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WHAT'S MY PLAN?

Estate plans, tax strategies, investment statements, and retirement plans may all look good individually, but quite often it is a challenge to understand how they fit together. We have found that many people with significant wealth really don't understand the important relationship between all of the pieces. This task appears to be rather benign and perfunctory. For most, it is not.

The following case study illustrates the process of going through a one-time comprehensive financial analysis. The names of the people and places have been changed, and the facts are a composite of several cases from all three of Diversified Trust's offices.

THE BACKGROUND

During a periodic review with his CPA on business and personal planning issues, a successful business owner explained that he was ready to turn over the reins of his business to the next generation and to move into the next phase of his life which included traveling, golf, spending more time with family, etc. The CPA knew that Mr. X had built up substantial retirement assets and possessed an assortment of bank and brokerage accounts which had become more spread out over time. Mr. X had a Will and estate planning documents, but he lacked a well-coordinated, overall wealth management plan. The CPA recommended that Mr. X interview a couple of wealth management firms for the purpose of selecting an advisor who could help him construct and oversee a wealth management plan. He explained that Mr. X needed someone who understood tax issues and public and private investments to help him make this transition and execute his plan going forward. Mr. X had heard of Diversified Trust from an attorney friend and gave us a call.

WHY IS THAT IMPORTANT?

In our first meeting Mr. X explained, "I am looking for someone to manage my retirement assets and help construct a cash flow plan which will support my living needs and gifting objectives." Mr. X stated that he had a wife, two adult children and five young grandchildren. He also mentioned that he was the beneficiary of a trust set up by his Mother's estate from which he received some income. He did not have an updated

figure for his net worth, but knew that it was somewhere north of \$7 million.

During our discussion, it became clear that investment questions for Mr. X lead to tax issues which in turn lead to cash flow expectations, charitable giving objectives, desired family gifts, decisions on vacation homes and so forth. Mr. X proclaimed that we were asking questions about things he had previously never considered being related. How does a retirement account have anything to do with a trust account established years ago by his Mother's estate? What's wrong with receiving income from his trust fund, and what did we mean by generation skipping trust? What do life insurance policies have to do with taxes? Was there a problem with his wife only having approximately \$600,000 of assets titled in her name excluding jointly held assets?

We explained that our firm could focus solely on developing an investment plan for his retirement assets if that is what he wanted us to do; however, we suggested that he consider the merits of having us conduct a one-time analysis of his overall wealth management picture. We explained that this review would give him a comprehensive assessment of how his assets would flow through his Will in the event of his death. In addition, it would provide cash flow and living expense projections, a compilation of personal assets and liabilities, a summary of wealth planning observations and recommendations for investment management for each basket of wealth (i.e., trusts, retirement accounts, life insurance policies, public and privately-held securities, and real estate assets). Mr. X agreed that he would value a better understanding of his financial affairs. What would all of this cost? We explained that this involved a one-time fixed fee without any commitment to use DTC for other services.

HOW DO WE GET STARTED?

He said, "I need help on the management of my retirement assets, but I do not need an overhaul of all of my investments. My non-retirement investments are in reasonably good shape. I do not need someone selling me products. I simply need good, solid advice and analysis. So what do you need to see?" We requested the following items for review to start this process:

- prior year's federal and state tax returns

- copies of current Will and Trusts
- shareholder agreement for his company
- recent statements from retirement plan and IRA
- retirement plan and IRA beneficiary records
- recent statements from life insurance companies
- recent statements for brokerage and bank accounts
- tax cost basis for non-retirement investments
- loan statements (if any) with terms and balances
- loans made to others with promissory notes
- listing of investments in privately held securities
- safe deposit box or family vault contents

We explained that other items may be requested if and when necessary.

DETAILS, DETAILS, DETAILS

To recount our detailed examination of the above financial records and planning documents would be painfully tedious to most readers. Suffice it to say that the devil is in the details, and it takes both expertise and experience to connect the dots between the analysis of tax issues (including income, gift and estate taxes), cash flow and living expenses, multi-state and foreign real estate ownership and acquisition matters, the ever-changing world of insurance products and services, multi-generational family planning, privately-owned investments, and good old-fashioned investment analysis. Typically this process involves working as a team with the client's existing CPA, estate attorney and other advisors to ensure all bases have been covered.

THE 20,000 FOOT VIEW

Mr. X had been a smart investor. He had avoided the "get rich quick schemes" and weathered the occasional storms of bear markets. He wasn't locked in to any expensive annuities. Most of his net worth was tied up in his company and its retirement plan. The Shareholder Agreement for his ownership of the company provided a valuation formula and a prescribed time frame for the sale of his shares after retirement. That had been well-planned. His retirement plan was well balanced, but he wanted to roll it over to an IRA so he could receive more timely statements and have more control and flexibility. Outside of those two key areas, he had three different stock portfolios with brokerage companies, a

Dividend Reinvestment account administered by a large bank on the West coast, a trust fund created by his Mother's estate which was being administered by a bank in the Northeast, a primary residence appraised at \$850,000, a condo in the Rocky Mountains valued at \$900,000, and some land in an adjacent state which had a hunting and fishing lodge on it. He also owned a paid-up life insurance policy which had a cash value of \$275,000 and a death benefit of \$1 million payable to his wife. During our review, Mr. X mentioned that no one used the mountain condo much anymore, and his children were prodding him to get a beach house somewhere for family vacations with the grandchildren. He hated paying taxes, and his condo had tripled in value since he had acquired it. Mr. X's overall financial situation was indeed the proverbial mixed bag of wealth and planning opportunities.

RECAP AND RECOMMENDATIONS

When all of the pieces were gathered, we estimated the estate of Mr. X to be approximately \$15 million. This sum did not include the value of his trust fund since it would not be included as part of his gross estate. However, the trust's value of \$2 million should be an important part of his family's legacy planning. Although he had not told us this on the front end, prior to seeing our report he had made a "back of the napkin" estimate of \$11 million for his net worth. He was very intrigued by what he had overlooked.

We noted that he could likely save significant estate taxes by transferring the ownership of his life insurance to a trust, or by possibly using annual exclusion gifts to transfer ownership of the policy to his adult children. We noted that his Will was approximately ten years old and had not contemplated the growth of his estate. If he predeceased his wife, no estate taxes would be due upon his death. However, upon her subsequent death, approximately \$5.8 million in federal estate and state inheritance taxes would be due.

We informed him that, according to the terms of his Will, his grandchildren could receive as much as \$1 million each at age 25 if one of his children died prematurely. This was not what he had intended. We disclosed that the trustee named in his Will was an institution which had been acquired by an out of state bank seven years ago and no

longer had any local servicing of trusts. We pointed out that the income distributions he had been receiving from his Mother's trust were subject to the maximum income tax and also ultimately subject to the maximum estate tax if retained in his estate. Leaving this income in this trust would allow the trust to compound its growth and avoid estate taxes (approximately 48 cents on the dollar) when he died. In addition, we pointed out that we knew of no good reason why this trust portfolio owned Michigan tax exempt bonds, although we suspected that the trustee's home office being located in Detroit had some influence on that circumstance.

We advised Mr. X to change the designated beneficiary of his retirement plan from "His Estate" to his wife. This would avoid his retirement account having to be probated, and it would provide much more advantageous income tax consequences and distribution flexibility for his wife during her lifetime. We suggested that he consult his CPA about the feasibility of a tax-free 1031 exchange by rolling over the proceeds of the sale of his mountain condo into the acquisition of a beach house. This would avoid the significant capital gain taxes which would otherwise be due upon the sale of the condo. We pointed out that although he owned the stocks of very good companies in his three brokerage accounts, all three accounts primarily contained "large cap growth stocks" and therefore did not offer the benefits of true diversification. His current stocks were also highly correlated with one another which increased his investment risk.

We recommended that he consider an annual gifting program to his two children and that he also establish trust accounts for his grandchildren to make gifts to each of them. This would help control the future growth of his taxable estate and help transfer more of his wealth tax-free to his family. In addition to annual gifts, we also noted that the government allowed him to pay his grandchildren's tuition to private schools without incurring any gift taxes. Lastly, we suggested that Mr. X consider placing his out-of-state property in a grantor trust under his control. One day this would save his executor the major headache of having to hire out-of-state attorneys to probate these assets in the courts of those states. It would also save on out-of-state probate costs.

GOOD TO KNOW

A wise man once said, “The older I get, the more I know how much I don’t know.” This statement certainly applies to the complex world of wealth management. Physicians strongly advise periodic examinations from head to toe as the effects of age begin compounding. We suggest that similar comprehensive check ups be conducted on your financial health as well. It makes no sense to devote a lifetime to prudently accumulating assets without insuring that these assets will ultimately serve the desired purposes. At Diversified Trust, our Principals have substantial experience in the multifaceted world of wealth management. Our diverse professional backgrounds include estate and tax planning, investment management and consulting, trust and estate administration, family-owned business advisory services, and philanthropy planning. An overall financial assessment is generally very constructive to those who ask for our help, and it often helps avoid negative surprises which arise when wealth plans are incomplete or become outdated. We have consistently found that a comprehensive financial review can uncover unintentional oversights and also critical mistakes caused by faulty execution. The successful execution of an effective plan involves dynamic communication and collaboration among your wealth management team of advisors – estate attorney, CPA, financial advisor, etc. working together on your behalf. As wealth accumulates and life circumstances evolve, it is prudent to ask yourself the question, “What’s my plan?”

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