

Tax Letter

September 2006, Vol 12 - Proposition 13 and Property Tax

Dear clients and friends:

In California, as far as property tax is concerned, the most important Proposition 13 (hereinafter Prop13) was adopted by the Voters in June 1978. Since then, the provisions of Prop13 and its related regulations have been subsequently changed at least 11 times. Most significant changes are those mandated by Proposition 8 in November 1978, Proposition 3 in June 1982, Proposition 46 in June 1986, Proposition 58 in November 1986, Proposition 60 in November 1986 and Proposition 9 in November 1988, etc. The purpose of this LETTER is to highlight certain key areas of Prop13 and the changes as mentioned above regarding residential properties, such as your home.

Firstly, valuation of property is the key in property taxation. The tax rate is applied to the value of the property to determine the amount of taxes being assessed against the property. Prop13 sets forth rules controlling the valuation of property for property tax purposes. It has been up-held by the Supreme Court that Prop13 provisions apply to the valuation of locally-assessed real property. Before Prop13, locally assessed real property was assessed each year using a "fair market value" (FMV) standard. Simply put, the value for which property would be taxed will be changed according to what will be the "FMV". This is definitely undesirable. Under Prop13, locally assessed real property can only be assessed by an "acquisition value" standard. This "acquisition value" is known as the "base year value". Simply put, the local authorities have no power to assess higher property taxes due to rising value. Only an annual increment of 2% is allowed, as long as the property is not subject to an ownership change or new construction. Conversely, property for which the market value declines below its "base year value" will be reassessed to reflect the lower value.

If there is an ownership change or new construction, the property will be reassessed to current "FMV" as of the date of ownership change or completion of construction. This new "value" will be the new "base year value", which will be thereafter adjusted upward by no more than 2% annually.

Secondly, the "change of ownership" is an important event in the game of property tax assessment. What is "change of ownership" and what is not "change of ownership" becomes very important. A "change of ownership" in real property occurs when there is a transfer of present interest in the property, and a transfer of the right to beneficial use thereof. Every transfer of property qualified as a "change of ownership" shall be regarded as a "change of ownership", whether the transfer or change is voluntary, involuntary, by operation of law, by grant, gift, devise, inheritance, trust, contract of sale, or any other means.

Thirdly, for purposes of property tax reassessment and/or reappraisal, there are exceptions and exclusions from the definition of "change of ownership". These

exceptions and exclusions including but not limited to the following:

A change in the name of an owner of property not involving a change in the right to the beneficial use .

Transfers which change the method of holding title without changing the proportional interest.

Change of less than controlling interest in corporations, partnership, or other legal entity having ownership in property.

Transfers for purposes to perfect title or for security interest, such as Deed of Trusts and/or their reconveyance therefrom.

Transfers to revocable trusts, where trustor retains substantially all rights and benefits in the property.

Interspousal transfers, including transfers between spouses and former spouses in marital dissolutions.

Transfers between parents and their children of their principal residences. For transfer of non principal residence, other property between parents and their children, the exclusion applies to transfers up to \$1,000,000 of value per transferor of property.

The creation, transfer, or termination of a joint tenancy interest in property if the transferor(s), after such creation or transfer, is/are among the joint tenants. In this situation, the transferor(s) remain among the joint tenants will be considered as “original” transferor(s).

Last, but not least, that under Proposition 60, any sales and re-acquisition of a Residence qualify for the “home owner exemption” within the same County, no reassessment or reappraisal for property tax purposes for the replacement residence. The “adjusted base year value” of the “old” will be transferred to the “new”. To qualify for this exception, the owner/seller must be at least 55 years of age, the replacement residence must be of “equal to” or “lesser” in market value than the “old” residence sold, and must be completed within 2 years (24 months). Further, Proposition 9 adopted in 1988 provided the legal foundation for owners 55 years or older to “change” their residence between Counties, as long as that the County where the replacement residence located has adopted an ordinance participating in the cross County program.

Any question, please give us a call at 415-381-0681, or visit our website at www.chochan.com.

Sincerely,

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