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## JUNE 2019 NEWSLETTER

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### PENDING TAXATION OF CRYPTOCURRENCY

By DeEtte L. Loeffler, J.D., LL.M., Taxation

Under current law, the IRS has determined cryptocurrency is an asset, not cash. On April 9, 2019, Representative Warren Davidson (R-OH) introduced H.R. 2144, the *Token Taxonomy Act of 2019*, which would address taxation of virtual currencies. The bill would exclude cryptocurrencies from the definition of securities under the Securities Act of 1933 and the Securities Exchange Act of 1934, and would provide a de minimis exclusion from income for certain gains related to sales of virtual currencies. The bill would also expand like-kind exchanges under Internal Revenue Code section 1031 to include cryptocurrencies.<sup>1</sup> The bill is still in committee and has five cosponsors, including Representative Tulsi Gabbard (D-HI) who has announced her candidacy for President.

### What is Cryptocurrency?

For those not already familiar with cryptocurrency and its history, a short explanation may be helpful. According to Investopedia, a “cryptocurrency is a digital or virtual currency

that uses cryptography for security. A defining feature of a *cryptocurrency* . . . [is that] it is not issued by any central authority, rendering it theoretically immune to government interference or manipulation.”

Initially, cryptocurrency was acquired by a process known as “mining.” People would solve complex math and other problems, and be rewarded with “coins” that they could then use to acquire other things. Anyone could (and still can) set up a currency on the Internet. As its popularity grew, formal “exchanges” opened to allow people to buy and sell cryptocurrency. While most cryptocurrency continues to be issued by non-government agencies, some countries have launched their own versions, sometimes backed by natural resources or other national assets, such as Venezuela. Country-backed currencies have not proven as successful as Bitcoin; for example, Ecuador, which issued its currency in 2014, discontinued it in 2017. Still, at least 14 countries, including Canada and Norway, are studying possibly issuing such currency, while several others, including Russia, Japan and Sweden, are expected to issue it soon.

### Currently Taxed as an Asset, Not Money

The United States continues to tax cryptocurrency like property instead of money. Taxpayers who acquire cryptocurrency by “mining” are required to report the value of the coins they receive as ordinary income on their

<sup>1</sup> Under the *Tax Cuts and Jobs Act of 2017*, the rules for 1031 exchanges were limited to only permit exchanges of real property.

income tax returns. Likewise, people who accept cryptocurrency in exchange for services must report the value of the coins received as ordinary income.

In addition, when exchanging “coins” to obtain other things, including US dollars or the currency of other countries, taxpayers must report capital gains (or losses) on these transactions. For federal tax purposes, gain on coins held less than one year are subject to ordinary income tax rates (as short term capital gains), while coins held longer than one year are subject to the lower long term capital gains rates. Most crypto coins are reportedly held less than one year.

Because it is “property,” gifts of cryptocurrency do not trigger an income tax for the donor. However, the recipient receives the coins with the donor’s same income tax basis (i.e., a “carryover basis”). For example, if you have a Bitcoin which you purchased for \$50 which is worth \$75, and you give it to your child, the child’s basis in the coin is \$50. However, if the child were to buy the coin from you for \$75, then the child would have a basis of \$75 (his cost), and you would have capital gain of \$25. Please note that gifting coins, like gifting other assets, may result in a reportable gift if the fair market value of the coins given exceeds your annual gift tax exclusion amount (currently \$15,000 per donee).

Gifting cryptocurrency to charity is not subject to tax, but your charitable deduction may be limited to your basis in the coins and you might be required to obtain a qualified appraisal. Presidential hopeful and cryptocurrency supporter Congressman Eric Swalwell (D-CA) recently announced his campaign would accept donations of cryptocurrency. Congressman Swalwell has pledged to improve government guidelines for such currency.

The IRS continues to warn taxpayers that failure to report receipt and exchanges of crypto coins may result in a tax deficiency, penalties and interest. In early 2019, the IRS reminded

taxpayers to report these on their annual tax returns. The IRS continues to look for ways to identify unreported transactions. In 2016, it issued a summons to Coinbase, a digital currency exchange located in San Francisco, and was able to obtain records on sellers and buyers who exchanged \$20,000 or more in coins between 2013 and 2015.

### **New IRS Guidance Expected Soon**

The IRS last issued formal guidance in 2014 in IRS Notices 2014-21 and 2014-41. This guidance left open a number of questions for taxpayers. An open letter from 21 Congressman in April to IRS Commissioner Charles Rettig demanded the IRS provide updated guidance, and in May Commissioner Rettig promised such guidance would be forthcoming. He specifically promised to provide guidance on, among other things, “(1) acceptable methods for calculation of basis; (2) acceptable methods of cost basis assignment; and (3) tax treatment of forks.”<sup>2</sup>

### **California Tax Treatment**

California currently conforms to federal law regarding the treatment of cryptocurrency as property and not cash. However, California does not provide a preferred rate for long term capital gains. (i.e., all gains are taxed at ordinary income rates).

### **Estate Planning**

If you own any cryptocurrency, you should make a plan for its transfer at death. Under state law, if you own assets outside of a trust which are valued at \$150,000 or more, a formal probate is required. Since California treats cryptocurrency as property, we recommend you transfer your “wallet” to your revocable living trust to avoid an unnecessary probate by signing an Assignment, and that you include with your estate planning documents the digital “key” to allow your trustee to manage this asset. If you have questions regarding such assets, we would be happy to discuss this with you.

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<sup>2</sup> A “fork” is a software upgrade that might result in two versions of blockchain running simultaneously (a community split) or a simple upgrade. These can be highly contentious.

The laws relating to cryptocurrency are still developing both in the United States and internationally. We will continue to follow these developments and will keep you informed as changes occur.



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## FEDERAL TAX UPDATE

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

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**Estate and Gift Issues With Opportunity Zones.** As reported in our May 2019 newsletter, the IRS recently issued proposed regulations governing Opportunity Zones under Internal Revenue Code section 1400Z-2. In REG-120186-18, the gift of an investment in a Qualified Opportunity Fund would trigger the deferred gain and a grantor trust that owns an interest in a Fund that ceases to be a grantor trust, except by reason of the death of the owner, would also trigger the deferred gain. Generally, gain is recognized upon sale, exchange, or disposition by an estate or trust, except for distribution at death to a beneficiary or heir at law. The heir would step into the shoes of the decedent for holding period and gain recognition, and the interest in the Fund would be treated as an item of income in respect of a decedent (“IRD”).

**Retirement Plan Bill Passed in House.** The House of Representatives passed H.R. 1957, the *Setting Every Community Up for Retirement Enhancement (SECURE) Act*, on May 23, 2019. The SECURE Act allows a taxpayer to contribute to an IRA at any age, even after age 70½. It also postpones the start of required minimum distributions (RMDs) until age 72. However, inherited IRAs will have to be distributed over a 10-year period, with some exceptions, rather than paid over the life of the heir. The bill makes it easier for taxpayers to move from one retirement plan to another, and even offers a tax credit to small businesses which automatically enroll their employees in

retirement plans. A similar bill, S. 972, was introduced in the Senate on April 1, 2019 as the *Retirement Enhancement and Savings Act of 2019* and is still in committee.

**Proposed Regs Regarding Foreign ESBT Income.** The IRS issued Proposed Regulations, REG-117062-18, on April 17, 2019. The Proposed Regulations govern S-corporation income in an Electing Small Business Trust (ESBT) when a nonresident alien is the deemed owner of the trust which is also a grantor trust. The Proposed Regulations require the ESBT’s S-corporation income that would otherwise be allocated to the nonresident alien under the grantor trust rules to be included in the S-corporation portion of trust income, allowing the income to be taxed in the United States to a U.S. taxpayer, the ESBT. This Regulation is a result of a change in the Tax Cuts and Jobs Act of 2017 which allowed a nonresident alien to be a potential current beneficiary of an ESBT without terminating the S-election.

**IRS Increases Enrolled Agent Fees.** The IRS issued final regulations that increase the enrollment and renewal user fee for enrolled agents from \$30 to \$67, effective June 12, 2019.

**Bill to Expand IRA Charitable Rollovers.** Senators John Thune (R-SD) and Bob Casey (D-PA) recently introduced the *Charities Helping Americans Regularly Throughout the Year (CHARITY) Act*, S. 1475. The bill expands options for IRA charitable rollovers and allows donors over age 70½ to transfer up to \$100,000 per year directly from an IRA to a donor advised fund. Additionally, the bill would simplify the calculation for the excise tax paid by private foundations on investment income.

**Ninth Circuit Confirms Citizenship of Trustee Controls for Diversity.** In *Demarest v. HSBC Bank USA, NA*, the Ninth Circuit held that the domicile of the trustee of a “traditional” trust controls for diversity jurisdiction purposes when sued in its own name, even when beneficiaries live in other states. The court drew a distinction between a “traditional” trust and a business

trust, the latter of which has “citizenship” determined by all of its members, in accordance with the U.S. Supreme Court decision in *Americold Realty Trust v. Conagra Foods, Inc.*

**Bill to Relieve Taxes for Gold Star Families.** Representative Elaine Luria (D-VA) introduced the *Gold Star Family Tax Relief Act*, H.R. 2481, in the House of Representatives. The bill would reduce the tax rate on benefits received by children of a U.S. service member who died while serving in a time of conflict for the purposes of kiddie tax. The Tax Cuts and Jobs Act subjected income *earned* by a child to tax rates for single individuals but subjected *unearned* income to trusts and estates tax rates, which generally reach higher brackets more quickly. If approved, the bill would allow military benefits to be taxed the same as earned income. The bill has broad bipartisan support and is currently with the Ways and Means Committee. On May 21, 2019, the Senate approved a similar bill, the *Gold Star Family Tax Relief Act*, S. 1370.

**IRS Expands Retirement Plan Letter Program.** In Revenue Procedure 2019-20, the IRS announced it will provide for a limited expansion of its existing determination letter program for individually designed retirement plans. The program allows for the sponsor of an individually designed retirement plan to submit a determination letter application for initial plan qualification. Such applications will be accepted for “hybrid plans” from September 1, 2019 through August 31, 2020 and “merged plans” on an ongoing basis.

**Federal Disaster Assistance for California.** President Trump in conjunction with FEMA approved California for federal disaster assistance to supplement state and local recovery efforts due to the fires and mudslides in February 2019. Federal funding is available to the state and eligible local governments, and certain private nonprofit organizations on a cost-sharing basis, for emergency work and the repair or replacement of facilities damaged by severe winter storms, flooding, landslides, and

mudslides in Calaveras, Colusa, Marin, Mariposa, Mendocino, Modoc, Napa, Riverside, Santa Barbara, Shasta and Trinity counties. Federal funding is also available on a cost-sharing basis for hazard mitigation measures statewide. Under the Tax Cuts and Jobs Act, taxpayers may now be able to claim casualty losses since the President declared these areas as federal disaster areas.

**IRS Corrects Errors in Schedule D worksheets.** The IRS announced that there were errors in the 2018 Schedule D worksheets for Forms 1040 and 1041 relating to taxpayers subject to the 28% capital gains rate or those who had recaptured Section 1250 gain. New versions of the worksheets have been posted.

**IRS Seminars.** The IRS will be hosting Nationwide Tax Forums in different cities in July, August, and September 2019. There will be a Forum in San Diego from September 17-19. More information can be found at: [www.irstaxforum.com](http://www.irstaxforum.com).

**FTB Immune from Litigation in Sister States.** On May 13, 2019, the United States Supreme Court ruled in *Franchise Tax Board of California v. Hyatt* that the FTB was immune from lawsuits in other states. Hyatt was a California taxpayer who moved to Nevada where he claimed the FTB committed torts against him. He sued the FTB in Nevada court, but the Supreme Court overturned its prior decision on this topic, ruling that a state cannot be sued by a private party in another state.



## STATE TAX NEWS

By Katie Lepore, CPA, J.D.,  
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**CA Estate Tax and Other Tax Bills.** Several California tax bills were recently removed from consideration by California lawmakers, with only a few tax bills moving forward for this legislative

session. Among the bills that will not be considered is SB 378 which would have brought back a California estate tax (as reported in our April 2019 newsletter), and a bill instituting a revised corporate tax based on the wage gap between the company's CEO and median level employees. Additionally, an excise tax on new firearm purchases and a soda tax will not be considered this legislative session. Those tax bills which remain for consideration include agricultural fees on water, fertilizer, and dairy to raise money for safe drinking water, reducing or eliminating tax exemptions, fees for opioid makers, and increasing fees for tires to prevent pollutants in stormwater runoff.

**CA Rent Control Bill.** AB 1482 was passed in the California Assembly on May 29, 2019. The bill caps rent increases at 7% per year plus the cost of inflation based on the consumer price index, but only for 3 years. The cap would be effective state-wide, with certain exceptions including local ordinances and those properties which are already under rent control. Landlords would not be able to evict tenants for the purpose of removing the rent cap if a companion bill, AB 1481 is passed. The bill now heads to the Senate. Proposition 10, which contained similar provisions, was not approved by voters on the 2018 ballot.

**San Diego County Invests Another \$25M in Affordable Housing.** On April 30, the San Diego County Board of Supervisors unanimously approved investing another \$25 million in a housing trust fund for building affordable housing throughout San Diego County. According to *The San Diego Union Tribune*, the Board expects the funds will finance construction of at least 1,000 new affordable housing units. The housing trust fund was originally created in 2017 and has already allocated \$12 million of its original funding, which reportedly financed 6 projects, resulting in 453 new affordable housing units. The *Union Tribune* reports those projects are valued at \$177 million and are scattered throughout the county, with 137 units in San Ysidro, 94 units in San Diego, 54 units in

Poway, 85 units in San Marcos and 81 units in Vista.<sup>3</sup>

**San Diego Plans \$1M Granny Flat Program.**

The San Diego Housing Commission is creating a pilot loan program to help residents build granny flats on their property in an effort to create more affordable housing. Homeowners would receive a loan through the Housing Commission to build the granny flat, or accessory dwelling unit, and so long as the unit is offered as a rental for a low-income household, the loan would be forgiven after a period of time. However, during the pilot program, the units would be built only on properties owned by the Housing Commission in an effort to research the most affordable way to build such units. Poway's mayor Steve Vaus implemented a similar program in February. According to *The San Diego Union Tribune*, Encinitas already contracts with architecture firms to design permit-ready plans for granny flats in an effort to reduce the cost and length of the building process. Additionally, the Vista City Council agreed to eliminate developer fees on granny flats if the owners agreed to lease the unit at below-market rates for 10 years.<sup>4</sup>

**Property Identified for State-Owned Housing Projects.**

As a result of Executive Order N-06-19 signed by Governor Gavin Newsom in January, the California Department of General Services (DGS) has identified and prepared an inventory of possible sites of state-owned land that could be transformed into affordable housing. The parcels were required to be in excess of the State's foreseeable needs and located in areas where a lack of housing is

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<sup>3</sup> Charles T. Clark. "County Invests Additional \$25 Million Into Affordable Housing Trust Fund." *The San Diego Union Tribune: Local*. April 30, 2019. <https://www.sandiegouniontribune.com/news/politics/story/2019-04-30/county-invests-additional-25-million-into-affordable-housing-trust-fund>

<sup>4</sup> Warth, Gary. "S.D. Plans \$1M Granny Flat Program." *The San Diego Union Tribune: Local*. May 13, 2019. <https://www.sandiegouniontribune.com/news/homelessnews/story/2019-05-10/san-diego-plans-granny-flat-pilot-program>

impacting the affordability of housing. Of the identified 44,370 parcels that fit that criteria, 1,330 parcels were chosen as potentially viable sites. DGS will be releasing additional information in the coming months after more research. Governor Newsom has specifically reached out to mayors in the most impacted housing markets of San Francisco, San Diego, Sacramento, Oakland, Fresno, and Chico to help identify areas for expedited development.

**California Proposed Budget Released.**

Governor Gavin Newsom released a “May Revise” budget entitled “California for All,” expanding on and revising his January 2019 budget. The proposed budget includes changes that would conform California tax law to federal tax law after changes made by the Tax Cuts and Jobs Act, including changes to the Earned Income Tax Credit (EITC). Among other things, the proposed budget also eliminates sales taxes on diapers and menstrual products and would provide for 8 weeks of paid family leave instead of 6, with workers receiving 60-70% of their current salary during that time. The new fiscal year begins July 1, 2019.

**Notices of Tax Return Change.**

The FTB estimated that it would begin mailing notices correcting error(s) on tax returns the last week of May 2019. The Notices of Tax Return Change are issued when the FTB corrects errors made by the taxpayer on his or her return.

**Santa Monica to Institute Business Tax Amnesty Program.**

The City of Santa Monica will be implementing a 6-week tax amnesty program to help bring unlicensed businesses into compliance with the City’s business license taxes. The program will run from May 1, 2019 through July 12, 2019 and will provide relief from penalties not previously identified. Unlicensed businesses that voluntarily register for a business license during the allotted period will receive a 90% reduction of any penalties due, regardless of the reason for non-compliance.

**BOE Website Improvement.** The California State Board of Equalization (BOE) issued a letter to county assessors to remind them that each state agency must comply with web accessibility requirements by July 1, 2019. As a result, the BOE’s website will be undergoing improvements and will be modernized, possibly with some items missing or unavailable during this time. The BOE reports that any material that is not compliant by July 1 will be removed from its website and made available in other formats until its website can be completely revamped.

**Disclaimer:** This newsletter is provided to share knowledge and expertise with our colleagues with the goal that all may benefit. The content of this newsletter is for general information purposes only.

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