



**Ginsburg Financial Advisors, Inc.**  
*Personal Financial Planning & Investment Management*  
**Larry P. Ginsburg, CFP®**

phone: (510) 339-3933  
fax: (510) 339-1611  
L.Ginsburg@GinsburgAdvisors.com  
www.ginsburgadvisors.com

## **What Does Proposition 19 Mean for California Residents?**

**Transferring Ownership of property to your children now to preserve lower property tax basis requires immediate consideration**

**Those over 55 now have more benefits when selling their primary residence**

### **Should you preserve lower property taxes for your children?**

Proposition 19 was passed in the November 3, 2020 election in California. We have been looking at the implications of Section 2.1 of Prop 19 that changes provisions of the parent-child and grandparent-grandchild exclusions on California residents.

Property values have increased over the years. Many California homeowners who purchased their homes years ago are paying much lower property taxes than those who purchase similar homes today. In California, the annual property tax for homeowners is calculated based upon the assessed value which is set when a property is purchased or transferred and is called the "base year value." After that, the base year value can only increase two percent or less each year, even if inflation is higher. This cumulative value is called the "factored base year value."<sup>1</sup> The base year value cannot increase by more than 2% annually unless there is a change in ownership or there was a home addition/remodel. Parents who own homes with a low factored base year value have an opportunity to pass that lower valuation to their children in what is called a parent-child transfer (or grandparent-grandchild transfer if the grandchild's parents are dead). Children who inherit their parent's property, can benefit from their parent's factored base year value and are able to continue to pay lower property taxes when they inherit property, instead of the tax rate that would be based on current market value.

Beginning on February 16, 2021 children who receive either by gift, purchase or inheritance, their parents' primary residence or farm that contains a primary residence who do not use the home as their own primary residence will no longer be able to keep their parent's factored base year value. In order to receive the property tax exclusion benefit, the recipient must claim the exemption at the time of purchase or transfer. The county will reassess the value of the property to the market value at the time of the transfer or sale. If the child uses the property as their principal residence, and the fair market value of the home is less than the sum of the factored base year value plus \$1,000,000, then the child's property taxes will be the same as the parent's factored base year value. If the fair market value of the home is equal to or more than the sum of the factored base year value plus \$1,000,000 then you will need to calculate how much the assessed taxable value will be increased. To do this you would:

1. Calculate the sum of the parents factored base year value plus \$1,000,000.
2. Determine whether the fair market value exceeds the sum of 1 above.

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Larry P. Ginsburg, CFP® – California Insurance License #0698190  
6201 Medau Place, Suite 101, Oakland, CA 94611

3. Calculate the difference.
4. Add the difference to the parents factored base year value to determine the new property tax.

Please find a link below to the State of California Board of Equalization's website for detailed information regarding Proposition 19: <https://www.boe.ca.gov/prop19/>.

The property's factored base year value should not be confused with the cost basis of the residence. The property's factored base year value of the home is used to calculate a homeowner's annual property tax. The cost basis of the residence is used to calculate the capital gains tax when the property is sold.

When a residence is inherited, the property typically receives a "step-up" in cost basis to the date-of-death market value allowing the beneficiary to sell the property soon after they inherit the property with little to no capital gains tax. If a residence is gifted, the original cost basis, plus or minus any adjustments, is transferred to the child and the property will not receive a step-up in cost basis but it will receive the donor's holding period for the residence. This will result in a larger long-term capital gains when the property is sold. If the child does not live in the property two out of the five years prior to the sale, the child would not be able to benefit from the capital gains exclusion of \$250,000 on the sale of a primary residence if single or \$500,000 if married.

Depending upon the child's intent to live in or sell the property, the annual property tax savings may not outweigh the capital gains tax savings at the time the residence is sold. If the parents expect to keep their primary residence within their family, then it may make sense to change the title of the residence to their children prior to February 16, 2021, the effective date of Proposition 19. Under the current law children can receive, by gift, sale or inheritance, the parent's primary residence, or up to \$1,000,000 of real property other than a primary residence prior to the effective date of February 16, 2021 and keep the parents' property factored base year value for calculating annual property taxes without being required to maintain the property as a primary residence. Facilitating a transfer of ownership now where the children will retain ownership enables the children to preserve the property tax basis from their parents. However, the children will lose the potential step up in adjusted cost basis and it would increase taxes on gains that would be applicable when the property is eventually sold. The ultimate question seems to be whether preserving the lower property tax basis is more important than potentially losing the step-up in adjusted cost basis when the parents die. Where it might make sense is if the next generation's intent is to keep the property regardless of whether it is used as a primary residence, vacation home or investment property for their lifetime. If the next generation's intent is to sell the property a step-up in cost basis may be preferred.

Each person's family dynamics is different. Please consult with your tax advisor and estate planning attorney to determine if changing the title of your property would be beneficial for you and your family. Please note that while the effective date of Proposition 19 is February 16, 2021, February 15 is Presidents' Day and certain local or State Offices may be closed on February 12. If you are advised to change ownership title, submitting documents to be recorded prior to February 10, 2021 would be advisable.

## **Selling Your Primary Residence over age 55, severely disabled or victim of a natural disaster or wildfire now has more options**

Proposition 19 will also allow those over age 55, severely disabled, or a victim of a wildfire or natural disaster (as declared by the Governor) to transfer their property factored base year value to a new home anywhere within California if purchased or newly constructed within two years of sale. With Proposition 19 the value of the replacement home can be lower or higher. If the home value purchased is higher than the home sold, the difference in value will be added to the principal residence's factored base value. This becomes effective April 1, 2021.

Those over 55 years old or disabled will be able to transfer their principal residence's factored base year value up to three times during their lifetime anywhere within California. Currently only one transfer is allowed, and the location of the replacement home is limited to within their own county or one of ten counties that accepted transfers of factored base year values. Proposition 19 will provide more flexibility for homeowners over 55 years old and those who are disabled with the ability to choose where they want to live within California without the fear of losing their low property factored base year value.

In addition, homeowners who lost their primary residence due to a wildfire or natural disaster (as declared by the Governor), who decide to move will also be able to transfer their factored base value to anywhere within California and will no longer be limited to purchase or newly construct a home within the same county or the thirteen counties that allow a factored base year value transfer for a principal residence. However, those who lost their home in a natural disaster or wildfire will have to purchase or newly construct a residence within two years from the time of sale, which is shorter than the current option of five years of disaster if within the same county or three years of disaster if within the thirteen counties that allow factored base year value transfers.

Proposition 19 brings many new changes offering homeowners new options and decisions that need to be considered. Prior to making any changes to the title of your real estate please consult with your estate planning and tax specialist. For those who plan on moving to a new county with your factored base year value, contact your future county tax assessor's office to ensure that you have filed the necessary paperwork for the smooth transition of your factored base year value.

This information is a general summary of the recent legislation. We would be pleased to discuss your situation in the event you have questions. We are here to be a resource, coordinating with your tax professional and estate planning attorney when helpful.

<sup>1</sup> <https://sonomacounty.ca.gov/CRA/Assessor/Real-Property/How-Property-Values-Are-Assessed/#:~:text=The%20assessed%20value%20is%20set,%E2%80%9Cfactored%20base%20year%20value.%E2%80%9D>

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*This information was compiled by Ginsburg Financial Advisors.*

*This communication is designed to provide accurate and authoritative information on the subjects covered. It is not, however, intended to provide specific legal, tax, or other professional advice. For specific professional assistance, the services of an appropriate professional should be sought.*

*Proposition 19 is a constitutional amendment, so additional legislation, regulations, and statewide guidance are expected to clarify its implementation. If there is a conflict between the information provided here and the proposition or any legal authorities implementing or*

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*interpreting the proposition, the text of the proposition and the other implementing or interpretive authorities will prevail. Please continue to visit the website of the [State Board of Equalization](#) for more information.*

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