

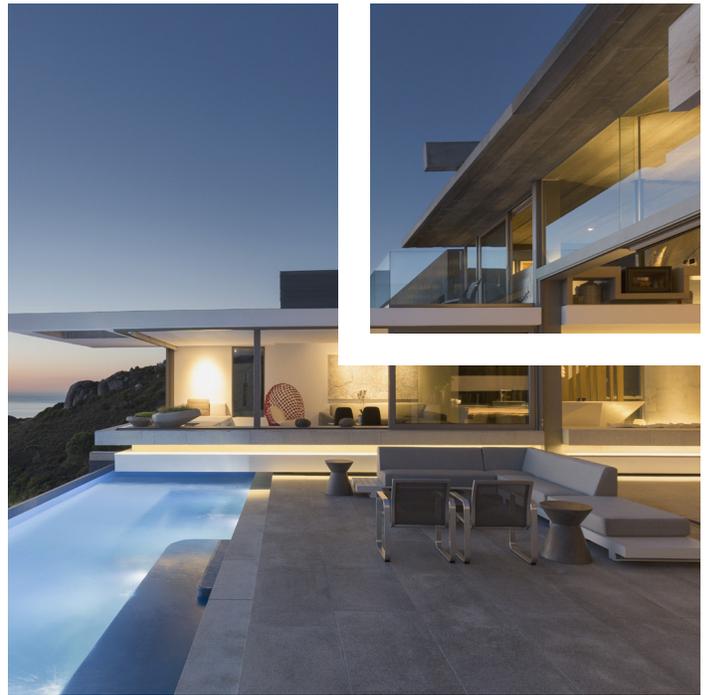
High Net Worth Family Tax Alert

November 2020

Significant Change to California Parent-Child Property Tax Exemption; Potential Impact of Biden Presidency on Gift Tax Exemption

While official results have not yet been announced, it appears certain that Californians have voted to implement Proposition 19, a ballot measure that proposes to significantly narrow the parent-child property tax exemption allowing transfers of real property between parents and children without a reassessment of the property's taxable value to its current fair market value. Proposition 19 also proposes to extend the current tax benefit for certain transfers of a principal residence by persons over age 55, as we explained in our [July 2020 Client Alert](#). As of this writing, with approximately 87% of votes counted, Proposition 19 is leading 51.2% to 48.8%. Proposition 15, another property tax measure on the ballot that would have significantly changed California's property tax laws by taxing most commercial and industrial properties at their fair market values, appears headed for defeat, with votes rejecting the measure at 51.7%.

Under current California law, all real property has an established taxable value that may be increased by no more than 2% each year except when there is new construction or a change in ownership of the property. Unless an exemption applies, a change in ownership triggers reassessment of the transferred real property to its current fair market value as of the date of transfer, which then becomes the property's new taxable value. This reassessment often results in a dramatic increase in the property's taxable value.



Under current California law, the transfer of a principal residence between parent and child may be fully excluded from property tax reassessment, regardless of the market value of the property and whether the child subsequently uses the property as a principal residence or for some other purpose, such as a vacation or rental property. Under the exemption, children not only receive the benefit of the existing taxable value of the property but also can pass some or all of that benefit along to their own children. For any other property, including vacation, rental and business property, the first \$1 million of the taxable value (not fair market value) transferred between a parent and child may also be excluded from reassessment. A similar exemption applies for transfers from grandparents to grandchildren if both parents of those grandchildren are deceased.

Proposition 19 repeals the existing exemption for transfers between parents and children (and between grandparents and grandchildren) and replaces it with a much more limited exemption. Beginning with transfers occurring on and after Feb. 16, 2021, the parent-child exemption is limited to transfers of a principal residence

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that the transferee will use as a principal residence, as well as to certain farm property. In addition, even if a transfer qualifies for the exemption, a principal residence with a fair market value in excess of the residence's current assessed value as of the date of transfer plus \$1 million will trigger a partial property tax reassessment, even if the property will continue to be used as a principal residence by the transferee. Starting Feb. 16, 2023, the \$1 million threshold will be adjusted annually at a rate equal to the change in the California House Price Index.

Given this likely change in law, if you are thinking about transferring real property in California to your family for estate planning purposes, making the transfer on or before Feb. 15, 2021, may enable you to preserve the property tax value under the existing exemption limits.

Gift Tax Exemption

In our [July 2020 Client Alert](#), we also noted that based on the tax plan proposed by President-elect Joe Biden, it is possible that the federal estate and gift tax (and generation-skipping transfer tax) exemption might be reduced from its current amount of \$11,580,000 (which would increase to \$11.7 million in 2021) to a level that predated the 2017 tax law changes: possibly \$5.6 million, plus inflation, or possibly as low as \$3.5 million.

This proposed change would be likely only if the Democrats control both houses of Congress, in addition to the presidency.

Control of the Senate will not be decided until the Georgia runoff election in early January. Because the increased estate tax exemption was part of the Republican tax plan in 2017, it is unlikely that a Republican-controlled Senate would vote in favor of as large a reduction as the Biden plan contemplates. It is possible, however, that a majority of senators would negotiate a comprehensive bipartisan tax bill that would include some reduction in the exemption. The exemption is also scheduled to be reduced automatically to approximately \$5.6 million, as adjusted for inflation, on Jan. 1, 2026.

If it would not be an economic hardship for you to use the current exemption, we still believe it makes sense to do so as soon as possible, particularly if your planning involves California real estate, as discussed above. For those of you who are on the fence about whether to use the exemption because of your economic situation, the answer is less clear-cut, and we suggest a discussion with your estate planner.

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6510 REV1 11-12-2020