ROBINSON & WILSON

A LAW CORPORATION
Street: 11665 Avena Pl #108, San Diego, CA 92128
Mail: P.O. Box 270099 San Diego, CA 92198

Roberta J. Robinson
RobertaRobinson@TrustLaw.us

State Bar of California
Legal Specialist
Estate Planning,
Trust & Probate Law

Tel: 858.485-1990
Fax: 858.487-8240
www.TrustLaw.us

Daniel J. Wilson
DanielWilson@TrustLaw.us

Master of Laws in Taxation
State Bar of California Legal
Specialist Estate Planning
Trust & Probate Law

WHAT'S NEW IN ESTATE PLANNING 2023

1. FEDERAL ESTATE TAX

A. $12,920,000 Estate Tax Exemption: The amount that you can give during your lifetime or at your death and be exempt from federal estate tax has risen from $12,060,000 to $12,920,000. This is an increase of $860,000. 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. Adjusted for inflation, the exemption will be about $7,000,000 in 2026.

Year of Death	Estate Exemption	Estate Tax
2023	$12,920,000	40% tax on amount over
2022-2025	same indexed for inflation	40% tax on amount over
2026	$5,000,000 + indexed for inflation (approx. $7 million)	40% tax on amount over

Example: $12,920,000 death in **2023** = $ 0 Federal Estate Tax
$12,920,000 death in **2026** = $2,368,000 Federal Estate Tax

C. Transfer Exemption to Spouse – Portability: A married couple has two exemptions, for a total of $25,840,000 ($12.92m * 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 Rev Proc 2022-32) This revenue procedure provides a simplified method for certain taxpayers to obtain an extension of time to make a portability election. For a decedent dying after 12/31/2010 who was not required to file an estate tax return (gross estate within exemption) and was survived by a spouse, the period to elect portability is extended to the fifth (5th) anniversary of the decedent's date of death!

   a. **Example:** Harry died June 20, 2018, and his gross estate was less than the estate tax exemption of $11,180,000 for 2018. Wanda, his wife, did not file a federal estate tax return since it was not required to be filed.

      Wanda's estate is now $8,000,000, and she is worried that the federal estate tax exemption will only be $7,000,000 in 2026, only 3 years away. Is there a way for Wanda to get Harry's unused $11,180,000 exemption?

   b. **Solution:** If Wanda files Harry's federal estate tax return before June 20, 2023 (the 5th anniversary of Harry's death), then she can elect portability of Harry's unused exemption! Wanda will have Harry's $11,180,000 plus her own exemption of about $7,000,000. This means that she could transfer $18,180,000 tax free.

   c. **Action Item:** If a person died within the last five years survived by a spouse, consider filing a federal estate tax return to capture the exemption amount.

D. Use it or lose it? When the exemption automatically reduces from almost $13m to approx. $7m, the $6m reduction in exemption disappears. If your estate exceeds approx., $13m (or $26m 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 $7m exemption before 2026 by making completed 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 $7m exemption to your lifetime gifts, you do not eat into the top $7m until you have consumed the bottom $7m 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 $7m exemption. If you give away $9m, then you use up the bottom $7m plus $2m of your $13m exemption. This means you have to make a very large gift to use your disappearing $7m exemption.

3) **Is it Worth It?** You be the judge. Using the $7m exemption saves 40% in federal estate tax, which is a tax savings of $2,368,000.

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.

2. GIFT TAXES

A. $12,920,000 Gift Tax Exemption: Lifetime Gift Amount without paying taxes

B. No Clawback (REG-106706-18; §20.2010-1): Completed gifts will not be brought back into the Estate.

C. $17,000 Annual Gift Tax Exclusion ($34,000 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.

3. GENERATION SKIPPING TRANSFER TAX (GST)

A. **Direct and Indirect GST Transfers**

A direct GST transfer occurs when there is a transfer to a grandchild. An indirect GST transfer happens when there is transfer to a trust for child's lifetime which later passes to grandchildren.

B. **$12,920,000 Generation-Skipping Tax (GST) Exemption**

C. **Extension of Time to Allocate the Generation-Skipping Tax (GST) Exemption:**

In 1976, Congress enacted the generation-skipping transfer (GST) tax. Now, 47 years later (!), the government is busy issuing Private Letter Rulings allowing estates additional time to elect the GST exemption. Why is this happening? Because executors, attorneys and CPA's have missed this issue and have failed to correctly report the transfer on estate or gift tax returns.

D. **No Clawback** (REG-106706-18; §20.2010-1)**:** Assume the same

E. **$17,000 Annual GST Tax Exclusion ($34,000 per couple):** Increased by $1,000.

4. INCOME TAXES

A. 529 College Savings Plans –

1) **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 ($17,000) and can even make 5 years' worth of gifts in one year ($85,000 = 5 x $17,000).

   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.

2) **Rollover to Roth IRA - Secure Act 2.0 -:** Beginning in 2024, a beneficiary of a 529 plan can roll over up to $35,000 to a Roth IRA in their name. Assets in the 529 plan grow tax-free, which can now be transferred to a tax-free Roth IRA, subject to certain conditions.

   For example, over the child's lifetime, their parents and grandparents contributed to a college savings account, a 529 Plan. These funds grew tax-free in the account for many years. Through hard work, the child received several scholarships to pay for their higher education, which left an unused balance in their 529 plan. Now, up to $35,000 can be rolled over into that child's own Roth IRA. When the child takes distributions from the Roth IRA, they don't pay taxes on the withdrawals.

B. Basis Step Up Planning

1) **New Income Tax Basis at Death (IRC 1014):** Assets owned by a decedent receive a new income tax basis at death equal to the fair market value at death. This means that the decedent's lifetime capital gain or loss is eliminated at death. However, retirement plans and annuities do not receive a new income tax basis.

2) **Upstream Basis Planning:** If assets are transferred to a an older/ill person who has a high federal estate tax exemption (currently $12,920,000), those assets will receive a new income tax basis at death.

   For example, Sam bought $25,000 of Qualcomm stock and it is now work $100,000. If Sam sells the stock, he will have to pay tax on $75,000 of capital gain. Frank, father of Sam, is 98 years old. Sam could gift the stock to Frank, and Frank could provide a bequest of the stock to Sam at his death.. If Frank survives for more than one year, then Sam could inherit the stock on Frank's death with a new income tax basis which eliminates the capital gain.

3) **Upstream General Power of Appointment Trust** If Sam transfers the stock to Frank outright, then Frank can change the distribution plan of the stock. Frank might decide that his daughter should have the stock rather than Sam.

   Instead of an outright gift to Frank, Sam could create an irrevocable trust for the benefit of Frank. If the trust states that Frank has a "general power of

appointment" over the trust, then the assets of the trust would be included in Frank's estate, receive a new income tax basis at death, and be distributed to Sam. The general power of appointment could provide that Frank can appoint the trust in favor of his creditors. Assuming Frank has no creditors, this power would not change the distribution plan.

5. 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.

6. RETIREMENT PLANS

A. **Secure Act 2.0: Distributions During Lifetime:** The beginning date for required minimum distributions (RMD) is pushed back. Taxpayers were required to start taking required minimum distributions from retirement plans at age 72. The new law signed 12/29/2022, increases the age from 72 to 73 in 2023; and in 2033, the age will increase to 75.

B. **Secure Act of 2019: Distributions After Death:** The rules for required minimum distributions following a death occurring 1/1/2020 or after, fall into three (3) different categories.

1) **Inherited Ira - 10 Years Vs. Life Expectancy**

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

      a) **IRS Notice 2022-53 (released Feb. 2022):** Under the proposed regulations, if an account owner dies on or after their required beginning date, beneficiaries who are subject to the 10-year rule must take annual life expectancy payments during the first nine years.

      b) **Make up Distribution:** RMD's were suspended in 2020, but not 2021 or 2022. If the RMD was not made in 2021-2022, the distribution may still have to be made but there will be no penalty. Further guidance will need to be issued by the IRS.

   ii. **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

   iii. **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"

2) **What Should I Do? Review Your IRA Beneficiaries**

   i. **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.

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

7. FIDUCIARIES

A. Post Fees on Website (Bus & Prof Code 6563): Beginning 1/1/2023, a California Licensed Professional Fiduciary (https://www.fiduciary.ca.gov/) with an internet website shall post a schedule or range of licensee's fees, including hourly fees, for services offered.

B. **Professional Fiduciary Association of California:** Another resource for the public to research professional fiduciaries in California is found at https://pfac-pro.org/

8. WILLS AND TRUSTS

A. **Uniform Partition of Heirs Property Act – California (CCP 874.311, et seq.):** The Act governs the partition of inherited property a court procedure to either buy-out or force a sale of inherited real estate at fair market value.

1) **What is a Partition Action in Real Estate?** Sometimes, when two (or more) people own the same piece of real property, they may disagree on what to do with the property. Should they sell it? Should one or two people keep it while the other does not?

a. One common example occurs when a parent passes away and leaves a piece of real property to their three children. If the children cannot agree on what to do with the real property, one of them may eventually be forced to file a suit for partition of the property.

b. A partition action asks the Court to divide the real property fairly between the different owners. For a property with a home or other development on it, this usually means selling the property and dividing the proceeds of the sale fairly among the different owners.

2) **Planning to Avoid Conflict and Partition Action**: In California, the family home is commonly valued at $1 million or more. It is important to be realistic about the whether your children can continue to own the home after your death. Does a child really want to live in the home? Can the child afford the property taxes, insurance, and ongoing expenses of the home? Are there sufficient assets to distribute to the other child? Plan ahead to avoid a partition action.

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. Effective 1/1/2022, 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: if you are the successor trustee of a trust, you may have to start administering the trust before the trustor's death if they become incompetent. In this case, you have a duty to send a Notification to heirs and beneficiaries. Reach out to your estate planning attorney for assistance.

C. **Does a Trust Amendment Have to be Notarized?** (Balistreri v. Balistreri) Mary Balistreri created a trust with her husband in 2017. The trust provided that "any amendment, revocation, or termination . . . shall be made by written instrument signed, with signature acknowledged by a notary public, by the trustor(s) making the revocation, amendment, or termination, and delivered to the trustee." Mary and her husband signed an amendment to the trust the day before he died. But it was not notarized. The Court held that the amendment was invalid.

However, in different case last year, (Haggerty v. Thornton), the court held an amendment was valid, even though it was not notarized. This case is now in the California Supreme Court for review.

Takeaway: Currently, the Courts are split on this topic until the California Supreme Court resolves this issue. Have your estate planning attorney prepare amendments following very closely the procedure specified in the trust and have them notarized rather than winding up in court.

HOW DOES AN UPDATE TO AN ESTATE PLAN WORK?

- Amendment v. Restatement
- Consider restating the trust in its entirety if you don't want your beneficiaries to see prior versions of your trust distribution plans
- When you change your "successor trustee" or "executor", you often need to change your Will, Trust, and Durable Power of Attorney for Finances
- When you change who will handle your medical decisions, you will need to change your Advance Health Care Directive and HIPAA Release and Authorization
- When changing your distribution plan, not only do you need to update your trust, but you may also need to change the beneficiaries on your retirement plans (IRA, 401k) and life insurance policies.
- Be prepared to talk about or research how your assets are titled and who are the named beneficiaries on your retirement plans
- Consider preparing a letter disposing of your personal effects (Items inside your house, jewelry, cars)

About Our Firm

ROBINSON & WILSON, A Law Corporation, provides services in the areas of estate and gift taxation, probate and trust administration, and wills and trusts. We are committed to providing the highest level of legal services in an understandable and compassionate way. The information provided in this newsletter is for informational purposes only and is not intended to be legal advice. No one should act on the basis of the content of this newsletter without seeking legal advice from an attorney.