1 describes an exclusion from change in ownership, we believe the date of "purchase or transfer" is the date of a change in ownership. Property Tax Rule (Rule) 462.260 sets forth the dates of change in ownership of real property. For transfers evidenced by the recordation of a deed, the date of recordation is rebuttably presumed to be the change in ownership date. (Rule 462.260, subd. (a)(1).) For transfers accomplished by an unrecorded deed, the date of the transfer document is rebuttably presumed to be the change in ownership date. (Rule 462.260, subd. (a)(1).) For transfers by inheritance, the date of death is the change in ownership date. (Rule 462.260, subd. (c).)

Because the Government Code grants a one day extension for acts that are to be performed on a holiday and February 15, 2021 is a holiday, transfers evidenced by recorded deed and transfers accomplished by an unrecorded deed may be accomplished on February 16, 2021 and still be excluded under subdivision (h) of Section 2. Since the change in ownership of inherited property does not involve an act that is required to be performed or the filing of any instrument, property must be inherited by February 15, 2021 for subdivision (h) of Section 2.1 to apply.

> **Q2**: Prop 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.

Subdivision (c)(1) of Section 2.1 provides, in relevant part,

> For purposes of subdivision (a) of Section 2, the terms "purchased" and "change in ownership" do not include the purchase or transfer of a family home 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 home of the transferee*.

(Emphasis added.)

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 also 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 subdivision (c)(1) is ambiguous, the legislative intent, as expressed in subdivision (a)(2) of Section 2.1, 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. Therefore, based on this intent, we believe that more than one child may be the recipient of the family 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 her family home?
>
> **A3**: The transferee must establish the family home as her family home within one year of the purchase or transfer of the family home.

Subdivision (c)(5)(A) of Section 2.1 provides,

> *Subject to subparagraph (B)*, in order to receive the property tax benefit provided by this section for the purchase or transfer of a family home, the transferee shall claim the homeowner's exemption or disabled veteran's exemption at the time of the purchase or transfer of the family home.

Subdivision (c)(5)(B), in turn, provides,

> A transferee who fails to claim the homeowner's exemption or disabled veteran's exemption at the time of the purchase or transfer of the family home may receive the property tax benefit provided by this section *by claiming the homeowner's exemption or disabled veteran's exemption within one year of the purchase or transfer of the family home* and shall be entitled to a refund of taxes previously owed or paid between the date of the transfer and the date the transferee claims the homeowner's exemption or disabled veteran's exemption.

(Emphasis added.)

The author's intent as stated in the ACA 11 Fact Sheet,

> ACA 11 also protects the constitutional rights of parents and grandparents to pass the family home to their children, ensuring that their heirs can afford *to move into that home* as their primary residence.

(ACA 11, Fact Sheet, emphasis added.)

Based on subdivision (c)(5)(B) of Section 2.1 and the author's intent, we believe 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**: Prop 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, subdivision (c)(1) of Section 2.1 requires that a family home "continues as the family home of the transferee" in order to qualify for exclusion. This language is ambiguous, susceptible to mean 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. (Cal. Const. art. XIII A, § 2.1, subd. (a)(2).) The author's fact sheet also stated:

> ACA 11 will protect the 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.

(ACA 11, Fact Sheet.)

Therefore, based on this intent, we believe 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. Rather, 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 had the parent-child exclusion not been applied.

> **Q5**: Prop 19 makes the parent-child exclusion applicable to family farms. What familial relationship will establish a farm as a "family farm"?
>
> **A5**: The "family farm" is the farm that is transferred between parents and children (or when applicable, between grandparents and grandchildren).

Subdivision (c)(3) of Section 2.1 provides,

> [The parent-child and grandparent-grandchild exclusions] shall also apply to the purchase or transfer of a family farm. For purposes of this paragraph, any

> reference to a "family home" in [the parent-child and grandparent-grandchild exclusions] shall be deemed to instead refer to a "family farm."

Subdivision (e)(2) defines "family farm" to mean,

> 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 read 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". Rather, the operative provision, subdivision (c)(1) of Section 2.1 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 subdivision (e)(2)) transferred between parents and children. If so (and it meets all other qualifications), the farm is a family farm.

> **Q6**: Prop 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.

Subdivision (c)(3) of Section 2.1 provides, "[p]aragraphs (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." Subdivision (c)(3) then directs how the parent-child and grandparent-grandchild exclusions are to be applied to family farms. It explains, "[f]or 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.'"

Paragraph 1 of subdivision (c) of Section 2.1, with "family home" replaced by "family farm" as required by subdivision (c)(3), provides, in relevant part,

> For purposes of subdivision (a) of Section 2, 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.

Subdivision (e)(2) of Section 2.1 defines "family farm" to mean,

> 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 read on January 1, 2020.

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 the family farm is used in the manner described in subdivision (e)(2), that the family farm be

transferred between parents and children, and that the family farm continues to be used as a family farm by a transferee. Although subdivision (c)(5) requires that a transferee claim either the homeowner's or disabled veteran's exemption to receive the exclusion, subdivision (c)(3) does not apply to (c)(5). In other words, the requirement in subdivision (c)(5) that the property qualify for either the homeowner's or disabled veteran's exemption is limited to the purchase or transfer of a family *home*, not of a family *farm*. Unlike paragraphs (c)(1) and (c)(2), the term "family home" is not replaced by the term "family farm" in paragraph (c)(5). Therefore, 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**: Prop 19 requires a transferee of a family home to qualify for the homeowner's or disabled veteran's exemption. What is the proper forum for appeal for a transferee denied the homeowner's or disabled veteran's exemption?
>
> **A7**: A transferee who has been denied the homeowner's or disabled veteran's exemption must file a claim for refund in the county in which the property is located and, if denied, must file an appeal in superior court.

Rule 302 sets forth the function and jurisdiction of assessment appeals boards and county boards of equalization (together, appeals boards). Subdivision (b) of Rule 302 provides that "[e]xcept as provided in subdivision (a)(4),[11] the board has no jurisdiction to grant or deny exemptions or to consider allegations that claims for exemption from property taxes have been improperly denied." Subdivision (a)(5), which is the exception to subdivision (b), provides that a county board has jurisdiction:

> [t]o determine the classification of the property that is the subject of the hearing, including classifications within the general classifications of real property, improvements, and personal property. Such classifications may result in the property so classified being exempt from property taxation.

Thus, an appeals board has no jurisdiction to hear and decide an application involving any exemption matter except to determine the proper classification of property, and may do so even if the classification causes the property to be exempt. However, whether or not a homeowner qualifies for either the homeowner's exemption or the disabled veteran's exemption is not a determination of the proper classification of property. Therefore, an appeals board may not hear an appeal of a denial of the homeowner's or disabled veteran's exemption. An appeal of a denial of the homeowner's or disabled veteran's exemption must be filed in superior court after the denial of a claim for refund with the county. (See Rev. & Tax. Code, §§ 5140 and 5141.)

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[11] A recent amendment to Rule 302 moved subdivision (a)(4) to subdivision (a)(5) without changing the reference. Rule 302, subdivision (b) should properly reference subdivision (a)(5).

cc: Ms. Brenda Fleming (MIC: 73)
Mr. David Yeung (MIC: 64)
Ms. Lisa Thompson (MIC: 120)

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BRENDA FLEMING
Executive Director

December 11, 2020

No. 2020/061

TO COUNTY ASSESSORS:

PROPOSITION 19
NOVEMBER 3, 2020 GENERAL ELECTION

On November 3, 2020, California voters approved Proposition 19. Proposition 19 (Assembly Constitutional Amendment 11, Stats. 2020, res. ch. 31) adds sections 2.1, 2.2, and 2.3 to article XIII A of the California Constitution. This Letter To Assessors (LTA) is a brief summary of the changes made by section 2.1, which adds new provisions for a base year value transfer of a primary residence for persons at least age 55 or severely disabled or for victims of wildfires or natural disasters. In addition, section 2.1 changes provisions of the parent-child and grandparent-grandchild exclusions.

Effective Date

Section 10 of article II of the California Constitution provides that a measure approved by a majority of votes cast takes effect on the fifth day after the Secretary of State files the Statement of the Vote for the election at which the measure is voted on, but the measure may provide that it becomes operative after its effective date.[1] The language of Proposition 19 for both the base year value transfer provisions and the parent-child and grandparent-grandchild exclusion provisions have specified operatives dates, as follows:

- The base year value transfer provisions become operative on April 1, 2021.
- The parent-child and grandparent-grandchild exclusion provisions become operative on February 16, 2021.

Base Year Value Transfer

Beginning on and after April 1, 2021, section 2.1(b) of article XIII A of the California Constitution provides that an owner of a primary residence who is over 55 years of age, severely disabled,[2] or a victim of a wildfire or natural disaster may transfer the base year value of their primary residence to a replacement primary residence located anywhere in California that is

[1] On June 5, 2018, the voters of California approved Proposition 71, which changed the effective date of ballot measures from the day after the election to five days after the California Secretary of State certifies the results of the election. See LTA No. 2018/068.

[2] Revenue and Taxation Code (RTC) section 74.3(b) defines a "severely and permanently disabled person" as "any person who has a physical disability or impairment, whether from birth or by reason of accident or disease, that results in a functional limitation as to employment or substantially limits one or more major life activities of that person, and that has been diagnosed as permanently affecting the person's ability to function, including, but not limited to, any disability or impairment that affects sight, speech, hearing, or the use of any limbs."

purchased or newly constructed as that person's principal residence within two years of the sale of the original primary residence, regardless of the value of the replacement residence.

If the replacement residence is of *equal or lesser value* than the original primary residence, the taxable value of the original primary residence may be transferred to the replacement residence. "Taxable value" is defined in section 2.1(e)(10) as the base year value determined in accordance with section 2(a) of the California Constitution, plus any adjustment authorized by section 2(b). Section 2(a) provides that real property is reassessed when purchased, newly constructed, or a change in ownership has occurred. Section 2(b) authorizes annual inflationary adjustments.[3] Thus, "taxable value" means the factored base year value.

If the replacement residence is of *greater value* than the original primary residence, partial relief is available. The new base year value of the replacement residence is the sum of the factored base year value of the original primary residence plus the difference between the full cash values of the original primary residence and the replacement residence.

> ***Example:*** Homeowner, who is over age 55, sells a primary residence on June 28, 2021 for a full cash value of $700,000. At the time of sale, the single-family residence has a factored base year value of $225,738. On July 22, 2021, a replacement primary residence is purchased for a full cash value of $800,000.
>
> Since the full cash value of the replacement primary residence exceeds the full cash value of the original primary residence, the difference in full cash values must be calculated and added to the transferred factored base year value.
>
> - $800,000 - $700,000 = $100,000 (difference in full cash values)
> - $225,738 + $100,000 = $325,738 (add difference to factored base year value)
> - New base year value of replacement primary residence is $325,738.

Please note that Proposition 19 is unclear whether one event (either the sale of the original residence or the purchase or new construction of the replacement residence) or both events must occur on or after April 1, 2021, in order to qualify for this base year value transfer.

For purposes of this base year value transfer:

- A "primary residence" is a residence that is eligible for either the homeowner's or disabled veteran's exemption.
- A "victim of a wildfire or natural disaster" is an owner of a primary residence that has been substantially damaged as a result of a wildfire or natural disaster that amounts to more than 50 percent of the improvement value of the primary residence immediately before the wildfire or natural disaster. "Damage" includes a diminution in the value of the primary residence as a result of restricted access caused by the wildfire or natural disaster.

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[3] These provisions are implemented by RTC section 51.

- A "natural disaster" is a condition of disaster or peril, as declared by the Governor, caused by conditions such as fire, flood, drought, storm, mudslide, earthquake, civil disorder, foreign invasion, or volcanic eruption.
- A "wildfire" means an unplanned, unwanted wildland fire, including unauthorized human-caused fires, escaped wildland fire use events, escaped prescribed fire projects, and all other wildland fires where the objective is to extinguish the fire.[4]

Under Proposition 19, a person who is over 55 years of age or severely disabled may transfer the base year value of a primary residence three times. However, the language in Proposition 19 is not clear as to whether the "three times" would include a previously transferred base year value or if the "three times" would be in addition to this.

As section 2.1(b)(1) states that these provisions are subject to "applicable procedures and definitions as provided by statute," we anticipate that the Legislature will clarify these procedures and definitions through future legislation.

Parent-Child and Grandparent-Grandchild Exclusion

Beginning on and after February 16, 2021, section 2.1(c) of article XIII A of the California Constitution provides that the terms "purchased" and "change in ownership" do not include the purchase or transfer of a family home of the transferor in the case of a transfer between parents and their children, if the property continues as the family home of the transferee. Partial relief is available if the value of the family home exceeds a specified value test.

These provisions also apply to a purchase or transfer of a family home between grandparents and their grandchildren, as long as all of the parents of those grandchildren, who qualify as children of the grandparents, are deceased as of the date of the purchase or transfer.

Family Home. Section 2.1(e)(3) provides that a "family home" means a principal residence that must be eligible for the homeowner's or disabled veteran's exemption. Section 2.1(c)(1) allows the purchase or transfer of a "family home of the transferor" to be excluded from reassessment, if the property "continues as the family home of the transferee." Thus, the family home must be the principal residence of both the transferor and the transferee.

Superseded – See Legal Memo dated 1/8/21, p. 10-11

A "family home" also includes a family farm that contains a principal residence.[5] A "family farm" is real property that is under cultivation or which is being used for pasture or grazing, or that is used to produce any agricultural commodity. "Agricultural commodity" means any and all plant and animal products produced for commercial purposes, including, but not limited to, plant products used for producing biofuels and cultivated industrial hemp.[6]

Value Test. Section 2.1(c)(1)(A) and (B) require adjustment of the taxable value if the assessed value of the family home exceeds the sum of the taxable value plus $1,000,000. "Assessed

[4] Government Code section 51177(j).
[5] California Constitution, article XIII A, section 2.1(c)(3) and (e)(2).
[6] Government Code section 51201(a) and Division 24 (commencing with section 81000) of the Food and Agricultural Code.

value" is defined in RTC section 135 as 100 percent of full value. "Full value" is defined in section 110.5 as fair market value. "Taxable value" means the base year value plus inflationary factoring (i.e., factored base year value).

If the fair market value of the family home is *less than* the sum of the factored base year value plus $1,000,000, then the factored base year value need not be adjusted.

If the fair market value of the family home is *equal to or more than* the sum of the factored base year value plus $1 million, an amount equal to the fair market value of the family home upon purchase by, or transfer to, the transferee, minus the sum of the factored base year value plus $1,000,000, is added to the factored base year value.

Example: A single family residence has a factored base year value of $425,738. Parent dies on March 1, 2021, and property is inherited by parent's only child. The residence was the principal residence of both parent and child. On parent's date of death, property has a fair market value of $1,750,000.

- Calculate the sum of factored base year value plus $1,000,000.

  $425,738 + $1,000,000 = $1,425,738

- Determine whether the assessed value exceeds the sum of the factored base year value plus $1,000,000.

  $1,750,000 is greater than $1,425,738

- Calculate the difference.

  $1,750,000 - $1,425,738 = $324,262

- Add difference to factored base year value,

  $425,738 + $324,262 = $750,000

- New combined base year value = $750,000

Please be aware that beginning February 16, 2023, and every other February 16 after that, 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. The State Board of Equalization will release this information biennially via Letter To Assessors.

Filing Requirements. In order to receive this property tax benefit, the transferee must claim the homeowner's or disabled veteran's exemption at the time of the purchase or transfer of the family home. If the claim is not filed at the time of the purchase or transfer, the transferee has *one year* from the date of purchase or transfer to file the claim for the homeowner's or disabled veteran's exemption and shall be entitled to a refund of taxes previously owed or paid between the date of the transfer and the date the transferee claimed the homeowner's or disabled veteran's exemption.

Propositions 58/193 Sunset Date. Effective November 5, 1986, Proposition 58 added subdivision (h) to section 2 of article XIII A to exclude transfers of real property between parents and their children. On March 27, 1996, Proposition 193 amended section 2(h) to extend this

exclusion to transfers from grandparents to grandchildren, under limited circumstances. These provisions are implemented by RTC section 63.1.

This exclusion applies to two types of property:

- Principal residence (no value limit)
- The first $1 million of all other real property

Each person can transfer up to $1 million of real property (other than a principal residence) to any combination of parents or children. The $1 million limit is cumulative over a lifetime. The value that counts towards the $1 million limit is a property's factored base year value, not its current market value.

Proposition 19 specifically provides in section 2.1(d):

> Subdivision (h) of Section 2 shall apply to any purchase or transfer that occurs on or before February 15, 2021, but shall not apply to any purchase or transfer occurring after that date. Subdivision (h) of Section 2 shall be inoperative as of February 16, 2021.

Thus, the provisions of RTC section 63.1 (Propositions 58/193) will apply to any transfers occurring on or before February 15, 2021.

Proposition 19 will apply to any transfers that occur on or after February 16, 2021. Proposition 19 limits the parent-child and grandparent-grandchild exclusion to a family home or farm that is the principal residence of both the transferor and transferee, and eliminates the exclusion for any other type of property.

Conclusion

At this time, there are still many uncertainties surrounding the implementation of Proposition 19, as the language does not address all issues. These issues will need to be resolved through future legislation. Once this implementing legislation has been enacted, we will issue future guidance on the matter. Until that time, we recommend that County Assessors track possible qualifying transfers, since it is likely that the implementing legislation will be retroactive to the applicable operative dates.

A copy of section 2.1 is enclosed. If you have any questions regarding the change in ownership provisions of Proposition 19, please contact the County-Assessed Properties Division at 1-916-274-3350.

Sincerely,

/s/ David Yeung

David Yeung
Deputy Director
Property Tax Department

DY:gs
Enclosure

California Constitution
Article XIII A
Section 2.1

(a) Limitation on Property Tax Increases on Primary Residences for Seniors, the Severely Disabled, Wildfire and Natural Disaster Victims, and Families. It is the intent of the Legislature in proposing, and the people in adopting, this section to do both of the following:

(1) Limit property tax increases 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.

(2) Limit property tax increases 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 they own in California.

(b) Property Tax Fairness for Seniors, the Severely Disabled, and Victims of Wildfire and Natural Disasters. Notwithstanding any other provision of this Constitution or any other law, beginning on and after April 1, 2021, the following shall apply:

(1) Subject to applicable procedures and definitions as provided by statute, an owner of a primary residence who is over 55 years of age, severely disabled, or a victim of a wildfire or natural disaster may transfer the taxable value of their primary residence to a replacement primary residence located anywhere in this state, regardless of the location or value of the replacement primary residence, that is purchased or newly constructed as that person's principal residence within two years of the sale of the original primary residence.

(2) For purposes of this subdivision:

(A) For any transfer of taxable value to a replacement primary residence of equal or lesser value than the original primary residence, the taxable value of the replacement primary residence shall be deemed to be the taxable value of the original primary residence.

(B) For any transfer of taxable value to a replacement primary residence of greater value than the original primary residence, the taxable value of the replacement primary residence shall be calculated by adding the difference between the full cash value of the original primary residence and the full cash value of the replacement primary residence to the taxable value of the original primary residence.

(3) An owner of a primary residence who is over 55 years of age or severely disabled shall not be allowed to transfer the taxable value of a primary residence more than three times pursuant to this subdivision.

(4) Any person who seeks to transfer the taxable value of their primary residence pursuant to this subdivision shall file an application with the assessor of the county in which the replacement primary residence is located. The application shall, at minimum, include information comparable to that identified in paragraph (1) of subdivision (f) of Section 69.5 of the Revenue and Taxation Code, as that section read on January 1, 2020.

(c) Property Tax Fairness for Family Homes. Notwithstanding any other provision of this Constitution or any other law, beginning on and after February 16, 2021, the following shall apply:

(1) For purposes of subdivision (a) of Section 2, the terms "purchased" and "change in ownership" do not include the purchase or transfer of a family home 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 home of the transferee. This subdivision shall apply to both voluntary transfers and transfers resulting from a court order or judicial decree. The new taxable value of the family home of the transferee shall be the sum of both of the following:

(A) The taxable value of the family home, subject to adjustment as authorized by subdivision (b) of Section 2, determined as of the date immediately prior to the date of the purchase by, or transfer to, the transferee.

(B) The applicable of the following amounts:

(i) If the assessed value of the family home upon purchase by, or transfer to, the transferee is less than the sum of the taxable value described in subparagraph (A) plus one million dollars ($1,000,000), then zero dollars ($0).

(ii) If the assessed value of the family home upon purchase by, or transfer to, the transferee is equal to or more than the sum of the taxable value described in subparagraph (A) plus one million dollars ($1,000,000), an amount equal to the assessed value of the family home upon purchase by, or transfer to, the transferee, minus the sum of the taxable value described in subparagraph (A) and one million dollars ($1,000,000).

(2) Paragraph (1) shall also apply to a purchase or transfer of the family home between grandparents and their grandchildren if all of the parents of those grandchildren, who qualify as children of the grandparents, are deceased as of the date of the purchase or transfer.

(3) Paragraphs (1) and (2) shall also apply to the purchase or transfer of a family farm. 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."

(4) Beginning on February 16, 2023, and every other February 16 thereafter, the State Board of Equalization shall adjust the one million dollar ($1,000,000) amount described in paragraph (1) for inflation to reflect the percentage change in the House Price Index for California for the prior calendar year, as determined by the Federal Housing Finance Agency. The State Board of Equalization shall calculate and publish the adjustments required by this paragraph.

(5) (A) Subject to subparagraph (B), in order to receive the property tax benefit provided by this section for the purchase or transfer of a family home, the transferee shall claim the homeowner's exemption or disabled veteran's exemption at the time of the purchase or transfer of the family home.

(B) A transferee who fails to claim the homeowner's exemption or disabled veteran's exemption at the time of the purchase or transfer of the family home may receive the property tax benefit provided by this section by claiming the homeowner's exemption or disabled veteran's exemption within one year of the purchase or transfer of the family home and shall be entitled to

a refund of taxes previously owed or paid between the date of the transfer and the date the transferee claims the homeowner's exemption or disabled veteran's exemption.

(d) Subdivision (h) of Section 2 shall apply to any purchase or transfer that occurs on or before February 15, 2021, but shall not apply to any purchase or transfer occurring after that date. Subdivision (h) of Section 2 shall be inoperative as of February 16, 2021.

(e) For purposes of this section:

(1) "Disabled veteran's exemption" means the exemption authorized by subdivision (a) of Section 4 of Article XIII.

(2) "Family farm" means 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 read on January 1, 2020.

(3) "Family home" has the same meaning as "principal residence," as that term is used in subdivision (k) of Section 3 of Article XIII.

(4) "Full cash value" has the same meaning as defined in subdivision (a) of Section 2.

(5) "Homeowner's exemption" means the exemption provided by subdivision (k) of Section 3 of Article XIII.

(6) "Natural disaster" means the existence, as declared by the Governor, of conditions of disaster or extreme peril to the safety of persons or property within the affected area caused by conditions such as fire, flood, drought, storm, mudslide, earthquake, civil disorder, foreign invasion, or volcanic eruption.

(7) "Primary residence" means a residence eligible for either of the following:

(A) The homeowner's exemption.

(B) The disabled veteran's exemption.

(8) "Principal residence" as used in subdivision (b) has the same meaning as that term is used in subdivision (a) of Section 2.

(9) "Replacement primary residence" has the same meaning as "replacement dwelling," as that term is defined in subdivision (a) of Section 2.

(10) "Taxable value" means the base year value determined in accordance with subdivision (a) of Section 2 plus any adjustment authorized by subdivision (b) of Section 2.

(11) "Victim of a wildfire or natural disaster" means the owner of a primary residence that has been substantially damaged as a result of a wildfire or natural disaster that amounts to more than 50 percent of the improvement value of the primary residence immediately before the wildfire or natural disaster. For purposes of this paragraph, "damage" includes a diminution in the value of the primary residence as a result of restricted access caused by the wildfire or natural disaster.

(12) "Wildfire" has the same meaning as defined in subdivision (j) of Section 51177 of the Government Code, as that section read on January 1, 2020.

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State Controller

CYNTHIA BRIDGES
Executive Director

September 5, 2013

No. 2013/044

TO COUNTY ASSESSORS,
COUNTY COUNSELS, AND
OTHER INTERESTED PARTIES:

PROPERTY TAX RULE 462.040
CHANGE IN OWNERSHIP—JOINT TENANCIES

Following a public hearing on June 11, 2013, the State Board of Equalization amended Property Tax Rule 462.040, *Change in Ownership—Joint Tenancies*. The amended rule was approved by the Office of Administrative Law on July 24, 2013 and will become effective October 1, 2013.[1]

The amendments to Property Tax Rule 462.040 make the rule consistent with:

- Current law which provides that the transfer of a joint tenancy interest to a trust severs the joint tenancy;
- Family Code section 297.5 and Revenue and Taxation Code[2] section 62(p) regarding registered domestic partners;
- Section 62.3 pertaining to transfers between cotenants; and
- Section 65(b) which provides that all transferor(s) must be among the joint tenants for a transfer to be excluded from change in ownership, and that the elimination of a joint tenant does not create "original transferor" status in any of the remaining joint tenants.

Enclosed is a copy of the amended rule. In addition, the rule will be posted on the Board of Equalization website at www.boe.ca.gov/lawguides/property/current/ptlg/rule/462-040.html. If you have any questions regarding the content of this rule, please contact the County-Assessed Properties Division at 1-916-274-3350.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:grs
Enclosure

[1] Government Code section 11343.4 provides that amendments to rules approved between June 1 and August 31 will become effective on October 1.
[2] All statutory references are to the Revenue and Taxation Code unless otherwise provided.

State of California

BOARD OF EQUALIZATION

PROPERTY TAX RULES

Chapter 1. State Board of Equalization – Property Tax
Subchapter 4. Equalization by State Board
Article 4. Change in Ownership and New Construction

Rule 462.040. Change in Ownership—Joint Tenancies.

Authority: Section 15606, Government Code.
Reference: Sections 60, 61, 62, 62.3, 63, 63.1, 65, 65.1, and 67, Revenue and Taxation Code; and Section 662, Evidence Code.

(a) GENERAL RULE. The creation, transfer, or termination of a joint tenancy interest is a change in ownership of the interest transferred.

Example 1: The purchase of property by A and B, as joint tenants, is a change in ownership of the entire property.

Example 2: The transfer from A and B, as joint tenants, to C and D, as joint tenants, is a change in ownership of the entire property.

Example 3: The transfer from C and D, as joint tenants, to C, as sole owner, is a change in ownership of 50 percent of the property.

(b) EXCEPTIONS. The following transfers do not constitute a change in ownership:

(1) The transfer creates or transfers any joint tenancy interest and after such creation or transfer all transferor(s) are among the joint tenants. Such a transferor who is also a transferee is, therefore, considered to be an "original transferor" for purposes of determining the property to be reappraised upon subsequent transfers. If a spouse of an "original transferor" acquires an interest in the joint tenancy property either during the period that the "original transferor" holds an interest or by means of a transfer from the "original transferor," such spouse shall also be considered to be an "original transferor." "Spouse" includes a registered domestic partner who shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities and obligations as granted to and imposed upon spouses pursuant to section 297.5 of the Family Code. For a transfer of a joint tenancy interest into trust from November 13, 2003 to a date before October 1, 2013, any joint tenant may also become an "original transferor" by transferring his or her joint tenancy interest to the other joint tenant(s) through his or her trust if the trust instrument names the other joint tenant(s) as the present beneficiary or beneficiaries. All other initial and subsequent joint tenants are considered to be "other than original transferors." To create original transferor status, a transaction must occur that either changes title to joint tenancy or adds an additional person to title. The elimination of a joint tenant does not create "original transferor" status in any of the remaining joint tenants.

Example 4: A and B own property as tenants in common and transfer the property to A and B as joint tenants. A and B are both "original transferors."

Example 5: A and B purchase property as joint tenants. On December 12, 2004, A and B transfer their property interests to each other as joint tenants through their respective trusts. A and B are transferors who are among the joint tenants and are, therefore, considered to be "original transferors." If A and B had transferred their interests into trust on any date after October 1, 2013, neither A's trust nor B's trust would be considered a joint tenant and neither A nor B would be considered an "original transferor" as a result of the transfer into trust.

Example 6: A and B purchase property as joint tenants. A and B transfer to A, B, C, and D as joint tenants. No change in ownership because A and B, the transferors, are included among the transferees and are, therefore, "original transferors." C and D are "other than original transferors." Likewise, if A, as the sole owner, had transferred to A, B, C, and D as joint tenants, no change in ownership. A would be an "original transferor" and B, C, and D would be "other than original transferors."

Example 7: A and B acquire property as joint tenants. A and B transfer to A, B, C, D, and E as joint tenants. E is B's wife. No change in ownership because A and B, the transferors, are included among the transferees and are,

therefore, "original transferors." E, the wife of an "original transferor," is also an "original transferor." C and D are "other than original transferors."

Example 8: A is the sole owner of property. A grants to A, B, and C as joint tenants. A is an "original transferor." B and C are "other than original transferors." A dies. A's interest passes by operation of law to B and C, resulting in a 100 percent change in ownership. Subsequently, B and C transfer to B, C, and D as joint tenants. D is A's husband. D does not become an "original transferor" because he did not acquire his interest from A during the period that A held an interest in the initial joint tenancy.

Example 9: A transfers to A and B as joint tenants. A is an "original transferor," and B is an "other than original transferor." C is A's registered domestic partner. A and B, as joint tenants, transfer to A, B, and C as joint tenants. C is an "original transferor" because he is the registered domestic partner of an "original transferor." B becomes an "original transferor" because he is a transferor who is among the transferees.

Example 10: A transfers to A and B as joint tenants. A is an "original transferor," and B is an "other than original transferor." A and B, as joint tenants, transfer to B and C as joint tenants. B becomes an "original transferor." C is A's registered domestic partner. C is an "original transferor" because C was the registered domestic partner of an "original transferor" and C acquired an interest by means of a transfer from A.

Example 11: A and B acquire real property as joint tenants. A and B transfer to B, C, and D, as joint tenants. 66 2/3 percent change in ownership of the transferred interests because A is not one of the transferees.

Example 12: A and B purchase property as joint tenants. On August 13, 2003, A and B sell a 50 percent interest to C and D, with the deed showing A, B, C and D as joint tenants. A and B become "original transferors." C and D become "other than original transferors." On December 13, 2003, C and D then transfer their joint tenancy interests to their respective trusts for the benefit of the remaining joint tenants. C and D become "original transferors." On January 13, 2004, A and B then sell their remaining 50 percent to C and D, and go off title. Under circumstances where application of the step-transaction doctrine to disregard the form of the transaction would be appropriate due to their intent to avoid a change in ownership, A, B, C and D do not become "original transferors" as the result of their transfers to each other.

(2) The transfer terminates an "original transferor's" interest in a joint tenancy described in (b)(1) and the interest vests in whole or in part in the remaining "original transferors"; except that, upon the termination of the interest of the last surviving "original transferor," there shall be a reappraisal of the property as if it had undergone a 100 percent change in ownership.

Example 13: A and B transfer to A, B, C, and D as joint tenants. A and B are "original transferors," and C and D are "other than original transferors." A dies or grants his interest to the remaining joint tenants, B, C, and D. No change in ownership because B, an "original transferor," remains as a joint tenant.

Example 14: A and B transfer to A, B, C, and D as joint tenants. A and B are "original transferors," and C and D are "other than original transferors." A dies or grants his interest to the remaining joint tenants, B, C, and D. No change in ownership because B, an "original transferor," remains as a joint tenant. Subsequently, B dies or grants his interest to C and D. 100 percent change in ownership because B was the last surviving "original transferor."

(3) The transfer terminates a joint tenancy interest held by "other than an original transferor" in a joint tenancy described in (b)(1) and the interest is transferred either to an "original transferor," or to all the remaining joint tenants, provided that one of the remaining joint tenants is an "original transferor." The "original transferor" status of any remaining joint tenants ceases when a joint tenancy is terminated.

Example 15: A and B transfer to A, B, C, and D as joint tenants. A and B are "original transferors," and C and D are "other than original transferors." A dies or grants his interest to the remaining joint tenants, B, C, and D. No change in ownership because B, an "original transferor," remains as a joint tenant. C, not an "original transferor," grants his interest to B and D. No change in ownership because C grants to the remaining joint tenants, B and D, and B is an "original transferor."

Example 16: A and B transfer to A, B, C, and D as joint tenants. A and B are "original transferors," and C and D are "other than original transferors." A dies or grants his interest to the remaining joint tenants, B, C, and D. No change in ownership because B, an "original transferor," remains as a joint tenant. C, not an "original transferor," grants his interest to B and D as joint tenants. No change in ownership because C grants to the remaining joint tenants, B and D, and B is an "original transferor." D dies and D's joint tenancy interest passes to B by operation of

law. Since B is an "original transferor," there is no change in ownership. Upon D's death, the joint tenancy is terminated and B ceases to be an "original transferor."

(4) For other than joint tenancies described in (b)(1), the transfer is between or among co-owners and results in a change in the method of holding title but does not result in a change in the proportional interests of the co-owners, such as:

(A) A transfer terminating the joint tenancy and creating separate ownerships of the property in equal interests.

(B) A transfer terminating the joint tenancy and creating a tenancy in common of equal interests.

(C) A transfer terminating a joint tenancy and creating or transferring to a legal entity when the interests of the transferors and transferees remain the same after the transfer. Such transferees shall be considered to be the "original co-owners" for purposes of determining whether a change in ownership occurs upon the subsequent transfer of the ownership interests in the property.

(5) The transfer is one to which the interspousal exclusion, pursuant to the provisions of section 63 of the Revenue and Taxation Code, or the registered domestic partner exclusion, pursuant to the provisions of section 62(p) of the Revenue and Taxation Code, applies.

(6) The transfer is of a joint tenancy interest of less than five percent of the value of the total property and has a value of less than $10,000; provided, however, that transfers of such interests during any one assessment year (the period from January 1 through December 31) shall be accumulated for the purpose of determining the percentage interest and value transferred. When the value of the accumulated interests transferred during any assessment year equals or exceeds five percent of the value of the total property or $10,000, then only that percentage of the property represented by the transferred accumulated interests shall be reappraised. For purposes of this subsection, the "accumulated interests transferred" shall not include any transfer of an interest that is otherwise excluded from change in ownership.

(7) The transfer is one to which the parent-child or grandparent-grandchild exclusion applies, and for which a timely claim has been filed as required by section 63.1 of the Revenue and Taxation Code.

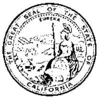
(8) The transfer is one to which the cotenancy exclusion applies pursuant to section 62.3 of the Revenue and Taxation Code.

(c) Rebuttable Presumption. For purposes of this section, for joint tenancies created on or before March 1, 1975, it shall be rebuttably presumed that each joint tenant holding an interest in property as of March 1, 1975, is an "original transferor." This presumption is not applicable to joint tenancies created after March 1, 1975.

(d) Reasonable Cause. For purposes of this section, the assessor may consider persons holding joint title to property, such as tenants in common, to be joint tenants and "original transferors" if there is "reasonable cause" to believe that the parties intended to create a joint tenancy and each person was a transferor among the persons holding title. "Reasonable cause" means a deed, Affidavit of Death of Joint Tenant, a trust, will, or estate plan indicating that a joint tenant was a transferor among the joint tenants, unless circumstances causing the application of the step transaction exist.

Example 17: A and B jointly purchase their primary residence and title is recorded as tenants in common. The sales contract states that A and B intended to take title as joint tenants. The assessor may determine that the sales contract establishes that A and B intended to hold title as joint tenants upon purchase.

History: Adopted June 29, 1978, effective July 3, 1978.
Amended September 26, 1978, effective October 2, 1978.
Repealed Old Rule and Adopted New Rule August 16, 1979, effective August 22, 1979.
Amended November 13, 1979, effective December 6, 1979.
Amended May 5, 1981, effective August 12, 1981.
Amended March 31, 1982, effective June 10, 1982.
Amended May 11, 1994, effective June 10, 1994. Renumbered, formerly 462(c).
Amended October 15, 1998, effective January 29, 1999.
Amended and effective April 3, 2001. Made grammatical change to subsection B(1), Example 5, and Example 8.
Amended July 9, 2003, effective November 13, 2003.
Amended June 11, 2013, effective October 1, 2013.



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Fourth District, Los Angeles

KATHLEEN CONNELL
State Controller, Sacramento

E. L. SORENSEN, JR.
Executive Director

March 14, 2000

Re: **Parent/Child – Proper Allocation of the $1 Million Exclusion.**

Dear Mr. :

This is in response to your letter of January 9, 2000, requesting our opinion as to whether the proposed distribution plan under an irrevocable trust properly allocates the assets for purposes of applying the $1 million parent/child exclusion, thereby avoiding a change in ownership. Based on the following described facts, and for the reasons hereinafter explained, the exclusion would apply and no change in ownership will occur.

Factual Background

1. The decedent, "Mother" died on August 25, 1999. Her estate consisted of cash, securities, and five residential properties with improvements, and one unimproved lot, all located in two counties and held in Mother's 1982 Revocable Living Trust. The Trust became irrevocable upon Mother's death, and her four children were the sole present beneficiaries.

2. The Trust provided that upon the decedent's death, the Successor Trustee should divide the trust estate into equal shares and distribute one share to each of the four children free of Trust, in cash or in kind, in divided or undivided interests. (Section 5.04, p. 14 of Mother's Trust.[1])

[1] Section 5.04, p. 14 of the Trust provides that "the Trustee in its absolute discretion, may divide or distribute such assets in kind, or may divide and distribute undivided interests in such assets, or may sell all or any part of such assets and make division or distribution in cash or partly in cash and partly in kind. The decision of the Trustee, either prior to or on any division or distribution of such assets, as to what constitutes a proper division of such assets or the Trust Estate or any Trust provided for in this Declaration, shall be binding on all persons in any manner…".

3. At the time of Mother's death, each of the improved parcels in the Trust Estate had an existing mortgage; only the unimproved lot was free of debt. The entire Trust Estate had a net worth of approximately $738,698, with the real property valued at approximately $453,247 and all other property valued at $497,441, less $211,990 in debt, taxes, and other costs. Pursuant to the Trust provisions, the Successor Trustee is proposing to distribute approximately $222,475 net worth of assets to each child, totaling $889,900. (This amount assumes increases between the net worth on date of death and the net worth on the date of future distribution).

4. Before making any distributions however, the Successor Trustee will sell Parcel 4 in order to raise the cash needed. Thereafter, $222,475, mixed between real property and cash, will be distributed non pro rata to each child. Each share will be funded with unequal interests in the five remaining parcels together with cash and notes, as follows:

   To M - $216,841 net value in Parcel 3, and $5,634 in cash;
   To C - $126,082 net value in Parcel 5, and $96,393 in cash;
   To E - $222,475 net value (all in cash and notes)
   To A - $147,750 net value in Parcel 2, $35,809 net value in Parcel 1, $4,500 net value in the undeveloped lot, and $34,416 in cash.

Each of the parcels, except the unimproved lot will continue to be encumbered by a mortgage.

Your questions are: 1) Will the proposed distribution plan qualify for the parent/child exclusion and avoid change in ownership, assuming timely claims are filed; 2) Would the parent/child exclusion apply to Parcel 4, assuming a timely claim is filed prior to its sale; and 3) Is it acceptable to equalize the children's net shares by considering the outstanding mortgage balances on the properties together with cash or other assets. As explained below, the answer to all three of these questions is yes.

Law and Analysis

As you are aware, Revenue and Taxation Code[2]section 61 provides that, subject to exceptions not here relevant, "change in ownership, as defined in section 60, includes, but is not limited to: ". .(g) [a]ny interests in real property which vest in persons other than the trustor...when a revocable trust becomes irrevocable."

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[2] All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

The parent/child exclusion (Proposition 58) was added to section 2 subdivision (h) of Article XIIIA of the California Constitution on November 6, 1986. It excludes from change in ownership the purchase or transfer of the principal residence of the transferor between parents and their children, as well as the purchase or transfer of the first $1 million of the full cash value of all other real property *between parents and their children*. Section 63.1, which implements Proposition 58, also states in subdivision (a)(2) that the exclusion applies to "the purchase or transfer of the first $1 million of the full cash value of all other real property *between parents and their children*." For purposes of interpreting the exclusion, Section 63.1(c)(1) states that the date of any transfer between parents and their children under a will (or trust) or intestate succession shall be the date of the decedent's death. Applied to the instant case, if the transfers of the six parcels in Mother's Trust qualified under Section 63.1, as transfers between Mother and her four children on the date of death, and if the Trustee's distribution plan merely executes such transfers based on the equal value of each child's beneficial interests received on Mother's death, then no change in ownership will occur.

1. **Will the distribution plan, allocating equal shares of theTrust real property on a non-pro rata basis among the four children, qualify for the parent/child exclusion and avoid change in ownership, assuming timely claims are filed?**

Yes. As we have explained in previous opinions, the property tax consequences of transferring property on a share-and-share-alike basis depend on whether the distribution plan conforms to the beneficiary provisions in the Trust instrument as of the date of death. You rely heavily on a Letter to Assessors No. 91/08, dated January 23, 1991, entitled "*Change in Ownership Consequences of Real Property in an Estate or Trust Distributed on a 'Share and Share Alike' Basis*," which sets forth this position in detail. The discussion in LTA 91/08 makes it clear that where a trustee's statutory powers over the property in an irrevocable trust are not limited by the trust instrument, and the trust instrument requires share-and-share alike distribution to children, no change in ownership occurs upon distribution, unless a trust beneficiary receives property or assets valued in excess of the value of his or her share. Regardless of the mixture of real property and assets constituting the shares ultimately distributed to each, the value of each share is the determining factor. If one sibling receives more value than the others, the result is a transfer from the other siblings to the one with the excess value. This view has been restated on numerous occasions since 1991, most notably in Annotation No. 625.0235 (attached).

The proposed distribution plan in the instant case falls squarely within the parameters of LTA No. 91/08 and Annotation No. 625.0235, in that the language of the Trust directs that all of the property and assets in the estate be distributed to the children on a share-and-share alike basis, and the Trustee's distribution plan executes this instruction by distributing to each child an

equal share in the total net worth of the assets. Each child will receive $222,475 in net worth, mixed between real property and cash, representing one quarter of the total net worth of the Trust Estate. Since each child received one quarter of the Trust Estate on the date of Mother's death (Article 3 of the Trust), and the share to each child will be equivalent on distribution, the result is no sibling-to-sibling transfer.

2. Would the parent/child exclusion apply to Parcel 4, assuming a timely claim is filed prior to its sale?

Yes. Equalizing the shares among the children is part of the job of the Trustee. The extent of the powers given to the Trustee to perform this function depends on the language in the Trust instrument. Where the Trust instrument confers on the Trustee broad powers to sell, encumber, lease, distribute, purchase or otherwise have unfettered discretion in dealing with all of the assets in the Trust Estate, then the sale of one parcel in order to gain cash for purposes of equalizing the shares upon distribution is permissible.

The trustee enjoys both the powers conferred by the trust instrument and the broad powers conferred by the provisions of the Probate Code, including Section 16246. Thus, the critical factor is whether the trust instrument limits the trustee's powers to distribute property. As indicated on pages 2-3 of LTA No. 91/08,

> "Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:
>
>> 'The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata.'"

> Consistent with the broad powers described in Probate Code Section 16246, there are no express limitations Mother's Trust that would prevent the Trustee from selling Parcel 4 in order to equalize the distribution or for any other reason. Rather, Section 4.02 of the Trust provides in part, the following unlimited discretion to the Trustee:
>
>> "The Trustee shall with respect to any and all property which may at any time be held by the Trustee pursuant to this Declaration, whether such property constitutes principal or accumulated income of the Trust provided for in this Declaration, have power, exercisable in the Trustee's discretion at any time and from time to time on such terms and in such manner as the Trustee may deem advisable, to:

> (a) Sell, convey, exchange, convert, improve, repair, partition, divide, allot, subdivide, create restrictions, easements or servitudes thereon, manage, operate and control;"

Based on the foregoing provisions, the Trustee's proposed sale of Parcel 4 from Mother's Trust does not prohibit the application of the parent/child exclusion to the transfer of Parcel 4 that occurred on Mother's death. Per the Trust instructions, each of the four children received a one-quarter beneficial interest in Parcel 4 at that time. Assuming a parent/child claim is filed and all of other requirements are met, that transfer will be excluded from change in ownership. If the Trustee then sells Parcel 4 in order to obtain sufficient cash to equalize the net worth of the Trust Estate into four shares (of $222,475 each) for distribution, there is no sibling-to-sibling transfer or change in ownership, since no child will receive value in excess of the others. Accordingly, the Trustee's proposed sale of Parcel 4 will not trigger a change of ownership as of the date of Mother's death, because the sale and distribution of the proceeds from Parcel 4 is within the Trustee's powers. As such, it constitutes a transfer from Mother to her children "through the medium of an inter vivos...trust" within the meaning of section 63.1(c)(7) and the guidelines of LTA 91/08.

3. Is it acceptable to equalize the children's net shares by considering the outstanding mortgage balances on the properties together with cash or other assets?

Yes. Where the Trustee has broad powers as described above, and there is no restriction on that Trustee's authority to encumber or to retain existing encumbrances, no change in ownership results, assuming the Trustee properly considers the value of the encumbrances on the Trust real property make distributions in equal shares.

That the proposed distribution allows the Trustee to calculate the existing mortgages on the parcels in equalizing the net value of the shares to be distributed among the four children, is not a change in ownership and is consistent with advice previously stated. As pointed out in the example in LTA 91/08, where a beneficiary receives real property that is encumbered, the encumbrance must be considered in determining whether a beneficiary has received real property valued in excess of his of her trust share.

In this proposal, no child will receive more than his/her share of the Trust estate. For example, Child A will receive the most real property, (three parcels), two of which are encumbered by existing mortgages. Based on the value of the mortgages at the time of the transfer, A's share of the total Trust Estate will be exactly the same as E's share, that contains only cash and notes with no real property. Accordingly, since the value of each child's share is equal one quarter of the total Trust Estate, there will be no transfer of real property between siblings and thus, no change in ownership.

The views expressed in this letter are, of course, only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding upon any person or entity.

Sincerely,

/s/ Kristine E. Cazadd

Kristine E. Cazadd
Senior Tax Counsel

KEC:tr
prop/precdnt/parchild/00/04kec

Attachments: LTA No. 91/08, Annotation No. 625.0235

cc: Honorable
County Assessor

Honorable
County Assessor

Mr. Dick Johnson, MIC:63
Mr. David Gau, MIC:64
Mr. Charlie Knudsen, MIC:64
Ms. Jennifer Willis, MIC:70

ANNOTATION

PARENT-CHILD TRANSFER (Add to existing Annotation Nos. 220.0767 and 625.0235)

Trusts. A trust distribution is within the parent-child exclusion where a trustee's statutory powers are not limited by the trust instrument, the trust instrument requires distribution to children in equal shares, and the trustee encumbers the trust real property after the trustor's death for purposes of distributing the real property to one child subject to the encumbrance and cash in an amount equal to the equity in the real property to the other child. **C** 9/10/96, **C 3/14/00.**

625.0201

STATE OF CALIFORNIA

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KATHLEEN CONNELL
Controller, Sacramento

E. L. SORENSEN, JR.
Executive Director

September 10, 1996

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Attention: Ms.

Re: **Proposition 58 Reassessment Exclusion**

Dear Ms. :

This is in response to your letter to me of August 8, 1996 in which you request our opinion as to whether a "change in ownership" for property tax purposes occurred and if so, to what extent under the following facts described in your letter and set forth below. For the reasons stated hereafter, we are of the opinion that no "change in ownership" occurred.

Factual Background

The decedent died on October 20, 1994. Her estate consisted of cash and her principal residence, all held in the ABC 1993 Family Trust. The decedent resided in the real property with her son prior to her death. The son still resides in the residence.

The Trust provides that following the decedent's death, the Successor Trustee should divide the trust estate into equal shares and distribute one share to each of the decedent's two children, a daughter and a son, free of trust. In the Trust, "trust estate" refers to "the assets listed in Schedule A and to any other property received by the Trustee." Furthermore, the Trust provides that "the Trustee is authorized to allot and make the division or distribution, pro rata or otherwise, in cash or in kind, including undivided interests in any property, or partly including undivided interest in any property, or partly in cash and partly in kind, in the Trustee's discretion." (Art. Sixth, Sec. A, p. 11.) The Trust also provides that the Trustee has the power to "encumber,

mortgage or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee." (Art. Fourth, Sec. G, p. 7.)

The Successor Trustee believed that the Trust estate had a net worth of approximately $322,000, with the real property valued at approximately $310,000 and all other property valued at $12,000. Pursuant to the Trust provisions, the Successor Trustee sought to distribute approximately $161,000 net worth of assets to each child. On April 24, 1995, before making any distributions, the Successor Trustee obtained a loan and Deed of Trust against the Trust real property for $160,000. The assets of the Trust then consisted of cash, including loan proceeds and the real property encumbered by the Deed of Trust.

On June 2, 1995, the Successor Trustee was ready to distribute the Trust property, and made a non pro rata distribution of $150,000 of the Trust's cash to decedent's daughter. On June 22, 1995, the Successor Trustee made a non pro rata distribution of the real property to decedent's son individually, subject to the $160,000 loan and Deed of Trust.

On June 22, 1995, the Successor Trustee executed a proper Claim for Reassessment Exclusion for Transfer Between Parent and Child. He submitted it to the Alameda County Recorder on June 26, 1995.

The Assessor issued a Notice of Supplemental Assessment on January 12, 1996 regarding the reassessment of one-half of the real property after the death of the parent and the distribution of the real property to the decedent's son. The property was previously on the tax roll at $47,441. The Assessor appraised it at only $220,000, one-half of which is $110,000. Thus, the new assessed value is $133,441. Subtracting the $47,441 already taxed, the Assessor issued a Supplemental Assessment to the son of $86,000 and a supplemental tax of 1.2990% thereon, or $1,117.14.

The Assessor has indicated that the property was reassessed because "there was not enough money in the trust estate to equally distribute cash to [the daughter]...The Trustee obtained a cash loan to distribute cash to [the daughter] instead of a 50% interest in the above referenced property." The Assessor relies heavily on a Letter to Assessor dated January 23, 1991, No. 91/08, entitled "Change in Ownership Consequences of Real Property in an Estate or Trust Distributed on a "Share and Share Alike" Basis" (LTA 91/08).

Law and Analysis

As you are aware, Revenue and Taxation Code[1] section 60 defines a "change in ownership" as "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."

[1] All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Section 61 provides that, subject to exceptions not here relevant, "change in ownership, as defined in section 60, includes, but is not limited to:...(g)[a]ny interests in real property which vest in persons other than the trustor...when a revocable trust becomes irrevocable."

Proposition 58 added subdivision (h) to section 2 of Article XIIIA of the California Constitution. Briefly, subdivision (h) excludes from change in ownership the purchase or transfer of the principal residence of the transferor in the case of the purchase or transfer between parents and their children. It also excludes the purchase or transfer of the first $1 million of the full cash value of all other real property between parents and their children.

Subdivision (h) is implemented by section 63.1. Section 63.1(c)(7), in part, defines "transfer" as including any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos trust. It seems clear, therefore, that if the transfer of the decedent's principal residence to the decedent's son qualifies as a transfer from decedent pursuant to the terms of her intervivos trust, then the transfer qualifies for exclusion from change in ownership under Proposition 58 and section 63.1.

The Board has addressed this issue in its LTA 91/08, a copy of which is attached, which provides in part:

> "The key to whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is whether the trust instrument limits the trustee's powers to distribute property.
>
> "Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:
>
>> 'The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata.' (Added by Chapter 820 of the Statutes of 1986.)
>
> "The statement 'a distribution in kind may be made pro rata or non-pro rata,' means that the trustee has a choice in how he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries common ownership in all the assets of the trust estate (pro rata) or can allocate specific assets to individual beneficiaries (non-pro rata).
>
> "California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McClogan (1948) 84 Cal. App.

2d 208. Thus, where the trust instrument conflicts with statutory power, the instrument controls unless a court, pursuant to Probate Code Section [16201], relieves the trustee of the restriction in the instrument. Absent a restriciton in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including Section 16246.

"Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rate or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust's assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1."

In this case, the Trust does not limit the statutory trustee powers contained in Probate Code sections 16220 through 16249. In fact, as indicated above, Article Sixth, Section A, of the Trust provides for the Trustee's distribution powers similar to but no less broad than those specified in Probate Code section 16246. Also, as indicated above, the Trustee has the power to encumber, mortgage, or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee. This provision is identical to Probate Code section 16228.

It is clear under LTA 91/08 discussed above that where a trustee's powers are as broad as they are in this case and where the trust requires distribution in equal shares, a trustee may distribute a 100 percent interest in a parcel of real property to a beneficiary without triggering a change in ownership as long as the value of the parcel received by the beneficiary doesn't exceed the value of his or her share of the trust property. Thus, where the trust property consists solely of two parcels of real property of equal value and the trust requires distribution in equal shares to the two children, the trustee may distribute one parcel to one child and one parcel to the other child without causing a change in ownership as long as the trustee's statutory powers are not limited by the trust instrument.

Similarly, if the same trust contained one parcel of real property and cash in an amount equal to the value of the real property, no change in ownership would result from a distribution of the real property to one child and the cash to the other child.

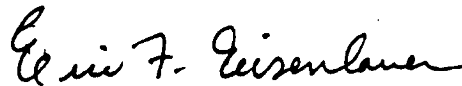
This case is different from the latter example only in that the successor Trustee encumbered the Trust real property in order to distribute the trust estate in equal shares by distributing cash to one child and equity in the principal residence of equal value to the other

child. As indicated above, the Successor Trustee had the power to encumber the real property and to make the non-pro rata distribution. In effect, the Successor Trustee exercised his power to encumber in order to be able to exercise his non pro rata distribution power. The creation of a security interest or the substitution of a trustee under a security instrument, if that occurs, is not a change in ownership (§62(c)). Accordingly, it is our view that the distribution made by the Successor Trustee in this case does not result in a change of ownership because the distribution of the real property under the Successor Trustee's powers was a transfer from the decedent to her son "through the medium of an inter vivos...trust" within the meaning of section 63.1(c)(7) and the guidelines of LTA 91/08. The fact that the assessor valued the real property at an amount less than what the Successor Trustee believed the property was worth for purposes of encumbering the property and distributing the trust estate does not change that result. As LTA 91/08 makes clear,where a trustee's statutory powers are not limited by the trust instrument and the trust instrument requires a share and share alike distribution to children, no change in ownership resulting from a transfer between siblings occurs unless a trust beneficiary receives real property valued in excess of the value of his or her share. As pointed out in the example in LTA 91/08, where a beneficiary receives real property which is encumbered, the encumbrance must be considered in determining whether a beneficiary has received real property valued in excess of his of her trust share. In this case, the son did not receive more than his share of the trust estate and, based on the Assessor's valuation, in fact, received less than his share of the trust estate. Accordingly, there was no transfer of real property between siblings and thus, no change in ownership.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Eric F. Eisenlauer
Senior Tax Counsel

EFE:sao
Attachment
cc: Honorable John N. Scott
Alameda County Assessor

Mr. James Speed - MIC:63
Mr. Dick Johnson - MIC:64
Ms. Jennifer Willis - MIC:70

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Controller, Sacramento

CINDY RAMBO
Executive Director

January 23, 1991

TO COUNTY ASSESSORS:

No. 91/08
CORRECTION

CHANGE IN OWNERSHIP CONSEQUENCES OF REAL PROPERTY IN AN ESTATE OR TRUST DISTRIBUTED ON A "SHARE AND SHARE ALIKE" BASIS

This letter sets forth the change in ownership consequences of transfers of property from parents to children when property is distributed according to a will or trust and the language of the document directs that the assets of the estate or trust be distributed to the children on a "share and share alike" basis.

Currently, when an estate or trust is to be distributed on a share and share alike basis many assessors presume, for property tax purposes, that the beneficiaries of a trust or the heirs of a will have an equal interest in each and every property owned by the decedent. Consequently, in these counties a change in ownership occurs if any heir or beneficiary obtains an interest in any real property greater than his/her proportional interest in the estate or trust. For example, if property is left to four children and one child is granted a 100 percent interest in the parent's residence, the assessor would have determined that 75 percent of the property interests transferred. Using this policy, the percentage of interests transferred is the amount that the interest in the real property exceeds the proportional interest in the estate.

Our recommendations for the change in ownership consequences of property distributed on a share and share alike basis depend on the provisions of the trust instrument or the will.

TRUSTS

The key to whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is whether the trust instrument limits the trustee's powers to distribute property.

Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

"The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata." (Added by Chapter 820 of the Statutes of 1986.)

The statement "a distribution in kind may be made pro rata or non-pro rata," means that the trustee has a choice in how he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries common ownership in all the assets of the trust estate (pro rata) or can allocate specific assets to individual beneficiaries (non-pro rata).

California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McColgan (1948) 84 Cal. App. 2d 208. Thus, where the trust instrument conflicts with statutory power, the instrument controls unless a court, pursuant to Probate Code Section 1620.1, relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including Section 16246.

Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rata or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust's assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1.

Example:

A parent leaves a trust estate with a net worth of $500,000 to his four children on a share and share alike basis. Each child is to receive $125,000 net worth of assets. The trust document does not limit the trustee's power to distribute the trust assets. Accordingly, as provided by Probate Code Section 16246, the trustee has the power to distribute sole ownership of any asset or a fractional interest in any asset to any of the children.

In distributing the trust, the trustee decides to deed the principal residence, worth $112,500 and no outstanding loans, to one child. In our view, this would be considered a 100 percent transfer from parent to child which may be excluded from change in ownership under Section 63.1 if a proper claim form is filed. This is because the net worth of the property is under the child's $125,000 share in the estate. If the property had a net worth which was more than $125,000, a partial change in ownership

would have occurred. The following example outlines the procedures for such a situation.

If the trustee deeds another child an investment property, with a market value of $225,000 and an outstanding mortgage balance of $50,000 (encumbrances in the property should be considered), then a 28.57 percent reappraisable change in ownership would occur. This is calculated as follows: equity in the property minus child's share of the trust estate divided by the equity in the property ($175,000 - $125,000/$175,000). In this case, the equity in the property that the child receives exceeds his/her proportional share of the trust estate by 28.57 percent. In effect, this 28.57 percent interest in the property is a transfer of property between siblings. It does not qualify as a transfer from parent to child since it exceeds the direction that the children share and share alike. Therefore, a 28.57 percent change in ownership of the property has occurred while the remaining 71.43 percent may be excluded from change in ownership according to the provisions of Section 63.1 of the Revenue and Taxation Code.

In practice, assuming a 1975 factored base year value of $75,000, the new base year value of the property would be calculated as follows:

1975	Factored base year value	$ 75,000 x 71.43% =	$ 53,572
1990	Market value	$225,000 x 28.57% =	64,282
Value to be enrolled for current roll			$117,854

WILLS

Whether a change in ownership occurs when a child receives a 100 percent interest in real property from a parent's estate when the estate is distributed according to a will on a share and share alike basis depends on whether the will gives the executor a clear grant of broad discretion to distribute property in kind on a pro rata or non-pro rata basis.

Under the Probate Code provisions applicable to wills, the general rule is that a devise of property to more than one person vests the property in them as owners in common. Probate Code Section 6143 provides that unless a contrary intention is indicated in the will, "a devise of property to more than one person vests the property in them as owners in common." See also Estate of Pence (1931) 117 Cal. App. 323, at 331, holding that a devise to more than one person to share and share alike indicates a gift in common. See also Noble v. Beach (1942) 21 Cal. 2d 91, 94; and Estate of Russell (1968) 69 Cal. 2d 200, 214-215.

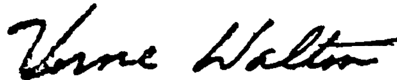
Of course, many wills contain provisions which grant discretion to distribute property in kind on a pro rata or non-pro rata basis or something equivalent. Probate Code Section 6140(a) states that the intention of the testator as expressed in the will controls the legal effect of the dispositions made in the will. In light of this general principle, a clear grant of discretion to distribute the property in kind on a pro rata or non-pro

rata basis must be given due recognition. In the absence of such a clear grant of broad discretion in the will, however, or an appropriate judicial determination of the meaning of the provisions of the will, assessors are entitled to rely on the general rule set forth in Section 6143 of the Probate Code.

Therefore, if it is determined that the will clearly grants the executor broad discretion in distributing property in kind on a pro rata or non-pro rata basis, the change in ownership consequences are identical to those in the example illustrated for trusts above. If it is not certain or it has not been proved that the executor has this power, then the assessor is correct in allocating an equal fractional interest in each and every property owned by the parent to each child for property tax purposes. It follows that a partial change in ownership will occur if any child acquires an interest in any real property owned by the parent greater than the proportional interest in the estate. It is important to note that the taxpayer carries the burden of proving, to the assessor's satisfaction, that the will in fact grants the requisite discretionary power in distributing the property.

If you have any further questions, please feel free to contact our Real Property Technical Services Unit at (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

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