Wealth planning
Securing your legacy

Wealth planning for the future of your legacy and your eventual heirs can be complex and difficult to face. There is no easy way to say it — planning for your death is an uncomfortable topic. The issues that need to be confronted are far easier to avoid than to address. But effective planning can reduce the likelihood of family conflict as well as the possible tax costs associated with your passing.

Regardless of the size of an estate, a basic estate plan is necessary to address fundamental issues such as guardianship of children, the disposition of assets, charitable bequests, and responsibilities for carrying out your express wishes. For wealthy individuals, the estate plan must do much more as it becomes the roadmap from which a legacy will be established and implemented.

Establishing who gets what, how they get it, and when they get it are, as a general rule, personal matters — but these decisions can have significant financial implications. And while it is human nature to procrastinate on such issues, the entire family benefits if these matters are addressed sooner rather than later. Be mindful of a few facts: (1) failure to address these matters while living (and healthy) is, in fact, a choice — a choice to follow the intestacy laws of the state in which you are domiciled or to leave the final determinations up to the courts; (2) controversial issues such as restrictions on distributions will continue to be controversial issues long after you're gone — and your heirs won't have the benefit of your counsel to assist them as they attempt to resolve disputes; (3) lack of clarity benefits no one — a protracted estate dispute will only serve to increase costs and delay the ultimate disposition of the estate.

By addressing your estate plan today, you are in a position to monitor its progress while you are living, making adjustments as circumstances prescribe. In addition, current planning provides peace of mind that comes from the knowledge that decisive action has been taken. Finally, planning will, in most cases, provide the family with a tax-efficient option to address the disposition of assets (many people fail to realize how much more tax efficient it is to transfer assets while living).

There are many planning strategies available to wealthy families — each detailed enough to be the subject of its own article.

The purpose of this article is not to review or suggest specific strategies, but rather to offer an overview of important considerations for current planning. Which aspects of planning do wealthy individuals and families most often overlook, and what are the consequences? Why is it often more tax efficient to transfer assets before death? How may you transfer assets during your lifetime, but still maintain some decision-making authority and control? And, how should you approach planning given the uncertainty around tax-law changes?

We hope this article provides a snapshot of the importance of estate planning and will aid you in future discussions with your family and your advisors.

Q. What does wealth planning typically include?

A. To be overly simplistic, there are three places your assets can go after your death: to your family and friends, to charity, or to the government. Wealth planning defines how you will "slice up the pie" and encompasses the many activities necessary to confirm that your affairs are in order and that your assets will be directed as you intend. In the case of wealthy individuals and families who will be subject to high estate taxes, predeath planning also may help direct more of your estate to family and beneficiaries and less to the government.

All estate plans should cover the basics, including having in place a current will, powers of attorney for property and health care (these documents will vary from state to state and can be called health care directives, living wills, etc.), and revocable trusts (if applicable). In addition, you should confirm that assets are titled properly and beneficiary designations are up to date so that assets pass as intended at death. For those with significant wealth, there will be some other important considerations. What is the succession plan for your business? Who are the other stakeholders in your estate — for example, grandchildren, employees, or charities? And who will get what, when, and in what proportion?

There are typically two facets to advanced wealth planning for individuals and families:

- Passive, or "defensive," strategies that arrange affairs in a tax-efficient manner while you are still alive. This effort does not remove assets from your estate, but instead repositions them to reduce the tax implications at death. Properly executed, these strategies can also reduce conflicts and misunderstandings.
- Active, or "offensive," strategies. These are wealth-transfer initiatives to prefund your plan with wealth-transfer strategies that are more tax efficient. In turn, these may reduce your estate — and ultimately the taxes due at death — by efficiently transferring assets prior to your death.

Q. Which aspects of planning do wealthy individuals and families most often overlook, and what are the consequences?

A. Most wealthy individuals and families have taken at least some actions with respect to wealth planning. The primary questions are whether they have done enough and whether their plans are up to date.

The extent to which an estate plan is "effective" will depend on many factors — from an individual's willingness to consider his or her mortality, to the family's ability to discuss such sensitive matters, to the capabilities of advisors as both counselors (providing a measured, unemotional path through the process) and technicians (understanding the intricacies of local law and federal and local taxes). Insufficient planning, however, may have significant financial and nonfinancial consequences — potentially leading to family conflict and unnecessary tax bills.

One of the most common gaps in planning is failure to keep documents up to date with changes in the family or the family's wealth picture. Relationships change — perhaps there has been a divorce, a child has predeceased the parent(s), or new grandchildren have been born. In addition, market volatility, asset sales, or the growth (or disposition) of a business also may impact wealth and, consequently, views on where the wealth should go upon death. As these changes occur, gaps begin to appear between an individual's documents and his or her preferences for wealth distribution. Over time, these gaps may widen — making it essential that plans be reviewed periodically. Such reviews can underscore another related issue, the failure of many individuals (or, perhaps, their advisors) to build into their plans some level of flexibility — providing the option to unwind or otherwise modify certain arrangements as circumstances warrant.

Another often-overlooked factor is estate liquidity. For wealthy individuals, estate taxes are inevitable, and there are many mechanisms available for creating liquidity — even in an "illiquid" estate, such as one where a significant percentage of wealth is tied up in a business. In many cases, though, estate documents do not specify a means for paying those taxes, potentially presenting problems for survivors who are unable to generate cash flow to retain assets or pay taxes.

Q. Why is it often more tax efficient to transfer assets before death? How much so?

A. Most wealthy individuals are familiar with gift and estate taxes — the gift tax is assessed on lifetime transfers of assets and the estate tax is assessed on assets transferred at death. And while these taxes have been part of a "unified" transfer tax system in the United States for a number of years, they are not equivalent taxes.

The estate tax is an "inclusive" tax; you are subject to tax on the value of the property that you own at the time of your death (including those assets that will be used to satisfy the estate tax liability). Consider this simple example: You die with $100 and are subject to a 50% transfer tax rate. In this case, $50 will go to the government to cover your estate tax liability, and $50 will go to your heirs.

As an alternative, let's say you elected to make a gift (and satisfy the related gift tax) of the same $100 during your lifetime. Because the gift tax is an "exclusive" tax, the amount subject to gift tax is only the amount the transferred. Using the same assumed 50% transfer tax rate, you can transfer $67 of the $100, and only $33 (50% of the $67 transferred) would go to the government to satisfy your gift tax liability. This computational factor alone makes it more efficient for wealthy individuals to transfer assets during lifetime rather than at death (note that deathbed gifting will not produce this benefit: only gifts more than three years before death gain this advantage — although there may still be state tax benefits to last-minute transfers).

An additional benefit of transferring wealth during your lifetime is that you remove the future appreciation from your estate. Assume the same $100 in the example grew to $110 at death — waiting would have just cost an additional $5 in tax.

Of course, there are many other factors involved in determining overall tax efficiency — not the least of which is the uncertainty around the direction of future federal estate and gift tax legislation. It is also important to consider state tax consequences, which may vary significantly by jurisdiction, as well as other factors such as the current interest rate environment, which may affect the efficiency of strategies for passing assets during your lifetime.

Given the complexities and interdependencies, it is important to work with your advisors to determine the most appropriate strategies for your particular set of circumstances.

Q. How can you transfer assets during your lifetime but still maintain decision-making authority/ control?

A. Many wealthy individuals are reluctant to make lifetime transfers of wealth because they feel that they will lose their ability to manage/control the assets. This fear of relinquishing control can often delay or completely derail the implementation of effective wealth planning.

A related, but distinct, concern is that lifetime transfers will result in spoiled, unproductive heirs. Many wealthy individuals somehow believe that their children are unaware of the family's wealth and that lifetime transfers of wealth will act as a disincentive, permitting the children to pursue an unacceptable lifestyle.

Effective planning can address these issues — but it requires striking a fine balance in order to satisfy the senior generation's concerns with the ability to achieve the desired financial and nonfinancial goals. For example, assets are oftentimes placed in trust, and the dispositive terms of those trusts can be thoughtfully crafted to address a particular family's goals and objectives. Where a family business is included in a family's holdings and the senior generation seeks to maintain decision-making authority, value may be transferred to junior generation family members through the use of nonvoting (or low-voting) interests.

As with other aspects of estate planning, it is important that you share your interests and concerns openly with your advisors.

Q. What are some special considerations for business owners?

A. One of the primary decisions a business owner may be called upon to make is whether to transfer a business to the family or to monetize the business and transfer the value to his or her family. While there are a host of reasons to consider monetizing a business (favorable market conditions, need for additional capital to fund expansion, etc.), one of the most common reasons is the lack of an identifiable successor to lead the business.

Because of the lack of an identifiable successor, for many family businesses the question is not "Will the business be sold?" but instead the question is "When will the business be sold?". In those cases, one set of additional factors for the senior generation to consider is whether such a sale should occur during their lifetime. Market and other factors are certainly considerations, but it may be beneficial to complete a sale during the current leader's life, when he or she can assist in increasing the purchase price and facilitate the transition to new owners.

If a business comprises a large portion of an individual's wealth and the family plans to transfer ownership to junior generations, then the ability to satisfy estate taxes must be addressed. It is essential that a plan be developed with consideration to producing sufficient cash flow and managing liquidity issues for both the family and the business.

Where it is contemplated that a business will be transferred to junior generations, the family must also address the issues raised if less than all family members are involved in the business (or if the contribution of various family members is unequal). Eliminating future family conflict may be impossible, but it's important for the current business leaders to contemplate — and attempt to address — possible conflicts that may arise (e.g., one family member feels that he or she is not being adequately compensated for his or her contributions to the business; the tensions that exist between those that want business profits to be reinvested versus those that seek the funds to diversify their holdings or supplement their lifestyle, etc.).

Q. Can family conflict be avoided?

A. Every family is unique, but many families confront similar issues and challenges. One common area of concern is the potential for conflict among family members/beneficiaries. There are many circumstances in which conflicts can arise, but one of the most common involves multiple marriages — for example, the distribution of assets to a second spouse versus children from the first marriage (especially where the children from the first marriage are contemporaries of the second spouse). Another common circumstance that often produces conflict is where the oldest child is appointed the executor or as a trustee for all trusts, and that child's younger siblings question whether he or she is acting in their best interests.

These are but a few examples of circumstances that can give rise to family conflict — and many a wealthy individual is unwilling (or, at least, very uncomfortable) to confront these issues currently. The thought is "let someone else worry about it." Unfortunately, these issues won't disappear and the possible resolution of these issues may be far more complicated after the wealthy individual has died.

Q. What other situations may complicate or add complexity to wealth planning?

A. Planning for a family member with special needs is extremely important, both to be mindful that the needs of the family member are being addressed and to be careful that family wealth isn't unnecessarily put at risk.

Planning to address international residency or property issues is another specialized topic requiring thoughtful planning. Where a wealthy individual (or his or her heirs) lives overseas or the estate involves property located overseas, advisors familiar with multiple jurisdictions should be consulted. International estate planning introduces another set of issues for wealthy families and is covered in more detail in our article, *International tax and estate planning for wealthy families: Responding to global mobility*.

Q. What if you want to leave assets to charity?

A. Wealth planning is also important for those who intend to leave assets to charity. Bequeathing assets at death may help manage estate taxes; but, by transferring them while living, wealthy individuals also may realize income tax benefits. Perhaps more importantly, they can have the pleasure of being acknowledged for their largesse by the community and can witness the good works made possible by their giving.

Generally speaking, the larger the commitment to charity, the more decisions are involved. To start, you will need to determine the proportion of assets that you want to leave to charity. In some cases, there may be some constraints; for example, your state law may stipulate that you cannot leave all assets to charity and nothing to a surviving spouse.

If you want to leave significant assets to charity at your death, then you will need to consider how to effectively structure your bequests and which charitable vehicle(s) to use. For many wealthy families, a family foundation is more than a vehicle for meeting charitable interests; it is a format that encourages the involvement of other family members and may incentivize children to be charitable, themselves. Learn more about family foundations in our article, *Private foundations: Structuring philanthropy to fulfill family goals*. Vehicles such as split-interest trusts enable wealthy families to combine wealth-transfer goals with charitable goals. Finally, you will need to consider how and when to fund and distribute bequests in order to realize the lifetime estate and income tax benefits.

Q. If you have not planned sufficiently, what may you to do start — or restart — planning?

A. First of all, recognize that you are not alone. Contemplating our own mortality is difficult on any level. Add to that the fact that people may find it particularly difficult to talk openly about their wishes for a variety of reasons, ranging from a desire to avoid conflict over matters such as the disposition of assets to a fear of ceding control.

If you have avoided planning for reasons such as these, a good starting point is to develop a picture of what things would look like if you died today. This analysis will cast light not only on tax implications, but also on matters such as liquidity, family dynamics, and other potential decisions that you may need to address — ultimately enabling you to quantify risks and begin working with advisors to assess potential solutions.

Your ability to articulate your wishes to family members and advisors is, of course, critical in this process. Many wealthy families find that once they have been able to open up about planning, many of the key pieces begin to fall into place — and that talking about these matters is not as hard as they thought. Family meetings may be one effective way to initiate or improve the dialogue — providing an opportunity to review current plans and to share concerns, fears, and ideas. In some cases — particularly where there may be conflicts of interest — a family office leader, advisor, or other impartial but trusted individual may be able to help in educating other family members and facilitating initial discussions.

Q. Whom should you include at the planning table?

A. The more wealth involved, the more complex the relationships and the more people typically involved. The more input, the more ideas that may result — but in the wrong situation it may also produce more pressure. At a minimum, planning should involve a husband and wife team (if married) — hopefully on the same page — as well as an attorney and tax and investment advisors. It is not uncommon for attorneys to interview a husband and wife separately to validate that they are both able to express their views and interests openly. Beyond that, you will need to consider family dynamics and relationships. At the appropriate time, you will need to involve the next generation and others in a position of trust — such as designated fiduciaries (executors, personal representatives, trustees, agents, etc.) — to communicate and confirm their understanding of your wishes and expectations.

As with many aspects of estate planning, there is no one-size-fits-all formula for choosing the right fiduciary; much depends on the size and complexity of your estate. Many wealthy families opt for a combined corporate/individual approach to serve as fiduciary — including an individual who understands the family dynamics and interests, such as the need to treat a certain child's bequest differently from others, and a corporation that understands the mechanics and calculations involved. Having one capable individual who may fulfill both roles offers some advantages, but keep in mind that when one family member is in a position of making decisions on behalf of others, there may be conflicts. In these cases, plans may be drafted to help reduce personal fiduciary liability for issues related to conflicts of interest.

Q. When should you review and update your plans?

A. A critical and often overlooked element of wealth planning is keeping plans and directives up to date, particularly as assets grow or relationships change. While life events such as marriages, divorces, deaths, or births should prompt an analysis of plans, so too should certain market factors — for example, substantial increases or declines in asset values, sharp changes in the interest rate environment, or significant tax law changes. For example, many wealthy families have been revising their plans to address the changes in the transfer tax system that are currently scheduled to expire on December 31, 2012.

Even in the absence of a significant change, it is wise to undertake a review every few years. Events that are not individually significant can have a bigger collective impact on your plans. In addition, regular analysis provides the opportunity to monitor your plans and your progress in prefunding wealth-transfer strategies and to verify these strategies remain relevant to your goals and objectives.

Q. In light of uncertainty around tax law changes, how should you approach planning?

A. No matter the environment, it can be difficult to create an estate plan that will hold up over time. The current environment is particularly uncertain. Not only is there potential for significant legislation, but also significant debate about the direction it may take — layered on top of the continued volatility in the financial markets, the only "clarity" may be the "lack of clarity." In such an environment, trying to anticipate change may be frustrating and may lead to inappropriate or short-sighted moves. One thing you can do is to have appropriate "exit strategies" in your plan, so that you may make adjustments if the environment moves in a significantly different direction in the future. In any event, it is a good idea to maintain regular touch points with your advisors, who will be watching the market, regulatory, and legislative environments and can help you understand how, when, and whether to take advantage of planning opportunities that may arise.

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