



Planning in a World of Prop. 19

WealthCounsel California Forum
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Considerations

- ▶ Prop. 58 vs. Prop 60/19 (for residence only)
- ▶ Kids maintaining current property tax basis?
- ▶ Achieving a Step-up in Basis?
 - ▶ Likely means property will be sold post death

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Considerations

- ▶ Avoiding federal estate tax?
 - ▶ Does the client's net worth exceed the current/future exemption (i.e., what will it be when the client dies?)
- ▶ Any other considerations?

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What can we do now?

- ▶ Is the property a ...
 - ▶ Principal Residence in CA?
 - ▶ = homeowners exemption has been granted
 - ▶ Any other real property in CA?
 - ▶ Or an entity owning CA real property



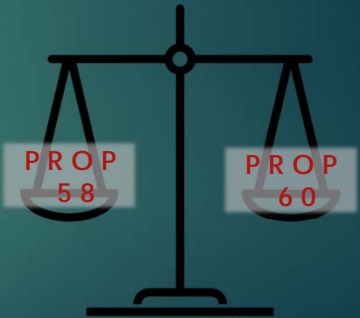
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Residence...Prop 58 vs. Prop 60

- ▶ Prop. 58 created the parent-child exclusion
- ▶ Prop. 60 allows those 55+ to port current property tax basis to new residence
 - ▶ Expanded by Prop. 19
- ▶ Cannot have both!



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Residence... Kids maintaining current property tax basis


- ▶ Likely means child(ren) plans to retain the property
 - ▶ Or at least not sell immediately
- ▶ Impact of rent control or other market limitations if plan to rent?



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Residence ... Planning Options?

- ▶ Do nothing
 - ▶ Perhaps under the belief that Prop. 19 will be overturned by CA voters?

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Residence ... Planning Option 1?

- ▶ Transfer the residence outright to child(ren) before 2/16/2021
- ▶ Sale can be structured as installment sale or SCIN
- ▶ If a gift, gift tax considerations
 - ▶ Requires a valuation and filing of a 709
- ▶ What about parent's continued occupancy?
 - ▶ Issues re FMV rent

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Residence ... Occupancy Issues

- ▶ Parent(s) may desire/require some type of Estate for Years/Lease/Occupancy Agreement
- ▶ Unless it's to the transferor or transferor's spouse, must be for less than 35 years – cannot be a life estate as that is a change of ownership now and at the end of the term
- ▶ NOTE: "Upon the termination of a reserved estate for years for any term, the vesting of the right to possession or enjoyment of a remainderman (other than the transferor or the transferor's spouse) is a change in ownership."
 - ▶ Property Tax Rule 462.060 ; See also Annotation 625.0084

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Residence ... Rent Issues?


- ▶ Will parent(s) pay FMV rent for their home?
 - ▶ If yes, rent will be taxable income to the children
- ▶ If no, will home be included in parent'(s) estate under IRC 2036(a)(1)?
 - ▶ I.e., "for any period which does not in fact end before his death"
 - ▶ Would provide a step-up or step-down in basis at death but wastes exemption and 709 costs



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Residence ... Planning Option 2?

- ▶ Transfer the residence in trust to child(ren) before 2/16/2021
- ▶ Child(ren) must be sole present beneficiary
 - ▶ One trust for each child to max. reassessment deferral?
- ▶ Same taxable gift, rent, income tax, and occupancy issues

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Residence ... Trust drafting considerations

- ▶ Must be drafted carefully to limit child(ren) as “present beneficiary”
 - ▶ Statement of Intent
 - ▶ Grantor trust powers (for Sec. 121 purposes) limited to power to borrow without adequate security
 - ▶ LPOA exercisable in other than a Will?
 - ▶ Other powers carefully limited so as to not distribute to anyone other than child during child’s lifetime
 - ▶ E.g., Child’s powers of appointment limited to testamentary powers
 - ▶ E.g., Limiting Trust Protector Powers

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Residence ... Trust drafting considerations

- ▶ Completed gift or incomplete gift trust for transfer tax purposes?
 - ▶ Retained but unexercised “special” (non-general) POA not a transfer according to BOE property tax annotations
 - ▶ See Annotation 625.0234
 - ▶ Exercised SPOA if a transfer from trustor to appointee*
 - ▶ Conservative approach – Limit LPOA to settlor’s spouse, if possible?
 - ▶ GPOA is a transfer from power holder to appointee
 - ▶ See Annotation 625.0234.005

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Residence ... Trust drafting considerations

- ▶ Can/should settlor serve as Trustee?
 - ▶ If controls distributions as to principal and income, likely causes estate tax inclusion under IRC Sec. 2038 if serving as trustee at time of death
 - ▶ Or if relinquishes trusteeship within 3 years of death
 - ▶ See 26 CFR § 20.2038-1, Revocable transfers
 - ▶ May be one way to accomplish estate tax inclusion and step-up without relying on testamentary LPOA

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Example 1


- ▶ Facts:
- ▶ \$1.8M FMV home purchased in 1985 for \$97,000
- ▶ Property tax basis = \$180,000
- ▶ Income tax basis = \$100,000
- ▶ Desire to get the residence to the 2 kids for use as a rental after their deaths



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Example 1: Options

- ▶ Do nothing
 - ▶ At death, children take the property with then property tax basis > \$1.8M
 - ▶ Property tax increases from \$1,800 to \$18k+ every year!
- ▶ Option 1: Gift or sale of 50% to each child outright
 - ▶ If a gifts, approx. \$900k to each child requiring 709s
 - ▶ FMV rent of \$4,500 per month
 - ▶ Income tax consequences of FMV rent

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Example 1: Option 2

- ▶ Transfer 50% to trust for each child
 - ▶ Separate trust for each child?
 - ▶ Completed gift vs. incomplete gift
 - ▶ Completed gift – should pay FMV rent
 - ▶ Incomplete gift - included in parent(s)' estate for step-up purposes
 - ▶ Thus rent arguably not required – but a taxable gift of rent from kids to parents

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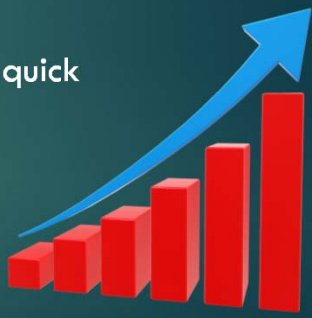
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Important Consideration ...


- ▶ Transfer occurs upon owner's death
- ▶ Thus reassessment occurs as of that date
 - ▶ See Rule 462.260(c)
- ▶ If plan to sell, use a revocable trust to permit a quick sale
 - ▶ Or children will be stuck paying significantly increased property tax from date of death!



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Non – Residence(s) ... Planning Option 1?

- ▶ Gift or sell the real property outright to child(ren) before 2/16/2021
- ▶ Utilize \$1M parent-child exclusion
 - ▶ Cumulative based upon current assessed value
 - ▶ Thus can transfer significantly more FMV
- ▶ If a gift, gift tax considerations
 - ▶ Requires a valuation and filing of a 709



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Non-Residence(s) ... Planning Option 2?

- ▶ Transfer the property in trust to child(ren) before 2/16/2021
 - ▶ Utilize \$1M parent-child exclusion
- ▶ Child(ren) must be sole “present beneficiary”
 - ▶ One trust for each child?
- ▶ Same gift tax issues as w/ the residence

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Example 2

- ▶ Facts:
- ▶ \$2.8M FMV 4-plex purchased in 1987 for \$325,000
- ▶ Property tax basis = \$531,962
- ▶ Income tax basis = \$0 (fully depreciated)
- ▶ Rental income = \$118,200 / year
- ▶ Desire to get the property to the 2 kids for rental income after their deaths




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Example 2: Options

- ▶ Do nothing
 - ▶ Children take the property at death with property tax basis >\$2.8M
 - ▶ Property tax increases from \$5,320 to \$28k+ every year!
 - ▶ Property steps up to then-current FMV (under current law)
- ▶ Option 1: Sell or gift 50% to each child outright
 - ▶ Gifts of <\$1.4M to each child requiring 709s



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Example 2: Comparison

Pre-planning



Year	Rental Income	Property Tax
2021	\$118,200	\$5,320
2041	\$213,482	\$120,051

Post-planning



Year	Rental Income	Property Tax
2021	\$118,200	\$5,320
2041	\$213,482	\$7,905


Assumptions:

- Two parents – assumed life expectancy : 20 years
- Annual Rent Growth: 3%
- Annual Property Tax basis growth: 2%
- Property Tax: 1%
- Annual Property Value Growth Rate: 7.5% [LA County]



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Example 2: Option 2

- ▶ Transfer 50% to trust for each child
 - ▶ Separate trust for each child
 - ▶ Completed gift vs. incomplete gift
 - ▶ Completed gift – removes from estate for estate tax purposes
 - ▶ Incomplete gift - included in parent(s)' estate for step-up purposes

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Example 2: Option 2

- ▶ Transfer 50% to trust for each child
 - ▶ Separate trust for each child
 - ▶ Completed gift vs. incomplete gift
 - ▶ Completed gift – removes from estate for estate tax purposes
 - ▶ Incomplete gift - included in parent(s)' estate for step-up purposes

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What if clients have multiple properties?

- ▶ Same issues as above except that each can transfer up to \$1M of cumulative current assessed value, per parent, among multiple properties
 - ▶ \$2M for both parents



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What if clients have multiple properties?

- ▶ Recall issues re LLCs (and other entities)
 - ▶ For original purchasers, can transfer <50% to any one party without triggering reassessment
 - ▶ Use of separate trusts simplifies this process

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What if clients have multiple properties?

- ▶ Recall issues re LLCs (and other entities)
 - ▶ For non-original purchasers, can transfer up to 50% total without triggering reassessment
 - ▶ Consider proportional interest transfers to one or more entities and then transfers of entity interests to trust
 - ▶ See Annotation 625.0124

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Example 3

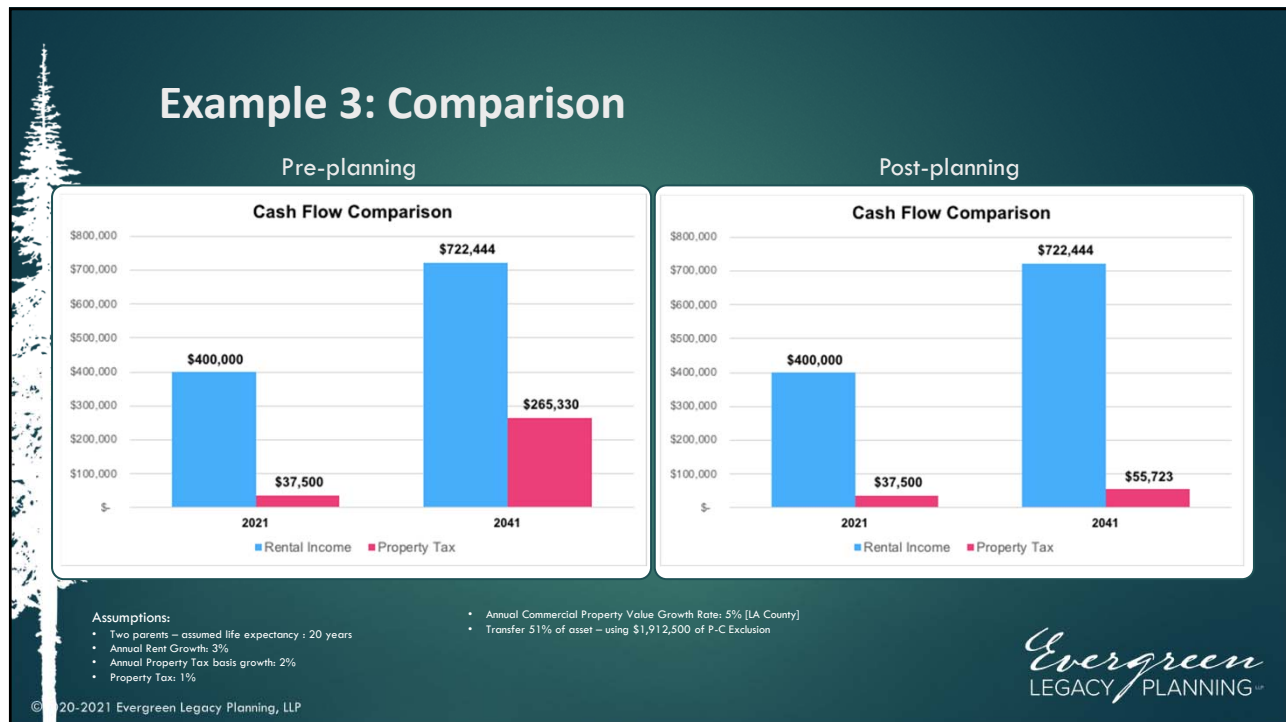
- ▶ Facts:
- ▶ \$10M FMV commercial prop. purchased for \$3.0M
- ▶ Property tax basis = \$3.75M
- ▶ Income tax basis = \$0 (fully depreciated)
- ▶ Rental Income = \$400,000 / year
- ▶ Desire to get the property to the 2 kids for rental income after their deaths



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Example 3: Options

- ▶ Do nothing
 - ▶ Children take the property at death with property tax basis >\$10M
 - ▶ Property tax increases from \$52,500 to >\$100k every year!
 - ▶ Property steps up to then-current FMV (under current law)
- ▶ Option 1: Sell or gift 53% (26.5% to each child) outright
 - ▶ Gifts of <\$2.65M to each child requiring 709s
 - ▶ Note: Property tax basis is \$3,750,000. So, if gave away 100% would exceed the \$2,000,000 allowed under the current parent-child exclusion, triggering reassessment of 46.67% of the property today.

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Example 3: Option 2

- ▶ Transfer 51% to trust – split for each child
 - ▶ Separate trust for each child
 - ▶ Completed gift vs. incomplete gift
 - ▶ Completed gift – removes from estate for estate tax purposes
 - ▶ Incomplete gift - included in parent(s)' estate for step-up purposes

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Example 3A

- ▶ Facts:
- ▶ \$10M FMV commercial prop. purchased for \$3.0M
- ▶ Property tax basis = \$3.75M
- ▶ Income tax basis = \$0 (fully depreciated)
- ▶ Desire to get the property to the 2 kids for rental income after their deaths
- ▶ Purchased originally in an LLC



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Example 3A: Options

- ▶ Do nothing
 - ▶ Children take the property at death with property tax basis >\$10M
 - ▶ Property tax increases from \$52,500 to >\$100k every year!
 - ▶ At death, property steps up to then-current FMV (under current law)
- ▶ Sell or gift LLC interests so no child >50%
 - ▶ Outright or in trust
 - ▶ No property tax reassessment now; will have a reassessment if one child acquires >50%
 - ▶ Requires 709s if a gift

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Example 3A

- ▶ What if we want to utilize P-C exclusion?
 - ▶ Consider a pro-rata distribution to parents who then transfer up to \$2M to the children
 - ▶ Could be outright or in trust
 - ▶ Could be completed gift or incomplete gift
 - ▶ See BOE Annotations 625.0190 et seq.
 - ▶ Legislative intent to not apply step-transaction doctrine in context of P-C exclusion

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Example 3A

- ▶ What if we want to utilize P-C exclusion?
 - ▶ Could then create a new LLC and transfer parents' and kids' interests pro-rata to potentially allow future transfers to kids w/o reassessment
 - ▶ I.e., Parents own 62%, kids cumulatively own 38%
 - ▶ But will step-transaction doctrine apply once there is no parent-child exclusion?
 - ▶ See Rule 625.0151?

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Example 3B

- ▶ Facts:
- ▶ \$10M FMV commercial prop. purchased for \$3.0M
- ▶ Property tax basis = \$3.75M
- ▶ Income tax basis = \$0 (fully depreciated)
- ▶ Desire to get the property to the 2 kids for rental income after their deaths
- ▶ Transferred after purchase to an LLC



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Example 3B: Options

- ▶ Do nothing
 - ▶ Children take the property at death with property tax basis >\$10M
 - ▶ Property tax increases from \$52,500 to >\$100k every year!
 - ▶ Property steps up to then-current FMV (under current law)
- ▶ Sell or gift LLC interests up to 50% total interests transferred
 - ▶ Outright or in trust
 - ▶ No property tax reassessment now; will have a reassessment when cumulative transfers >50%
 - ▶ Requires 709s if a gift

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Example 3B

- ▶ What if we want to utilize P-C exclusion?
 - ▶ Again, consider a pro-rata distribution to parents who then transfer up to \$2M to the children
 - ▶ Could be outright or in trust
 - ▶ Could be completed gift or incomplete gift

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Example 3B

- ▶ What if we want to utilize P-C exclusion?
 - ▶ Could then create a new LLC and transfer parents' and kids' interests pro-rata to potentially allow future transfers to kids w/o reassessment
 - ▶ I.e., Parents own 62%, kids cumulatively own 38%

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Example 4

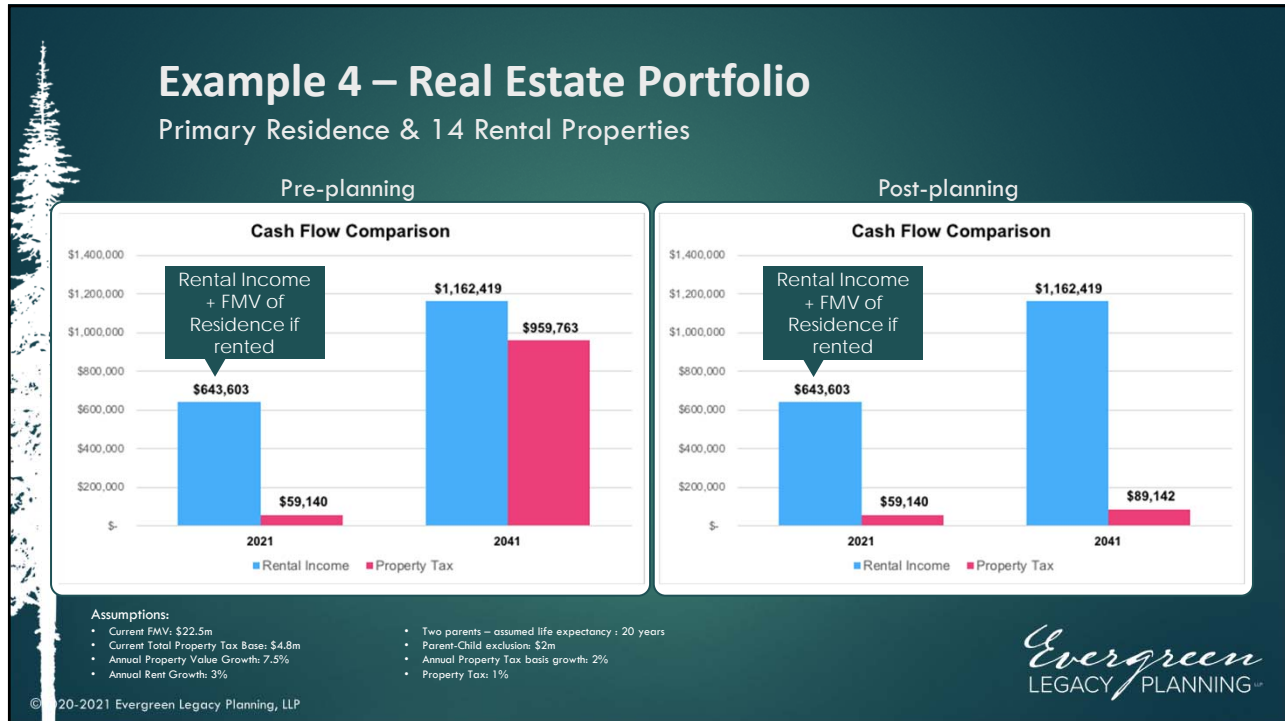
- ▶ Facts:
 - ▶ Real Estate Portfolio of 14 rental properties plus Personal Residence
 - ▶ \$22.5M FMV of property purchased for \$3.6M
 - ▶ Property tax basis = \$4.8M
 - ▶ Income tax basis = \$700,000 (rental properties fully depreciated, residence has purchase price basis)
 - ▶ Rental Income = \$539,131 / year (FMV rent of residence = \$104,472)
- ▶ Desire to get the property to 3 kids for rental income after their deaths



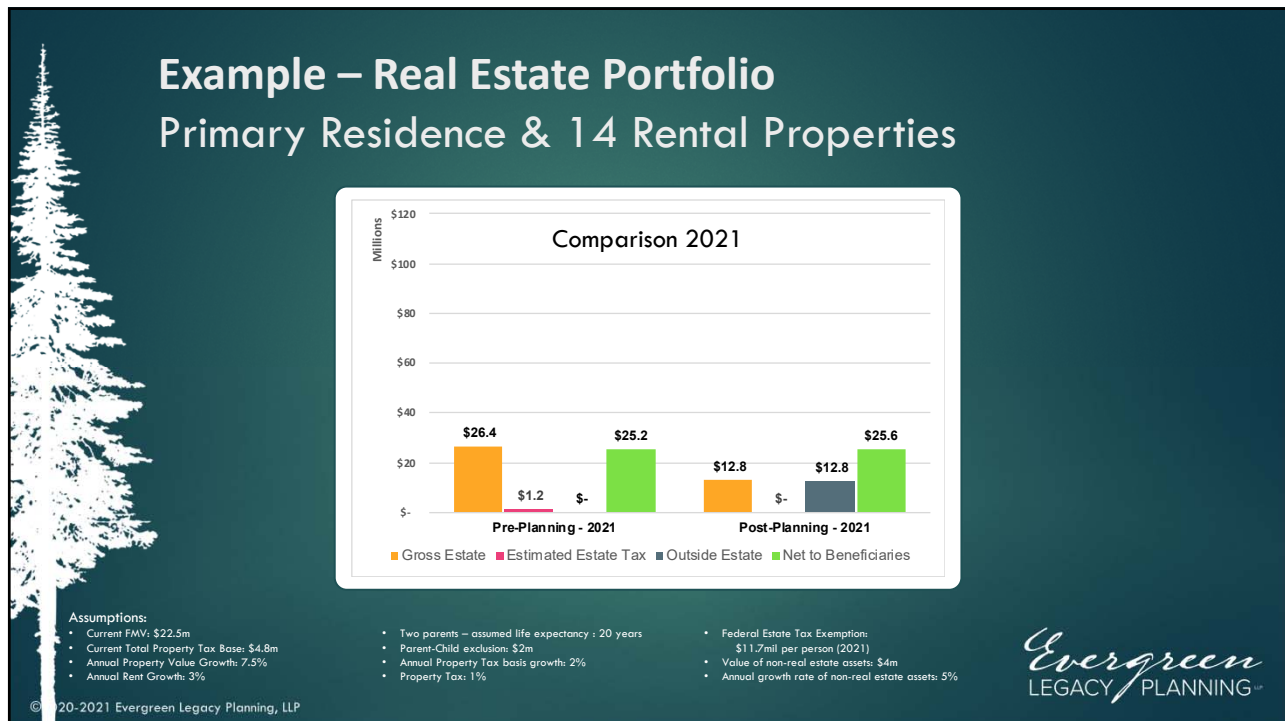
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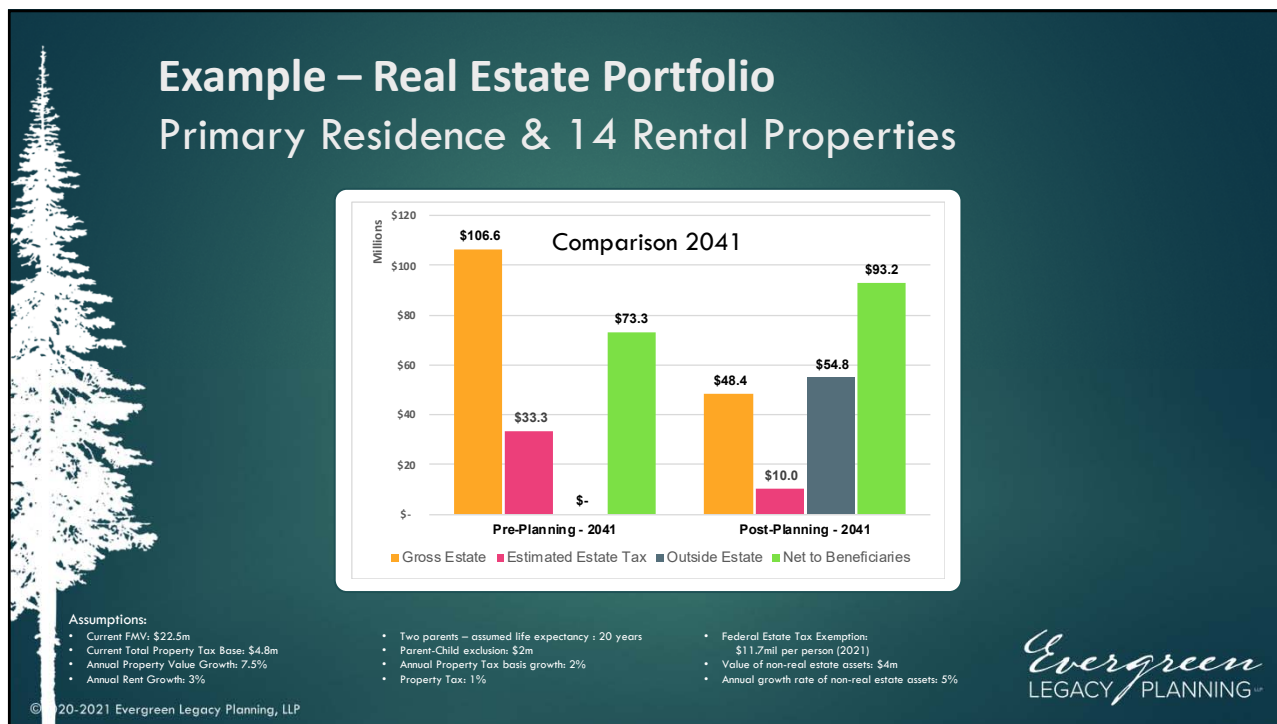
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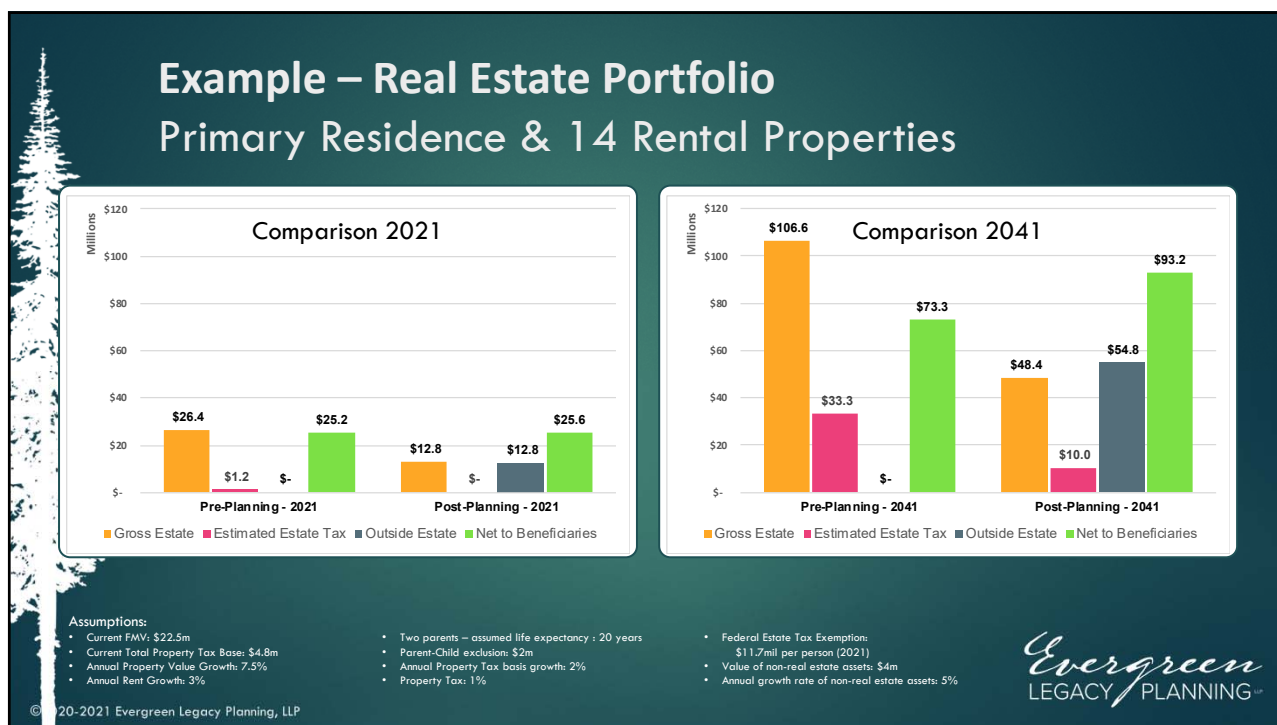
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Checklist

- ▶ Residence or Rental Property?
 - ▶ If rental property, is there any remaining P-C exclusion?
- ▶ Outright or in trust?
- ▶ If in trust, drafting considerations:
 - ▶ Irrevocable trust – “Intentionally Defective Grantor Trust”?
 - ▶ Complete or incomplete gift?
 - ▶ Crummey Powers?
 - ▶ Grantor Trust Powers?

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Checklist

- ▶ Drafting considerations continued:
 - ▶ Trust Protector? If yes, TP Powers?
 - ▶ Must not affect present beneficial interest
 - ▶ Decanting Power?
 - ▶ Power to amend?
 - ▶ Grant a beneficiary a GPOA for later step-up purposes?
 - ▶ Do not include child's descendants as current beneficiary
 - ▶ Transfers must take place before 2/16/21
 - ▶ Rebuttable presumption that recording date is transfer date
 - ▶ Use signing date as transfer date and so indicate on PCOR

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