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To Our Clients, Advisors and Friends:

It is a pleasure to contact you once again with advice about new laws and to discuss frequently asked questions.

I. 2023 Estate Tax Exemption and Annual Gift Exclusion Amounts

The 2023 Estate, Gift and Generation-Skipping Transfer Tax Exemption Amount (the "Estate Tax Exemption") will be increased for inflation to $12,920,000 (up from $12,060,000 in 2022). The Estate Tax rate remains at 40% on the taxable estate in excess of the Estate Tax Exemption. This figure will likely increase further in 2024 and 2025. However, unless Congress acts to continue these higher amounts, the Estate Tax Exemption will decrease to the old $6M level for deaths and gifts after 2025. We have some clients who are very fearful of a reduction to a $6M Estate Tax Exemption, and if they have sufficient assets to afford to make large gifts to use the full current Exemption (i.e., $12,920,000 per person) and if they have no concern about gifting to children or irrevocable trusts for children, then gifts are sometimes being made now at the current Exemption level to remove assets from their taxable estate, tax free.

The 2023 Annual Gift Tax Exclusion rises to $17,000 per person per donee (increased from $16,000 in 2022). Don't forget that education and medical expenses paid directly to the provider (NOT as reimbursements) are allowed as additional non-taxed gifts.

II. Post-Death Checklist and Action Items

Following a death, during our initial meeting with clients and in subsequent meetings, there are multiple items and concepts to cover, and steps that should be taken, dependent upon the terms of each specific estate plan, the types of assets owned, and the family or group of beneficiaries named in the estate plan. Below is an initial list of items that we use for discussion.

A. Notice to Beneficiaries. When a Trust becomes irrevocable, whether the assets are left in an irrevocable trust for a spouse, or for children or other beneficiaries, California law requires that the Trustee mail a Notice to each beneficiary and remainder beneficiary, and to the closest heirs, within 60 days. There are several things that are required to be in the Notice, including the name, address, and telephone number of the Trustee, that the Trust is now irrevocable, that they have a right to see a copy of the Trust, and that they cannot contest the Trust unless the contest is filed within 120 days from mailing of the Notice. At the direction of Trustee, we provide this Notice on behalf of the Trustee, and we collect a list of addresses for the parties to be notified around the time of our initial meeting. However, if the Trust remains entirely revocable and is held for the surviving spouse, then no official Notice to Beneficiaries is required.

B. Asset List and Title Review. We ask the Trustee (or person in charge) for an initial listing of all accounts and assets as of the date of death. We look at the title of each account or asset to determine if title is in the name of the Trust or whether it was in the name of the Decedent. If title is in the name of the Trust, then it is relatively easy for the successor Trustee to quickly take charge, but if title is in the Decedent's name alone, a probate may need to be opened with the court, unless there is an alternative to probate available. If title is in joint tenancy or if a beneficiary is designated, then the person named may be able to directly receive that asset.

C. Tax ID Number and Certificate of Trust. If a Trust has become irrevocable upon death of the creator, then we prepare an Application for Tax ID Number. The Decedent's social security number can no longer be used. After a Death Certificate is received, we prepare a Certificate of Trust, to reflect the successor Trustee's legal ability to take charge of accounts.

D. Property Tax Notices.

1. When a person dies holding title to California real property, either in their name or in their trust, property tax notices need to be provided to the County Tax Assessor's office within 150 days. In general, when someone dies, real property in the decedent's name or trust is reassessed for property tax purposes, because a Change in Ownership ("COO") occurs at death. There are a few exceptions to this, including if real property is going to a spouse. If the principal residence of the decedent is passing to a child who will use it as the child's principal residence and the child files proper paperwork, including a homeowner's tax exemption and claim for reassessment exclusion with a year of death, then Proposition 19 allows a partial exemption from reassessment so long as the child continues to use the principal residence.

2. If title to real property is held in an entity (i.e. a corporation, partnership, or LLC) then a Statement of Change in Control and Ownership of Legal Entities may be required to be filed with the State Board of Equalization within 90 days. This form is required to be filed any time there is a change in control of a legal entity or if there is a change in ownership, which may happen on the death of an owner of the entity. It is very important to determine whether this Statement is required, as the tax assessor has begun strictly enforcing penalties for late filed forms.

E. Estate Tax Return. During our initial meeting, it is important to determine or discuss whether an Estate Tax Return will be necessary. If a Decedent's gross estate is larger than the Estate Tax Exemption (e.g. $12,920,000), then an Estate Tax Return, Form 706, must be filed with the IRS within 9 months after death. However, the IRS will grant a 6 month extension, bringing the filing deadline to 15 months from date of death, if the extension request is filed within that first 9 month period. If the gross estate is less than the Estate Tax Exemption, then the Estate Tax Return is not required to be filed. However, a surviving spouse may still want to file an Estate Tax Return to elect "Portability" of the Decedent's unused Estate Tax Exemption (see our prior Newsletter where we discuss pros and cons of portability). If real property is owned in another State or in another Country, then other inheritance taxes could apply.

F. Appraisals. During our initial meetings, we discuss the appraisals that should be ordered. As appraisals sometimes take several months to have prepared, and as valuation discount appraisals are sometimes recommended to reduce estate taxes, it is important to begin discussing these early. Appraisals are generally required for real property and entities when an Estate Tax Return is being filed or to establish the basis adjustment, discussed below.

G. Basis Adjustments. Upon death, a person's assets receive an adjustment to their income tax basis to the fair market value of the assets on the date of death (this is important for reporting of future capital gains or depreciation in the hands of the beneficiary). In general, a person's assets will usually have appreciated in value, and we call this adjustment a "step-up" in basis. Alternatively, if the value of has deceased, then the basis is adjusted down. We help to guide investment advisors to make these adjustments for marketable securities and assist the client and the accountant in reflecting basis adjustments for entities and real estate, based on the appraisals obtained. If an Estate Tax Return was required to be filed, then a Form 8971 is required to be provided to the beneficiaries and the IRS within 30 days of filing the Estate Tax Return.

H. Income Tax Returns. The personal income tax returns and sometimes the tax returns of the beneficiaries for that year may be put on extension by the accountant in order to wait for calculation of net income, for appraisals and new depreciation schedules. Be patient.

I. RMD. If the Decedent didn't yet take his/her RMD from a retirement plan in the year of death, plans should be made to take the RMD and pay income tax on it before the year end.

J. Division or Distribution of Assets. Some Trusts direct allocation into sub-trusts for a spouse, children or other beneficiaries, and after assets are appraised and an Estate Tax Return is filed, if necessary, we and the accountant guide the Trustee as to establishing the new sub-trusts, with new tax id numbers. We also prepare to record in each County where real property is owned an Affidavit of Successor Trustee and Deeds to change titles to the real property. Alternatively, if assets are distributed outright, we assist the Trustee with making the distributions.

III. The New Inherited IRA Rules

If you are a non-spouse beneficiary of a traditional IRA from someone who died in 2020 or after, the SECURE Act changed the Required Minimum Distribution ("RMD") rules, and the IRS further detailed those rules in regulations released in late 2022.

Beneficiaries of IRAs whose owners hadn't begun taking RMDs before death, have 10 years to empty the accounts and pay taxes on withdrawals, and RMDs are not required. There are some exceptions to the 10-year rule, including for spouses and minor children of the owner.

Beneficiaries of IRAs whose owners had been taking RMDs at death also have 10 years to empty the accounts, with similar exceptions and payment of income tax; however, these beneficiaries must at least receive annual RMDs. It was initially not clear to tax advisors and plan administrators that RMDs were necessary in this situation and many beneficiaries have not taken RMDs. In regulations just released, the IRS will waive RMDs for 2021 and 2022, but they must be taken in the future.

Many of our clients own large IRA accounts and don't want to designate their children directly as beneficiaries, usually because the children are young or because a child won't be prudent in using and conserving funds. Sometimes, we designate a sub-trust under the Trust as the IRA beneficiary, but special care needs to be taken to include special language in the Trust and this should be carefully considered and discussed in a meeting with us.

IV. Expecting Dissention Amongst Your Beneficiaries?

In our experience, if children or relatives don't get along now, then after the client's death, it only gets worse and long-ago grievances surface. Clients normally can predict family dissention, and we encourage those clients to specifically plan for a smooth and protected transition after their deaths. Some steps for protection may include:

A. Having a letter from your physician as to your mental capacity to sign a Will or Trust. If the issue of incapacity is particularly challenging, have a professional (psychologist, neurologist, psychiatrist) administer mental tests and write a comprehensive report of sufficient mental competence.

B. Providing evidence that the person who is inheriting (i.e. a second spouse, significant other, or favored child) is not "unduly" influencing you to leave more to them. This may be a report or letter from a medical professional, or a close friend, lawyer, and even a neighbor. The person helping here needs to know what your assets are and why you are leaving them in an other-than-equal or standard manner.

C. There are times when a video or audio tape is made of a conversation with you as to why you have selected various beneficiaries and successor trustees, and to reflect your mental competence to engage in conversation.

V. Selecting a Trustee

A successor Trustee serves in the event you become incapacitated or to settle a Trust after your death. It is important to nominate the right person for this important job. When selecting a Trustee, the main criteria is to select someone who is honest (won't steal assets from the Trust), who has the common sense to select and listen to advice from a team of professionals, including the attorney, accountant and financial advisor, and can handle dealing with the beneficiaries of the Trust.

Many times, the successor Trustee is the spouse, and then one or more children. Family members should be evaluated, though, to fit the above criteria, and also to determine whether selecting a particular child will reinforce siblings' perceptions of continued unfairness. Sometimes a parent seeks to avoid the dilemma by naming all children to serve together as Co-Trustees ("they'll get along if they have to", or "I'll be gone, so I won't care"). This is almost always a terrible idea. This can lead to deadlock of the Trustees and can lead to each trustee hiring his/her own attorney and fighting it out in court (a long and expensive process). Neither do we advise naming a Trustee who is ill suited for the job out of a perception of "fairness", or because you feel all should be named, or because he or she is the oldest.

In some situations, it may be advisable to name a licensed professional fiduciary, bank, or trust company as successor Trustees, as a professional and impartial choice. We recommend checking with the proposed professional fiduciary, bank, or trust company first to confirm their fee schedule, and to see if they have a minimum estate size, or whether they only accept certain types of assets, or to see if they have any special language that they require to be in the Trust.

We wish you Good Health and Happiness in 2023 and beyond.

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