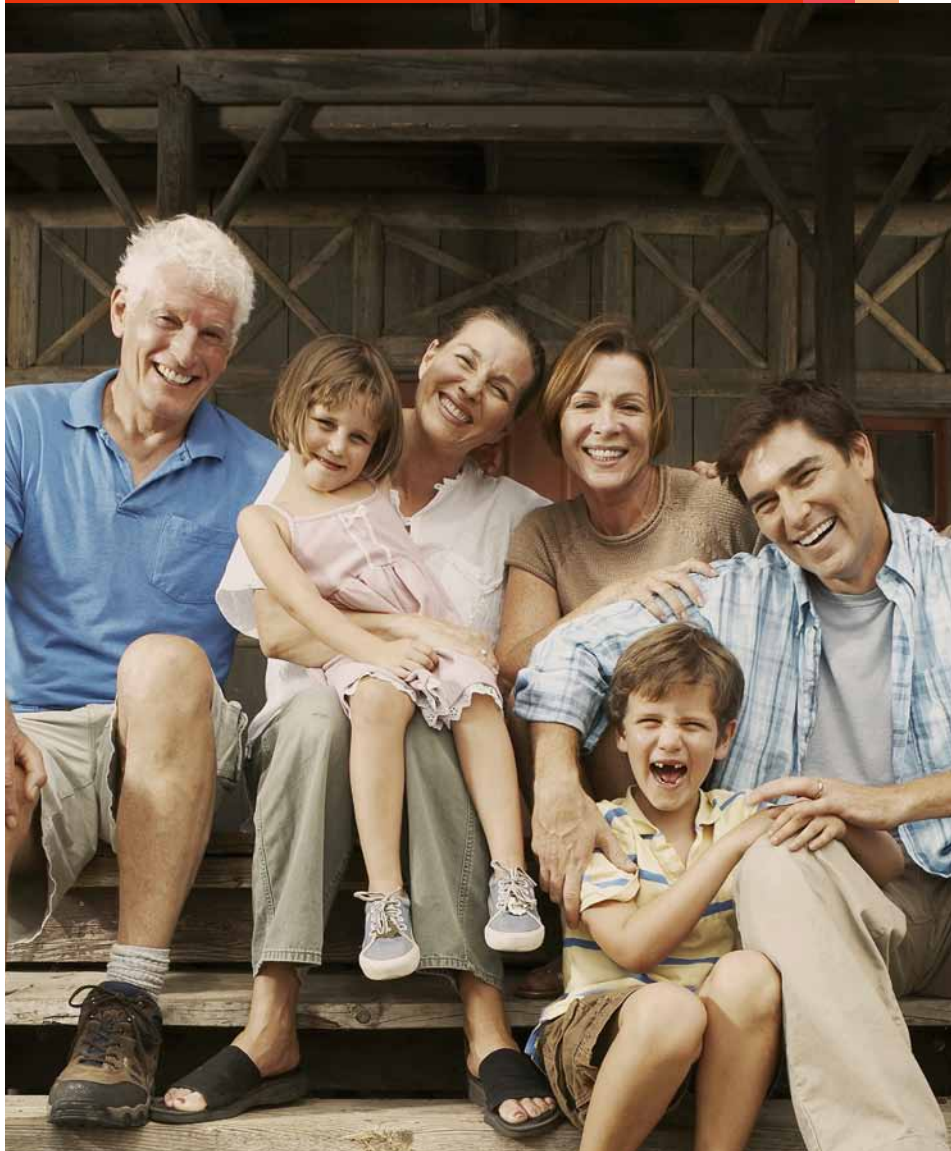


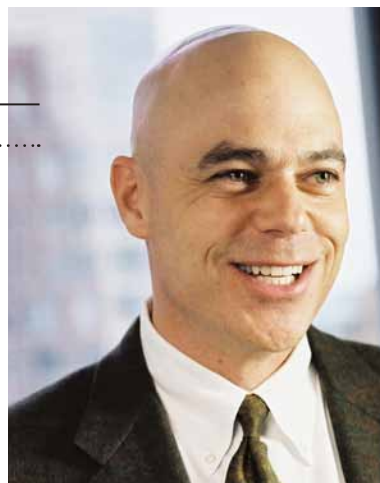
# *Managing your wealth*

*Guide to tax and  
wealth management*

2011



**Richard Kohan**  
US Leader  
Personal Financial Services



### **October 2010**

Wealth management and tax planning, done right, have always entailed care and thoughtfulness. Nowadays, however, diligence is required in greater measure than before.

In large part, that is because certain things we once took for granted in the market and overall economy are no longer a given. Families and individuals who felt they could pretty much let their wealth management run on autopilot, after choosing the right strategy and advisors, have found it necessary to rethink matters in the wake of the financial crisis.

What is the best path forward? What does wise wealth management look like in a post-crisis era? These questions do not lend themselves to easy answers. Although a new, post-crisis wealth management paradigm is beginning to emerge, it hasn't come into full focus yet. We are living through the paradigm's formative years. What is already crystal clear, however, is that from now on high-net-worth individuals will need to be more actively engaged in their wealth management strategy.

This isn't to say that knowledgeable advisors won't remain critical to investment and

tax-planning decisions. They will. But individuals will want to ask more questions of those advisors than in the past and review the answers regularly. Doing so will help them better understand the strategies undertaken on their behalf—in the areas of personal income tax, investing, charitable giving, and estate and gift planning—so that they feel confident their interests are being managed effectively for them.

To ask the right questions of your investment advisors, for instance, you will need to understand the various factors that influence investment performance in today's world. This requires basic knowledge of macroeconomics, coupled with an awareness of new, novel, or complex investment products—and their use in nontraditional investment approaches that might not be compatible with growing and preserving your family's wealth. How much your investment strategy relies on these approaches is something you'll want to monitor carefully.

You will also want to be alert to which way the political winds are blowing as you assess your overall wealth management plan. Decisions made in Washington over the next few years—particularly regarding the national deficit and attempts to reduce it through tax policy—are

***PwC's Personal Financial Services practice comprises a national network of experienced personal tax and financial advisors who help high-net-worth individuals preserve and enhance their wealth.***

likely to have a profound and far-reaching effect on the growth and preservation of your family's wealth. The impact of these and other governmental policy changes is apt to be felt not only by this generation, but also the next.

Some of the changes are already upon us: economic stimulus measures; recently passed financial regulatory reform; the scheduled sunset of the Bush-era tax cuts (as of this writing); and healthcare reform, with its tax increases on high-net-worth individuals. These developments are making it necessary to take a fresh look at your wealth management plan.

This guide aims to help you in that endeavor. Like last year's guide, the current edition discusses the various strategies for meeting your family's tax and financial needs while also growing and preserving its wealth for the long term. New chapters have been added to address risk management, the increasing importance of communicating a well-understood wealth management philosophy within families, and common mistakes in working with financial advisors. Other sections have been updated to reflect recent and anticipated legislation, as in the tax-planning chapter, and to layer in additional perspectives, as in the chapter on managing your investment portfolio.

We—all of us—received a wakeup call not too long ago. The investment model changed overnight. That, coupled with changing tax policies, has made it necessary for wealth management techniques to adapt. The importance of revisiting your estate and gift plan, charitable-giving strategy, investment portfolio, and income tax plan in the context of the new, evolving wealth management paradigm—and carefully considering how that context impacts your family's long-term financial goals—cannot be overemphasized.

I hope that after you've read our book, you will feel well-equipped to update your plan based on new laws and policies, as well as remain confident that you can continue to manage your wealth against the backdrop of a changing environment, creating lasting value for you and your family for generations to come.

Sincerely,



---

# Table of contents

## 5

### Effective tax planning

---



Good tax planning is integral to sound wealth management. In today's fluid tax environment you'll want to consider a variety of strategies so that you will be well-positioned regardless of tax-policy outcomes, preserving your wealth in any scenario.

## 23

### Managing your investments

---



Greater personal engagement in your investment planning is required in today's world. Understanding the factors influencing investment performance and how those play into investment decisions made on your behalf will help you work effectively with your advisors to create a resilient investment strategy in a still-volatile market.

## 35

### Charitable giving

---



Tailoring a charitable-giving strategy to your family's short- and long-term needs while benefiting society in the process can be among the most rewarding aspects of managing your wealth. Proper planning will help your charitable contributions go far in both meeting your philanthropic goals and serving as a tax-efficient means to transfer wealth.

---

## 47

### Estate and gift planning

---



So that your wealth and your vision for it survive you, it is important that you convey your intentions in well-documented plans. It is equally important that you revisit those plans periodically, to make sure they continue to reflect your wishes and take into account any changes in tax laws.

## 61

### Business succession planning

---



The longevity of a family business depends on early and ongoing succession planning. Communicating the results of that planning to family members and other key stakeholders in a timely fashion will increase the likelihood that the business and its value will endure well beyond the leadership transition.

## 71

### Risk management

---



Protecting your family's wellbeing and assets from various risks involves more than just obtaining adequate insurance coverage. It also entails making strategic choices about forms of asset ownership. Making wise decisions in both these areas of personal risk management will help to preserve your family's health and wealth for the long term.

## 83

### Family offices

---



The managerial and administrative needs of high-net-worth families can be extensive, ranging from tax and estate planning to managing multiple complex entities, such as family partnerships, trusts, family businesses, and foundations. A family office can help meet those needs, tailoring the breadth and depth of its services to both the family's near-term requirements and long-term wealth management goals.

## 89

### Family meetings

---



Communicating a clear wealth management vision within families is important to the ongoing growth and preservation of family wealth. Family meetings can be highly useful in this regard, enabling the older generation to impart the family's values and wealth management mission to younger members, while also setting new goals, devising strategies for achieving them, and actively engaging family members in their attainment.

## 95

### Working with advisors

---



Assembling a team of trusted advisors is critical to effective wealth management. Your advisors should work together to ensure that the various tax, investment, and other strategies pursued on your behalf are not at cross-purposes, but rather, form a cohesive approach to achieving your specific wealth management goals.

A photograph of an older man with grey hair, wearing a brown turtleneck sweater, looking intently at a silver calculator held by another person's hands. The man is holding a white document, likely a tax form, in front of him. The background is a bright, out-of-focus window with light-colored curtains. The overall scene suggests a professional consultation or a focused financial review.

*Effective tax  
planning*



---

**Ch1** The need for you to be actively engaged in your personal tax planning is of particular importance this year.

The current tax environment is dynamic and evolving, full of speculation regarding the structure of the future tax code. As of this writing, much of the speculation revolves around whether Congress will extend some of the tax-cut provisions that were enacted in 2001 and which are now scheduled to expire on December 31, 2010. Given the uncertainty about near-future tax rates, the need for you to be actively engaged in your personal tax planning is of particular importance this year.

***Key considerations this tax season***

This year, being actively engaged will entail discussing alternative scenarios with your tax advisor. In recent years, your advisor may have taken a relatively consistent approach from one tax season to the next, requiring minimal consultation with you. If tax rates rise as scheduled, however, the standard strategy of postponing income and accelerating deductions is something you and your advisor will want to consider doing in reverse this year. That's because accelerating income into 2010 will allow you to take advantage of the current, lower tax rates. Likewise, delaying deductions until 2011, when tax rates are scheduled to be higher, will help you offset your tax liability that year. This presumes that your income remains relatively stable from year to year and that taxes will indeed rise when 2010 ends.

Regardless of what happens with taxes come 2011, you should keep in mind the higher rates that will go into effect in 2013. These are the result of tax provisions in the federal healthcare act, which includes a 3.8% tax on certain net investment income. Consequently, for people in the highest tax bracket, the overall tax rate associated with interest, dividends, short-term capital gains, and passive income could rise to 43.4% in 2013, reflecting the combined effect of the 3.8% tax and the scheduled expiration of the Bush-era tax cuts. In fact, expiration of the tax cuts means that the favorable 15% tax rate for qualified dividends will go away, so that all dividends will be taxed at ordinary income rates. Anticipating these changes as you consider your tax strategy will help you and your tax advisor devise a plan that generates the largest tax savings—for both this year and in the future.

It is important that you stay actively involved in your tax planning even after rate increases take effect, since doing so will help you ensure that the strategy your tax advisor pursues on your behalf adequately reflects and does not compromise your overall, long-term wealth management goals.

To this end, the following pages describe various tax-planning techniques that you may want to consider, presenting them in the context of particular categories of income and deductions.

### ***Planning based on income type***

The type of income you receive will determine the rate of tax you pay. For tax-planning purposes, gross income can be divided into three categories: ordinary, portfolio and capital gain.

#### **Ordinary income**

Ordinary income includes wages, self-employment income, bonuses, retirement-plan distributions, short-term capital gains, interest income, rents, royalties, and trade or business income from partnerships.

#### ***Increased tax rate on ordinary income***

In 2001 and 2003, Congress passed legislation that has reduced the top tax rates for personal income these past 10 years. The reductions are due to automatically expire on December 31, 2010, returning the tax code to its pre-2001 status. More than 100 million individual taxpayers will therefore see their taxes increase on New Year's Day 2011, barring legislative action between now and then.

At present, the top tax rate for ordinary income is 35%. In 2011, a 36% bracket will be created, and the top marginal tax rate will revert to 39.6%. Jointly filing married couples with combined taxable income of approximately \$215,000 and unmarried individuals with income of roughly \$177,000 will enter the 36% tax bracket. People with income over an estimated \$385,000 (whether filing jointly or individually) will find themselves in the 39.6% bracket.

As noted, the general strategy is to accelerate or shift income and defer deductions when rates are on the rise. We recommend that in pursuing this strategy, you consider when income is earned and understand when expenses are deductible. Since individuals are cash-basis taxpayers, income is earned in the year it is actually or constructively received, and expenses are deductible in the year payments are made.

Generally speaking, accelerating and shifting income may be challenging for an individual wage earner. Such individuals might nonetheless want to consider generating additional ordinary income in a lower-tax-rate year by accelerating bonus payments and/or exercising nonqualified stock options, if either opportunity arises.

## ***Example***

Jeff is an executive at ABC Corporation, where he earns \$250,000 per year. ABC Corporation offers its executives a 401(k) match of 1%, so long as the employee contributes 6% of his own money. Jeff is currently contributing 5%, or \$12,500, of his salary to his 401(k), which decreases his overall tax burden by \$4,375 (assuming he is in the 35% tax bracket). Jeff's CPA advises him that by increasing his 401(k) contribution to 6% (an additional \$2,500 per year), he will decrease his tax burden by an additional \$875, while increasing the overall funding of his retirement vehicle to \$17,500, because of his employer's matching contribution (which will equal \$2,500). By making only a small increase in his pre-tax contributions, Jeff will receive the benefits of the company match, compounding interest on the increased contribution and decreasing his overall taxable income.

# **5% to 6%**

**Small increase creates  
multiple benefits.**

*Although the tax implications of a transaction should not drive your investment decisions, you should always bear them in mind so that your overall investment strategy generates the greatest value for you.*

#### *401(k) plans*

In addition to accelerating income where possible, consider making the maximum contribution to your 401(k) retirement plan, since 401(k) contributions lower your taxable income. Such contributions will allow you to defer taxable income until retirement years while saving for your future—which is a strategy worth pursuing regardless of tax rates. Indeed, we recommend saving for retirement as early as possible, given the impact of compounding interest and the tax-deferred income accumulation. Make sure you contribute enough to your 401(k) plan to receive your company's match, if the company provides one. Missing out on the company's match program is tantamount to passing up "free money." For many people, a 401(k) match plan is the only way to receive employer funding for retirement.

#### *Self-employed individuals and business owners*

Individuals who are self-employed or who own a business have more flexibility in the timing of their compensation, as well as when they pay their business expenses. Because income for cash-basis taxpayers is not taxed until it is received, self-employed individuals have an incentive to bill and collect cash during 2010, before tax rates go up in 2011.

Conversely, this year might not be a good time to pre-pay expenses. Deferring expense payments until next year, when the tax rates will be higher,

might make better sense, since doing this will enable the expenses to offset next year's income, thus resulting in a greater tax savings for the individual business owner.

Self-employed individuals can also take advantage of contributions to retirement plans. If you have a simplified employee pension individual retirement account (SEP-IRA), your maximum contribution this year may be equal to the lesser of \$49,000 or 25% of your net self-employment income. Making such a contribution will offset the ordinary income you earn in 2010, which will, in turn, reduce your overall tax burden.

A SEP-IRA plan is relatively easy to set up with any financial institution; the deadline for setting up and funding a plan is as late as the due date of your 2010 individual tax return, including extensions (October 15, 2011 if your return is extended). This gives you significant flexibility in how you time your contribution, as well as allows you to determine the exact maximum contribution that can be made.

Alternatively, a self-employed individual can establish a solo 401(k) plan. Advantages that a 401(k) has over a SEP-IRA include the ability for the individual to take a loan from the plan, which is not allowed with IRA-type arrangements. The maximum total contribution that an individual is allowed to make to a solo 401(k) is the same

that is allowed for a SEP-IRA (\$49,000); however, the percentage of income limitation on SEP-IRAs and solo 401(k) plans is calculated differently. Therefore, individuals earning less than \$200,000 in self-employment income may find that a solo 401(k) plan allows a higher contribution.

Solo 401(k) plans can be established as late as the last day of the business's tax year (generally December 31). However, you must establish the plan before you can make any elective deferrals. Therefore, if you wish to stagger your contributions throughout the year, it might be prudent to establish the plan earlier in the year.

#### *Passive-activity losses*

It is possible to use ordinary losses from business activities to offset income from other sources and thus reduce your overall tax burden—but only if complex passive-activity-loss rules don't apply. These rules provide that losses will be allowed in the current year only if the taxpayer is actively involved in the business. Taxpayers who are decision-makers for their businesses may have influence over the timing of income and the deferral of expense payments, thus enabling them to use the same type of strategies that are available to self-employed individuals (noted above). Whether self-employment tax applies to your situation is something you should consider when devising your tax strategy.

Taxpayers have less flexibility in timing income from, and deductions for, business and rental activities in which they do not materially participate. They also are subject to more stringent rules with respect to deducting losses that pass through to them from the business. The passive-activity rules stipulate that a taxpayer is allowed to deduct losses stemming from passive activities to the extent that he or she has passive income in the current year or if it is the final year of the investment. When passive losses exceed passive income, unused passive losses are carried forward to offset future passive income in later years.

Taxpayers who entered tax year 2010 with passive-activity loss carryforwards should consider pursuing investment strategies that might produce passive ordinary income, since the loss carryforwards will potentially offset income that is taxed at the highest rates. Another tax-planning option is to trigger the release of the suspended passive losses by disposing of the investment in the year of higher tax rates. The overall effect of these strategies is a decreased tax burden. However, these opportunities should be pursued only after you have carefully considered them in the context of your overall investment and business strategy.

#### *Net operating losses*

If you are in an overall loss position for the year after all your items of income and loss are calculated, you may be entitled to a deduction for a net operating loss. Significant planning opportunities become available with net operating losses, because you have the option to offset the losses with prior or future income.

Typically, you are allowed to carry back your loss two years, and then carry forward, for 20 years, any remaining unused loss. On your individual income tax return, however, you can forgo the carryback and make an irrevocable election to carry the loss forward. Before making this decision, you should carefully consider past and future tax rates, the amount and type of income that is available to offset the loss, and the impact of the alternative minimum tax.

Generally speaking, if tax rates are on the rise, it makes sense to carry the loss forward to the years of higher tax rates. Bearing in mind the time value of money, however, you may decide it's more prudent to carry the loss back to years of higher income and get the refund now, rather than wait for future year's tax savings.

### *Retirement income*

A retired individual's overall tax planning should take into account the timing of distributions from retirement plans. Certain qualified retirement plans allow an individual to receive a lump-sum payment instead of staggered annual payments. The form of payment you choose should depend on your current and future income. It should also depend on whether the savings of paying income tax on a lump-sum payment now—at the lower rates currently in effect—outweigh the investment potential you'll forgo if you take only the minimum distribution and let the remainder continue growing tax-deferred in your retirement account.

Beginning in 2010, all taxpayers have the option of converting their traditional IRA accounts into Roth IRA accounts. As a result of recent legislation, income limitations that had previously prohibited high-income individuals (those with an adjusted gross income over \$100,000) from converting traditional IRAs into Roth IRAs are now suspended.

The suspension of the income limitation delivers several advantages to taxpayers who are now able to convert traditional IRAs to Roth IRAs. Those advantages include tax-free investment growth (if distributions satisfy the "five-year holding period" criterion and certain other requirements) and no required minimum distributions during the owner's lifetime. However, the conversion will qualify as a "taxable event" in the year it occurs. Currently, there is an option either to pay all of the conversion-triggered tax cost in the year of conversion or to stagger the payment over the next two tax years (2011 and 2012).

If after converting a traditional IRA to a Roth IRA, you change your mind, you can reverse your decision, if you haven't yet filed your 2011 tax return. Given the scheduled increases in tax rates, you'll want to give thoughtful consideration to whether an IRA conversion is a wise choice in your circumstances. We strongly recommend that any taxes you end up owing as a result of the conversion be paid from funds outside the retirement account.

### **Portfolio income**

Portfolio income encompasses investment income in the form of interest, dividends, royalties, and capital gains. This type of income is generally taxed at ordinary income tax rates, except for qualified dividends and long-term capital gains. While there isn't much you can do to change the timing of interest or dividend payments from bonds and equity investments, you can ensure that your portfolio is tax-efficient. Ways of doing this include realigning your personal portfolio to include more tax-exempt municipal bonds and shifting less tax-efficient investments into retirement accounts, where the assets will grow tax-deferred. These tactics could be especially beneficial for individuals in higher tax brackets, since converting investment income into tax-exempt or tax-deferred income will have a significant impact on the after-tax rate of return.

Another portfolio income-planning strategy involves lending money to family members. If, for instance, a family member is seeking a mortgage, you may want to consider acting as the lender. Currently, the minimum rate that you would be required to charge the mortgagee, the applicable federal rate (AFR), is at an all-time low—lower than the interest rate a financial institution would charge for a conventional loan. The potential benefit for you, financially, is that the arrangement could very well generate a

better rate of return than you'd obtain by keeping the money in a conventional investment. If the loan is secured by the residence, the mortgagee (i.e., your relative) might be able to deduct the interest. By obtaining a loan from you instead of through a financial institution, the mortgagee will pay considerably less interest expense in the long run.

### Capital gains and losses

With the scheduled expiration of the Bush-era tax provisions, the tax rates for capital gains are set to increase on January 1, 2011. The Obama administration has proposed maintaining the current tax rates for taxpayers who have income up to \$200,000 (\$250,000 for married couples). Short-term capital gains realized on the sale of investments held for less than a year are taxed at the same tax rate as ordinary income. Barring legislative action, the maximum tax rate for ordinary income is due to increase from 35% to 39.6% at the beginning of 2011. The tax rate for long-term capital gains realized on the sale of investments that are held for longer than a year is scheduled to rise from 15% to 20%. It is important to remember, however, that in 2011 a special reduced long-term capital gain rate for five-year long-term gains is to be reinstated. If you purchased an asset after 2000 and have held the asset for more than five years, you may qualify for a reduced long-term capital gain rate of 18%. Careful planning will help you limit the impact that the increased tax rate will have on your capital gains.

A capital gain or loss can arise from the sale of an asset that is held for personal or investment purposes. It is important to note that losses on personal assets are not recognized for tax purposes.

Capital gains that are triggered during 2010 will be taxed at the current lower tax rates. Conversely, capital losses triggered in 2010 will first be used to offset this year's capital gains, which are subject to the lower capital gains tax rate.

Current-year capital losses will first be applied to offset capital gains that are in the same category as the losses. Any additional loss will then be applied to gains in the other category. For example, long-term capital losses will first be applied against long-term capital gains. Any remaining net capital loss in the long-term category will then be applied against net short-term capital gains.

Therefore, you should employ a strategy that ensures that your carryover losses offset short-term capital gains when possible, regardless of whether those losses result from short-term or long-term transactions. If you have net capital losses overall this year, you may use up to \$3,000 of the capital loss to offset ordinary income, with the rest of the loss carried forward to offset capital gains in future years until it is fully diminished. Capital loss carryovers cannot be carried back to offset previously taxed capital gains.

As a result of stock market turbulence over the last few years, many taxpayers find they have unused capital loss carryovers. Given the expected rise in tax rates, these capital loss carryovers should be viewed as an asset. If you maintain a loss position through 2010, your previously generated losses will offset future capital gains when the tax rates rise, thus providing you with greater tax savings.

Before the tax year ends, you and your advisors should do a comprehensive review of your portfolio to determine what, if any, investments should be disposed of, and whether it makes sense for you to sell those assets this year or wait until 2011. For capital transactions that will produce capital gains, it might be best to proceed with those transactions in 2010, whereas transactions that will result in a loss might best be deferred until offsetting gains are realized at the higher tax rates that are scheduled for the near future.

#### *“Wash sale” rule*

Bear in mind the “wash sale” rule that applies to the disposition of an asset when a loss is recognized. You won’t be allowed to deduct the loss if you repurchase the same security during the 30-day period before or after the sale date. This rule ensures that you will not be able to reinvest in an identical position of the investment while recognizing the benefit of a loss on your original investment. Note, however, that currently there are no such provisions for a transaction in which a gain is recognized. Therefore, if you have an investment position that has appreciated significantly, you may sell the investment and realize the gain at the current lower tax rates, then immediately reinvest with a higher cost basis to offset any future sales.

### ***Example***

Tom is reviewing his November 2010 monthly statement from his brokerage account. His statement reports that his portfolio is, overall, in an unrealized loss position. During 2010, Tom sold an asset outside his portfolio, on an installment-note basis. He is scheduled to receive payments in 2010, 2011, and 2012. The total long-term capital gain is \$600,000, to be recognized equally over the next three years. His federal tax burden for 2010 will be \$30,000,

and \$40,000 for both 2011 and 2012. Worried about the increase in tax rates, Tom meets with his tax and investment advisors to discuss his planning alternatives. He could harvest the unrealized losses in his investment account to offset the \$600,000 capital gain, or he might elect to forgo the installment sale treatment and recognize the entire capital gain in the current year at the lower rates.

### *Commodities and collectibles*

When there is prolonged uncertainty in the stock market, commodities and collectibles tend to rise in popularity as investments. They include gold, silver, and various types of artwork.

Upon being sold, such investments garner less-favorable tax treatment than other capital assets, if the seller has possessed the items for a long-term holding period. Specifically, commodities and collectibles held as a direct investment are taxed at a rate of 28% if they've been owned for longer than 12 months—this in contrast to the more-favorable long-term capital gains rate of 15% (which is scheduled to rise to 20% in 2011). If, on the other hand, the seller has owned the investment for a short-term holding period, the tax rate is the same as for any other type of investment (i.e., the investment is taxed at ordinary tax rates).

If investing in commodities and collectibles interests you, but you've been deterred by the increased tax burden that such investments would put on your portfolio, you might want to consider indirect ownership through an investment vehicle that is designed specifically for these types of assets. For example, you can make long-term investments in equity-based exchange-traded mutual funds (ETFs) that focus on the economic returns of the corporations involved in the commodities industry.

Although the tax implications of a transaction should not drive your investment decisions, you should always bear them in mind so that your overall investment strategy generates the greatest value for you.

### **Itemized deductions**

#### **Personal-exemption phase-out and itemized-deduction haircuts**

Individual taxpayers are allowed to claim several types of deductions to offset taxable income. These deductions include personal exemptions for yourself and any dependents you claim. You are also allowed to deduct the state and local taxes you've paid, medical expenses, charitable contributions, casualty losses, gambling losses (to the extent of gambling income), miscellaneous deductions, and most types of interest expense. Miscellaneous deductions include unreimbursed business expenses, tax-return preparation fees, and investment management fees.

Limits on itemized deductions should be taken into consideration during the tax-planning process. High-income taxpayers will need to pay particular attention to such limits in 2011, which will see the return of the personal-exemption and itemized-deduction phase-outs. These phase-outs were created during the Clinton administration to gradually reduce ("phase out") personal exemptions and itemized deductions for high-income taxpayers.

Under the Bush administration, the phase-outs were put into reverse, albeit slowly. For years now, they've been gradually rolling back so that at last, in 2010, no taxpayer of any income level will be losing his or her personal exemptions or itemized deductions. Taxpayers won't be able to enjoy this state of affairs for long, however, if the Bush-era tax provisions expire as scheduled on December 31, 2010. With the sunset of those provisions, the personal-exemption and itemized-deduction phase-outs will boomerang back into effect.

The Obama administration has proposed that the phase-outs not be imposed on taxpayers with adjusted gross income below \$200,000 (\$250,000 for married couples). However, as of this writing, Congress has not passed any relief provisions related to the phase-outs. Taxpayers whose adjusted gross income is greater than \$200,000 (\$250,000 for married couples) will be affected by the return of the phase-outs regardless of whether Congress takes up the Obama administration's proposal. The personal exemptions for these high-income individual taxpayers will be reduced and possibly disallowed completely if a person's income exceeds the threshold amount.

As for the itemized-deduction phase-out, it will cause high-income taxpayers to lose a portion of their itemized deductions. The phase-out requires that taxpayers reduce their itemized deductions by 3% of the amount that their adjusted gross income exceeds a threshold, with a cap applied to ensure that taxpayers do not lose more than 80% of their itemized deductions. This phase-out does not apply to deductions claimed for medical expenses, investment interest expense, casualty losses, and gambling losses.

During a time of rising tax rates, the common strategy is to defer deductions until tax rates are expected to be highest, since doing so ultimately renders the largest tax savings. Taxpayers with a large adjusted gross income should therefore keep in mind that because the limitations resulting from the itemized-deduction phase-out are not based on the amount of the deduction, but rather on a percentage of adjusted gross income, their itemized deductions will be significantly reduced. However, once the maximum phase-out amount has been reached, a benefit will be received for each additional dollar of deduction claimed.

High-income taxpayers should consider the alternative minimum tax (AMT) when deciding to accelerate or defer deductions (the AMT is discussed later in this chapter). They should also be sure to consider how a deduction deferral will align with accelerated income (highlighted earlier in this chapter).

If you are planning to accelerate a large amount of income into an earlier year, to take advantage of lower tax rates, you should factor in the time value of money. In other words, determine whether your money is best spent on the tax liability that will be incurred in the earlier year or whether it would be better to pay the taxes at a later date and invest those dollars in the meantime, considering both your expected investment return and your expected tax rate in the future.

#### State income taxes

The timing of state income tax payments should play a role in your overall income tax-planning strategy. In the past, taxpayers have generally sought to accelerate year-end state tax payments into the current year, to obtain the maximum deduction for that particular tax year. This logic might bear rethinking this year, given that tax rates are scheduled to increase in 2011. And, as state governments continue to face budgetary shortfalls and deficits, you could soon see an increase in many states' individual income tax rates. Such an increase would result in larger itemized deductions for payers of state income tax, making the timing of these payments even more crucial than before. Accelerating the payment of state income taxes should always be determined in conjunction with planning for the alternative minimum tax (discussed later in this chapter).

## Outlook: Top tax rates for personal income

The following table depicts how tax rates will increase for high-income taxpayers between 2010 and 2013 if Congress does not intervene.

	Wages	Long-term capital gains	Dividends	Passive income	Active income from general partnership	Active income from S corp
<i>2010 highest tax bracket</i>	35%	15%	15%	35%	35%	35%
<i>Medicare/SE tax on earned income</i>	1.45%	0%	0%	0%	2.9%	0%
<i>2010 marginal rate</i>	36.45%	15%	15%	35%	37.9%	35%
<i>Expiration of tax cuts in 2011</i>	4.6%	5%	24.6%	4.6%	4.6%	4.6%
<i>2011 marginal tax rate</i>	41.05%	20%	39.6%	39.6%	42.5%	39.6%
<i>New Medicare/HI tax effective in 2013</i>	0.9%	3.8%	3.8%	3.8%	0.9%	0%
<i>2013 top rate</i>	41.95%	23.8%	43.4%	43.4%	43.4%	39.6%
<i>Increase from 2010 to 2013</i>	5.5%	8.8%	28.4%	8.4%	5.5%	4.6%

*The key to AMT planning is finding the break-even point where your regular tax liability and your AMT liability are equal.*

Taxpayers considering a change in state residency should carefully and strategically plan the change, so that there is no question regarding the taxpayer's tax home. Some factors that are considered in determining state residency include place of voter registration, the state registration of automobiles, the time spent in a particular state, and the taxpayer's state-issued driver's license. The taxpayer should consult a qualified tax professional before changing his or her official state residency.

#### **Charitable contributions**

Charitable-contribution planning should be done by year-end to ensure maximum deductibility and to determine if any charitable contributions should be deferred until 2011. To be deductible in the current year, your cash charitable contributions to public charities should not exceed 50% of your adjusted gross income. Similarly, if you plan to deduct contributions of appreciated property to public charities, they cannot exceed 30% of your adjusted gross income. Any contributions above these limits will be carried forward for up to five years and be used to offset future income. Contributions to private foundations are more highly limited. You will need to bear this in mind and plan accordingly if you make contributions to both public charities and private foundations within the same year.

Gifts of appreciated property is an excellent income tax strategy for many taxpayers (however, such gifts should be discussed with a tax planner before being made, since there are a variety of restrictions relating to them). For instance, if you were to sell appreciated stock that you've held for longer than 12 months, you would trigger a capital gain that would result in a tax burden. Conversely, if you were to donate the stock to a qualified charity, you would escape the capital gains tax on the appreciation of the security and could be allowed to deduct the fair market value of the security, applying the deduction against your ordinary income (subject to the limitations noted above).

### Casualty losses

Casualty losses are realized as a result of theft, vandalism, fire, or storm. These losses may be claimed as itemized deductions based on the amount of the loss. Traditional casualty loss deductions require you to first reduce the amount of the loss by \$500 and then to further reduce the loss by 10% of your adjusted gross income. However, if you live in a place that the president of the United States has declared a federal disaster area warranting assistance, and you experienced a loss as a result of a storm but were not reimbursed for the loss, more-generous casualty-and-theft loss provisions may apply to you.

### Other taxes to consider

#### Alternative minimum tax

The alternative minimum tax (AMT) often causes confusion and concern for many taxpayers. The AMT was instituted to ensure that high-income taxpayers paid at least a minimum amount of tax each year. To this end, a parallel tax calculation was created, one that incorporated the regular taxing system, along with certain adjustments called “tax preference and adjustment items.”

One of the most significant adjustments in the AMT calculation is the disallowance of certain itemized deductions, including state and local income taxes and miscellaneous itemized deductions. Other items that must be adjusted for AMT purposes include tax-exempt interest on private activity bonds; the bargain element of incentive stock options; and depreciation, which must be recalculated for AMT purposes over a longer recovery period. The maximum tax rate that can be applied to your AMT income is 28%. It is important to note that although the AMT rate is lower than the current and expected regular tax rates, this lower rate is applied to a higher taxable amount, often resulting in an increased overall tax liability. Long-term capital gains that are taxed at the lower 15% rate for regular tax purposes continue to be taxed at the same preferential rate under the AMT structure.

Oftentimes, taxpayers who find they are subject to the AMT have significant income from long-term capital gains and qualified dividends that is being taxed at the preferential rates, or have significant adjustments for the other reasons listed above. Taxpayers who live in states with a high income tax rate, such as California and New York, often find themselves paying AMT as a result. As various states attempt to balance their budgets, they, too, may raise their tax rates. These potential rate increases could have a direct impact on a taxpayer’s overall federal income tax liability if the increases expose him or her to the AMT.

Being actively engaged in your tax planning will allow you to understand how the AMT will affect your tax liability. As discussed earlier in this chapter, the AMT needs to be considered when you are determining if income or deductions should be accelerated or deferred. The key to AMT planning is finding the break-even point where your regular tax liability and your AMT liability are equal. Knowing where that point is will help you decide whether it makes sense to accelerate additional income or deductions into the current year.

Once you are subject to the AMT, you’ll receive only a 28% benefit for your deductions. Accelerating the deductions that are considered AMT preference items will not result in any additional benefit for taxpayers who are subject to the AMT. The AMT break-even point should also be considered when you’re determining whether to accelerate income. If you are subject to the AMT and able to accelerate income without moving yourself out of the AMT, you would benefit from paying tax at a rate of 28% instead of at the ordinary tax rate that’s based on your income level.

Each year Congress has to address the exemption that is built into the AMT calculation. If the exemption amount is not indexed for inflation each year, then the AMT ends up not only affecting high-income taxpayers (as was the original purpose), but also many other taxpayers too. This adjustment of the exemption amount is known as an AMT patch. Typically Congress does not address the patch until the second half of the calendar year. The Administration and many in Congress favor repeal, or at least a substantial overhaul, of the AMT system. However, budgetary pressures are expected to preclude a long-term solution this year. Taxpayers who believe they'll be subject to AMT in 2010 should approach their tax planning accordingly.

#### **Kiddie tax**

Income shifting generally involves transferring income-producing property from high-income taxpayers to someone who is taxed at a lower rate. For high-income individuals, shifting income to children or other family members who are in lower tax brackets generally proves to be an effective long-term planning strategy. Bear in mind, however, that children under the age of 18 and fulltime students under the age of 24 will be taxed at the parent's higher income tax rate on investment income that exceeds a threshold amount (for 2010 this amount is \$1,900), potentially preventing the shifting of such income to children from resulting in any tax savings. (There are also gift tax implications to consider, which will be discussed in a later chapter.)

#### **Household employment taxes**

Many households hire individuals to do various kinds of work. Often, however, the personal tax effects and filing requirements of hiring household employees are overlooked. Determining whether, from a tax perspective, these individuals are considered employees or independent contractors depends on the type of services

they render and the control that you, as the employer, have over how they perform their tasks. If you pay a household employee more than the annual limit of cash wages (for 2010 this amount is \$1,700) you will be liable for Social Security and Medicare taxes for these individuals. These tax payments are remitted when you file your individual income tax return and may need to be factored into your quarterly estimated tax payments if you are to avoid underpayment penalties.

You should also take care to remember informational filings (such as W-2s and 1099s) that you are required to provide to the IRS and to service providers, including household employees. Additionally, state unemployment tax filings are often required for household help.

#### **Other special considerations**

##### **Year-end planning for business owners**

Strategic tax planning for business owners and their companies should incorporate all the strategies discussed in this chapter, in addition to tax savings techniques geared specifically to entities. Many of the elections made at the entity level will have a significant impact not only on the tax burden of the company, but also on the individual shareholders and partners.

There are several types of entity structures for businesses. Each structure has tax ramifications for the individual owner. A sole proprietorship, S corporation, partnership, or limited liability company impacts the tax planning of the owners more than a C corporation does. These entities do not typically pay income taxes; rather they "pass through" the income and deductions to the shareholders and partners. Consequently, many of the tax-planning strategies mentioned in this chapter should be considered at the entity level, if they align with the overall goal of the business.

*For high-income individuals, shifting income to children or other family members who are in lower tax brackets generally proves to be an effective long-term planning strategy.*

Some businesses often apply a deduction-acceleration strategy whereby they make an IRC §179 expense election for certain types of property, which allows the business to expense up to a certain amount of the cost of assets in the year they are placed into service, rather than depreciating the purchase(s) over time. This approach enables the business to increase the deduction in the current year instead of expensing a portion of the cost over several years. For pass-through entities, choosing this type of election for the business's assets will directly impact the taxation of the individual owner. Whether such an election is wise this year should be considered in light of the scheduled increase in personal income tax rates.

#### Foreign investments

Many US investors include direct foreign investments in their overall investment portfolio. These investments are permitted under US tax law but require additional reporting and compliance.

A passive foreign investment company (PFIC) is one of the vehicles for making such investments. A PFIC is a foreign corporation that meets certain criteria relating to income or assets that produce passive income. Investors in PFICs have a few options for how they calculate and report income from their investment. The options for income reporting include making a qualified electing fund (QEF) election, which requires inclusion of all income and capital gains currently as they are earned; making a mark-to-market election if the foreign entity is traded on a foreign exchange; and applying the deferred-tax calculations to excess distributions, which require no current inclusion of income but do require that the distribution be allocated over the investment's holding period by days held, with interest being calculated on the holding period. The deferred-tax calculations can be time-consuming and intensive. Be sure to incorporate into your overall tax-planning strategy the tax effects of these investments to ensure that you are making the appropriate elections to calculate the income from these types of investments.

Investing directly in foreign currencies is another investment strategy that some taxpayers are employing. Gains and losses realized on foreign currency transactions are not treated as capital transactions. Foreign currency gains and losses are taxed at the higher ordinary tax rates (those rates are discussed earlier in this chapter). Given the expected increase in ordinary tax rates, you'll want to manage the timing of the gains and losses from these transactions if you decide to incorporate foreign currency investments into your overall wealth management strategy.

### Report of foreign bank and financial accounts

As a US taxpayer, you are required to report your worldwide income on your US tax return. Recently, the IRS has sharpened its focus on US investors' foreign account holdings, since many people were not reporting the income from their foreign investments. Foreign accounts should be disclosed in the investor's Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1), which is a mandatory filing that the IRS has begun to scrutinize more closely.

US investors are required to file this report if they have a financial interest in or signature authority over foreign financial accounts with aggregate balances greater than \$10,000. In filing this report, a taxpayer is not required to pay any tax (the income amounts are included on your individual income tax return), but he or she does have to report on an annual basis the maximum balance for each account. The definition of a foreign "account" for purposes of this report is very broad, and many investments that might not seem as though they need to be disclosed do in fact have to be reported. The penalties for noncompliance are steep, including civil and criminal penalties, as well as

finances up to \$500,000 and potentially five years imprisonment. To avoid these consequences, consult a tax advisor before making foreign investment decisions.

### Conclusion

Taking a strategic approach to tax planning is particularly important for high-net-worth individuals this year, given the scheduled tax rate increases, coupled with the ongoing uncertainty (as of this writing) about possible legislative action—which could potentially postpone or alter some of the anticipated changes. Distracting though the tax environment is at present, you will want to ensure that this year's tax planning nonetheless incorporates the long view, taking into sufficient account your overall investment objectives and retirement strategies. Working with a professional tax advisor is one way to make certain that your tax objectives are well-integrated with your wealth management goals.

*The IRS has sharpened its focus on US investors' foreign account holdings.*



*Managing  
your  
investments*



---

**Ch2** Your investment plan is an integral component of your overall wealth management plan.

***Know your game plan***

Finding the time to manage your personal investments and plan for your family’s ongoing financial security is often seen as a daunting task. Certainly, it hasn’t been made any easier by the economic environment of the past two years, during which one has heard declarations of a “new normal,” on the one hand, and speculation about a double-dip recession, on the other. This prevailing atmosphere of uncertainty only serves to underscore the importance of having a sound wealth management plan—one incorporating a meaningful investment strategy that will allow you to survive the ups and downs of a still-volatile market.

A well-considered game plan entails developing and coordinating a team of advisors, evaluating your wealth management plan, and reviewing your investment performance. In assembling your team, avoid a haphazard approach to managing wealth through a series of advisors who might not have a full awareness of your overall goals. It is important that your advisors work productively together as a cohesive team. The more cohesive your advisory team, the more cohesive your game plan.

### **Building your investment plan**

When it comes to investments, having a well-thought-out plan will pay dividends over the long term. Your investment plan is an integral component of your overall wealth management plan. Done well, your investment plan will help see you through swings in the market. You should monitor your investment plan regularly to make sure you are on the right track and to determine whether you need to make changes.

There are several steps to creating your personal investment plan. They include the following:

- Establish goals and constraints
- Determine the appropriate risk/return tradeoff to meet your goals
- Allocate assets and implement your investment strategy
- Review your investment performance and rebalance your portfolio accordingly

### **Goals and constraints**

The first step in creating your investment strategy should be to establish your investment goals and constraints. Goals should include near-term ones—such as investing to fund the purchase of a vacation home within a year or two—as well as long-term goals, such as investing to fund your financial independence, your children’s or grandchildren’s education, inheritances, and even charitable bequests.

Specific investment strategies can help you achieve these goals. Those strategies may include investing to grow capital, preserve capital, or create a moderate yield.

Don’t forget to take into account the constraints you face in implementing your strategy. Typical constraints include dollars available to invest, limited risk tolerance, and liquidity needs.

### **Risk/return tradeoff**

The next step is to focus on the risk/return tradeoff. There is much more to consider than the expectation of taking more risk in order to achieve higher returns. Since your “real” return (nominal return minus taxes and inflation) is the true measure of your wealth gain, you need to consider this in the context of your real investment return. Make sure you are also considering it in the context of a few different types of risk (see the discussion below).

Just as it is important to understand that real return is significant to your analysis of risk and return, it is also critical to understand the type of risk you are facing. Most people focus on return volatility, but there are also many other risks to consider when developing an investment strategy. Because investors differ from one another in how they weigh particular risks, there is no single portfolio that fits all investors. Common to most investors, however, are certain core risk factors that are generally considered when investment decisions are being made.

### **Required risk**

A certain amount of risk is needed to achieve a particular investment goal (as well as to achieve your investment goals overall). For example, if you want to ensure that you can maintain your current lifestyle, you should run an analysis of your future cash flow, whereupon you may determine that you’ll need to achieve an overall real return of 5% to meet your specific lifestyle goals.

Analyzing your required risk will help you quantify the risk/return tradeoff needed to meet your goals, allowing you to determine whether the goals are achievable given the financial risk you would be required to take. If you consider the required risk too high, you can proceed to revise your goals to stay at an acceptable risk level.

## *Assessing your risk capacity*

This entails looking at the additional risk (beyond required risk) that you could take on without jeopardizing your goals. For instance, a 5% rate of real return might enable you to meet your goals with relative ease. If that's the case, you might want to consider whether you would still be able to meet those goals if you were achieving a real return of 4% or 3%.

# 5%, 4% or 3%

### **Risk capacity**

Assessing your risk capacity entails looking at the additional risk (beyond required risk) that you could take on without jeopardizing your goals. For instance, a 5% rate of real return might enable you to meet your goals with relative ease. If that's the case, you might want to consider whether you would still be able to meet those goals if you were achieving a real return of 4% or 3%.

Making this determination will reveal the additional amount of cushion that would protect you against a change in investment assumptions, such as achieving a lower-than-expected return, encountering higher-than-expected retirement costs, or taking in lower-than-expected income flows. Assessing your risk capacity may also demonstrate your ability to decrease the targeted return in an effort to reduce the risk exposure of your portfolio, provided that this fits within the context of your plan.

*It makes more sense to concentrate on the correct asset allocation and asset-class selection to meet your goals rather than trying to pick the individual security that will produce the most desired performance.*

One common method of measuring risk capacity is a Monte Carlo Analysis. This analysis simply runs a set of assumptions through multiple simulations using random variables, such as rate of return, to measure the probable success or outcome. Commonly, the Monte Carlo Analysis is used to test assumptions in all types of hypothetical market conditions and based on all types of returns. The higher the success rate, the more likely you are to achieve your stated investment goals, regardless of the market environment going forward.

**Risk tolerance**

An investor's personal tolerance of risk is perhaps most easily described as the level of risk that the person can withstand and still sleep well at night. This type of risk tends to have a greater psychological component and is more abstract than the other two types discussed here. It deals with a person's willingness to accept short-term losses in the effort to achieve a long-term return.

An individual's risk tolerance can change greatly as the remaining time in which to achieve a stated goal diminishes and the resilience of his or her investment portfolio wanes. The past several years, in particular, have put the risk tolerance of investors to the test. Swings in the market can unsettle even the most seasoned and experienced investor, further highlighting the need to have a

solid investment plan that will see you through both the ups and the downs of the market.<sup>1</sup>

**Asset allocation**

This technique is considered the underlying principle of modern portfolio theory. It lays out a roadmap that will keep you from chasing returns or overreacting to unexpected market conditions. But as everyone knows, a roadmap won't alert you to details such as traffic conditions, detours, or a closed exit ramp—an important consideration to bear in mind when applying this metaphor to your investment strategy, as well as a key reason for assembling a solid investment management team. Time and again, studies have demonstrated that trying to pick the right entry and exit points in the market rarely, if ever, works. The same holds true of investment fads. A vigilant investment team will help you steer clear of these wrong turns.

**Asset-class selection**

Asset classes are groups of various investments with similar characteristics. Since various asset classes will react differently to similar economic

---

**Footnote 1**

For a detailed look at specific types of systematic and unsystematic risks, please refer to the *2010 Guide to Tax and Wealth Management*.

conditions, it is possible to combine several asset classes that do not have closely related performances. This creates a portfolio return that will be less than that of the return of the best-performing asset class but above that of the worst-performing asset class. Given the uncertainty about future market conditions, this approach reduces the overall volatility of a portfolio while seeking a more stable long-term return.

Most investment managers acknowledge that decisions about asset allocation account for over 80% of performance variability over time and are much more important than the selection of individual securities and other risk-control factors, such as timing. Therefore, it makes more sense to concentrate on the correct asset allocation and asset-class selection to meet your goals rather than trying to pick the individual security that will produce the most desired performance.

#### Asset allocation as diversification

Asset allocation is a form of diversification, since you're not putting all your eggs in one investment basket. By investing in several asset classes, you are reducing the level of risk that is required to achieve a desired rate of return. However, you also need to diversify within your asset classes and have an adequate number of individual securities or bonds within each sub-category.

For example, if you owned one cash account, one intermediate-term government bond, and one stock, your portfolio would be allocated but not diversified. Greater diversification can be achieved by owning a portfolio of bonds or stocks that can be obtained through the use of money managers or via the purchase of funds that cover the different characteristics of investments within a specific asset class.

Investing in short-term-bond funds (here "short term" is defined as less than one year), might provide diversification among numerous short-term bonds, but it does not address diversification within the sub-categories. Further diversification can be achieved by also investing the targeted percentage into intermediate, long-term, municipal, corporate, or treasury bonds, to name just a few.

#### Strategic and tactical allocation

Two common types of asset-allocation approaches are strategic allocation and tactical allocation.

- **Strategic allocation:** This technique seeks long-term results by sticking to pre-defined levels for each asset class—regardless of the market environment and regularly rebalancing—to ensure that the overall portfolio stays within pre-defined parameters of the targeted asset allocation. Strategic allocation is founded on modern capital market theory and assumes that additional economic analysis won't consistently promote higher investment results over the long term.
- **Tactical allocation:** This technique is more opportunistic than strategic allocation and takes the overall market environment into consideration, including economic factors for each asset class (e.g., valuation), asset classes trading below historical levels, the current interest rate environment, and other market conditions.

### *Overall goals and risk management considerations*

When determining the correct asset allocation vis-à-vis meeting goals such as retirement planning, don't forget to incorporate the basic rules of personal liquidity risk management: Have a liquid cash reserve available to pay living expenses in the event of a personal crisis or a down market. Advisors differ on how large a cash reserve you should maintain. Generally, however, it is considered prudent to have enough cash on hand to cover one to three year's living expenses, depending on your circumstances.

Also, make sure you are looking at your investment portfolio as a whole when considering the correct asset allocation for your needs. It can be tempting to put brokers and investment advisors in competition with one another as they seek accounts that provide the highest return. However, this approach often leads to inefficiencies, with multiple accounts having separate asset allocations and varying levels of risk while serving similar objectives.

To avoid this situation, make sure you draw on your full team to determine an overall investment strategy and asset allocation. It is important that different advisors or team members work together to devise your overall allocation. In addition, having a trusted advisor who can monitor your plan and coordinate the advisory team's efforts will help to ensure greater efficiencies and a reduced level of risk.

### *Reviewing portfolio performance*

It is likely that your personal financial goals will change as time passes. Therefore, revisit your wealth management plan on an annual basis to decide whether your investment portfolio is still suited for achieving those goals or whether changes should be made.

### *Rebalancing your portfolio*

Making changes often entails rebalancing your portfolio. Rebalancing will be necessary as new cash is added to the portfolio or as the portfolio grows disproportionately for each asset class. Both of these circumstances will change the overall allocation, which can, in turn, materially change the overall risk level of the portfolio.

Rebalancing also effectively sells the excess from the portfolio's winning asset classes each year and purchases the losing asset classes. Put another way, when you rebalance your portfolio, you sell investments at potential highs in the market and purchase other investments at potential lows. This is often counterintuitive, as many investors want to buy the best performing assets in a given year. Study after study, however, has shown that the "hot" asset classes in a given year rarely repeat their strong performance in subsequent years. By rebalancing your portfolio, you'll not only be restoring it to the original asset allocation established during the initial planning process, but may also be enhancing your returns along the way.

This is also the perfect time to monitor your holdings and compare your investments with their respective benchmarks or asset classes. However, make sure you are taking into account more than just historical rates of return. Other factors that are important to consider include fund size, manager tenure, composition of underlying securities, fees and expenses, and risk-adjusted performance. Monitoring your portfolio (either quarterly or annually) is an important step that you and your team should take care you don't skip.

### *Using an investment advisory team*

An important step that many investors do skip is forming an investment advisory team. This team would be in addition to your broader team of wealth management advisors and would focus solely on the investment portion of your overall wealth management plan.

You'll want to assign someone to head up the team. That person should work with you and the other team members to create an investment plan and then coordinate the execution of that plan with the rest of the team.

Members of your investment team may include money managers, custodians, financial counselors, accountants, and even adult children, among other people:

- *Money managers* can help the team execute a specific investment strategy and may be brokers, asset managers, mutual fund managers, or exchange-traded fund managers.
- *Custodians* are responsible for the safekeeping of a portfolio's investment assets and for providing the team with performance reports.
- *Financial counselors* can help with risk assessment and retirement analysis.
- *Accountants* should lead the tax-strategy aspect of your investment planning.
- *Adult children* may be encouraged to participate so that they'll develop the knowledge and skills necessary for dealing with the family investments, as well as learn to work cooperatively in reaching wealth management decisions.

Some team members may fill multiple roles, including that of team manager. It is recommended that the manager of your team be a credentialed individual, such as a chartered financial analyst, a general securities representative, or a certified public accountant who specializes in personal finance. Certifications help to ensure that there is a baseline of knowledge on your team, as well as the fulfillment of continued education requirements. Above all, your team manager should be someone whose advice you trust and who is adept at keeping the investment team working cohesively on maintaining your investment plan.

#### *Investment policy statement*

A formal part of an investment strategy often includes an investment policy statement (IPS). An IPS describes a person's investment strategy in some detail. Your team manager might suggest including multiple sub-IPSs within the main IPS. For example, you might create one statement/strategy for a family foundation, another one to address your lifestyle needs, and so on. Once the IPS is created, the manager should work with the team to implement the investment strategy and monitor its performance.

#### *Fees and expenses*

While it is reasonable to expect to incur some level of expense and fees while investing, you will want to keep an eye on the impact these costs have on the overall return and performance of your portfolio. The impact can be considerable. The recent Wall Street Reform and Consumer Protection Act of 2010 highlights the need for fiduciaries to monitor and evaluate the fees charged in retirement plans. Your team should take the same diligent approach to your portfolio.

There are many types of fees you'll want to be alert to when reviewing your portfolio:

- *Frontload fee*: This is a commission charged up front when you invest in a mutual fund. It is in addition to the fund's ongoing operating costs. For example, a mutual fund may charge you a 5% frontload fee for investing in the fund. If you invest \$10,000, then \$500 will be taken out of the investment up front, and the remaining \$9,500 will be invested in the fund. This fund will have to generate a higher rate of return if it is to equal the return you receive from a no-load fund, assuming that all other fees are equal.

- *Deferred-load fee*: In contrast to a frontload fee, a deferred-load or redemption fee applies to certain funds if you sell them within a stated timeframe. Such fees are often meant to discourage short-term investing in a fund.
- *Management fees*: These are part of a fund's annual operating expenses and are used to compensate the fund manager.
- *Transaction costs*: These are the costs associated with buying and selling securities, either within a fund or directly. They are what a brokerage house charges to trade a bond or security and typically range from \$5 to \$50 but may be higher than that.
- *12b-1 fees*: These fees are applied toward fund advertising and marketing, primarily to compensate fee-based advisors who provide services to shareholders of the fund. These fees can range from zero to .75% of the assets' value.
- *Annual account fee*: This is sometimes charged by brokerage houses to cover required IRS reporting and filing costs.
- *Investment management fee*: This fee is charged by an investment advisor who is overseeing a personal portfolio. It is commonly charged as a percentage of assets or as an hourly rate by fee-only planners.
- *Other expenses*: These include indirect costs such as those associated with accounting, administration, recordkeeping, and legal work, as well as fees for separately managed funds.

### Investor behavior

The investment-planning and decision-making process may be a logical sequence of actions, but an investor's psychology can disrupt even the best-laid plans.

Generally speaking, investors' behavior tends to mirror the current state of the economy and the business cycle: If things are looking good, investors tend to be positive; if things start to take a turn for the worse, their attitudes turn negative. Most investors focus on the present (current job situation, current economy, recent stock movements, and so on), making investment decisions that are very nearsighted and often counterproductive.

Ideally, an investor is slightly ahead of the crowd, selling before markets fall and buying before they begin to rise. Unfortunately, predicting market movements and their exact time of occurrence is extremely difficult.

A more reliable strategy—one that has proved effective in managing risk and capturing reasonable returns—is a systematic asset allocation that is focused on achieving long-term goals. When combined with a well-documented strategy (or investment policy statement) and tactical rebalancing, systematic asset allocation can go a long way toward keeping a person's investment behavior and game plan on track.

### Asset location

Up to this point we have not said much about the impact of income taxes on investment decisions. Make no mistake: Income taxes matter in the investment process. With rising tax rates on the horizon, income taxes will soon matter even more.

## Example

Dan and Allison make an initial portfolio investment of \$1,000,000, which grows at a rate of 8% annually. There is an annual expense rate of 1.5%, as well as a blended tax rate of 25.5% for their taxable investments and a rate of 35% in the final year for their tax-deferred accounts. Dan and Allison are contemplating three alternative actions: (1) lowering the annual expense rate to .5%; (2) moving to a state with no tax rate, and (3) changing the location of their investments to better use qualified dividends, capital gains, tax-free investments, and tax-deferred accounts to obtain a blended rate of 11% annually and 35% in the final year, for their retirement accounts. As you can see, each of these scenarios could have a significant impact on the overall return of Dan and Allison's portfolio over time.<sup>2</sup>

		Alt 1	Alt 2	Alt 3
Year	Current situation	Lower fee	No state taxes	Asset relocation
0	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
5	\$1,242,779	\$1,284,177	\$1,264,120	\$1,286,021
10	\$1,547,857	\$1,653,754	\$1,601,177	\$1,661,533
25	\$3,022,949	\$3,580,631	\$3,284,264	\$3,654,228
50	\$9,498,480	\$13,470,079	\$11,124,320	\$14,094,989

<sup>2</sup> The table ignores the impact of inflation.

One way to make your investment portfolio tax-efficient is through what's often referred to as asset location. Essentially, asset location entails determining the best "place" for you to own a particular investment, given the objectives you want that investment to meet. The investments of wealthy individuals are rarely held in just one place—that is, they are rarely kept in just one account or entity. Instead, they're usually held in different buckets that have been established to help implement the investors' financial and wealth-transfer planning over time.

As of this writing, tax reductions enacted in 2001 and 2003 are scheduled to expire at the end of 2010. In addition, new proposed legislation aims to increase income tax rates and limit deductions for individuals. Therefore the asset location decisions you make must take into account the impact that income taxes will have on portfolio return.

Each investment bucket is established for a particular purpose and therefore requires a specific investment strategy. A bucket can be invested in either taxable or tax-deferred accounts that delay taxation—such as individual retirement accounts (IRAs), 401(k)s, and deferred compensation plans. They may also be invested in accounts such as Roth IRAs and college savings plans, which offer potentially tax-free investment opportunities and may have different time horizons.

Which investments to own inside these accounts depends on the investment purpose of a given bucket. For example, taxable bonds generate interest income that is taxed at ordinary income tax rates and for that reason are often held in tax-deferred accounts. Stocks may distribute qualified dividends that are taxed at a favorable rate (currently 15%, but possibly 20% if certain

proposals pass and become effective in 2011) or nonqualified dividends taxed at ordinary income tax rates.

Stocks also generate capital appreciation that could be taxed at ordinary income rates (if held less than one year) or at favorable tax rates (currently 15%, but possibly 20% if proposed legislation passes and becomes effective in 2011) if held longer than one year. For this reason, stocks have generally been held in taxable accounts. Of course, if the investment holding period is very long, owning stocks inside tax-deferred accounts may make more sense, because their potentially higher returns could make up for the ordinary income tax rate upon distribution.

Asset-location decisions are often very complicated and must take into account many variables besides income taxes. Other considerations—such as estate- and gift-planning goals, income and liquidity needs, age of the investor, and the portfolio's investment time horizon—will all need to be taken into account before you decide which asset location is likely to produce the most tax-efficient investment environment and still meet your goals.

### **Conclusion**

Investment planning is a complex undertaking that, while rooted in fundamental principles, must be approached differently in the case of each individual or family's particular wealth management needs and expectations. By working closely with your team of advisors, you can help to ensure that your investment game plan serves your goals, both today and in the long term.

*By working closely with your team of advisors, you can help to ensure that your investment game plan serves your goals, both today and in the long term.*



*Charitable  
giving*



**Ch3** Ideally, charitable structures and wealth-transfer strategies complement each other in an overall wealth management plan.

Without private philanthropy, few charitable organizations would survive. That they do survive brings important benefits to society. Planned properly, charitable giving can also bring personal benefits to you, the donor, serving as an effective tool in your overall wealth management strategy. The primary way it does this is by offering a tax-efficient means to transfer wealth. You may, for instance, find that making a philanthropic donation is an attractive alternative to dealing with a large, appreciated portfolio of securities. Other individuals may look to philanthropic activity as a potential income stream. Then, too, some people simply desire to create a legacy of family giving, with tax benefits being a secondary though important consideration.

Be aware, however, that potential changes are afoot where charitable-giving deductions are concerned. President Obama's budget proposals include a provision that would limit the value of certain itemized tax deductions, including those for charitable contributions, to 28%. That limitation would apply to jointly filing married taxpayers whose income is over \$250,000 and to single taxpayers with income over \$200,000.

The plan has met with opposition from some members of Congress, who have reservations about this type of tax funding. They have requested that the president rethink his proposal. Many charitable

and nonprofit organizations are concerned as well, anticipating that the proposed limitation would result in lost contributions.

In this time of tax law uncertainty, we recommend that you meet with your wealth management advisors to review your charitable-giving strategies, particularly around the timing of charitable contributions, given the potential tax-deduction cap that might apply to future giving. We also recommend that before adopting a particular plan of charitable giving, an individual or family consider the main alternative approaches, assessing them in light of the donor's overall charitable goals.

### **Charitable structures**

There are a number of commonly used charitable structures. Each carries different tax considerations. It is important, therefore, not only to align your charitable goals with the structure that will best support them, but also to adequately contemplate the accompanying tax implications.

### **Public charities**

A public charity is a tax-exempt organization created and operated exclusively for religious, charitable, scientific, literary, or educational purposes. It either receives broad public support, is an organization operated to support another public charity, or is a religious institution, school, or hospital.

Generally, gifts of cash to public charities are fully deductible up to 50% of a donor's adjusted gross income.<sup>3</sup> Gifts of appreciated securities are usually deductible up to 30% of a donor's adjusted gross income. To the extent that the amount of a specific year's charitable gift(s) exceeds the adjusted gross income thresholds, excess contribution amounts are carried forward and are deductible for up to five years following the year of the gift.

Public charities such as community foundations, as well as the use of donor-advised funds, have been viewed by many high-net-worth families and individuals as attractive alternatives to establishing a private foundation, relieving donors of the recordkeeping, tax filing, and other administrative chores associated with a private foundation. Community foundations and donor-advised funds can generally be established with smaller amounts than would be needed to justify the expense of maintaining a private foundation.

### *Community foundations*

Many of the larger metropolitan areas have community foundations that accept donations for the general benefit of the people in those areas. Giving to a community foundation allows you more flexibility—both in structuring your gifts and in advising the foundation on how to benefit the surrounding community—than if you were to give to a particular charity. For income tax purposes, gifts to a community foundation are treated the same as gifts to public charities.

### *Donor-advised funds*

Many mutual fund groups, investment firms, large banks, brokerage houses, and community foundations have established donor-advised funds. These funds have become popular among people who want a greater sense of control over how their donations are being applied, since they enable donors to request that their public charity donations be used in certain ways.

---

#### **Footnote 3**

Throughout this chapter, we refer to gifts of securities that are made to different types of charitable organizations. Before making any gift of an appreciated security to a charitable organization, a person should speak to a tax advisor about the value of the deduction that he or she will receive. In many cases, a person is eligible to receive a fair-market-value deduction for such a gift only if he or she has held the appreciated security for more than one year.

*Although donors do not have the legal right to insist that their donated funds be used in a particular manner, most charities oblige the donor's wishes.*

While donors do not have the legal right to insist that their donated funds be used in a particular manner, most charities oblige the donor's wishes. Likewise, although the administrator of a donor fund can deny a donor's request that a contribution be directed to a particular organization, a negotiated solution is often reached. For income tax purposes, gifts to a donor-advised fund are treated the same as gifts to public charities.

Donors should make sure they understand the fee structure of the fund they choose; possible restrictions regarding what organizations they can support via the fund (e.g., a community organization's donor-advised fund might not permit donations to be applied outside the community); limitations with respect to how long a family will have influence over its donated funds (influence usually does not extend beyond one or two generations); and the administrative services the fund offers to donors (e.g., help in crafting a family's charitable-giving mission statement and policy; dealing with compliance matters related to charitable giving).

**Private foundations**

A private foundation is a tax-exempt organization created exclusively for religious, charitable, scientific, literary, or educational purposes. However, the degree to which it relies on volunteers and public

donations isn't sufficient to qualify the foundation as a public charity. Unlike public charities, private foundations generally pay a 1% or 2% excise tax on their net investment income, including capital gains.

Private foundations typically fall into two categories: operating and nonoperating. Nonoperating private foundations are required to make annual distributions to qualifying charitable organizations equal to at least 5% of the fair market value of their assets. Operating foundations actively conduct programs of charitable activities rather than merely provide passive support for other charities. (Common examples of operating foundations are museums and libraries.) Nonoperating foundations tend to serve primarily as vehicles that distribute funds to other charitable organizations.

Gifts of cash to private nonoperating foundations are fully deductible up to 30% of a donor's adjusted gross income. Gifts of appreciated securities to nonoperating foundations are generally deductible up to 20% of a donor's adjusted gross income. A key benefit of a private operating foundation is that gifts to it are subject to the same adjusted-gross-income limitations as gifts to public

charities. Regardless of whether the foundation is categorized as operating or nonoperating, it will be subject to the five-year carryforward (referenced earlier) that applies to gifts made to any type of private foundation.

A private foundation is an excellent vehicle for developing an intergenerational plan for charitable giving. While there is no particular dollar amount required to establish a private foundation, it is generally advisable to consider \$1 million as the minimum initial funding contribution, since that will help cover the administrative costs associated with the operation of this type of charitable entity.

#### *Supporting organizations*

A supporting organization is a privately organized, donor-influenced (but not donor-controlled) organization that supports a named public charity. In many respects, a supporting organization is similar to a private foundation, the major difference being that the board of a supporting organization must be linked to the public charity it supports (e.g., through membership overlap between the two boards).

A supporting organization is treated as a public charity for purposes of the contribution deduction rules and does not pay an excise tax on net investment income like a private foundation does.

#### **Donation methods**

Once you know what type of charitable structure best aligns with your wealth management plan, you should solicit the help of your investment and tax advisors, as well as input from any involved charitable groups. Donors need to take into account their current and future wealth management plans overall to determine whether their charitable goals are attainable and manageable. They should also keep in mind that once they transfer assets to a charitable organization,

those assets move beyond the control of the individual or family. No such decision should be made without understanding its impact on one's current and long-term needs.

A major consideration, therefore, is how contributions will be made over time. Generally, near-term giving is done through contributions to public charities, private foundations, community foundations, donor-advised funds, and supporting organizations. Gifts that will benefit a charitable organization at a later date are often referred to as deferred gifts.

The most typical deferred gift involves a transfer in exchange for a retained benefit or a lifetime benefit. Deferred gifts to charities can consist of annuity-type arrangements, remainder interests in certain types of property, and various types of charitable remainder or lead trusts. The flexibility inherent in being able to match the type of property to the type of charitable gift option is one of the primary advantages of deferred giving. When neither outright nor deferred giving is possible, there are other charitable vehicles, such as conservation easements or property restrictions, which would-be donors can explore.

#### **Gift annuity**

One of the most popular forms of deferred charitable giving is the charitable gift annuity. The simplest way of going about this is for the donor to transfer cash, securities, or, in some cases, real estate to an established charity in exchange for the charity's promise to pay an annuity to the donor and/or other named beneficiaries. The value of the charitable contribution is the difference between the annuity value and the value of the property transferred. In addition, a portion of each annuity payment is deemed a return of the original investment and is tax-free for the recipient over the person's life expectancy, as determined by actuarial tables.

## **Example**

### *Gift annuity*

Jessica, who is 60, contributes stock with a fair market value of \$100,000 and a tax basis of \$50,000 to her alma mater in exchange for a guaranteed annuity of \$5,200 per year. She will receive a charitable income tax deduction, and each annuity payment will consist of an ordinary income piece, a capital gain piece, and a portion that is a tax-free

return on her investment. So, rather than selling the stock and paying taxes on the capital gain, Jessica has set up a plan wherein she gets an upfront charitable deduction, provides an asset for her alma mater, and has a guaranteed revenue stream for the rest of her life.

#### **Remainder interest in a personal residence**

A popular method of avoiding estate tax on a personal residence (i.e., a residence that is not your primary residence but is, say, a vacation home or a farm) while gaining a lifetime income tax charitable deduction is to give to charity a remainder interest in that property. Such a gift permits the donor to avoid capital gains tax if the residence is eventually sold. The income tax charitable deduction is based on the present value of the charity's remainder interest. Although the personal residence would be included in the individual's estate, an offsetting charitable deduction would be available for estate tax purposes.

#### **Conservation easement**

A charitable contribution deduction is also allowed in connection with the transfer of a perpetual easement in (i.e., a permanent restriction on the future use of) real property for conservation purposes. The contribution must be made to a qualified organization—generally a government entity or a publicly supported charity. In addition, the property must be used exclusively for conservation purposes, such as preserving land for outdoor recreation by the general public; protecting a relatively natural habitat of fish, wildlife, and plants, or a similar ecosystem; preserving

open space (including forests and farms); or preserving a historically important area or certified historic structure.

The value of the contribution of a qualifying conservation easement is the change in the fair market value of the property in the time since the restriction began. Absent comparable sales of easements, fair market value is calculated by determining what the land's fair market value had been before the easement was granted and then comparing that number with the land's fair market value after the restriction is granted.

#### **Charitable remainder trust**

The charitable remainder trust (CRT) is a popular vehicle for deferred giving, one that offers alternative structures to match the needs of donors. The transfer is accomplished by creating a trust that pays income to individuals, with the remainder going to charity. Thus this form of charitable giving allows the donor or other named beneficiaries to receive from the transferred assets both an income stream and a current charitable deduction. When the trust's term ends, the remaining assets become the outright property of the charitable organization.

## ***Example*** ***Charitable remainder trust***

Elaine and Charles, who are both 45 years old, own stock worth \$1 million, having purchased it for \$500,000. They wish to diversify their holdings but would like to avoid a large capital gains tax. Therefore, they place the stock into a charitable remainder unitrust so that the trust sells the stock.

The trust pays no income or capital gains tax on the sale and pays Elaine and Charles 5.5% of the trust's net fair market value annually while they both remain alive. Elaine and Charles name their local art museum as the remainder beneficiary. The unitrust arrangement provides them with a charitable income tax deduction of approximately \$113,000 in the year of the trust's creation.

Because the annual distribution is keyed to the fair market value of the trust each year, Elaine and Charles either enjoy the benefits of the trust investments from year to year if the investments increase in value, or they suffer the detriments from year to year if the investments decrease in value. Elaine and Charles's first annual payment is roughly \$55,000.

---

## Two main types of CRTs

Charitable remainder annuity trust (CRAT)

Charitable remainder unitrust (CRUT)

---

A CRT is an irrevocable trust created during the donor's lifetime or through his or her will. Under the terms of the trust, a specified amount of the trust's net fair market value (not less than 5% of that value and not more than 50%) is paid to at least one noncharitable beneficiary (additional beneficiaries must include at least one person) on an annual or more frequent basis.

A CRT can last for either the donor's lifetime (or the lifetimes of several income beneficiaries) or a period not exceeding 20 years. A CRT requires that the income beneficiaries be alive when the trust is created. The charitable remainder beneficiary may be a private foundation created by the donor. When the noncharitable interests terminate, the remainder must pass to charity.

There are two main types of CRTs: the annuity trust and the unitrust. The charitable remainder annuity trust (CRAT) pays a set dollar amount each year based on the fair market value of the assets at the time the trust is funded. The charitable remainder unitrust (CRUT) pays a dollar amount, as determined each year based on an annual valuation of the trust assets. There is sufficient flexibility in how a CRUT may be structured that it can include a net-income-only payout with a makeup provision. This allows a donor (1) to transfer a non-income-producing asset to the CRUT (such as real estate), (2) to take the time to sell the asset, and (3) to make up the lower, income-only payments before the sale with larger payments after the sale proceeds have been reinvested to produce higher income.

A CRT generally does not pay income tax on investment earnings (dividends, interest, or capital gains). This permits the trust to sell appreciated property and not trigger current tax on the gain. Instead, the income beneficiary of the trust is responsible for income tax on amounts received from the trust.

## Charitable lead trust

Charitable lead trusts (CLTs) provide a charity with income for a set period, with the remainder going to a family member or noncharitable beneficiary. In essence, a CLT is the opposite of a charitable remainder trust. Like the CRT, CLTs come in two forms: the charitable lead annuity trust and the charitable lead unitrust.

Upon creation of the CLT, the donor is entitled to an income tax charitable deduction if the charitable interest is in the form of a fixed percentage of trust assets or a guaranteed annuity and if the donor will be taxed on the trust's annual income as it is earned (i.e., a grantor trust). If the donor establishes a nongrantor CLT, the donor will not receive a charitable income tax deduction, but nor will he or she be taxed on the trust's income each year.

Important gift tax and estate planning objectives can be achieved through the use of a CLT. The transfer of the property to a family member at the end of the period will result in a current gift for gift tax purposes or will trigger estate taxes upon the grantor's death. The gift or estate tax is reduced with a CLT because the value of the gift is reduced by the value of the income interest that's received by the charity. The value of the remainder interest that passes to the family members can be structured to produce significant savings in transfer taxes.

It should be noted that some of the charitable-giving strategies discussed above will benefit from the fact that the rates used to determine charitable deductions are historically low right now (i.e., the lower the rate, the higher the deduction). Once again, please consult your tax advisor in planning your strategy for charitable giving.

## ***Gift annuity***

### ***Advantages***

- Grants the donor a current charitable deduction
- Reduces the donor's taxable estate
- Provides the donor with a current income stream
- Provides the charity with current assets
- Requires less tax-compliance effort on the donor's part than do charitable remainder or lead trusts

### ***Disadvantages***

- Donated assets pass to charity instead of heirs
- Transaction is treated partly as a charitable contribution and partly as the purchase of an annuity, meaning you cannot take a charitable deduction for the full amount that is placed in the trust

## ***Remainder interest in a personal residence***

### ***Advantages***

- Grants the donor a current charitable deduction
- Reduces the donor's taxable estate
- Provides the charity with future real estate for growth and expansion
- Allows the donor to live in or use the house or farm for a term of years or for life

### ***Disadvantages***

- Donated property passes to charity instead of heirs
- The charity must wait to receive the real estate
- Exclusion of gain on sale of primary residence may be lost

---

### ***Charitable remainder trust***

#### ***Advantages***

- Grants the donor a current charitable deduction for the value of the property transferred to the charity in the future
- Reduces the donor's taxable estate
- Provides the donor or designated beneficiary with a current income stream
- Provides the charity with assets in the future

#### ***Disadvantages***

- Donated assets pass to charity instead of heirs
- The charity must wait to receive donated assets

---

### ***Charitable lead trust***

#### ***Advantages***

- Provides the charity with current income
- Gives the donor the opportunity to reduce his or her taxable estate
- Grants the donor a current charitable deduction for all payments to be made to the charity if the donor is taxed on income as it is earned by the trust
- Allows the donor or designated beneficiaries to retain donated assets

#### ***Disadvantages***

- Donor may be taxed on the trust's income
- Donor loses control of the assets during the term of the charity's interest

---

### ***Conservation easement***

#### ***Advantages***

- Provides a unique benefit for society through the creation of a historic area/structure or the preservation of outdoor space
- Grants the donor a current charitable deduction

#### ***Disadvantage***

- Donated property passes to charity instead of heirs

## **Example** *Charitable lead trust*

George and Michele place appreciated securities with a value of \$200,000 into a nongrantor charitable lead unitrust, which is to pay income for the funding of a scholarship at the private school their children attended. The payout is set at 8% of the annual value of the trust's assets for a term of 10 years. At the end of the 10 years, the remaining assets will pass to George and Michele's children.

A taxable gift results at the time the trust is established, but the gift tax is significantly reduced by the value of the income interest given to the school—reducing a \$200,000 gift to approximately \$87,000 (calculated by using IRS tables in the month of the contribution, at an assumed rate of 2.4%).

Upon the deaths of George and Michele, there will be no additional estate tax, and any appreciation in the securities

after their transfer to the trust will not be subject to gift or estate taxes. (Note that no income tax charitable deduction will be permitted, because George and Michele set up the trust as a nongrantor trust and therefore are not taxed on the trust's annual income.)

Another option that had been presented to George and Michele was the inclusion of their grandchildren among the remainder beneficiaries of the charitable lead unitrust. Had they chosen to include their grandchildren, the transfer would have been subject to the generation-skipping transfer tax. Under that option, George and Michele could have considered using some of their generation-skipping transfer tax exemption upon creating the trust.

### ***Postmortem planning through charitable strategies***

Many people are familiar with the income tax benefits of charitable giving because the tax savings are realized almost immediately. However, charitable giving can also provide substantial estate tax benefits and should be considered when you develop your overall wealth management plan. Most of the charitable structures mentioned in this chapter can be implemented upon your death, potentially resulting in a deduction when the taxable value of your estate is determined.

Unlike the income tax charitable deduction, the estate tax charitable deduction is not subject to adjusted-gross-income limitations, and no distinctions are made among the types

of qualified donees or the types of property that are used to satisfy the charitable gift donation. Because there are complexities in implementing a postmortem charitable strategy, proper steps should be taken to ensure that the charitable deduction isn't lost.

### ***Why a charitable structure might not be suitable for your overall wealth management strategy***

In many charitable structures, the donor must relinquish control of the donated assets. If moving your family's assets outside your control makes you uncomfortable, charitable giving might not be a good component to include in your overall wealth management plan.

Charitable structures can also add a layer of complication to your wealth management strategy. Many of the options discussed in this chapter require careful planning. If simplicity is what you're after, incorporating charitable giving into your wealth management plan might not be the right move for you.

### **Misconceptions**

As with all areas of tax planning, charitable giving is surrounded by certain misconceptions. For example, many people assume that the financial benefit of charitable giving is essentially on the side of the recipient, when in fact creating an income stream for the donor is often part of an overall charitable-giving plan. As already described in this chapter, certain trusts and annuity arrangements can provide the opportunity to turn non-income-producing assets into an income stream for the donor, on top of resulting in a charitable income tax deduction.

There is also the misconception that all gifts qualify for a charitable income tax deduction. They do not. Only some gifts qualify for a deduction, and the tax benefit is not automatic. To receive the tax benefit, the donor must put the gift down as an itemized deduction on his or her individual income tax return (or a return filed jointly with a spouse/partner). Contributions that are not deductible include those made to the following entities:

- Political parties
- Organizations that engage primarily in lobbying activities
- Political action committees
- Social and sports clubs
- Chambers of commerce
- Trade associations
- Labor unions

- Certain social welfare organizations
- Most foreign charities
- Other nonqualified organizations

Likewise, the following payments are among those that do not qualify as charitable contributions: tuition; dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups; and purchases of raffle tickets. The same holds true for the value of a volunteer's time or services. In some cases, a portion of the ticket or admission price that charitable organizations charge for fundraising events (e.g., dinners, golf tournaments) may be deducted by attendees. In other instances, however, these costs might not be deductible, so be careful that you don't automatically assume that they are (the charitable deduction substantiation requirements specify that charities must disclose to their donors the deductible and nondeductible portions of any tickets or admission charges).

Another misconception about charitable giving regards which assets can be incorporated into a giving plan. For example, property can be the primary contribution to a charitable-giving plan, as can stocks and securities.

### **Conclusion**

Ideally, charitable structures and wealth-transfer strategies complement each other in an overall wealth management plan. Creating these elements alongside each other should help you to make your plan more effective. Indeed, you may find that tailoring a charitable-giving strategy to your family's short- and long-term needs while benefiting society in the process is among the most rewarding aspects of wealth management planning.

A photograph of a man carrying a young boy on his shoulders. They are in an art gallery, looking at framed pictures on the wall. The man is wearing a dark green sweater and the boy is wearing a blue shirt and a patterned vest. The scene is brightly lit, suggesting a window or large light source. The text 'Estate and gift planning' is overlaid on the right side of the image in a bold, orange, serif font.

***Estate  
and gift  
planning***



**Ch4** There are many potential objectives, both financial and nonfinancial, to consider in the estate planning process.

Thoughtful estate and gift planning helps you to preserve your wealth and pass it on to your designated beneficiaries in the manner you choose. Done haphazardly, however, such planning can result in your family and other beneficiaries receiving less than you had intended. You will therefore want to take care to make yourself aware of the various estate and gift planning options and assess which ones are best for you and your family.

There are many potential objectives, both financial and nonfinancial, to consider in the estate planning process. Those objectives—and the relative weight a person places on them—are likely to change over time. Tax implications will change with time, too, and should be carefully considered in the development of an estate plan. In particular, the estate tax itself is in a state of flux right now and has historically been subject to numerous changes over the years.

For these reasons, you should review your estate plan periodically to be sure it still reflects your objectives and the current laws.

### **Current status of estate- and gift-tax rules for 2010 transfers**

To everyone's surprise, the estate tax was allowed to expire in 2010. Unless Congress moves to reinstate the estate tax retroactively, the estates of individuals who die in 2010 will not pay an estate tax. Also, the generation-skipping transfer (GST) tax has been repealed for generation-skipping transfers made during 2010. The gift tax, however, was not repealed. The lifetime gift tax exemption remains at \$1 million. Gifts beyond the \$1 million threshold will be subject to a maximum gift tax rate of 35%.

In 2010 there has also been a change in the tax basis for inherited property. Before 2010, property received from a deceased individual generally was assigned a tax basis equal to the property's fair market value on the date of death. That is, the tax basis in the property was "stepped up" or "stepped down" from the deceased individual's basis in the property to the date-of-death fair market value.

For 2010 only, a modified carryover basis regime replaces the basis step-up in inherited property. (Note that the basis step-down rules still apply if the date-of-death fair market value is less than the price originally paid for the property.) Under the modified carryover basis regime, each person's estate is generally permitted to increase the basis of the transferred assets by \$1.3 million; the basis of any property transferred to a surviving spouse may be increased by an additional \$3 million.

So, in total, an estate may be allowed a total basis step-up of \$4.3 million for appreciated property that passes through the estate. It is the executor's duty to decide how to allocate this limited basis step-up.

### **Rules for transfers after 2010**

In 2011, estate, gift and generation-skipping tax laws and rates will return to their pre-2001 status, barring legislative action. This means that for the estates of individuals dying in 2011 or thereafter, the maximum federal estate tax rate will return to 55%, with an estate tax exemption of \$1 million. This is a radical change from the \$3.5 million exemption and 45% maximum rate that applied to deaths in 2009.

Also, with the return of the estate tax, the modified carryover basis regime that applies in 2010 only will be repealed, at which time the stepped-up basis rules that were in effect in 2009 will resume. For gifts made in 2011 and afterward, the maximum federal gift tax is tied to the 55% estate tax rate, and the gift tax exemption amount remains at \$1 million.

The following table illustrates the estate and gift tax rates and exemptions that are in effect for 2010, and shows how things have changed since 2009. It also illustrates the rates and exemptions applicable for 2011 under current law, although many observers expect Congress will enact more favorable rates and exemptions for 2011 and future years.

It is widely anticipated that Congress will pass legislation that will address the uncertainty about estate, gift and generation-skipping tax laws and rates. For purposes of this chapter, we are proceeding on the assumption that the estate tax will be the law as it currently stands for 2011 and that full repeal of the estate tax will not extend beyond 2010.

	2009	2010	2011
Highest estate/gift tax rate	45%	Estate tax rate – N/A; gift tax rate – 35%	55% <sup>4</sup>
Estate tax exemption	\$3,500,000	N/A – Estate tax repealed	\$1,000,000
Gift tax exemption	\$1,000,000	\$1,000,000	\$1,000,000
GST exemption	\$3,500,000	N/A – GST tax repealed	\$1,000,000

<sup>4</sup> A surtax of a 5% additional estate tax or 60% is added on estates between \$10,000,000 and \$17,184,000 to eliminate the effect of the marginal estate tax rates, effectively creating a flat 55% estate tax rate.

### **When is an estate plan appropriate?**

Although the complexity of an estate plan can vary widely depending on a person's individual circumstances, objectives, and family situation, you should have some form of estate plan if

- You want to be sure that specific assets or a specific amount of assets will pass to certain beneficiaries
- You want to leave property to a trust for beneficiaries instead of leaving property to beneficiaries outright—in order to have the property managed for the beneficiaries, to delay or stagger the beneficiaries' receipt of the property, or to allow multiple beneficiaries or generations to benefit from the same assets
- You have, or anticipate eventually having, an estate large enough to require the payment of estate taxes upon your death
- You have minor children
- You are a business owner
- You want to protect your assets from potential claims by your creditors and beneficiaries (as well as protect your beneficiaries from potential creditor claims)
- You own property in more than one state
- You or your spouse is not a US citizen
- You are in a nontraditional relationship, or your immediate relatives are not your intended beneficiaries

Nearly everyone falls into at least one of these categories, so it's almost always appropriate to have an estate plan. Failure to have an estate plan could result in

- Inheritance of your property by people you did not wish to be your beneficiaries or in a manner you did not intend—i.e., your children inheriting all or a portion of your estate that you intended to leave to your surviving spouse, or vice versa
- An incorrect form of property transfer—for example, property transferred directly to a person who is uninterested in or incapable of handling property or, conversely, property placed in a trust when in fact circumstances warrant giving the property directly to the beneficiary
- Improper ownership of assets (separate ownership by husband or wife, or some form of joint ownership), which can jeopardize full use of tax exemptions or cause property to pass in a way that is contrary to your intention
- Higher combined estate and gift taxes because of failure to take full advantage of available estate and gift tax exemptions, exclusions, deductions, and credits
- Adverse impact on a family-owned business due to lack of an ownership or management succession plan
- Lengthy and emotionally painful court proceedings concerning the appointment of guardians for your children
- The court appointment of a representative to make financial or healthcare decisions for you in the event of your incapacity

- Higher-than-necessary nontax administration expenses and transfer costs
- Lack of liquidity and the forced sale of estate assets to pay expenses and taxes

Although each person’s situation is unique, estate planning generally follows a four-step process:

- Assess the current situation
- Determine planning options
- Implement the estate plan
- Monitor the plan

**Step 1: Assess the current situation**

The first step in any plan is to review your current financial situation. Once you’ve done that, determine your goals with respect to your wealth preservation and legacy. With those in mind, you should then analyze any current wills, trusts, and other wealth management documents.

For financial information purposes, it’s useful to create an estate tax balance sheet. This entails

- Listing the types and locations of your assets, as well as the current value and tax basis of each asset
- Determining the current ownership of each asset—that is, whether the property is owned by you, your spouse, or jointly (and the type of joint ownership) or is community property; the form of ownership can dictate who receives the property upon death, so this is a critical part of the estate planning process
- Reviewing the beneficiary designations for certain assets (life insurance policies, retirement plans, deferred compensation, etc.)
- Evaluating the appreciation potential for various assets <sup>5</sup>

We’ve already noted a number of common reasons for having an estate plan (listed above, under “When is an estate plan appropriate?”). Other key objectives tend to include

- Maintaining your current standard of living and planning for your future standard of living
- Providing for your surviving spouse and dependents
- Naming guardians for your minor children
- Designating someone to make financial and healthcare decisions in the event that you or your spouse becomes incapacitated
- Maintaining control over your assets during your lifetime
- Ensuring that your property is distributed according to your wishes—e.g., specifying who receives your property, the amount the recipient receives, the form in which he or she receives it (outright or held in trust), and who will manage your property for your heirs
- Making sure your property is transferred in an efficient, quick, and orderly manner
- Reducing the overall estate and gift tax liabilities associated—e.g., reducing the assets that are subject to tax, deferring the payment of tax, and taking maximum advantage of available exclusions, exemptions, deductions, and credits
- Preserving the value of your business and planning for ownership and management succession

---

**Footnote 5**

.....  
 A major benefit of making lifetime gifts is that any appreciation in the property that is given away escapes estate and gift taxes. Therefore, identifying the appreciation potential of each asset is important.

It's essential to determine how important each of these objectives is to you. Once you have done so, you may find it helpful to create an estate flowchart that illustrates how your estate will pass to the beneficiaries designated in your current documents. The flowchart can incorporate the estimated estate tax due, if any, and a liquidity analysis to determine how the tax and other expenses will be paid. It is a good idea to make the plan sufficiently flexible to remain applicable if various circumstances change.

### **Step 2: Determine planning options**

Using the information gleaned from the assessment stage, you can begin to determine which estate planning techniques are best suited to you and your family. The first few techniques discussed in this section make sense for just about anyone. They're followed by more-advanced estate planning ideas.

#### **Draw up a will**

If you do not have a will, the law of your state of residence will generally determine who receives your property upon your death and how and when the designated individuals receive the property. In many states, if you are married with children, lack of a will means that your surviving spouse will not receive all of your assets; instead, a portion will pass to your children. In addition, you will miss the opportunity to generate significant estate tax savings for your family. Even if an estate is not large enough to require the payment of estate tax, a will is nonetheless worth having, since it can be used to name guardians for minor children and specify who will receive assets and when.

#### **Sign “durable power of attorney” and healthcare proxy forms**

It's also useful to complete a “durable power of attorney” form and a healthcare proxy form. These documents specify who can make financial and healthcare decisions for you in the event that you become incapacitated. They, along with a will, are especially important to have if you are in a nontraditional relationship (i.e., a relationship not necessarily recognized by law) or do not want your immediate relatives to be your beneficiaries or to make decisions on your behalf.

#### **Designate an executor and trustee**

Your executor will be in charge of administering your estate. The trustees will be in charge of administering any trusts created during your lifetime or through your will. An important part of the estate planning process, therefore, is the selection of the individuals who will fill those roles (and their alternates, in the event that the selected individuals are unable or unwilling to serve). This involves weighing the advantages and disadvantages of assigning these roles to family members instead of to a professional advisor such as an attorney, a professional trustee, or some combination thereof.

#### **Review property ownership and beneficiary designations**

For couples, part of the estate planning process involves evaluating whether you and your spouse (or partner) each have enough property in your separate names to take full advantage of the estate, gift, and generation-skipping transfer (GST) tax exemptions, exclusions, and credits that are in effect at any particular time. A review of asset ownership can help you determine whether lifetime gifts or transfers between you and your spouse or partner should occur to ensure that you each have enough assets in your own names to

take full advantage of your available tax exemptions. Failure to plan properly in this vein can significantly increase your overall tax liability.

Bear in mind, however, that if you want some of your property and assets to go to individuals other than your spouse or partner upon your death, joint ownership with right of survivorship can defeat an otherwise excellent estate plan. That is because right of survivorship means your spouse or partner will automatically receive the jointly owned property and assets when you die, with none of those assets going to your children or other potential beneficiaries. Owning property and assets in this manner might also prevent you from taking advantage of the full estate tax exemption amounts allowed for both you and your spouse or partner.

Another consideration to keep in mind is that if you live (or used to live) in a community property state and are married, all assets and property acquired while you were living in that state as a married person are generally treated as half-owned by each spouse, regardless of whose name the property and assets are in. This can cause issues similar to those that may arise as a result of joint ownership with right of survivorship (i.e., with regard to passing the property to children or other beneficiaries; taking advantage of the full estate tax exemption amounts allowed for both you and your spouse).

Realize, also, that the recipients of several types of assets, such as deferred compensation and payouts from life insurance policies and retirement plans, are not specified by your will, but rather, are determined by beneficiary designations that you arrange through the plan providers. It is important to review the beneficiary

designations, as well as the alternate beneficiary designations, for all of these assets. Failure to do so can result in adverse consequences, such as the wrong person receiving the asset, less flexibility in your estate plan, increased income tax liability, and increased estate tax liability due to failure to use exemption amounts or take full advantage of charitable bequests.

### Consider the form and amount of property left to your spouse

For most married people, providing for the surviving spouse is a primary estate planning goal. For both estate and gift tax purposes, there is an unlimited marital deduction for amounts transferred to a spouse, so long as the receiving spouse is a US citizen.

Wills should address how property is to pass to the surviving spouse. Generally, to qualify for the marital deduction, property must pass to the surviving spouse in one of three basic ways: (1) outright, (2) via a “general power of appointment” trust, or (3) via a “qualified terminable interest property” trust.

An important part of estate planning involves determining which of these three options is best suited to meet your goals. Recognize that these options are not mutually exclusive; the total property passing to the surviving spouse may be divided, with different methods potentially used for each part of the transfer.

Outright transfers to a surviving spouse qualify for the marital deduction. However, such transfers may give rise to concerns regarding control over the property’s ultimate disposition and financial management. If the marital transfer is made by outright bequest, the spouse who dies first will have no control over the ultimate disposition of the property. This concern may be particularly relevant if either spouse has children from a previous marriage or if the

## ***Example***

Diane, a divorcee in her fifties, has \$1 million, which her investment advisor tells her is likely to grow to \$3 million by the time she dies. After consulting with him, as well as with her accountant and estate attorney, Diane decides to give the \$1 million to her three children, so that the \$1 million gift tax exemption can be used now instead of upon her death, eliminating roughly \$2 million of future appreciation from her estate. If she were to wait to bequeath that money through her will, there still would be an exemption for \$1 million, but the additional \$2 million would be subject to tax.

*Over time, an annual giving program can remove hundreds of thousands of dollars from your estate on a tax-free basis.*

surviving spouse remarries. Additionally, the surviving spouse may lack experience—or have little interest—in the financial management of property; discussing this potential responsibility with your spouse before making a decision is therefore advisable.

One way to address concerns about the financial management of property, while also ensuring that a transfer to a spouse qualifies for the marital deduction, is to use a trust for the transfer. One such trust is a “general power of appointment” trust. It stipulates a mandatory annual distribution of income to the surviving spouse, allows for discretionary distributions of principal to that individual, and lets him or her decide who receives the property when he or she dies. The drawback to this arrangement is that it doesn’t give the first-to-die spouse control over the ultimate disposition of the property. In some states, this is the only type of trust that qualifies for the marital deduction.

A transfer also qualifies for the marital deduction for federal purposes if the property is transferred to a “qualified terminable interest property” trust. This type of trust stipulates mandatory annual distribution of income to the surviving spouse, allows for discretionary distributions of principal to that individual, and lets the first-to-die spouse decide who will receive the remaining property upon the death of the surviving spouse. This arrangement may alleviate concern about both the financial management and ultimate disposition of the property. However, this technique also makes it so that the plan has considerably less flexibility to adapt to changes in circumstances in between the deaths of the spouses.

### Use the estate tax exemption

Spouses are each entitled to an estate tax exemption of \$1 million (for 2011), which can be used after their deaths to shelter that amount from estate tax. As discussed above, if you leave all of your property to your spouse, there will be no estate tax (due to the marital deduction), but your surviving spouse will not be allowed to use your estate tax exemption. When the surviving spouse dies and the combined property then passes to other beneficiaries, only his or her own estate tax exemption can be used to offset the estate tax, thereby wasting the exemption of the first-to-die spouse.

There are various ways to use the first-to-die spouse's estate tax exemption that avoid this significant potential increase in overall estate tax: outright transfers to beneficiaries other than a spouse or charity, transfers to trusts that benefit both the spouse and other beneficiaries, and the potential use of disclaimers by the surviving spouse, to name several methods.

### Give lifetime gifts

Over time, an annual giving program can remove hundreds of thousands of dollars from your estate on a tax-free basis. You can give individual gifts of up to \$13,000 (\$26,000 if you're married and your spouse joins in the gift) to any number of people annually without having to pay a gift tax (as of 2010).

These "annual exclusion" gifts remove property from your estate without resulting in a gift or estate tax cost and can shift income-earning property to family members in lower income tax brackets. This also eliminates from your estate any future appreciation in the value of the transferred property.

If the people to whom you would like to make gifts are minors, and you do not want to make outright transfers, you can avail yourself of several alternative account and trust arrangements that will qualify your gift for the annual exclusion without requiring you to make outright transfers.

In addition to the \$13,000 annual exclusion, there is an unlimited gift tax exclusion for any tuition paid directly to a school or for medical care payments made directly to a healthcare provider on someone else's behalf. Not only are these tuition and medical payments free of gift tax, but they also do not count against the annual gift tax exclusion. Tuition payments (but not room and board, books, or other expenses) made directly to a private elementary school, secondary school, or college generally qualify for this exclusion.

Gifts to a qualified tuition program, or 529 plan, do not qualify for the unlimited tuition gift tax break. However, there is a special rule allowing a contribution that is made to such a program or plan in a single year to be spread over five years. If done properly, this technique enables you to use five years of annual gift tax exclusions for a gift made in one year.

You're also entitled to a \$1 million gift tax exemption; the first \$1 million of cumulative lifetime gifts is exempt from gift tax. The gift tax exemption amount used during a lifetime is subtracted from the estate tax exemption amount available upon death. However, you may still want to make gifts up to the \$1 million exemption in order to eliminate future appreciation from your estate.

### Consider trusts and family entities

Earlier in this chapter, we discussed using trusts to transfer property to a surviving spouse. We will now look at several other types of trusts that can be used to pass on wealth.

#### *Life insurance trust*

When the proceeds from a life insurance policy that you've taken out on your life are distributed to your beneficiaries, those proceeds are subject to estate tax. One way to shelter them from estate tax is to transfer the policy into an irrevocable trust created for the purpose of holding the policy and managing or distributing the death benefit proceeds. A life insurance trust may also help address the liquidity needs of your estate. There are various options regarding the terms and beneficiaries of this type of trust.

Note that a life insurance policy that is transferred to an irrevocable trust will not be officially removed from your estate until three years after the date of transfer. For a new policy, you should consider having the trust acquire the policy directly rather than receiving it from you or someone else. This may allow the death benefit proceeds to escape estate taxation immediately.

#### *Grantor retained annuity trust*

To transfer the future appreciation of an asset to beneficiaries but retain the current value of the asset, plus a fixed annual interest payment based on the asset's current value, consider transferring the asset to a grantor retained annuity trust (GRAT).

A GRAT allows you to retain the right to receive for a specified term of years an annuity stream that is equal to (1) the fair market value of the property at the time you create the trust plus (2) a fixed rate of interest. The fixed return over the

entire annuity term is based on the prevailing interest rate (as published by the IRS) for the month the GRAT is created. If the trust assets produce an actual economic rate of return that exceeds the fixed return, the GRAT's beneficiaries will receive the excess either in an additional trust or outright, and at little or no gift tax cost.

A GRAT works best with assets that are likely to appreciate rapidly. The higher the rate of return on trust assets, the greater the amount that will go to the GRAT beneficiaries free of gift tax. Typical assets placed in this type of trust include interests in closely held businesses, publicly traded stock, and other assets that are expected to grow quickly.

GRATs also work best when interest rates are low, because appreciation in the assets above the benchmark rate of return (the interest rate published by the IRS for the month the trust is created) passes to the beneficiaries. The lower the benchmark rate of return, the more the beneficiaries will receive.

Although no changes to the GRAT rules have yet been made, Congress has been discussing new legislation that would make them less beneficial. If passed, the proposed new legislation would, among other things, require a 10-year minimum term for GRATs and a remainder interest greater than zero, effectively eliminating the "zeroed-out" GRAT. For this reason, and because interest rates are currently at record low levels, it may be wise to consider establishing a GRAT sooner rather than later.

#### *Qualified personal residence trust*

A personal residence—either a principal residence or vacation home—can be transferred to the beneficiaries of a qualified personal residence trust (QPRT) at a discount from the home's current fair market value. The grantor can continue to live in that principal residence

or vacation home for a specified term of years and continue to take a mortgage interest deduction, as well as a real estate tax deduction. When the term interest in the trust ends, arrangements can then be made to rent the home from the trust or its beneficiaries at fair rental value. This is an excellent means to further reduce the estate.

A QPRT is especially desirable when (1) significant future appreciation is expected in the value of the home, because any appreciation that occurs after the trust is created can escape estate and gift tax, and (2) interest rates are higher, because a higher interest rate (which helps determine the value of your right to live in the home) will result in a lower gift tax value.

#### *Intentionally defective trust*

Use of an intentionally defective irrevocable trust (IDIT) is a technique that may allow you to transfer the future appreciation in an asset to beneficiaries while keeping the current value of the asset, plus a fixed annual interest payment that's based on the asset's current value.

An IDIT is ignored for income tax purposes. After setting up an IDIT, you would sell an asset to the trust in exchange for the trust's promissory note. The terms of the promissory note would require the trust to pay you whatever amount the fair market value of the property was at the time you sold the asset to the trust, plus a fixed rate of interest. The interest rate would be based on the prevailing interest rate (as published by the IRS) for the month the sale occurs, and would also depend on the length of the note and the frequency (annually, semiannually, quarterly, etc.) that interest payments must be made. IDITs work best when interest rates are low, because appreciation in the assets above the interest rate on the note passes to the beneficiaries.

If the trust assets produce an actual economic rate of return that exceeds the specified interest rates, the IDIT's beneficiaries will receive the excess either in an additional trust or outright, at little or no gift tax cost. Unlike GRATs, IDITs can also be used effectively as a tax-planning tool vis-à-vis the generation-skipping transfer tax.

Like a GRAT, an IDIT works best with assets that are likely to appreciate rapidly. The higher the rate of return on trust assets, the greater the amount that will go to the IDIT beneficiaries free of gift tax. Typical assets placed in this type of trust include closely held businesses, publicly traded stock, and other assets that are expected to grow quickly.

Realize that although the IDIT will be the legal owner of the asset, you will remain liable for the income tax on the income earned by the trust—hence, the trust is “defective.” The reason that an IDIT is nonetheless an appealing option is that the income tax payment provides an income tax benefit for the trust beneficiaries. The tax benefit stems from the fact that what the beneficiaries receive from the trust will not be diminished by the income taxes owed by the trust, yet payment of the income tax by the person who set up the trust is not considered a gift to the trust or to the beneficiaries.

#### *Dynasty trust*

A dynasty trust is generally created as part of a plan to minimize generation-skipping transfer (GST) taxes. The GST tax is an additional tax applied against the value of property that's transferred to people who are defined as “skip people.” A skip person is someone who is considered one or two generations younger than the person who

is making the transfer. The GST tax is often in addition to potential estate or gift taxes on the same transfer. It is designed to ensure that a tax is collected on the transfer of wealth in each generation. For 2010, the generation-skipping transfer tax is repealed. As noted earlier, the GST exemption for 2011 is \$1 million. A dynasty trust helps you to take full advantage of your GST exemption and is typically set up to last for as long as is allowed by the state law under which the trust is governed.

A dynasty trust can be established either during your life or through your will. This trust allows you to set aside assets for your grandchildren and future descendants (while still allowing for distributions to your children, if necessary) without paying gift, estate, or GST tax in each generation.

#### *Charitable trust*

Charitable trusts can help you to achieve your charitable objectives and obtain a charitable deduction while (1) still retaining an interest in your property or (2) giving an interest in the same property to other beneficiaries, such as children.

In a charitable remainder trust you would transfer assets to the trust and either keep or give to others the right to receive an annual annuity payment for a specified number of years (or for life). At the end of the term (the specified years or your death), the remaining assets go to charity.

A charitable lead trust essentially works in reverse: The charity is entitled to receive an annuity payment for a specified number of years; at the end of the term, the remaining assets are returned to you or given to the beneficiaries of your choosing.

#### **Family limited partnerships**

A family partnership is an excellent way to control and grow wealth. The family partnership is a separate business entity that can hold title to assets, collect income and gains, pay expenses, and file tax returns. A family partnership often takes the form of a limited liability company (LLC), which is treated as a partnership for tax purposes, or a limited partnership (often referred to as a family limited partnership or FLP).

One popular reason for forming a family partnership is to facilitate the transfer of wealth, because making gifts of partnership units to children, grandchildren, or trusts for their benefit allows the passage of family wealth without losing any of the sophisticated investment attributes available to large investment pools. Generally, property is contributed to a family partnership in exchange for both general and limited partnership units.

As a rule, the retained general partnership interest will be small, because the objective is to transfer the bulk of the value, through the limited partnership units, to younger generations. If the partnership is properly structured and administered, gifts of partnership or LLC units will not be included in the donor's estate once those gifts have been made.

Additionally, substantial discounts are often allowed in valuing the limited partnership units that are transferred—for instance, if the limited partnership units aren't marketable (marketability discount) or if the limited partners don't control the partnership (minority interest discount).

There is also a level of asset protection associated with family partnerships. The partnership unit ownership can be restricted to family membership or to trusts for family members. In addition, family partnerships offer protection of assets from creditors. Finally, family partnerships

enable family members to invest through a single vehicle, which can reduce investment costs, facilitate recordkeeping, and provide flexibility that might not be available in a trust setting.

Because family partnerships are often involved in sophisticated estate planning arrangements, they are routinely scrutinized by the IRS. When the IRS is involved, the most controversial issue is typically the question of whether the value of a partnership unit should be discounted for gift or estate tax purposes; if the IRS invalidates the partnership, the discount related to the partnership is removed.

The IRS tends to concentrate on partnerships that are operated in a sloppy manner or on ones in which family members need constant distributions for living expenses. Properly structured and operated, however, an FLP can be a very useful tool.

### **Step 3: Implement the estate plan**

Once the different estate and gift planning alternatives have been evaluated, the next step is implementation. This includes having new documents drafted by an attorney and reviewing the documents to ensure their accuracy.

Implementation also involves producing an estate tax balance sheet that reflects the changes made and revising the estate flowchart to illustrate how the estate will pass according to the new plan.<sup>6</sup> The flowchart would, as described earlier in this chapter, include the estimated estate tax due under the new plan and a liquidity analysis to determine how the tax and other expenses will be paid.

### **Step 4: Monitor the plan**

The final step in the estate planning process is to periodically review and monitor your plan. Over time, you may find it necessary to alter your plan to reflect changes in

- Your objectives or their relative importance to you
- The composition of your family (birth, marriage, divorce, death)
- Your beneficiaries' personal situations
- Your financial situation
- Tax law

When such changes occur, it is appropriate to either modify your estate plan or create a new one.

### **Conclusion**

Preserving your wealth for loved ones and subsequent generations is a primary objective of wealth management. Though careful estate planning can be complex, it is an undertaking best not deferred. Establishing a well-considered and comprehensive plan now, and updating it as needed, should help to ensure that your wealth—and your vision for it—survives far into the future.

---

#### **Footnote 6**

For couples, two flowcharts should be drafted—one showing how the estate would pass if you were to die before your spouse or partner, and the second flowchart showing vice versa.

A photograph of two men in a bright, modern office setting. An older man with glasses, wearing a dark blue sweater and khaki pants, stands with his hands on his hips, leaning against a white table. A younger man, wearing a light-colored sweater and pants, sits at the table with his hands clasped, smiling broadly. The background is a large window with a view of a city skyline. The text 'Business succession planning' is overlaid in orange, italicized font on the right side of the image.

***Business  
succession  
planning***



---

**Ch5** Successfully transferring a business depends on good planning.

Family businesses comprise a significant percentage of all businesses in the United States. Ownership of these entities tends to be closely held within one or more families. However, there can be many other interested parties, too, including customers, suppliers, and employees, to name just a few.

Often, the controlling or majority owner is as emotionally invested in the business as he or she is financially invested. In such cases, the owner tends to maintain voting control, usually for his or her lifetime. This factor, along with the desire to keep all aspects of the business confidential, generally means that the majority owner is integrally involved in the operations of the business—sometimes to the exclusion of more hands-on involvement by other family members, who would benefit from better understanding how the business is run.

The day will come, however, when the controlling owner must—whether because of illness, death, or other circumstances—relinquish his or her ownership interests to another party.

Unfortunately, many business owners choose to ignore this inevitability. As a result, they don't develop a business succession plan. This can lead to a host of problems when the current owner ceases to maintain control, ranging from family infighting to erosion of the business's value. Thus, difficult though it may be to contemplate a succession plan, matters will ultimately prove more difficult if none is in place.

### **Avoiding common mistakes**

Successfully transferring a business depends on good planning. That entails taking certain basic but critical steps. Failure to do so can hinder a smooth leadership transition later on:

- *Create and monitor a succession plan:* A succession plan should be devised early in the existence of a business and then be revisited regularly. Early planning provides flexibility, allowing a family's succession strategy to alter course more easily if circumstances change.
- *Identify a successor:* To provide an adequate level of certainty that a solid succession plan is indeed in place, the owner(s) of a family business must decide who will run the business down the line—whether it be another family member, other shareholders, key employees, or a third party.

Difficult though this decision may be, it is a crucial one. While some family members might be disappointed about not being selected to lead the business, it is important that they and all other appropriate parties are informed of whatever decision is made, and well in advance. Making this decision and communicating it sooner rather than later not only demonstrates the intention to keep the business going once the current leader steps down, but also helps to prevent surprises—within the family and among other stakeholders—which might otherwise be disruptive to the business.

- *Adequately train the successor:* If a family member is the identified successor, it could be useful for that person to obtain business experience outside the family's business. Doing so is likely to give the successor a fresh perspective, as well as new knowledge and skills that could benefit the business. Of course, the chosen successor should also obtain solid experience within the family business itself. Rotating through various roles in the organization will allow the individual to learn key aspects of the business.
- *Delegate leadership authority and company oversight:* Singular power in the majority owner may inhibit the organization's ability to grow and adjust to a changing environment. Giving key members of management real authority and including outside members on the board of directors will allow the business to draw from a wider base of knowledge and expertise.
- *Distinguish between proper compensation and earnings distribution policies:* If only some of the members of a family help to run the business, the owner may struggle in the effort to be fair to all. It serves both the business and the family's long-term interests to acknowledge the contributions of family members who work in the business, by establishing a compensation policy that is commensurate with the fair value of their services. Nonparticipating family members can be given equity interests and possibly periodic dividend distributions in an effort to make all family members feel equal.

### **Planning for the transfer of business interests**

Family-business owners who don't follow the steps above often rely on a default plan, whereby the ownership interests are bequeathed to one or more beneficiaries in the business owner's will. Although such designations constitute a "plan" of sorts, announcing a successor in this manner tends to be far from ideal.

## *A successful transition almost always hinges on a well-considered written plan that clearly specifies the disposition of ownership interests in the business.*

A successful transition almost always hinges on a well-considered written plan that clearly specifies the disposition of ownership interests in the business. The earlier the owner develops the plan, the better. That's because the more time there is to prepare for succession, the greater the opportunity to maximize the business's value and reduce the risks involved when an owner or key employee exits the business. Early communication of the plan also gives a family time to resolve potential tension among its members (e.g., between those who are actively involved in the business and those who are not), which, in turn, should allow for a smooth transition when the new leader takes the helm.

A written plan should answer multiple questions, including these:

- Who should receive the ownership interests?
- When should the ownership interests be transferred?
- Should restrictions be placed on the transferred interests?
- How should the transferee be permitted to deal with the ownership interests?
- Will the planned transfer cause conflicts that should be anticipated and addressed?
- What are the tax consequences of the planned transfer?

Addressing these issues now, and reconsidering them as circumstances change, will substantially increase the likelihood of a successful transfer of the ownership interests. In contemplating these matters, a business owner may also want to consider arrangements such as a buy-sell agreement or perhaps even an initial public offering, depending on his or her objectives:

### *Buy-sell agreement*

Every business with more than one owner should consider using a buy-sell agreement to describe the terms and process for an orderly transfer of the ownership interests in the event that the owner wishes to sell, becomes disabled, retires, or dies. There are two categories of buy-sell agreements: the redemption agreement and the cross-purchase agreement. Sometimes, a hybrid of these two types of agreements is used.

Under a redemption agreement, the business entity purchases the selling owner's interests by using its own cash or debt. In a cross-purchase arrangement, the selling owner sells his or her interests to other owners rather than to the business entity. This benefits the buying owner(s) by increasing the tax basis of the purchased ownership interests equal to the purchase price, which can reduce future tax upon subsequent sale of the ownership interests.

In many cases, neither the entity nor the other owners have enough cash to purchase the entire business. Life insurance is sometimes acquired on the owners' lives and is owned individually or by a partnership or trust. The insurance proceeds can be used to fund the buyout, with any balance funded by the business entity through a redemption transaction.

#### *Sale to a third party*

If a sale of the business is contemplated, owners must take into account the financial strength of the business; the financial position of potential buyers; available sources of financing; collateral; guarantees; the tax consequences for both parties; and cash flow issues.

The timing of a transfer is another critical consideration. A business owner who is considering selling the business may want to complete the sale transaction in 2010 to secure the capital gains tax rate of 15% and the top ordinary rate of 35%, before scheduled rate increases take effect in 2011 (as of this guide's publication date, the rate increases haven't been postponed or modified). Doing so could result in net after-tax proceeds that are substantially higher than if the deal were to be delayed until 2011 or later.

To manage these various issues, owners should engage advisors who can help them make effective and timely decisions, as well as give them a detailed understanding of the sale process.

#### *Initial public offering (IPO)*

The number of private businesses looking to access the equity markets has begun to grow again. Reasons a business may decide to go public include the following:

- To access capital markets and raise funds
- To acquire other publicly traded companies
- To attract and retain talented employees

- To diversify and reduce investor holdings
- To provide liquidity for shareholders

However, an IPO isn't necessarily the best way for a business to meet these objectives. A business's key stakeholders should therefore give considerable thought to why going public is appropriate in their particular circumstances. They should also bear in mind that the required preparation in the months leading up to an IPO is significant and can be quite challenging, time-consuming, and expensive—as well as distracting to the business. Less than full preparation is not an option: A business that goes public must be ready to meet shareholder, regulatory, and market expectations from day one.

Fulfilling those expectations will be an ongoing responsibility throughout the life of the company. Part of that will entail disclosing details about the company that might never before have been known outside its walls. Family businesses that prize confidentiality may find they aren't comfortable with this level of outside scrutiny. Thinking through this and other realities of public life well in advance is critical to a successful IPO.

#### ***Saving taxes through lifetime transfers***

Lifetime transfers remain an attractive option from a tax perspective. Typically, the estate tax cost of transferring business interests upon an owner's death will be greater than the gift tax cost associated with lifetime transfers of the same business interests.

Indeed, during the owner's lifetime there are generally many opportunities to transfer ownership interests in a way that avoids gift taxes entirely. Transfers can be structured to permit the business owner to retain control while transferring entity interests and substantially reducing the tax liability.

## ***Saving taxes through lifetime transfers***

Lifetime transfers remain an attractive option from a tax perspective. Typically, the estate tax cost of transferring business interests upon an owner's death will be greater than the gift tax cost associated with lifetime transfers of the same business interests.

Indeed, during the owner's lifetime there are generally many opportunities to transfer ownership interests in a way that avoids gift taxes entirely. Transfers can be structured to permit the business owner to retain control while transferring entity interests and substantially reducing the tax liability.

For the current owner to maintain some degree of control and security, he or she needs to have a succession plan that is sufficiently flexible to respond to changing circumstances. Such flexibility can be achieved by incorporating into a plan different types of entity structures, trust arrangements, or other vehicles. It is critical that the business owner embed these features into the plan as early as possible.

A number of options for lifetime transfer planning should be modeled and considered for inclusion in a succession plan:

- Recapitalizing the business into voting and nonvoting interests so that the nonvoting interests can be transferred during the business owner's lifetime to save taxes without relinquishing voting rights
- Using valuation discounts to reduce the tax impact
- Obtaining a valuation appraisal from a qualified appraiser to support the value that is reflected in lifetime transfers of business ownership interests
- Selling ownership interests to intended transferees or to a trust for the benefit of the intended transferees, often in exchange for a note that provides interest for the seller
- Using lifetime transfer tax exemptions to efficiently transfer business ownership interests without incurring gift tax

While the tax aspects and consequences of succession planning can be extremely important, owners of family businesses should bear in mind that the nontax aspects of such planning (e.g., who is best suited to run the business, potential family conflicts regarding ownership/involvement, etc.) are usually far more important to the long-term success of the business.

### **Special considerations**

Economic conditions and the ongoing uncertainty surrounding future rates for income tax and estate tax (as of the date of this guide's publication) are causing many private companies to reconsider whether their current operating structure is either appropriate or optimal. We've begun to see some family-run businesses abandon their current structures for alternative ones, in anticipation of higher tax rates or to position themselves for the possible pursuit of an exit strategy, so that their families can realize value for the business.

Family businesses can be organized in a variety of forms. These can range from the relatively simple form of sole proprietorship to the most formal type of structure, which is a corporation. Within that range there are also limited liability companies and pass-through entities, such as partnerships.

Many factors should be considered in deciding what is the most appropriate structure for a particular family's business, both at the company's inception and as the business evolves and matures. Prime considerations in choosing a structure include how it will affect the family's ability to (1) raise capital for the business, (2) protect the business's assets from creditors, and (3) limit owner liability.

Equally important is the need to weigh tax factors. In this respect, a family generally seeks a business structure that will avoid tax at two levels—the entity level and the ownership level. It is important, therefore, to determine which of the various tax rates among entity types will be most advantageous to the family’s business. Some family businesses, for instance, may find that the usefulness of the pass-through nature of Subchapter S corporations will be reduced by upcoming increases in tax rates for personal income (specifically, those resulting from the scheduled sunset of the Bush-era tax provisions at the end of this year, as well as tax increases taking effect in 2013 as a result of the federal healthcare act). Consequently, certain “S” corporations may want to consider converting to “C” corporation status.

Other reasons that family-owned S corporations may be contemplating conversion to C corporation status include concern about the still-tight credit market, the desire to have wider access to financing sources, and the wish to have greater ability to retain earnings in the business.

As of late, we’ve also seen family businesses consider exchanging a corporate form for that of a limited liability company (LLC)—this as a result of their watching the worth of their businesses decline in the economic downturn. Such businesses find themselves sitting on significant unused losses or strapped with depressed business asset values. In such cases, the tax and transaction costs of a corporate liquidation may be reduced to a point where conversion to the more flexible LLC structure is a viable option for certain family businesses.

Adequate understanding of the tax and nontax implications of changing a business entity’s structure requires careful consideration. Before undertaking a transaction of this significance, a family business should first discuss it with experienced tax advisors.

Our *2010 Guide to Tax and Wealth Management* discussed the general characteristics of the various types of business structures. Those characteristics are summarized in the chart on page sixty-nine.

The tax aspects of an entity’s structure are vital considerations. The following questions should therefore be contemplated carefully:

- Are the principal owners in the highest tax bracket?
- What types of owners are expected to participate?
- Is it expected that the business will retain or will distribute most of its earnings?
- Do the owners plan any special allocations of tax items?
- Is the business generating, or expected to generate, either operating or capital losses?
- Will the income or losses generated be derived from passive activity?
- Should the business use a tax year different from that of its principal owners?
- What impact will employment tax obligations have on the business?

- Do owners need to limit their exposure to liabilities?
- What state tax treatments are applicable?

These and other considerations should be carefully discussed with experienced advisors before a business changes its structure.

### ***Conclusion***

The longevity of a family business depends on early and ongoing succession planning—and on communicating the results of that planning to family members and other key stakeholders in a timely fashion. Doing so will increase the likelihood that the business and its value will endure well beyond the leadership transition.

## Overview comparison of entities

	Partnership	S corporation	C corporation	LLC
<b>Liability</b>	Unlimited for general partners	Limited to amounts invested and loaned	Limited to amounts invested and loaned	Limited to amounts invested and loaned
<b>Double taxation</b>	No	No (except for some built-in gains and passive income)	Yes	No
<b>Pass-through of profits and losses</b>	Yes	Yes	No	Yes
<b>Limitation on entity losses deductible by owners</b>	Net investments plus net income plus share of debt	Net investment plus net income plus loans to corporations	None deductible	Net investment plus net income plus share of debt
<b>Subject to passive activity loss rules</b>	Yes	Yes	Only certain small C corporations	Yes
<b>Tax rates</b>	Income taxed to owners at marginal tax rates	Income taxed to owners at marginal tax rates	15% on first \$50,000, increasing to 34% over \$335,000 and 35% over \$10 million	Income taxed to owners at marginal tax rates
<b>Special allocations</b>	Possible if substantial economic effect	No	Possible if tracking stock is issued	Possible if substantial economic effect
<b>Fiscal year</b>	May be the year-end of majority interest or principal partners; alternatively, may be the tax year that provides the least aggregate tax deferral	May end up to three months earlier than the year-end of principal shareholders	New corporations: any fiscal year. Existing corporations: fiscal year with business purpose; automatic change permitted in certain circumstances	May be the year-end of majority-interest or principal partners; alternatively, may be the tax year that provides the least aggregate tax deferral
<b>Tax-free fringe benefits to owners</b>	Limited	Limited	Permitted	Limited
<b>Public offering</b>	Yes, but with some difficulty	No	Yes	Yes, but with some difficulty
<b>Tax-free merger with corporations</b>	Yes, under certain circumstances; additionally, possible tax-free incorporation available	Yes	Yes	Yes, under certain circumstances; additionally, possible tax-free incorporation available
<b>Accumulated earnings tax</b>	No	No	Yes	No
<b>Personal holding company tax</b>	No	No	Yes	No

*Risk  
management*





**Ch6** Protecting your property and other assets from various risks involves more than just obtaining adequate insurance coverage.

Life is full of uncertainty. Though many of us will never experience a natural disaster, lawsuit, or debilitating accident, we are nonetheless wise to take protective measures. That is the purpose of sound risk management. Putting a well-considered plan in place and routinely reviewing it will help protect you and your assets, preserving your family's health and wealth for the long term.

### **Asset ownership**

Protecting your property and other assets from various risks involves more than just obtaining adequate insurance coverage. It also entails making strategic decisions about forms of asset ownership. How you own your assets can be a determining factor in whether they are at risk or are safe.

Choosing the right form of asset ownership is important for several reasons:

- Protection from creditors (liability protection)
- Protection from probate process upon death (court-supervised asset distribution)
- Protection from estate taxes either now or later

The actual level of protection is a function of state law (which varies significantly across jurisdictions). Where decision-making does come into play is in determining which form of asset

ownership is most appropriate for you and your circumstances. Some forms offer considerably more protection than others.

Assets held in *joint name with a spouse* (with rights of survivorship) are thought to have a slight degree of liability protection and certainly are protected from the probate process. However, jointly held assets are often quite problematic for estate-planning purposes since they pass directly to the survivor and do not flow into estate-tax savings trusts. Assets held in *joint name with others* remain in the estate of the original owner (i.e., are not removed from the estate for tax purposes) but do not go through the probate process. Assets held as *tenants in common* (with each person owning an undivided interest in the asset) are subject to the probate process and do not provide any asset protection. The account may be entitled to a discount in value upon an asset-holder's death, and it can flow into estate-tax savings trusts.

Trusts are especially helpful in protecting assets. Assets held in the name of a *revocable trust* (or living trust) have no special liability protection, but they are protected from the probate process and can flow into estate-tax savings arrangements upon death. Assets transferred to *irrevocable trusts* provide liability protection, do not go through the probate process, and can provide significant estate-tax savings. However, irrevocable trusts involve issues regarding gift tax and generation-skipping tax, as assets are transferred into them. Irrevocable trusts created by someone else for your benefit have significant advantages (liability protection, probate avoidance, and estate tax protection).

Some states provide liability protection for *self-settled asset protection trusts*. When it comes to probate protection, these trusts are much like revocable trusts but with the added liability protection that's normally associated with trusts

created by others. There is some disagreement in the legal community about the exact amount of liability protection such trusts offer. The states usually require the use of an in-state institutional trustee for full protection. Such trusts can incorporate significant estate-tax savings features and are very popular.

These special state trusts have reduced the popularity of offshore asset protection trusts. *Offshore asset protection trusts* are self-settled trusts created in another country. There are professional groups that specialize in advising people on where they should set up these trusts and how to structure them. Such arrangements come with multiple complications and fees. How well they truly protect assets is a subject of debate in the legal community.

Assets held in the name of a limited liability company (LLC) or limited partnership (LP) also provide significant risk management advantages. While the LLC/LP ownership interests can be transferred, the assets within the LLC/LP are generally considered free from forced sale. The traditional view is that LLC/LP interests are not attractive assets for creditors (including divorcing spouses). Combining the LLC/LP with an irrevocable trust is considered a double form of asset protection and is quite popular with financial advisors.

### **Insurance protection**

A fundamental form of asset protection is insurance. Key types of insurance include

- Property and casualty
- Liability
- Medical
- Disability
- Long-term care
- Life

---

## *Given economic events over the past couple of years, it is advisable to assess the financial strength of your insurance carrier.*

Given economic events over the past couple of years, it is advisable to assess the financial strength of your insurance carrier. You should no longer take for granted any particular insurance company's ability to pay claims.

### **Property and casualty insurance**

Property and casualty insurance includes homeowner's insurance, auto insurance, boat insurance, and airplane insurance. Special rules apply to each type of coverage, and some states regulate auto insurance rates and coverage. It's important to find a well-respected agent to guide you through the process and help you price different coverage options.

It's also important to investigate whether one policy cancels out or overlaps with another one, since you'll want to consider cancelling redundant policies. You'll also want to make sure that your property and casualty insurance policies cover all of your jewelry, artwork, or other collectibles. If you obtain combined coverage from one carrier, you may be eligible for a discount.

### **Liability coverage**

We live in a litigious world in which large judgments are sometimes awarded for injuries. An umbrella policy provides liability coverage in addition to regular homeowner's or auto insurance. You should probably purchase the maximum amount of coverage (premiums are relatively low for this coverage). Make sure to coordinate your umbrella policy with your homeowner's, auto, and boat policies so that you don't inadvertently look past gaps in your overall coverage.

For airplane coverage, the key considerations are the ownership and use of the plane. Special Federal Aviation Administration (FAA) rules apply to airplane use. The liability coverage associated with airplanes is often linked to specific planned use, as defined by the FAA. Be especially careful when insuring aircraft that are used for mixed purposes—partly for business and partly for personal activities. Also realize that coverage eligibility depends on which person or entity owns the aircraft. Placing ownership of an aircraft in a limited liability company can significantly alter or invalidate liability coverage.

### **Medical insurance**

The rising level of healthcare costs is no secret. Recent federal legislation requires everyone to have some level of coverage, beginning in 2014. You should be proactive in ensuring that you have the health insurance that best fits your needs. The trend has been to require individuals to make greater contributions toward their medical costs. This includes contributions to so-called high-deductible plans that are designed to cover catastrophic medical events. When choosing among different forms of coverage, make sure you keep in mind certain tax-favored, optional health-plan features:

- *Flexible spending account (FSA)*: This is an employer-sponsored savings arrangement for medical costs. The costs are funded annually. The advantage of an FSA is that the contributions are made on a pretax basis. The disadvantage is that if you do not spend all of the funds that you've set aside, they revert to your employer. In other words, "use it or lose it."

When funding an FSA, estimate the out-of-pocket costs you expect to incur during the next year—such as for co-pays or eyeglasses—and then arrange for that estimated amount to be withheld from your wages. Recent healthcare legislation eliminates the ability to use funds for over-the-counter drugs (such as aspirin).

The healthcare legislation also reduces the maximum amount that can be set aside in these accounts—\$2,500, starting in 2013 (this amount will be indexed annually for inflation). FSAs are not available to partners in partnerships or to shareholders in S corporations.

- *Health savings account (HSA)*: This is a special account connected to high-deductible medical plans. Contributions to an HSA are tax deductible. Both employers and employees can make contributions to the account (subject to an annual limit). Income tax does not apply to distributions from an HSA, as long as they're used for medical expenses. For HSA distributions that are not applied to qualified medical expenses, there is a 20% tax penalty (increased from 10% as a result of the federal healthcare act).

Because an HSA can continue for long periods, the best strategy is to leave it alone as long as possible, paying current medical expenses with other funds. This allows the account to accumulate earnings, tax-free, which can be

used later in life (after retirement). Health savings accounts are available to partners in partnerships and to shareholders in S corporations.

Also, when taking the long view, bear in mind that if you have a high-cost ("Cadillac") health-care plan, your employer may have to pay a 40% excise tax, starting in 2018, if the aggregate value of the coverage for a participant is over a certain amount: \$10,200 for individual coverage and \$27,500 for family coverage. Employers may choose to revise their high-cost plans by 2018 or else possibly pass on the cost of the excise tax to employees, in the form of higher contributions.

#### Disability insurance

Disability insurance replaces your earnings while you are unable to work. The standard replacement level is 60% to 70% of gross earnings. The key features of a disability policy are the definition of a disability, the level of coverage, cost-of-living adjustments, waiting periods, and earnings caps.

Disability benefits are taxable if an employer either deducts or pays for the insurance premiums. Income tax does not apply to disability benefits if the premiums are not deducted or if the employee treats the premiums as wages. Generally, high-income individuals should not deduct the premiums—or else they should make sure the premiums are included in their wages, to minimize the tax impact of any benefits received.

It's important that the definition of a disability be job-specific rather than general. In other words, it is your current job that you cannot perform—not just any job. Often, the job-specific definition applies to the first several years and is followed by a general disability description. Another factor in disability insurance is that the longer the waiting period, the lower the premium. Likewise, the addition of a cost-of-living feature increases the premium.

### Long-term-care insurance

Medicare generally does not pay the nonmedical costs of retirement homes, custodial care, or home care for the elderly. This is where long-term-care insurance can be of assistance.

Whether or not to purchase long-term-care insurance is an intensely personal decision, in part because it involves protecting assets for children and grandchildren. While long-term-care insurance is generally not recommended for those of high net worth (who can self-insure), it is a prudent choice for individuals of moderate wealth.

### Life insurance

Life insurance is an important component of an individual's overall financial plan. It is particularly important for purposes of estate tax planning. Amount of coverage, ownership of policy, and designated beneficiary are all factors a person should take into careful consideration when choosing a plan.

### Life insurance decision factors

The market offers a wide variety of life insurance products. Insurance carriers continually add, delete, and change policy features to meet the demands of a competitive market. Further, it may be difficult to find a comprehensive, stable source of information about how life insurance policies compare with one another, the investment performance of each, or fee structures (whereas there are such sources for researching mutual funds). However, the following questions should help you narrow down the search:

- *How long do you need the insurance?* Is it meant to provide a level of security only until your children reach adulthood? If you're a business owner, are you intending to hold the life insurance only until a liquidity event occurs? Or is the policy meant to last throughout your life and be used to pay estate taxes?
  - *How much insurance do you need?* Have you done calculations to determine what your family or other beneficiaries would need as an income replacement? Do you know what your future estate taxes are expected to be? How will your business affect your insurance needs?
  - *Who should be insured?* Is it the main breadwinner? Both husband and wife? The whole family, including grandchildren? The business owner(s)?
  - *Who should own the insurance?* It's typically not the insured party, the insured party's spouse, or the insured party's business. Most insurance is owned by a special life insurance trust or cross-purchase partnership.
  - *Who should be the beneficiary?* While a spouse or children are typically named as beneficiaries, in many cases the owner of a trust or partnership is named.
  - *Who should pay the premiums?* If a business owner is paying the premiums, there are a number of related income tax issues. And there can be gift tax issues if there is a life insurance trust in place.
- *What is the purpose of having the insurance?* Is it to insure the family breadwinner? Pay off debts upon death? Pay estate taxes? Obtain protection in transitioning a business? Or, rather, is the insurance a form of investment?

### Trends in life insurance policy choice

People seeking temporary life insurance most often find that their needs are met via level-premium term insurance. With that type of policy, you pay the same amount for a set number of years (five to twenty years, depending on your age), and then the coverage ends. This is very cost-competitive insurance, without any additional features (adding features to life insurance makes comparing policies nearly impossible).

The need for longer-term life insurance used to be met by whole life insurance, which is a type of permanent life insurance that guarantees lifelong protection as long as you pay the premiums. This type of coverage is very predictable but inflexible. Universal life insurance—which is permanent life insurance, but with fewer guaranteed features—became popular in the 1980s and 1990s (a period of relatively high interest rates) because agents could engineer policy returns to illustrate lower premiums. Many of the interest rate assumptions built into the illustrations could not be sustained.

Variable life insurance—wherein the policy owner could choose the investments, much like a 401(k) plan—became popular in the late 1990s. Again, agents could engineer policy returns based on robust stock market returns, thus showing reduced premiums. Many universal life and whole life policies were surrendered in exchange for variable life coverage. With the major market declines in 2001–03 and again in 2008, the variable policy lost its popularity.

The latest form of coverage is universal life insurance with so-called secondary guarantees. As long as certain minimum premiums are paid, the coverage is guaranteed to continue for life no matter what happens in the markets. As one would expect, this guaranteed coverage is most popular among those seeking long-term life insurance coverage (for estate tax payments and business transitions).

Second-to-die insurance (also known as survivorship insurance or joint life insurance) pays a benefit upon the death of the second of two jointly insured lives. These policies are very useful in estate planning, because their benefits can be used to pay estate taxes triggered by the death of a surviving spouse. The feature is further enhanced if the policy is owned by an irrevocable life insurance trust.

### Diversification

Life insurance is an insurance carrier's promise to pay. That promise is only as strong as the carrier. When you choose life insurance carriers, diversification is important, just as in any other investment. Large amounts of death benefits should be placed with a variety of carriers, since the best or safest carrier today might not be the best or safest carrier 20 or 30 years from now. Several independent agencies such as Fitch Ratings and Moody's Investors Service provide ratings for insurance companies; those ratings can be helpful in selecting insurance carriers with financial strength and stability.

### Strategies—insuring the breadwinner

The most common use of life insurance is to provide, upon the death of the insured, cash for the care of surviving family members. The death proceeds can be set aside either in income-producing investments (which will serve as a substitute for the breadwinner's wages) or to pay off mortgage obligations. Today, families often have more than one breadwinner and may therefore need a life insurance program that provides coverage for several breadwinners, based on their individual earnings level and insurability.

Traditional single-life products are more appropriate than second-to-die products for families that want the life insurance proceeds to be available upon the death of the breadwinner. The most cost-effective product is usually level-premium term insurance. However, keep in mind

that no simple formula (such as a multiple of salary) can determine how much life insurance you need. Rather, you should consider many factors, including liquidity needs, the earning power of surviving family members, projected expenses, family involvement and financial support, and other sources of income, such as pensions and Social Security.

When determining coverage needs, keep group term life insurance in mind. Group term is an employee benefit available to most full-time employees through their jobs. Often, additional, supplementary coverage can be obtained through employer-sponsored arrangements. However, because this coverage is available to all employees without the need for a physical exam, it can sometimes be more expensive than coverage purchased in the marketplace.

***When you choose life insurance carriers, diversification is important, just as in any other investment.***

### Strategies—paying estate taxes

Estate tax can be a heavy financial burden for a family, particularly if the estate holds closely held stock or other illiquid assets. Using life insurance proceeds to provide cash for estate tax payment can be an effective planning strategy, sparing the family the necessity of selling assets at fire-sale prices.

Moreover, judicious use of life insurance trusts and annual gifts to the trust will enable you to remove the proceeds of the life insurance from the taxable estate and pass them on to future generations, free of estate taxes.

Under current federal estate tax laws, as well as most state estate tax regimes, the major estate tax is not due until the death of the surviving spouse. Thus, estate taxes usually are postponed until the survivor's death. To provide cash to pay estate taxes, the policy should insure both the husband and the wife but not provide a payout until the death of the survivor. As noted above, this type of insurance is known as second-to-die insurance, or survivorship life insurance.

Determining the amount of coverage is not as easy as simply calculating estate taxes based on current assets. Instead the following factors should be considered as well:

- Target premium level
- Target inheritance level
- Current asset mix
- Future asset mix
- Gift strategies with trusts

As mentioned earlier, a very popular form of survivorship insurance is a universal product with secondary guarantees. Coverage is guaranteed regardless of changes in interest rates, as long as you make premium payments on time. The cost of coverage can be compared easily among carriers.

### Strategies—businesses and their owners

Business owners use life insurance for many reasons. For instance, they may want to ensure that they can

- Continue operations after the loss of a key employee
- Provide survivor income for the family
- Provide liquid assets for estate taxes
- Provide an equalizing inheritance for other children
- Fund buy/sell agreements
- Fund cross-purchase agreements

By carefully structuring the ownership and beneficiary designations of a life insurance policy, you can reduce or eliminate the impact of income tax, gift tax, and estate tax.

*Key-person life insurance:* Income tax and estate tax issues are not the primary reasons for obtaining key-person life insurance. The purchase of this particular type of insurance is driven by business considerations.

Key-person insurance provides funds for continuing a business after the death of a key employee (for example, a financial manager, an operations manager, or an ideas manager). Bank covenants sometimes require this type of insurance. The amount of insurance should be tied to the costs

of searching for and hiring a suitable replacement for the deceased employee (which could involve additional salary costs), as well as any temporary professional management costs.

Normally, the business owns and is the beneficiary of the key-person insurance policy. If the insured key employee is later replaced by another employee, many carriers will retain the existing policy by substituting the new employee for the prior employee, rather than issue a new policy—although such substitution usually has income tax consequences.

*Survivor income, estate taxes, and inheritances:* If the business owner is also the family's sole wage earner, the survivors may encounter problems obtaining funds from the business, due to technical corporate income tax rules. Therefore, many business owners purchase life insurance to provide a temporary source of funds for surviving family members until the business's future is settled.

Most businesses, although quite valuable, can be illiquid in the hands of the estate administrator, whereas life insurance is liquid upon the death of the insured. Business owners often purchase life insurance to pay estate taxes, especially when the family wants to hold on to the business.

Finally, insurance can provide a separate inheritance for those children who will not share ownership of the business. For example, one technique is to leave ownership of the business to the children who will be involved in managing the business—and then rely on life insurance to provide for the children who will not be running the family business. This can be an effective way to avoid an arrangement in which some of the children acquire ownership in the business as absentee investors—a situation that sometimes leads to family conflicts.

*Insurance funding for buy/sell agreements:* Life insurance for a business transition should be arranged in a tax-efficient manner. Changes in the owner or beneficiary can produce radically different tax results. This is especially true with buy/sell agreements.

A common arrangement is for a company to purchase life insurance on shareholders' lives. The company is the owner and beneficiary of the policy and makes all premium payments. The shareholder agreement calls for the company to purchase shares from the estate or family members of any deceased shareholder. The technical term for this arrangement is *redemption*.

*Avoiding corporate redemption arrangements:* A corporate redemption (buy/sell agreement) funded by corporate-owned life insurance is not a tax-efficient way to transfer ownership upon death. The major issues are as follows:

- Distortion of the business value, because the insurance death benefit is added to the value of the business for estate tax purposes
- Potential corporate-level income tax on the insurance death benefit (alternative minimum tax)
- Complicated tax rules associated with purchasing stock from the estate, especially when payments take place over time
- No basis increase in the stock held by the remaining shareholders

Despite these tax issues, the redemption buy/sell arrangement is a common form of dealing with the death of a business owner. It is the easiest arrangement to put in place.

*Insurance funding for a cross-purchase agreement:* A more tax-efficient (and flexible) arrangement than the traditional buy/sell agreement is the cross-purchase agreement. In this arrangement, the other business owners agree to buy the deceased owner's shares. The company itself is not a party to the agreement.

The owners of the business purchase life insurance on one another's lives. Only one policy per owner's life is needed (multiple policies are not required). The owners create a special partnership to hold the life insurance. The partnership is the owner and beneficiary of the policies and makes all premium payments. Upon the death of a shareholder, the partnership distributes the cash among the remaining shareholders, and they purchase the deceased owner's shares.

This arrangement has the following advantages:

- No distortion of the business value, because the insurance death benefit is not added to the value of the business for estate tax purposes
- No potential corporate-level income tax on the insurance death benefit (alternative minimum tax)
- No complicated tax rules associated with purchasing stock from the estate
- Full-basis increase for the stock held by the remaining shareholders

The types of policies used for funding cross-purchase arrangements typically are permanent types of life insurance (since such arrangements are likely to continue for a long time), such as whole life, universal life, and variable life insurance.

### Strategies—funding nonqualified deferred compensation arrangements

Many corporations, both large and small, use life insurance as their investment mechanism for funding employee perquisites such as deferred compensation plans and supplemental executive retirement plans. Such company-owned life insurance policies involve special income tax, accounting, and investment features.

Congress more than once has changed the income tax treatment of life insurance policies owned by corporations (especially treatment of the interest expense on policy borrowings). Despite those changes, life insurance funding for deferred compensation remains a viable alternative.

In the typical arrangement, a corporation purchases life insurance policies on the lives of the participants in the executive benefit plan. Policy premiums are paid each year and reduce current earnings, but they are not deductible for income tax purposes. New tax laws require that companies obtain an executive's permission before purchasing the policy, and then provide the IRS with information on the policy when the business files its annual tax return. Policies on individuals who are not executives or employees at the time of their death have less favorable tax consequences.

The cash value in the policies builds during the employment years and represents an asset of the corporation. When benefit payments are scheduled to begin, the employer pays those

benefits out of its current cash flow. The employer has the option to borrow from the policies to pay the benefits. The benefit payments produce compensation for the executive and a tax deduction for the corporation. Finally, the death benefit, which is paid to the company, is normally exempt from income tax, as long as the insured individual was an executive, a shareholder, or an employee shortly before death.

As a practical matter, such arrangements require careful bookkeeping and can create cash flow issues for a company, due to the mismatch in cash flow payments: Premium payments and executive benefit payments are cash outflows in the early years, while death benefit payments are cash inflows much later. In addition, it's sometimes difficult to tell whether you have an economically successful arrangement until all of the insured executives are dead. The arrangement is especially problematic if there is turnover in the executive ranks, which necessitates turnover in life policies, thereby defeating the income tax advantages.

#### Strategies—life insurance as an investment

Life insurance is really an investment for the next generation. The after-tax investment return on life insurance sometimes compares favorably with that of other asset classes (of course, the investment return of life insurance has a major variable—the death of the insured). However, investment professionals have become attracted to life insurance because the investment returns do not seem to be correlated with traditional asset classes. This is because the investment return is based on an insurance carrier's estimate of future investment returns from the carrier's portfolio, mortality rates, and administration expenses. The investment return is engineered by the carrier's assumptions and depends on the carrier's promise to pay.

Sometimes life insurance is purchased with an eye toward favorable tax consequences for the internal investment within the policy. In these cases, the policy itself is being used as an investment wrapper. Another reason life insurance is attractive as an investment product is because insurance policies have special income tax rules that apply to withdrawals, and the death benefit is generally exempt from income tax.

#### Conclusion

Effective risk management is a critical component of any sound wealth management plan. By making wise decisions about insurance policies and forms of asset ownership, you can mitigate the risks posed to your health and wealth, helping to ensure longevity for you and lasting value for your family.



# *Family offices*



**Ch7** The managerial and administrative needs of high-net-worth families can be extensive.

Increasingly, high-net-worth families are establishing family offices as a way to address the ever more complex tax and investment issues that affect their wealth management. In the United States alone, there are an estimated 4,000 family offices, with over \$1 trillion in assets under advisement. Such offices not only help a family to manage its wealth, but also to maintain continuity and preserve its legacy.

**Recognizing the need**

The managerial and administrative needs of high-net-worth families can be extensive. Many families rely on a group of core external advisors—including an attorney, accountant, and investment manager—to take care of those needs and advance the family’s goals. Ideally, one of those advisors coordinates the activities of the family’s advisory team as a whole. Setting up a family office tends to be an effective way to enable and enhance that coordination.

The combination of a well-coordinated advisory team and a family office frees up family members’ time so that they can focus on the family business, philanthropy, outside careers, and other pursuits. This setup is especially useful for families whose wealth management activities involve multiple and complex entities, such as family partnerships, trusts, family businesses, and foundations. In some cases, there may also be a specific catalyst that prompts (or hastens) the opening of a family office—an approaching liquidity event, for instance.

Once a family office is established, it is likely to serve multiple generations, across which there may be a range of different needs, requiring varying wealth management strategies. A well-run family office successfully synthesizes these strategies to ensure that they support the wealth management goals of the family as a whole.

### **Structure and creation**

How a family office is structured depends, in part, on how many families it serves. There are two main categories of family offices: the single-family office and the multiple-family office. Beyond this distinction, family office structures vary with the nature of the families they serve. Some families may desire only basic administrative help, whereas others may want the family office to oversee asset management or perhaps even run their daily affairs. Services traditionally provided by family offices include

- Bookkeeping and accounting
- Income tax planning and compliance (domestic and international)
- Investment advisory and management services
- Trustee services
- Estate planning
- Family risk management (insurance)
- Handling of personal family matters (dispute resolution, cash flow management)
- Charitable planning
- Overseeing office technology and centralization of administrative functions
- Implementing and monitoring internal controls

- Gate-keeping (controlling which individuals and entities have access to the family or its information)
- Concierge (personal) services
- Managing aircraft/yacht issues (personal use and charter issues)

Typically, the lead family member and a key outside advisor work together to decide the main objectives of the family office. Those objectives will dictate which services the office provides and how it is organized, staffed, and technologically supported. The legal structure (partnership, limited liability company, S-corporation, etc.) will also have to be decided, as will the office's initial funding, anticipated operational costs, and allocation of costs among family members. Other key decisions concern the size and location of the office, who will run it, and how the office will keep the family informed of its activities.

### **Single-family office versus multiple-family office**

A single-family office (SFO) generally affords a family greater privacy and independence than an office that is shared with other families, as well as allows for a more-tailored business model. SFOs can be expensive, though, as the cost of recruiting and retaining top talent continues to increase. To spread that cost across a larger base of assets and income, many families turn to the multiple-family office (MFO).

## *Example*

In running her family's business, Jill travels a good deal, leaving little time to address her personal finances and monitor her family's wealth. Although she has investment, tax, and legal advisors, Jill is worried that there's insufficient alignment among them—this after they gave her different and sometimes conflicting advice on how to develop a wealth management plan for her family. Jill decides to establish a family office to coordinate the work of her various advisors—so that they function as a cohesive team. She also hands over the management of her

personal finances to the family office, entrusting an office manager and small staff to oversee the cash flow of the family, pay bills, and regularly provide her with a report that consolidates the financial results of all her wealth management advisors. The family office manager supervises and evaluates the investment advisors (hiring new ones as needed), watches interest rates, and refinances debt when advantageous. Jill and her family compensate the manager for these services by paying the person a fixed salary.

MFOs operate in much the same way as SFOs. However, MFOs tend to employ larger staffs, whereas an SFO may be somewhat resource-constrained. Also, MFOs generally have well-established relationships with third-party vendors (which take time for a newly established SFO to build), allowing an MFO to achieve a good balance between in-house and outsourced services. Another advantage to using an MFO is that it typically will have transparent prices and attract top talent. In catering to more than one family, however, an MFO must guard against spreading itself too thin, so that quality is not compromised, as well as take extra care to maintain the confidentiality of each family it serves.

### ***Ongoing operations***

The focus of the family office is often on the growth and preservation of the family's wealth, with an eye toward ensuring that there will be sufficient assets for subsequent generations. Offices that take this approach coordinate the different investment plans of individual family members—so that the plans of parents and grandparents, for instance, are taken into consideration during the preparation of investment plans for children and grandchildren (who are likely to inherit much of the older generation's assets). This focus lends itself to helping subsequent generations gain an understanding of the family wealth and to becoming involved in the family's wealth management.

Much like a closely held business, a high-net-worth family benefits from setting goals (both short-term and long-term ones) and then routinely reviewing them. At a minimum, a family should meet on an annual basis to formally discuss its wealth management goals and assess the prior year. Any change in the family's priorities or wealth management objectives should be communicated to the family office's manager and other key advisors, so that the changes can be executed and the family's wealth management plan modified as needed.

As the number of family offices increases, more resources have become available to them, including family office networks and conferences, as well as various family office organizations and communities. These communities can provide guidance and information on best practices for effectively managing a family office.

### ***Special considerations***

One major distinction between an investment plan created by a family office and one created by an outside investment advisor is that the family office views the plan as part of the family's larger wealth management strategy—one that takes into account the family's tax planning needs and philanthropic goals, among other considerations. Investment plans created by family offices also tend to deal with a much broader range of assets than plans created by an outside investment advisor, including noninvestment assets such as private airplanes, artwork, yachts, and other valuable property. The family office's investment advisors recognize the important role that such nontraditional assets play in the wealth of a family, especially when the family intends to pass those down for several generations.

### **Tax considerations**

A family office aligns strategic tax planning with a family's investment plan, to ensure that the investments chosen for the family are tax-efficient and thus reduce tax consequences. One of the tax-planning strategies that a family office might pursue is to have a number of the family members be represented as a single unit, which can lead to various tax efficiencies.

The family office can also evaluate the tax implications of wealth transfer and estate planning, which is expected to undergo a major overhaul in 2011. Because the family office focuses on multi-generational wealth transfers, it readily assesses possible strategies such as yearly gift plans and the creation of various trusts.

Families that have their own business may be able to treat family office expenses as relating directly to the ongoing operations of the business. In circumstances that allow this treatment, some of the associated costs may be deducted "above the line" (i.e., be fully deductible) rather than treated as miscellaneous itemized deductions. Because only business expenses that are over 2% of adjusted gross income may be treated as miscellaneous itemized deductions, many high-net-worth taxpayers will receive no tax benefit for such deductions (e.g., accountant and attorney fees). Above-the-line deductions do not come under this limitation and therefore present a tax-savings opportunity for qualifying family offices. Family offices that support a family business may also be able to pursue opportunities to set up tax-deferred retirement plans.

### **Conclusion**

The structure and function of each family office is tailored to the needs of the family it serves. While every family is different, the mission of a family office is nearly always the same: to facilitate the wealth management of a family so that its short-term needs are adequately met in tandem with furthering the family's long-term goals.

# *Family meetings*





**Ch8** A successful family meeting is one that encourages open dialogue and trust.

Families with significant wealth recognize the importance of managing their investments, charitable giving, and trusts with an eye toward successive generations. By taking a multigenerational approach to such matters, families help to ensure that younger members understand how effective wealth management both reflects and supports the family's values, meets its near- and long-term goals, and preserves the family's estate for future generations.

There is nothing new in that, and yet the need for these principles to be communicated within families is greater today than ever before. In large measure, that's because families are realizing they can no longer rely on their wealth management plans to more or less maintain themselves with minimal oversight. Rather, what we've learned from the financial crisis is that families need to be actively engaged in the wealth management decisions being made for them. That includes understanding more clearly the types of investment products in their portfolios. And so relatively static wealth management plans that were passed on from one generation to the next, with only minor changes, are now being replaced by more dynamic plans—ones that families are making sure will take into account today's fluid economy, changing tax rates, and legislative uncertainty.

## ***Example***

The Smiths are holding their first family meeting. The patriarch appears to feel somewhat threatened by the prospect of having his wealth management strategy questioned by certain people in the room. Holding her ground, the matriarch voices alternatives that she's aware other family members embrace, only to have her husband dismiss her remarks. The outside facilitator does not allow this to stand. He diplomatically asks Mrs. Smith to repeat what she said so that he'll be sure to understand her. The facilitator doesn't ignore the patriarch, but he effectively circumvents his efforts to dominate the conversation and prevent an exchange of ideas. As a result, other family members feel encouraged to air their views and, by the end of the day's discussion, concur that the meeting was a success.

This requires the current generation of high-net-worth individuals to be more knowledgeable about investing and tax planning than perhaps they were in the past. To preserve their wealth well into the future, they will have to pass on their knowledge to the next generation. Family meetings can be an effective way of doing this.

### **Why have a family meeting?**

Communicating the family's investment and tax-planning strategy to younger generations is just one reason that a patriarch or matriarch might call a family meeting. Such meetings can also serve as a forum for discussing estate plans, charitable giving, and managing the family's risk exposure (e.g., through effectively using insurance and applying other asset-protection techniques). Historically, senior members of high-net-worth families have met with outside advisors to discuss these matters, generally with little input from junior members. Some families, however, have begun bringing children, adult grandchildren, and even in-laws into these discussions.

Family meetings tend to address the following issues:

- Inheritance—Who gets what, when, and why
- Succession planning for the family business and/or foundation
- Investment priorities, tax planning, and other wealth management considerations
- Philanthropy

As changes occur in each of these areas, subsequent family meetings should be held, to modify the family's wealth mission. Ideally, the family will have a mission statement. If it doesn't, the first family meeting could be devoted to creating one. The mission statement should present the family's wealth-transfer objectives, broader family goals, philanthropic concerns, and leadership structure—all of which should clearly reflect the family's value system.

Families that hold meetings have generally done so on an annual basis. Now, however, some families have been finding it beneficial to meet more frequently so they can assess the effect that economic and legislative developments are having—or may have—on their wealth management. Such meetings present good opportunities for educating younger family members on how developments today—such as passage of new legislation and tax policies—will impact the family's wealth preservation in critical ways down the line.

### **Deciding who runs the meeting**

A good facilitator is critical to having a successful family meeting. As a rule, choosing a neutral, outside party for this role enables all family members to feel comfortable voicing their opinions—particularly junior members, who might feel intimidated if the head of the family were to preside over the meeting. Some people have been specially trained to guide family meetings. They may be particularly helpful to have on hand for families that are holding a meeting for the first time.

Regardless of who runs the meeting, he or she should be adept at moving past rough spots, working through any conflicts that arise, and making sure everyone is heard. Strong diplomatic skills are therefore required on the part of the facilitator. Ideally, that person will also be good at communicating things in plain English, particularly since some of the financial and tax matters addressed could be complex. For the meeting to be a success, everyone should come away from it with a good understanding of what was discussed.

*Setting the stage sufficiently ahead of time is critical to having things run smoothly on the appointed day.*

#### ***Who should attend?***

Once it is agreed that a family meeting is desirable, there is the matter of deciding who should attend it. Some family meetings include spouses and adult grandchildren, others do not. Generally, who's invited depends on the issues that will be discussed and how each group is likely to be affected by what's decided.

Bringing your attorney and accountant into these discussions may be beneficial, since they can coordinate and collaborate on family issues. The family's investment advisors, trustees, and insurance advisors, on the other hand, are usually invited only when a meeting's objectives suggest a need for their presence. Depending on the length of the meeting, you might want to involve certain people in just those discussions that directly affect them, or to which their input would be particularly useful.

#### ***Elements of a successful meeting***

Setting the stage sufficiently ahead of time is critical to having things run smoothly on the appointed day. By the time that date arrives, everyone should know why he or she is in attendance and what the meeting is meant to accomplish—as well as what it's not meant to accomplish. To that end, it should be made clear in advance how much financial information will be shared so that family members who aren't in control of the wealth don't come to the meeting with false expectations about what they'll learn.

It is recommended that, before the meeting, you not only apprise everyone of the meeting's topics and goals—in the form of a structured agenda—but also obtain everybody's input and signoff. It's also important that you select a time and date that enables everyone to attend. If possible, choose a neutral setting, so that all involved will feel comfortable expressing their opinions and concerns. A resort, for instance, might make a better setting than the home of the matriarch or patriarch.

A successful family meeting is one that encourages open dialogue and trust. With that in mind, make sure the agenda facilitates everyone's involvement in the day's discussions. An outside facilitator can be especially useful in this respect, particularly if the head of the family tends to talk over people. If the younger generation feels too intimidated to raise certain questions, misconceptions they might have won't be dispelled, leaving junior members less well-positioned to steward the family's wealth in the future.

One way to avoid such situations is to set ground rules. Emphasize that people need to listen to one another, quell the urge to interrupt, and speak respectfully, even when discussing contentious points. Also, it is advisable to request that people turn off their mobile devices or leave them in another room so that they don't pose a distraction during the meeting. Conclude the meeting with a review of all the agreed-upon decisions, concur on which issues remain unresolved, and then decide how those issues will be managed between then and the next meeting.

### **Outcomes**

The real work begins when the meeting ends. Family members will need to show that they are committed to accomplishing the goals asked of them during the meeting. They should routinely update the facilitator about progress made toward achieving those goals, so that he or she can then inform the group as a whole.

At the end of the day, a successful family meeting is one in which everyone involved openly participates and agrees to work collectively toward achieving the family's shared objectives. However, if your first family meeting doesn't go smoothly, don't despair. Families can be every bit as complex as the wealth management strategies they apply, so it's unrealistic to expect perfect harmony at the first family meeting. Likewise, it is important to understand that one meeting does not, in itself, constitute success. Families should meet routinely. Doing so is essential to achieving the family's mission today and to educating the younger generations in how to fulfill it tomorrow.

A photograph of two men in business suits standing in a modern office hallway. The man on the left is facing the camera, gesturing with his hands as if speaking. The man on the right is seen from the back, looking towards the first man. Large windows in the background show a cityscape. The text 'Working with advisors' is overlaid in orange script on the right side of the image.

*Working  
with  
advisors*



**Ch9** The key to getting the most out of the client-advisor relationship is finding the right people to fill the advisory roles and using them effectively.

Managing personal wealth is, in many ways, like running a business. Successful business leaders develop strategic plans for growth in consultation with a group of advisors, such as a board of directors. Individuals should manage their financial matters in much the same way. Doing so lets a person take a more controlled and strategic approach to all aspects of his or her wealth management. The key to getting the most out of the client-advisor relationship is finding the right people to fill the advisory roles and using them effectively.

### ***Building your team***

#### ***The key players***

Your wealth management team should start with you (and your spouse or partner). Recent history has underscored the importance of being aware of what decisions are made on your behalf by investment advisors and others. Therefore, it is recommended that you be very much at the helm of whatever team you assemble.

Typically, a wealth management team includes the following outside advisors:

- Tax advisor
- Investment advisor
- Insurance advisor
- Estate attorney

You may find that other advisors are necessary as well. For example, you might require the help of multiple lawyers to deal with areas such as real estate, business, and litigation. You might also need a trustee or want to enlist specialists in areas such as financing and business valuation.

### The right advisors

Although they may have numerous professional qualifications, your advisors' most important qualities are their ability to understand your goals and their motivation to achieve them. In researching potential advisors, therefore, you should look not only at their skills and certifications, but also at how well their overall approach is likely to support your particular goals. Personal recommendations from trusted sources make a good starting point, but take care that you do your due diligence. Analyze a potential advisor as carefully as you would any major business decision:

- Review the advisor's resume, qualifications, certifications, licenses, background, years of experience, and referrals.
- Call references but also check to see if the advisor has any formal complaints against him or her.
- Request the tax and income profiles of the advisors' other clients. Those profiles will indicate whether your circumstances are the type that the advisor is accustomed to addressing.

- Determine what services the advisor provides.
- Find out how the advisor approaches financial planning.
- Ask how the advisor is paid for services.
- Assess an advisor's objectivity and the likelihood that particular products and services will be offered primarily because the advisor benefits from those offerings.

### How advisors are compensated

The fees for each advisor should be carefully considered before a decision is made to hire the person. Financial advisors typically use one of several common payment structures:

- Hourly rate
- Flat fee
- Fee based on a percentage of your overall account value
- Commissions from products you buy from the advisor, such as investment or insurance products
- Combination of fees and commissions

Compensation structures such as flat or hourly fees are relatively transparent. When it comes to commission-based fees, however, you'll want to be certain that you understand what the services or products are likely to cost you. Doing so will help you determine whether working with an advisor who charges a commission-based fee will be more or less expensive than using an advisor who charges by the hour.

## ***Working effectively as a team***

Once you have your team in place, you'll need to ensure that you are working with its members effectively. A common mistake in working with advisors is failing to assign one member of the team as point person. A point person on an advisory team essentially functions as the "chief executive officer," with you filling the role of "chairperson." The point person's job is to lead the team in its effort to craft a wealth management strategy that you believe is appropriate for you and your family, ensure that the wealth management plan is well-documented, and then lead the team in implementing the plan.

An experienced advisor who charges by the hour can typically provide a rough estimate of what your total fee will be for the services requested. It may be more difficult for commission-based advisors to make similar estimates, since their fees will depend on which products they ultimately recommend to you. In all cases, fee estimates should be discussed in an open and frank manner and periodically reviewed, so that there are no surprises.

### **Working effectively as a team**

Once you have your team in place, you'll need to ensure that you are working with its members effectively. A common mistake in working with advisors is failing to assign one member of the team as point person. A point person on an advisory team essentially functions as the "chief executive officer," with you filling the role of "chairperson." The point person's job is to lead the team in its effort to craft a wealth management strategy that you believe is appropriate for you and your family, ensure that the wealth management plan is well-documented, and then lead the team in implementing the plan.

Ideally, the point person not only fills a specific role on your team (e.g., as tax advisor), but also has enough expertise in the other areas of your plan to effectively manage the team as a whole. Working with a point person should help to give you a bird's-eye view of your wealth management plan, better enabling you to focus on its guiding vision and priorities—which, in turn, should help your advisors execute the plan. Developing a trusted advisor relationship with someone who is able to place your needs in the right context vis-à-vis the various strategies encompassing all areas of your wealth management is the best way to achieve success.

Over the next several pages, we will look at the roles that key advisors habitually play on an advisory team and at the various responsibilities they may assume in the context of your particular wealth management plan.

### **Working with your CPA** **More than just tax advice**

Firms of certified public accountants (CPAs) typically have a broad range of expertise, covering areas such as income taxes, business valuation, wealth management planning, and financial statement preparation and analysis, as well as many other areas of accounting and taxes that pertain to both business and personal needs. Quite often, your CPA will be one of the advisors who has the most exposure to the various aspects of your personal finances and may therefore be well positioned to play an important role on your advisory team.

A key component of your CPA's role and responsibilities will be tax planning. Because taxes figure in every area of your wealth management plan, your CPA is a valuable resource for the team overall. Therefore, you may wish to view your CPA as a consultant, not just as the person who prepares your tax returns.

You should feel comfortable calling your CPA with questions about tax issues or financial matters, such as an upcoming transaction, the purchase of an asset, or the sale of a business. Staying in touch with your CPA throughout the year and contacting him or her before any significant decision will help you structure transactions in the most tax-efficient way.

### What your CPA doesn't know can hurt you

It is normal practice during tax time to compile tax documents and ship them off to the CPA. When you do this, make sure that you fully disclose to your CPA all transactions, accounts, or any other relevant financial facts. This is especially important if some of the transactions you conducted during the course of the year did not involve the CPA's help. Items that people commonly forget to disclose include the creation of a new trust or organization (e.g., charitable foundation), gifts to a relative or friend, bank accounts held in a foreign jurisdiction, housekeeper or nanny expenses, medical costs, tuition payments, a new investment in a business, or a property purchase. These and other items can have a significant impact on your tax-filing obligations. Err on the side of caution by employing a financial recordkeeping system that enables you to disclose as much financial information as possible to your CPA.

### Outgrowing your CPA

Many people have worked with the same CPA for years. This longtime relationship is beneficial for both parties, as long as you feel that the CPA is still meeting all of your financial needs and objectives. As with any other advisor, you should evaluate your CPA's expertise and performance regularly, matching your current and future needs to that person's capabilities.

Try to be as objective as possible in your evaluation, especially if a friend or relative is serving as your CPA. Questions to consider include the following:

- Does your CPA provide proactive advice or assistance?
- Is your CPA effectively meeting all of your financial and tax needs?

- Do you feel comfortable calling your CPA with your tax or other financial questions?
- Do you have a unique tax situation that has become increasingly complex over time?

With respect to this last consideration, a person's tax situation is likely to be complex if he or she

- Owns a small business
- Is self-employed
- Owns multiple real estate properties
- Is in the venture capital or private equity business
- Has significant alternative investments
- Engages in a significant amount of trading activity
- Lives outside the United States

If any of these circumstances apply to you, you'll want to make sure you have a CPA with the right industry knowledge, expertise, and experience.

### Working with your investment advisor

As pre-crisis asset-allocation models are replaced by or updated with new approaches, it is more important than ever that your wealth management team include the right investment advisor. In addition to understanding and pursuing your goals, your investment advisor should be objective, collaborative, and up to date on the dynamics of today's financial markets.

### Maintain control

When you hear stories about people losing all their money, quite often the problem stems from one issue: a loss of control. Even though you may have a team of highly qualified advisors working for you, it is important that you maintain some control over the decisions they're making on your behalf. In other words, your investment advisor and the rest of the advisory team should not be holding the reins to your future. They are there to provide you with guidance and advice, and then to carry out whatever recommended plan you approve.

How much authority they are allowed will depend on your personal preference and comfort level. Some people may want their investment advisor to call them before every trade. Other people may instruct their investment advisor in what kind of trades to make. While yet others may be more passive and simply turn all the investment decisions over to the advisor after an agreed-upon plan is in place. No matter which category you fall into, you should maintain some degree of control, such as overseeing the broader investment strategy, asset-allocation model, and performance benchmarks.

It is also recommended that you have a written plan that clearly defines the boundaries in which your investment advisors may operate. In that plan, you may want to stipulate that advisors either inform you when they've acted outside the plan's parameters or seek your approval before taking such actions.

### Update your investment plan

Because the long-term success of your investment portfolio will, in large part, depend on having a detailed, goal-oriented, and measurable investment plan that is tailored to your needs, it is essential that you review your plan periodically. Doing so will allow you to update it as your investment needs and objectives change over time. You may find that when you are conducting these reviews, it is also an ideal time to review and update the policies that govern the ways your investment advisors are permitted to execute your investment plan.

### Assessing your advisor's performance

A common mistake is to view the success (or otherwise) of an investment portfolio as a direct reflection of an investment advisor's performance. Evaluating the investment advisor's performance should be an exercise that is separate from assessing the performance of the portfolio. It is important, therefore, that your investment plan contain distinct sets of criteria for measuring the performance of specific investments, on the one hand, and the performance of the investment advisor on the other.

The term "investment advisor" tends to be used broadly, describing individuals who may perform any number of investment functions—ranging from managing a particular portfolio of stocks and bonds to devising and steering a person's overall investment strategy. The key investment advisor in a wealth management team plays the latter role.

If your investments are complex or in specific niches of asset classes, you may need to have several investment advisors. Your key investment advisor is responsible for conveying your investment-plan goals to the other investment advisors and ensuring that no one is working at cross-purposes. This is important—if your investment advisors are operating in a vacuum, your overall asset allocation could inadvertently change. So, too, could your market exposure. Such changes impact how much risk you are taking with your portfolio, ultimately affecting the return on your investment.

---

*Even though you may have a team of highly qualified advisers working for you, it is important that you maintain some control over the decisions they're making on your behalf.*

In assessing your key investment advisor's performance, you'll want to consider how well he or she fulfills the following responsibilities:

- Devise, monitor, and update your investment strategy
- Create an investment policy statement
- Put in place the processes for implementing your investment strategy
- Choose and oversee a team of additional investment managers (who will function as a sub-team within the larger wealth management team) to implement various components of your investment strategy
- Establish a process for measuring the performance of individual members on the investment team

It is important that benchmarks for investment performance are included among your criteria for assessing the wealth management team's key investment advisor. Documenting those benchmarks is a good idea, as is discussing them with your investment advisor on a routine basis. Other important criteria that should be reviewed in assessing the advisor's overall performance include that person's investment philosophy, management process, fees, alertness to market movements, and quickness to ensure that the investment team acts on those movements. After the market tumble of 2008/2009, many individuals complained that their investment advisors were not proactive in providing useful advice. How proactive you want your investment advisor to be should be among the criteria you use to evaluate that person's performance.

### **Tax considerations**

As mentioned earlier in this chapter, taxes touch every aspect of your financial plan. Ensure, therefore, that your investment advisor discusses the income tax consequences of an investment with your CPA, since your CPA is generally the only advisor who knows your entire tax situation. Be careful, however, to avoid making investment decisions based solely on tax consequences.

### **Working with your insurance advisor**

Insurance planning is an important part of, and critical tool in, most financial, retirement, and estate plans. Therefore, ensure that your team includes an advisor who understands your particular insurance needs.

Your insurance advisor should be clear on how a recommended insurance product fits your needs. The type of policy, the riders attached to the policy, the amount of insurance, and the price for the policy should be reviewed by you and the members of your advisory team. If you already have policies in place, ask an advisor to review them to see whether all are appropriate for your needs.

## *Example*

John and Mary have accumulated a significant amount of wealth over the years. To help them manage that wealth, they rely on a carefully chosen team of advisors, including an investment advisor, an accountant, an attorney, and an insurance advisor.

Recently, they met with their attorney to discuss how best to update their wills in light of potential changes in estate taxes. She suggested that they create a life insurance trust to help their family pay estate taxes, as well as create a charitable remainder unitrust to achieve their charitable intentions. Pursuing this suggestion, John and Mary ask their insurance advisor to transfer their insurance policies into the new insurance trust and then use the transferred funds to buy new policies.

They also meet with their investment advisor to discuss realizing certain capital gains this year, before the tax rate for capital gains increases. The investment advisor suggests reinvesting some of their sales proceeds in private equity LLCs. Shortly afterward, John and Mary meet with their accountant to discuss year-end planning.

From John and Mary's perspective, they've held the meetings they needed in order to achieve their estate- and income tax-planning objectives. However, they forgot to mention to their accountant the life insurance trust they recently funded and the new private equity LLCs they invested in. As a result, their accountant will end up having a long list of questions for them when he receives their tax information in March, which is when he'll first become aware of the transactions they conducted in the final part of 2010.

At that time, he is also likely to point out that John and Mary's private placement deals generate a significant amount of unrelated business taxable income—meaning that if they intend to hold those investments long term, it could cause problems in funding their charitable remainder unitrust upon their death.

John and Mary would have been better off if they'd brought their advisors together as a team, rather than meeting with them separately. Not only would they have covered all their bases, but they would also have done so in a way that was in sync with all aspects of their wealth management planning.

### Comprehensive insurance planning

Your insurance plan needs to be comprehensive. Quite likely you hold many types of insurance policies. They may include the following:

- Life
- Property and casualty
- Disability
- Medical
- Long-term care
- Personal excess liability

It is good to have an advisor who understands your entire insurance picture. Such an advisor can help to ensure that

- All your insurance needs are being met
- Costly redundancies in your coverage are eliminated
- Risks that could diminish your wealth are minimized

For example, does one disability policy cancel out or overlap with another? Does it make sense to replace one policy with a different, updated one? Does your umbrella policy truly fill in the gaps of your auto and home policies? Does your property insurance cover all of your jewelry, artwork, and other collectibles?

### Revisiting your coverage

Your insurance needs change over time. Consequently, your insurance coverage should be reviewed regularly to ensure it is still adequate and appropriate. Just as getting car insurance for a new car or a homeowner's policy for a new house is standard procedure, a comprehensive review of your overall insurance coverage should be a matter of routine as well.

### Working with your estate planning attorney

With impending changes in the estate tax law, many individuals are seeking legal counsel to create, revise, or revisit their current estate plans. Finding a qualified attorney who has estate and gift planning experience relevant to your needs can be crucial to the success of your estate plan. You and your spouse/partner may want to meet in person with the attorney to make sure that the individual is a comfortable fit—and not just for your current needs; bear in mind that the person may be called upon at a later point to assist with estate administration.

### One size does not fit all

Your estate plan is just that, yours. It is unique to you, so much so that your spouse or partner will need his or her own set of documents. He or she is also likely to have certain estate-planning objectives that differ from your own. Your attorney should be made aware of such differences, as well as be alerted to any upcoming changes. Also be sure that your attorney knows about any potential cross-border issues, including ownership of property in multiple locations (different states or countries); employment or significant time spent in other states or countries; dual citizenship; marriage to a non-US citizen; relatives in other countries, and so on. Quite often laws can differ significantly across jurisdictions, possibly resulting in higher or double taxation. If not adequately anticipated in your estate plan, these differences might also lead to difficulties in distributing assets.

### Ongoing dialogue

It is important to maintain an ongoing dialogue with your estate attorney after the documents are drafted. It's not only changes in tax law that impact your estate plan. Your plan can also be affected by changes in residence, changes in your family, and, of course, changes in your health and wealth. Your attorney can be of assistance

with matters such as property titling, beneficiary designations, and changes in life insurance policy, in addition to updating and reviewing estate planning documents.

Maintaining an ongoing dialogue will also help to ensure that “administrative” tasks are not overlooked. Many estate plans are drafted with trusts that require action on a yearly basis, such as issuing notices to beneficiaries, making a payment to a grantor or beneficiary, or filing a trust tax return or gift tax return.

Also, it is important that the titling of your assets and your beneficiary designations are current and aligned with your estate plan. Oftentimes, a person’s attorney drafts the documents and assumes that the client’s accountant is monitoring them, while, on the other end, the accountant is assuming the same of the attorney. The cost of missing a critical date or other actionable item in the documents can be significant, potentially reducing or eliminating intended tax savings. Therefore, after your documents are drafted, make sure that you or a member of your advisory team understands what has to be done to maintain the validity of the documents, then assign that task to one of your advisors.

### **Conclusion**

Choosing your advisors is an important decision that will affect your long-term financial wellbeing. Because wealth management is a fluid process, it is important to revisit aspects of your plan on a routine basis. To do this with the greatest effectiveness, you’ll need to maintain a trusting relationship with your advisory team, one that is flexible and in keeping with your personal wealth management vision.

---

## About our PwC authors

**Richard Kohan** is a principal in our Private Company Services (PCS) practice in New York, where he serves as the national strategic leader of our Personal Financial Services group. In that capacity, he acts as a trusted advisor to our high-net-worth clients, addressing the tax and wealth management issues that they and their families face.

Rich also leads seminars on various aspects of wealth management for the owners of privately owned businesses, top executives in a number of Fortune 1000 companies, and partners in private investment firms. He regularly speaks to other audiences as well, discussing family office structure and strategy, estate and gift planning, investment strategies, employee benefits, stock options, and retirement planning.

Rich received a BS in political science from Syracuse University, a JD from Western New England School of Law, and an LLM in tax from Boston University School of Law. He is a member of both the American and Connecticut bar associations.

**Brittney Saks** is a Personal Financial Services partner in our Private Company Services practice in Chicago. She has provided business owners, corporate executives, and wealthy families with consulting and compliance services in areas such as compensation, investment planning, business succession, charitable giving, estate tax, trusts, and retirement planning.

These days most of Brittney's time is spent working with high-net-worth families on tax and wealth management issues. Her clients include some of the largest and most complex family offices in Chicago.

Brittney has received the Personal Financial Specialist designation and is a certified public accountant. She earned a BS in accounting from the University of Illinois at Urbana-Champaign, where she graduated with highest honors, and received a master's in taxation from DePaul University, where she earned special distinction. She is a member of the American Institute of Certified Public Accountants and the Illinois CPA Society.

---

## ***Acknowledgments***

Writing this book was a highly collaborative effort. We gratefully acknowledge the assistance of key PwC colleagues.

Kent E. Allison  
Evelyn Capassakis  
Yan Chen-Wong  
Erik Christianson  
Kristen Cunningham  
Mary Delman  
Cecily Dixon  
Phyllis Dorian  
Sheryl Eighner  
Robert Farr  
Denise Fleming  
William Fleming  
Roxanne Laine  
Ryan Lauridsen  
Jennifer Lydon  
Heather Mahoney  
Tina Malek

Andrew McDevitt  
Carol McNeil  
James Medeiros  
Martha Michael  
Ellen Mulcahy  
Lori Myers  
Mark Nash  
Amy Waldron O'Brien  
Alfred Peguero  
David Plotts  
Andrew Prior  
Daniel Russell  
Steven Scheibe  
Allison Shipley

Jessica Sullivan  
Tenaya Taylor  
Timothy Thompson  
Scott Torgan  
Rich Wagman  
Becky Weaver  
Karl Weger  
Karlyn Wright

© 2010 PricewaterhouseCoopers LLP. All rights reserved. In this document, “PwC” refers to PricewaterhouseCoopers LLP, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

This document is provided by PricewaterhouseCoopers LLP for general guidance only, and does not constitute the provision of legal advice, accounting services, investment advice, written tax advice under Circular 230 or professional advice of any kind. The information provided herein should not be used as a substitute for consultation with professional tax, accounting, legal, or other competent advisors. Before making any decision or taking any action, you should consult with a professional advisor who has been provided with all pertinent facts relevant to your particular situation. The information is provided ‘as is’ with no assurance or guarantee of completeness, accuracy, or timeliness of the information, and without warranty of any kind, express or implied, including but not limited to warranties or performance, merchantability and fitness for a particular purpose.

FSC certification and number to be placed here by printer.

This publication is printed on Mohawk Options 30PC. It is a Forest Stewardship Council (FSC) certified stock using 30% post consumer waste (PCW) fiber and manufactured with renewable, non polluting, wind-generated electricity.



For more information on the concepts and strategies discussed in this guide, please visit [pwc.com/pfs](http://pwc.com/pfs) or contact a professional in our Personal Financial Services practice.

***Boston***

James Medeiros  
617-530-7353  
[james.m.medeiros@us.pwc.com](mailto:james.m.medeiros@us.pwc.com)

Richard Wagman  
617-530-7003  
[richard.s.wagman@us.pwc.com](mailto:richard.s.wagman@us.pwc.com)

***Chicago***

Brittney Saks  
312-298-2450  
[brittney.b.saks@us.pwc.com](mailto:brittney.b.saks@us.pwc.com)

***Dallas***

Mark Nash  
214-999-1424  
[mark.t.nash@us.pwc.com](mailto:mark.t.nash@us.pwc.com)

***Florham Park, NJ***

Kent E. Allison  
973-236-5253  
[kent.allison@us.pwc.com](mailto:kent.allison@us.pwc.com)

***Los Angeles***

Alfred Peguero  
415-498-6111  
[alfred.peguero@us.pwc.com](mailto:alfred.peguero@us.pwc.com)

***Miami***

Allison Shipley  
305-375-6303  
[allison.p.shipley@us.pwc.com](mailto:allison.p.shipley@us.pwc.com)

***New York***

Evelyn Capassakis  
646-471-2363  
[evelyn.capassakis@us.pwc.com](mailto:evelyn.capassakis@us.pwc.com)

Richard Kohan  
646-471-1421  
[richard.kohan@us.pwc.com](mailto:richard.kohan@us.pwc.com)

***Philadelphia***

Karl Weger  
267-330-2496  
[karl.weger@us.pwc.com](mailto:karl.weger@us.pwc.com)

***San Francisco***

Alfred Peguero  
415-498-6111  
[alfred.peguero@us.pwc.com](mailto:alfred.peguero@us.pwc.com)

Scott Torgan  
415-498-6240  
[scott.a.torgan@us.pwc.com](mailto:scott.a.torgan@us.pwc.com)

***St. Louis***

Becky Weaver  
314-206-8490  
[becky.weaver@us.pwc.com](mailto:becky.weaver@us.pwc.com)

***Washington, DC***

Ryan Lauridsen  
703-918-4251  
[ryan.lauridsen@us.pwc.com](mailto:ryan.lauridsen@us.pwc.com)