

TAXATION



presents

2024 Estate and Gift Tax Conference

Panel 12: Understanding Proposition 19 and Parent to
Child Transfers, Tax Base Transfers and How to
Effectively Submit Claims to the County Assessor

Friday, March 22, 2024

11:00am - 12:00pm

Speakers: Michael Lebeau and Assessor Phong La

Conference Reference Materials

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Proposition 19: What Can We Do for Our Clients?

Bewley | Lassleben | Miller
LEGAL EXCELLENCE SINCE 1888



13215 PENN STREET, SUITE 510 562.758.1443
WHITTIER, CALIFORNIA 90602-1797 714.994.5131

Michael T. Lebeau

mikel@bewleylaw.com

949.678.9177 mobile

Proposition 19

Repealed § 63.1 Parent-Child Exclusion

- Eliminated Prop. 58 Parent-Child Exclusion for all real property other than parents' principal residence when used as child's principal residence and certain family farms effective February 2021;
- Requires that inherited homes that are not used as principal residences, such as second homes or rentals, be reassessed at market value when transferred;
- Increases the number of times that persons over 55 years old or with severe disabilities can transfer their tax assessments from one to three times;
- Allows eligible homeowners to transfer their base year values anywhere within the state and allow base year value transfers to more expensive homes with an upward adjustment; and
- Allocates additional revenue or net savings resulting from the ballot measure to wildfire agencies and counties.

Proposition 19

Repealed § 63.1 Parent-Child Exclusion

- Pandering to firefighters — and their campaign contributions— proponents promised additional taxes to fund emergency services

	Cash Contributions	In-Kind Contributions	Total Contributions	Cash Expenditures	Total Expenditures
Support	\$41,231,476.40	\$1,156,109.87	\$42,387,586.27	\$45,302,059.01	\$46,458,168.88
Oppose	\$395,924.39	\$50.00	\$395,974.39	\$324,558.54	\$324,608.54

- **The Orange County Register Editorial Board:**

"But Prop. 19 is best understood for what it is: an attempt by real estate interests to accomplish what they couldn't accomplish two years ago by pandering to the state's firefighters union. This is a special-interest measure that seeks to raise hundreds of millions of new tax revenues to appease yet another special interest. Prop. 19 has one good feature — portability. Counties ought to enable it forthwith, as a few already have done. But Prop. 19 is a cash grab, not tax reform; it's not fair to property heirs, and it buys off a union so it has a better chance of passing. Vote it down."

What Can We Do?



Proposition 19 Aftermath

Potential Tax Savings Strategies

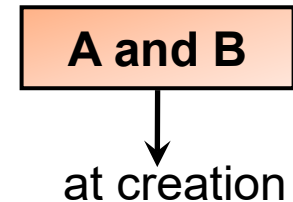
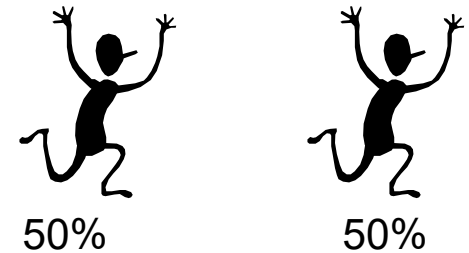
- **Joint Tenancy Exclusion (Rule 462.040)**
 - No Relationship Requirements
 - No Use Restrictions
 - No Value Limits
- **Cotenant Exclusion (§ 62.3)**
 - Both own 100% record title for over 1 year
 - Principal residence for both
 - Excludes transfers occurring upon death
- **Legal Entity Exclusions**
 - Can transfer up to 50% to next generation
 - Potential § 64(c)(1) and (d) Reassessments

Rule 462.040 Change in Ownership: *Joint Tenancies*

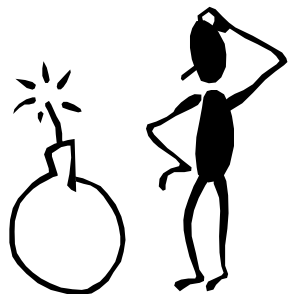
Civil Code Section 683: Joint Tenancy Defined

Estate in property owned by two or more people:

- In equal shares (unity of interest)
- Expressly declared (unity of title)
- By grant, agreement, or devise (unity of time)
- For benefit/possession of each other (unity of possession)



Key Characteristic = Right of Survivorship



A DIES

B Succeeds to A's Interest



A and B

Rule 462.040 Joint Tenancies

“Original Transferors” on title will delay Changes in Ownership of Joint Tenancies

Subdivision (a) General Rule: Creation, transfer, or termination of a joint tenancy interest results in a change in ownership of the interest transferred.

Subdivision (b)(1) Exception: No change in ownership upon the creation, transfer, or termination if all the transferors, after such creation or transfer, are among the joint tenants.

***After the creation or transfer, the transferors
become “original transferors”***

Subdivision (b)(2) Termination: Termination of any interest described in subdivision (b)(1) results in a change in ownership of entire property held in joint tenancy unless the interest vests in at least one original transferor.

What is an

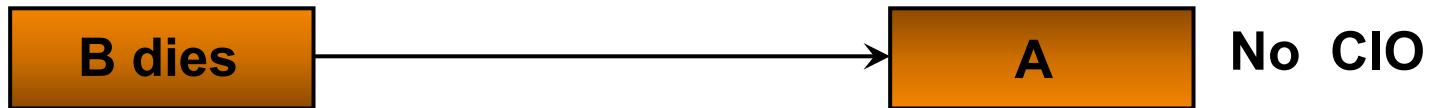
Original Transferor ?

An original transferor is a person who owns real property and transfers the real property to themselves and others in joint tenancy.



A becomes an original transferor (OT).

B becomes an other than original transferor (OTOT).



Transfer of joint tenancy interest to an original transferor is not considered a change in ownership, and therefore, not reassessed.

What is the purpose of an

Original Transferor ?

- **Legislature created the concept to delay changes in ownership for joint tenancies.**
- **Recognition that family joint tenancies were often created by parents who want children on title as part of their estate plan.**
- **No change in ownership until the termination of the interests of all original transferors.**
- **At the termination of the last original transferor's interest, change in ownership of 100% of all property that was held in joint tenancy.**

Rule 462.040 Joint Tenancies

“Original Transferors” delay Joint Tenancies Changes in Ownership

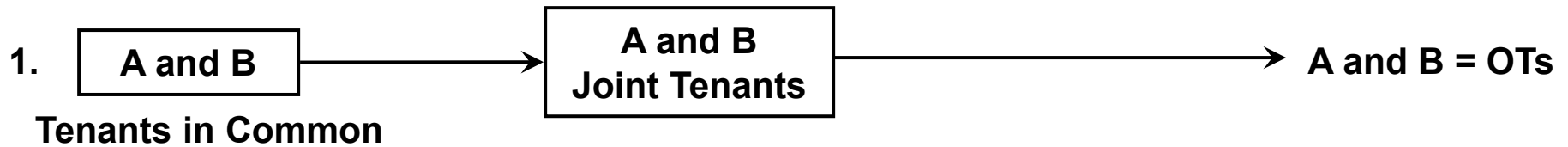
Property Tax Rule 462.040, Joint Tenancies was amended by the SBE on June 11, 2013, with an effective date of October 1, 2013.

Changes sought by assessors and approved by the SBE include:

- 1. “All” transferors must be now among joint tenants to obtain original transferor status*
- 2. To create original transferor status, a transaction must either change title to joint tenancy or add an additional person to title*
- 3. Eliminating a joint tenant does not create "original transferor" status in any of the remaining joint tenants.*
- 4. Transfers of joint tenancy interests to trust for benefit of other joint tenant will no longer qualify for OT status after October 1, 2013.*

Rule 462.040

How to Become an Original Transferor



Change in Ownership if A dies, but no change in ownership if B dies.



*No Change in Ownership if either A, B, C, or D dies,
but a Change in Ownership occurs when both A and B die.*

Cotenant Exclusion

Rev. & Tax. Code § 62.3 effective January 1, 2013

Change in ownership does not include a transfer of a cotenancy interest in real property from one cotenant to the other that takes effect upon the death of the transferor cotenant if all of the following conditions apply:

- (1) Solely between two individuals who together own 100 percent of the real property in joint tenancy or as tenants in common.*
- (2) As a result of the death of the transferor cotenant, the deceased cotenant's tenancy in common or joint tenancy interest in the real property is transferred to the surviving cotenant*
- (3) Record title coowned by cotenants for the one-year period immediately preceding the transfer*
- (4) The real property constituted the principal residence of both*

Cotenant Exclusion

Rev. & Tax. Code § 62.3 effective January 1, 2013

- *Applies to transfers:*
 - (1) *Pursuant to will or trust, upon the death of the transferor cotenant;*
 - (2) *Through intestate succession; or,*
 - (3) *By operation of law, upon the death of the transferor cotenant.*
- *Only Principal Residences Qualify*
- *No Value Limits*
- *See, SBE LTA No. 2013/021*

Cotenant Exclusion

Rev. & Tax. Code § 62.3 effective January 1, 2013

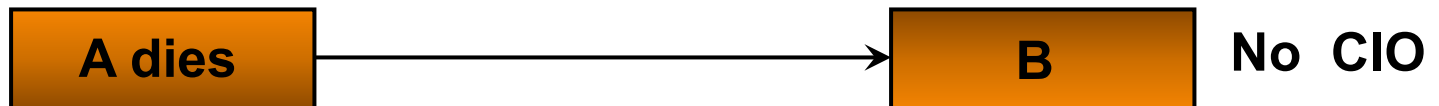


A becomes an original transferor (OT).

B becomes an other than original transferor (OTOT).

Creation of JT excluded from reassessment since A is among JT's

A & B live in principal residence for one year



Transfer of cotenancy interest to B occurring upon A's death is excluded from change in ownership by § 62.3 provided:

A and B lived in principal residence for one year,

Transfer occurred as a result of A's death and

B obtained his interest by will, trust or operation of law.

Legal Entity Ownership

I. *Primary Question: What Will Transfer?*

A. Real Property Interests?

- or -

B. Legal Entity Interests?

Why is this question important?

The answer drives the entire change in ownership analysis.

Basics: Legal Entity Ownership

II. *Legal Entity Transfers of Real Property*

A. Transfers of ***real property interests*** to, from, or between legal entities and any other person ***are presumed to be changes in ownership*** (Rev. & Tax. Code, § 61(j)). This presumption applies to all real property transfers:

1. Recorded Deeds, Judgments, and Merger Certificates
2. Contributions by or distributions to equity owners
3. Foreclosures / Transfers by operation of law
4. Unrecorded land sales contracts

B. Only Two Potential Exceptions (“Exclusions”):

1. “Proportional Interest Exclusion” (Section 62(a)(2))
2. Affiliated Corporation Transfers (Section 64(b))

NOTE: No Interspousal or Parent-Child Exclusions are available (except in case of divorce)

Basics: Legal Entity Ownership

1. *“Proportional Interest Exclusion”* *(Section 62(a)(2))*

Excluded from Change in Ownership -

(a)(2) Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, that results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer. The provisions of this paragraph shall not apply to transfers also excluded from change in ownership under the provisions of subdivision (b) of § 64.

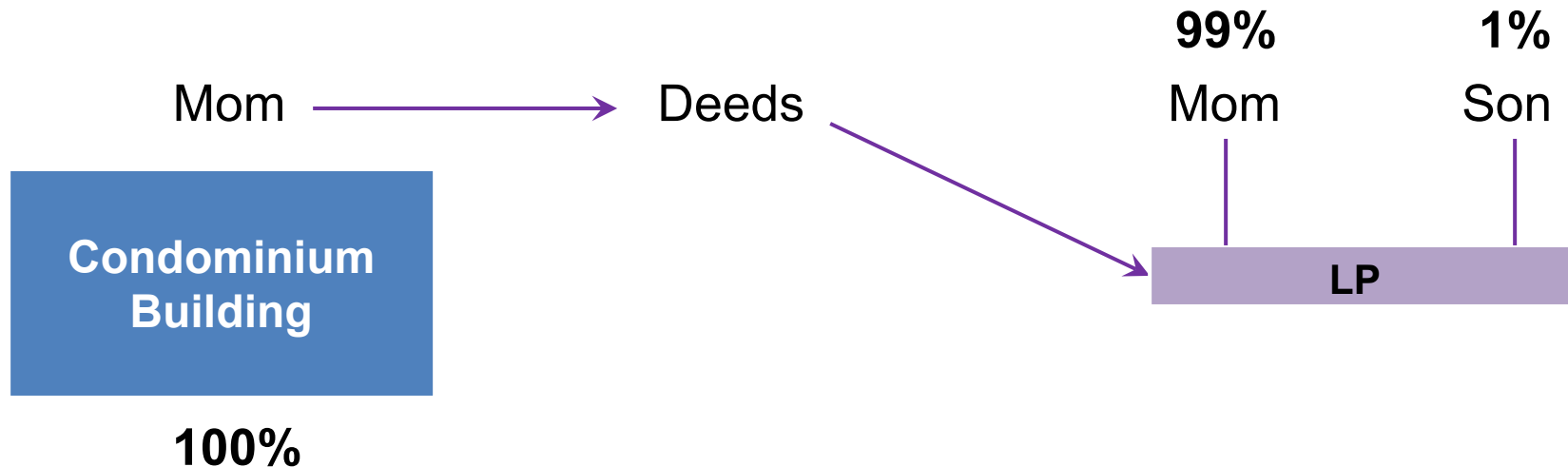
Basics: Legal Entity Ownership

1. *“Proportional Interest Exclusion”* (Section 62(a)(2))

- a) Primary exclusion for transferring real property to a legal entity without a change in ownership reassessment.
 - (i) Exclusion applies if legal entity ownership interests perfectly “mirror” ownership of the real property
- b) Also applicable to the distribution of real property by a legal entity to partners, members, or other legal entities.
- c) Disproportionate transfer of entity or property interests results in a change in ownership.

Problem 1: Proportional Interest Failure

Penner v. Co. of Santa Barbara (1996) 37 Cal.App.4th 1672



- Disproportionate Transfer = 100 Percent Reassessment
- De Minimis Interest Exclusion (§ 65.1) Does Not Apply to Transfers to Legal Entities
- Parent-Child Exclusion Does Not Apply to Legal Entities (§ 63.1(c)(8))

Solution 1: Avoiding Proportional Interest Failure

Steps For Applying § 62(a)(2) & Avoiding Penner

Step 1

Mom → Deeds → Son

1% Interest
in Condo

Condominium
Building

100%

§ 65.1
(De minimus Exclusion)

Mom

Son

Condominium
Building

Alternate Solution:

- Deed to single-member LLC wholly-owned by Mom
- Gift 1% interest to Son **AFTER** assessor approves § 62(a)(2) proportional interest exclusion

Step 2

§ 62(a)(2)

99%

1%

LP

99%

1%

Basics: Transfers of Legal Entity Interests

III. Transfers of Legal Entity Interests Presumed Not a Change in Ownership

Section 64: (a) Except as provided in subdivision (i) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership or limited liability company interests, shall not be deemed to constitute a transfer of the real property of the legal entity. This subdivision is applicable to the purchase or transfer of ownership interests in a partnership without regard to whether it is a continuing or a dissolved partnership.

What does this mean? Transfers of Legal Entity interests are not changes in ownership, subject to two important exceptions:

- A. “Change in Control” – Legal Entity Ownership Interests Directly/Indirectly Exceed 50 Percent - § 64(c)(1)**
- B. Legal Entity’s “Original Coowners” have transferred greater than 50 percent of their interests - § 64(d) (“Original Coowner Change in Ownership”)**

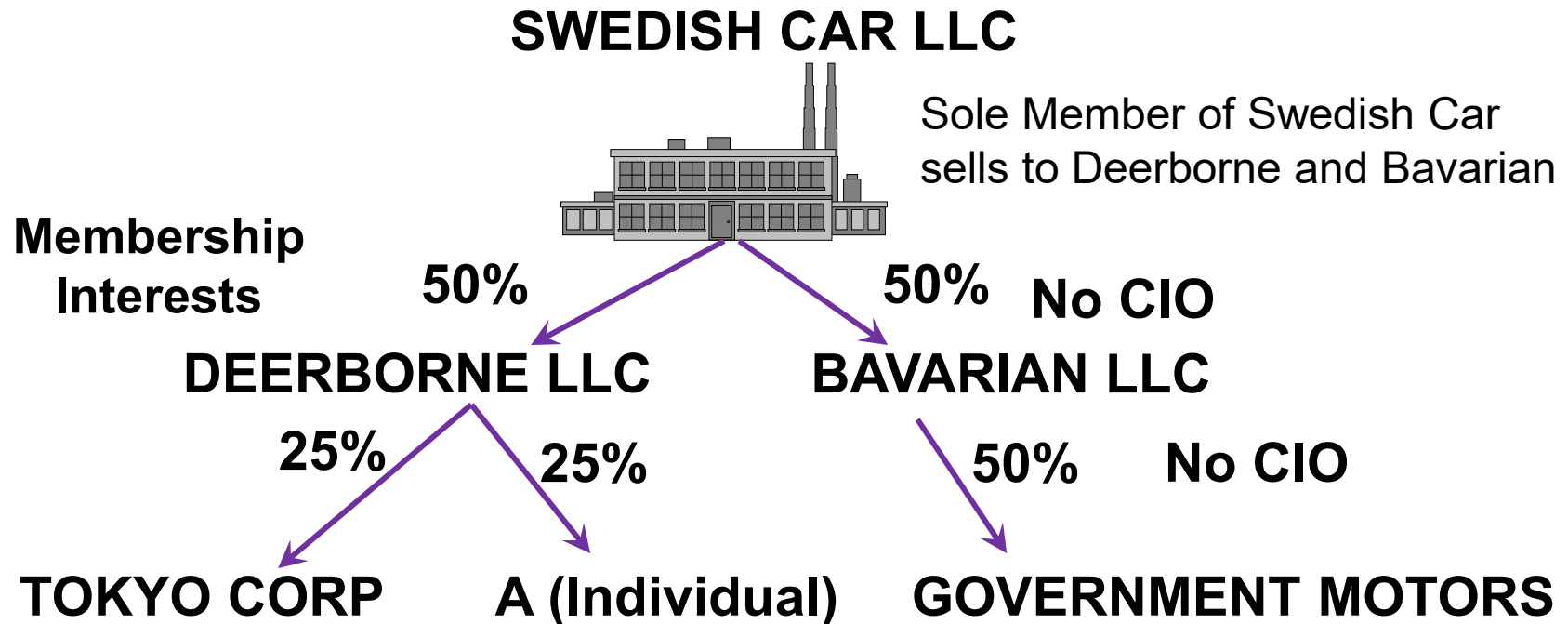
Basics: Transfers of Legal Entity Interests

A. *“Change in Control” (Section 64(c)(1))*

1. Obtaining direct or indirect “control” of a legal entity that owns California real property results in a change in ownership of the real property owned by that entity.
 - a) For corporations “control” is defined as owning greater than 50 percent of voting stock
 - b) For partnerships and LLC’s “control” means greater than 50 percent of capital and profit accounts

Basics: Legal Entity Changes in Ownership

A. Change in Control (Examples)

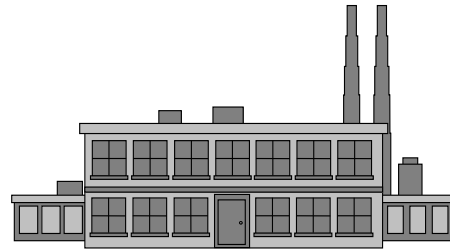


No change in ownership even though 100 percent of Swedish Car LLC's membership interests transfer in a single transaction to Deerborne and Bavarian because no one person obtains control of Swedish Car LLC. *Ocean Avenue LLC v. County of Los Angeles* (2014) 173 Cal.Rptr. 3d 445

Basics: Legal Entity Changes in Ownership

A. Change in Control (Examples) (cont'd)

SWEDISH CAR CORPORATION



Voting Stock 51% ← 1% → 49% Change in Control

DEERBORNE CORP

BAVARIAN CORP

Basics: Legal Entity Changes in Ownership

B. “Original Coowners” (Section 64(d))

(d) If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by section 62(a)(2), then the persons holding ownership interests in that legal entity immediately after the transfer shall be considered the “original coowners.” Whenever ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transaction, a change in ownership of that real property owned by the legal entity shall have occurred, and the property that was previously excluded under section 62(a)(2) shall be reappraised. The date of reappraisal shall be the date of the transfer of the ownership interest representing more than 50 percent of the interests in the entity. A transfer of ownership interests that also results in a change in control of any legal entity is subject to reappraisal as provided in subdivision (c) rather than (d).

Basics: Legal Entity Changes in Ownership

B. “Original Coowners” (Section 64(d))

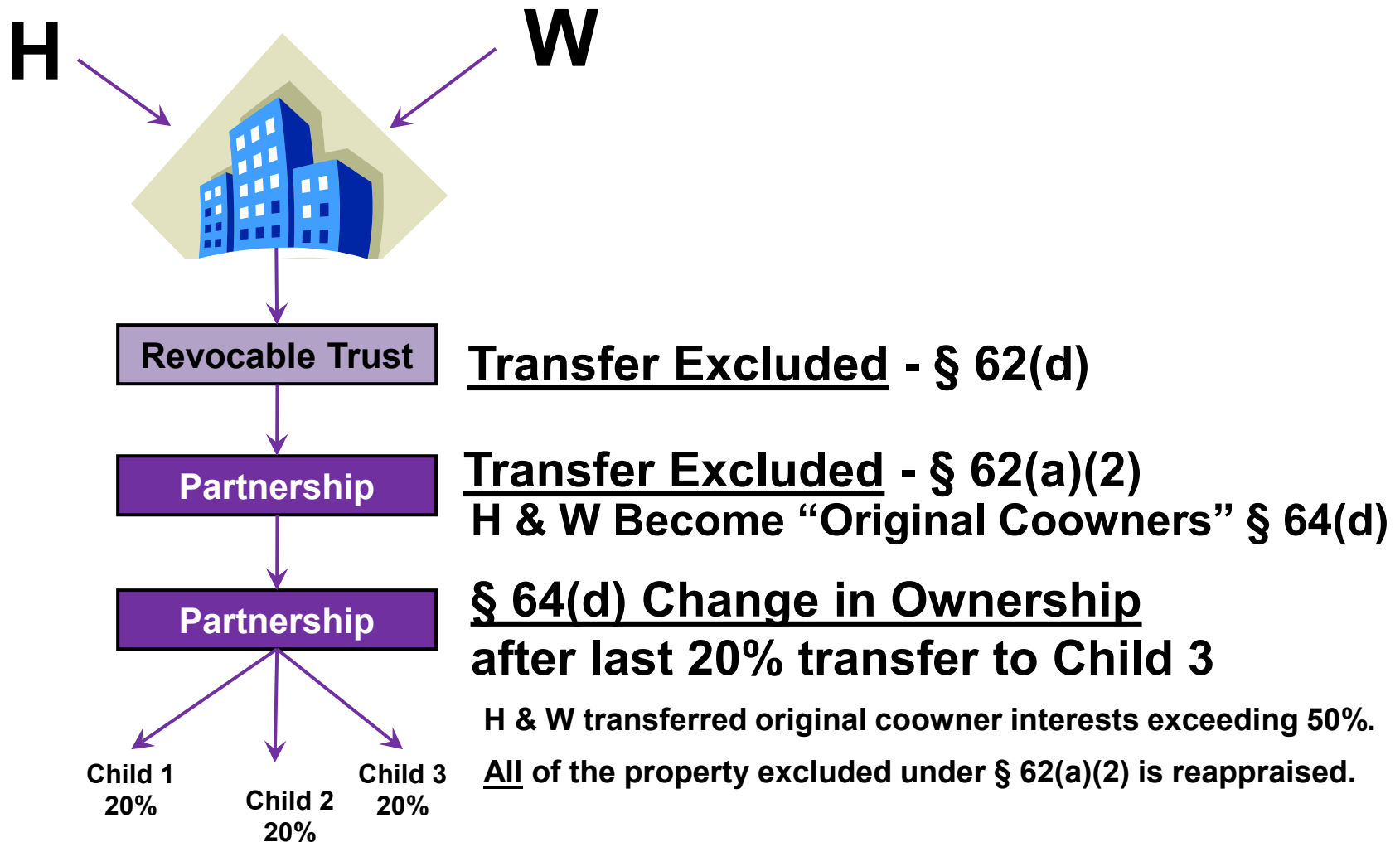
If real property interests were:

1. Transferred (contributed) TO a legal entity AND
2. That transfer/contribution was excluded from reassessment under Section 62(a)(2), THEN
3. All shareholders, partners or LLC members AFTER that transfer are labeled “original coowners.”

Section 64(d) provides that a change in ownership will occur IF those original coowners cumulatively transfer more than 50 percent of their interests in the legal entity.

Basics: Legal Entity Changes in Ownership

B. “Original Coowners” (Example)



C. Step Transaction Doctrine

Reassessment Even if Exclusions Apply

Apply substance over form doctrine where multiple transfers are made to avoid CIO.

Doctrine is applicable even if various steps accomplish business purpose other than tax avoidance.

Three alternative tests:

(1) Binding Commitment Test – at time of first step, there is a binding commitment to take later steps.

(2) Independence Test – first step fruitless without the completion of the series of steps.

(3) End Result Test – end result was intended at outset; separate transactions were component parts of single transaction.

Exception: Former Parent-child/grandparent-grandchild exclusion - § 63.1

PHONG LA, ASSESSOR

OFFICE OF ASSESSOR

OFFICE OVERVIEW & PROPOSITION 19



March 2024

Disclaimer

This information has been prepared by the Alameda County Office of the Assessor for information purposes only and does not constitute legal advice.

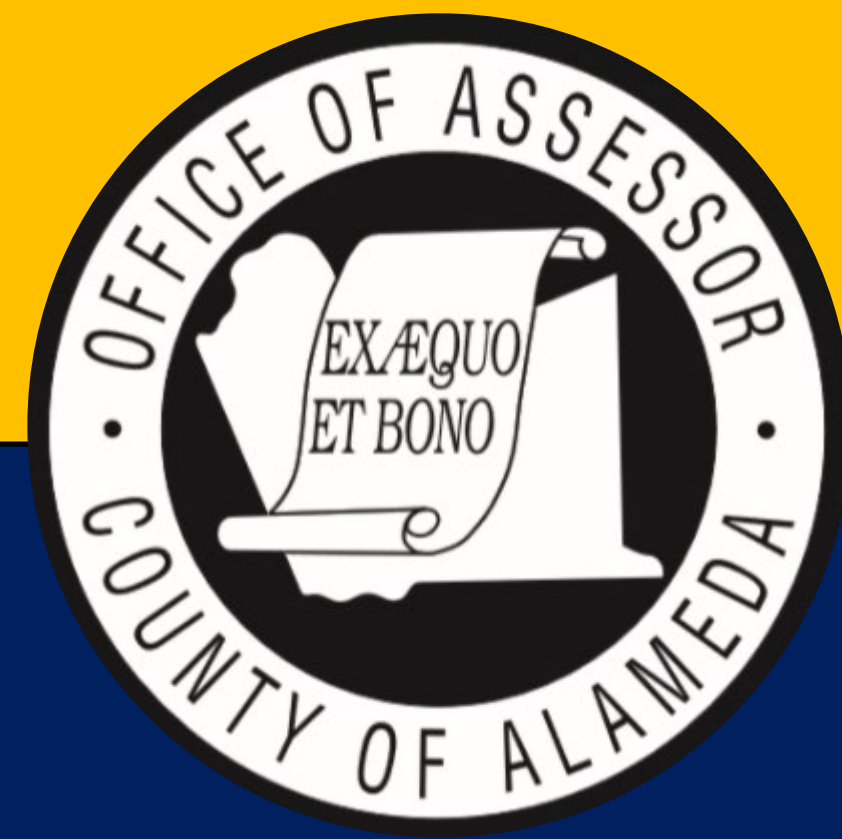
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Any person who reviews the information should not rely upon it or act on it in any manner without first engaging professional counsel.

The information is intended to communicate general information.

About Us

ALAMEDA COUNTY ASSESSOR'S OFFICE



- The Assessor's Office is responsible for locating all taxable property in the County, establishing its taxable value, and applying any legal exemption.
- We are one of the largest assessment agencies in the state.
- We are committed to establishing accurate and fairly assessed property values.

What goes into property taxes?

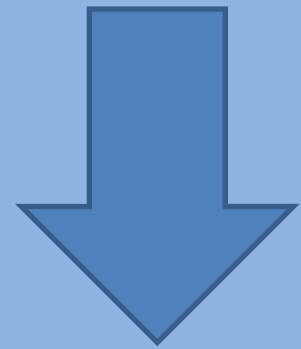
The Assessor, Auditor-Controller,
and Treasurer-Tax Collector

**ASSESSED
VALUE**

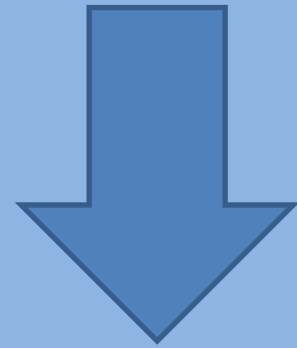
**TAX
RATE**

**SPECIAL
ASSESSMENTS/
FEES/LIENS**

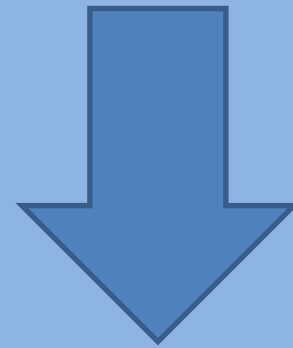
**PROPERTY
TAX DUE**



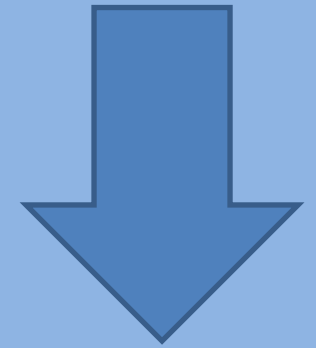
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**Phong La
Assessor**



**Melissa Wilk
Auditor-Controller**



**Special Tax
Districts**



**Henry C. Levy
Treasurer-
Tax Collector**

Proposition 19

Proposition 13 gives property tax benefits for long term ownership

My parents buy a house in Fremont, CA for \$100,000 in 1980.

They are assessed \$100,000 and pay about \$1,250 in property taxes in 1980.

The property is now worth \$1,000,000 in 2023

But the property is assessed at about \$200,000 (\$100,000 plus 2% a year for 40 years compounded) – property taxes are about \$2,500 **per year in 2023** for my parents.

Under Prop 58, it does not matter if they live there or rent it out. I keep the low basis when transferred to me.

New owners of the same house

Properties are re-assessed when there is a “change in ownership”, assessments are increased with new construction.

New family buys my parents’ house in Fremont, CA for \$1,000,000 in 2023.

They are assessed \$1,000,000 and pay about \$12,500 in property taxes in 2023.

Proposition 13 restricts the increases in assessments to 2% a year and caps the property tax amount to 1% of the assessed value (with special assessments added such as school bonds, vector control, etc. that voters approve)

Prop 13: Previous law until 2/15/2021

- **Which transfers are excluded?**
 - Transfers of primary residences (no limit on value)
 - Transfers of the first \$1 million (assessed value not market value) of real property other than the primary residence (applies separately to each eligible transferor)
 - Transfers may result in a sale, gift or inheritance
- **What value of the transferred property is counted?**
 - The Proposition 13 value (factored base year value) just prior to the date of transfer)
- **Eligible children/grandchildren**
 - Child born of parents, stepchild, son or daughter in law, adopted child; any child of parents who qualify as children of grandparents

Prop 13: Previous law until 2/15/2021

- My parents bought a house in Fremont, CA for \$100,000 in 1980.
- They are assessed \$100,000 and pay about \$1,250 in property taxes in 1980.
- The property is now worth \$1,000,000 in 2023
- Current Assessed value of \$200,000
- Parents transfer the house to me (gift, sale, or inheritance)
- If child timely files a Claim for Reassessment Exclusion Between Parent and Child, assessed value remains at \$200K (must be filed within 3 years)
- If done properly, property taxes stay at about \$2,500 per year... and increase about \$50 per year. Otherwise the property is re-assessed and property taxes become about \$12,500 per year.

Proposition 19 has two main components:

1. Base Value Transfers (for people 55 years old and older, Fire Victims)
2. Parent/Child Exclusion for primary homes and investment properties

In order to understand Proposition 19, we must understand Proposition 13 which was passed by California voters in 1978

Parent/Child Transfers

So how do Proposition 13 taxes work now when a parent dies and leaves property to a child...?

Proposition 19

The Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfire or Natural Disasters Act of 2020

- Effective February 16, 2021, Changes the Parent to Child(ren) and Grandparent to Grandchild(ren) Exclusions
- Principal residence of the parent/grandparent must remain principal resident of the child(ren)/ grandchild(ren) and capped at \$1 million plus assessed value
- Must file for homeowner's exemption within 1 year
- Transfer of other property is no longer available after February 15, 2021 (rental, commercial properties, vacation homes, etc.)

After February 15, 2021

Parent to Child/Grandchild Transfers *eliminated* for the following:

This means that your residential rentals will be *reassessed at transfer to your children (death, gift or sale)*

This means that your commercial rentals will be *reassessed at transfer to your children (death, gift or sale)*

This means your industrial rentals will be *reassessed at transfer to your children (death, gift or sale)*

This means that your family vacation home or cabin will be *reassessed at transfer to your children (death, gift or sale)*

Primary Home exception:

Parent to Child/Grandchild Transfers exclusion-

Parent to child transfer of the parent's primary home **but** child must occupy property as his/her primary home... no reassessment on the assessed value plus \$1M in market value, but reassessment over assessed value + \$1M

WHAT WE KNOW ABOUT PARENT TO CHILD EXCLUSION

Example 1:

My parents buy a house in Fremont, CA for \$100,000 in 1980.
The property is now worth \$1,000,000 in 2023.

But the property is assessed at about \$200,000 (\$100,000 plus 2% a year for 40 years compounded) – property taxes are about \$2,500 **per year through 2023** for my parents.

If the sum of the assessed value (base value) plus \$1M is greater than the market value, then I get to keep the current assessed value.

My parents give me the house, I get to keep the \$200,000 assessed value and the low property taxes.

WHAT WE KNOW ABOUT PARENT TO CHILD EXCLUSION

Example 2:

My parents buy a house in Fremont, CA for \$100,000 in 1980.

The property is now worth \$2,000,000 in 2023.

But the property is currently assessed at about \$200,000 (\$100,000 plus 2% a year for 40 years compounded) – property taxes are about \$2,500 **per year through 2023** for my parents.

My parents give me the house, my new property taxes are assessed at \$1,000,000 rather than the full market value of \$2,000,000 but it's more than the \$200,000 that my parents were paying on.

Why? Calculation on next slide.

EXAMPLE 2 (cont'd)

\$200,000 current assessed value (base value)

- \$200,000 assessed value from previous slide
- Assessed value (\$200k) plus \$1M is not reassessed. But \$200k remains plus the value over \$1.2M
- Value over \$1.2M is \$800k.
- \$800k plus original assessed value of \$200k equals new assessed value of \$1M

- New property tax amount is about \$12,500
- Higher than my parent's amount of \$2,500 but lower than market value assessment of \$25,000

- Transferee must reside in principal residence within one year of transfer.

- Effective February 16, 2021 no parent to child exclusion for properties other than principal residence.

WHAT WE KNOW ABOUT PARENT TO CHILD EXCLUSION

Example 2:	<u>Property taxes each year:</u>
Parent's keep the house:	\$2500
Parent's transfer the house to me before 2/15/21:	\$2500
Parent's transfer to me the house after 2/15/21:	\$12500
Parent's used the house as a rental property and transfer after 2/15/21:	\$25000

Items of Concern

(Speak to an Attorney about legal issues, speak with a CPA/accountant/Tax Attorney about tax issues)-

Transferring property:

Loss of control, subject to child's divorce, law suits and bankruptcy, loss of rental income and your child may die before you do (we don't know if child can transfer to parents anymore)

Your basis carries over to the child (capital gains tax), "Basis" is purchase price, plus improvements, minus depreciation

Sale Price – Basis = Taxable Gain

At death, property generally gets an "adjusted basis" to fair market value at date of death

Items of Concern

Transferring property:

If your kids are going to keep one or more properties as a rental, vacation home or primary home, then your plans may be different than if your kids are going to sell your real estate after you pass away. Property tax savings versus capital gains.

Prop 19 may or may not affect you and your family depending on the situation.

SEEK ADVICE FROM AN EXPERT (Speak to an Attorney about legal issues, speak with a CPA/accountant/Tax Attorney about tax issues)-

Proposition 19 has two main components:

~~1. Parent/Child Exclusion for primary homes and investment properties~~

2. Base Value Transfers (for people 55 years old and older, Disabled Individuals, Fire Victims) --- referred to as Prop 60/90

We will discuss the base value transfer under Prop 13 next

WHAT WE KNOW ABOUT BASE YEAR TRANSFER PRINCIPAL RESIDENCE ONLY

- Base year transfer expands from some counties to all counties
- Replacement property can cost more than sale price of original
- Base year transfer can be taken 3 times
- If replacement costs more than original sold for, difference between those values is added to base year of original for transfer purposes.
- Examples on the next slides.

Downsizing (in price not square footage)

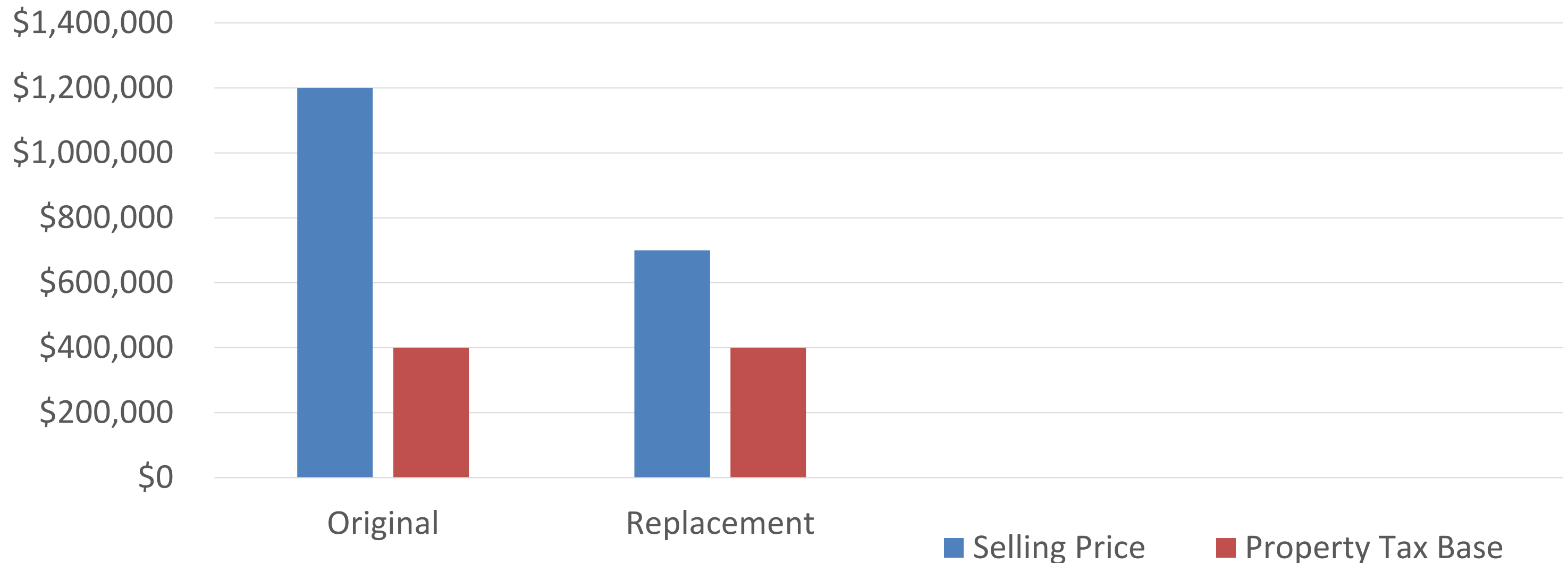
Spouses buy a home in Union City in 1980 for \$200,000. The assessed value is about \$400,000. The property taxes are about \$5,000 a year.

Today the house is worth \$1.2M (market value)

Spouses sell the Union City (or anywhere in CA) home and buy a home in Livermore to be closer to their daughter for \$700,000

Their new home in Newark maintain their \$400,000 assessment and they continue to pay just \$5,000 per year in property tax

GRAPH OF EXAMPLE



Example: original home sells for \$1,200,000. Replacement home costs \$700,000. Assessed Value of original is \$400,000. Transferred base year will be \$400,000 saving \$3,750 in property taxes a year.

Upsizing (in price not square footage)

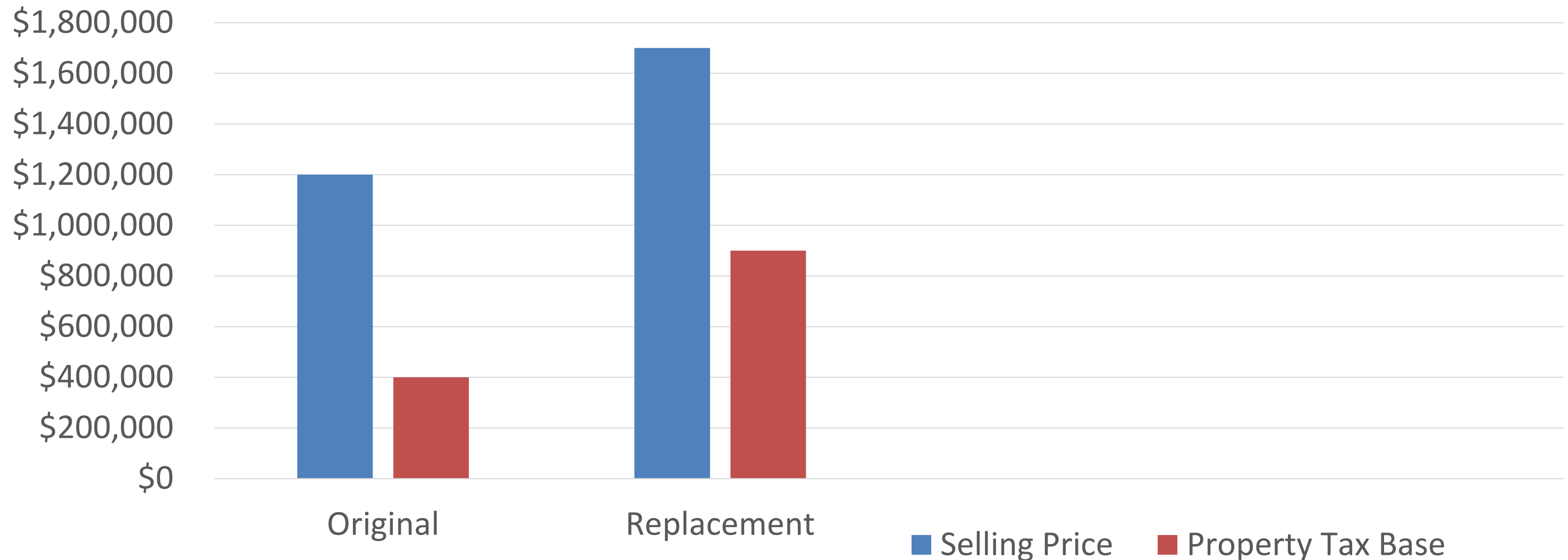
Spouses buy a home in Fremont in 1980 for \$200,000. The assessed value is about \$400,000. The property taxes are about \$5,000 a year.

Today the house is worth \$1.2M (market value)

After April 1, 2021, spouses sell the Fremont home and buy a home in San Diego to be closer to their daughter for \$1,700,000

Their new home on San Diego (or anywhere in CA) will have an assessed value of \$900,000 and they will pay about \$11,250 per year in property tax rather than \$21,250

GRAPH OF EXAMPLE



Example: original home sells for \$1,200,000. Replacement home costs \$1,700,000. (Assessed Value) Base year of original is \$400,000. Transferred base year will be \$400,000 plus \$500,000 (difference between \$1.7 and \$1.2M) or \$900,000 saving \$10,000 a year in property taxes

**Basics of Parent to Child Transfers
to Avoid Reassessment of Property
Taxes When Transferring Property
Held in Trust**

**When a Trust Holds Real Property and No (or
Limited) Other Assets
and
One of the Beneficiaries Wants
the Real Property as their
Share of the Distribution**

**The Main Requirement for a Full Exclusion for
Reassessment is that the Trust be Distributed Evenly**

Equalizing Distributions

- A trustee may equalize distribution to beneficiaries of the trust (when authorized to make a non-pro rata distribution) by encumbering the real property with a third party loan
- Third Party
- Beneficiary receiving the real property cannot obtain the loan or give their own cash to equalize the distributions
- Loan must be to the trustee



PHONG LA
ALAMEDA COUNTY ASSESSOR

1221 OAK STREET, ROOM 145
OAKLAND, CA 94612

Email:

AssessorWebResponse@acgov.org

Website:

acassessor.org/proposition-19/

Phone: (510) 272-3787