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MMPPH welcomes Paralegal Colleen Richmond Ergastolo to our staff. Colleen graduated from California State University, Fullerton with degrees in Psychology and Criminal Justice. She is also a certified forensic document examiner and expert handwriting analyst for document authenticity and profiling. She has worked exclusively in trust and estate planning offices her entire career. Originally from Orange, California, she is a member of a 5th generation family of lawyers. She married local attorney Joe, and together raised their two daughters Madeleine and Adelaide. Recently being empty nesters, they moved downtown to enjoy the city life. Her passions include friends, movies, reading, dining and playing soccer.

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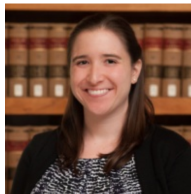


65-DAY RULE MAY PROVIDE TRUST AND ESTATE TAX SAVINGS

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

Have you ever sat down to start preparing your taxes and realized that you underestimated the amount of income you had the prior year? Have you wished that you had garnered more deductions throughout the year to offset that income but are disheartened that now December 31 has passed and it is too late? Luckily, the IRS provides some exceptions that allow irrevocable trusts and estates to take income tax deductions for distributions made in the first 65 days of the year on the prior year's tax return. This means that as you are sitting down in February 2020 to prepare a Form 1041 for tax year 2019 and realize the irrevocable trust or estate has taxable income, you may be able to make a distribution in 2020 and deduct that distribution on the 2019 tax return. You would have the benefit of hindsight, after receiving all the year-end statements and Forms 1099.

<u>The Law</u>

Internal Revenue Code Section 663(b) allows a trustee or executor to make an election to treat all or any portion of amounts paid to beneficiaries within 65 days of the close of the trust's or estate's tax year as though they were made on the last day of the prior tax year. It is important to note that the trustee or executor must actively make an election on a timely filed tax return to enjoy the benefits; they are not

automatically extended to a trust or estate. A fiduciary may make the election for only a portion of the distributions made within the 65-day window, but once the election is made it is irrevocable. Also, this rule is applicable for irrevocable trusts that file their own tax returns; revocable living trusts and other grantor trusts are subject to different tax rules.

Limitations

The election is not unlimited in amount. The election is limited to the greater of the trust's accounting income as calculated under Section 643(b) for the year in which the election is made, or the trust's distributable net income ("DNI") for the year reduced by amounts paid, credited, or required to be distributed in such year. For those tax accounting scholars, this essentially means the election can only be used to absorb Tier 1 Section 643(b) income or DNI that was not distributed at the end of the year, but prevents the fiduciary from using the 65-day rule from making large Tier 2 tax-free distributions.

Practical Applications

The Regulations to Section 663 contain several examples for practitioners to follow. This rule can possibly provide drastic tax savings because trusts are subject to higher income tax brackets much more quickly than individuals. For instance, trusts reach the highest tax bracket of 37% federally at taxable income of only $12,950; married couples are subject to the 37% tax bracket at income levels of $622,051.

Therefore, for example, if a trust has taxable income of $13,000 in 2019 and then subsequently makes a distribution of $13,000 to a beneficiary within the 65-day window in 2020, the trust could potentially reduce its taxable income to zero for 2019, saving approximately $3,200 (the tax is not simply 37% of $13,000 because of the graduated tax rates). If the trust had, instead, $50,000 of taxable income, the savings grow at a much faster rate because anything above $12,950 is taxed at 37%, saving approximately $16,900 in taxes if a $50,000 distribution is made (the 2019 tax rate is 37% for income above $12,750). Of course, this is assuming the distribution qualifies for a DNI deduction. The $13,000 distribution or $50,000 distribution, respectively, would then be taxed on the beneficiary's tax return at his or her marginal income tax rate (which is likely to be lower than the trust's bracket).

There is also the 3.8% net investment income tax to consider as well, which could mean that making a distribution within the 65-day window could save more than 37% federally. This analysis does not even take into account California taxes where the top rate is 13.3%.

Special Rules for Charitable Deductions

There is a similar rule available for some irrevocable trusts and estates that make charitable distributions. Per Reg. §1.642(c)-1(b), the trustee can elect to deduct charitable payments made before the close of the next following taxable year on the return for the preceding taxable year (i.e., deduct in 2019 amounts paid before the fiscal year ending in 2020). In some instances, estates and trusts may elect to deduct payments made for the benefit of a charity on their income tax returns for the year preceding the actual year of payment. This election must be made not later than the due date of the trust's income tax return for the year following the year for which election is made (i.e., in the above example, not later than April 15, 2021). Once the election is made, it is irrevocable. It is important that the fiduciary must first determine that the payment does in fact qualify for the charitable deduction, following the rules of Section 642(c) (permanently set aside, paid from gross income, pursuant to the governing instrument, etc.).

Conclusion

These small code sections could add up to huge savings for trusts and estates. If you should have any questions about the 65-day rule, or charitable deductions, please contact our office.

MENTAL ILLNESS: THE EMPOWERMENT OF CHOOSING YOUR EMERGENCY *by Colleen Ergastolo, Paralegal*

Are Mental Health Care Instructions important to include in your Advance Health Care Directive ("AHCD")? Statistics say "maybe so" if you are under the age of 45 and have a mood disorder. In 2019, the National Alliance on Mental Illness published 2018 statistics indicating that 1 in 5 adults experience a mental illness with 43% receiving treatment, and 1 in 25 adults experience *serious* mental illness with 64% receiving treatment.[1] With these strong facts and statistics, the following information may be helpful.

What can adding these Mental Health Care Instructions do for you? It allows you to document your choices of certain people, doctors, and institutions to help you when you experience a serious mental health event. For example, if you currently have medical treatment including prescriptions and want to convey that information to a 24-hour emergency care, they may be able to follow your wishes based on the information provided in your AHCD. It also allows you to indicate your preference for care in a particular program or institution instead of psychiatric hospitalization.

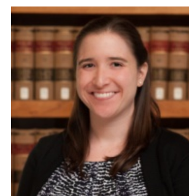
If you have been admitted to a mental health treatment facility, your AHCD may include prioritized preferences of how you wish to receive treatment, such as whether you would like to have a quiet private space, wish for physical exercise, wish to be provided with materials to write or draw, or a radio to listen to music. Your stated preferences can help you to more quickly receive the kind of care you already know works best for you.

In most severe situations requiring an emergency intervention, your priority of choice can be noted as to how you wish to receive medication (such as pill, liquid, or injection), and whether you prefer a male or female to provide seclusion, or physical restraints, to your body. If you are concerned about side effects of medication, you can include certain restrictions based on various side effects that you wish to avoid, such as loss of sensation, tremors, nausea, or other various problems.

The people you name in these documents can be your agents, or doctors already named in your AHCD, or additional persons of importance. In the event of necessary 24-hour care of your person, you can also document certain doctors or institutions you do not want involved in your care as well as state reasons for these wishes.

If you believe Mental Health Care Instructions are important for you personally, or you know someone who may benefit from including them, we recommend contacting our office to prepare an Advance Health Care Directive with personalized Mental Health Care Instructions.

[1] *See* https://namica.org/resources/mental-illness/mental-illness-facts-numbers/



FEDERAL TAX UPDATE
By Katie Lepore, CPA, J.D., LL.M., Taxation

IRS Confirms No Clawback for Large Gifts. The IRS issued final regulations November 22 confirming that individuals who use their lifetime estate and gift tax exclusion while it is a higher amount (from 2018 to 2025) will not have the gifts "clawed back" into their estates once the exclusion drops in 2026. Individuals who wish to make large gifts now in possible anticipation of a lower exclusion amount later can do so without fear of adverse tax consequences later.

Tax Provisions in 2020 Spending Bill. The 2020 spending bill signed into law on December 20, 2019 to prevent a government shutdown contained a number of tax provisions. Certain tax extenders were approved, including subpart F rules for controlled foreign corporations. Additionally, the medical device excise tax, the "Cadillac" tax on certain high-cost employer-provided health insurance plans, and the health insurance provider fee that were part of the Affordable Care Act were repealed. The SECURE Act, passed by the House in May, is also included. The SECURE Act, as detailed in our June 2019 newsletter, 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.

House Works to Repeal SALT Cap. On December 10, 2019, Representative Suozzi (D-NY) introduced H.R. 5377, *the Restoring Tax Fairness for States and Localities Act*, which aims to raise the $10,000 state and local tax credit to $20,000 for married couples for 2019. Further, the SALT cap would be repealed for 2020 and 2021, after which it then reverts back to $10,000. To offset the lost revenue, a top tax bracket of 39.6% (current top tax bracket is 37%) would be effective at lower income levels. The bill passed the House on December 19, but is not likely to pass in the Senate.

Retirement Plan Limit Increases. Employees can contribute up to $19,500 to their 401(k) plans for 2020, increased from $19,000 for 2019. The catch-up contribution limit for employees age 50 or over increased to $6,500, up from $6,000 in 2019. The income phase out range for the ability to deduct contributions to a traditional IRA also increased. The income range for eligible contributions to a Roth IRA increased, though the contribution limit of $6,000 remains unchanged.

Final Regulations Regarding Opportunity Zones. On December 19, 2019, the IRS issued final regulations regarding Opportunity Zones under Section 1400-Z. The Regulations clarify what types of gains are eligible to be invested and the timing of investment, how C-corporations can invest, and other items.

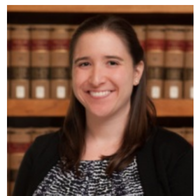
IRS Offers Online Education. The IRS is offering continuing education credits online through its 2019 IRS Nationwide Tax Forums. There are 15 self-study seminars covering a range of topics. The courses can be listened to for free if the user is not seeking continuing education credits.

FTC Regulations Issued. On December 2, 2019, the IRS issued final regulations regarding the calculation of the Foreign Tax Credit under the Internal Revenue Code. The Regs also cover the allocation and apportionment of deductions under Sections 861 through 865.

Bill to Require Disclosure of Corporate Owners. The House of Representatives passed H.R. 2513, the *Corporate Transparency Act of 2019*, which requires corporations and limited liability companies created in the U.S. to report on an ongoing basis "beneficial owners." The bill only applies to small businesses – those making less than $5 million or who have no more than 20 employees. The bill requires disclosure of names, birthdates, Social Security numbers, passport numbers and other sensitive data. The reporting must be made to the U.S. Department of Justice FinCEN of those beneficial owners who exercise substantial control over the company, own 25% or more of the equity interest, or receive substantial economic benefits from the company. Failure to comply can result in civil fines of $10,000

and criminal penalties of up to three years in prison. The ABA opposes the bill as imposing unreasonable burdens on small businesses. The bill is currently in Senate committee review.

Bill Regarding Nonresident Employee Taxes. In October, Representative Steube (R-FL) introduced H.R. 4796, the *Mobile Workforce State Income Tax Simplification Act of 2019*, which would create a national standard for determining when nonresident employees would be subject to nonresident taxes in other states. If passed, the bill would enact a 30-day required period of working in a nonresident state before the foreign state could subject the employee to tax. The bill is similar to S. 604, introduced in February and also H.R. 1393 which was approved by the House in June 2017 but never became law. The bill has bipartisan support.



STATE TAX NEWS
By Katie Lepore, CPA, J.D., LL.M., Taxation

Corporate Minimum Tax Reduced. Governor Newsom signed AB 308 on October 2, 2019, which creates exemptions from California tax for certain corporations and other entities solely owned by deployed military members. Additionally, the corporate minimum franchise tax of $800 is reduced for years 2020 through 2024 for all corporations with gross receipts under $15 million, regardless of ownership. For corporations with gross receipts under $2,500,000, the $800 tax is reduced to $200. For corporations with gross receipts under $7,500,000, the tax is reduced to $400. For corporations with gross receipts under $15,000,000, the tax is reduced to $600. Corporations with gross receipts above $15,000,000 are still subject to the full $800 annual minimum tax. C-corporations remain subject to an 8.84% income tax and S-corporations remain subject to a 1.5% income tax in California.

Disregarded LPs Not Subject to Minimum Tax. The FTB issued Legal Ruling 2019-02 on November 20, 2019, stating that limited partnerships that are disregarded for federal income tax purposes are not required to pay the California $800 minimum tax or file a California partnership tax return. Alongside this Legal Ruling, the FTB issued Notice 2019-06 outlining the process to request a refund and provide documentation and proof that the partnership is indeed disregarded.

Real Estate Tax Withholding Forms Updated. Effective January 1, the FTB has revised its real estate tax withholding forms and consolidated Forms 593-C, 593-E, and 593-I into one single Form 593. Form 593-V must still be submitted with any tax payment.

Apple Pledges $2.5 Billion to Help Housing Crisis. Apple has pledged $2.5 billion to Governor Newsom to help combat California's housing crisis and ease the problem of homelessness. One billion of Apple's funds will be used to create a mortgage assistance fund for first-time homebuyers and one billion will be used to give credit to support low income housing. Three hundred million worth of land Apple owns in San Jose will be available for affordable housing. Facebook and Google have each also recently pledged $1 billion to address California's housing crisis.

County Supervisors Approve Housing Subsidy Program. On November 19, 2019, the San Diego County Supervisors approved a flexible funds housing program. The program will reduce restrictions on accessing available funds to provide additional assistance for housing, such as providing gap funding for direct rental assistance or helping to provide a security deposit. Additional proposals and details will be reviewed in the coming months.

Electric Vehicle Rebate Limits. California recently enacted new rebate rules for

purchasers of electric vehicles. Single taxpayers who make more than $150,000 per year ($300,000 for joint filers) will be barred from obtaining the rebate. The state cites that the majority of previous state rebates were paid to purchasers of Tesla cars who do not need financial assistance. Additionally, plug-in hybrids with EPA electric ranges of less than 35 miles are no longer eligible for the rebate. Currently, the rebates offered are $2,000 for battery-electric cars, $1,000 for plug-in hybrids, and $4,500 for hydrogen fuel-cell cars.

State Increases Deductions for Cannabis Businesses. In October, Governor Newsom signed AB 37, causing California tax laws to diverge from IRC Section 280E, which only allows cannabis businesses to deduct the cost of goods sold. In California, licensed cannabis businesses may now deduct ordinary and necessary business expenses on their California income tax returns. The law is effective from January 1, 2020 through December 31, 2024. Unlicensed cannabis businesses are still only allowed to deduct the cost of goods sold.

Seven-Month Extension for Forms 100 and 100W. The FTB released Notice 2019-07 on December 2, 2019, stating that the FTB will grant an automatic seven-month extension to all corporate taxpayers in good standing which file forms 100 or 100W, without the need to file a written request. However, the extension does not apply to S-corporations. As always, this is an extension of time to file but not an extension of time to pay.

Change in Ownership Exclusion for Corporate Stock. AB 872, effective October 9, 2019, allows for an exclusion from a "change in ownership" for property tax purposes due to a transfer of corporate stock from a parent to child. The transfer of stock must be for a "qualified corporation" that owns a home and must be due to the death of the last surviving parent. The law largely affects family-owned corporations created between March 1, 1975 and November 6, 1986 which received a residence and land. The bill was narrowly drafted to prevent inequity for small family-owned farms.

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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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

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