

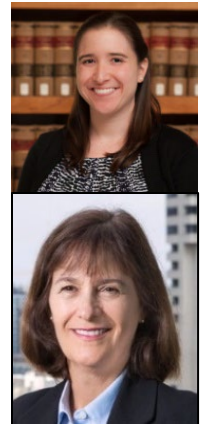
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MARCH 2023 NEWSLETTER

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Firm News: **Katie A. Balatbat** will be a featured speaker at the California Lawyers Association: Young Tax Lawyers Annual Conference on April 27, 2023. Her presentation entitled *Wanted Dead or Alive: Taxes and the Importance of Estate Planning* is available for online viewing by attorneys who are attending the conference.

Congratulations are in order for **Mary J. Peshel** and **Katie A. Balatbat**, named as a Super Lawyer and Super Lawyers Rising Star, respectively, for 2023! Such awards are granted after a vetting process and based upon nominations by peers in the legal community. The Rising Star Award specifically is granted to the top 2.5% of attorneys in the San Diego area under age 40. Congratulations, Mary and Katie!



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**EVALUATING CAPACITY:
TRUSTS, WILLS, AND
CONSERVATORSHIPS**
By Linda A. Nelte, J.D.

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Could lawyers have greater exposure to legal malpractice claims as the Baby Boom generation, the largest proportion of the U.S. population, starts to age? Unfortunately, the risk of Alzheimer's and other dementias increases when an individual is age 65 and older. In 2020, the number of people living with Alzheimer's in the United States was 5.8 million; this number is projected to increase to 13.8 million in 2050.¹ This suggests that attorneys will likely encounter more situations in the future in which they need to assess whether clients have legal capacity to create estate plans and enter into legal transactions.

¹ ALZHEIMER'S ASS'N, 2019 ALZHEIMER'S DISEASE FACTS AND FIGURES (2019),

<https://alz.org/media/Documents/alzheimers-facts-and-figures-2019-r.pdf>.

Law

The law generally presumes that a client has capacity to enter into legal transactions. How to overcome this presumption will depend on the legal transaction at issue and the jurisdiction. This article will focus on how to assess a client's testamentary capacity to make a Will or trust. Additionally, this article will evaluate the requirements to appoint a conservator for an adult and the least restrictive alternatives to such an appointment.

Testamentary Capacity

The Restatement of Property provides a widely recognized definition of testamentary capacity among the states: A testator has capacity to make a Will if, at the time of the will execution, he or she is capable of knowing and understanding in a general way the nature and extent of his or her property, the natural objects of his or her bounty, and the disposition that he or she is making of that property, and if he or she is capable of relating these elements to one another and forming an orderly desire regarding the disposition of the property.²

Many jurisdictions assess the facts and circumstances of each case to determine if testamentary capacity exists. For example, a New Mexico court held in favor of testamentary capacity despite testimony from a neuropsychologist that the decedent had cognitive function issues the week of the Will execution because at the time of the Will execution, the decedent identified the document he was signing as his Will, indicated that he understood the document was to distribute his property, and indicated he was not under the influence of any medication or duress.³

Additionally, a California court held that a guardianship does not support a finding of testamentary incapacity without evidence that

the decedent's incompetence continued at the time of the Will execution. Further, in California, when a testator has a mental disorder in which there are lucid periods, it is presumed that the decedent executed his or her Will during a period of lucidity.⁴

Uniform Guardianship, Conservatorship and Other Protective Arrangements Act

The Uniform Law Commission's (ULC's) Uniform Guardianship, Conservatorship and Other Protective Arrangements Act provides that a court may order a conservator for an adult only if it finds by clear and convincing evidence that (1) the adult cannot manage his or her property or financial affairs because he or she cannot receive and evaluate information or make or communicate decisions, even with appropriate supportive services, technological assistance, or supported decision-making; (2) a conservatorship is necessary to avoid harm to the adult or "significant dissipation of the property of the adult"; and (3) a conservatorship is the least restrictive method to meet the adult's demonstrated needs.⁵

Additionally, the court may only grant to a conservator powers that are necessary to meet the demonstrated limitations of the adult, nothing greater. The court shall issue orders that "will encourage development of the respondent's maximum self-determination and independence."⁶ The comments by the ULC indicate that imprudent or wasteful management of property is not sufficient to impose a conservatorship.

State Trend in Following the Uniform Guardianship, Conservatorship and Other Protective Arrangements Act

In alignment with the ULC, there is a trend among the states to encourage self-determination and independence rather than

² See RESTATEMENT (THIRD) OF PROPERTY § 8.1(c) (AM. L. INST. 2003).

³ See *Reeves-Evins v. Daniel*, No. A-1-CA-38205, 2021 WL 1714768 (N.M. Ct. App. Apr. 30, 2021).

⁴ See *Andersen v. Hunt*, 196 Cal. App. 4th 722, 727 (2011).

⁵ Unif. Guardianship, Conservatorship, and Other Protective Arrangements Act § 401 (UNIF. L. COM'N 2017), <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.aspx?DocumentFileKey=9621a464-2d79-ba7c-658d-c1f1854c7473&forceDialog=1>.

⁶ *Id.*

impose guardianships or conservatorships on adults. Twenty-four jurisdictions have enacted supported decision-making legislation.⁷ Supported decision-making allows adults with disabilities to make their own decisions with the help of some assistance (e.g., from individuals acting as supports).

Steps for Analyzing Client Capacity

The American Bar Association's *Assessment of Older Adults with Diminished Capacities* provides a useful approach for assessing client capacity.⁸ A lawyer's assessment of capacity should consist of an examination of factors affecting a client's decision-making ability and a determination of what supports and services could strengthen a client's decision-making ability.

Building Client Trust and Confidence

During client meetings, lawyers should aim to make clients as comfortable as possible to increase their decision-making ability. Clients who are not comfortable may not communicate clearly, making it difficult to accurately assess their decision-making ability. Consider conducting client meetings in clients' homes, so they feel more at ease. When introducing yourself, take time to "break the ice." Interviewing clients alone is important to build trust and help eliminate the chance of undue influence. But also consider if clients are more comfortable with a support person during the meeting (e.g., a family member or friend). If this is the case, ensure that you speak directly to the clients rather than past them to others. Additionally, letting clients know of the confidentiality of the attorney-client relationship and that anything said during the meeting will not be shared with others is a good idea to build trust and confidence.

Implicit Bias

When assessing client capacity, it is important to be aware of implicit biases that can arise when

dealing with older clients. Some may assume that aging and cognitive impairment go hand-in-hand. But clients may lack decision-making ability for a multitude of other reasons besides cognitive impairment, including hearing or vision loss or even grief from the loss of a loved one.

Addressing Hearing Loss, Vision Loss, and Cognitive Impairment

For clients who are hearing impaired, consider using a handheld hearing amplifier (e.g., Williams Sound's Pocketalker, Bellman and Symfon's Mino) to amplify your voice when speaking, and try to minimize background noise. Also, consider providing a follow-up letter to clients summarizing what was discussed during the client meeting to compensate for issues with the client's hearing.

For clients with vision loss issues, face clients away from bright windows and avoid glossy print materials to accommodate clients with sensitivity to glare. Format printed materials in large-sized font (i.e., 14- or 16-point font) and double-spaced. Also, consider having reading glasses and magnifying glasses available on conference tables for clients.

For clients who may be cognitively impaired, conduct the client meeting during a time of the day when clients are at their peak performance (e.g., mid-morning). Discuss one issue at a time with clients, and let clients know when you are switching the discussion to another topic or issue. Repeat or summarize clients' answers to questions to ensure correctness of communication.

Conclusion

Some jurisdictions demonstrate that evidence of impaired cognitive function does not preclude testamentary capacity if the impairment did not continue during the time of the Will execution. Additionally, a client's lack of decision-making

⁷ Alaska, California, Colorado, Delaware, District of Columbia, Illinois, Indiana, Kansas, Louisiana, Maine, Maryland, Minnesota, Missouri, Montana, Nevada, New Hampshire, New York, North Dakota, Oklahoma, Oregon, Rhode Island, Texas, Washington, and Wisconsin.

⁸ AM. BAR ASS'N COMM'N ON L. AND AGING, ASSESSMENT OF OLDER ADULTS WITH DIMINISHED CAPACITIES (2d ed. 2021), <https://www.apa.org/pi/aging/resources/guides/diminished-capacity.pdf>.

ability in the realm of conservatorships is not static. Individuals can have increased decision-making ability when provided with the right supports, whether they be personal, technological, or social service support. Following the ULC, almost half of the states have enacted supported decision-making legislation.



TAX PLANNING FOR THE RICH AND FAMOUS: ITEMS OF CONSIDERATION FOR ENTERTAINMENT CELEBRITIES

By Michael W. Rashmir, J.D., MBA, LL.M.

Proper tax and estate planning are critical to maintaining wealth and avoiding long, drawn out legal battles. Many actors and musicians are undergoing public scrutiny and lengthy legal battles because they failed to establish an estate plan. Notably, just recently Lisa Marie Presley's estate has been in the news, as well as that of Stephen "tWitch" Boss. While everyone should ensure their affairs are in order with a proper estate plan, this article details a few items specific to the "stars." Specifically, this article will analyze considerations to build and maintain wealth through: (1) Capital Gains Elections, (2) Loan Out Corporations, (3) Foreign Tax Credits, and (4) Passive Activity Income.

Capital Gains Elections

Most people are familiar with how capital gains receive preferential tax treatment, enjoying lower tax rates than ordinary income like wages. For successful musicians, it can often be to their advantage to sell entire catalogs of songs rather than lease out individual songs. This is because Section 1221(b)(3) of the Internal Revenue Code allows for capital gains treatment on the sale of self-made musical works.⁹ As such, musicians can save cash by taking advantage of special code sections and planning for the future,

hopefully to avoid years-long legal battles, such as with the estate of Michael Jackson.

Loan Out Corporations

Many actors consider operating through their own company. Typically called a Loan Out Corporation, as the name implies, the company loans out the services of its employees, namely, the actor or other talent. Due to recent changes in the tax laws, specifically surrounding the eligibility of deducting miscellaneous itemized deductions on an individual tax return, sole proprietors, including certain actors, may have lost the ability to deduct business expenses that previously were deductible. As a result, forming an entity for which the acting talent becomes an employee allows for income to be received at the business entity level, which also allows for business expenses and deductions.

Thus, for example, the loan out corporation could hire an actor as an employee and then loan out the services of its employee to fulfil a given contract, with payment being received by the company and then passed along to the actor in the form of wages as an employee. The corporation can then take income tax deductions towards the money generated, which an individual may not be able to deduct on his or her personal income tax return. The actor becomes an employee of his or her wholly owned corporation.

The benefits can include deducting 100% of business expenses, such as attorney fees and payments to agents; deferring income into the following year by operating on a fiscal year rather than calendar year; the opportunity to incorporate as an S-corporation to possibly save additional employment taxes; and the ability to contribute to pre-tax expenses like retirement plans and medical insurance.

However, the drawbacks can include: additional incorporation costs; additional bookkeeping and recordkeeping; additional tax return filing

⁹ <https://news.bloombergtax.com/tax-insights-and-commentary/capital-gains-election-will-keep-driving-music-catalog-sales>

requirements; minimum/annual/franchise taxes or similar; double taxation as a C-corporation; employer side withholding; additional insurance coverage; possible increased IRS and state tax agency scrutiny; and business licenses.

Foreign Tax Credits

You may be familiar with the concept of foreign tax credits, as perhaps they appear on your annual Form 1099 from your brokerage account. The credits tend to be available to reduce U.S. tax liability due to tax paid to foreign jurisdictions. While operating as an S-corporation is typically touted for saving employment taxes, there are some additional benefits to operating as an S-corporation through possible foreign tax credits. For example, take Beyoncé, who just announced her world tour. Any entertainer rendering their services in foreign countries through their corporation could be subject to foreign taxes on the income earned in that country. If operating as an S-corporation, it is possible for such entertainers to benefit from these taxes as a foreign tax credit, to offset U.S. income. Due to the pass-through nature of S-corporations, the foreign tax credit may pass through to the individual earning the income, to help offset the W-2 income reported by that entertainer. If operating as a traditional C-corporation, the credit could be at the corporate level, but the bulk of the income reported at the individual level, creating a disconnect between the income and deductions.

A tax indemnity agreement typically provides for one company or taxpayer to provide income to another company or taxpayer for paying the tax liability of the other. Entertainers could also consider obtaining a tax indemnity agreement requiring the employer/Loan Out Corporation to reimburse the individual entertainer for any foreign taxes imposed in excess of the US tax liability due to operations of the corporation. However, the reimbursement income is subject to U.S. tax, so perhaps the entertainer should consider including a gross-up provision to make him/her whole in a sort of circular calculation. Because tax indemnity is typically only used for

the A-list stars who garner top dollar, a tax indemnity agreement can be important to reduce foreign taxes imposed to a level that can be fully creditable. It may be possible to make this reduction by carefully allocating income to things like: (a) a signing bonus, (b) promotional services, and (c) a name and likeness license.

Generate Passive Activity Income

The Internal Revenue Code distinguishes between passive activities wherein the taxpayer generally does little action to receive the income, like rental real estate income for a landlord, and active income, like real estate income for a realtor. However, losses from passive activities may be offset only against passive activity income. See IRC Section 469. Entertainers may have such losses to offset from leasing equipment, rental real estate, or other hobby activities. If so, they should consider converting service/active income into passive activity income to absorb any passive losses. This might be possible by obtaining an ownership interest in the production or film (as a limited partner or similar), possibly as partial payment for their acting work or in addition to individual compensation. Note the IRS has broad discretion to recharacterize all income from such equity interest as service income, which may disallow the offsetting.¹⁰

Conclusion

Overall, it will be in an entertainer's best interest to seek out proper tax and estate planning from competent professionals, including making capital gains elections, looking into operating through loan out corporations, taking advantage of foreign income tax credits when working abroad, and evaluating ways to generate passive income to offset any passive losses. We would be happy to evaluate any of these options for you to see if they are recommended in your specific situation, and we recommend that you discuss such options with your tax advisor(s).

¹⁰ Bloomberg Law, The Bureau of National Affairs, Inc.



FEDERAL TAX NEWS

By Katie A. (Lepore) Balatbat,
CPA, J.D., LL.M., Taxation

IRS Delays 1099 Reporting Requirement. As featured in *MMPPH's December 2022* newsletter, a new law requiring third party payment processors to issue Forms 1099 to taxpayers was delayed from taking effect. On December 23, 2022, the IRS issued Notice 2023-10 which provided a delay to tax year 2023 before reporting requirements are effective.

IRS Tax Deadline Extended. The IRS tax deadline for San Diego and certain other California counties was extended to October 16, due to the recent severe winter storms and flooding and places in California being considered disaster areas. It also extends the deadline for quarterly tax payments.

SECURE Act 2.0 Expands Retirement Provisions. Becoming law on December 29, 2022, the *Consolidated Appropriations Act of 2023*, which includes the *SECURE 2.0 Act of 2022*, expands the 2019 *SECURE Act* to increase the catch-up contribution limit for employees who are aged 60-63 as well as increase the amount eligible to be contributed under catch-up provisions to the greater of \$10,000 or 150% of the Age 50 Catch-Up Limit, effective in 2025. Additionally, required minimum distributions are required to be taken at later ages, increasing from age from 72 to 73 in 2023, and to age 75 in 2033. Several other retirement provisions are also included. Also of note, beginning in 2024, up to \$35,000 of unused funds in 529 plans can be rolled into a Roth IRA, so long as the 529 plan was in existence for 15 years or more.

Federal Renters Bill of Rights. On January 25, the Biden Administration announced a *Blueprint for a Renters Bill of Rights*. It identifies several actions that various federal agencies will take to

protect tenants as well as increase housing affordability. The Federal Trade Commission (FTC) and Consumer Financial Protection Bureau (CFPB) will be responsible for identifying unfair practices in leasing, and evaluating whether a federal limit on rent increases should be a consideration. Similarly, the Senate Finance Committee has had bipartisan discussions about how tax policy can expand access to affordable housing.

Broker Reporting of Digital Assets Delayed. On December 23, 2022, the IRS issued Announcement 2023-2, which states that until regulations are issued, brokers are not required to report additional information on dispositions of digital assets that otherwise were not previously subjected to reporting prior to the 2021 *Infrastructure Investment and Jobs Act*. Under amended provisions of IRC 6045 and 6045A, brokers would have expanded requirements to report information surrounding digital assets, and further guidance is forthcoming.

Supreme Court Case on FBAR Penalties. A recently issued Supreme Court opinion from February 28, 2023 in *Bittner v. United States* held that the *Bank Secrecy Act's* \$10,000 maximum penalty for non-willful failure to file a Report of Foreign Bank and Financial Accounts ("FBAR") is calculated per report, not per account. In the case, the taxpayer had a maximum penalty of \$50,000 over 5 years of failing to file FBARs instead of approximately \$2.7 million, if levied per account. The opinion was held 5-4, with Justices Gorsuch, Jackson, Roberts, Alito, and Kavanaugh in the majority; Justices Barrett, Thomas, Sotomayor, and Kagan filed a dissenting opinion.


Biden Presidential Budget Revealed. On March 9, President Biden released his 2024 fiscal budget, totaling approximately \$6.8 trillion. Although unlikely to be effectuated with a Republican-controlled House, the budget proposes a 25% minimum tax for wealthy Americans, a higher marginal personal income tax rate of 39.6%, higher capital gains rates for high-income taxpayers, as well as an expanded

child tax credit and Earned Income Tax Credit. In order to help fund Medicare, President Biden proposes increasing the Medicare tax rate on earned income above \$400,000 from 3.8% to 5.0%.

Bill to Repeal Estate Tax Introduced. Rep. Robert Latta (R-OH) introduced *H.R. 338, Permanently Repeal the Estate Tax Act of 2023*. If passed, it would repeal the estate tax but retain basis step-up under IRC 1014.

Houses Passes Bill to Rescind IRS Funding. On January 10, the House of Representatives passed *H.R. 23, the Family and Small Business Taxpayer Protection Act*, to cancel some funds that were allocated to the IRS in the Inflation Reduction Act passed in 2022. It passed along party lines in the House, but is not expected to pass the Senate.

Senate Confirms New IRS Commissioner. On March 9, the Senate confirmed President Biden's choice for IRS Commissioner, Daniel Werfel. The vote was 54-42. Werfel previously served as acting Commissioner in 2013 under President Obama.



CALIFORNIA TAX UPDATE
By Katie A. (Lepore) Balatbat,
CPA, J.D., LL.M., Taxation

Middle Class Tax Refund. The California FTB issued guidance anticipating that the IRS would include any California Middle Class Tax Refund in federal taxable income, and began issuing Forms 1099 respectively. However, the IRS later confirmed that Middle Class Tax Refunds would not be included in taxable income, creating somewhat of a debacle for any taxpayers who received a Form 1099. Please reach out to your tax preparer if this affects you.

California Tax Deadline Extended. The California FTB announced that it would follow federal deadlines for tax return due dates, due to

the recent severe winter storms. As a result, California income tax returns for San Diegans and many others in California is now October 16, 2023.

Housing Bills Encourage Residential Development. On September 28, 2022, Governor Newsom signed into law *AB 2011, Affordable Housing and High Road Jobs Act of 2022* and *SB 6, Middle Class Housing Act of 2022*, which allow local zoning rules to be overridden to allow for residential development in otherwise commercial zones. Local governments in certain circumstances must streamline applications and approve qualifying projects to build more residential housing more quickly. *SB 6* requires the developer to include affordable housing options, pay fair wages to construction workers, and provide relocation assistance to displaced commercial tenants.

Governor Newsom's Budget Release. Governor Gavin Newsom recently released his fiscal years 2023-2024 budget for consideration. The budget totals \$297 billion, with a projected \$22.5 billion deficit. Priorities in the budget include education, homelessness, housing, healthcare, and public safety, including helping low- or middle-income families to purchase health insurance through Covered California, and increasing UC and CSU funding by 5% for five years.

Employment Payscale Disclosures. Beginning January 1, 2023, California employers with 15 or more employees are required to include the pay scale for a position on any job posting. For purposes of the new law, it may also subject out-of-state employers as well if hiring for remote positions that could be filled from California. Only base pay is required to be posted and not necessarily bonuses or other benefits.

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