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New Year, New Habit

Many of us are in the habit of dating documents using just the last two digits of the year. For example, for April 23, 2019, we would typically use 4/23/19. However, it may be important to establish a new habit for the year 2020. When dating a document on April 23, 2020, if you simply abbreviate as 4/23/20, someone could easily change the date to 4/23/2012, and your document would have an incorrect date. Consider adopting the habit of writing out the year in its entirety. This is an easy way to protect yourself, and your documents.

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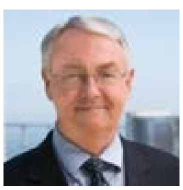


SECURE ACT: MAJOR PENSION LAW CHANGES

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

On December 20, 2019, President Trump signed into law a $1.4 trillion spending package that, while primarily designed to fund federal agencies through September 2020, includes provisions which substantially modify many of the rules governing retirement plans and IRAs. The *Setting Every Community Up for Retirement Enhancement ("SECURE") Act* (the "Act") will likely have a major impact on the structure and administration of retirement plans. The impact will be greater given that the sweeping rule changes generally apply to tax years beginning after 2019.

<u>Analysis of some of the High Points of the SECURE Act affecting estate and income tax planning</u>

A. <u>Elimination of Age Limit for IRA Contributions</u>. Effective for contributions made for tax years beginning after December 31, 2019, the Act repeals the prohibition on contributions to a traditional IRA by a taxpayer who has attained age 70½. Thus a taxpayer may continue to make contributions to an IRA at any age so long as the taxpayer has earned income at least equal to the amount contributed to the IRA.

B. <u>Age for Beginning Required Distributions Increased.</u> Effective for distributions required to be made after December 31, 2019, the Act increases the age at which required minimum distributions must begin to be made from qualified plans and IRAs from 70½ to 72. This extension also applies for purposes of the date by which a surviving spouse must begin taking required minimum distributions as the designated beneficiary of the employee or IRA owner if the surviving spouse has not rolled over the funds from the deceased spouse's IRA into his or her own IRA. It is worth noting that the Act does not alter the rule allowing qualified retirement plan participants (other than five percent (5%) owners and IRA holders) to defer required minimum distributions until retirement from the company sponsoring the qualified retirement plan.

C. <u>Required Distribution Rules for Designated Beneficiaries Significantly Changed</u>. Effective for distributions with respect to plan participants and IRA owners who die after December 31, 2019, the Act will require distributions to individuals, other than individuals who qualify as an "Eligible Designated Beneficiary" (described below), to generally be made by December 31st of the 10th calendar year following the year of the employee's or IRA owner's death. *See* new IRC Section 401(a)(9)(H). Unlike prior law, the new 10-year period will apply regardless of whether the plan participant or IRA owner dies before or after reaching the required beginning date (i.e., April 1st of the year after the plan participant or IRA owner attains the age of 72). The modified rules will not apply to Eligible Designated Beneficiaries, which are defined as: (i) the surviving spouse of the employee or IRA owner; (ii) a minor child of the employee or IRA owner; (iii) a disabled person under IRC Section 72(m)(7) (i.e., a person unable to engage in any substantial gainful activity due to a medically determinable physical or mental impairment); (iv) a chronically ill individual (as defined in IRC Section 7702B(c)(2)) whose period of inability to perform at least two activities of daily living, such as bathing, dressing, or toileting, has been certified as indefinite and is expected to be lengthy; and (v) an individual who is not more than 10 years younger than the deceased employee or IRA owner. Importantly, the determination of whether a "Designated Beneficiary" (i.e., an individual who has been designated as a beneficiary by the employee or IRA owner) is an Eligible Designated Beneficiary will be made as of the date of the employee's or IRA owner's death. As a note, under prior law, an "undesirable" beneficiary designation (e.g., one naming the estate or a charity as a beneficiary since these are not individuals and therefore do not qualify as Designated Beneficiaries) could be rectified by September 30th of the year following the year the employee or IRA owner died. This period to rectify the beneficiary designation so that only Designated Beneficiaries are the beneficiaries on the September 30th date will no longer apply in determining if a beneficiary qualifies as an Eligible Designated Beneficiary. It is also important to note that the exception applicable to minor children of the employee or IRA owner will no longer apply once the child reaches the age of majority, which in California is age 18. Thus once a minor child reaches the age of majority, any remainder of the child's interest in the qualified retirement plan or inherited IRA must be distributed within 10 years after the date on which the age of majority is attained.

With the exception for the Eligible Designated Beneficiaries, the new 10-year default rule will severely limit, if not eliminate, the use of the "stretch IRA" as an effective estate planning tool. The amended rules will subject non-spousal beneficiaries to a potentially large tax liability on an accelerated time frame. However, IRA owners may consider other strategies, such as charitable remainder trusts, to achieve similar, if not exactly the same, financially beneficial results. A few of these options are described below.

<u>The Use of Trusts as Beneficiaries of Qualified Retirement Plans and IRAs</u>

Over the past fifteen plus years, IRA owners have increasingly elected to create and name certain trusts as the primary beneficiary of IRAs. As the value of IRAs increased, IRA owners became more determined about preserving the IRA assets for the benefit of the

IRA beneficiary by using certain trusts for asset, divorce, spendthrift and investment management protection. Importantly, if the trust met the requirements to be treated as a "see-through trust", then the trust is disregarded (i.e., was seen through) and the beneficiary (or beneficiaries) of the trust was treated as the beneficiary of the IRA. Consequently, when a see-through trust was named as the beneficiary of the IRA, the IRA was treated as having an individual Designated Beneficiary and the distributions from the inherited IRA could be "stretched" over the life expectancy of that individual beneficiary.

The asset protection goal of the see-through trust became even more important when the U.S. Supreme Court issued its decision in *Clark v. Rameker*, 134 S. Ct. 2242 (2014), which held that inherited IRAs are not protected in bankruptcy. Importantly, there is no creditor protection for an inherited IRA here in California outside of bankruptcy.

A brief description follows of the two types of IRS approved see-through trusts, "conduit" and "accumulation" trusts, as these have been widely used by individuals with large IRAs. However, the Act now requires that all funds in an inherited IRA must be distributed to the designated beneficiary no later than December 31st of the year containing the tenth anniversary of the death of the IRA owner. Consequently, IRA owners who previously created a see-through trust should review their goals and objectives and decide if that trust is still appropriate or if other strategies need to be considered.

<u>Conduit Trusts</u>. To qualify as a "conduit trust", the terms of the trust must require that the trustee, upon receiving the required minimum distribution each year from the inherited IRA, or upon withdrawing any other funds from the inherited IRA, must, as soon as practicable, distribute all of those funds to the primary beneficiary of the trust. Thus, while the funds distributed to the beneficiary from the conduit trust would be exposed to any creditors of the beneficiary, the funds in the inherited IRA would remain fully protected from those creditors. Importantly, one of the benefits such a trust provided was that the initial required minimum distributions to the beneficiary from the inherited IRA would be relatively small in the years just after the death of the IRA owner. The other benefit was that only the primary beneficiary needed to be identifiable for determining whose life expectancy was to be used in determining the required minimum distributions. Thus the IRA owner had complete discretion in naming the successor beneficiaries of the conduit trust who would receive the distributions from the conduit trust if the primary beneficiary died before all the funds from the inherited IRA have been distributed.

Now, with the 10-year rule, the conduit trust has significant problems that need to be reviewed by the IRA owner. The primary problem is that the trustee might not withdraw any funds from the inherited IRA until that ten year deadline, resulting in significant adverse tax consequences to the beneficiary of the conduit trust upon receiving those funds essentially in a lump sum. Even if the conduit trust permits the trustee to withdraw funds, other than the RMDs, from the inherited IRA ratably over the ten-year period, and such funds are then distributed to the beneficiary, all of the deferred tax will still have to be paid by the beneficiary over that ten year period. Moreover, it might be otherwise detrimental for the beneficiary to receive the funds at this accelerated rate, such as where the beneficiary is young or has a spending problem. Consequently, it is very important that the IRA owner begin to analyze these issues and decide whether the conduit trust is still appropriate.

<u>Accumulation Trusts</u>. In contrast to the conduit trust, the terms of an "accumulation trust" clearly provide the trustee complete discretion as to whether, upon receiving either RMDs or other withdrawn funds from the inherited IRA, to distribute those funds to the

primary beneficiary of that trust or to retain those funds in the trust, thus, the name "accumulation trust." Therefore, the trustee can evaluate the beneficiary and decide whether to distribute the funds to the beneficiary or "accumulate" those funds in the trust for creditor, divorce, spendthrift or investment management concerns. The dilemma for the trustee of the accumulation trust is that all funds received from the inherited IRA but not distributed to the beneficiary will be subject to the highly compressed federal income tax rates imposed on trusts. In 2020, the 37% federal tax rate will apply for trusts with income in excess of just $12,950. This issue is magnified since the ten year rule now applies and all funds from the inherited IRA must be withdrawn within this compressed period. However, the IRA owner, upon learning of these issues, may still decide that the adverse tax consequences of accumulating the funds from the inherited IRA in the trust and retaining them in the trust even past the original ten year period is still prudent after considering the creditor, divorce, spendthrift and investment management protection provided by the accumulation trust. Thus, as with the conduit trust, the IRA owner needs to review the initial goals and objectives of the accumulation trust and determine whether any of the strategies described below may result in better results over time.

Brief Description of Some Strategies In Response to the 10 Year Rule

Roth Conversions. The primary concerns discussed above pertain to traditional retirement plans and traditional IRAs, where income and the related taxes are going to be substantially accelerated (and therefore very likely to be taxed in higher tax brackets) than under the previous laws regarding distributions to the beneficiaries of IRAs and pension plan accounts. With a Roth IRA, the acceleration of distributions from the inherited IRA or pension plan account upon the death of the IRA owner or employee does not increase taxes since the distributions from an inherited Roth IRA, for example, are tax-free. The acceleration just means a loss of future tax-free growth within the inherited Roth IRA. Thus, one strategy to be considered by the IRA owner will be the conversion of the traditional IRA to a Roth IRA during the life of the IRA owner. Consequently, one response to the new 10 year rule will presumably be increased Roth conversions, especially if the IRA owner is in a lower income tax bracket than he expects his beneficiary to be (which will often be the case if the beneficiary is an accumulation trust). Also, with the current lower income tax rates and brackets created under the Tax Cuts and Jobs Act sunsetting on December 31, 2025, IRA owners may decide to do the Roth Conversion now based on an expectation that Congress may significantly increase income tax rates in 2026 and beyond.

Life Insurance. Another strategy IRA owners may apply to financially assist the beneficiaries of their IRAs is to purchase life insurance. For example, the IRA owner could increase distributions from the IRA, pay the tax on the distributions, and then use the net proceeds to purchase life insurance to replace the IRA funds withdrawn. The concept being that while the value of the IRA will be depleted, the life insurance proceeds which replace the IRA will be received by the beneficiaries free of tax. Another example could have the IRA owner purchase life insurance with a lower death benefit and use less (or none) of the IRA funds to pay the premiums. The concept in this scenario is that the IRA owner simply wants to name the beneficiaries of the IRA as the beneficiaries of the life insurance so that the beneficiaries will have a source of funds with which to pay the tax on the distributions from the inherited IRA during the compressed 10 year period when the distributions must be taken. This may be particularly helpful for those with self-directed IRAs which often hold assets that are illiquid.

Charitable Remainder Unitrust. Owners of IRAs, once they understand the adverse tax consequences of the 10 year rule, may want an alternative that can still “stretch out” taxable distributions. The charitable remainder unitrust is one alternative strategy that can be considered.

In this strategy, the IRA owner creates and names a charitable remainder unitrust as the beneficiary of the IRA. Upon the death of the IRA owner, all of the funds in the inherited IRA are distributed to the charitable remainder unitrust (“CRT”). Since the CRT is tax exempt, the CRT does not recognize any taxable income when it receives the funds from the inherited IRA. Once funded, the CRT will then begin making annual distributions to the non-charitable beneficiaries who could be the children of the IRA owner. Pursuant to the rules affecting CRTs, the distribution rate selected by the IRA owner can range between 5% and 50% of the funds per year. However, based on these rules affecting CRTs, the distribution rate selected will likely range between 5% and 10%. Importantly, the CRT can provide that the distributions will be made to the beneficiary for as long as the beneficiary is alive, not just over that beneficiary’s life expectancy.

The distributions to the beneficiary will be taxable in accordance with the four “tier system” which will likely result in the distributions being treated primarily as ordinary income. Upon the beneficiary’s death, the remaining funds in the CRT will be distributed to the charity named as the ultimate beneficiary of the CRT. While the CRT has better tax benefits than the ten-year mandatory payout, the primary reason many IRA owners, as parents, may select a charitable remainder unitrust is to provide their child or children with a steady payout stream for a 20 year term or life. The asset and creditor protection benefit may also be a primary reason for selecting the CRT strategy even though there are also excellent tax benefits with a CRT funded with an IRA or other qualified retirement plan.

There are other possible ways to reduce the effects of the 10 year mandatory payout, but these will likely have the biggest impact. Please feel free to contact the author with any questions regarding the above.

OTHER IMPORTANT CHANGES MADE BY THE SECURE ACT *by DeEtte L. Loeffler, J.D., LL.M., Taxation*

As discussed in the prior article, the SECURE Act (“Act”) made changes to the way IRAs and pensions can distribute their assets after the death of the plan participant. In addition to these important changes, the Act also made other significant tax related changes. This article focuses on some of these other changes and their potential impact on your personal or business planning.

Changes Affecting Individuals. Changes to the tax law that might affect you individually include:

1. 529 Plans Now Allow More Distributions. In general, 529 Plans are college savings plans allowing tax free growth on investments where the funds are used for (i) “qualified” higher education expenses (including tuition, fees, education related books, supplies, and equipment such as computer and peripheral equipment), (ii) room and board, (iii) up to $10,000 for tuition at elementary or secondary schools, and since 2015, (iv) special needs expenses (under the *ABLE* Act). The Act expands the use of 529 plans again, this time to allow payment for fees, books, supplies and equipment relating to an apprenticeship program. In addition, the Act allows payment of principal or interest on qualified education loans of the plan participant or a sibling (without making the sibling the plan beneficiary). Loan payments are limited to a lifetime cap of $10,000 per individual and are not subject to income phase out limits, but no

deduction is allowed under IRC Section 221 for interest paid by a 529 plan.

2. Higher Kiddie Tax Rates No Longer Apply. *The Tax Cuts and Jobs Act* of 2017 ("TCJA") increased the income tax rates applicable to certain unearned income received by children under age 19 (or age 24 if a full time student). The TCJA required such income to be taxed at the same rate as trusts and estates. It also reduced the child's exemption under the alternative minimum tax rules. This law was seen to unfairly impact certain children, such as those receiving survivor benefits from a deceased military parent ("Gold Star children"). The Act repeals the rate change for years after 2019, but taxpayers may elect to apply them retroactively to 2018 and/or 2019, and repeals the AMT rules retroactively to years after 2017. Those who paid higher taxes because of the TCJA may wish to file amended returns this year to seek reimbursement.

3. Penalty Free Pension Withdrawals Allowed for Birth or Adoption Expenses. Distributions from a "qualified retirement plan" (i.e., IRA, 401(k), 403(b), and 457(b) plan) are subject to income tax. In addition, with a few exceptions, such distributions before the age of 59-1/2 are subject to a ten percent (10%) early withdrawal penalty. The Act adds an exception, allowing distributions after December 31, 2019 from any such plans of $5,000 total per qualifying birth or adoption. A distribution qualifies if made within one year following the birth or the adoption of an "eligible adoptee." An adoptee is eligible if under age 18 or physically or mentally incapable of self-support. In addition, the Act allows distributions in some cases to be recontributed to the plans and treated as a trustee-to-trustee transfer, thus avoiding the tax as well.

4. Changes Affecting Certain IRA Contributions. Contributions to IRAs can only be made based on taxable income. The Act expanded what qualifies as "taxable income" for purposes of contributions to IRAs. Now all taxable amounts received by a person pursuing a graduate or postdoctoral degree qualify for these contributions, including stipends and non-tuition fellowship payments. In addition, non-taxable "difficulty of care" payments received by foster parents related to a child with a physical, mental or emotional disability also qualify as income for IRA contribution purposes even though such payments are not subject to income tax.

5. Volunteer Firefighter and EMT Benefit. A minor credit is allowed again to volunteer firefighter and emergency medical services persons who receive a state benefit from their services after December 31, 2019. Up to $50 per month can be received tax free.

6. Increased Penalties for Failure to File Income Tax Returns. Prior to the Act, individual taxpayers who fail to file an income tax return within 60 days of the date it is due were subject to a minimum penalty equal to $250 or 100% of the amount due with the return. Starting after December 31, 2019, the Act increased the minimum penalty to $400 (adjusted for inflation) or 100% of the amount of tax due.

Changes Affecting Employers. Other changes under the Act affected employers and/or pension plan administrators.

1. Pension Start-up Credit Increased and Automatic Enrollment Credit Added. Under prior law, employers who establish a pension plan for employees were entitled to a three year tax credit for the start-up costs equal to the *lesser* of $500 per year, or fifty percent (50%) of the start-up costs. Under the Act, starting after December 31, 2019, the annual credit for such costs is increased to the *greater* of (i) $500 or the lesser of $250 per non-highly-compensated eligible employee, or (ii) $5,000. In addition, employers are entitled to a $500 credit per year if the new plan includes automatic enrollment of eligible employees in the plan. Finally, employers who amend an existing plan to add automatic enrollment can qualify for three years of $500 credits.

2. Qualified Plans Adopted Before Contribution Date Can Relate to Prior Year. Previously, a qualified plan had to be in place, even if not funded, before the close of a tax year in order for it to accept contributions for that tax year. Under the Act, after December 31, 2019, any plan adopted before contributions are due for the prior year (i.e., generally April 15th) can be treated as though the plan was in effect for the prior tax year.

3. 401(k) Safe Harbor Tests Modified. Under IRC Section 401(k), pension plans must meet an "actual deferral percentage" test annually. Two "safe harbor" options allow plans to qualify without such testing. The "automatic enrollment" option requires employees to make minimum annual contributions of three percent (3%) increasing to six percent (6%) over four years for the plan to qualify, with a maximum permitted required default rate of ten percent (10%). Under the Act, this maximum rate is increased to 15% after the first year. Also, the three percent (3%) "non-elective contribution" (i.e., from the employer) safe harbor rule remains in effect, but the notice requirement is eliminated and new rules for amending such plans were adopted.

4. 401(k) Plans Must Cover Some Part-Time Employees. Under prior law, a 401(k) plan could exclude employees who were (i) under age 21 years, and who (ii) had worked less than 1000 hours in the prior year. Under the Act, after December 31, 2020, employers must permit contributions to plans (other than a collective bargaining plan) from part-time employees who are over age 21 and who have worked at least 500 hours during each of the previous three years. However, employers are not required to include such employees in employer matching or non-elective contributions, and the actual deferral test does not include them.

5. Pooled Employer Plans Now Less Risky. Unrelated employers sometimes pool together in order to provide qualified retirement plans to their employees at a lower cost. Such plans were subject to the risk that if one employer failed to satisfy applicable requirements it would cause the entire plan to fail. Under the Act, some plans will avoid disqualification if they are formed or amended after December 31, 2020. Qualifying plans must be maintained by employers which have a common interest other than the plan, or must have a qualifying pooled plan provider. In case of a non-compliant employer, the plan must require the assets attributed to such employer to be transferred to a separate plan and the non-compliant employer must be solely liable for any liabilities associated with this failure.

6. Annual Benefit Statements Must Be Provided. Under ERISA, administrators of defined contribution plans must provide benefit statements to participants of the plan. In 2013, the Department of Labor (DOL) proposed requiring administrators to provide participants an estimate of their lifetime payments based on the current account balance. The Act requires such statements to be provided annually and protects plan fiduciaries which follow DOL guidance from any liability for such disclosures.

7. New Restrictions on Easy Loans from Plans. Some employer plans permit loans to plan participants without triggering income tax or penalties on the distributions so long as the loan meets certain requirements (including the loan cannot exceed $50,000 or 50% of the borrower's plan account), and it must be repaid within five years (or 15 if used to purchase a house). To discourage the casual use of plan loans, the Act now treats the use of credit or debit cards, or similar methods, to access plan funds as taxable distributions instead of permitted loans.

8. Increased Penalties for Failure to File Form 5500. The penalty for a pension plan that fails to file form 5500 (*Annual Return/Report of Employee Benefit Plan*) has increased from $25 per day, with a maximum of $15,000, to $250 per day with a maximum of $150,000.

The form is due July 31st, or on extension on October 15th of each year.

Other technical Rules Changes. The Act made a number of other technical changes which affect some pension plans. If you have questions about what else might affect your plan, we recommend you follow up with your plan provider or the attorney who prepared the plan for your business.

FEDERAL TAX UPDATE
By DeEtte L. Loeffler, J.D., LL.M., Taxation

Tax Law Changes Delayed IRS Season Opening to January 27th. According to the IRS, the tax season started late again this year to ensure the security and readiness of key tax processing systems and to address changes made to the Tax Code by H.R. 1158, *Consolidated Appropriations Act*, and H.R. 1865, *Further Consolidated Appropriations Act,* which became law in late December. For most taxpayers, the due date for federal income tax return filings will be April 15, 2020 (it is unaffected this year by Washington D.C.'s celebration of Emancipation Day).

Important Tax Changes For Individual Taxes. Important changes made by the budget acts which may impact individual taxpayers include: the elimination of the kiddie tax changes made by the Tax Cuts and Jobs Act which taxed such income at the higher estate/trust rates; the extension through 2019 of the 7.5% AGI floor for medical expense deductions; the above the line deduction for tuition and fees; the treatment of mortgage insurance premiums as deductible qualified residence interest; the exclusion of qualified residence indebtedness from gross income; the elimination of the 40% Cadillac Tax on employee sponsored health insurance; and the application for 2020 only of the health insurer tax which greatly increased premiums for insured Medicare and other policies (the tax did not apply in 2019).

Bipartisan Proposal Made to Bring Back Carryover Basis At Death. In conjunction with the 2019 end-of-year budget negotiations, Senators Mitt Romney (R-UT) and Michael Bennet (D-CO) proposed a bill that would have replaced the current basis-step up for assets transferred at death under IRC Section 1014 with one that would impose a modified carry-over tax basis for assets held at death. The bill would have allowed the first $1.6 million of assets to receive a new fair market value basis (plus an additional $3.7 million transferred to a spouse). A modified carryover basis was last tried in 2010 and later repealed retroactively with estates given the option to apply the carryover or step-up basis rules. One difficulty with imposing carryover basis is determining the decedent's prior basis. Revenue from the bill was intended to fund an expanded child tax credit, and to address issues which were ultimately included in the 2019 *SECURE Act*, including making technical corrections to the *Tax Cuts and Jobs Act* of 2017, and permanently repealing the medical device excise tax. It is unclear whether a version of this bill will be reintroduced in 2020.

IRS Announces New Lower Standard Mileage Rates. The IRS released the following new, lower standard mileage rates for business, charity, and medical purposes for 2020:

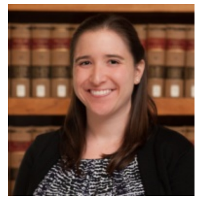
- 57.5 cents per mile for business miles driven (it was 58 cents in 2019);
- 17 cents per mile driven for medical or moving purposes (it was 20 cents in 2019);
- 14 cents per mile driven in service of charitable organizations (no change).

Changes made in the 2017 *Tax Cuts and Jobs Act* suspended all miscellaneous itemized deductions subject to the 2%-of-adjusted gross income (AGI) floor under IRC Section 67 until 2025, including unreimbursed employee travel expenses. However, employers may still reimburse employees required to use personal automobiles for work so long as it does not exceed this standard rate, and the reimbursement is tax-free so long as the employee substantiates the time, place, business purpose, and mileage of each trip.

<u>Procedures Issued Regarding Student Debt Forgiveness</u>. The IRS recently issued Revenue Procedure 2020-11 which provides relief to students or their parents who had student loan debt discharged. The Revenue Procedure provides safe harbor provisions and encourages creditors not to furnish the debtors with a Form 1099-C. The rules apply to both nonprofit and for-profit schools, and apply to both federal and private student loans.

<u>IRS Narrows Private Letters It Will Issue</u>. In January the IRS indicated that it will no longer provide private letter rulings regarding the income tax treatment of certain non-grantor incomplete gift trusts ("ING's"). Such trusts, which are used to shift income out of the grantor's estate while retaining control over the disposition of the assets at death, have generally received favorable rulings, but states do not like them as they allow the grantor to shift taxable income to low or no-tax states. Following the Supreme Court's ruling on *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust,* 139 S. Ct. 2213 (2019), such tax shifting may be more popular. No IRS rulings will be provided if distributions are made within certain parameters, such as at the discretion of certain disinterested parties.

The IRS has also indicated it will not provide private letter rulings regarding the application of the excise tax under IRC Section 4947 to non-exempt split-interest charitable trusts if the parties indicate they have not and do not intend to take a charitable deduction (income, estate or gift tax). Generally, split interest trusts are trusts which have at least one non-charitable beneficiary, and which claim a charitable deduction for a portion of the trust that is allocated to charity.



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

<u>Minimum Wage Increases</u>. Effective January 1, 2020, the state minimum wage increased to $12 per hour under a law that gradually increases wages to $15 in 2023. Many cities will be unaffected because they already impose a higher minimum wage. San Diego increased its minimum wage to $13 per hour in 2016 under the *Earned Sick Leave and Minimum Wage Ordinance,* Municipal Code Chapter 3, Article 9, Division 1. The higher rate applies to employees who perform at least 2 hours of work in one or more calendar weeks of the year within the geographic boundaries of San Diego. Under the Gig Economy law, AB 5, which went into effect on January 1, 2020, more workers are expected to qualify for the $13 per hour rate since the law reclassified most workers as employees rather than independent contractors.

<u>Updates in Estate and Probate Figures</u>. Governor Newsom recently signed into law several bills affecting estate and probates in California, effective January 1, 2020. As reported in prior newsletters, AB 473 provides for the "small estate" amount to increase from $150,000 to $166,250 pursuant to Probate Code Section 13100. The Small Estate Set Aside outlined in Probate Code Sections 6602 and 6609 increased from $20,000 to $85,900, allowing surviving spouses and minor children to petition the court for a set aside. Additionally, Probate Code Section 13200 increases the Affidavit Procedure for Real Property of Small Value from $50,000 to $55,425, allowing a successor-in-interest to real property to record an affidavit to transfer title for lower value real property.

The amount a surviving spouse may petition to collect for salary and other compensation owed to the decedent, and the offsetting deduction in arriving at the estate value, has increased from $15,000 to $16,625 in Probate Code Sections 13600 and 13050, respectively. The figures are to be indexed for inflation every 3 years, beginning in April 2022. Other changes of note to probate and trust attorneys include Donative Transfers to Caregivers in AB 328 amending Probate Code Section 21380 and 21611, discovery rules in SB 370 amending the Code of Civil Procedure Section 2031.280, SB 17 adding two new sections to the Code of Civil Procedure imposing sanctions and instituting optional initial disclosure procedures, and AB 1349 which amends Code of Civil Procedure Sections 2030.210 and 2033.210 regarding interrogatories and requests for admissions, respectively.

New Renter Rights Are Now In Effect. As discussed in our October 2019 Newsletter, effective January 1, 2020, AB 1482 limits rent increases to no more than 5% per year. Exceptions apply for single family homes and condos. Evicting tenants is also harder and more expensive now. In addition, under SB 222 and SB 329, landlords can no longer decline to accept potential tenants solely due to inadequate income sources if they plan to pay using housing vouchers (i.e., so-called "Section 8" renters).

Law Changes Affecting Real Property. Several new laws were instituted in 2019 affecting real property, including some of those listed here. AB 827 requires a business that generates 4 cubic yards or more of commercial solid waste to provide clearly-marked recycling bins adjacent to trash bins. AB 1110 requires landlords of month-to-month contracts who increase rent by 10% or less to provide 30 days' written notice to tenants; landlords of month-to-month contracts who increase rent by more than 10% need to provide 90 days' written notice to tenants. AB 38 requires sellers of real property located in high or very high fire hazard zones to provide documentation that the property is in compliance with wildfire protection measures and a list of features that make the home vulnerable to wildfire.

AB 670 restricts the enforceability of agreements that unreasonably prohibit the building of an accessory dwelling unit ("ADU") on a lot zoned for single-family residences. Similarly, AB 68 and 881 encourage the building of ADUs, requiring jurisdictions to allow the development of ADUs in certain circumstances. SB 323 outlines several law changes with regard to homeowner association election laws, and SB 326 requires inspections of certain balconies and other structures by condominium homeowner associations.

San Diego Recorder Fee Changes. On November 19, 2019, the San Diego County Board of Supervisors approved an ordinance updating fees for the San Diego Recorder/County Clerk's Office by increasing 18 fees, decreasing 7 fees, and adding 2 new fees for time and material labor rates, effective January 1, 2020. A list of the new fees can be found at:
https://arcc.sdcounty.ca.gov/documents/FeeChanges2020.pdf.

Housing Bill Reintroduced. Senators Jim Beall (D-15), Mike McGuire (D-2), and Anthony Portantino (D-25) have introduced SB 795 to address the housing shortage in California. The bill would establish an Affordable Housing and Community Development Investment Program to oversee building affordable housing. Program funding would come from the General Fund in such a way that the percentage allocated to schools and community colleges would not be reduced. Under the bill, up to $2 billion a year (increasing over a decade from $2 million) would be committed to building such housing. Governor Newsom vetoed a similar bill, SB 5, last October on the grounds that spending of this magnitude needed to be included in the budget instead of a separate bill. Housing advocates are urging the governor to include up to $3 billion in the budget for affordable housing.

California Corporate Form SI-PT Updated. The California Secretary of State has updated Form SI-PT, the Corporate Disclosure Statement for Domestic and Foreign Corporations effective January 1, 2020. Prior versions of the form will no longer be accepted. The form incorporates new statutory reporting requirements mandated in Corporations Code Sections 301.3 and 2115.5, namely that publicly held corporations with principal executive offices in California must have a minimum number of female board members.

No Privacy for Cordless Calls with Businesses. A recent court case reduces the privacy of calls made with a business if one party uses a cellular or cordless phone. In *Smith v. LoanMe Inc*., E069752, 2019 WL 6974386 (Cal. App. 4th Dist. Dec. 20, 2019), the court held that Penal Code Section 632.7 does not apply to *participants* in a call if one of the parties to the call is using a cordless device, essentially allowing the recording of calls if done by the participants in the call. The case involved a business which recorded a conversation with a customer without expressly telling the customer that the call was being recorded. Under the *California Invasion of Privacy Act* generally, no one may record a conversation unless he or she has the consent, express or implied, of all parties to the call. The court limited this privacy by prohibiting only third parties who intercept such calls from recording them. This case is important because few people still use a “land line” for business or home. However, this interpretation expressly does not impact “confidential calls” under Penal Code Section 632 (such as calls with your lawyer, doctor or stock broker), which still cannot be recorded by any means without the express consent of all parties.

FTB Reminds Taxpayers of E-Pay Requirement. The Franchise Tax Board is reminding taxpayers that they may be required to pay electronically if they meet certain criteria. Failure to comply can result in a penalty equal to one percent (1%) of the amount not paid in this manner. Electronic payment is required if the taxpayer (a) makes an estimated tax or extension payment exceeding $20,000, or (b) files a tax return with a tax liability over $80,000. The taxpayer must continue to pay electronically until granted permission to stop by submitting FTB Form 4107 (*Mandatory e-Pay Election to Discontinue or Waiver Request*). Taxpayers may pay online using FTB Web Pay, by requesting an electronic funds transfer with an e-filed return, by credit card, or by phone. More information is available at https://www.ftb.ca.gov/about-ftb/newsroom/tax-news/january-2020/print-version.pdf.

AREAS OF PRACTICE

ESTATE PLANNING

& ADMINISTRATION
WILLS & TRUSTS
ESTATE & GIFT TAX PLANNING
INSURANCE TRUSTS
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

TAXATION
IRS RULING REQUESTS
TAX REPRESENTATION

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

BUSINESS & CORPORATE LAW
BUSINESS MERGERS, ACQUISITIONS, & SALES
CORPORATIONS, PARTNERSHIPS
LIMITED LIABILITY COMPANIES
BUY/SELL AGREEMENTS
EMPLOYMENT MATTERS
REORGANIZATIONS
ASSET PROTECTION

REAL ESTATE
SALES & LEASES
FINANCING
SHARED EQUITY AGREEMENTS
CO-OWNERSHIP ARRANGEMENTS

LITIGATION
ERISA LITIGATION
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