Linda C. Slider

Attorney at Law

P.O. Box 5756
Walnut Creek, California 94596

Tel: (925) 932-8450
Fax: (925) 938-4844
Linda@sliderlaw.com

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Dear Clients and Friends:

I hope that you are continuing to keep yourself, your loved ones, and your community safe from COVID-19 (the Coronavirus). The purpose of this letter is to alert you on (i) the potential impact of the 2020 election on the amount of your federal estate & gift tax credit and the potential benefits (and downsides) of making substantial gifts to use your current federal estate & gift tax credit, (ii) the impact of Prop 19 on the parent-child exclusions for California property tax purposes and on homeowners aged 55 and older, and (iii) a brief summary of tax planning moves that may help lower your tax bill for this year and possibly next.

E&G Tax Credit and Potential Benefits / Downsides of Using Current E&G Tax Credits. Every taxpayer have a federal estate & gift tax credit (the "E&G Tax Credit") which can be used to shelter both lifetime taxable gifts from gift tax and the remaining estate from estate tax at the taxpayer's death. For taxpayers dying in 2020, the E&G Tax Credit is $11,580,000 (less any E&G Tax Credit used to shelter prior gifts from gift tax). For 2021, the E&G Tax Credit is scheduled to rise to $11,700,000.

Although Joe Biden has won the 2020 presidential election, his ability to pass substantial income tax increases in 2021 is still unknown. The control of the Senate will not be decided until the Georgia Senate race run-offs on January 5, 2021. Even if the Democrats win control of the Senate after the Georgia Senate races are decided, this control will be at a razor-thin margin. Whichever party controls the Senate, any tax measures are likely to be modest and bi-partisan.

In the area of estate tax legislation, there have been proposals to roll the E&G Tax Credit back to "historical norms" (in the $3,500,000 - $5,000,000 range). Whether this proposal might make its way into 2021 tax legislation is unknowable at this time. Although the need for bi-partisan action to enact any significant tax change argues against substantial change in the estate tax area, practitioners cannot rule out the risk that an E&G Tax Credit rollback will occur in 2021.

The Tax Cuts and Jobs Act of 2017 already provides for the rollback of the E&G Tax Credit amount in 2026. Although the Tax Cuts and Jobs Act of 2017 was silent on the issue of what will happen to taxpayers who make gifts using the larger E&G Tax Credit and who then die after the planned 2026 E&G Tax Credit rollback, the IRS has issued regulations to prevent "claw back" of prior gifts (which were sheltered from gift tax using the larger E&G Tax Credit prior to the planned 2026 rollback) into the taxpayer's estate for taxation at the taxpayer's death.

However, these IRS regulations are not a perfect solution. The regulations provide that on a taxpayer's death, estate taxes on the taxpayer's estate will be calculated using the higher of

(i) the E&G Tax Credit used by the taxpayer in prior years to shelter taxable gifts from gift tax, or (ii) the E&G Tax Credit in effect at the time of the taxpayer's death. In other words, unless the taxpayer's total taxable gifts exceed the amount sheltered by the reduced E&G Tax Credit in effect at the taxpayer's death, accelerated gifting to take advantage of the current E&G Tax Credit will not be effective to reduce estate taxes due at death.

In addition, any potential estate tax savings need to be carefully weighed against other potential impacts, most importantly the loss of the ability to obtain stepped-up tax basis for appreciated assets if held until your death, your future needs for the assets, and the ability to use other estate tax planning techniques.

Impact of Prop 19 on Parent-Child Exclusions for California Real Property Taxes and on Homeowners Aged 55 and Older. California voters approved Proposition 19, which will have a profound impact on the transfer of California real property between parents and children. Under the current Prop 13 rules, (i) parents can transfer their primary residence (of unlimited value) to their children, without triggering a reassessment for property tax purposes, and (ii) a parent can transfer up to an additional $1,000,000 of "assessed value" (not fair market value) of other California real property (excluding real property held in partnerships, LLCs or corporations) to their children, without triggering a reassessment for property tax purposes. Prop 19 dramatically changes these rules, effective for transfers occurring on or after February 16, 2021.

Under Prop 19, the transfer of the parent's principal residence will qualify for a parent-child exclusion from reassessment (i) only if the child uses the property as the child's primary residence, and (ii) the exclusion from reassessment applies only to the first $1,000,000 of assessed value of the personal residence. If the assessed value of the primary residence exceeds $1,000,000, the primary residence will be partially reassessed in a proportionate manner. The child must apply the child's homeowners exemption at the time of transfer in order to qualify for the parent-child exclusion, or the child can apply the child's homeowners exemption to the property within one year of transfer to obtain a retroactive reassessment exclusion and refund of excess property taxes paid. A similar parent-child exemption will remain for "family farms", with a $1,000,000 assessed value limitation. Under Prop 19, the transfer of any other real property (other than the parent's primary residence or "family farm" which will be used by the child) will no longer qualify for a parent-child exclusion, for any reason, on or after February 16, 2021.

There has been a flurry of published advice for parents to hurry to gift real property to their children before February 16, 2021. However, before taking this step, you need to take into consideration the potential income tax impacts of gifting real property. Real property held until your death is entitled to a stepped-up tax basis to fair market value at death, which may eliminate capital gains tax for real properties which are likely to be sold by your beneficiaries. In addition, investment properties which receive a stepped-up tax basis also receive a new depreciation schedule. Accordingly, in considering whether to gift real property before the February 16, 2021 effective date, you should balance the property tax benefits against the income tax detriments of a lifetime transfer. If it is likely that a child will sell the property during the child's lifetime, especially if the child might sell in the years just after the parent's death, the cost of preserving the low property tax assessment may not be justified.

Finally, in addition to restricting the availability of the parent-child exclusion for transfers of real property, Prop 19 provides additional tax benefits for homeowners aged 55 and older.

Previously, Prop 13 permitted homeowners aged 55 and older to buy a home of lesser value and roll their Prop 13 assessment over to the lesser valued home (if the County permitted). Prop 19 expands this program statewide and permits inter-county rollovers. In addition, Prop 19 permits a homeowner aged 55 and older to buy a home of greater value than the current home and to acquire a "blended" assessment rate (lower than the value of the new home). A homeowner may make up to three "Prop 19" moves, keeping the original Prop 13 assessment value of the initial home (or "blended" assessment value if homes of higher value are purchased). The Prop 19 provisions applicable to homeowners aged 55 or older go into effect April 21, 2021.

Year-End Tax Planning Moves. Year-end planning for 2020 takes place during the COVID-19 pandemic, which in addition to its devastating health and mortality impact has widely affected personal and business finances. New tax rules have been enacted to help mitigate the financial impact of the disease, some of which should be considered as part of this years' planning, most notably elimination of required retirement plan distributions, and liberalized charitable deduction rules.

Major tax changes from recent years remain in place, including lower income tax rates, larger standard deductions, limited itemized deductions, elimination of personal exemptions, an increased child tax credit, and a lessened alternative minimum tax (AMT) for individuals; and a major corporate tax rate reduction and elimination of the corporate AMT, limits on interest deductions, and generous expensing and depreciation rules for businesses. Non-corporate taxpayers with certain income from pass-through entities retain a valuable deduction.

Despite the lack of major year-over-year tax changes, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, as does the bunching of expenses into this year or next to avoid restrictions and maximize deductions. The following is a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them.

Year-End Tax Planning Moves for Individuals

- Many taxpayers won't be able to itemize because of the high basic standard deduction amounts that apply for 2020 ($24,800 for joint filers, $12,400 for singles and for marrieds filing separately, $18,650 for heads of household), and because many itemized deductions have been reduced or abolished. Like last year, no more than $10,000 of state and local taxes may be deducted; miscellaneous itemized deductions (e.g., tax preparation fees and unreimbursed employee expenses) are not deductible; and personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met. You can still itemize medical expenses but only to the extent they exceed 7.5% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, plus interest deductions on a restricted amount of qualifying residence debt, but payments of those items won't save taxes if they don't cumulatively exceed the standard deduction for your filing status. Two COVID-related changes for 2020 may be relevant here: (i) individuals may claim a $300 above-the-line deduction for cash charitable contributions on top of their standard deduction, and (ii) the percentage limit on charitable contributions has been raised from 60% of modified adjusted gross income (MAGI) to 100%.

- Some taxpayers may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, a taxpayer who will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2020 and 2021. The COVID-related increase for 2020 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy, especially for higher income individuals with the means and disposition to make large charitable contributions.

- As always, higher-income earners must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI. An important exception is that NII does not include distributions from IRAs and most other retirement plans.

- The 0.9% additional Medicare tax also may require higher-income earners to take year-end actions. It applies to individuals for whom the sum of their wages received with respect to employment and their self-employment income is in excess of a threshold amount ($250,000 for joint filers, $125,000 for married couples filing separately, and $200,000 in any other case). Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. For example, if an individual earns $200,000 from one employer during the first half of the year and a like amount from another employer during the balance of the year, he or she would owe the additional Medicare tax, but there would be no withholding for the additional Medicare tax since wages from each employer don't exceed $200,000.

- Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. If you hold long-term appreciated assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (e.g., $80,000 for a married couple). If the 0% rate applies to long-term capital gains you took earlier this year, then try not to sell assets yielding a capital loss before year-end because the first $5,000 of those losses won't yield a benefit this year. It will offset $5,000 of capital gain that is already tax-free.

- Consider postponing income until 2021 and accelerate deductions into 2020 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2020 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2020. For example, that may be the case for a person who will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or who expects to be in a higher tax bracket next year.

- If you believe a Roth IRA is better than a traditional IRA, consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2020 if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2020, and possibly reduce tax breaks geared to AGI (or modified AGI).

- Required minimum distributions (RMDs) that usually must be taken from an IRA or 401(k) plan (or other employer-sponsored retirement plan) have been waived for 2020. This includes RMDs that would have been required by April 1 if you hit age 70½ during 2019 (and for non-5% company owners over age 70½ who retired during 2019 after having deferred taking RMDs until April 1 following their year of retirement). If you don't have a financial need to take a distribution in 2020, you don't have to. Note that because of a recent law change, plan participants who turn 70½ in 2020 or later needn't take required distributions for any year before the year in which they reach age 72.

- If you are age 70½or older by the end of 2020 and have traditional IRAs, consider making 2020 charitable donations via qualified charitable distributions from your IRAs. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the entire standard deduction. (Previously, those who reached reach age 70½ during a year weren't permitted to make contributions to a traditional IRA for that year or any later year. While that restriction no longer applies, the qualified charitable distribution amount must be reduced by contributions to an IRA that were deducted for any year in which the contributor was age 70½ or older, unless a previous qualified charitable distribution exclusion was reduced by that post-age 70½ contribution.)

- If you are younger than age 70½ at the end of 2020, you anticipate that you will not itemize your deductions in later years when you are 70½ or older, and you don't now have any traditional IRAs, establish and contribute as much as you can to one or more traditional IRAs in 2020. If these circumstances apply to you, except that you already have one or more traditional IRAs, make maximum contributions to one or more traditional IRAs in 2020. Then, in the year you reach age 70½, make your charitable donations by way of qualified charitable distributions from your IRA. Doing this will allow you, in effect, to convert nondeductible charitable contributions that you make in the year you turn 70½ and later years, into deductible-in-2020 IRA contributions and reductions of gross income from later year distributions from the IRAs.

- If you become eligible in December of 2020 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2020.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $15,000 made in 2020 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. Such transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

- If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2020 return normally filed next year), or on the return for the prior year (2019), generating a quicker refund.

- If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2020 in order to maximize your casualty loss deduction this year.

Year-End Planning Moves for Trusts and Estates. Fiduciaries for irrevocable trusts and estates should consider whether to make income distributions to beneficiaries to minimize income taxes:

- Under federal income tax laws, irrevocable trusts and estates pay income tax at a highly-compressed tax schedule and reach the top marginal income tax rates of 37% once taxable income exceeds $12,950 (for 2020). In addition, irrevocable trusts and estates pay capital gains tax at the top rate of 20%, and further pay the additional Medicare surcharge tax of 3.8% on "unearned income" (e.g., dividends, interest, royalties, and rents) once taxable income exceeds $12,950.

- Irrevocable trusts and estates are entitled to a "distribution deduction" for taxable income earned in the specified year, as long as the taxable income is distributed by the 65th day of the following year (generally March 5 for non-leap years, if the irrevocable trust or estate is using a calendar year). In this event, the taxable income is shifted from the irrevocable trust or estate's fiduciary income tax return to the beneficiaries' personal tax return for the specified year, where the taxable income may be taxed at lower rates. Fiduciaries need to act quickly once their 2020 tax information is available to decide whether it is advantageous to distribute taxable income by the 65th day deadline.

Year-End Tax-Planning Moves for Businesses & Business Owners. Businesses and business owners continue to enjoy favorable tax provisions under the Tax Cuts and Jobs Act in 2020:

- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2020, if taxable income exceeds $326,600 for a married couple filing jointly, $163,300 for singles, marrieds filing separately, and heads of household, the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income between $326,600 and $426,600, and to all other filers with taxable income between $163,300 and $213,300.

- Taxpayers may be able to achieve significant savings with respect to this qualified business income deduction, by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2020. Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

- More small businesses are able to use the cash (as opposed to accrual) method of accounting in than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test. For 2020, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $26 million (the dollar amount was $25 million for 2018, and for earlier years it was $1 million for most businesses). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making prepayments.

- Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2020, the expensing limit is $1,040,000, and the investment ceiling limit is $2,590,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is in service during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2020, rather than at the beginning of 2021, can result in a full expensing deduction for 2020.

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2020.

- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2020.

- A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2020 (and substantial net income in 2021) may find it worthwhile to accelerate just enough of its 2021 income (or to defer just enough of its 2020 deductions) to create a small amount of net income for 2020. This will permit the corporation to base its 2021 estimated tax installments on the relatively small amount of income shown on its 2020 return, rather than having to pay estimated taxes based on 100% of its much larger 2021 taxable income.

California Tax-Planning Moves. Finally, California still has not conformed the majority of its tax laws to include the changes to federal tax laws enacted by the Tax Cuts and Jobs Act of 2017. Taxpayers still need to pay attention to the following changes in California state taxes:

- California passed legislation to conform to the federal CARES Act in certain areas, most notably (i) to waive the requirement that taxpayers take their required minimum distribution (RMD) from retirement accounts for 2020, and (i) to address the tax impact of Payroll Protection Program (PPP) loan forgiveness for taxpayers with tax years starting on or after January 1, 2020. Entities with fiscal years starting before January 1, 2020, need to take special care regarding the California tax reporting of expenses covered by PPP loan forgiveness.

- Minor conforming changes have been made in the area of corporate and partnership tax laws, most notably in the area of changes of accounting methods, the disallowance of carrybacks of net operating taxable losses to prior years, and Section 1031 exchanges.

- Most notably, California still retains its alternative minimum tax for taxpayers, including corporations. Accordingly, as you consider your year-end tax moves, you should remember to take California's AMT into account.

- The federal Tax Cuts and Jobs Act eliminated the federal penalty for individuals who fail to maintain qualifying health insurance under the Affordable Care Act. However, California has adopted its own health insurance mandate. Starting 2020, Californians who choose not to buy qualified health insurance, will face a tax penalty of the greater of $695 per adult ($347.50 per child) or 2.5% of their annual income (adjusted for the number of members of your household). Exemptions are available for various reasons, including hardship, religious conscious, short-gaps in coverage, etc. California also adopted a new state subsidy program that will help lower the cost of health insurance for low and middle-income Californians. Previously, those who made above 400% of the federal poverty line (FPL) were not eligible for premium tax credits. In 2020, those who make between 400 to 600% of the FPL are eligible for subsidies. If a taxpayer does not already have qualified coverage through the taxpayer's employer, Medicare, Medicaid, etc., individual coverage through Covered California can be obtained through January 1, 2020.

If you or your accountant would like more details about any aspect of year-end tax planning, please do not hesitate to call.

Very truly yours,

Linda C. Slider