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Firm News: We congratulate **Mary J. Peshel, J.D.** on being named as a 2021 *Super Lawyer*, and **Katie A. Lepore, CPA, J.D., LL.M., Taxation** on being named as a 2021 *Super Lawyers Rising Star*. Such awards are granted by our peers in the legal community and are a great honor. The Rising Stars designation is reserved for the top 2.5% of attorneys in San Diego under age 40. Congratulations, Mary and Katie!

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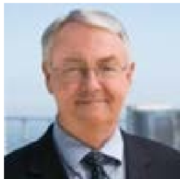

RECOMMENDATIONS FOR RETIREMENT DISTRIBUTION PLANNING

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

The following is a list of recommendations for individuals with IRAs and/or qualified retirement plans (jointly referred to as "IRAs") regarding the distribution rules related to federal income tax and estate planning for these assets.

IRA owners need to know:

- It is important to periodically update and/or review your existing beneficiary designation forms on file with the IRA custodian.
- Periodic reviews are also typically needed of your existing estate planning documents to determine whether your IRAs will be charged with an allocable portion of the estate tax upon your death or your IRAs are exonerated from the estate tax liability. If exonerated, then it is important to make sure that there are sufficient other assets to pay the estate tax allocable to the IRAs.
- Exonerating the IRA from any estate tax liability will permit more tax-deferred growth of the retirement assets and tax-free growth of Roth IRAs. However, this exoneration approach may come at the expense of other beneficiaries of the estate. Thus, it is important to know and evaluate if certain beneficiaries will be adversely affected by the projected estate tax.
- In conjunction with the above, it is important to do an estimated estate tax liquidity analysis to determine the extent of the estate tax liability and the source of payment of the projected estate tax liability.

- In selecting the beneficiaries of the IRA, one needs to understand if a "designated beneficiary" (i.e., individual) may qualify as an "eligible designated beneficiary" at the time of death of the IRA owner and thus be able to use the beneficiary's life expectancy to "stretch out" the required distributions from the inherited IRA.
- Generally, a minor, though qualifying as an "eligible designated beneficiary," should not be directly designated as a beneficiary of an IRA. If the IRA owner wants to name a minor as beneficiary of the IRA, then the IRA owner needs to be advised as to how to use the Uniform Transfers to Minors Act in a manner permitted under California law.
- The difference between selecting "per capita" instead of "per stirpes" provisions on the beneficiary designation form can affect who will be the beneficiaries of the IRA.
- Serious consideration should be given to permitting the agent in the owner's Power of Attorney form to manage IRA distributions, including rollovers and beneficiary designations.
- A specifically designed trust may be the beneficiary of an IRA provided that the rules under the Treasury Regulations are satisfied. If naming an IRA Beneficiary Trust as the beneficiary of the IRA, the IRA owner should inform the beneficiaries of that IRA Beneficiary Trust how that trust will work after the death of the IRA owner.
- There is a "One-Per-Year Limit" on IRA rollovers. In addition, to avoid this restriction, instead of a rollover, transfers between IRA custodians can be done by direct "trustee-to-trustee" transfers.
- Roth IRA conversions can no longer be recharacterized as a result of the Tax Cuts and Jobs Act.
- If the IRA owner failed to take a required minimum distribution in any year, he or she should file IRS Form 5329 requesting a waiver of the 50% penalty.

The projected surviving spouse needs to know:

- The spousal rollover rules or direct transfer rules will apply after the IRA owner's death. The surviving spouse qualifies as an "eligible designated beneficiary" and is thus able to "stretch out" the distributions from the inherited IRA using his or her life expectancy under the IRS tables if the surviving spouse decides initially not to do a spousal rollover.
- While a surviving spouse named as the beneficiary of an IRA can rollover the funds from the deceased spouse's IRA, there cannot be a rollover of the required minimum distribution from the IRA attributable to the deceased spouse in year of death.

Other beneficiaries need to know:

- If the IRA owner had started taking required minimum distributions before death and did not withdraw the required minimum distribution for the year of death, it must be withdrawn by the beneficiaries before December 31st of the year of death to avoid incurring a penalty. Beneficiaries of an IRA who fail to take this withdrawal in the year of death can file an IRS Form 5329 with the IRS requesting a waiver of the 50% penalty.
- The inherited IRA distribution rules were changed by the SECURE Act. Now "designated beneficiaries" must withdraw all funds from the inherited IRA by December 31st of the year containing the 10th anniversary of the IRA owner's death. However, we do not currently think there are any required minimum distributions that need to be taken by the "designated beneficiary" for the years one through nine.
- If the beneficiaries are the beneficiaries of a ROTH IRA, they will be subject to the post-death required minimum distribution rules just as beneficiaries of a Traditional IRA.
- Beneficiaries, especially those likely to be under the age of 59½ after the death of the IRA owner, need to know that

retirement distribution post-death payments paid to a beneficiary are generally not subject to the 10% early withdrawal penalty.

- The balance in an inherited IRA is included in the gross estate of the beneficiary for estate tax purposes when the beneficiary subsequently dies with a balance remaining in the inherited IRA. Importantly, this estate tax issue can be avoided if an irrevocable trust is the beneficiary of the IRA and not the beneficiary personally.
- For post-death planning purposes, the beneficiary may timely disclaim an inherited IRA.
- There are potential benefits to having "separate accounts" if there are multiple beneficiaries of an IRA.
- IRS penalties apply to beneficiaries of inherited IRAs when post-death required minimum distributions are not timely made.
- The federal estate tax attributable to an IRA may be deducted by the beneficiaries on a pro-rata basis.
- If an IRA Beneficiary Trust has been named as the beneficiary of the IRA, the Trustee of the IRA Beneficiary Trust must know that certain Treasury Regulation trust documentation requirements must be satisfied with the IRA custodian by no later than October 31st of the year following the IRA owner's death.
- The Pension Protection Act of 2006 permits a non-spouse beneficiary of an eligible retirement plan to establish an inherited IRA and have the funds transferred from the eligible retirement plan to the inherited IRA. These provisions apply to non-spouse beneficiaries with respect to amounts payable from a qualified retirement plan, a government section 457 plan and a 403(b) tax sheltered annuity. Initially, the IRS determined this provision was optional under the 2006 Act and not mandatory. Then under the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA") this provision became mandatory for plan years commencing after December 31, 2009.
- Beneficiaries should timely prepare a "successor-in-interest designation of beneficiary form" with respect to the inherited IRA. If not done, then the "default beneficiary" under the IRA custodial agreement becomes the successor beneficiary.

FEDERAL TAX NEWS

By Linda A. Nelte, J.D.

American Jobs Plan ("AJP") Proposal. On March 31, 2021, the Biden Administration released the AJP proposal, totaling $2.3 trillion, though President Biden indicated he is open to reducing the price tag. The AJP proposes investments in traditional infrastructure priorities such as transportation, and domestic manufacturing. As part of his broader AJP proposal, President Biden introduced the *Made in America Tax Plan*. Such Plan would fund the AJP through an increase in corporate tax rates from 21% to 28% as well as a 15% minimum tax on corporations with a net "book" income of at least $2 billion. The tax proposals also focus on additional revenue through taxing foreign income. A Republican counterproposal aims to scale down the cost and also preserve the existing corporate 21% tax rate.

American Families Plan ("AFP") Proposal. On April 28, 2021, President Biden announced the *American Families Plan*, a $1.8 trillion proposal. The AFP proposal would fund "human infrastructure" priorities, including paid family and medical leave, universal childcare, free community college, and provide $800 billion in tax cuts and credits for low- and middle- income taxpayers. To fund these projects, the AFP seeks to increase the capital gains rate from 20% to ordinary rates for households with over $1 million in income, as well as end the "step-up" in

basis of inherited assets at death for capital gains greater than $1 million per person. The proposal also seeks to increase the highest individual tax rate from 37% to 39.6%, without repealing or relaxing the cap on state and local tax ("SALT") deductions. It also would permanently extend the current limitation on the deductibility of "excess business losses" for noncorporate taxpayers (e.g., LLCs, S-corporations, and partnerships). Furthermore, the proposal would eliminate deferrals on capital gains taxation under Section 1031 for gains in excess of $500,000.

Bills to Reform Estate Taxes. As a companion bill to Senator Sander's "*For the 99.5 Percent Act*" reported in our April 2021 newsletter**,** Rep. Jimmy Gomez (D-CA) introduced *H.R. 2576* in the House to reduce the estate and GST tax exemption to $3.5 million per person and reduce the gift tax exemption to $1 million, as well as raise the tax rates for these taxes. Two proposals regarding estate taxes and taxes paid at death have been introduced but no text has been released yet. These proposals are: (1) *H.R. 2286*, introduced by Rep. Bill Pascrell (D-NJ) entitled *"To amend the Internal Revenue Code of 1986 to treat property transferred by gift or at death as sold for fair market value, and for other purposes,"* and (2) the Van Hollen Senate Discussion Draft, introduced by Senator Van Hollen (D-MD). Both of these proposals would tax a decedent's accrued gains at death or a donor's accrued gains on lifetime gifts. In another pathway toward estate tax reform, Senator John Thune (R-SD) introduced the *Death Tax Repeal Act of 2021, S. 617*, to repeal estate and generation skipping transfer taxes and modify the gift tax computation.

Proposals from Senator Warren. Senator Elizabeth Warren (D-MA) continues to promote her proposals for a wealth tax that would levy an annual 2% surtax on households and trusts valued at $50 million to $1 billion and a 3% surtax on those households valued higher than $1 billion through the "*Ultra-Millionaire Tax Act of 2021,*" as reported in our April 2021 newsletter. Senator Warren also plans to introduce legislation for a *"Real Corporate Profits Tax."* The proposal would levy a 7% flat tax on profits greater than $100 million that corporations report to their shareholders. Further, on April 26, 2021, Senator Warren re-introduced the *American Housing and Economic Mobility Act of 2021*, to create affordable housing. The bill would pay the costs of the proposal by reducing the basic exclusion amount for estate and GST taxes to $3.5 million and increasing estate and gift tax rates to 55% on the transfer of assets in estates below $13 million, 60% on estates over $13 million but not over $93 million, and 65% on estates over $93 million. The proposal calls to increase the GST tax rate to 65% and requires that Grantor Retained Annuity Trusts (GRATs) have a minimum term of 10 years.

CALIFORNIA TAX UPDATE

By Katie A. Lepore, CPA, J.D., LLM., Taxation

Partial Conformance with Federal PPP Laws. On April 29, 2021, Governor Newsom signed *AB 80* applying the federal corporate and individual income tax treatment from the *Paycheck Protection Program* ("PPP") loans and *Economic Injury Disaster Loan* ("EIDL") advance grants under the *Coronavirus Aid, Relief, and Economic Security Act* ("CARES Act"), and the *Consolidated Appropriations Act* to California taxes. Under *AB 80*, California taxpayers may exclude forgiven PPP loans or EIDL advance grants from their gross income when computing California corporate and individual income tax for tax years on or after January 1, 2019 if the borrower can show sufficient reduction in revenue (at least 25% in one quarter). Also, taxpayers that are not "ineligible entities" may deduct business expenses paid with the proceeds of forgiven PPP loans or EIDL advance grants. Taxpayers that have already filed their 2019 and 2020 returns should consider amending their returns if they received forgiven PPP loans or EIDL advance grants.

Wealth Tax Proposals. Several bills have been introduced that seek to increase California taxes. *AB 8*, introduced by Assemblymember Alex Lee (D-San Jose), would amend the California Constitution to allow a tax on "extreme wealth," whether tangible or intangible personal property, and would create a task force on wealth administration. *AB 310,* also introduced by Assemblymember Lee, would impose an annual 1% tax on a California resident's worldwide net worth in excess of $50 million (or $25 million for a married taxpayers filing separately). For taxpayers with a net worth above $1 billion, an extra 0.5% would be imposed. *AB 1253*, introduced by Assemblymember Miguel Santiago (D-Los Angeles), seeks to increase income tax rates by 1% for incomes over $1 million, by 3% on incomes over $2 million, and by 3.5% on incomes over $5 million, for total tax rates of 14.3%, 16.3%, and 16.8% respectively.

Restrictions on Evictions. On May 4, the San Diego Board of Supervisors passed an ordinance which prevents lease terminations and evictions unless the tenant poses an "imminent health or safety threat" to other tenants or occupants of the same property. The bill is effective June 4 and would remain in place until 60 days after all COVID-19 stay-at-home orders are lifted (presumably August 15). A lawsuit has been filed by an association of rental owners seeking an injunction. In January, California (through *SB 91*) extended the moratorium evictions for "no cause" until June 30th for those who have paid at least 25% of their rent and were affected economically by the COVID-19 pandemic.

San Diego Short Terms Rental Ordinance. On April 6, 2021, the San Diego City Council passed an ordinance to cap short-term rentals at 1% of the city's housing supply and prioritize "good actors" in a lottery to determine which homeowners will rent their properties on a short-term basis. The new law will go into effect on July 1, 2022. The ordinance calls for a reduction of whole-home short-term rentals but not home-sharing short-term rentals (i.e., the host lives on the premises as their primary residence). The ordinance will require a minimum of a two-night stay for whole-home short-term rentals to reduce the frequency of turnover and neighborhood disturbances due to noise. The ordinance also includes a detailed Good Neighbor Policy along with strict enforcement guidelines, and a fine structure for violations. The change will reduce revenue from San Diego's Transient Occupancy Tax, which applies to all properties rented on a short-term basis.

Pass-Through Entity Tax Bill Amended. *SB 104,* first reported in our March 2021 newsletter was significantly amended on April 12, 2021. The pass-through tax would allow California taxpayers who are owners in select pass-through entities to deduct for federal income tax purposes state and local taxes (SALT) exceeding the $10,000 cap, so long as such payments are consistent with IRS Notice 2020-75. As amended, the pass-through entity could elect to pay a 9.3% entity level tax on net income in exchange for a credit.

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