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A Major Tax Policy Failure for California

by DeEtte L. Loeffler, J.D., LL.M., Taxation

States usually use tax legislation as a way to either raise revenue or to encourage (or discourage) certain behaviors in taxpayers. Legislation adopted by California voters in 2016 fails on both counts by encouraging the smoking of marijuana over cigarettes and decreasing tax revenues from the sale of the marijuana. How did this happen? You can blame the use of propositions to make tax policy, as these bits of legislation are not required to be coordinated.

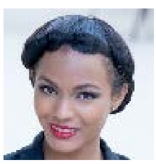
In May, the California legislature adopted a bill prohibiting the sale and use of tobacco products by persons under the age of 21 years. The premise of the legislation was that most smokers begin smoking before age 19, so delaying their access to tobacco would make it less likely they would start smoking and become addicted. (Yes, this overlooks the fact that many individuals started smoking while still minors and were obtaining their cigarettes illegally anyway).

In the November election, voters adopted a punitive $2 per pack tax increase on cigarettes. This tax increase was primarily promoted, not as a legitimate way to raise tax revenue, but as another way to discourage smoking. The tax increase (if any) is to be used in part for programs to help people stop smoking and to discourage others from starting. So far, so good. Use of tobacco is being discouraged.

However, at the same time, voters adopted Prop 64 which makes the use of "recreational marijuana" legal with sales to begin starting in January of 2018. Prop 64 restricts the sale of recreational marijuana to persons under the age of 21 years (which is consistent with the smoking age for cigarettes). However, the law does not limit the sale of "medical marijuana." Medical marijuana became legal in 1996 though Prop 215 which permit sales to those 18 years or older (and to minors with appropriate paperwork). Under Prop 64, individuals under the age of 18 can continue to access medical marijuana, just not recreational marijuana.

Finally, Prop 64 was strongly promoted as a way to raise large amounts of tax revenue for the state (as was the reported experience of other states that have legalized it). It imposes a 15% *excise tax* on all sales of marijuana (both recreational and medical), but exempts medical marijuana sales from the 7.5% *sales tax.* Unfortunately, the bill was worded imperfectly, and on November 9, 2016 the State Board of Equalization interpreted the law as immediately prohibiting the state from collecting sales taxes on the sale of some medical marijuana. The cost of this blunder? California estimates it receives $50 - $100 million in sales tax revenue from medical marijuana sales each year, with 2015 collections estimated at $58 million.

It seems unlikely the state will forgo all that revenue willingly for 2017, but it has lost the revenue for at least three months. Why? Because of another proposition which was adopted in November. Under Prop 54, legislators must post new bills on line for public review for 3 days before they can be voted on. The lame duck session for 2016 did not have sufficient time to post and vote on a bill before the close of the legislative session. We anticipate that the new legislature will be able to obtain the necessary two-thirds (2/3) majority to re-impose the sales tax on medical marijuana in 2017, but likely it will only be able to apply going forward.



Personal Revival Trusts – From Science Fiction to Reality

by Marica L. Sutton, B.A., Communication, University of San Diego Paralegal Student
and
DeEtte L. Loeffler, J.D., LL.M., Taxation

Usually when a Trustor creates a Trust, there is intent to leave the estate to living beneficiaries or active entities. A recent surge in media focus has put a spotlight on the cryogenic preservation process. Some individuals are creating Personal Revival Trusts (“PRT”s) which name them as both the Trustor and as the future Beneficiary. Legal challenges are surfacing in the structure, enforcement, and termination of PRTs as the popularity and science behind cryogenics seemingly advances.

The effectiveness of a PRT depends on an individual being successfully “revived” after being cryogenically frozen post-mortem. Cryonics is the practice of using liquid nitrogen at incredibly cold temperatures to preserve a recently deceased person. There is a hope by those investing in this technique that, in the future, humans will have advanced scientifically to the point in which all diseases will be cured, age can be reversed, and death can be evaded. The goal for the previously deceased individuals who were frozen is to be revived and live off of the funds in the PRTs they established.

PRTs are often structured like a Dynasty Trust. In Dynasty Trusts, assets are held for many generations and distributed at various points in time. A well-organized plan for the succession of Trustees is needed in order to ensure there will always be someone or some entity to perform the trust administration. Beneficiaries of the trust must be living at the time in which the assets are distributed. In most of these types of trusts, there are provisions for individuals that are not yet born. If the beneficiary is non-existent or deceased, the assets skip to the next generation.

What happens when the deceased Trustor is the beneficiary? If the Trustor is never revived, then the trust could essentially continue to exist for eternity. Many states, including California, put limits on the length of time a trust can exist (also known as the “Rule against Perpetuities). However, at least 20 states have now repealed this rule. In the states where PRTs are legal, construction of the trusts must be very concise and include details of the Trustor’s wishes in every possible situation (i.e. in what circumstances can the Trust be terminated, who receives the balance, etc.).

In states in which PRTs cannot yet be established, provisions for cryogenic preservation can still be made inside a trust and funds can still technically be held for the future benefit of the Trustor until the revival. These trusts would resemble a normal trust, but name the facility in charge of the cryogenic process as the beneficiary. Some popular facilities include Alcor Life Extension Foundation and the Cryonic Institute. This type of trust restricts the use of trust principal and terminates upon the revival of the “patient” in the facility’s care.

Another challenge that comes up when creating PRTs is jurisdiction. Which court, at any point in time, has the legal authority to approve the trustee’s actions or resolve disputes involving cryogenically-preserved Trustors? Obviously, upon the death of the Trustor, probate court is likely to hear all issues concerning the trust. In the case of revival, would the case be heard elsewhere?

If the PRT does not have a living beneficiary, it may also be challenged by potential heirs. Family members or beneficiaries with moral objections to the cryogenic process may claim that the Trustor was subjected to the fairy tale of immortality and under undue influence by money-hungry cryogenic institutions. Will the courts be more sympathetic to the living family members or respect the wishes of the Trustor?

Assuming that the PRT goes unchallenged, another issue arises - who is in charge of the revival and when should the Trustor be revived? The PRT should contain a very detailed description of the Trustor’s intent. Often, the cryogenic institute will be named as Trustee, but various professional Trustees can also be assigned. The Trustor may indicate a specific revival date in his/her Trust (i.e. September 2116) or leave the revival date up to the Trustee’s judgment. This date would be some time in the future in which revivals have a high success rate, most illness has been eradicated, and the effects of aging have either been reversed or minimized. A Trustor can even be as detailed as “Revival should be on the day in which the average age for humans is 220 years old.”

Most cryogenic institutes encourage Trustors to name the institute on insurance policies. The cost of the procedure can range from $30,000 to $150,000 to ensure there are sufficient funds to preserve the Trustor’s body until it is revived. The institutes are not allowed to tap into the PRT funds. These funds are exclusively reserved for post-revival care. In the case that a cryogenic institute goes bankrupt, the Trust should include a provision requiring the assets, be transferred to another comparable facility or, if none, for termination of the Trust.

Finally, the circumstances in which a PRT may be terminated should be explicitly laid out in the articles. The Trustor can allow the Trustees, courts, or heirs to make this decision. There should be a clear indication where the remaining assets should go and what arrangements to make for the Trustor’s body. In drafting a PRT, the Trustor must give thought to every possible situation that could happen in the future before, during, and post-revival.

Cryogenic preservation may seem like science fiction now, but some individuals are taking this fringe-science very seriously. From average citizens to celebrities like Simon Cowell and Larry King, investments for an extended future are becoming increasingly popular. Forming a trust that can properly fund the process, the revival, and life after the revival can be as challenging as the process itself. Personal Revival Trusts cannot be established in many states. For this reason, some people are resorting to loop-hole trusts that name the cryogenic institute as the beneficiary. A lot of consideration must be taken into account when terminating a trust, because it is essentially terminating the Trustor’s second chance at life. The future holds some very interesting possibilities in cryogenic preservation, estate planning, and trust administration.

FEDERAL TAX NEWS

by DeEtte L. Loeffler, J.D., LL.M., Taxation

<u>“Cadillac Tax” on Health Care Plans Likely to Be Repealed</u>. When the Affordable Care Act (aka “Obamacare”) was enacted, it included a punitive 40% excise tax to be imposed on employers who provided employees with high quality health care plans. This “Cadillac Tax” would be imposed on employers for every dollar spent by them (or by employees) above a certain level and would not be deductible by the employer. The tax was originally meant to go into effect in 2018, but was postponed to 2020. President-elect Trump has indicated this tax will be repealed and, with a Republican-controlled House and Senate, this seems likely.

<u>Repatriation of Overseas Profits Appears More Likely</u>. In 2016, Congress appeared to be agreement over imposing a one-time tax on offshore corporate profits which are brought back to the US (i.e., “repatriated”). They could

not, however, agree on how to spend the tax funds once received. In 2017, with a single party in control of Congress and the White House, agreement appears more likely. President-elect Trump has proposed a one-time 10% tax on cash and a 4% tax on other earnings. Whether this tax will take the form of a “deemed repatriation”, a transition tax (to force funding of infrastructure) or a tax holiday is currently unclear.

Democrats Propose Extensions of Certain Expiring Tax Credits. On mid-November, Democrats in the House proposed extensions for some of the expiring federal tax credits, including the energy efficient commercial buildings credit, the alternate fuel refueling property credit, the biodiesel and renewable fuel credit, the fuel cell motor vehicle credit, the energy efficient new (and existing) home credits, the qualified microturbine credit, the mine rescue training credit, certain film and television credits, the qualified tuition credit, and the mortgage insurance premium credit. We anticipate more bills will be introduced in early 2017, but are unable to predict which credits may be renewed under the new legislature.

STATE TAX NEWS

by DeEtte L. Loeffler, J.D., LL.M., Taxation

Attempt to Pass Infrastructure Bill Fails. California’s last ditch effort to adopt legislation to pay for critical infrastructure repairs failed in late November. California needs to spend about $140 billion on road and other repairs. Democrats, who will have a supermajority in 2017, expect to be able to adopt this critical legislation. However, Governor Jerry Brown and moderate Democrats have consistently resisted tax hikes. Californians already pay the highest tax rates in the nation, and additional taxes are unlikely to be popular, even if the funds are used for essential infrastructure repairs.

Biodiesel Credit Set to Expire. The federal $1 per gallon tax credit for biodiesel is set to expire on December 31, 2016. Loss of this credit may harm California’s eight biodiesel producers, including San Diego’s New Leaf Biofuel. Democrats in the House of Representatives have introduced legislation to extend the credit for an additional 2 years. However, a simple extension of the existing tax credits may be inadequate, due to increasing competition by foreign producers. In addition, such credits may face a difficult renewal process given President-elect Trump’s public statements in support of increased oil drilling and questioning the scientific accuracy of climate change research.

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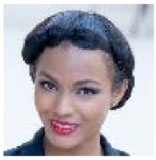

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