California State Board *of* Equalization

Legislative Bill Analysis

ACA 9 (Kiley)
May 3, 2021 (Introduced)
Program: Property Taxes
Section 2.1 of Article XIII A of the California Constitution
Effective: February 16, 2021

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This analysis is limited to the property tax provisions.

Summary: Assembly Constitutional Amendment 9 would repeal several subsections of section 2.1 of article XIII A of the California Constitution to return the intergenerational base year transfer exemption language to mirror the language that existed prior to the passage of Proposition 19.

Fiscal Impact Summary:

The fiscal impact of the intergenerational transfer exclusion is indeterminable.

Existing Law: Current 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 or new construction occurs.[1] Exceptions to this reassessment requirement have been enacted.

Operative February 16, 2021, Proposition 19 replaced the then existing parent-child and grandparent-grandchild exclusion with a new intergenerational transfer exclusion that applies, generally, to a transfer of a family home or family farm, if the property continues as the family home or family farm of the transferee. *Section 2.1(c) and (d).*

Family Home. Family home has the same meaning as "principal residence," as used in subdivision (k) of section 3 of article XIII. Proposition 19 provides that "family home" includes a "family farm," which means any real property that is under cultivation or being used for pasture or grazing or to produce any agricultural commodity, defined as any and all plant and animal products produced in California for commercial purposes.[2] *Section 2.1(c)(3).*

Principal Place of Residence. To qualify for this benefit, Proposition 19 requires that (1) the home must be the principal residence of the transferor and continue as the principal residence of the transferee and (2) the transferee must file for the homeowners' or disabled veterans' exemption. *Section 2.1(c)(1) and (5).*

Principal Residence Value Test. Proposition 19 provides that the existing adjusted base year value of the principal residence will remain if the reassessed value is less than the sum of the

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[1] Article XIII A, section 2.

[2] Government Code section 51201 provides that "agricultural commodity" means any and all plant and animal products produced in California for commercial purposes, including, but not limited to, plant products used for producing biofuels, and industrial hemp cultivated in accordance with Food and Agricultural Code division 24 (commencing with section 81000).

adjusted base year value of the principal residence of the transferor plus $1 million. If the reassessed value is equal to or exceeds the sum of the adjusted base year value of the principal residence of the transferor plus $1 million, then the difference between (1) the sum of the adjusted base year value plus $1 million, and (2) the reassessed value, is to be added to the property's existing adjusted base year value. *Section 2.1(c)(1).*

Adjustment of $1 Million. Beginning February 16, 2023, the $1 million amount will be biennially adjusted by an inflation factor that is the percentage change in the House Price Index (HPI) for California for the prior calendar year, as determined by the Federal Housing Finance Agency. This bill requires the BOE to calculate and publish the adjustments required. *Section 2.1(c)(4).*

Grandparent-Grandchild Middle Generation Limitation. Proposition 19 provides that the exclusion applies to a transfer between grandparents and grandchildren if all of the parents of those grandchildren, who qualify as children of the grandparents, are deceased as of the date of the purchase or transfer. *Section 2.1(c)(2).*

Proposed Law:

California Constitution. This bill deletes the following requirements implemented by Proposition 19 for a property to qualify for an intergenerational transfer exclusion and not considered a change of ownership for assessment purposes:

- The requirement that the property be the family home or family farm of the transferor.
- The requirement that to qualify for the exclusion, the property must be a principal residence or family farm; the ability to exclude up to $1,000,000 in “other property” transferred would be reinstated.
- The requirement that to qualify for the exclusion, a homeowner's exemption or disabled veteran's exemption must be claimed.
- The principal residence value test would no longer be needed as any principal residence would qualify regardless of value.

Grandparent-Grandchild Middle Generation Limitation. This bill would reinstate the previous exclusion that applies to a transfer from grandparents and grandchildren if all the parents (other than a stepparent) of those grandchildren, who qualify as children of the grandparents, are deceased as of the date of the purchase or transfer.

Retroactive. This bill is retroactive to February 16, 2021, the effective the implementation date of the new intergenerational transfer exclusion requirements of Proposition 19.

Background:

Prior parent-child and grandparent-grandchild exclusion. 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* do not include the purchase or transfer of:

- A principal residence between parents and their children. There is no limit as to the value of the residence or how many principal residences may be transferred.

- The first $1 million of the base year value[3] of all real property other than a principal residence between parents and children (called "other property"). Each person may transfer real property to any combination of parents and/or children up to $1 million cumulatively over a lifetime.

Revenue and Taxation Code (RTC) section 63.1 implements the parent-child exclusion. 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 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.

Proposition 19, approved by the voters on November 3, 2020, added section 2.1 to article XIII A of the California Constitution, and provided the following intergenerational exclusion:

- Operative February 16, 2021, sections 2.1(c) and (d) replaced the former parent-child and grandparent-grandchild exclusions with a new intergenerational transfer exclusion, if the property continues as the family home or family farm of the transferee, and requires the family home or family farm to meet a specified value test.

Section 2.1(d) specifically provides that subdivision (h) of section 2 becomes inoperative as of February 16, 2021.

In General: **Property Tax System.** In 1978, voters approved Proposition 13, which added article XIII A to the California Constitution. Under this system, property is valued at its 1975 fair market value, with annual increases thereafter limited to the amount of inflation or 2-percent, whichever is less, until the property changes ownership or new construction occurs. Once a reassessable event occurs (i.e., a change in ownership or new construction), the value of the property for tax purposes is redetermined based on its current market value. The value initially established, or redetermined where appropriate, is referred to as the "base year value." Because real estate values generally appreciate at a rate greater than 2-percent per year, when an event occurs triggering a reassessment of property to its current market value, the reassessed value (i.e., its new base year value) will likely be substantially higher.

California property tax law provides for various situations where the base year value of a property is either: (1) retained, notwithstanding that new construction has taken place or that the property has changed ownership, or (2) transferred to another property, notwithstanding that the property has changed ownership. These special situations are provided pursuant to various constitutional amendments modifying the original Proposition 13 framework and serve to avoid the otherwise required reassessment of a property to its current market value.

[3] Article XIII, section 2(h) uses the term "full cash value." RTC section 63.1 provides that "full cash value" means full cash value as defined in section 110.1, which describes a property's base year value, not its current market value.

Commentary:

1. **Implementation.** This bill has language that is intended to repeal provisions added to the California Constitution by Proposition 19 regarding intergenerational transfers. As guidance regarding Proposition 19 has already been issued, passage of this bill would require BOE to issue updated guidance.

2. **Forms.** The BOE has already created new forms to implement the provisions of Proposition 19, which will need to be updated with the passage of this bill.

3. **Related Legislation.** SB 539 provides clarifying language to Proposition 19, as relevant to this bill, through the addition of RTC section 63.2. This section is in regard to the intergenerational transfer exclusion. SB 668 would add section 63.3 to the RTC in an effort to delay the intergenerational transfer provisions of Proposition 19 until February 16, 2023; two years after the initial implementation date.

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

Revenue Impact:

Estimating the revenue impact of ACA 9 is somewhat difficult. While the BOE maintained somewhat useful information about claims granted under the previous $1 million exclusions (Proposition 58/193 parent/child and grandparent/grandchild), that information did not include:

- the values of the properties transferred;
- how often a transferred home subsequently became the transferees' principal residence;
- consequences of the property no longer being used as the transferees' principal residence; and,
- how many of those properties were considered "other real property".

The changes Proposition 19 made to prior law are still very recent and at this time there is no data available regarding revenue as it relates to these changes. While the exact revenue impact is indeterminable, we can use the following data to determine the potential revenue loss:

According to the California Association of Realtors, the January 2021 median home price in California was $700,000. For roll year 2021-22, the estimated average assessed value of a property receiving the homeowners' exemption is $466,000. Therefore, where a claim for transfer is granted, the estimated amount of assessed value difference per home on average is $234,000 ($700,000 – $466,000). Average revenue loss at the basic 1-percent property tax rate is estimated at $2,340 per replacement home ($234,000 x 1%), or roughly $2.34 million for every one-thousand claims granted.

The allowance for property that is not a principal residence to be transferred through the intergenerational transfer exemption will have an indeterminable revenue loss, estimated at approximately $2,340 per property using the same methodology described above for principal residences.

The allowance for property that is not a principal residence to be transferred through the intergenerational transfer exemption will have an indeterminable revenue loss.

Qualifying Remarks: This revenue estimate does not account for any changes in economic activity that may or may not result from the enactment of the proposed law.