Issue: Vol. 43 / No. 52 / 26 December 2013

The Bay Area Reporter
Serving the gay, lesbian, bisexual and transgender communities since 1971

More fallout from tax rule change

Guest Opinion

by Alma Soongi Beck

Published 12/12/2013

Last July, in the wake of the U.S. Supreme Court marriage decisions, the *Bay Area Reporter* published an op-ed that I wrote regarding two crucial changes in property tax rules that took effect in 2013. These rules especially impact co-owners of property who are neither married nor California state registered domestic partners (SRDPs).

That piece was an attempt to bring the issue of property tax reassessment back to the forefront for those couples who choose not to marry or become SRDPs. Prior to 2003, same-sex couples – regardless of marriage or domestic partnership status – had almost no way to avoid an expensive property tax reassessment upon the death of a co-owner. Then, for the first time in California history, an exemption from reassessment was permitted to some same-sex and unmarried couples under a 2003 expansion of property tax rule 462.040 (discussed below). This change occurred before SRDP status became equivalent to marriage, which later came in 2005. Soon thereafter, in 2006 and 2008, the state began permitting exemptions from reassessment to SRDPs (under Senate Bill 565) and then to same-sex married couples (based on the California Supreme Court marriage cases).

For those couples who remain unmarried and non-SRDPs, the 2003 change still applied, at least until October 2013. The expansion of Rule 462.040 consisted of two parts: (A) transfers by co-owners from tenancy in common (TIC) to joint tenancy; and (B) transfer by co-owners from joint tenancy into trust (e.g. revocable trust) that names the other co-owner(s) to inherit at death.

However, earlier this year, two changes occurred that completely changed the game. First, a new rule, the cotenancy rule, took effect January 2013, expanding reassessment exemptions to owners who meet certain criteria. The new rule requires (a) two owners, (b) who, together, own a 100 percent interest, (c) who lived in the property as a primary residence for at least a year, (d) where the property interest passes upon death of an owner completely to the other owner (e.g., by right of survivorship or via will or trust).

Secondly, repeal of Part B of the expanded Rule 462.040, which omitted from exemption transfers from joint tenancy into trust that occur October 1, 2013 or later.

So first, the good news. The cotenancy exemption now protects many unmarried, non-SRDP couples who were not previously protected. It is also straightforward, avoiding the need for the convoluted legal analysis and attorney intervention that Rule 462.040 often requires. Lastly, the new exemption logically and intuitively protects the most important property owned by couples – their primary residence.

Now the bad news. On October 1, 2013, Part B of the expanded version of Rule 462.040 was repealed, leaving some gaps that even the cotenancy exemption does not fill. Specifically, the cotenancy exemption does not cover couples who:

– Own real property that is not a primary residence for one or both;

– Own with other people, even if it is their primary residence (e.g., TIC ownership of one unit in multi-unit buildings);

– Have owned real property for less than one year, such as where one person may be terminal and possibly dying before the one-year mark;

– May have previously relied on Part B of Rule 462.040 (transfers from Joint Tenancy to Trust), where the property was removed from Trust (e.g., during a refinance), but may not have put it back.

Even worse, the repeal of Part B of Rule 462.040 has created some unexpected and counterintuitive problems for unmarried, non-SRDP couples who own real property.

For this reason, co-owners of real property who are unmarried and non-SRDPs, may want to consider taking immediate action. Some ideas include the following:

(1) Check with an attorney about whether you're covered by any of the current exemptions, and if not, consider marriage or SRDP registration.

Marriage and SRDP registration can be excellent options for couples, but not always. If you are considering this option, consider first consulting with your estate planning attorney, tax preparer, and financial planner to help you understand the implications.

(2) If you do not marry or register as SRDPs, and have previously done a transfer prior to October 1, 2013 from joint tenancy into a trust (where the trusts each name the other owner as beneficiary upon death), you can still qualify for Part B of Rule 462.040, but only if you never take their property out of trust, even for refinance purposes.

The repeal of Part B of the expanded Rule 462.040 does not affect pre-October 1, 2013 transfers. It only affects future transfers from joint tenancy to revocable trust. This means that if you can still rely on the Part B exemption if the transfer occurred prior to October 1, but only if the property is never removed from the Trusts.

To avoid problems, be particularly careful:

During estate planning, if you set up new trusts instead of amending and repealing current trusts;

During refinance, if anyone tells you that you can "just take the property out of the trust and put it back."

(3) If you have previously transferred from a TIC to joint tenancy, thus qualifying for Part A of the expanded Rule 462.040, a subsequent transfer from joint tenancy into trust will now disqualify you from property tax protection, if it occurred October 1, 2013 or later.

The problem with this last point: it is counterintuitive. The exact thing that used to bring more protection before October 1, 2013, is now the exact thing that eliminates the same protections now for co-owners who are not married or SRDPs.

This situation most commonly arises when a couple sets up revocable living trusts, and are then advised to transfer all real property into the trust(s). In fact, making the transfer could make sense for other reasons – e.g., avoiding double counting for estate tax purposes, lack of control over who inherits after the second co-owner dies, probate risk upon the second death.

But now, this same routine advice can disqualify a couple from Part A of Rule 462.040, such as if the couple had relied on their transfer from TIC to joint tenancy for reassessment exemption. The potential increase can be massive, depending on how much the property has appreciated beyond its current assessed value.

As I previously emphasized, don't be caught unaware. Make sure you understand the rules affecting your property tax situation and seek competent legal counsel if you need help.

Alma Soongi Beck is an attorney in San Francisco. For more information, visit www.becklawgroup.com. This column is not intended as legal advice and people should consult with their attorney. To read the initial op-ed, see http://www.ebar.com/openforum/opforum.php?sec=guest_op&id=426.