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## NEWSLETTER DECEMBER 2020

To Our Clients and Friends:

In this Newsletter, we want to continue to update you by briefly covering topics of the most current interest to our clients. In this issue, we would like to review with you several significant changes and potential changes in tax law which may directly affect you. This brief article is general in nature and you should not rely on this summary because there are so many individual factors to be considered. You should contact us or another tax professional to discuss taking any action.

### ALERT: PROPERTY TAX LAWS ARE CHANGING-PASSAGE OF PROPOSITION 19

California voters have passed Proposition 19, resulting in major changes to existing property tax laws, including drastically limiting the property tax reassessment exclusion for Parent-to-Child transfers of real property, and completely eliminating the property tax reassessment exclusion for Grandparent-to-Grandchild transfers of real property. The effective date of this new law is February 16, 2021. However, some gifting and planning opportunities remain.

Current law permits parents to gift, sell, or bequeath a personal residence and investment property up to \$1,000,000, based on its current property tax base value, to children without a reassessment of property taxes. After February 16, 2021, the New Law will generally result in an immediate reassessment of property tax to the current value upon a transfer, with very limited exceptions. The New Law does preserve the exclusion from reassessment for transfers from parents to child(ren), but only if (i) the property is the principal residence of the parents, and (ii) the property will immediately be used as the principal residence of the child(ren). Additionally, if the fair market value of the residence upon transfer exceeds the parent's assessed value plus \$1,000,000, then the property will still be partially reassessed.

Existing laws protecting transfers between spouses and the property taxation of properties owned by an entity (LLC, partnerships, or corporations) are not affected by the New Law. Additionally, if it is anticipated that the residence or investment property will be sold soon after a parent's death, then clients need not be overly concerned about these changes, as any reassessment will only be for the period of time after the parent's death but before the sale.

#### A. Planning Opportunities.

We often say, "Don't let the tax tail wag the dog," but it is important to be educated to make sound tax and estate planning decisions for your family. The following are some potential planning opportunities to consider before Proposition 19 takes effect on February 16, 2021:

1. Gifts of Real Property Prior to February 16, 2021. If you and your children contemplate that they will retain your residence or other investment property for many years, you might consider making a taxable gift before the New Law takes effect, to retain your lower property tax base for your children long after your death.

However, there could be practical difficulties and potential adverse tax consequences in gifting real property to children now. Parents need to be willing to part with the income from their investment property. For their residence, they would need to start paying market-value rent to the children in order to continue to live in the home, with the children reporting the rent on their tax returns. Parents will also need to file a timely gift tax return with the IRS. An important adverse tax consequence to consider would be the loss of a step-up income tax basis upon your death, to avoid capital gains taxes for your children upon a sale (see below discussion about the Biden Administration's plan to abolish stepped-up basis). Additional difficulties include: that it would be more difficult to refinance the property or obtain a reverse mortgage; the property would be subject to claims of your child's creditors; a transfer could potentially violate a loan prohibition on transfers; and there may be potential management issues with your children after the transfer which are difficult to navigate.

Gifts to children could be outright, or through Trusts. There are IRS gift and estate tax factors to consider while planning for protections under the Current Law. Trusts will make matters more complex, but may be able to help the parents retain some amount of control or tax deferral.

2. Sales. Some clients may consider selling their real property to their children prior to February 16, 2021. A straight-forward sale may work for some clients, particularly if they've already recently received a step-up in tax basis or if the gain may be protected by the exemption from capital gains tax for a primary residence. Some clients may consider complex transactions including sales to "defective" trusts, etc. Many of the same considerations and complexities need to be considered for a transfer to children, whether it's a sale or a gift.

3. Entities (such as LLC's, Corporations, Partnerships). The rules regarding reassessment of property held by an entity haven't changed. These rules are very complex and fact specific; however, in general, clients using entities to own real property with children, grandchildren or other persons *may* be able to retain their low property tax base for longer if cumulatively more than 50% of the ownership in the entity doesn't change hands and there isn't a change in control. Parents may want to consider making a gift of a portion of a property to children prior to February 16, 2021, such that the parents would then own 50% or less of the property; and then the new owners would transfer the property to an entity for liability protection and to potentially maintain low property taxes.

Some clients have been holding title as tenants-in-common ("TIC") only to take advantage of the Current Law for Parent-to-Child property tax exemption. Since that property tax goal may no longer be achievable, those clients may want to consider owning the property in an LLC for liability protection, and they may be able to achieve their property tax goals through gifting, as described above.

Clients purchasing new investment property should strongly consider taking title to the property in the name of an LLC, which could avoid a reassessment when passed to the next generation, under existing law, unless there is a later change of control.

B. Additional Consideration for Clients With a QPRT. For clients who used a Qualified Personal Residence Trust to transfer house ownership to the children, and the QPRT term of years has already expired and title has already been deeded to the children, you no longer own the property, and you have likely already applied for parent-to-child exclusions from property tax reassessment.

Clients with a QPRT which term of years has expired but who have not yet directed their attorney to prepare a Deed to transfer title to the children or to a children's trust, should sign and record a Deed IMMEDIATELY, and apply for the Parent-to Child Exclusion.

For clients with a QPRT for which the term has not yet expired, the estate tax savings for the gift will still be achieved, but the house will be reassessed when the house title transfers to the children at the end of the QPRT term. You may want to contact us IMMEDIATELY to discuss the possibility of taking alternative action.

C. It isn't all bad.

The New Law does include some advantages. Commencing April 1, 2021, seniors (age 55+), as well as persons with severe disabilities and victims of natural disasters and hazardous waste contamination, would be allowed to defer property tax reassessment when changing from one home to another, whether for more or less value, no matter which county in California. This transfer of base value for seniors and others who qualify can be used up to three times. The assessment will be adjusted based on the difference in fair market value between the two properties.

#### ESTATE TAX EXEMPTIONS AND POSSIBLE TAX CHANGES 2021

The current estate tax exemption is \$11,580,000 for those dying in 2020, and \$11,700,000 for deaths in 2021. The estate tax exemption is reduced to around \$6,750,000 (calculated with inflation index) for deaths after 2025. The annual gift tax exclusion amount for 2020 and 2021 remains at \$15,000 for gifts each individual can make to another individual tax free.

The current ability of a surviving spouse to elect that a deceased spouse's unused estate tax exemption be "portable" to the surviving spouse to use at the spouse's later death is unchanged. Thus, we continue to prepare many Estate Tax Returns within 9 months of the death of the first spouse to provide estate tax savings to the children.

As to Estate Tax changes on the horizon, it has appeared to some tax practitioners that the IRS gave the Biden team its "hit-list", which was included as part of its platform. The hit-list included substantial limitation of valuation discounts for gifts and bequests; terminating the ability to use stepped-up cost basis for income tax purposes to avoid capital gains tax following a death; and immediately reducing the current \$11,580,000 estate tax exclusion down to \$5.5M, or even to \$3.5M per decedent. Even if Congress does pass legislation in these areas, it is believed that the effective dates will not be retroactive to January 1, 2021. There are many who believe that major tax legislation will not be accomplished any time soon, if at all, but especially before the 2022 mid-term elections, because: there is so much more important legislation for Congress to attend to, including Covid relief, infrastructure planning, and energy; there is a divided Congress and passing bills will require a lot of good will and compromise so that only "important" bills will reach a vote; these bills may actually personally harm many in Congress, with their own large estates; because the Estate Tax Exemption will be reduced soon anyway, in 2026; because Congress hasn't in recent times raised taxes in the midst of high unemployment; and because the actual dollars resulting from

these changes is small in the overall picture of the government's large budget. However, there is no crystal ball, and there are some practitioners who believe that the Government is in dire need of funds and that Congress will raise taxes wherever and whenever it can.

For clients with significant wealth who could gift (husband and wife) \$23M to children and grandchildren, thought should be given to making the gift before the estate tax exclusion is reduced in order to "lock in" the current high exemption amount. Most practitioners believe that the IRS will not be able to "claw back" these gifts, even if the Estate Tax Exemption is ultimately reduced.

Whichever way you believe, it is prudent for your family to investigate opportunities for tax savings. We are, of course, always willing and able to work with our clients to investigate, discuss, and accomplish tax savings that are right for each situation.

#### CHARITABLE TAX-DEDUCTIBLE OPPORTUNITY DURING 2020-HURRY UP.

During 2020, the CARES Act allows for large donations of cash to public charities to be deductible in an amount as high as 100% of AGI. Thus, you could satisfy charitable desires or future commitments during 2020 with something equivalent to perhaps a 28% discount. Talk to your accountant about how these numbers would work for your income tax bracket.

Further, consider that one could artificially increase one's 2020 AGI by opting to take an IRA withdrawal, to then convert to a ROTH IRA, thereby being able to make additional charitable contributions with a tax-deductible discount effect.

#### MAGASINN & FELDMAN "PIVOTS" TO NEW TECHNOLOGIES AND EFFICIENCIES

During these very difficult and troubling times of Covid, we have been able to adapt and adopt new technologies and ways of doing business to permit us to continue to work effectively and efficiently with our clients. While in-office meetings are limited for safety concerns, all attorneys and staff are fully set up to work remotely and we have found that "Zoom" meetings and telephone conferences are very effective. In fact, many clients appreciate the time savings. Although we have primarily been working remotely, we do have staggered in-office time when permitted and safe. If an in-person client meeting is necessary, we schedule meetings at staggered times and require masks to be worn. We constantly disinfect and follow the guidelines for office space. Outdoor meetings in our beautiful courtyard can also be arranged. We are looking forward to one day to being able to meet with all of our clients in person; but, for now, we'll "pivot" as necessary.

We have also embraced new technologies to electronically record deeds (avoiding the weeks of back-log with the Recorder's Office) and file entity organizational documents, tax forms, and Probate Court documents. Probate Courts have continued their trend toward electronic document filings, and Judges are strongly encouraging (or demanding) only remote appearances from our office, via phone or Zoom. This is saving time for us and money for our clients.

We have sadly lost clients to Covid-related deaths, and we urge you to stay safe and well going forward in 2021.

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