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DEAR FRIENDS AND CLIENTS,

In response to our January 2009 Letter to Friends and Clients we received several questions related to California property taxes and retirement plans in light of the economic downturn and state and federal legislation recently adopted. The interest was so strong that we thought it worth sending a follow-up letter on these points. See the last page for **some important deadline dates** and further general comments on retirement plans. If you have not yet received your copy of our January 2009 Letter, you can view it on our website (www.taxlawsb.com) or call our office and we will send you a copy.

California Property Taxes in This Economic Climate

Many of the following topics are explained further on our website (www.taxlawsb.com/resources/PptyTax.htm), County Assessors' web sites (e.g., Santa Barbara County Assessor's website at www.sbcvvote.com), or the Board of Equalization website (www.boe.ca.gov).

Declining Market Values – Temporary Lower Assessment. Under Prop. 13, the assessed value of real property is never to be higher than its “full cash value” which is basically the current fair market value. Sometimes the Assessor will voluntarily reduce an assessment, but also at any time you believe that the market value of your property is lower than its assessed value you can request the Assessor to review the values under former Prop. 8 (“Prop. 8 adjustment”). (Property owners may also get mailings from businesses offering to lower your assessment for a fee, but they only file the same form with the County that you can file yourself for free.) The Santa Barbara County Assessor is requesting that owners complete their Request for Informal Assessment Review form and file it **by March 15, 2009**. (This deadline appears to be only requested, not mandatory.) This Prop. 8 adjustment may also be obtained through the appeals process, and in Santa Barbara County an appeal may only be filed between July 2 and November 30, 2009. **Now this Prop. 8 adjustment is only temporary**; it does not change your base year value and does not limit future increases to only 2% per year. Being a temporary reduction due to market fluctuations, the future assessments will increase with the market until they come back to the factored base year level and only thereafter will they once again be limited to the Prop. 13 2% per year increase.

Declining Market Values – Making the Temporary Lower Assessment Permanent. No one, of course, knows exactly how far real property values will fall in this recession or when the bottom will hit. Santa Barbara North County has already seen a much more dramatic decrease than the South County. In a situation where the market value of property is significantly lower than its Prop. 13 assessed value, and if a person could gauge the timing of the lowest point in the recession, then it would obviously be more desirable to have a lowered assessed value made permanent by establishing a new base year value at the low point so that future assessment increases would not follow the market but instead be limited to only 2% per year. This can be done, but only by some sort of a transfer which constitutes a change in ownership triggering a

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reassessment of the property. It would also be wise to get a Prop. 8 adjustment from the County (or if one has successfully appealed the valuation) so that the County has already agreed on what the new assessed value will be before triggering a permanent reassessment.

Example: If you transfer 25% of the property to your child as a gift, and do not file a parent/ child exclusion claim with the Assessor, then that 25% will be reassessed and (if the market value is lower than the assessed value) it will set a new base year value for the 25% interest lower than its current assessment. Note, however, in this example that your child becomes a tenant in common owning 25% of the property, and you will also have to comply with the federal gift and estate tax laws for this transfer.

To trigger reassessment, therefore, it must be a real transfer and you must accept all the related consequences of a change in ownership, i.e., new owner, gift taxes, capital gain or other income tax. So in principle, the strategy is to maximize the percentage of reassessment while minimizing the percentage of ownership shifted to another and its attending other tax consequences. We have developed strategies utilizing new or existing legal entities which can obtain 100% reassessment of the property with only minimal ownership transferred to someone else with minimal or no other estate, gift, capital gain or income tax consequences.

Removing the “Cumulative Count Rule” for Real Property Owned by a Legal Entity. Clients with family limited partnerships, LLCs or corporations who own real property, may have an almost inevitable reassessment in the future (particularly on the death of an owner) which may, however, be avoided by deliberately triggering a reassessment ahead of time. (We say “almost” because there are additional strategies, depending on the situation, which can be taken to avoid the reassessment.)

To explain: when owners of real property form a legal entity (such as a family limited partnership) and then contribute (after March 1, 1975) the real property to the entity as a capital contribution in exact proportionate interests as to each and every piece of real property so that the property is not reassessed at the time of contribution, then future reassessment of that property will occur based on the interests in the partnership which transfer from the original partners to new partners. All transfers of partnership interests over time are cumulatively added together and when cumulatively they reach more than 50%, then 100% of the real property is reassessed. (We call this the “cumulative count rule” of Revenue & Tax Code section 64(d), where there are “original coowners.”) When this rule applies, it means that it is inevitable that the real property owned by the entity will be reassessed at some point in the future (unless some additional steps to postpone or avoid the reassessment are taken, if possible).

On the other hand, if the application of this cumulative count rule were removed, then future reassessment is no longer inevitable – it would only occur when one person gains a more-than 50% controlling interest in the entity per Revenue & Tax Code section 64(c), and usually that can be avoided indefinitely. In a time of recession, triggering a reassessment (as suggested in the preceding topic) may lower the property taxes, **but even if there might be little or no tax savings from a reassessment, it would still be worth it to trigger a reassessment as that will remove this cumulative count rule from applying to the real property in the future** provided there would not be a significant tax increase. In other words, the almost inevitable future reassessment under the cumulative count rule goes away once there is a reassessment.

Other Ways to Lower Assessment. Analysis of the particular facts of a particular situation may present opportunities to lower the property taxes. Some examples:

- Where a partnership owned real property and we were asked to see if a new reassessment due to an owner’s death could be reversed, we discovered a missed reassessment from 15 years prior where, fortunately, the market value was lower than the assessed value at the time, and so were able to lower

the base year value retroactively to 15 years prior which resulted in reversing the current reassessment, lowering the property taxes even further than what they had been before the reassessment, and obtaining a refund for several prior years.

- In a different partnership situation where a prior reassessment was missed but which resulted in retroactive higher taxes which could not be avoided, we were able to argue that tax collection (escape assessment) was limited to only four years (rather than all years of the retroactive period), and then to also trigger a new reassessment when market values were lower in order to reduce the taxes from the prior reassessment.
- In another situation where a partnership and long-term lease (more than 35 years, including options) were involved, we obtained a reversal of two reassessments reaching back about 18 years (one of which had been previously unsuccessfully appealed), restoring a 1975 base year value which slashed current taxes to a fraction of what was being paid, and obtaining a refund of excess taxes paid for several prior years.
- Frequently we will do statutory conversions of entities, instead of transfers among entities, not so much to save a present reassessment (which can usually be avoided anyway), but to avoid the “cumulative count rule” mentioned above and save a future reassessment.
- We have also planned transfers of partnership interests where a long-term commercial lease was involved, so that both the partnership who was the landlord and the partnership who was the tenant could each transfer significant partnership interests timed correctly so that the real property was never reassessed.
- Similarly, we have advised tenants of long-term leases on when and how to purchase the property from the landlord so as to avoid reassessment at the time of purchase.
- We have also worked with several trust situations designing interests for beneficiaries which would or would not trigger reassessment, or sometimes overturning reassessments because of specific trust terms limiting beneficial interests which were not understood by the County.
- Any time California real property is involved, the property tax planning should be integrated with the rest of the planning. For example, we did one strategic tax plan for a foreign citizen owning California real property which integrated planning to avoid reassessment both during life and upon a future death with the planning for minimization of estate, gift and income taxes, both domestic and foreign.

Checklist of California Property Tax Exemptions and Exclusions

We are amazed at the number of people who do not even have a homeowners’ exemption on file for their principal residences, so we put together a checklist of different kinds of exemptions and exclusions for you to review to see if anything might help you reduce your property taxes. Further information and forms to file for all the following are on County Assessors’ web sites (e.g., Santa Barbara County Assessor’s website at www.sbcvot.com) or the Board of Equalization website (www.boe.ca.gov).

Disaster. Santa Barbara County provides property tax relief for property which has suffered major disasters such as the Tea Fire, or individual misfortunes which are not the fault of the property owner. The relief is in the form of a reassessment of the property in its damaged condition (lowering taxes while damaged), and then if the structure is re-built in a similar condition to the original, it will retain the previous assessed value prior to the disaster instead of getting a “new construction” assessment which is typically much higher. A written application is to be filed with the County within 12 months of the date of the disaster. Alternately, the base year value may be transferred to a comparable property within the county (or a handful of counties will allow inter-county transfers) within five years of the disaster. (Also keep in mind the income tax disaster loss treatment which permits a taxpayer to claim the loss either in the year it occurred or in the year preceding the loss by amending the prior income tax return.)

Replacement Property. There are three situations where it is possible for a lower base year value (i.e., the low Prop. 13 assessed value) to be transferred from a property you no longer own to a newly acquired property (either purchased or constructed) and avoid the otherwise higher property taxes that might be incurred with the new property. Disaster is mentioned above. It can also apply to eminent domain proceedings (when the government takes your property). But the replacement property benefit used most often is available to persons age 55 and older, or blind or disabled (a “Prop. 60” transfer). The general purpose of the Prop. 60 benefit is to allow seniors and the disabled to keep their current lower assessment if they move into another residence of generally **equal or lesser value**, the idea being that once the children have grown, the parents should not be penalized when they want to move into a smaller home for retirement. The replacement property must be purchased within two years of sale of the original residence, and generally it must be located in the same county although a handful of counties allows transfers between counties. This Prop. 60 benefit can only be used once in a person’s lifetime, and a claim form must be filed with the Assessor. However, there is a negative side to this Prop. 60 benefit: if your old property is sold or given to a child, parent, or grandchild, the parent/child and grandparent/grandchild exclusion may not be used at the same time the Prop. 60 exclusion is used, so you must choose between the two exclusions and cannot use both for the same property (although multiple-family properties are handled differently).

Other Exemptions and Exclusions. Various exemptions to reduce the value of the total assessment, or exclusions from assessment, are available for specific situations. Typically claim forms must be filed and other requirements met (see the web sites mentioned on page 1).

- **Homeowner’s.** The homeowner’s exemption applies to a principal residence.
- **Veteran’s.** The veteran’s exemption applies to veterans, their unmarried surviving spouses and pensioned parents of a deceased veteran.
- **Disabled Veteran’s.** A separate, larger exemption for disabled veterans or the unmarried surviving spouses of deceased veterans is also available.
- **Welfare.** Property used exclusively for church, college, cemetery, museum, school or library may qualify for an exemption; and properties owned by and used exclusively by non-profit religious, charitable, scientific or hospital corporations may also qualify for an exemption. The claim for this exemption must be filed annually. Where property is newly purchased or newly constructed, effective January 1, 2009, IRC section 501(c)(3) organizations (public charities) have 180 days to file a claim for exemption; all other organizations have 90 days.
- **Parent/Child.** Transfers of certain real properties (residence plus \$1 million in assessed value of property other than residence) between (both to and from) parents and children, or from grandparents to grandchildren where the parents are deceased, may be excluded (the parent/child and grandparent/grandchild exclusions). Step-children, in-laws, children adopted as minors, and certain foster children all may be eligible.
- **Builder.** A builder of new construction for sale may, by notifying the Assessor prior to or within 30 days of construction, obtain a builder’s exclusion wherein the supplemental assessment on the new construction will not be created until the property is sold to the new owner (thus avoiding the increased property taxes to the builder).
- **Disabled.** The value of modifications to a home to make it more accessible for a severely disabled person may be excluded. This exclusion could apply to portions of construction of a new residence, but does not apply to any portion of the purchase of a property already designed for access by the disabled.
- **Seismic.** The value of certain construction to improve seismic safety may be excluded. New construction to existing unreinforced masonry structures currently has an exclusion limited to 15 years, but other qualified construction improvements for seismic safety have no limit. The Secretary of State has certified a proposition for the June 8, 2010, primary election ballot to remove the 15-year limit for unreinforced masonry structures so that all such construction is treated the same.

- **Solar.** The value of construction of active solar energy systems for energy use (but excluding swimming pool or hot tub heaters). Effective September 28, 2008, this exclusion was extended and also expanded to include an exclusion applicable to purchases of properties improved with solar energy systems. The exclusion is set to be repealed January 1, 2017.
- **Fire Detection.** The value of construction of fire sprinklers or other fire detection or extinguishing systems may be excluded.
- **Underground Tanks.** The improvement or replacement of underground tanks to comply with regulations may be excluded.
- **Contamination.** On qualified contaminated real property where the environmental remediation requires substantial destruction or damage to a structure, the repair or replacement of the structure may be excluded.
- **Maintenance.** New construction on an existing property but which adds value to the property does not trigger reassessment of the existing structure, but will add to the assessment the increase value to the property added by the new construction. Construction that is considered normal maintenance and repair and does not add new value to the property is not assessable new construction. Such maintenance and repair would include replacement of a roof, heating and cooling systems, replacing kitchen or bathroom fixtures or cabinets with similar items, fixing dry rot or termite damage, replacing wall or floor coverings, replacing or repairing doors, windows, stairs, fences or decks. Remodeling may be reassessable if new square footage is added or if significant value is added to the property after the remodel. If, however, the space remodeled is substantially similar before and after, it would not trigger an assessment for new construction.
- **Historical, Agricultural.** Other reductions in assessed value may be obtained for designated historical buildings through the Mills Act, or for agricultural properties through the Williamson Act or other land conservation programs. Effective January 1, 2009, Williamson Act contracts may include plant products used for producing biofuels, not just commercial crops.

Property Tax Assistance for Seniors and Disabled Terminated

Property Tax Assistance Program Discontinued. The Franchise Tax Board had administered programs for qualified persons age 62 and older, or blind or disabled, to assist with property tax payments for low-income homeowners or renters (as a refund of part of rent attributable to property taxes). However, the State 2008 fiscal year budget adopted in October did not include funding for this program so it ended as of December 31, 2007, and 2008 claims are not being processed.

Property Tax Postponement Discontinued. The State Controller had a program for eligible senior citizens age 62 and older, or blind or disabled persons, where household income did not exceed \$24,000 annually, to postpone payment of all or part of their property taxes. However, this program was also nixed in the recent budget legislation signed by the Governor on February 20, 2009, and the State will no longer accept any claims as of February 20th.

Non-Payment. Unfortunately, not paying the property taxes is not a good solution in hard times. Each installment not paid on December 10th or April 10th automatically adds a 10% delinquent penalty. If taxes remain unpaid as of June 30th, the property becomes tax defaulted and additional penalties accrue at 1.5% per month. Additional fees also apply. After five years following tax default, the County Treasurer-Tax Collector has the power to sell the property. However, Santa Barbara County does offer an installment payment plan for taxpayers unable to pay the full redemption amount after a default in their property taxes. The installment plan must be set up before the five years expire, but will then remove the property from the possibility of sale as long as payments are kept current.

More on Retirement Plans

2009 Required Minimum Distributions. In our January 2009 Letter, on page 7, we notified you that new law suspends for 2009 the requirements that certain plans make no required minimum distribution (“RMD”). A RMD is the amount that an individual must take from his or her qualified retirement account on an annual basis over the course of his or her life expectancy after retirement, and failure to take the RMD can result in a 50% excise tax. The exception for 2009 came from federal legislation H.R. 7327, called the “Worker, Retiree and Employer Recovery Act of 2008 ” (the “Act”). These provisions affect individual retirement plans (IRAs) and employer-provided qualified retirement plans that are defined contribution plans (e.g., 401(k), 403(b) and certain 457(b) plans). The Act does not require plans to eliminate the RMD requirement for 2009 *per se*, but the plan can be amended (generally before the last day of the first plan year beginning on or after January 1, 2011) to eliminate the RMD requirement for 2009. Of course, if a person wanted the 2009 distribution, it may still be taken.

The Act makes no change to the 2008 required minimum distributions rules, so if you must take a RMD for the 2008 calendar year (e.g., if a person is already or turns age 70½ in 2008), that 2008 RMD still must be taken. As you may know, if you turn age 70½ in 2008 and begin your distributions, **the deadline for taking that first distribution is April 1, 2009** (not April 15th, the tax return filing date).

What if a person turns age 70½ in 2009? Under prior law, the first distribution (for 2009) would have to be taken no later than April 1, 2010. Under the new law, while the 2009 distribution which normally would begin the distributions is not required, the 2010 distribution must be taken by December 31, 2010 (as a second year distribution, inasmuch as the retirement date of 2009 remains although no requirement for a 2009 distribution).

What about the five-year distribution period for an inherited IRA? Under the new legislation, the five-year period will be calculated without regard to calendar year 2009, e.g., for a person who died in 2007, the five-year period would end in 2013 instead of 2012.

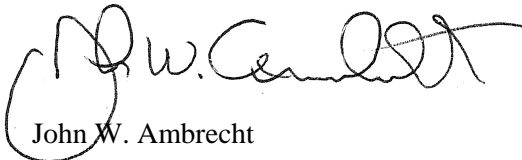
Another important retirement plan development in the Act is that commencing after 2009, employer plans will have to offer non-spouse beneficiaries rollover options, which will give greater flexibility to non-spouse beneficiaries who inherit retirement plan accounts.

This letter is for informational purposes and should not be treated as legal advice. The scope and technicalities of both the items discussed and all the new legislation are extensive. You will need to discuss your particular situation with your own professional advisor for specific legal advice.

Sincerely,

AMBRECHT & ASSOCIATES

By:


John W. Ambrecht