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Legal Matters®

Estate Planning
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Opportunity Zones offer tax breaks

For a limited time, investors can help reinvigorate distressed communities while deferring capital gains on profits earned elsewhere.

The 2017 Tax Cuts and Jobs Act created the Qualified Opportunity Zone program in order to offer tax incentives for investment in economically blighted communities. When you invest in an Opportunity Zone, you can defer and possibly reduce taxes on recognized capital gains.

If you will be subject to a large tax bill as a result of capital gains in the near future, an Opportunity Zone investment may be worth exploring.

An investment that defers capital gains

Opportunity Funds are investment vehicles that allow investors to defer capital gains for up to 10 years and possibly receive greater tax advantages. To do so, investors need to reinvest capital gains (from any investment, such as stocks, real estate or business interests) into certain census tracts, which are designated as Opportunity Zones.

Each state nominated communities they wanted included in the program. To qualify, census tracts had to meet a Low Income Community requirement or have a poverty rate of 20 percent or greater. The goal is that investments in these impoverished communities will promote sustainable economic growth and help narrow the gap between them and their more affluent neighbors.

There are approximately 8,700 Opportunity Zones nationwide, including all 50 states, Washington, D.C., and U.S. territories. You can find a list at cdfifund.gov/pages/opportunity-zones.aspx.

To qualify for the program, an Opportunity Zone Fund must have 90 percent of its assets in a qualified Opportunity Zone property and must make substantial improvements to that property. Those are defined as improvements equal to the fund's initial investment in the property, over a 30-month period.

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Three ways to save

Investors in an Opportunity Fund can potentially save taxes in three ways:

1. Tax deferral. Taxable gains in an Opportunity Zone Fund are not recognized until 2026 or until the interest in the fund is sold or exchanged, whichever comes first.

2. Capital gains tax deduction. When you defer gains through an

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CORREIRA & CORREIRA LLP
800-699-5040 | CorreiraLaw.com

20 Park Plaza, Boston, MA, 617.723.5040
20 Cabot Boulevard, Mansfield, MA, 508.991.5040
1010 GAR Highway, Swansea, MA, 508.679.5040
1415 Panther Lane, Naples, FL, 239.649.5040
127 Dorrance Street, Providence, RI, 401.454.5040

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Opportunity Zone Fund, you receive a 10 percent step-up in tax basis after five years and an additional 5 percent step-up after seven years. Due to the 2026 deadline, you'd have to invest in 2019 to get full advantage of the 15 percent step-up.

3. No tax on appreciation. If you remain in the fund for at least 10 years, the capital gains tax is eliminated on the future sale of the investment. Essentially, the cost basis of the property becomes equal to the fair market value on the date of the sale. You do still have to pay the deferred taxes on your original investment.

Example scenario

Imagine you realize $250,000 in capital gains in 2019. If you roll those gains into an Opportunity Zone Fund within 180 days, none of those gains are taxable this year. After five years, you'll earn $25,000 in stepped-up tax basis in the fund (10 percent of $250,000). After two more years, you'll earn another $12,500 of stepped-up basis. At a 23.8 percent tax rate, that's nearly $9,000 in tax savings.

Now, let's say you waited until 2029 to sell the investment at an appreciated value of $450,000 (roughly 6 percent annual rate of return.) You'd have $200,000 in gain that would not be taxable. However, you'd still have phantom income on your original $250,000 investment (minus the 15 percent reduction), in 2026 when, per program deadlines, the deferred gain had to be recognized.

In total, that yields approximately $56,600 in tax savings over 10 years ($9,000 in capital gains deduction and $47,600 in capital gains tax eliminated). Your 10-year net, in this scenario, is just shy of $400,000.

Instead, imagine you'd paid the capital gains tax on that $250,000 in 2019 ($59,500 at 23.8 percent) and then reinvested the remainder ($190,500) at a 6 percent annual return. If you sold the investment at the end of 10 years (at a value of $341,000) and paid capital gains taxes again ($35,700), you would net just over $300,000.

If you have questions about this new investment and whether it would be a prudent part of your wealth management plan, reach out to your estate planning attorney. Be sure you understand the investment risks involved.

Just like other investments, the fund may increase or decrease in value. Due diligence is essential when choosing funds, especially because this is a new incentive program.

Estate planning critical for non-traditional couples

Generally speaking, estate planning laws were designed for the traditional nuclear family, a married couple with kids.

But according to the 2010 U.S. Census, such families are less than 50 percent of the total. Non-traditional families, including single parents, blended families and unwed partners, need to pay particular attention to their estate plans to avoid unwanted consequences.

If you die without a will, your assets will be distributed according to your state's default laws. If you're not married, these laws indicate that your assets are passed on to your next of kin, such as children, parents or siblings.

Consider wills, trusts, a durable power of attorney, and healthcare proxies to designate whom you want to step in for you if you're incapacitated and who should receive property after your death. Take a look at how your assets are titled as well as your beneficiary designations. These will also impact how your assets are distributed after your death.

Title property with care

Ensure that family real estate is titled appropriately, consistent with your wishes and instructions in your will. Titling issues are especially important if you are unmarried and want your partner to continue living in the property after you die.

Two titling options include tenants in common (TIC) and joint tenants with rights of survivorship (JTWROS). When a property is held as a TIC, each owner holds an interest. When one owner dies, that interest passes to an heir, per his or her estate plan. That means your partner could end up as a joint owner with your children or siblings. With JTWROS, on the other hand, property automatically transfers to the surviving owner.

Protect a partner and the next generation

For blended families, consider ways to protect your

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Preventing a will contest

When you write a will, you have control over how your assets will be distributed after your death. However, if someone in your family disputes your will, an anonymous probate court judge could end up with the final say over who gets your property.

Emotions run high when someone dies. If family members aren't content with what they've received, or don't believe your wishes are being interpreted properly, they may contest your will. Will contests can drag out for years, preventing your heirs from getting the assets you wanted them to receive.

As part of creating an estate plan, look for ways to reduce the possibility that someone could challenge your wishes. Here are some steps you can take to ward off a will contest after your death:

1. Start early. Make your estate plan while you are of sound mind. If you wait until your health is failing, or your mind is impacted by an accident, your will becomes vulnerable to claims that you lacked sufficient mental capacity to draft it.

2. Prove competency. When you write your will, you can ask a physician and/or your attorney to certify that you are mentally competent. A video record at the time you sign the will can also help demonstrate you acted with a clear head, of your own free will.

3. Get qualified legal advice. There are do-it-yourself books and online tools available for writing your will. But using an estate planning attorney is the best way to ensure it is properly executed and valid. If you do choose the DIY route, have it reviewed by a lawyer.

4. Consider trusts. There are a variety of trusts that direct how your assets are managed, held and distributed to your heirs. With a trust, you generally can avoid probate and increase control over how your estate is settled. Your heirs will receive their inheritance more quickly and privately, with potentially fewer costs to the estate.

5. Write your will without interference. Avoid complaints that someone exerted undue influence over you when you wrote your will. To help avoid such contests, don't have your beneficiaries sign as witnesses and don't include them in meetings with your attorney.

6. Share your intentions. Consider talking to your family about the intentions in your will. Let your heirs know why you've designed it the way you have, or write an explanatory letter to accompany your will. Generally, what you put in the letter will not have a legal effect on your will, but it can help family members accept your choices.

7. Include a no-contest clause. A no-contest clause stipulates that anyone who contests the will, and then loses that contest in court, is disinherited from what they would have otherwise received. No-contest clauses aren't enforceable in all states, and they're only effective if you're leaving your heirs enough value that they wouldn't want to risk the challenge.

Once your will is complete, don't just file it away. Sit down with an attorney regularly to make updates that reflect your current situation. Changes such as moving, having grandchildren, or losing a loved one can impact your plan.

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Estate planning critical for non-traditional couples

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spouse's quality of life into retirement while still providing assets to your children after your spouse's death. Otherwise, all your assets could transfer to your spouse, and then ultimately to his or her children. Trusts are one option to give your spouse rights while still setting aside assets for the next generation.

Alternately, a couple may pool their resources into a joint trust. Any remaining assets could be distributed to all your children equally after you've both died.

Talk with an estate planning attorney about other planning strategies that can benefit unmarried couples and other non-traditional families. Arrangements can be made for retirement plans, estate taxes, wills, real estate, and healthcare powers of attorney.

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Correira & Correira LLP
20 Park Plaza, 4th floor
Boston, MA 02116

Protect assets, retain access with a Spousal Lifetime Access Trust

A Spousal Lifetime Access Trust (SLAT) is an estate planning tool that can be used to lock in the current estate tax exemption while still allowing a certain degree of access to trust assets.

SLAT basics

A SLAT is an irrevocable trust created by one spouse for the benefit of the other. The gift removes assets from your estate but allows your spouse to access the trust. It provides you with indirect access to the funds while protecting assets from both creditors and estate taxes.

Here are the key benefits of creating a SLAT:

- **Avoiding probate:** Assets in a SLAT avoid probate. That reduces costs and ensures funds are available immediately after death.
- **Avoiding estate tax:** The Tax Cuts and Jobs Act roughly doubled the exemption value for the estate tax to nearly $11.2 million. This change will sunset after 2025, but it could be repealed by a future administration before then. For high-net-worth families, it may make sense to shift assets out of their taxable estates now, before the rules change.
- **Tax-free growth:** SLATs are taxed as a grantor trust, meaning the donor spouse is responsible for income tax on trust earnings. That way, the trust grows tax-free, increasing the asset protection benefits.

The trust can be structured in a variety of ways. One option is to allow only the beneficiary spouse to access funds during his or her lifetime with descendants receiving benefit after the beneficiary's death. However, SLATS can also be structured to allow distributions to a beneficiary spouse and children at the same time.

Think carefully before creating a SLAT. If your spouse dies before you do, or if you and your spouse divorce, you will no longer have indirect access to trust assets.