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By Mary J. Peshel, J.D.

SERVING AS TRUSTEE: PART III PAYING TAXES AND FUNDING SUBTRUSTS

ESTATE TAX RETURN (Form 706)

One of the Trustee's most important responsibilities is filing the Federal Estate Tax Return (IRS Form 706), and any applicable state estate and/or inheritance tax returns. For a death occurring in 2019, an estate tax return is required when the Trustor's estate exceeds \$11,400,000. If taxable lifetime gifts have been made, a return may be due even if the estate is valued at less than \$11,400,000 at death. In addition, if there is a surviving spouse, filing an estate tax return may be desirable in order to make an election allowing the surviving spouse to use any of the deceased spouse's unused estate tax exemption. It may also be prudent to file an estate tax return for a smaller estate, as doing so may limit the amount of time the IRS has to assess additional tax (for which the Trustee could be personally liable) to 3 years. If no return has been filed, the IRS can assess additional tax at any time.

The estate tax returns must be filed and the tax paid within nine months of the Trustor's date of death. The IRS will grant a six-month extension for filing the return (upon request), but typically an extension is not available for paying the estate tax. Therefore, you should obtain a good estimate of the value of the estate tax liability and pay all of the estate tax within the nine-month time frame, even if you do not file the estate tax return until later. If it is not possible to pay the entire tax, paying as much of the estimated estate tax as possible will help reduce the interest and penalties that may accrue.

In some cases, the Trustee may not be in control of all of the decedent's assets. Joint tenancy, pay-on-death, pension and/or life insurance may pass to others. You must learn about all of these assets of the decedent's taxable estate before making a determination as to whether an estate tax return is due.

California does not currently impose an inheritance or estate tax. However, if the decedent was a resident of another state, or had property in another state which has a separate state inheritance or estate tax, you may need to file a tax return in that state. You should seek advice from an attorney in that state to determine any filing obligations.

TRUSTOR'S INDIVIDUAL TAX RETURNS

The Trustee will have to file the Trustor's final state and federal income tax returns for the period starting January 1 through his or her date of death. You may also have to file a final gift tax return as well.

Understandably, a Trustor who was ill during the last part of life may not have filed his or her tax returns, thus the Trustee may need to confirm that all returns were filed. If the Trustor died before April 15, there may be an income and/or gift tax return due for the prior year. These returns may be filed jointly with the surviving spouse. It will also likely be necessary to file tax returns in the state where the Trustee lives.

MAKE SURE THE STATE AND FEDERAL AGENCIES ARE PAID

As Trustee, you are legally responsible for filing the tax returns and paying taxes, both income and estate, before the assets are distributed to the beneficiaries. Both the IRS and the California Franchise Tax Board (FTB) will hold a Trustee personally liable for any tax due if that Trustee made distributions to beneficiaries and/or creditors before paying the taxes. This liability is limited to the value of the assets in your possession at the date of death. In addition, the IRS provides mechanisms for discharging this personal liability. These include requesting an “early determination” of estate tax liability. Even if you, as Trustee, are relieved of personal liability, both the estate, and the beneficiaries (to the extent of their distributions), continue to be liable for the tax due.

Certain important tax elections must also be made in a timely fashion by the Executor/Trustee. These include: a QTIP election (for the marital deduction), a spousal election to use any unused estate tax exemption (portability), an election under IRC 754 regarding partnerships, and a QSST election if the trust is an owner in an S-corporation. If you have any questions about whether or not to make one of these elections, please consult an attorney or other tax specialist.

TRUST INCOME TAX RETURNS

You will also be responsible for reporting the yearly income of the trust (and/or estate) to both the IRS and the FTB. In addition, you must supply each of the beneficiaries with IRS Schedule K-1, which sets out all distributions made to that beneficiary during the trust’s taxable year. This schedule is necessary for each beneficiary to report his individual income tax properly. Additionally, if an estate tax return is filed, you will need to provide the trust beneficiaries with Form 8971 showing the basis in the assets which they received.

FUNDING THE TRUSTS

Couples often set up a family trust that will be divided into several “subtrusts” upon the death of the first spouse. It is your responsibility to make sure that each of these subtrusts is properly funded, which can be quite tricky, so receiving the assistance of an attorney is highly recommended.

Funding usually occurs after the estate tax return (if any) is filed and the estate has received a closing letter from the IRS. The trust itself will dictate how assets will be divided among the several subtrusts, though usually the trust does not specify which assets should be distributed to each subtrust.

For example, the bypass trust (which will not be subject to estate tax at the surviving spouse’s death) is often funded with assets that are likely to appreciate, because the assets plus future growth can pass free of estate tax at the surviving spouse’s death. However, with the estate tax exemption currently at $11,400,000, it might be better to put assets which are anticipated to grow into the marital or survivor’s trusts which will be included in the survivor’s taxable estate and therefore may receive a basis step-up at the survivor’s death.

SUMMARY

Preparing and filing timely tax returns for the estate and trust, and paying the taxes, are significant responsibilities of the Trustee and carry with them personal liability. Likewise, careful subtrust funding can enhance the benefits available to the trust beneficiaries.

SERVING AS A TRUSTEE: PART IV

By Mary J. Peshel, J.D.

TRUSTEE LIABILITY

It is very important for you, as the Trustee, to be familiar with the provisions of the Trustor's estate planning documents. The trust gives you certain powers as Trustee. You also have powers conferred under California and Federal law. An attorney can help familiarize you with your powers and the possible limits on those powers. You need to be aware of potential pitfalls that could make you personally liable for any resulting harm.

DUTIES TO BENEFICIARIES

A primary concern is the duty you owe to the beneficiaries. The Trustee must remain impartial as between all beneficiaries, including between the income beneficiaries and the remainder beneficiaries. Doing business with one of the beneficiaries is usually prohibited. A Trustee must keep all the beneficiaries reasonably informed about the trust and the administration of the trust. Also, you must provide a beneficiary with information requested, including a copy of the trust.

NO SELF-DEALING

The Trustee has a duty to avoid conflicts of interest and to avoid self-dealing. An example of what not to do would be to use trust money to invest in your own personal start-up company. These and other acts of misconduct are called "breaches of trust" and can result in personal liability for any harm done as well as removal as Trustee. Other acts of misconduct include allowing an insurance policy to lapse and not securing personal property adequately. You also have a duty to employ any special skills you may have (i.e., as investment advisor, attorney, accountant, real estate broker, etc.).

PRUDENT PERSON/INVESTOR

As Trustee, you must conduct yourself as a "Prudent Person" would and as a "Prudent Investor" would. Among the actions taken by Prudent Persons and Prudent Investors are preserving the trust assets, making them productive, and reviewing the investment strategy on a regular basis. Of course, all such duties are subject to the terms of the trust instrument itself. Fortunately, you may enlist the help of financial planners and other advisors in satisfying your financial duties. However, keep in mind that, generally, you will remain personally responsible for the actions taken by the trust advisors you hire, and YOU must make all final decisions.

ADEQUATE TIME

As Trustee, you must spend adequate time administering the trust and its assets. Annual tax filings and accountings, and regular monitoring of investments, are necessary to manage and preserve the trust. A Trustee who fails to manage and monitor a trust adequately is subject to being removed by a court and may be liable for any damages resulting from such lack of attention to trust matters. Fortunately, most trusts permit the Trustee to hire others to assist with these tasks.

ADVISORS

When dealing with advisors like accountants, financial advisors and attorneys, make sure that each individual knows the scope of his/her duties. Putting the assigned responsibilities in writing, even in a simple letter, will help avoid confusion and missed deadlines. For example, you do not want your CPA and your attorney each thinking that the other was responsible for filing a tax return with the result that it does not get filed.

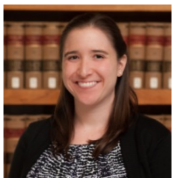
CO-TRUSTEES

Oftentimes, the trust provides for two or more Co-Trustees to serve. If this is the case, all decisions must be made unanimously, unless the trust directs otherwise.

SUMMARY

Trustee liability can be a serious issue for a Trustee. Being sure to understand your duties, devote adequate time, and ask for help from advisors can go a long way toward avoiding costly mistakes.

*Ms. Peshel will be publishing the final chapters to this Trustee's Handbook in our February Newsletter.



FEDERAL TAX UPDATE

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

IRS Warns of Scams. On November 19, 2018, the IRS issued a notice alerting taxpayers as to yet another phishing scam. The most recent scam attempts to lure email recipients to open a document or click a link supposedly to take them to a copy of their "tax transcript," which is a copy of their tax return. The IRS reminded taxpayers it does not send unsolicited emails to the public and would never send such sensitive information as a tax transcript over email. Recipients are encouraged to forward any suspected scam emails to phishing@irs.gov.

Tax Bill to Correct Portions of TCJA. House Ways and Means Chairman Kevin Brady (R-TX) released on November 26 new bills to amend the Retirement, Savings and Other Tax Relief Act (H.R. 88). The bill includes tax extenders, retirement savings provisions, disaster tax relief, IRS reform legislation, and several technical corrections to the Tax Cuts and Jobs Act. A vote on the bill was cancelled in early December due to the death of former President George H.W. Bush. On December 10, 2018, Brady unveiled a revised tax package as an amendment to the original bill. The bill passed the House on December 20, 2018, but its fate is uncertain in the Senate. Other lawmakers have indicated they are more apt to vote for the bill if it were part of a major spending bill encompassing more topics.

New Voluntary Disclosure Practice. On November 29, 2018, the IRS released updated Voluntary Disclosure Practice (VCP) procedures applicable to both offshore and domestic voluntary disclosures. Previously, the IRS had in place its long-standing Offshore Voluntary Disclosure Practice (OVDP), which ended in September of 2018. Taxpayers wishing to make a voluntary disclosure must submit a preclearance request to the IRS Criminal Investigation Division.

Chuck Grassley Announced as Chair of Senate Finance. Senator Chuck Grassley (R-IA) will serve as chairman of the Senate Finance Committee during the 116th Congress beginning in January 2019. Previously, Orrin Hatch (R-UT) served as chairman. Senator Grassley held the role of chairman in 2001 and from 2003-2007.

New Deputy Treasury Secretary and Tax Court Judge Update. On December 11, 2018, the Senate voted 55-44 to confirm Justin Muzinich as Deputy Secretary of the Treasury. He has been working at Treasury since 2017 as an advisor to Secretary Steve Mnuchin. On December 13, 2018, the Senate Finance Committee unanimously voted to favorably report the nomination of Courtney Dunbar Jones to be a Judge of the US Tax Court.

IRS Issues Final Regulations for IRC 263A. On November 19, 2018, the IRS published the final version of regulations for "negative 263A," the uniform capitalization rules. The regulations provide for a new modified simplified production method for allocating additional Section 263A costs to ending inventory, along with other changes and definitions. Additionally, the IRS issued Revenue Procedure 2018-56 which provides procedures for taxpayers to obtain automatic consent to make method changes to conform to the new regulations.

IRS Issues Proposed Regulations for IRC 163(j). On November 27, 2018, the IRS issued proposed regulations (REG-106089-18) on the interest expense limitation under IRC 163(j), which was modified by the Tax Cuts and Jobs Act. IRC 163(j) generally deals with the deductibility of business interest and contains an exception for certain small businesses that meet a gross receipts test.

STATE TAX NEWS

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

New State Use Tax Collection Rules. In response to the *South Dakota v. Wayfair, Inc*. Supreme Court ruling in June, the California Department of Tax and Fee Administration (CDTFA) recently announced a new use tax collection requirement for out of state sellers. Beginning April 1, 2019, an out of state seller is required to collect use tax if the retailer's sales into California exceed $100,000, or the retailer made sales into California in 200 or more separate transactions. In-state sellers already registered with the CDTFA will see no change.

CalSavers Pilot Running. California recently opened its newest pilot program, CalSavers. The program allows employees who do not have the option of participating in a retirement plan through their employer save for retirement by creating an account with a state-sponsored Roth IRA. The program is largely geared toward self-employed individuals, although employers who do not offer a retirement plan will be required to register with the State. After a business registers, employees will be automatically enrolled at a contribution rate of 5% unless the employee opts out or changes the contribution percentage. Employers may voluntarily enroll in the pilot program, but will be required to enroll beginning in 2020 through 2022, depending on the number of employees.

Changes to Schedule CA. California has released a new version of the Schedule CA for the 2018 tax return making changes for the Tax Cuts and Jobs Act. The Schedule CA will allow certain deductions when California does not conform to federal law, including allowing moving expense reimbursements, excluding transportation fringe benefits, and allowing mortgage interest up to $1 million of acquisition indebtedness. Additionally, California does not conform to the new entertainment limitation and allows a 50% deduction of entertainment expenses. Similarly, state and local real and personal property taxes are not subject to a $10,000 cap and certain miscellaneous itemized deductions such as tax preparation fees and attorney fees may still be deductible for California purposes.

Assessor May Send Information Electronically. AB 2425 amends Sections 408, 441, and 470 of the Revenue and Taxation Code to allow the county Assessor and property owners to exchange information electronically. The changes also require information to be sent within a "reasonable time period" from the time requested by the other party.

More HOMES Act Introduced. On December 3, 2018, California Senator Scott Wiener (D-San Francisco) introduced Senate Bill 50, called the "More HOMES Act." "HOMES" is an acronym standing for Housing, Opportunity, Mobility, Equity, and Stability. The bill would change zoning laws to permit more affordable housing close to sources of major publicly-funded transportation.

AREAS OF PRACTICE

ESTATE PLANNING
& ADMINISTRATION
WILLS & TRUSTS
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FAMILY LIMITED PARTNERSHIPS
GENERATION SKIPPING/DYNASTY TRUSTS
ESTATE/GIFT TAX DISCOUNT PLANNING
CHARITABLE GIFT PLANNING
PROBATE & TRUST ADMINISTRATION
ESTATE & GIFT TAX RETURNS
PRE-MARITAL AGREEMENTS

VALUATION SERVICES
BUSINESS APPRAISAL SERVICES/DISCOUNT OPINIONS
VALUATIONS FOR ESTATE AND GIFT TAX PURPOSES

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IRS RULING REQUESTS
TAX REPRESENTATION

TAX PLANNING
BUSINESSES & INDIVIDUALS
REAL PROPERTY TRANSACTIONS &
REORGANIZATIONS
BUSINESS ACQUISITIONS/SALES
EMPLOYEE COMPENSATION

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PROBATE & TRUST LITIGATION
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