page 2
Living with your parents (or adult children)

page 3
Addressing PPP loans in ownership transitions

page 4
The issue of too much money in one investment

Legal Matters®

Estate Planning
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Your 401(k) limits may be much higher than you think

If you participate in an employer-sponsored 401(k) plan, you can contribute up to $19,500 to your retirement in 2021. But did you know some plans allow you to contribute up to $38,500 more?

If you're looking for increased savings options, find out if your existing plan allows additional after-tax 401(k) contributions. In 2021, after-tax 401(k)s have a total plan maximum of $58,000, including traditional contributions, employer contributions and after-tax contributions. As is true for traditional 401(k)s, these limits are higher ($64,500) if you're age 50 or older.

> After-tax 401(k) accounts are beneficial for high-income earners looking to put away extra funds.

Be aware that after-tax contributions are not tax deductible. The contributions grow tax-deferred, meaning the earnings will be taxed as income when you withdraw them. (This differs from Roth 401(k) contributions in which the entirety of the account balance grows tax-free.)

Benefits of after-tax contributions: After-tax 401(k) accounts are beneficial for high-income earners looking to put away extra funds in a tax-advantaged investment account. Your contributions will grow tax deferred, and the compound value of those tax savings, over time, can provide a sizable boost to your retirement account.

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In-plan Roth rollovers: If your 401(k) plan allows you to move your after-tax money, you can boost your tax advantages with an in-plan Roth rollover. Dubbed by some as the "mega backdoor Roth," this strategy allows you to get funds into a Roth IRA regardless of your income.

continued on page 3

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Living with your parents (or adult children)

The way families are living in the day to day has changed dramatically over the past several months due to the pandemic.

Most families have one or more parents working remotely, and many have one or more children in school remotely, part-time if not all of the time. The situation has also made it challenging to spend time with parents and grandparents who life in different households.

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As a result, some older adults are exploring or have already taken action to move in with their adult children and their families, or vice versa.

Before you take the leap, be aware of the various issues involved in moving in with family, especially if you're going to share home ownership across multiple generations.

First, there are several considerations when thinking through the home ownership arrangement, either for a new home or to share the burden of an existing one.

If older parents are making a contribution to buying a home, determine how that will be treated.

The contribution might be considered as any of the following: 1) a gift, 2) a loan, 3) an advance on the adult children's inheritance, or 4) a contribution to the home purchase to share an ownership interest in the property.

Make sure you have a plan in place in case any couple involved — either the older parents or their adult children — gets divorced. Define who will be able to live in the home and how any shared ownership interest will be divided.

You will also need to make decisions based on whether the older parents have enough assets without the home itself to afford nursing home care. Otherwise, Medicaid could attempt to garnish their interest in the home to pay for that care.

Estate planning considerations

There are many important estate planning elements related to a shared ownership arrangement.

First, think about who will receive the ownership interest when one of the owners dies and define it clearly in writing. You'll also need to define how estate taxes will be paid.

In figuring out ownership interests, you'll also need to think through how you want your assets divided at your death.

Parents often seek to distribute their estate equally to their children. But be aware that what looks like equal division of assets isn't always what it might seem when it comes to shared homes.

For example, consider an older adult who owns a home worth $1.5 million and stock and mutual fund investments worth $1.5 million. Let's assume say his son, daughter-in-law and two grandchildren move in with him, and he also has a daughter. A typical scenario might be for the older adult's will to say that the home goes to the son, the remainder of the estate goes to the daughter and the estate taxes will be paid from the residue, which are any assets not left to anyone specifically. That's how a standard will would be written.

However, the result here would not be the equal division of assets the father intended. That's because the home would pass to the son free of estate tax, he would receive a step-up in basis that brings the value of the home to the fair market value on the date of the father's death, and there would be no taxable gain for selling the home at that value.

The daughter would not fare so well, as the estate tax would have to be paid out of the accounts she inherited. Further tax implications would reduce her share if the assets were contained in retirement accounts.

To ensure that assets are divided in the way you intend, consult with an estate planning lawyer to set up a trust arrangement that makes sense for your family. The assets within the trust can be set up to ensure an equal division of assets.

Family limited partnership option

Another option to consider is shared ownership using a family limited partnership.

The family limited partnership agreement would lay out how the property will be used and maintained, and how any home renovations will be handled. A family member could make a capital contribution or loan to the partnership to pay for any improvements and all loans and contributions would be tracked.

The agreement would explain that, when a family member exits the arrangement, the home will be appraised to determine the fair market value of the departing partner's interest. At that point, the other family members sharing ownership of the home can buy out the partner who is leaving or decide to sell the home entirely.

If the home is sold, any secured loans would be paid, along with closing costs and expenses. After any capital contributions are repaid to the partners, the net proceeds of the home sale would be divided based on each family member's interest in the partnership.

Addressing PPP loans in ownership transitions

By the end of June 2020, the U.S. Small Business Administration had approved nearly 4.9 million Paycheck Protection Program (PPP) loans. Some of the businesses that applied for those loans are either in the process of a "change in ownership" or see the current climate as an opportunity to transfer value to their heirs.

Estate tax exemptions are high, interest rates are low, and business valuations may have dipped. These are all factors that make this an opportune time to evaluate succession issues in your estate plan. It may be a good time to gift ownership interests or complete other ownership transfers.

However, businesses that took out a PPP loan may face hurdles in completing those transactions. Many PPP borrowers will need to notify their lender in advance, and some will need SBA approval before a deal can move forward.

Under SBA guidance (Procedural Notice 5000-20057), when the ownership transfer totals less than 20 percent, no special notices or approvals are required by the SBA. Borrowers should, however, check their underlying loan documents to determine whether advance notice is required by other parties.

Be aware that ownership transfer limits set by the SBA are aggregate numbers for transfers that occur during the life of your loan.

When an ownership transfer totals between 20 percent and 50 percent, the borrower must provide their PPP lender with advance notice, including copies of the proposed agreement and transaction documentation. The guidelines stipulate the PPP lender can approve these transactions without SBA approval.

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SBA approval may be required if the sale or transfer is over 50 percent of the common stock or ownership interest. In order to receive approval, the buyer will need to assume the PPP borrower's outstanding obligations under the loan. The SBA has 60 days to review such transactions, so consider that in deal timelines.

No SBA approval is necessary if the borrower has completed a loan forgiveness application and deposited funds into an escrow account equal to the outstanding loan, pending the SBA's determination of forgiveness.

Be aware that ownership transfer limits set by the SBA are aggregate numbers for transfers that occur during the life of your loan. That means you would still need to provide notification if you gifted 15 percent interest to a family member months before selling another 15 percent interest in a separate transaction.

401(k) limits may be higher than you think

continued from page 1

Per the IRS, once your income exceeds a certain milestone, you can no longer contribute directly to a Roth IRA. It is, however, perfectly acceptable to make after-tax contributions to a 401(k) first and then roll those into a Roth IRA. The sooner you make the rollover, the more years you get of tax-free earnings.

Note, however, that in-plan Roth rollovers will be subject to required minimum distribution rules when you retire, unless you move the in-plan Roth funds to a regular Roth IRA outside your retirement plan after you leave your employer but before you turn 70 ½. If you don't already have a Roth IRA account outside your retirement plan at that time, you may be subject to a five-year holding period.

This newsletter is designed to keep you up-to-date with changes in the law. For help with these or any other legal issues, please call our firm today. The information in this newsletter is intended solely for your information. It does not constitute legal advice, and it should not be relied on without a discussion of your specific situation with an attorney.

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The issue of too much money in one investment

Some households find themselves with a large investment in one single stock.

That can happen when a great investment takes off (think: Apple or Amazon). But concentrated equity positions can also occur through employee compensation arrangements or inheritance.

This can be both good fortune and significant risk. Past performance of a stock is no guarantee of future results, and if that one stock were to tumble, it could have serious repercussions for your financial wellbeing.

If you have a large amount of wealth in one single asset, talk to your estate planner about strategies to protect yourself from risk. One option, of course, is to sell some of that asset to diversify your portfolio.

However, selling assets doesn't always make sense. When that's the case, hedging strategies can act as insurance against loss of value in the stock. Alternately, you can use the stock as leverage to borrow against your portfolio and use the loan to invest in other assets.

Resolving concentrated equity positions can be complicated, emotionally and financially. Whether you choose liquidation and diversification or some other strategy, be proactive in managing that risk. Informed decisions now can help protect your nest egg long-term.

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