

[Senate Constitutional Amendment 3](#) (Hill)

Date: 12/4/2018 (introduced)

Program: Property Taxes

Sponsor: Author

California Constitution Article XIII A, Section 2

Effective: Upon voter approval

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**Summary:** This bill would place a constitutional amendment before the voters to provide that the parent-child and grandparent-grandchild principal residence exclusion applies to a transfer of a principal residence only if the transferee occupies the property as a principal residence within 12 months of the transfer and continues to occupy the property as a principal residence. This bill limits the parent-child and grandparent-grandchild \$1 million exclusion to purchases or transfers of nonresidential real property. This bill also adds clarifying lettering and numbering to the provisions for the base year value transfer for homeowners at least age 55 or severely disabled.

**Fiscal Impact Summary:** Regarding the proposed changes to the parent-child principal residence exclusion, revenue gain due to reassessment at the 1 percent basic property tax rate is estimated at \$1,780 per instance when a transferee does not make the transferred property their principal residence within 12 months after the transfer.

### Age 55/Disabled Base Year Value Transfer

**Existing Law:** For property tax purposes, the law requires assessors to reassess real property from its Proposition 13 protected value (called the "base year value") to its current market value whenever a change in ownership occurs.<sup>1</sup> However, subject to many conditions, the law<sup>2</sup> allows homeowners at least age 55 years or qualified disabled persons to sell their existing home, buy or build a new home, and transfer their base year value to the new home (replacement home). This benefit gives homeowners property tax relief by allowing property taxes to remain essentially the same<sup>3</sup> after the move, provided the replacement home is of equal or lesser value. The replacement home must be purchased within 2 years, before or after, the original property's sale.

**Proposed Law:** This bill would amend subdivision (a) of section 2 of article XIII A of the California Constitution to add clarifying lettering and numbering for the base year value transfer for homeowners at least age 55 or severely disabled.

### Commentary:

1. **No Companion Measure.** This constitutional amendment does not have a companion measure. If these changes are enacted, the constitutional reference in section 69.5(a) may be amended to reflect the more specific paragraph numbering. We note that the existing reference would still be correct without the more specific paragraph numbering.

**Costs:** The BOE would incur costs to update forms, publications and the website.

<sup>1</sup> California Constitution article XIII A, section [2](#).

<sup>2</sup> California Constitution article XIII A, section 2(a), Revenue and Taxation Code (RTC) section [69.5](#).

<sup>3</sup> The property tax bill for the new home may not be identical to the property tax bill of the original home because the precise tax rate and direct levies (special assessments, parcel taxes, etc.) differ for each home's location.

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.*

## Parent-Child and Grandparent-Grandchild Exclusion

**Existing Law:** Under existing property tax law,<sup>4</sup> real property is reassessed to its current fair market value whenever there is a "change in ownership." The law<sup>5</sup> excludes from the definition of change in ownership transfers of certain property between parents and children occurring on or after November 6, 1986.

Specifically, the following transfers between parents and children may be excluded:

- Principal places of residences, and
- The first \$1 million of real property other than principal residences

The parent-child exclusion may be extended to the purchase or transfer of real property from grandparents to their grandchild(ren) if all of the parents of that grandchild who qualify as the children of the grandparents are deceased as of the date of purchase or transfer.<sup>6</sup> The grandparent-to-grandchild exclusion is available to transfers of property occurring on or after March 27, 1996.

**Principal Residence.** For purposes of this exclusion, a principal residence is a dwelling that is eligible for a homeowners' or disabled veterans' exemption as a result of the transferor's ownership and occupation of the dwelling. A "principal residence" includes the residence and only that portion of the land underlying the residence that consists of an area of reasonable size that is used as a site for the residence.<sup>7</sup>

**\$1 Million Limit.** Under current law, each person may transfer up to \$1 million of factored base year value<sup>8</sup> over a lifetime to any combination of parents or children. Any real property that was not the transferor's principal residence at the time of transfer to a child qualifies under the \$1 million exclusion.

**Proposed Law:** This bill would amend subdivision (h) of section 2 of article XIII A to make changes to the principal residence and the \$1 million parent-child exclusion.

**Principal Residence Exclusion.** If enacted, this bill would provide that the principal residence portion of the parent-child and grandparent-grandchild exclusion applies in the following circumstances:

- The transferee uses the residence as his or her principal residence within 12 months after the transfer.
- Only for the period in which the transferee uses the residence as his or her principal residence.

If enacted, this bill would also provide that once the transferee ceases to use the residence as his or her principal residence, the property is to be reassessed at its full cash value as of the date of transfer from the parent or grandparent to the transferee.

**\$1 Million Exclusion.** If enacted, this bill would provide that the \$1 million exclusion applies only to nonresidential real property transferred between parents and their children or from grandparents to their grandchildren.

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<sup>4</sup> Article XIII A, section 2; Revenue and Taxation Code sections 60 - 69.7

<sup>5</sup> Article XIII A, section 2(h) of the California Constitution and RTC section [63.1](#).

<sup>6</sup> A stepparent of a grandchild who is an in-law child of the grandparent is excepted need not be deceased (RTC section (a)(3).

<sup>7</sup> RTC section 63.1(b)(1).

<sup>8</sup> While Constitution and RTC section 63.1 use the term "full cash value," RTC section 63.1(c)(5) defines "full cash value" as that in section [110.1](#), which defines the base year value, plus factoring.

**In General:** In 1986, the voters approved Proposition 58, which, in part, added subdivision (h) to section 2 of article XIII A of the California Constitution. Subdivision (h) provides that the terms *purchased* and *change in ownership* exclude the purchase or transfer of:

- A principal residence between parents and their children; and
- The first \$1 million of the base year value of all real property other than a principal residence between parents and their children (called "other property").

Section 63.1 was added to the Revenue and Taxation Code to implement the parent-child exclusion provisions of Proposition 58. The parent-child exclusion applies to changes in ownership that occur on or after November 5, 1986.

In 1996, the voters approved Proposition 193, which amended subdivision (h), to extend the parent-child exclusion to transfers from grandparents to their grandchildren if certain members of the intervening parent generation are deceased. Section 63.1 was subsequently amended to reflect these new provisions. The grandparent-grandchild exclusion applies to changes in ownership that occur on or after March 27, 1996.

**Principal Place of Residence.** For a principal place of residence, currently there is no limit as to value or how many times a principal residence can be transferred to a qualifying parent, child, or grandchild. To qualify for the principal residence exclusion, the real property must be eligible for either the homeowners' exemption or the disabled veterans' exemption, based on the property owner's ownership and usage of the home as a principal place of residence.<sup>9</sup> Additionally, a "principal residence" includes only that portion of the land underlying the residence that consists of an area of reasonable size that is used as a site for the residence. Any "excess" land may be excludable under the transferor's \$1 million limit.

For purposes of the grandparent-grandchild exclusion, a grandparent's principal residence may be transferred to a grandchild and qualify for the principal residence exclusion as long as that grandchild did not receive a principal residence that was eligible for the parent-child exclusion when the grandchild's parent died. If the grandchild received a principal residence from their deceased parent that was eligible for the parent-child exclusion, then the principal residence received from the grandparent must be excluded under the \$1 million limit.

**Statewide Tracking Database.** To monitor and enforce the \$1 million limit statewide, assessors report information from approved claims<sup>10</sup> to the State Board of Equalization (BOE), which maintains a database that tracks the \$1 million limit of persons who transfer "other real property" (transferors) that receives the parent-child or grandparent-grandchild exclusion. When a transferor exceeds the \$1 million limit, the BOE sends a report to the county assessors to take action (i.e., verify database information and, if necessary, reassess property). These reports are generated on a quarterly basis.

## Background:

**Change in Ownership Exclusions.** Article XIII A, section 2 provides for certain exclusions from the meaning of "change in ownership" and "newly constructed." Additionally, certain definitional

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<sup>9</sup> RTC section 63.1(b)(1).

<sup>10</sup> RTC section 63.1(f).

"exclusions" were embodied in the initial statutory definitions to implement Proposition 13 immediately after its passage. The following exclusions were statutorily provided:

<b>Bills</b>	<b>Year</b>	<b>Change In Ownership Exclusion</b>	<b>R&amp;T Code</b>
AB 1488	1979, Ch. 242	Interspousal Transfers (later amended into the Constitution via Prop. 58)	§63
AB 2718	1982, Ch. 911	Parent to Minor Child Upon Death of Parent – Residence	§62(m)
AB 2890	1984, Ch. 1010	Parent to Disabled Child – Residence	§62(n)

Since the enactment of Proposition 13 and the initial implementing statutory legislation, the Constitution has been amended twice to provide for additional change in ownership exclusions between family members. These transfers will not trigger a reassessment of the property to current fair market value. Instead, the property will retain the prior owner's base year value.

<b>Prop.</b>	<b>Election</b>	<b>Change In Ownership Exclusion</b>	<b>R&amp;T Code</b>
58	11/6/1986	Interspousal- statutorily provided since 1979	§63, §63.1
193	3/26/1997	Grandparent-Grandchild	§63.1

Other legislation previously before the Legislature but not enacted to exclude certain transfers from change in ownership either through constitutional amendment or statutory amendment include:

<b>Bills</b>	<b>Year</b>	<b>Change in Ownership Exclusion</b>
AB 1419	1981	Transfers between family members – spouse, brother, sister, lineal ancestor, or lineal issue
ACA 8	1987	Transfers of principal place of residence between siblings who lived together two years prior
ACA 55	1988	Transfers of principal place of residence between siblings who lived together two years prior
<a href="#">AB 2799</a>	2006	Transfers between siblings who share at least one biological parent or adoptive parent

Additionally, Proposition 36 of November 1984, a "Save Proposition 13" constitutional initiative sponsored by Howard Jarvis, would have, among other things, excluded certain family transfers from change in ownership. That proposition failed.

<b>Prop.</b>	<b>Election</b>	<b>Change in Ownership Exclusion</b>
36	11/6/1984 45.2% - 54.8%	Transfers to parents, grandparents, grandchildren, stepparents, uncles, aunts, spouses, stepchildren, siblings, and lineal descendants

## Commentary:

2. **Author's Statement.** This bill ensures that California's tax break on inherited residential property benefits only individuals who live in the home left to them by parents or grandparents. We need to close the legal loophole that has allowed some individuals to dodge thousands of dollars in property taxes while reaping rental income from homes they have inherited and do not use as their primary residence. The practice robs communities of property taxes that fund vital public services for residents. SCA 3 is about stopping people who game the system and use their residential property inherited from their parents as a cash cow while avoiding their fair share of property taxes.<sup>11</sup>
3. **No Companion Measure.** This constitutional amendment does not have a companion measure. If these changes are enacted, section 63.1 would have to be amended to conform.
4. **Principal Residence Exclusion – no limitation.** Currently, each transferor may transfer any number of principal residences to an eligible parent or child, or grandchild (under limited circumstances). There is no value limit and no limit as to the number of principal residences a transferor can transfer to an eligible parent or child over a lifetime. For example, a parent may transfer their large family home to a child, and move into a smaller home. Later, the parent may transfer this smaller home to another child, and move into a condominium. Subsequently the parent may transfer the condominium to their child and move into a retirement facility. It doesn't matter whether the transfers are to one child or different children. All three transfers may be excluded under the principal residence exclusion as each home was the principal residence of the transferor just prior to transfer.

Also under current law, a grandparent may transfer a principal residence to a grandchild as long as the parent did not transfer a principal residence to that child; if a principal residence was transferred to the child by a parent previously, then the residence is counted under the \$1 million exclusion. Likewise, under this bill, if a child has received a principal residence from the parent, the transfer of a principal residence from the grandparent to the grandchild will not be excluded. However, by contrast, under this bill a principal residence transferred by a grandparent to a grandchild that had already received a principal residence from his or her parent *cannot* be counted under the \$1 million exclusion, since the \$1 million exclusion will apply only to nonresidential properties.

5. **Principal Residence of Transferee.** Currently, the principal residence parent-child exclusion applies if the property is the principal residence of the transferor on the date of transfer. Under existing law, there is no requirement that the property be the principal residence of the transferee. This bill requires that the transferee occupy the property as a principal residence within 12 months of the date of transfer.
6. **Basis for New Base Year Value.** Under existing law, real property can only be reassessed upon a change in ownership or completion of new construction.<sup>12</sup> The fact that a property owner moves out of a principal residence is not an event that would trigger a change in a base year value. This bill provides that the principal residence parent-child exclusion applies as long as the transferee occupies the property as a principal residence. If the transferee, while living, subsequently

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<sup>11</sup> <https://sd13.senate.ca.gov/print/news/2018-12-04-senator-jerry-hill-proposes-ballot-measure-end-californias-property-tax-inheritance>.

<sup>12</sup> RTC section [110.1](#).

ceases to use the residence as his or her principal residence, the bill provides that the exclusion will "no longer apply" and the residence "shall be assessed at its full cash value as of the date of the transfer from parent or grandparent to the transferee." If a move-out date is not an event that can trigger a change in base year value, how can a new base year value be enrolled as of the transferee's move out date, the lien date following the transferee's move-out date, or any date? In our view, it would be necessary that the bill and implementing legislation address this issue.

7. **Exclusion Cancellation.** An exclusion from change in ownership means a property is not reassessed to current market value and a new base year value established when its ownership changes. In a situation where the transferee ceases to use the residence as his or her principal residence and the property is reassessed "at its full cash value as of the date of the transfer from parent or grandparent to the transferee," will the reassessment apply retroactively or prospectively? If it is meant to apply prospectively, does this mean that a transferee will be granted the exclusion during the period of time the property is used as his or her principal residence, and that the property will be reassessed as of the date the property ceases to be used as a principal residence? If so, the exclusion appears to be more like an exemption than an exclusion in that a transferee gets the benefit of the reduced base year value while he or she qualifies (i.e. while he or she uses the property as a principal residence), and loses the benefit of the transferor's base year value on the date he or she ceases to use the residence as his or her principal residence (typically the move out date).

If the intent is for the reassessment to apply retroactively, will the transferee receive a tax bill for the period between the date of transfer and the move-out date? This could result in unintended consequences (forcing a transferee to remain in the property if payment of the tax bill will exceed the equity in the property). Depending on the length of time between the date of change in ownership and the move-out date, the assessor may not be able to capture all the years of the interim period due to the statute of limitations for supplemental and escape assessments.<sup>13</sup>

8. **Notification to Assessor.** If a principal residence is receiving the homeowners' exemption, the homeowner must terminate the homeowners' exemption with the assessor when that property ceases to be the property owner's principal residence. If the property is not receiving the homeowners' exemption or if the property owner fails to terminate the homeowners' exemption for any reason, it may be difficult for the assessor to discover that the property owner has moved out.
9. **\$1 Million Exclusion – Nonresidential Property.** This bill limits the \$1 million parent-child exclusion to nonresidential property. Under these provisions, the exclusion will apply to commercial, industrial, agricultural, and vacant property that is not zoned residential. This means the exclusion would not apply to vacation homes, second homes, residential rental properties, multi-unit residential properties, and vacant property zoned residential. A mixed-use property (for example, part residential, part commercial or agricultural) could be partly reassessed if the transferee does not occupy the residential portion as a principal residence. It would be helpful to have a definition of nonresidential property in the implementing legislation.

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<sup>13</sup> RTC sections [75.11](#) and [532](#); Letter To Assessors [2002/014](#).

10. **Transfer between Parent and Child or from Grandparent to Grandchild.** Currently, section 2(h) of article XIII A and RTC section 63.1 exclude transfers directly between parents and children and, under limited circumstances, from grandparents to grandchildren. Existing law does not allow legal entities, such as corporations or limited liability companies, to receive this exclusion.<sup>14</sup> At recent Taxpayers' Bill of Rights hearings, a taxpayer explained he inherited a family farm along with his sibling. The inheritance triggered a reassessment of property owned by the corporation.<sup>15</sup> They applied to have the property's tax base passed down from their parents under RTC section 63.1. This exclusion from reassessment was denied because the property was held in the family corporation before and after the parents transferred their interests in the corporation to the children. The BOE 2015-16 Taxpayers' Rights Advocate's Annual Report identified this as an emerging issue.<sup>16</sup>
11. **Effective Date.** This constitutional amendment is prospective. Therefore, if enacted, it will apply to transfers occurring on or after the date the California Secretary of State certifies the election.

**Costs:** The BOE would incur costs to update forms, publications and the website, and address ongoing implementation issues.

**Revenue Impact:** Current property tax law excludes from the term "change in ownership," the purchase or transfer of principal places of residence or the first \$1 million of all other property (1) between parents and children, or (2) from a grandparent to a grandchild whose parents are deceased.

Under this bill, the principal residence exclusion would be limited to a residence that is the principal residence of both the transferor and transferee. We know the 15-year average for parent-child and grandparent-grandchild claims granted is about 64,000 per year; however, we don't have data readily available to determine how many of those subsequently become the transferees primary residence. This limitation may decrease the number of transfers excluded between parents and children or from a grandparent to a grandchild.

In addition, this bill limits the \$1 million exclusion to nonresidential property. For residential property, while we don't have sufficient data available to estimate the number of potential events, we can estimate the affected revenue gain per reassessment event based on averages.

The 2017-18 average assessed value of all properties receiving the homeowners' exemption was \$394,000. Per the California Association of Realtors, the October 2018 median home sale price for a single family residence in California was \$572,000. The affected assessed value difference is \$178,000. At the 1 percent basic property tax rate, the revenue gain is \$1,780 per instance when a transferee does not make the transferred property their principal residence within 12 months after the transfer.

**Revenue Summary.** Revenue gain due to reassessment at the 1 percent basic property tax rate is \$1,780 per instance when a transferee does not make the transferred property their principal residence within 12 months after the transfer.

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<sup>14</sup> RTC section 63.1, subdivisions (c)(6), (c)(7), and (c)(8).

<sup>15</sup> RTC section 64(d).

<sup>16</sup> <http://www.boe.ca.gov/tra/tra1516.pdf>.