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WHAT'S NEW IN ESTATE PLANNING 2022

1. BUILD BACK BETTER ACT – PROPOSED LEGISLATION

On November 19, 2021, the House passed the Build Back Better ("BBB") Act by a narrow vote. However, until the Act passes by both the House and the Senate, the new law is not in effect. The news is what is NOT in the bill, which is reviewed throughout this outline.

The good news is that many of the changes affecting Estate Planning were dropped from the most recent proposal, such as:

- **No** reduction in estate/gift/generation skipping tax exemption amounts
- **No** elimination of the step-up in basis at death

2. FEDERAL ESTATE TAX

A. **$12,060,000 Estate Tax Exemption:** Despite proposals that threatened to reduce the Estate Tax Exemption, the amount you can leave free of estate tax for a death in 2022 has increased to $12,060,000. The exemption will continue to be indexed for inflation annually through December 31, 2025.

B. Return of the $5,000,000 Estate Tax Exemption in 2026: In 2026, the Exemption will return to $5,000,000, plus an amount indexed for inflation, unless the law is changed.

Year of Death	Estate Exemption	Estate Tax
2022	$12,060,000	40% tax on amount over
2022-2025	same indexed for inflation	40% tax on amount over
2026	$5,000,000 + indexed for inflation (approx. $6 million)	40% tax on amount over

Example: $12,060,000 death in **2022** = $ 0 Federal Estate Tax
$12,060,000 death in **2026** = $2,424,000 Federal Estate Tax

C. Transfer Exemption to Spouse – Portability: A married couple has two exemptions, for a total of $24,120,000 ($12.06m * 2) to their beneficiaries tax free.

1) **Oops – I had to do something?** The exemption of a deceased spouse does not automatically transfer to the surviving spouse. The executor/trustee needs to file a Federal Estate Tax Return (Form 706) within nine months of the death and elect portability of the deceased spouse's unused exemption (DSUE).

2) **Is it Too Late?** (IRS PLR 202108007): In a Private Letter Ruling, the IRS confirmed an extension of time to make the portability election when the Federal Estate Tax Return was not required to be filed since the estate was less than the exemption and the spouse acted reasonably and in good faith for example the spouse's advisors did not inform the spouse of the portability election.

3) **What About that Funny Sounding "QTIP" Election?** (Rev. Proc. 2016-49) A deceased spouse might leave assets in trust for a surviving spouse, rather than outright to the spouse. The trust might be a "Trust B/Bypass Trust" or a "Trust C/Qtip Trust."

   If the executor/trustee files a Federal Estate Tax Return (Form 706) within nine months of death and makes the QTIP election, the assets of the trust can get a stepped-up income tax basis when the surviving spouse dies. In other words, this election can eliminate capital gain when the survivor dies.

4) What is the Reverse Qtip Election? If there is a trust for a spouse, the executor/trustee can elect to use the deceased spouse's Generation Skipping Tax exemption on the Federal Estate Tax Return (Form 706), since this exemption cannot be "ported" to the surviving spouse.

D. Use it or lose it? When the exemption automatically reduces from $12m to approx. $6m, the $6m reduction in exemption disappears. If your estate exceeds approx., $6m (or $12m for a married couple), what can you do to use up the extra exemption before it evaporates?

1) **The Good News - No Clawback** (REG-106706-18; §20.2010-1): The good news is that you can use up all or part of the disappearing $6m exemption before 2026 by making lifetime gifts. The IRS issued final regulations that avoid potential claw back of gifts made before 2026.

2) **The Bad News - Exemption Spent from the Bottom Up**: Although you want to apply the disappearing $6m exemption to your lifetime gifts, you do not eat into the top $6m until you have consumed the bottom $6m exemption first. You cannot have dessert until you eat a full meal. For example, if you give away $5m, you have not even touched your $6m exemption. If you give away $7m, then you use up the bottom $5m plus $2m of your $6m exemption. This means you have to make a very large gift to use your disappearing $6m exemption.

3) **Is it Worth It?** You be the judge. Using the $6m exemption saves 40% in federal estate tax, which is a tax savings of $2,400,000.

4) **The Hidden Cost of Gift: No Stepped-Up Income Tax Basis**: Most assets which you own at death receive a new income tax basis equal to the date of death value. This means that your lifetime gain and loss is eliminated. If you gift assets in your lifetime, those assets will not receive a new income tax basis. You give your income tax basis along with the gift.

   Note that certain assets which do not receive a new income tax basis at all. These are retirement plans, IRA's, annuities, and installment sale notes.

E. Executors/Trustees Beware: Rules and Cases

1) **Distributions to Beneficiaries before paying Federal Estate Tax** (IRC 3713): If a fiduciary distributes all the assets to the beneficiaries knowing that the estate tax liability has not been paid, the fiduciary can be held personally liable for the unpaid taxes. Do not succumb to pressure to "distribute by Christmas." Always retain a reserve.

2) **Discover the Lifetime Gifts** (Leighton v. U.S., IRC 6651): The fiduciary must reasonably inquire as to whether any Gift Tax Returns were filed (Form 709) by the decedent during their lifetime. These gifts are reported on the Federal Estate Tax Return (Form 706) at death. A fiduciary should go through the decedent's papers, ask the decedent's CPA and estate planning attorney (and any prior estate planning attorneys) if Gift Tax Returns were filed. The estate can be liable for interest and penalties if gifts are later discovered, and the fiduciary did not try hard enough.

F. The Price of Fame (Michael J. Jackson v. Commissioner): Michael Jackson died in 2009, and this tax case was reported in 2021, twelve years later. This maybe the first reported case about the value for tax purposes of a celebrity's image and likeness.

1) **Valuation Issues:** During Jackson's lifetime, the value of his celebrity changed from famous to infamous. The IRS and his estate could not agree on the value of three assets:

- His "image and likeness," which are his "publicity rights."
- Trust #1, which owned 50% of Sony Music Publishing and some Beatles music; and
- Trust #2, which owned rights to music Jackson wrote.

2) **Court Decision:**

	Image & Likeness	**Trust #1**	**Trust #2**
Estate Tax Return	**$2,000**	0	**$2,200,000**
IRS Perspective	$434,200,000	$469,000,000	$60,600,000
Estate at Trial	$3,000,000	0	$2,200,000
IRS at Trial	$161,300,000	$206,200,000	$114,200,000
Tax Court Ruling	**$4,100,000**	0	**$107,300,000**

- Image & Likeness: Court decided estate would have had to spend a significant amount of money to rehabilitate Jackson's image.
- Trust #1: Court determined that the Beatles music was valuable but was secured by Jackson's substantial debt to fund his extravagant lifestyle
- Trust #2: Jackson's own works were difficult to value. Used a discounted cash flow projection to value.

3. GIFT TAXES

A. **$12,060,000 Gift Tax Exemption:** Lifetime Gift Amount without paying taxes

B. **No Clawback** (REG-106706-18; §20.2010-1): Gifts won't be brought back into the Estate.

C. **$16,000 Annual Gift Tax Exclusion ($32,000 per couple):** Increased by $1,000.

D. **Unlimited Medical and Educational Expenses:** You can pay anyone's medical care and educational expenses if you make your payment directly to the provider of services. These transfers do not count against your Gift Tax Exemption.

E. **Carryover Income Tax Basis**: When you make a gift, you give your income tax basis (cost, plus improvements, less depreciation) to the recipient. In general, this means that your donee will continue to hold your capital gain or loss.

4. GENERATION SKIPPING TRANSFER TAX (GST)

A. **$12,060,000 Generation-Skipping Tax (GST) Exemption**
B. **No Clawback** (REG-106706-18; §20.2010-1)**:** Assume the same
C. **$16,000 Annual GST Tax Exclusion ($32,000 per couple):** Increased by $1,000.

5. INCOME TAXES

A. **529 College Savings Plans – What Can it Pay For?** (AB 340): Many parents and grandparents establish 529 College Savings Plans for a young child. The account is typically set up through a financial institution such as a brokerage firm. You can make annual tax-free gifts into the account ($16,000) and can even make 5 years' worth of gifts in one year ($80,000 = 5 x $16,000).

The account grows tax-free. Distributions for the beneficiary's higher education are not subject to tax, including:

- Tuition, fees, books, supplies, equipment.
- Special needs services.
- Room and Board if enrolled at least half time.
- Computer technology and internet.
- Elementary or secondary public, private, or religious school tuition up to $10,000 in aggregate.

This law expands the definition of "qualified higher education expenses" to conform to federal changes, and include expenses for:

- Apprenticeship program fees, books, supplies, and equipment.
- Educational loan payments subject to a lifetime limit of $10,000.

B. **Build Back Better Act: No Elimination of Stepped-Up Basis:** Under current law, when a person dies, most assets receive a new income tax basis equal to date of death value.

Residence	FMV	Basis	Gain
Lifetime	$900,000	$500,000	**$400,000**
Death	$900,000	$900,000	**$ 0**

Despite much talk about eliminating stepped-up basis at death, the Build Back Better Act (not yet passed) does NOT eliminate the new basis.

6. PROPERTY TAXES – PROP 19 AND THE PARENT CHILD EXCLUSION

If you transfer California real estate to a child during your lifetime or at death, can the child continue to pay the same property taxes? Or will the property be reassessed at current value and the property tax bill will increase?

A. Gifts or Deaths before February 16, 2021: The old Parent-Child Exclusion applied to all transfers. These transfers would NOT be reassessed:

1) The property is the parent's primary residence regardless of use by child.
2) Other (non-residence) property with assessed value up to $1 million.

B. Gifts or Deaths starting February 16, 2021: California real estate passing from Parents to Children IS reassessed, unless:

1) The property is the **parent's primary residence**; and
2) The child makes the property the **child's primary residence**.
3) **Partial Reassessment**: If the fair market value of the residence is $1 million or more above the assessed value, then the excess amount will be partially reassessed.

C. Planning Opportunities

1) Residence: Methods to qualify for the Parent-Child Exclusion:

   i. Include Right of First Refusal (Option to Purchase): Parent includes language in trust to allow a child to buy the residence from trust with their own funds.

   ii. Non-Pro Rata Distribution: If trust has enough assets to distribute among the children, one child can take the residence as part of their share of the trust without triggering reassessment.

   iii. Parent-Child Equalization Loan: If the trust does not have enough assets to make a non-pro rata distribution, the trustee can obtain a loan from third party secured by the residence and distribute encumbered residence to child and cash to others.

   Beware! If child "buys" out their siblings, the property will be reassessed (Bohnett v. County of Santa Barbara).

2) Rental/Commercial Property: Recalculate cash flow with increased property taxes. Sell property, which now has a new income tax basis?

3) Creation of LLC so that "entity rules" apply vs. parent/child exclusion.

4) Purchase property or receive trust distribution as co-owners and then put property in joint tenancy. If a joint tenant dies and property passes to an "original transferor," the property will not be reassessed.

7. RETIREMENT PLANS

The SECURE ACT- January 1, 2020, Changes to Retirement Plan Distribution Rule
The Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law on December 20, 2019 and became effective January 1, 2020.

The aim of the Act is to prevent older American's from outliving their assets. Some of the cost of the bill will be paid for by the acceleration of the income tax due on an IRA after the death of the owner. The cost to support older Americans will be paid by younger Americans.

A. INHERITED IRA - 10 YEARS VS. LIFE EXPECTANCY

1) **Designated Beneficiary (DB):** 10-year payout, not RMD, not life expectancy.

2) **Eligible Designated Beneficiary (EDB):** Life Expectancy Payout.

   i. Spouse
   ii. Minor Child of Participant (until majority, then 10-year payout)
   iii. Disabled Person
   iv. Chronically Ill Person
   v. Person not more than 10 years younger

3) **Non-Designated Beneficiary (Non-DB):** 5-year payout.

   i. Not naming a beneficiary
   ii. A named beneficiary does not survive
   iii. Naming the Estate as a beneficiary
   iv. Naming a trust as beneficiary that does not qualify for "see-through treatment"

B. WHAT SHOULD I DO? REVIEW YOUR IRA BENEFICIARIES

1) **Beneficiary Designation Form:** Obtain a copy of your Beneficiary Designation form from each institution that holds your IRA or retirement plan (e.g., Schwab, Fidelity, Vanguard). For corporate pension plans, contact your plan administrator.

2) **Professional Review**: Bring the beneficiary designation form to meet with your estate planning attorney.

8. WILLS AND TRUSTS

A. **Charitable Trust - Notice of Sale to Attorney General** (AB 900, PC 16106): This new law requires the trustee of a charitable trust to give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of "all or substantially all" of the charitable assets. Effective July 1, 2022.

Takeaway: Trustees of charitable trusts (e.g., charitable remainder trust) need to consider whether they need to notify the Attorney General.

B. **Trustee Duty to Notify and Account to Beneficiaries when Trustor Becomes Incompetent** (AB 1079, PC 15800 & 16069): The law previously required a trustee to send a Notification upon the death of the trustor to all heirs and beneficiaries letting them know of their right to a copy of the trust and limiting their time to contest the trust to 120 days. Now for the first time, unless the trust states otherwise, the trustee must 1) provide a copy of the trust when the trustor becomes incompetent, and 2) provide an annual accounting to the beneficiaries (not heirs) of the trust. Incompetency is established by the procedure in the trust, or a court determination of incompetency.

   Takeaways: Do you want to eliminate this new requirement? Also, acting trustees of an incompetent Trustor need to review this new requirement.

C. **Did Grandma have Capacity?** (Eyford v. Nord): A 90-year-old Grandma changed her trust to omit her granddaughters and instead leave everything to charity. Prior to signing the trust leaving all to charity, Grandma was hospitalized with a condition that caused confusion. After she left the hospital, Grandma believed the granddaughters were trying to get her money. Grandma made statements to her friends that she decided to disinherit her granddaughters because 1) they were stealing from her, 2) trying to kill her, 3) had shredded her papers against her will, and 4) had closed her bank accounts. These beliefs were false. After Grandma died, the granddaughters contested the trust claiming Grandma lacked testamentary capacity. The court upheld Grandma's changes, stating that even if Grandma's beliefs were false, irrational, or unfounded, she was not acting under an insane delusion and the granddaughters could not provide that she suffered from a mental health disorder. Thus, the granddaughters were unable to prove lack of capacity due to a heavy burden of proof and the law presumes Grandma had capacity.

   Takeaway: When making substantial changes to your distribution plan or omitting your heirs, consider preparing a handwritten letter and even getting physician's letter of capacity.

D. **Undue Influence: When does the Certificate of Independent Review Work?** (Cortez v. Orozco): Dad changed the distribution plan to leave everything to one grandchild and omit his four daughters. Dad got a Certificate of Independent Review from a separate attorney stating that Dad was not acting under undue influence in making this change. The Court decided that the Certificate did not rebut the presumption of undue influence of a dependent adult. The Certificate is effective only as to a "disqualifying person," which would be a caretaker other than his own family member (PC 21382).

   Takeaway: Dad should prepare a handwritten letter stating his intent to include only his grandchild and disinherit his children.

E. **Community Property Presumption v. Form of Title Presumption – With a Splash of Undue Influence** (Estate of Wall): Husband bought home in his own name with his separate property funds and had Wife to sign off any interest she may have to Husband. Husband died. Husband's children claimed home goes to them because title is in Husband's name and Wife claimed home was really community property (50% hers) since it was purchased during marriage. The property would have passed to the children under since the title was in Husband's name, however, the Court held that Husband unduly influence Wife to sign off on her interest and, ultimately, that undue influence prevailed over the title presumption. Therefore, Wife owned 50%.

   Takeaway: Husband and Wife should have entered a property agreement stating the home was Husband's separate property, with Wife having her own attorney.

F. **Did Wife "Sever" the Joint Tenancy?** (Pearce v. Briggs): Wife had 2 children. She and new Husband adopted 3 children, for a total of 5 children. Husband and Wife bought a property as joint tenants. Wife's Will stated that the property was intended to be "community property," which would go to the 5 children after Husband's death. After Wife died, Husband became full owner of property since he was the surviving joint tenant. Husband transferred the property to his new trust and left all to the 3 children, excluding Wife's 2 children. The court held that Wife Will did not sever the joint tenancy because it did not explicitly state that she severed the joint tenancy, the Will was never recorded, and there was no agreement between Wife and Husband to "transmute" their interests to community property.

   Takeaway: Joint tenancy property passes to the surviving joint tenant. To sever joint tenancy, wife should sign and record a deed stating that she severs the joint tenancy (Civil Code 683.2).

G. **Does a Trust Amendment Have to be Notarized?** (Haggerty v. Thornton): Jeane prepared a handwritten amendment to her trust and gave it to her attorney to keep with her trust. The amendment was not notarized. The former beneficiary contested the change. Because Jeane complied with California law by signing and delivering a writing to herself as trustee during her lifetime, the court held the amendment was valid, even though it was not notarized. The Court determined that unless the trust provides that notarization is the exclusive method for amendment, this method of amendment is sufficient.

   Takeaway: Have your estate planning attorney prepare amendments and have them notarized rather than winding up in court.

9. TRUST ADMINISTRATION

A. **Trustee Breaches Trust – Conflict of Interest** (Strojan v. Strojan, PC 16420): The trustee took an unsecured $60,000 loan from the trust and did not pay on it for 6-7 years. He leased the trust cattle grazing property to his own partnership and failed to distribute rent to the income beneficiary for many years. The court removed the trustee and denied any trustee fees. The trustee had to pay his own costs and attorney fees without reimbursement from the trust.

   Takeaway: If you are a trustee, you can never benefit from the trust except to receive compensation.

10. ELDER LAW & ELDER ABUSE

A. **Financial Elder Abuse by Son** (Keading v. Keading): After Wife died, Husband amended his trust to leave all to his son and daughter equally. In the month before Dad died, son had Dad sign a declaration that no financial abuse had taken place, had Dad sign a power of attorney to son, had Dad transfer stock to son, and using the power of attorney transferred the residence to Dad and son in joint tenancy, and amended trust to remove sister as successor trustee. The court found the son committed financial elder abuse by undue influence (even without finding bad faith) and awarded double damages.

   Takeaway: Unfortunately, a senior (55+) can be taken advantage of by their own child, especially towards the end of their life. Be cautious of who you name in your Estate Planning documents as your fiduciary/trustee.

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