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Yes – We are available to help you!

While many of our Miller Monson team members continue to work remotely, we are all available, virtually, for you, your family and your business. For everyone's safety, we are not holding in-person meetings unless critical, but remain available by email and telephone, and can host conference and Zoom calls. We can also send a notary to your home or office so you can sign your documents. We value you, and will continue to meet your changing needs.

IN THIS ISSUE

- **Do I Need to Keep Original Documents?** *by Mary J. Peshel, J.D.*
- **Tax Planning To Do Before 2021** *by DeEtte L. Loeffler, J.D. LL.M., Taxation*
- **Federal Tax Update** *by Katie Lepore, CPA, J.D., LL.M., Taxation*
- **State Tax News** *by Katie Lepore, CPA, J.D., LL.M., Taxation*



DO I NEED TO KEEP ORIGINAL DOCUMENTS?
By Mary J. Peshel, J.D.

Recently I received a telephone call from a man whose parents were clients of the office years ago. The second parent died in 2007. After the trust administration was complete, all original documents were delivered to the child who was the trustee of the trust.

Fast forward to 2020. The children of our now deceased clients are selling a property that is owned by the trust. The escrow company requires them to provide the *original* trust document. The children know that one of them received the original documents, but no one knows where they are located, or if they still exist.

The requirement of an original document, for purposes of a sale, or for any other reason, is unusual. However we do see this occasionally. Perhaps this is a result of the many scams that seem to be so rampant these days.

We recommend keeping original documents in a safe place, and destroying originals only if you are certain that the document in question is no longer significant. For example, check ownership records and be sure title to real property or other assets is no longer held in the name of a trust before destroying the original document.

While our world is becoming more and more digital, we find that some original documents are still required. If you are short on space, or just don't like keeping many physical documents, it might be worthwhile to invest in a safe deposit box where important original documents can be stored.

If you have a choice between keeping and tossing a document, the better, more cautious option may be to keep the document. We may also be able to advise you as to whether a particular document is important to keep.



TAX PLANNING TO DO BEFORE 2021

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

You will not be surprised to hear that taxes are going up. You might be surprised, however, by how quickly that may happen. Experts are predicting that as early as January 1, 2021, the federal estate tax exclusion may drop dramatically, and the tax rate may increase from the current 40%. In addition, income taxes will likely go up for corporations and high-income earners, but also for pensioners and retirees. Property taxes could also increase for anyone who owns a home valued at over \$1 million. There are some things you can do, however, to improve your personal future tax picture.

Why Taxes Will Rise

One obvious reason taxes will rise is declining tax revenues and increased government spending due to the current pandemic. To date, the federal government has spent \$2.4 trillion on pandemic-related bills to help taxpayers and prop up the economy, and last week the Republicans proposed spending another \$1 trillion on such programs (to which the Democrats objected as the proposal is not large enough). Basic economics indicates that either spending must be reduced or taxes increased to cover that spending.

According to the Congressional Budget Office Monthly Budget Review report for June, the

federal deficit has tripled and is currently \$2 trillion more for the first nine months of fiscal year 2020 than in the prior fiscal year. The deficit was \$8 billion in June of 2019 and \$836 billion in June of 2020 – the largest deficit ever. While some of this was caused by delayed revenue collection (tax deadlines delayed from April 15th to July 15th), some of this delayed tax revenue may now be uncollectible as taxpayers struggle financially from the pandemic.

California has likewise increased its spending. On June 25th Governor Newsom declared an emergency allowing the state to access the \$16.1 billion “rainy day” fund to help reduce a \$54.3 billion deficit in the 2020 fiscal year budget. Cities and counties have also increased spending programs to assist businesses and individuals, providing low-cost loans and grants. Lost revenues for cities and counties include reduced revenue from the hotel tax and tourist spending, parking revenue, and sales taxes.

That is not the complete answer, however. The tax revenue projected to be produced by the 2017 *Tax Cuts and Jobs Act* never fully materialized¹, as corporations did not rush to repatriate offshore funds, and in December the three major taxes imposed under the 2010 *Patient Protection and Affordable Care Act* (aka “Obamacare”) were repealed (and the Act cost \$938 billion more than projected over the first 10 years).² The federal and state gas taxes have not fully supported infrastructure since 2008.³ In California, Proposition 13 (1976), Proposition 58 (1986) and Proposition 193 (1996) significantly limited local revenue by restricting property tax increases and allowing certain real property to pass without a reassessment when transferred between parents and children or grandchildren. The perceived “unfairness” of these tax policies makes them easy targets in a time when revenue is tight and the needs of many are great.

¹ See Analysis by Brookings Institute at <https://www.brookings.edu/policy2020/votervital/did-the-2017-tax-cut-the-tax-cuts-and-jobs-act-pay-for-itself/>

² See <https://www.thebalance.com/cost-of-obamacare-3306050>

³ See Congressional Research Report entitled *Funding and Financing Highways and Public Transportation*, updated May 11, 2020 at <https://fas.org/sgp/crs/misc/R45350.pdf>;

Raising Taxes is Easier Than Reducing Them

Raising federal taxes is fairly easy. Unlike enacting tax cuts, which congressional rules require to be offset by spending reductions, it is relatively easy to enact tax increases. The process requires a vote of only 50% of the Senate under the budget reconciliation rules. If in November the Democrats retain the House of Representatives and gain a majority in the Senate⁴, tax policy will very likely change.⁵ Moreover, the Supreme Court has ruled that Congress can enact tax legislation retroactively.⁶ This means that the newly elected Congress could enact new tax laws in 2021 (or even 2022) and impose them back to January of 2021.

Raising California taxes is not as easy, but recent court rulings have made it easier. To increase taxes, both legislative houses must approve the increase by a two-third majority. However, according to recent court rulings, tax changes made by initiative require only a simple majority. In 2012, then Governor Jerry Brown used this process to increase sales taxes and to “temporarily” increase income taxes on the wealthy. In addition, the state legislature is currently considering a bill (discussed in 1(c) below) that would increase taxes **retroactive to January of 2020** and which might succeed in gaining this two-thirds approval.

California has already raised some taxes. On July 1, 2020, the gas tax rose by 3.2 cents to 50.5 cents a gallon.⁷ In addition, on June 29, 2020 Governor Newsom signed the 2020-2021 state budget temporarily raising taxes on medium and large businesses by suspending the use of net operating losses and temporarily limiting to \$5

million the amount of business incentive credits a taxpayer can use in any given tax year. This suspension is expected to generate \$4.4 billion in new revenues in the 2020-21 fiscal year, but the tax burden is expected to be passed along to consumers in the form of higher prices.

Which Taxes May Go Up?

President Trump has not yet released his “2.0 Tax Plan”, but commentators think he will seek to make permanent the tax reductions made in the 2017 *Tax Cuts and Jobs Act*. Proposals from others that could become law as early as January of 2021 are discussed below.

1. Income Taxes.

a) **Capital Gains Taxes.** Democratic presidential candidate Joe Biden has proposed eliminating the IRC Section 1014 basis adjustment on assets at death, which eliminates capital gains (and losses) at death. He has also called for taxing capital gains and dividends as “ordinary income” (i.e., like wages) for those earning more than \$1 million. Senator and former presidential candidate Bernie Sanders advocated imposing this higher rate on those with income over \$250,000.⁸ Capital gains are currently taxed at 15% or 20% federally, depending on the taxpayer’s marginal bracket (California does not provide a preferred tax rate for capital gains). Candidate Biden has also called for disallowing like-kind exchanges of real property under IRC Section 1031 for those with income levels over \$400,000.⁹

⁴ Democrats would need to gain four (4) seats to control the Senate (or three (3) plus the White House); Republicans would need to gain 25 seats to retake the House.

⁵ This assumes Senator Bernie Sanders would vote with the Democrats on tax measures, providing a 50% voting block and the Democratic vice president would vote to break the tie.

⁶ See *United States v. Carlton*, 512 U.S. 26 (1994) (tax imposed 14 months retroactively).

⁷ Under SB1, which passed in 2017, the gas tax rises automatically every year, and has risen a total of 17.6 cents a gallon since 2017. See <https://www.latimes.com/business/story/2020-06-25/column-california-gas-tax>

⁸ See Tax Policy Center Report dated March 11, 2020 at <https://taxfoundation.org/2020-tax-plans/>

⁹ See https://www.washingtonpost.com/business/what-is-the-like-kind-exchange-rule-that-biden-wants-dead/2020/07/24/daf373bc-cddd-11ea-99b0-8426e26d203b_story.html

b) **Federal Individual Income Taxes.**

Candidate Biden has also called for broadening the tax base (i.e., imposing the rates at lower income levels) and increasing the top federal income tax rate to 39.6% again from the current 37%. For those earning \$400,000 or more, the IRC Section 199A deduction for income from certain types of pass-through entities would no longer be available. In addition, he has discussed capping itemized deductions at 28% of value, phasing out for taxpayers in the top three tax brackets, and restoring the Pease limitation on itemized deductions for incomes over \$400,000.

c) **California Individual Income Taxes.** A bill currently in review before the California Senate Governance and Finance Committee would raise personal income taxes in California retroactive to January 1, 2020. AB 1253, if enacted, would create three top millionaire tax rates, increasing the rate for those with income over \$1 million from 13.3% to between 14.3 and 16.8%.¹⁰

d) **Payroll Taxes.** Candidate Biden has called for expanding Social Security withholding at 12.4% to also apply to earnings over \$400,000. Currently, the tax is only imposed on the first \$137,700 of income. This would create a “doughnut tax”, not taxing income between \$137,700 and \$400,000.

e) **Corporate Taxes.** Candidate Biden has also proposed increasing the corporate tax rate to 28% (from its current 21%), doubling the tax rate on foreign profits from US multinational corporations to 21%, and setting a minimum 15% “alternative” minimum tax on the book profits of companies with at least \$100 million. Estimates of revenue vary, with the Tax Policy Center estimating \$1.3 trillion and

the American Enterprise Institute estimating \$2 trillion in new revenue between 2021 and 2030, if enacted.¹¹ Finally, Candidate Biden would repeal the temporary net operating loss (NOL) provisions contained in the March 2020 CARES Act which allow businesses to carry back NOLs from 2018 through 2020 for up to five years.¹²

2. **Federal Estate and Generation-Skipping Transfer Taxes.**

These two taxes have historically been coupled, so any change in the estate tax affects the GST Tax as well. Candidate Biden has stated that he wants to return estate taxes to the “norm.”¹³ This statement was made in July and has not yet been clarified, but commentators think he means to reduce the lifetime exclusion to the levels in effect prior to the 2017 *Tax Cuts and Jobs Act*, which was \$5 million indexed for inflation and a 40% tax rate; others think he means to reduce it to 2009 levels, which were \$3.5 million with a 45% tax rate.

3. **Gift Taxes.** Early in the campaigns there was talk of amending the federal gift tax, with some suggesting the lifetime exclusion be reduced to \$3.5 million and the tax rate increased to 45% as it was in 2009, and others suggesting that a \$1 million exclusion and 55% rate is appropriate. The proposals would “decouple” this tax again from the estate tax. No recent proposal regarding this tax has been made. Lifetime gifts allow taxpayers to shift income-producing assets to younger generations who usually pay tax at a lower rate, and also allows the shifting of future appreciation.

4. **Wealth Tax.** Former presidential candidates, Senators Bernie Sanders and Elizabeth Warren, have proposed imposing a wealth tax on Americans with high assets, with Sanders’ plan to be imposed on couples with assets in excess

¹⁰ See https://leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB1253

¹¹ See *Details and Analysis of Former Vice President Biden’s Tax Proposals*, The Tax Foundation, April 2020; and *An Analysis of Joe Biden’s Tax Proposals*, by American Enterprise Institute, June 2020.

¹² See <https://www.kiplinger.com/slideshow/taxes/t055-s001-2020-election-joe-biden-s-tax-plans/index.html>

¹³ See Biden-Sanders Unity Tax Force Recommendations, <https://joebiden.com/wp-content/uploads/2020/07/UNITY-TASK-FORCE-RECOMMENDATIONS.pdf>

of \$32 million and Warren's plan to be imposed on those with \$50 million. These flat taxes would apply annually. In July, Candidate Biden sought to reduce the differences between his tax plan and Senator Sanders', so this tax proposal might reemerge, although it was not included in the recent joint statement from their campaign camps.¹⁴

5. California Property Taxes. Two measures on the November 2020 ballot would cause property taxes to increase on some real properties which were previously given preferred tax treatment by the 1978 law known as Prop 13. Prop 13 limited property tax increases to 2% per year unless the property was transferred. Prop 58 in 1986 and Prop 193 (1996) further shielded a personal residence of any value plus up to \$1 million in total assessed value of other property under a "parent-child" or "grandparent-grandchild" exclusion.

a) **Proposition 15**, the "split roll", would reassess as of the 2022-2023 tax roll all commercial and industrial properties (not residential or agricultural) if: (i) the value of the property exceeds \$3 million, or (ii) the indirect or direct owners of the property hold more than \$3 million of such properties. The bill is estimated to raise \$6.5 to \$11.5 billion in new tax revenue for schools. However, since most business property leases are "triple net", the increased rent will likely be paid by the tenants and not the landlords. According to the San Diego County Assessor's Office, the County would need to hire and train an additional 300 assessors, and any delays in assessment appeals will result in lower revenues, as by law the County cannot challenge an owner's estimate of value if not timely made.

b) **Proposition 19** would limit the value of a personal residence that can be transferred between parents/children and grandparents/grandchildren without

triggering a reassessment of the property taxes. Currently, a personal residence of any value can be transferred, but under Prop 19 the exclusion would be capped at \$1 million fair market value plus the transferor's tax assessed value. Any excess value would be subject to reassessment. In addition, to qualify, the transferee would have to use the property as a primary residence. For example, a home with a fair market value on the date of transfer of \$2 million and a tax assessed value of \$400,000 would be reassessed on the difference between the exclusion (\$1,400,000) and the current value, (i.e., \$600,000 excess). The \$1 million exclusion would adjust for inflation. Revenue raised would be allocated to firefighting but could be appropriated as part of the General Fund.

What Can You Do Now?

With so many different taxes potentially in play, there are still some things you can do now to improve your future tax situation.

First, if the value of your taxable estate exceeds \$5.79 million (or maybe just \$3.5 million), we recommend you strongly consider gifting your entire remaining exclusion from the federal estate and gift taxes before the end of 2020 if you can afford to do so. Before making gifts, it is critically important that you determine if you can live without the assets and income you plan to gift, given your health and life expectancy. Giving away too much can leave you in financial jeopardy and leave an opening for the IRS and/or FTB to challenge the gifts. Consideration should also be given to making sure you relinquish all control over entities that you currently control if these entities may control others that you previously gifted (i.e., such as general partner interests in limited partnerships where you plan to gift, or previously gifted, limited partner interests).

¹⁴ The Unity Task Force Recommendations included as a goal "the wealthiest Americans can shoulder more of the tax burden, including in particular by making investors

pay the same tax rates as workers and bringing an end to expensive and unproductive tax loopholes." See Id.

The IRS has issued guidance stating that there will be no “claw back” of gifts into an estate at death if the gifts were made when the lifetime exclusion was higher. Remember, however, that gifts take a “carryover” basis for the donee, locking in any built-in capital gains. In the event capital gains tax rates are increased to ordinary rates and the donee sells an appreciated asset, it could trigger a large tax bill for the gift recipient, but the same tax result could occur if the basis step-up under IRC Section 1014 is eliminated and the asset is sold following death. If capital gains rates are not increased, then a 15% or 20% capital gains tax bill from a carried over low basis is still better than a 40% estate tax on the value of the entire property.

Second, we recommend you gift interests in a primary residence, and other real properties, to the full extent of your parent/child exclusion (a residence of any value plus \$1 million in other assessed value property). Gifts of your primary residence can be made using a Qualified Personal Residence Trust which would allow you to retain use of the house until the trust terminates. Gifts of other properties should be made without any strings to ensure the gift is “complete” for gift tax purposes. Gifts using entities are also a good option as they can provide more protection from third party creditors and greater valuation discounts also might apply.

Third, if your income exceeds \$250,000, you may also want to sell assets with built-in gains in the event the capital gains tax goes up. Combining a sale with gifts might work well but deferred recognition of the gain could also cause you to recognize gain at a higher tax rate in the future, so multiple scenarios should be reviewed.

Fourth, in the event you hold investment real estate and wish to complete a like-kind “Section 1031” exchange, you should consider completing the exchange before 2021. Political commentators are not in agreement that Congress would agree to completely disallow 1031 exchanges, but it seems possible they might disallow them for high-income taxpayers.

Fifth, if you have a Charitable Remainder Trust (CRT), you may want to trigger capital gains now as well. Gifting to charity may also be a great option since in 2020 donation of cash (not other assets) may be made for up to 100% of your adjusted gross income (AGI), which might allow you to make bigger gifts while retaining an income stream using a Charitable Remainder Unitrust (CRUT). With interest rates near zero, CRUTs are especially attractive, and using the annual distributions from the CRUT to purchase life insurance through an irrevocable life insurance trust (ILIT) can provide wealth replacement outside of your taxable estate.

Sixth, those with a smaller C-Corporation may also want to consider converting to an S-corporation to avoid the possibly higher federal corporate tax rates and to take advantage, if permitted, of the Section 199A preferred deduction.

Finally, “bunching” of deductions remains a viable option for increasing tax deductions in 2020, especially for any deductions that you think may disappear in 2021. Gifts to Donor Advised Funds would allow you to take a deduction in 2020 but to defer to 2021 (or beyond) when the charities actually receive a distribution.

We are living in very unusual times, with unusual challenges and opportunities. If you would like to discuss these challenges and your options, we would be happy to discuss them with you.



FEDERAL TAX UPDATE

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

[IRS to Focus on High Net Worth Taxpayers.](#) Beginning on July 15, 2020, the IRS started a new campaign to audit hundreds of high net worth individuals. The so-called Global High Wealth Industry Group, part of LB&I, focuses on complex individual returns, offshore accounts,

trusts, and controlled entities. An audit often starts with a single return and then includes a related business return.¹

PPP Program Extended. On July 4, President Trump signed into law S. 4116, which extended the application date for the PPP program through August 8. Congress is expected to further address the PPP program in the coming weeks.

IRS to Pay Interest on Late Refunds. Some lucky taxpayers may receive interest from the IRS on their tax refunds this year. Any payments made by the IRS more than 45 days late generally accrue interest, but the IRS has announced it will accrue interest from April 15 until the refund is issued. The average amount of interest per taxpayer will be \$27.²

IRS Seeking Input on Section 67(g). The IRS will be holding a public hearing on proposed regulations for Section 67(g), regarding deductions for trusts and estates. As previously reported in our [May 2020](#) newsletter, the proposed regulations clarify that the deductions listed in the regulations are not miscellaneous itemized deductions, and therefore are eligible deductions not affected by the *Tax Cuts and Jobs Act's* suspension of itemized deductions. The hearing will be held August 12, 2020.

PTIN Fees Announced. The IRS announced that the 2021 fee for Preparer Tax Identification Numbers will be \$21 (plus a \$14.95 fee for a contractor) for each application or renewal. Renewal is expected to be open beginning in mid-October. The IRS suspended collecting a fee in 2017 after losing a case in federal court, but in 2019 the District Court in DC cleared the way for the fee to be imposed again. Anyone who prepares federal tax returns for compensation (or assists in their preparation) is required to have a PTIN.



STATE TAX NEWS

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

California Taxes Trusts' Source Income. In *Steuer v. Franchise Tax Board* (Cal Ct App, June 20, 2020, No. A154691), the First District California Court of Appeal held that a trust's California-source income is all taxable in California, even if one of the co-trustees is a nonresident. California-source income is not allocated among the resident and non-resident trustees; the trust's non-California source income would be apportioned among the resident and non-resident trustees.

San Diego Extends Eviction Moratorium. The San Diego City Council voted on June 30 to extend the eviction moratorium on both commercial and residential properties through September 30, 2020, and on July 28th they voted to potentially extend the moratorium to December 31, 2020 (this second extension is subject to a second vote). The requirements to qualify for protection from eviction remain in place, including the renter's need to show an adverse financial impact due to COVID-19. Additionally, the Council approved a rental assistance program totaling \$15.1 million to assist certain renters to pay unpaid past rent. A renter must have no more than 60% of the median income in San Diego and not have enough money in a savings account to pay their bills in order to qualify for a one-time payment of up to \$4,000 from the fund.

Parent/Child Exclusion on Ballot. Proposition 19 has qualified for the November ballot. Under current law, parents can pass to children (or vice versa) real property with a collective

¹ See

<https://www.forbes.com/sites/jasonbfreeman/2020/06/21/the-irs-intends-to-audit-more-high-wealth-taxpayers/#2643f167596e>

² See

<https://www.cnn.com/2020/07/10/you-might-get-two-tax-checks-from-the-irs-this-year.html>

assessed value of \$1,000,000, plus an unlimited amount for a principal residence. Proposition 19 would require the transferee recipient to live in the principal residence in order for it to qualify for the unlimited principal residence exclusion. If the transferee recipient does not use the parent's principal residence as his/her own, it will need to qualify for the \$1 million overall cap. Additionally, even if the principal residence is going to be used by the transferee recipient, if its assessed value plus \$1 million is less than its fair market value, the principal residence may be subject to partial reassessment. If approved by voters, the new law would be effective February 16, 2021 and the \$1 million would be indexed for inflation. Proposition 19 would also allow taxpayers over age 55 (or disabled) to transfer the assessed value of their residence to a new primary residence anywhere in the state.

Trust Revocation Not Exclusive. In *Cundall v. Mitchell-Clyde* (Cal Ct App, June 29, 2020, No. B293952), the Second District held that unless a California trust explicitly states the manner of revocation provided in the trust is *exclusive*, a trustee can use the statutory manner of revocation.

Supermajority Tax Allowed. The California First District Court of Appeal held that a local San Francisco tax passed by ballot measure (Prop C in 2018) does not require a two-thirds supermajority. Only taxes imposed by local governments require a two-third majority rather than those proposed by citizen groups. This is one of a series of recent appeals court decisions addressing California's constitutional requirement of a supermajority vote for the legislature to increase state taxes, and is expected to impact the number of propositions being offered in the future as an end run around this limitation.

Housing Bills and COVID-19. Several housing bills are being considered at the State Legislature. *SB 1410* would allow a tenant and landlord to enter into a COVID-19 Eviction Relief Agreement whereby the tenant repays unpaid rent to the state in installments between January

1, 2024 and January 1, 2034. In exchange, the landlord would receive a tax credit for the amount of unpaid rent. *AB 828* would prevent foreclosures during the state of emergency and for 15 days past the end of the state of emergency and prevents certain evictions due to nonpayment of rent. It would allow forgiveness of rent in some circumstances, requiring the landlord to show financial hardship if the rent is not collected (see our [May 2020](#) newsletter for expanded description). *AB 3040* would relax local zoning laws for single family residences to allow for multi-family housing to be built, and still count toward a local government's Regional Housing Needs Allocation quota.

Leasehold Interest Not Subject to Documentary Transfer Tax. A California District Court held in *731 Market Street Owner, LLC v. City and County of San Francisco* (Cal Ct App, June 18, 2020, No. A154369) that the County Assessor could not impose a documentary transfer tax on a leasehold that was sold which had a remaining term of 35 years. In California, a lease of more than 35 years constitutes a "change in ownership," triggering a property tax reassessment. In this case, the landlord recorded the 45-year lease upon execution, and when they sold the building, including the leasehold, to a new buyer, the leasehold was taxed again. The Court held that since over 35 years remained on the original lease that was taxed once, the leasehold could not be taxed again upon the sale of the building. The court drew a distinction between the creation of the leasehold of more than 35 years and the mere transfer of a leasehold.

Los Angeles Postpones Vacancy Tax. The Los Angeles City Council decided to delay consideration of a vacancy tax until 2022. The "Empty Homes Tax" would have imposed a tax on landlords for having vacant units in an attempt to encourage affordable housing or renting to low-income tenants. The Los Angeles Housing and Community Investment Department estimates that such a tax would raise \$120 to

\$150 million annually.¹ The tax was originally being considered for the November 2020 ballot.

Clarification: We would like to clarify that the article “Working from Home Due to Coronavirus? Can You Claim a Home Office Deduction?” in our [July 2020](#) newsletter focused on federal tax laws. California still allows certain miscellaneous itemized deductions for expenses that exceed 2% of your federal adjusted gross income, which may include a home office deduction.

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 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

¹ See <https://www.jdsupra.com/legalnews/proposed-los-angeles-city-residential-89982/>

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
- FIDUCIARY LITIGATION
- PROBATE & TRUST LITIGATION
- WILL CONTESTS
- REAL PROPERTY MATTERS
- BUSINESS & COMMERCIAL DISPUTES
- LABOR LAW LITIGATION

EMPLOYEE BENEFITS & ERISA

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