



How to Avoid or Defer Property Tax Reassessments

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California Property Taxes Avoiding Reassessment

With the passage of Proposition 13 in June 1978, property taxes are not allowed to increase by more than 2% annually over the previous year. However, if a “change of ownership” occurs, the property or the interest transferred is reappraised to its full market value on the date of the change. The costs of reassessment of the property value can in some cases outweigh the benefits of any estate planning (family limited partnerships, transfers to trusts, estate freeze techniques or gifts) or substantially add to the cost of any contemplated transaction (e.g. sale-leasebacks, merger, transfers to partnerships or other legal entities). Therefore it is essential to understand the exceptions to the revaluation rules, avoid unintentional increases in your property tax assessment and structure your transaction to defer or substantially reduce the increase in property values. These rules are complex; if you need assistance, please call at Steven Singer 510-797-8661 or email him at ssinger@groco.com.

Change in Ownership

A change in the ownership (CIO) is the mechanism by which the appropriate taxing authorities can reappraise the value of the real estate to current market value. Without a change in ownership, reassessment will not occur except up to the statutory maximum of 2% over the previous year. A CIO is defined 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” (Cal R&T Code Sec 60). When a CIO occurs, the interest transferred or in some cases, the entire interest is reappraised as of the date of the ownership change to the full cash value. The general rule CIO will occur when you create, transfer or terminate an interest in real property unless one of the exceptions is met.

Exceptions

Interspousal Transfers (R&T Code 63)

If you transfer your interest in real property or your interest in a legal entity that owns real property to your spouse, a CIO event will not occur. This exception also applies upon the death of a spouse or a CIO in connection with a former spouse where there is a property settlement agreement or post dissolution amendment. Interspousal transfers are also not included in the computation of changes in control in legal entities or original co-owners.

Less than 5% of the Property Interest and less than \$10,000 of the Market Value (R&T 65.1)

If you transfer a tenancy in common interest or certain joint tenancies of 5% of the property interest that is less than \$10,000 of the current market value of the property during a calendar year, no CIO event is deemed to occur. Only transfers during the year

for a specific property are cumulated for purposes of determining if you had exceeded the exemption amount.

Transfers between Parents and Children (R&T 63.1)

The R&T code provides two distinct exceptions to the CIO rules. However, these exceptions do not apply to transfers in legal entities (e.g. partnerships, corporations, or LLC interests). To qualify, only unrestricted transfers are eligible. These exceptions do apply to interests in trusts:

Principal residence transfers

A purchase or transfer of a principal residence of the child to the parent or the parent to the child or in some circumstances a transfer from a grandparent to a grandchild or grandchild to a grandparent is exempt from property tax revaluation. A child can be a child born to the parent, an adopted child who was adopted before reaching the age of 18, a step-child or son-in-law or daughter-in-law until terminated by divorce or remarriage upon the death of the spouse, or a grandchild if the grandchild's parents are deceased at the time of purchase or transfer. The principal residence is the dwelling unit of the transferor for which a homeowners or disabled veterans exemption was granted. Only the portion of land underlying the principal residence will qualify. Therefore, a transfer of an entire ranch on which the principal residence resides will not qualify for the full exclusion. Similarly, a multiple unit building in which the transferor resides in one of the units as their principal residence will not receive the full exclusion

Up to \$1,000,000 of "Full Cash Value" of Other Real Property

The parent/child exclusion a transfer also applies to other real property interests up to \$1,000,000 of assessed (and not appraised) value other than the principal residence. The "Full Cash Value" is the taxable value on the property tax roles before the date of transfer or purchase. In many cases, the "Full Cash Value" is substantially less than the "Fair Market Value". The exclusion does not apply to transfers of interest in other legal entities (other than trusts) that hold real estate and in certain circumstances where the transferor held the property in joint tenancy.

Note that transfers between siblings do not qualify and will cause a revaluation of the interest transferred. As a result, an inadvertent property tax reassessment can occur under the following circumstances. Assume the parents want to leave real estate to all the children, but the children want to own 100% of an asset and not a percentage of a share asset. When they swap, there is no exemption. Careful planning and drafting can solve this. See non prorate distributions in the irrevocable section.

Transfers as a result Eminent Domain or Inverse Condemnations (R&T 68)

Transfers pursuant to an inverse condemnation or eminent domain proceeding qualify for exclusion.

Joint Tenancy and Original Property Transferor Exclusion

If property is held in joint tenancy, each owner of the property owns an equal undivided interest in the property as a whole. This is contrasted with property held as tenants in common where various owners may own differing percentage interests of a specific property. Upon death of a joint tenant, his or her interest passes equally to the surviving joint tenant. Joint tenancy property cannot be disposed of by will because by operation of law it passes directly to the surviving joint tenant.

When a joint tenancy interest is created either by purchase or change in the method of which property is held, the persons creating the joint tenancy interests are called the "original transferors" (OT). The spouse can also become an OT if during the period the other spouse holds the property, the spouse becomes a joint tenant (e.g. gift).

Transfers of Joint Tenancy Interest Exclusion (R&T 65(b) &(d))

If the (OT) transfer interests to owners "other than the original transferors" (OTTOT) no revaluation will occur if the OTs are still joint tenants.

Similarly, when an OTTOT transfers back their interest to the remaining joint tenants there will not be any revaluation as long as one of the joint tenants is an OT. If an OTTOT transfer their interest to a third party who is not a joint tenant at the time of the transfer, a revaluation of the percentage interest transferred occurs.

Upon the death or transfer of the last of the OT's interest, a 100% revaluation of the property occurs. This unnecessary result should be avoided by proper planning.

Transfers of Joint Tenancy Property to Tenants in Common (R&T 62(a)(2))

If all of the joint tenants agree to transfer their interests as joint tenants to tenants in common with equal undivided interests, the transfer is excluded from reassessment because each owner had the same percentage.

Base Year Value Transfers for Persons Age 55+ and Disabled Persons (R&T 69.5)

Individuals over the age of 55 and disabled persons are eligible to transfer their base year value to their new principal residence. To qualify, one must sell their property (residence which is eligible for the homeowner's exemption) and purchase or construct a replacement dwelling of equal or lesser value within two years before or after the sale of the prior dwelling. The property sold and the replacement property is required to reside in the same county. However, each county may adopt a provision that allows you to transfer your base value even though they are located in a different county. You should check with the assessor in your area to see if you are able to transfer your property values.

Transfers to/From or between Legal Entities

Transfers that Retain the Proportional Interests of the Owners (R&T 62(a)(1))

If the owners of a property transfer their ownership interests to another legal entity and keep their proportional interest in the same property upon transfer, the transfer is excluded from reassessment. This applies to the individual property ownership percentage interest transferred and not to proportionate value of the properties transferred.

Transfers to Partnerships

The above exception only applies if the owners transferring real property to a partnership keep the same proportionate interests in both capital and profits of the partnership as they had in each and every piece of each real property transferred. Contribution of two parcels of real property with unequal values by different owners will cause a reassessment of the entire two parcels.

Transfers between Partners (R&T 64(c)(2))

If the persons or entity who hold a majority interest in a partnership purchases or is transferred the remaining interests in a partnership (e.g. becomes the sole partner), no reassessment will occur.

Partnership Agreements

Partnership agreements can have a major impact on reassessment. Even if the transfers are proportional, an agreement where some of the other partners share in the increase in value or income after the contribution will cause reassessment. Additionally, if there is no provision to provide that the partnership will continue upon the death, withdrawal or incapacity of the general partner, the partnership will be considered dissolved and reassessment may occur.

Transfers between Affiliated Corporations (R&T 64(b)(1)&(2))

Transfers of real property between wholly owned Corporations of affiliated groups are not a reassessment event.

Transfers pursuant to a corporate reorganization that qualifies under Internal Revenue Code 368 are also not reassessment events.

Transfers of Control or Transfers of Interest in More than 50% of the Entity (R&T 64(c))

If cumulatively since the date of contribution or purchase, a person or entity (including trusts) obtains direct or indirect control from the original owners of more than 50% of the ownership interests or majority ownership interest in an entity then a reassessment event occurs.

Thus, additions or deletions of interests in an entity that do not constitute transfer of a majority interest or cumulatively more than 50% of the entity from its original co-owners will not trigger a reassessment event. Interspousal transfers, transfers to revocable trusts, transfers to a trust where the trustor holds a present interest and proportional transfers do not count toward determining whether a 50% change of ownership occurs. However, parent/child transfers are included in the count. Requesting confirmation from your local assessor may be advisable when contemplating a transaction where a majority interest may be transferred.

Transfers to Family limited Partnership (FLP) and transfers of interests in FLP

Transfers of real estate first to the child and then contributions of both interests to the partnership will not trigger reassessment as long as the same proportionate interest are kept. Contrast this result with the parents contributing their interests to a FLP and then transferring cumulatively a majority interest or more than 50% interests to the children. In this case a 100% reappraisal event has occurred because the parent/child transfer exclusions do not apply to interests in entities.

Transfers to and transfers of Interests in Trusts

Transfers to Revocable Trusts (R&T 62(d))

Transfers to a revocable trust in which the trustor, trustee and beneficiary are all the same person are exempt from revaluation because there is not a transfer of the present interest in the trust.

If the trust becomes irrevocable or terminates as a result of the death of the transferor, the property will be revalued unless the parent/child or interspousal transfer exceptions apply.

Transfers to Irrevocable Trusts (R&T 61(h))

Transfers of property to an irrevocable trust will not cause a revaluation event if the trustor-transferor retains a reversionary interest and the beneficial interests of others does not exceed 12 years.

Upon the death of the trustor-transferor, a revaluation event will not occur if the other present interest beneficiaries qualify for an exclusion (e.g. parent/child or spouse).

Qualified Personal Residence Trust (QPRTs)

Transfers to QPRTs also qualify for the exclusion since the trustor-trustee is the sole present interest beneficiary. Upon termination or death of the trustor-trustee, a revaluation event will occur unless an exclusion applies to the named beneficiaries.

Charitable Trusts (CRTs)

Transfers to charitable remainder trust are exempted from revaluation as long as the trustor-trustee retains the present right to the income. Contrast this situation with a charitable lead trust (CLT). CLTs will cause a revaluation upon the contribution to the trust and upon distribution or termination unless the terminating beneficiaries qualify for one of the other exclusions.

Sprinkle and Spray Powers (Rule 460.160)

If a trustee has the discretion to distribute income and principals to beneficiaries and all of the beneficiaries can meet one of the exceptions above, the property is exempt from revaluation. However, if only one of the beneficiaries does not meet the exception the property is subject to revaluation since the trustee could potentially distribute to a non-exempt beneficiary.

Powers of Appointment

If the beneficiary has a general power of appointment, they are considered owners of the property. Therefore, if one of the above exceptions applies to the beneficiary, the property is exempt from revaluation.

However, if the beneficiary only has a special power of appointment and is not a present interest beneficiary, they are not considered the owner of the trust and a revaluation event may occur if the trust is irrevocable and the other present interest beneficiaries do not qualify for an exception.

Qualified Terminal Interests Trusts (QTIPs) By Pass Trusts and, Survivor's Trusts

QTIP trusts are not subject to revaluation upon creation since the surviving spouse is the present income beneficiary of the trust. However, upon the death of the surviving spouse, the property may be revalued depending upon the remainder beneficiaries.

For a By-pass trust, if the spouse retains a present interest in the trust, the property will not be subject to revaluation until the death of the spouse unless the other beneficiaries qualify for an exclusion.

For the Survivor's trust, since the spouse has a general power of appointment and is probably a revocable trust, the interspousal exception and revocable exceptions apply. Thus, the property is not subject to revaluation until it becomes irrevocable, depending on the remainder beneficiaries.

Life Estates for Years (R&T 61(g) & 62(e))

For property that contains a life estate provision which grants the transferor or their spouse a right of use, occupancy and control during their lifetime, no revaluation occurs until the death of the surviving tenant. If the remainder beneficiary is able to claim the parent/child or \$1,000,000 exemption, a revaluation event will not occur.

If the life estate is granted to someone other than the spouse, transferor or child, a revaluation event will occur upon the transfer. It may also trigger a revaluation when the

life estate terminates if the remainder beneficiaries does not qualify for an exclusion. The remainder beneficiaries ability to claim an exception comes from their relationship with the trustor and not with holder of the life estate.

Non pro-rata distributions

Distributions pursuant to a will or a trust may not always be on a pro-rata basis. If the testamentary document provides non pro-rata distributions and the beneficiaries meet one of the above exceptions, no revaluation occurs. However, if the instrument provides that equal shares are required and the beneficiaries decide not to take equal shares, the difference between their portion of the equal share and the actual share distributed is subject to revaluation. This occurs even if the beneficiaries are entitled to one of the above exclusions.

Leasehold Interests (R&T 62(g))

A transfer of a lessor's interest in real property subject to a lease with a remaining term (including renewal options) of 35 years or more is excluded from revaluation. Additionally, residences eligible for the homeowners' exemption (other than manufactured (mobile) homes) located on leased land are conclusively presumed to have a renewal option of 35 years or more. However, if the property is located in a legal entity such as a corporation or partnership and a change or change in control of the entity occurs, the property will be subject to revaluation.

What is the Date of Transfer? (Rule 462.260(a)(1))

The general rule is the date of the transfer is the date when the deed is recorded. This is not the case for federal gift tax purposes which are completed the date on which the deed is signed.

Problems arise however, if there is a substantial time lag between the date the deed is signed and the date the deed is recorded. There may be a substantial increase in the property value. Additionally, if the deeds are recorded in the incorrect order or on different dates, it may cause an unintended ownership change even if the deeds where executed on the same date.

Care must be taken to make sure that the recorded dates do not inadvertently cause a revaluation. It is always advisable to document in your correspondence with the assessor's office the date of the transfer if it is other than the recorded date to create your rebuttable presumption.

Trusts (Rule 462.260(d)(1))

For revocable trusts, the date the transfer becomes effective is the date the trust becomes irrevocable (i.e. death of the trustor).

For irrevocable trusts, the general rule applies (i.e. the date of the recording of the deed).

Changes in Ownership of Entities (Rule 462.260(a)(2))

The general rule is the transfer document date determines the date of transfer. However, this presumption can be overcome by proving that a different date was contemplated by the parties such as the date when all instructions are met in escrow or the date the agreement between the parties becomes specifically enforceable.

Leases

The date the lessee has right of possession.

Reporting & Filing Requirements

Reporting Changes in Ownership

When a change of ownership occurs through a recorded instrument, the preliminary change of ownership (PCOR) form is usually filed with the recorder at the time of recording. If the PCOR is not filed with the recorder, the PCOR must be filed with the assessor within 45 days of the ownership transfer.

For probate estates, the personal representative files the PCOR form within 150 days of death or at the time the inventory and appraisal is filed with the court.

For changes of ownership or control in a legal entity such as a partnership, LLC or corporation, a form PT-100-B form is required to be filed with the State Board of Equalization in Sacramento within 45 days of the change of ownership or control. Many counties have their own change of ownership forms; for example, San Francisco require that its form be filed along with the PCOR. A penalty for failure to file is imposed if not filed timely.

Reporting Exclusions from Reassessment

A child/parent transfer must be recorded on form PT-58 and must be filed before the earlier of three years from the change in ownership or a transfer of property to a third party. A PT-58 can also be filed within six months from the mailing date of the Notice of Supplemental Assessment or Notice of Escape Assessment. You may also file a PT-58 if all of the above deadlines have passed but before the property is sold. You would not be eligible to receive any property tax refunds but the prior base value of the property would be reinstated..

Transfers that meet the interspousal exception and 5% \$10,000 rule do not need to be reported. However, you may want to file with the county so they have a record.

Signatures

The transferee or an officer of the transferee must sign the forms. Agents acting for the transferee are no longer able to sign.

Statute of Limitations

Generally, a four year statute of limitations applies to changes of ownership that occur by a written recorded instrument, the change in control statement was timely filed or if an escape assessment notice is received. There is a six-year statute if the change in ownership is based on fraud and an eight-year statute if the change in ownership statement was not timely filed.

Chart #1 -- Transfers of Real Property

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Real Property Owned by	Transfer to	Change in Ownership (Reassessment)?	Available Exclusions	Percent Reassessed
Individual(s) solely, as tenants in common, or as community property	Other individuals, tenants in common, joint tenancy, or community property	Yes	Spousal; parent/child; leasehold	% transferred
Individual(s), per above	Individual, with transferor retaining a life estate	No	N/A	N/A
Individual(s), per above	Individual, with life estate given to third party	Yes	Spousal; parent/child; leasehold	% transferred
Individual(s), per above	Revocable trust	No, if <u>all</u> the sole present beneficiaries (including sprinkling powers) are the transferors; otherwise, yes	Spousal; parent/child; leasehold	% transferred
Individual(s), per above	Irrevocable trust	No, if <u>all</u> the sole present beneficiaries (including sprinkling powers) are the transferors; otherwise, yes	Spousal; parent/child; leasehold; retaining proportional ownership interests	% transferred
Individual(s), per above	Trust not exceeding 12 years; transferor retaining the reversion	No	N/A	N/A
Individual(s), per above	Partnership, corporation, LLC	Yes	Retaining proportional ownership interests; leasehold	% transferred
Individual(s) with life estate	Upon death of person holding life estate	Yes	Spousal; parent/child; leasehold	% owned
Joint tenants	Transfer in which no "original joint tenant" remains on title	Yes	Spousal; parent/child; leasehold	100% of property formerly held in joint tenancy
Real Property	Transfer to	Change in Ownership	Available Exclusions	Percent Reassessed

Owned by		(Reassessment)?		
Joint tenants	Transfer in which an "original joint tenant" remains on title	No	N/A	N/A
Trustee of revocable or irrevocable trust	Sole present beneficiary(ies)	No	N/A	N/A
Trustee of revocable or irrevocable trust	Other than present beneficiary(ies)	Yes	Spousal (settlor of trust = transferor); parent/child (settlor of trust = transferor); leasehold	% transferred
Where lessee has 35+ years remaining on lease (including options to renew)	From owner/ lessor to lessee	No	N/A	N/A
Creation of a lease with term of 35+ years (including options)	From owner/ lessor to lessee	Yes	Spousal; parent/child	% leased
Partnership, corporation, LLC	Owners	Yes	Retaining proportional ownership interests; leasehold	% transferred
Partnership, corporation, LLC	Other than owners	Yes	Leasehold	% transferred

NOTE: Other exclusions from a change in ownership may be applicable in certain instances, for example, from a parent or guardian to a disabled child (R&T 62(n)); intrafamily transfer of eligible dwelling to minor children pursuant to court order on death of parents (R&T 62(m)); for replacement property application to eminent domain proceedings, acquisitions, or judgments of inverse condemnation (R&T 68); contributing real property to, or distribution from, an employer benefit plan (R&T 66); and others. Also, for homeowners over 55 years of age or severely disabled, the base year value may be transferred upon purchase of a new residence or new construction in some instances (check with your county) (R&T 69.5).

Chart #2 -- Change in Ownership of Entities

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Entity	Ownership Change	Change in Ownership (Reassessment)?	Available Exclusions (i.e., not included in the more-than-50%)	Percent Reassessed
Partnership, corporation, LLC (any other legal entity) -- as to real property which was transferred after 3/1/75 and received proportional interest exclusion	Each transfer of ownership interest in the entity is counted until more than 50% has been transferred (transfers of interest among spouses are not included in the count)	Yes, reassessment occurs when more than 50% cumulative interests have been transferred [but thereafter changes are determined by the next rule below]	Leasehold; spousal; qualified trust; proportional ownership	100% of real property owned by entity
Partnership, corporation, LLC (any other legal entity) -- as to all other real property	Whenever one owner gains control, defined as a more than 50% ownership interest	Yes	Leasehold; spousal; qualified trust; proportional ownership	100% of real property owned by entity