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OCTOBER 2018 NEWSLETTER

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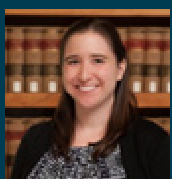
FIRM NEWS



On October 4, Katie Lepore, Esq., CPA will be speaking to the Reef Point Investor Club about some of the most common legal questions that arise in the context of real estate investment. The meeting takes place from 6:30 p.m. to 8:30 p.m. at Long Island Mike's Pizza, located at 5250 Murphy Canyon Road, San Diego, CA 92123. The Club welcomes all homeowners, sellers, investors, and real estate professionals to attend monthly meetings.

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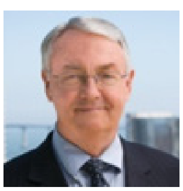


IRAs: CONSEQUENCES WHEN THERE IS NO DESIGNATED BENEFICIARY

by Bradford N. Dewan, J.D., MBA

One of the most important steps that an IRA owner must take is the filling out of the IRA Custodian's "beneficiary designation form." Unfortunately, an IRA owner may (1) fail to fill out a beneficiary designation form and submit it to (and have it accepted by) the IRA Custodian, (2) fail to update the beneficiary designation form if the named beneficiary (e.g. the spouse) has died, or (3) name his or her estate as the beneficiary.

In the above described scenarios, the typical result is that the estate of the IRA owner will be treated as the "beneficiary." Since an estate is not a "designated beneficiary" (i.e. an individual), then the ability to maximize the "stretch out" of the "required minimum distributions" (RMDs) after the death of the IRA owner has been lost. If an individual is the beneficiary of an inherited IRA, he or she may take RMDs over his or her life, often dubbed "stretching out the RMDs," as opposed to an estate being forced to take RMDs over the first five years after the IRA owner's death or over the remaining life expectancy of the IRA owner if he/she died after the "Required Beginning Date" discussed below. This is beneficial since the assets grow tax-deferred within the inherited IRA allowing the beneficiary to likely realize a significantly larger financial benefit over the life expectancy of the beneficiary (which expectancy is determined in the year after the year of death of the IRA owner).

However, some confusion often arises when the IRA owner has a pour-over Will that transfers all of the decedent's assets to a trust and the IRA owner's children, for example, are the beneficiaries of the trust. Sometimes the question arises as to whether seeking a probate court order (with consent of all beneficiaries) that directs that the trust be "skipped over" with the assets then to be distributed directly to the children might preserve the children's ability to stretch out and take the RMDs at least over the life expectancy of the oldest child.

Unfortunately, a post-death change of beneficiary allowed by the probate court will not provide tax benefits. Since the IRA was payable to the IRA owner's estate on death, whether by specific listing on the beneficiary designation form or by the "default beneficiary" under the IRA custodial agreement (i.e. the spouse was the only listed beneficiary but the spouse predeceased the IRA owner), there is no "designated beneficiary" since only individuals qualify as "designated beneficiaries" and only "designated beneficiaries" are able to do the "stretch out." This "beneficiary designation" cannot be changed or altered after the death of the IRA owner. The IRS has been clear that any attempt to change the beneficiaries that existed on the date of death of the IRA owner will be treated as "adding" beneficiaries which cannot be done after the death of the IRA owner.

In PLR 201021038 the children who were the beneficiaries of a trust that was named as the beneficiary of the IRA went to probate court to receive approval for revisions of the trust terms so that they could "stretch out" the RMDs using the life expectancy of the oldest child. The probate court approved the requested changes. But the IRS stated that any such changes to the terms of the trust constituted "adding" beneficiaries after the death of the IRA owner which was not permitted. Thus, in the probate court scenario described above, the IRS will likely not accept any probate court order that "skips" over the estate of the IRA owner and/or trust created by the IRA owner since this probate court order takes place after the death of the IRA owner. It is important to note that the Treasury Regulations make it clear that if the interests in the deceased owner's IRA pass to a certain individual under a Will or otherwise under applicable state law, this does not make that individual a "designated beneficiary" unless the individual was actually designated as a beneficiary on the IRA beneficiary designation form.

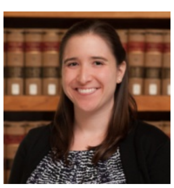
Consequently, the payouts from the inherited IRA will depend upon whether the IRA owner died before the "required beginning date" (RBD) (i.e. April 1st of the year after the year the IRA owner became 70 ½) or after the RBD. If the IRA owner died before the RBD, then the funds must be distributed within five years after the year of death of the IRA owner. If the IRA owner died after the RBD, then the RMDs must be paid out over the remaining life expectancy of the IRA owner. The life expectancy is determined under the Single Life Table using the decedent's age in year of death. Each year thereafter, the life expectancy is reduced by one. To clarify, in looking at the Single Life Table, one uses the decedent's age he/she would have obtained in the year of death (i.e. what would be his/her age if he/she lived until December 31st of the year of death).

The next issue is how the RMDs will be distributed, especially if the decedent died after the RBD. First, the funds in the decedent's IRA must be transferred into an "inherited IRA." The title to the inherited IRA must include the name of the decedent. Thus, the title to the inherited IRA would be "John Jones (deceased) FBO ______________." In the scenario described above where the estate of the deceased IRA owner is the beneficiary, the title might be "John Jones (deceased) FBO the Estate of John Jones". This form of title (i.e. listing the estate as the beneficiary) notifies the IRS that there will be no "stretch out" over the life expectancy of a "designated beneficiary."

When an owner of an IRA dies, it is advisable to contact the IRA custodian to let him or her know of the death and to confirm with the custodian if the "beneficiary" of the IRA is the IRA owner's estate. It can then be discussed with the custodian that the Will of the decedent directed that the assets of the decedent, including the IRA, be transferred to the decedent's trust. Consequently, with the custodian receiving a copy of the final court order the custodian might then agree to title the inherited IRA using the name of the trust, e.g. "John Jones (deceased) FBO the John Jones Trust utd ________," or "John Jones (deceased) FBO Charles Jones, Trustee of the John Jones Trust utd ________." In this way the Custodian will be agreeing as to who has the authority to withdraw funds from the inherited IRA to satisfy the RMDs or for other purposes permitted under the trust.

Finally, if the IRA owner had started taking RMDs, and in the year of death did not take the full RMD for that year, 2018 for example, then the "beneficiary" must take the balance of the RMD not taken by the IRA owner no later than December 31, 2018. There will be a 50% penalty imposed on the "beneficiary" for any RMD not taken in the year of death of the IRA owner.

In summary, by naming (and updating when necessary) "designated beneficiaries" (i.e. individuals such as family members of the IRA owner) on the beneficiary designation form filed with, and accepted by, the IRA custodian, the goal of obtaining the maximum "stretch out" of the RMDs from the inherited IRA will be achievable.



LESSONS TO R-E-S-P-E-C-T FROM ARETHA FRANKLIN: THE IMPORTANCE OF AN ESTATE PLAN

By Katie Lepore, CPA, J.D., LL.M., Taxation

Recently, with the recent death of Aretha Franklin, the importance of having an estate plan is once again brought to life for the general public to see the struggles of an intestate death. Prince also died without a Will, as did Howard Hughes. Without an estate plan, at death comes a long drawn out process in court called probate. Given most people dying intestate do not usually have the wealth of any of these great American icons, nor the public's desire to know the celebrity's net worth, having a proper estate plan still provides several benefits. As one can learn from the stories in the press, an estate plan provides one obvious benefit immediately: privacy.

Estate plans have several additional benefits such as reducing the risk of infighting among children, step-children, or grandchildren; creating peace of mind; significantly reducing the costs of administration after death; and allowing the decedent's wishes to be carried out per their own desires rather than a predetermined formula the state provides. Proper planning also can have major tax benefits as well, and can be particularly important for families with minor children.

Major Goals of Estate Planning

Some of the major goals of estate planning involve the creation of a definite plan for managing your wealth while you are alive and distributing it after your death. Three major estate planning obstacles to avoid are: (1) Probate, (2) Conservatorship, and (3) Taxes.

Probate

Probate is a court supervised process, which includes collecting and valuing your assets, paying your debts and taxes, and distributing your assets to your heirs. As part of this process, a notice of your death is published in a newspaper in order to allow your creditors to make claims against your estate. Probate proceedings are open to the public and anyone can review the court file and examine the details of your financial life. Probate is expensive, with fees and costs in the range of perhaps 2-10% of the value of your estate. Probate is also a lengthy process that normally takes a year to complete but can take several years for a complicated estate. During this process, your assets are often tied up, forcing your heirs to pay for costs of administration themselves until finances can be properly arranged.

Estates of decedents in California which have less than $150,000 in assets and no real property can avoid probate by virtue of having a "small estate" so long as there are no Will contests or creditors choosing to open a probate. In California, a $150,000 net worth accumulates very quickly, subjecting most intestate decedents to a full probate.

Courts require a public probate case, unless the decedent held his or her assets at death either in community property with right of survivorship, joint tenancy, pay-on-death accounts, or in a trust. Administering a probate is a lot of work and can be a huge burden and waste of time for the decedent's family, even for families without strife or disagreement.

The estates of decedents who die without a Will are distributed according to a pre-determined formula called "intestate succession" as determined by state law and the court. It will not matter if one child was closer to the decedent or is more financially sound; the distribution of assets will follow state rules without regard to family dynamics or the decedent's wishes.

Conservatorship

A conservatorship is a court supervised procedure by which an agent is appointed to manage your assets and/or personal affairs, including medical care, when you are not able to do so yourself. Your court-appointed agent is required to file annual accountings with the court. This procedure is expensive, time consuming, and makes your life a matter of public record (including the nature of your estate and your physical and/or mental condition).

Tax Considerations

Separate from the expense and delay of probate, an estate may also be liable for estate taxes. There are two types of death taxes: the federal estate tax and the state estate tax. California's estate tax, known as a "pick-up" tax, was equal to the state death tax credit given by the federal government. The state death tax credit has been phased out and there is currently no California estate tax. However, if the decedent owns assets in another state at the time of death, these may be subject to an estate tax in that other state upon death. The federal estate tax is currently levied at a hefty 40% on estates valued at over $11,180,000, if the decedent made no taxable gifts during life. State estate tax exemptions vary.

Aside from estate taxes at death, there are income tax considerations as well as gift tax and property tax considerations that come into play when formulating an estate plan.

Additional Benefits

A trust also allows one to identify which assets are to go to which person, and in what percentages. A trust also allows for specific bequests for those prized possessions that one wants to go to a person with a special connection to the item.

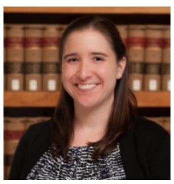
Additionally, a trust allows restrictions to be placed on a beneficiary receiving assets, such as young children or grandchildren inheriting large sums of money or wealth before they are financially independent and able to handle such assets. A trust can also provide for the care, support, and education of children or other young beneficiaries by providing management of the assets by the trustee. The assets can be distributed to the children at an age or ages chosen when drafting the trust. This also avoids the costs and burdens, and loss of privacy, associated with a court supervised guardianship for minor beneficiaries.

A continuing trust can also be helpful if a beneficiary is or becomes disabled and/or receives government benefits. Even insurance proceeds can be paid to the trust so your successor trustee can manage the proceeds for the benefit of disabled heirs.

Conclusion

With a living trust, upon death, trust assets pass directly to the beneficiaries named in the trust, according to the terms set forth in the trust instrument. There are no court costs associated with assets held in trust, and there are no court-ordered executor or attorney's fees. The trustee is, however, entitled to compensation for services rendered. Furthermore, there are generally fewer delays in distributing the assets following the payment of estate debts and expenses, and the terms of your estate plan remain private.

As the nation mourns the death of a great American icon Aretha Franklin, "You Better THINK" about what one can learn from her death about the importance of having an estate plan.



FEDERAL TAX NEWS

By Katie Lepore, CPA, J.D., LL.M., Taxation

Tax Reform 2.0. On September 10, 2018, the House Ways and Means Committee released three bills that comprise "Tax Reform 2.0." The three bills are H.R. 6760, the "Protecting Family and Small Business Tax Cuts Act of 2018"; H.R. 6757, the "Family Savings Act of 2018"; and H.R. 6756, the "American Innovation Act of 2018" and they were marked up and passed by Committee on September 13. The bills would make permanent several of the provisions in the Tax Cuts and Jobs Act of 2017, including the state and local itemized deduction limitation, the pass-through income deduction in Section 199A, and the increased estate tax exemption amount. The bills are expected to come to vote in the House soon.

Estate and Trust 2019 Tax Items. The Department of Labor released the Consumer Price Index for 2018, on which several estate and trust items which are indexed for inflation are based. As a result, the Thomson Reuters Checkpoint editorial staff have projected the 2019 unified estate and gift tax exclusion amount to increase to $11,400,000 and the annual gift tax exclusion to remain at $15,000. In 2019, trusts and estates will be subject to the highest 37% marginal tax rate at income over $12,750.

New IRS Commissioner. On September 12, the Senate approved Charles "Chuck" Rettig as the IRS Commissioner, whose term expires November 2022. Rettig was previously a tax litigator in Los Angeles. The nomination of Michael J. Desmond to be Chief Counsel of the IRS remains pending in the Senate.

Repeal of Obamacare Provisions. On September 13, 2018, the House voted and approved House Resolution 1059, which allows consideration of H.R. 3798, dubbed the "Save American Workers Act of 2018." The bill (H.R. 3798) changes the definition of a full-time employee from a person who works 30 hours per week to 40 hours per week, thereby reducing employer responsibilities for providing healthcare. It also would retroactively remove employer mandate penalties for employers who did not offer coverage previously. Additionally, it would delay the excise "Cadillac tax" on health care plans until 2023.

STATE TAX NEWS

By Katie Lepore, CPA, J.D., LL.M., Taxation

Trust Decanting. On September 14, 2018, Governor Jerry Brown approved and signed into law SB 909, enacting the California Trust Decanting Act. It adds Part 9 (commencing with Section 19501) to Division 9 of the Probate Code. This new law is expected to significantly impact the way irrevocable trusts will be amended in the future. The purpose of the new law is to allow a fiduciary of an irrevocable trust to distribute the property from a first trust to one or more second trusts, or to modify the terms of the first trust without the consent of the beneficiaries or approval of the court, subject to certain exceptions. The law is effective beginning January 1, 2019. The text of the new Sections can be read on the California legislature website at:
https://leginfo.legislature.ca.gov/faces/billCompareClient.xhtml?bill_id=201720180SB909

Proposition 5. The November ballot includes Proposition 5, relating to property tax transfers for primary residences of homeowners over age 55. Propositions 60 and 90, which are current law, allow a homeowner in certain counties in California to transfer the base year property tax value of their primary residence to a new residence purchased within particular counties. The purpose of Propositions 60 and 90 was to encourage older homeowners to move to smaller homes by removing the property tax burden of obtaining a new home. San Diego County is one of the existing counties which follows Propositions 60 and 90. To qualify, the new residence must be of "equal or lesser" value than the original property. The exemption can only be used one time. Proposition 5 would allow the base year value to transfer to any county in California and to carry over to a new home that is greater in value than the original home, with an adjustment to the base year value. It also would allow residents over age 55 to use the exemption more than once.

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