



2021 Trust & Estates Newsletter

Under existing federal tax law, the exclusion amounts for federal estate, gift and generation-skipping transfer taxes will be adjusted as of January 1, 2021.

Under a new California property tax law, significant changes in property tax reassessments will go into effect in February and April of 2021. This newsletter will address these updates and changes.

2021 Estate & Gift Tax Inflation Adjustments

Several important federal gift and estate tax exemptions are adjusted periodically to reflect the rate of inflation. The IRS has announced the following adjustments for 2021:

- **Basic Exclusion** – For 2021, the basic estate, gift and generation-skipping exclusion amount is \$11,700,000. The basic exclusion represents the amount that can be transferred, during lifetime or at death, free of estate tax, gift tax or generation-skipping transfer (GST) tax, as the case may be. This represents the base exclusion amount of \$10,000,000, plus an inflation adjustment.
- **Exclusion for Lifetime Gifts to Non-Citizen Spouse** – Lifetime gifts to a spouse who is a U.S. citizen are not subject to gift tax regardless of the amount. Lifetime gifts to a spouse who is not a U.S. citizen *are* subject to gift tax to the extent the gifts exceed the authorized exclusion in any year. For 2021, this exclusion is \$159,000.
- **Annual Gift Tax Exclusion** – The annual exclusion amount for gifts of present interests is unchanged at \$15,000.

The marginal estate, gift and GST tax rates remain at 40%.

It is important to note that on January 1, 2026, the basic exclusion amount will be reduced by half.

All estate planning eyes will be on the January 5th Georgia Senate run-off elections. If both Democrat Senate candidates win their elections in Georgia, the presidency and both houses of Congress will be controlled by the Democrats, making a federal tax law change in 2021 possible. As noted in our October 2020 Bulletin, there is much speculation that any 2021 tax legislation reducing the basic exclusion amount, increasing the marginal estate, gift and GST tax rate, and/or eliminating the income tax basis step-up in basis at death could be retroactive to January 1, 2021. This would create great uncertainty about the gift tax treatment of large gifts made after January 1st.

Proposition 19 – Changes to the Parent-Child Exclusion from Property Tax Reassessment

If you own real property in California, you know that your property taxes are based on an assessed value of the property (“tax base amount”) that is different from the market value (“market value”). Proposition 19, which passed by a narrow margin in November, makes significant changes to the rules that allow for a transfer of the tax base amount between parent and child, known as the “parent-child reassessment exclusion.” The new rules for this exclusion will be applied to transfers of real property occurring after February 15, 2021. Until then, the current rules apply. Currently, there are two separate types of exclusions from property tax reassessment for transfers of California real property between parent and child. The first exclusion allows for the transfer of a *principal residence* of any market value between parent and child without property tax reassessment. The second exclusion allows for the transfer of \$1 million of tax base amount (not market value) in *other property*, such as a vacation property or commercial property, between parent and child without property tax reassessment.

Proposition 19 eviscerates the benefits of the exclusions described above for property transfers made after February 15, 2021. First, under the new rules, the \$1 million exclusion for a non-principal residence is eliminated entirely. The parent-child exclusion will now only apply to the transfer of a principal residence (that is, the parent’s primary personal residence). Second, the child receiving the residence must use it as her own principal residence following the transfer. If these requirements are met, and if the market value of the residence at the time of the transfer is not more than \$1 million in excess of the tax base amount, the residence will not be reassessed for property tax purposes. If the “personal residence” requirements are met, and the market value of the

residence at the time of the transfer exceeds the tax base amount of the residence by more than \$1 million, then the residence will be partially reassessed based on the excess amount (but not up to full market value).

Here are some examples of how the new rules will be applied, assuming the property is the parent's primary residence and the child makes the property her primary residence following the transfer:

Example #1

- Tax base amount = \$500,000
- Market value of property at time of transfer = \$1.3 million
- Market value minus tax base amount = \$800,000
- Because the difference between tax base amount and market value of the property does not exceed \$1 million, there is no reassessment upon transfer; tax base amount remains at \$500,000

Example #2

- Tax base amount = \$500,000
- Market value of property at time of transfer = \$3 million
- Market value minus tax base amount = \$2.5 million
- Because the difference between tax base amount and market value of the property exceeds \$1 million, there is a partial reassessment upon transfer; tax base amount increases to \$2 million [(\$2.5 million - \$1 million) + \$500,000]

In light of these changes, you may wish to consider making a transfer of your California real property to your child or children before February 16, 2021, to take advantage of the existing rules before they change. In particular, (1) parents who own a vacation home that will remain in the family for many generations, (2) parents with property that has low tax base value relative to market value and where the children wish to retain the property for the long term; and (3) parents who currently hold their residence in a qualified personal residence trust (QPRT) should contact us to discuss planning options as soon as possible.

Note – There is a separate property tax exclusion for transfers between grandparents and grandchildren, with the added requirement that the grandchild's parents must be deceased in order for the exclusion to apply. The changes to the parent-child exclusion discussed above similarly affect the grandparent-grandchild exclusion.

Proposition 19 – Reassessment Exclusions for Persons Age 55 and Older, Disabled Persons and Wildfire Victims

Proposition 19 also makes significant changes to the property tax rules for older California homeowners who wish to transfer the property tax assessed value (“base tax amount”) of their home to a newly purchased home. These rules take effect on April 1, 2021. Until then, the current rules govern. Under the current rules, homeowners age 55 and older have a one-time opportunity to transfer their existing base tax amount to a replacement home but only if (1) the fair market value of the replacement home is of equal or lesser value to the original home, (2) the replacement home is within the same county as the original home or is in one of ten counties in California which honors reciprocity, and (3) the replacement home is purchased or built within two years of the sale of the original home. Unless all these requirements are met, the homeowner may not transfer his or her tax base amount to the new home and property taxes on the new home will be based on the purchase price.

Under Proposition 19, a qualifying homeowner may still transfer his or her tax base amount to a replacement property of lesser value. If the replacement property has a higher market value than the original home, Proposition 19 allows a blending of the tax base amount of the original home with the purchase price of the replacement home (see example below). Under Proposition 19, the replacement home may be in any county in California so long as it is purchased or built within two years of the sale of the original home. A qualifying homeowner is a person age 55 or older, a person who is severely disabled, and a victim of wildfire and/or other natural disaster. A qualifying homeowner may apply the new transfer rules up to three separate times.

Here is an example of how the blended calculation is applied:

- Original home’s tax base amount = \$100,000
- Original home’s sale price = \$500,000
- Replacement home’s purchase price = \$800,000
- Tax base amount of replacement home under blended calculation = \$400,000 $[(\$800,000 - \$500,000) + \$100,000 = \$400,000]$

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