CHAPTER 6D

OVERVIEW OF SPECIAL STATE TAX PROVISIONS FOR HOMEOWNERS

HIGHLIGHTS

- Sales of a Principal Residence
- Deductibility of Home Mortgage Interest
- Homeowners' Exemption
- Property Tax Reappraisal Relief

1. OVERVIEW

California tax law contains a number of provisions for tax relief to homeowners. Tax relief is available for both property and personal income taxes, under certain circumstances.

2. PERSONAL INCOME TAX BENEFITS

Sale of a Principal Residence. Prior to mid-1997, the gain from the sale of a taxpayer's principal residence was taxable as capital gains income. However, an owner was permitted to defer the tax on the sale of his/her principal residence if he or she purchased a new house of equal or greater value. The new house had to have been purchased within the period beginning two years before and ending two years after the sale of the original residence. Furthermore, taxpayers that were at least 55 years old prior to the date of the sale of the principal residence were allowed a one-time exclusion of up to $125,000 of the gain from the sale from taxation. For married taxpayers filing separate returns, the maximum exclusion was $62,500 on each separate return.

The tax treatment of principal residence sales was changed significantly at the federal level in 1997. California conformed to the change in federal law effective January 1, 1998. Under current state and federal law, single taxpayers may exclude up to $250,000 and married taxpayers filing jointly may exclude up to $500,000 of gain they realize on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling a principal residence meets certain eligibility requirements, but generally no more frequently than once every two years. To be eligible for the exclusion, the taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange.

Deductibility of Home Mortgage Interest. Under both state and federal tax law, individuals may deduct the interest on a home loan for their principal or secondary residence, subject to certain limitations. Interest is deductible on loans of up to $1 million used to purchase a home and on home equity loans of up to $100,000. However, the home equity loan may not exceed the difference between the fair market value of the home less the debt incurred to acquire the loan.

3. PROPERTY TAX BENEFITS

Homeowners' Exemption. Under the California Constitution, homeowners are eligible for a partial property tax exemption for their principal residence. The first $7,000 of the full value of the property is not taxed. So, if a principal residence has a base year value of $150,000, the amount on which property tax is assessed is $143,000. If the property tax rate is 1%, then the homeowners' exemption reduces the total tax from $1,500 to $1,430.

New owners must file with the county assessor by February 15 preceding the fiscal year for which the exemption is sought. If an eligible homeowner fails to file by February 15, he or she will receive 80% of the exemption, if a filing is made by December 10. (See Chapter 6E for more information on the homeowners' exemption.)

Property Tax Reappraisal Relief. Proposition 13 requires that property be reassessed at fair market value when there is a change of ownership or when it is newly constructed. Three significant exemptions from the change in ownership reassessment rule are:

- Intrafamily Transfers. Under Proposition 58 of 1986, transfers of property between spouses are not considered changes in ownership (this codified implementing law previously enacted by the Legislature). In addition, Proposition 58 provided that transfers of principal residences plus transfers of up to $1 million of other property between parents and children are not subject to change in ownership reassessment.

  Proposition 193 of 1996 provided that transfers between grandparents and grandchildren are not subject to reassessment if the parents of those grandchildren are deceased as of the day of the transfer.

- Replacement Residences of Senior Citizens. Under Proposition 60 of 1986 and Proposition 90 of 1988, senior citizens may transfer the adjusted base year value of the principal residence to a replacement principal residence, if the replacement is of equal or lesser value and located in the same county. The same relief is available for moves between counties if the county where the replacement home is located has adopted an ordinance permitting the valuation transfer. (See Chapter 6A)

- Replacement Residences of Severely and Permanently Disabled Persons. Under Proposition 110 of 1990, severely and permanently disabled persons, as defined, may transfer the adjusted base year value of the principal residence to a replacement principal residence. To qualify, the person must obtain a doctor's certificate as to the disability and must certify that the cause of the move is the disability itself or its financial consequences. The replacement residence must meet the same value tests established under Propositions 60 and 90.

Several exemptions from reappraisal due to new construction are also available. Among them are construction to improve seismic safety in an existing building, construction to modify an existing residence or other structure to improve accessibility for the disabled, construction on a residence severely damaged in certain types of disasters and for property acquired or reconstructed as a replacement for property destroyed as a result of environmental contamination cleanup activities may be excluded from fair market value reassessments.

4. CODES

Revenue and Taxation Code Sections 63, 63.1, 69.5, 70, 218, and Section 17152

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