

# ESTATE PLANNING NEWS



## Real Property Taxes:

### How to Avoid Triggering a Reassessment

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California taxes real property at a rate equal to 1% of the property's **assessed value**, plus any local or ad valorem taxes. Prior to 1978, the assessed value was the property's fair market value, reassessed every year. However, as market values skyrocketed, voters passed Proposition 13. Proposition 13 returned assessed values to their March 1, 1975 levels and limited annual increases. Now a property's assessed value equals fair market value, plus an annual inflation adjustment not to exceed 2% of the prior year's assessed value, until a change in ownership or other event triggers reassessment.

Since Proposition 13 was enacted, property values generally have increased by far more than the 2% maximum annual increase. As a result, the disparity between fair market value and assessed value has widened, and the consequences of triggering a property tax reassessment have increased significantly. Avoiding reassessment may be critical to a successful transfer of property to the next generation.

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# Estate Planning News

## Announcements

### Uganda Modernizes Its Wills & Estates Law

This month, the Constitutional Court of Uganda nullified several sections of Uganda's outdated Succession Act.

- 1) In the case of intestacy (*i.e.*, dying with no Will), the administrator-general will no longer take over family property. This law previously left the widow with no rights.
- 2) It is unfair to entitle a widow to 15% of her husband's estate when a widower is presumptively entitled to 100% of his wife's property.
- 3) A widow's rights to matrimonial property will not terminate upon remarriage. The law previously permitted a widower to remarry and keep his rights.
- 4) If a parent dies, the father will not have the sole right to determine guardianship.
- 5) Male lineage rights were removed. Previously, the husband's male relatives took over the family property and offspring, wresting control out of the widow's hands.

## Tip of the Month

### Ademption: Failure of a Specific Gift

Ademption is a legal term that describes what happens when property devised in a trust or will is sold, gifted, or otherwise disposed of during the owner's lifetime. Specific gifts generally fail if they are not owned at death.

For example, Arlene's trust devises her Tahoe rental property to her friend, Nelson. Toward the end of her life, Arlene sells the property to pay for her medical expenses. When Arlene dies, the gift to Nelson is adeemed, and he takes nothing.



## Entertainment

### Blood Diamond (2006)

Set during Sierra Leone's bloody 1999 civil war, this thriller stars Leonardo DiCaprio as Danny Archer, a smuggler who sells "blood" diamonds used to finance terrorists. When Archer meets a local fisherman whose son has been forced into a child army, the two men's lives become intertwined, and they set off on an adventure that leads them through the world's major diamond centers.



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Anybody can mean what he says.

It's saying what one means that's the real difficulty.

- - JAMES HILTON

*The Meadows of the Moon*

## Real Property Taxes

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### **Change in Ownership**

California Revenue and Taxation Code §60 defines a change in ownership as: *A transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.*

A present interest in real property may transfer by: (1) sale, (2) inheritance, (3) gift, (4) transfer to or from a trust, or (5) change in beneficiary of a trust.

### **Identifying the Transferor & Transferee**

To analyze a transfer, one must determine who is treated as transferring an interest (the "transferor") and who is treated as receiving the interest (the "transferee"). This is not easy when trusts are involved.

#### **A. Transferor**

The settlor (*i.e.*, trust maker) is the transferor (1) when he/she contributes property to an irrevocable trust, or (2) when a revocable trust becomes irrevocable (*e.g.*, when the settlor dies). Trustees, who hold legal title for the benefit of the beneficiaries, are not considered transferors or transferees.

Generally, when a beneficiary's interest terminates, and the property is distributed to (or held in trust for) a new beneficiary, the settlor continues to be the transferor.

#### **B. Transferee**

The transferee is the current beneficiary of the trust. Beneficiaries holding future interests are ignored until their interests become present interests.

### **Reassessment Exclusions**

#### **A. Revocable Trust**

A transfer to a revocable trust or change in the present beneficiary of a revocable trust is not a change in ownership. However, when a revocable trust becomes irrevocable, a change in ownership occurs and real property held by the trust will be reappraised unless an exclusion applies.

#### **B. Proportional Interest**

If the owners' proportional interests remain the same before and after the transfer, there is no change in ownership.

#### **C. Reversionary Interest**

If property is transferred to a trust and the transferor retains a reversionary interest (*i.e.*, an interest that returns to the transferor) that will take effect in 12 years or less, there is no change in ownership.

#### **D. Transfer Between Trusts**

A transfer from one trust to another trust is not a change in ownership if the transfer qualifies for an exclusion.

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### **E. Qualifying Beneficiary**

Beneficiaries who may qualify for an exclusion include the transferor and the transferor's spouse, registered domestic partner, child, parent, and grandchild.

#### **1. Interspousal Exclusion**

A transfer from the transferor to his/her spouse is not subject to reassessment. Similarly, although the exclusion is not the same, a transfer made in or after 2006 to a registered domestic partner is exempt.

#### **2. Parent-child Exclusion**

A parent may transfer to his/her children the principal residence *plus* up to \$1MM of the full cash value of other real property without a change in ownership.

(a) A transfer may be from parent to child or from child to parent.

(b) "Child" includes a natural child (unless adopted by someone else as a minor), a child adopted during minority, a stepchild, and the "child's" spouse. When the parent-child relationship is based upon marriage, it terminates upon divorce. However, if the marriage ends by death, the parent-child relationship continues until the in-law or stepparent remarries.

(c) "Full cash value" is the assessed value of the property before the transfer.

Each parent is entitled to a \$1MM exclusion. To use the deceased parent's exclusion, property should be held in trust for the surviving parent for life, remainder to children.

**Example:** H and W made an A-B Trust. When H died in 2005, Trust B was funded with a La Jolla rental (assessed value = \$800,000; market value = \$1.5MM). W is the income beneficiary. She may invade Trust B principal for her health, education, maintenance and support. When W dies, Trust B will be divided among the children, who can claim a \$1MM exclusion from H.

#### **3. Grandparent-grandchild Exclusion**

Generally, the grandparent-grandchild exclusion applies only if all parents of the grandchild who qualify as children of the grandparent are deceased.

**Example:** Marge's family consists of son, daughter-in-law, and their child, Gabby. Son dies. On Marge's death, she leaves her home in trust for Gabby. If daughter-in-law is alive and has not remarried, she is considered Marge's "child." Therefore, Marge's home will be reassessed.

### **Conclusion**

When real property will be passed down to the next generation, it is important to work with an estate planning attorney who is familiar with the intricacies of Proposition 13. Depending upon the intended transfer, there may be additional requirements, which are beyond the scope of this article. Navigating these rules is critical to avoiding reassessment.

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