ZOLLA LAW FIRM

DECEMBER 2019 NEWSLETTER

Inflation Adjustments

Effective January 1, 2020:

Estate tax threshold is now $11.58 million.

Gift tax threshold is still $15,000.

Threshold for “small estates” to avoid probate is now $166,250.

Changes to Retirement Plans

There are a number of changes in the pipeline for IRAs and other tax-deferred retirement accounts, such as 401Ks and 457 plans.

As you probably know, once a person attains age 70½, he has to withdraw funds from his retirement plan, and pay income taxes on the money that is withdrawn. (Let’s ignore Roth IRAs and 401ks for this article.) Although a person can take out as much as he wants from his own account, many people choose to only withdraw what’s required by the IRS: called a required minimum distribution ("RMD"). The RMD is based on a person’s life expectancy. If a person is 70 years old, the person’s life expectancy for the purpose of their RMD is 27.4 additional years, so in the first year of mandatory withdrawals, the person must take out a fraction of the account equal to 1/27.4 (3.6%). Each year as a person ages, his life expectancy gets shorter and the percentage he must withdraw gets larger, with the expectation that the entire plan will be withdrawn (and all the income taxes will be paid) by the owner’s death.

Just last month, the IRS issued proposed changes to the RMDs, which assume that people have longer life expectancies. The agency is currently requesting public comment on a rule change that would increase expectancies by about 1.5 years, meaning that fewer funds will need to be withdrawn from retirement accounts in the first few years after 70½, and increasing the likelihood that money will remain in the accounts at the owner’s death. The IRS will make a decision in early 2020, and the changes will likely be in effect beginning January 1, 2021.

A much bigger change to IRAs could occur if Congress gets over its partisan bickering and begins passing some laws again. In May, the House of Representatives passed the SECURE Act with an incredible vote of 417-3, but the law has been held up in the Senate since the summer. During the summer most pundits thought the law would also pass easily in the Senate, but with all that's going on in Washington, the SECURE Act seems unlikely to be voted on in what remains of 2019, but may be rejuvenated in early 2020. In any event, the SECURE Act will make a number of changes to the rules for retirement plans, namely: the age for beginning RMDs will change from 70½ to 72, it will be easier for employers to set up 401ks, and there will be more wiggle room in making penalty-free distributions from plans before 59½.

But, the biggest issue for me relates to inherited IRAs (retirement plans that are inherited from the original owner after a death). Currently, in most cases, if an owner of an account clearly identifies the beneficiary in the plan documentation, the beneficiary can make withdrawals over the beneficiary's lifetime. This beneficiary RMD is similar to the owner's RMD, but it begins the year after the owner's death, and not when the beneficiary attains age 70½. Also, the life expectancy table for an inherited IRA is more compressed than for an owner's IRA. But, here's the big change: if the SECURE Act passes, all inherited IRAs will need to be withdrawn within ten years of the original owner's death. This isn't a big deal if the IRA is worth about $200,000, which is apparently the median size of an account. See: https://money.usnews.com/money/retirement/articles/2015/07/06/how-your-retirement-account-balance-compares-to-your-peers. $200,000 divided by 10 years, is just $20,000/year, which isn't going to push anyone into a higher income tax bracket or dramatically increase a beneficiary's income taxes. But, I have many clients with retirement accounts that exceed $2 million. If the owner has an only child, that child will have to take out $200,000/year, which will definitely change income tax brackets. It will also mean that less will be kept in the retirement plan to grow tax-deferred.

I can certainly understand that the IRS wants their tax money (they've been holding off on taxing the money since retirement plans were created in the mid-70s). But, for many of you with accounts that are significantly larger than average, this change will have a huge impact. Going forward, it may be worth it for some IRA owners to consider taking more than the RMD to start draining the accounts prior to death, converting to Roth IRAS, or even making larger charitable gifts from the retirement accounts (charities don't pay income taxes). Stay tuned next year to see if this law passes.

Other Tax Laws

Although Democrats control both houses and the governorship in California, they've been having a hard time passing laws which increase taxes. Some legislators attempted to introduce a revised California estate tax, but that bill seems dead in the water. Any death or inheritance tax would require an amendment to the California Constitution, which means a supermajority of both houses and a majority vote in a general election.

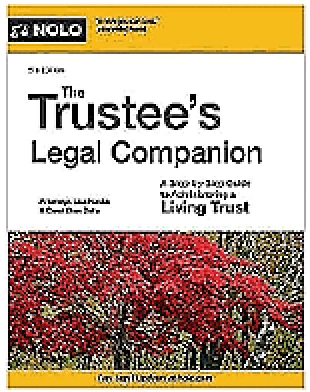
I am more surprised that property tax reform failed this year. Everyone's heard of Prop 13, but many people are unaware of Prop 58, which allows children to retain their parent's property tax basis. A child can protect her parent's property tax basis for the parent's personal residence (of any value) and for up to $1 million in other property (valued at its assessed value, not its current fair market value). Various laws were introduced to take away Prop 58 for commercial property, limit the benefit of Prop 58 for higher value homes, and to require the children to reside in the parent's home to be eligible for the Prop 58 benefit. As I mentioned, none of them passed. But, be on the lookout for them to be resurrected next year as well.

Do YOU need a Bypass Trust?

A number of couples have contacted me this year to revise their revocable trusts and eliminate the Bypass Trust provisions because it can be complicated for a surviving spouse to administer, and it may cause additional capital gains taxes after the surviving spouse's death. I've had people tell me they were only aware of the issue of a Bypass Trust after talking with their widowed friends or financial advisors. Quite frankly, that bothers me, because I've been writing -- in this newsletter -- about Bypass Trusts for quite a few years and have been encouraging my clients to think about whether the Bypass Trust is still the best option for their situation. Keep in mind: if you and your spouse have a blended family, or if one spouse has significant separate property or debts, a Bypass Trust may still be the best choice to protect each spouse's property and ensure that the assets are allocated appropriately after death. But, if your trust is more than ten years old and if you believe you only created the Bypass Trust to minimize estate taxes, please schedule an appointment with me to discuss whether it's time to amend your plan.

Zolla Law Firm

Thank you for your business and your referrals. It was a pleasure to work with you all in 2019 and I look forward to seeing you in 2020!



This Newsletter is for information and discussion purposes only. Before any action is taken, professional advice, based on your specific situation, should be obtained.