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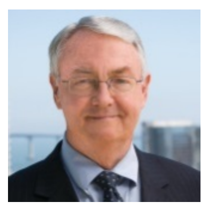
IN THIS ISSUE

INTRODUCING NEW MMPPH ASSOCIATE: KATHLEEN "KATIE" LEPORE, JD, LL.M. TAXATION

We are pleased to announce Kathleen ("Katie") Lepore has joined the firm as an associate, effective July 5, 2017. Katie focuses her practice on estate planning, trust administration and taxation. She received her Bachelor degree in Accountancy and a Master of Science in Taxation from the University of San Diego, a Juris Doctor from the University of San Diego School of Law, and a Masters of Law in Taxation from Georgetown University Law Center. She is also a licensed Certified Public Accountant in California.

In between graduate school and law school, Katie worked in Los Angeles at one of the "Big Four" accounting firms preparing tax returns for large C-corporations, pass through entities, high net worth individuals, and complex trusts.

In her leisure time, Katie enjoys Do-It-Yourself projects and is currently renovating her home. Her hobbies include photography, baking, scrapbooking, and learning about U.S. history. She also enjoys attending baseball games. One of her goals is to attend a game at every Major League Baseball Park.



ROLLOVER IRAs AND CONTRIBUTORY IRAs: WHY IT IS IMPORTANT TO KNOW THE DIFFERENCE

by Bradford Dewan, J.D., MBA

Knowing the differences between a "rollover IRA" and a "contributory IRA", and keeping them separate, can provide important benefits, and preserve options, for the IRA owner. This article explains the differences and why it is recommended that the IRA owner keep them separate.

The term "rollover IRA" refers to an IRA that was established to receive funds from a qualified employer retirement plan like a 401(k) Plan ("Qualified Plan"). That is, the funds from the Qualified Plan were transferred (i.e. rolled over) from the Qualified Plan into the newly created IRA.[i] In contrast, a "contributory IRA" is funded solely by annual contributions directly by the IRA owner.

When an individual intends to roll funds over from a Qualified Plan to an IRA, the financial institution that will serve as the custodian for the IRA may recommend that a new IRA be created to receive the funds from the Qualified Plan. Importantly, creating a new IRA to receive the funds to be transferred from the Qualified Plan is not required. One can transfer those funds into any other IRA that may already exist because there is no legal requirement that the distribution from the Qualified Plan be kept in a separate IRA from any other IRAs that the individual may own. But even though a separate IRA is not legally required when transferring funds from a Qualified Plan, there are at least three reasons to consider for keeping the distribution from a Qualified Plan separate from other IRAs, especially a contributory IRA, which, as referenced above, was funded solely by annual contributions by the IRA owner.

The first reason to create a separate rollover IRA is derived from federal bankruptcy law.[ii] An IRA is protected from one's creditors under federal bankruptcy law if the IRA owner declares bankruptcy. But this protection is currently limited to $1.28 Million for all of one's IRAs. Very importantly, however, the $1.28 Million limit does not apply to amounts that are rolled over to any IRA from a Qualified Plan, or any earnings on the funds in the rollover IRA. The funds in this rollover IRA are protected in full if the IRA owner declares bankruptcy, just as they would have been if the funds had remained in a Qualified Plan. Clearly it is easier to track, and maintain the records for, the amount of funds rolled over, and any future earnings on such funds, if those funds are in a separate IRA rather than an IRA that is funded with both annual contributions and rolled over funds.

The second reason for rolling over funds from a Qualified Plan into a separate IRA relates to the protection of assets from the creditors of the owner of that IRA funded with rollover funds outside of bankruptcy. Under California law, assets held in private retirement plans are fully exempt from execution, both before and after distribution to the judgment debtor.[iii] IRAs, however, are exempt only to the extent "necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires."[iv] But this limited exemption for IRAs does not apply in California if the funds in the IRA can be traced back to a private retirement plan in which the funds would be fully exempt as described above.

This issue was addressed in <u>McMullen v. Haycock</u>[v]. In the appeal, the California Court of Appeals stated that it must decide which exemption under Section 704.115 of the CA Code of Civil Procedure applied to assets that were rolled over from a fully exempt private retirement plan into an IRA - - the full exemption for private retirement plans under Sections 704.114 (b) and (d) of the CA Code of Civil Procedure, or the limited exemption for IRAs under subdivision (e) of Section 704.115.

In this case, the appellant judgment debtor, Don H. Haycock, appealed from a post judgment order that applied the limited exemption under subdivision (e) of section 704.115 to the assets that were rolled over from his fully exempt private retirement plan into an IRA. Haycock contended that under the California tracing statute[vi], because all of the assets in his IRA can be traced to his fully exempt private retirement plan maintained by his former employer, the full exemption continues to apply

[i] It is recommended that the transfer be made by a "trustee-to-trustee" transfer.
[ii] 11 USC 522 (n)

[iii] Code of Civ. Proc. Sections 704.115 (b), (d)
[iv] Code of Civ. Proc. Section 704.115 (e)
[v] 147 Cal. App. 4th 753 (2007)
[vi] Code of Civ. Proc. Section 703.080 (a)

to those funds. The judgment creditor, Hugh McMullen, contended, however, that the full exemption was lost when the exempt private retirement plan assets were rolled over into the IRA, because IRAs are given only a limited exemption under Section 704.114 (e).

The Appellate Court concluded that because California law permits the tracing of exempt funds under the above referenced Section 703.080 (a), the mere transfer of the fully exempt private retirement plan assets to the IRA did not eliminate their full exemption under Section 704.115, subdivisions (b) and (d).

Importantly, the debtor claiming this exemption has the burden of tracing the claimed exempt funds.[vii] Consequently, complying with the "tracing" requirements will be easier if the funds from the fully exempt private retirement plan are rolled over into a completely separate and newly formed IRA.

The third reason to create a separate rollover IRA is that the IRA owner might decide in the future to roll the funds in that rollover IRA into a Qualified Plan with a new employer. In the past, Qualified Plans could accept rollovers only from rollover IRAs. That is, rollovers from IRAs that were previously funded solely by annual contributions were not permitted. Now, however, Qualified Plans can accept rollovers from both contributory IRAs as well as rollover IRAs. Despite this flexibility, the administrators of Qualified Plans, while permitted, are not required to accept rollovers and, in addition, they can limit the types of contributions they will accept. While it is becoming less common, some Qualified Plans will accept rollovers only from rollover IRAs. Consequently, an individual who is planning on rolling over funds from a Qualified Plan into an IRA might keep this in mind if there is a possibility of rolling the funds from an IRA into a Qualified Plan with a new employer in the future.

In summary, knowing the differences between a rollover IRA and a contributory IRA is important. As described above, keeping funds from a Qualified Plan solely in a separate rollover IRA (and not mixed with a contributory IRA) may provide significant benefits to the IRA owner in the form of creditor protection, whether in or outside of bankruptcy. If you are considering transferring funds from a Qualified Plan and have questions as to whether to transfer the funds to a newly created rollover IRA or to an existing contributory IRA, we would be glad to assist you.

[vii] Code of Civ. Proc. Section 703.080 (b)

NEW HEALTH BILL WOULD REPEAL TAXES, INCREASE DEFICIT

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

A bill passed by the House of Representatives in May, and another proposed by Senate Republicans in late June, would replace the Patient Protection and Affordable Care Act (commonly known as Obamacare) with new legislation. Both bills would repeal taxes which were adopted to fund Obamacare, including the unpopular 3.8% "Net Investment Income Tax" (which would be repealed retroactively to December 31, 2016), the 0.9% Medicare surtax (after 2022), a 10.0% tax on indoor tanning, and the 2.3% levy on medical device sales (beginning in 2018). The NIIT and Medicare Tax currently apply only to individuals with income over $200,000 or to couples with income over $250,000. The Congressional Budget Office estimates the elimination of these taxes would increase the federal deficit by $664 billion over a ten-year period.[viii]

Both bills retain the 40% "Cadillac Tax", which is to be imposed starting in 2020 on employer provided health plans with annual premiums over $10,800 for individuals, and $29,500 for families, but would delay implementation until 2026. This tax is to be paid by insurance companies, which would likely pass it through to employers in the form of higher premiums.

[viii] Some Senators have stated a willingness to retain the NIIT and Medicare surtax as these do not increase the cost of healthcare.

Retaining this tax reduces the tax impact of each bill and would permit the bills to be adopted without any votes by Democrat members of either body.

There are other significant differences between the two bills which would have to be reconciled before one could become law. First, both bills would cut Medicaid spending in the future years, but the Senate bill would cut it considerably more. The Senate bill would cap program funding at the rate of inflation in 2025, while the House bill would cap program funding at the rate of medical inflation plus 1.0%.

While both bills would retain tax credits for some taxpayers, the Senate bill would provide tax credits based on both income and age, while the House bill would provide them for age only. Both bills also would deny tax credits for plans which cover elective abortions. The Senate bill would retain cost-sharing subsidies for insurance companies which provide policies to low income persons through the Exchanges, while the House bill would not. The Senate bill would also provide an additional $50 billion in subsidies to the Exchanges through 2021.

Finally, the Senate bill would provide a three-year phase out of Obamacare's Medicaid expansion, beginning in 2021. Several states previously took advantage of the Medicaid expansion and would need time to adjust to lower funding levels. To compensate, the Senate bill would reduce Medicaid reimbursement rates which in turn may make it more difficult for Medicaid patients to obtain care. Instead, the Senate bill would provide a total of $62 billion over eight years to a state innovation fund for such things as coverage for high-risk patients and reinsurance.

Debate continues in the Senate regarding the adoption of their version of the new healthcare law. If adopted, the two houses of Congress will still need to reconcile the differences between the two bills before a new healthcare law could go into effect.

FEDERAL TAX UPDATE

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

<u>Tax Reform Stalls</u>. With both houses of Congress focused on health care reform, tax reform has made little headway. Republicans are seeking steep tax cuts for business and higher income taxpayers, which no Democrats appear willing to support. Under the budget reconciliation rules, any legislation that adds to the federal deficit must sunset by ten years. Some Republicans are now proposing a change to the budget reconciliation rules to extend the tax window from 10 to 20 or 30 years. They argue this would provide taxpayers with more certainty, but the impact on the federal deficit from such a change could be substantial. So far, Paul Ryan, Speaker of the House, has not agreed to seek this rule change.

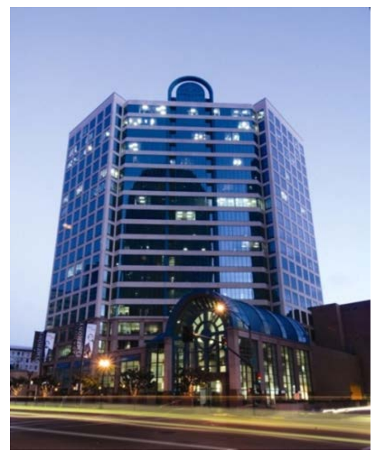
<u>Proposed 2704 Regulations May be Dead</u>. The IRS may withdraw recently proposed regulations under guidance from the White House to reduce burdensome regulations. The regulations in question, under IRC Section 2704, would deny common discounts, such as lack of marketability and lack of control, for transfers of interests between related parties in family controlled businesses. If adopted, the regulations would treat such transfers differently than those between unrelated parties, even when the transfers are made for fair market value and at arms-length. Tax professionals have argued that the changes would unduly increase the tax cost of such transfers and complicate valuation by applying new and different standards, and that these changes are arbitrary and capricious. The IRS took comments on the regulations in December of 2016, but stopped work to finalize the regulations when they received direction from the President to study ways to reduce burdensome regulations.

STATE TAX NEWS
by DeEtte L. Loeffler, J.D., LL.M., Taxation

Partnership Return Due Date Extended. For 2017 and beyond, a new state law (AB 119) permits the Franchise Tax Board to grant partnerships (and limited liability companies taxed as partnership) an automatic 7-month extension of time to file income tax returns. In 2016, California conformed return filing dates for partnerships to match those for federal tax returns, resulting in an extended filing date one month earlier than under prior law. Under AB 119, partnership tax returns can be extended to October 15th to file. The FTB is directed to make exceptions for 2016 returns which are filed after September 15, 2017 but not later than October 16, 2017.

BOE Power Sharply Curbed. Effectively July 1, 2017, AB 102 stripped the State Board of Equalization (BOE) of many of its taxing and collection functions. The BOE will retain only the duties, powers and responsibilities assigned to it by the state Constitution, and the power to adjust the fuel tax (until July 2019). The BOE will mainly be responsible for property tax assessments, utility tax (canals and pipelines, but not power/gas, phone or rail), tax on insurers, and excise taxes on the sale, manufacturing, or importation of alcoholic beverages.

All other duties of administering and collecting various taxes, including sales and use tax, will be transferred to the new California Department of Tax and Fee Administration, while all other tax appeals will now be handled by the new Office of Tax Appeals. It appears taxpayers may be required to hire legal counsel for appeals, going forward. Expect a bumpy transition, as this change goes into effect immediately.



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