Wealth Management & Investment Management

Week 5

High Net Worth Product and Tax Policy Consequences

High Net Worth Individuals HNWI

Investopedia explains *High Net Worth Individual - HNWI*

The most commonly quoted figure for membership in the high net worth "club" is $1 million in liquid financial assets. An investor with less than $1 million but more than $100,000 is considered to be "affluent", or perhaps even "sub-HNWI". The upper end of HNWI is around $5 million, at which point the client is then referred to as "very HNWI". More than $50 million in wealth classifies a person as "ultra HNWI".

HNWIs are in high demand by private wealth managers. The more money a person has, the more work it takes to maintain and preserve those assets. These individuals generally demand (and can justify) personalized services in investment management, estate planning, tax planning, and so on.

Product Issues

- Suitability – Accredited Investors etc.
- Code Products – Plans 401k, 529 etc.
- Legal products – ILITS etc.
- Trusts and Testaments – Living Trust Sales Again
- Structured Products -
- Hedge Funds -

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2011

- Because Taxes are in flux over the coming years, these products may be more in favor again.

- Estate Plans, Wills, and more
- Retirement Accts
- Donations
- Business
- Real Estate

Cap Gains

- **Tax Rate on Capital Gains** - The tax rate on capital gains from the sale of assets held longer than one year remains at zero percent for people in the 10 percent or 15 percent tax brackets. The 15 percent maximum tax rate on long-term capital gains for taxpayers in higher brackets also remains the same. **Lower Capital Gains and Dividend Tax Rates Extended Through 2012 -** The tax rate reductions for long-term capital gains remain in effect for 2011 and 2012.
- Remember, state tax applies to cap gains too.

Dividends

- Also, while qualifying dividends are taxed in 2010 using the same capital gains tax rates described (i.e., 15% and 0%). Similarly, the special 5 percent maximum rate on dividends of taxpayers in the 10 percent and 15 percent tax brackets remains at zero percent.
- If this changes, it hits the poor and rich too as your dividend income tax may go up 50% etc.

Estates

- **Estate Tax Exemption**
- For 2010, there is no federal estate tax.
- However the executors of estates where the taxpayer died in 2010 can elect to apply the 2011 exemption of $5,000,000, with a maximum estate tax of 35%. Different rules for the step up in cost basis apply in these two years, meaning some estates may find the 2011 rules more beneficial. The estate tax was reinstated in the 2010 Tax Relief Act

Investors Rush to Beat 2011 Capital Gains Tax Increase

- **Stockholders with major positions may sell Long Term Capital Gains before any major changes occur.**
- **Similarly, Hedge Funds may dissolve before any major changes…**

Charity

- **Charitable Contributions may become more beneficial….**

The products and services

The Short List

Corporations and LLCs and Anything to maximize Expenses in Legitimate business and Business Continuity

- Deductions
- Expenses
- Liability Protections
- Use of LLCs as a TRUST
- Splitting of INCOME

Trusts

- Marital
- Bypass
- Charitable
- Insurance Trusts
- CRAT, CRUT and more.
- Annuity Trust Donations that pay income for Insurance

Gifts and Donations

- Donations of Private Stock or business Interests
- Donations of traded stock
- Donations of Land
- Donation of Partnership or LLC shares.
- Seeking out Minority ownership for Estates

Gift Exclusions

- **Investopedia explains *Gift Tax***

  The following are generally excluded from gift tax:

  1. Gifts to one's spouse.
  2. Gifts to a political organization for use by the political organization.
  3. Gifts that are valued at less than the annual gift tax exclusion for a given year.
  4. Medical and educational expenses - payments made by a donor to a person or organization such as a college, doctor or hospital.

  http://www.investopedia.com/terms/g/gifttax.asp

Gift Exclusion Amounts

- **How many annual exclusions are available?**
  The annual exclusion applies to gifts to each donee. In other words, if you give each of your children $11,000 in 2002-2005, $12,000 in 2006-2008, and $13,000 on or after January 1, 2009, the annual exclusion applies to each gift. **Higher Annual Gift Tax Exemption** For 2010, you can give up any individual up to $13,000 without owing any gift tax.
- **What if my spouse and I want to give away property that we own together?**
  You are each entitled to the annual exclusion amount on the gift. Together, you can give $22,000 to each donee (2002-2005) or $24,000 (2006-2008), $26,000 (effective on or after January 1, 2009).
- http://www.irs.gov/businesses/small/article/0,,id=108139,00.

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529 Plans and donations

- More parents and grandparents will begin making the annual gift exemption.
- 529 plans (also known as a "qualified tuition program") were created under the Small Business Job Protection Act of 1996 (SBA '96) as a means of allowing tax-payers to save for paying for higher education expenses for a designated beneficiary. A 529 plan may be provided by a State, an agency of the state or by an educational institution.

  Like the education savings account (ESA), the 529 plan is an excellent way to save for education expenses. Earnings accumulate on a tax-deferred basis and distributions that are used for qualified education expenses are tax- and penalty-free. Unlike the ESA, the 529 plan may be set up in a way that allows individuals to prepay a student's qualified higher-education expenses at an eligible educational institution. Also, the contribution limits for a 529 plan are considerably higher than those for an ESA.
- **Topic 313 - Qualified Tuition Programs (QTPs) http://www.irs.gov/taxtopics/tc313.html**

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529 More

- There are two types of 529 plans:
  Prepaid tuition programs: Which may be offered by a State of eligible educational institution, allows the advance purchase of credits for the designated beneficiary. These are usually established during enrollment periods established by the State of eligible educational institution.
- ***College savings plan:*** This allows contributions to be made to the account on behalf of the designated beneficiary. These can usually be established at any time, including immediately after the designated beneficiary is born.
- For purposes of a 529 plan, an *eligible educational institution* is any college, university, vocational school, or other post-secondary educational institution eligible to participate in a student aid program administered by the Department of Education.
- http://www.irs.gov/publications/p970/index.html

LifeTime Learning

- The lifetime learning credit for 2009 is gradually reduced (phased out) if your modified adjusted gross income (MAGI) is between $50,000 and $60,000 ($100,000 and $120,000 if you file a joint return). You cannot claim a credit if your MAGI is $60,000 or more ($120,000 or more if you file a joint return). This is an increase from the 2008 limits of $48,000 and $58,000 ($96,000 and $116,000 if filing a joint return). See *Effect of the Amount of Your Income on the Amount of Your Credit* , later, for more information.

Minor Accounts

- Guardian Accounts & Ownership
- UGMA ***Uniform Gifts to Minors Act***
  The donor can appoint him/herself or another person to be custodian. The custodian, who has a fiduciary duty to manage the minor's assets wisely, can use the funds to buy securities on behalf of the minor. Access to the gift must be given to the minor when he or she reaches the age of majority, either 18 or 21 (sometimes even 25), depending on UGMA state law. Should a donor acting as the custodian die before the custodial property is transferred to the minor, the entire custodial property is included in the donor's taxable estate.

The Uniform Transfers To Minors Act (UTTMA)

- is a uniform act drafted and recommended by the National Conference of Commissioners on Uniform State Laws in 1986, and subsequently enacted by most U.S. States, which provides a mechanism under which gifts can be made to a minor without requiring the presence of an appointed guardian for the minor, and which satisfies the Internal Revenue Service requirements for qualifying a gift of up to $13,000 for exclusion from the gift tax. It is an extension of the Uniform Gifts to Minors Act (UGMA).
- http://www.finaid.org/savings/ugma.phtml

Family Office Services

Family offices are private wealth management advisory firms that serve ultra-high-net-worth clients. According to the Family Office Exchange, there are more than 3,500 family offices based in the United States. By offering a complete outsourced solution to managing finances and investments, including budgeting, insurance, charitable giving, family-owned business, and wealth transfer and tax services, these offices set themselves apart from traditional wealth management firms.

Insurance and RISK

- Larger Insurance Policies will be issued
- Second to die may become more popular too.
- Single Premium Life may become popular again
- Insurance using pre-tax dollars will become more popular i.e. Disability, Health, Life or other.
- Deferred Tax Annuities will become very popular again.

Exchange Funds – Concentrated…

- Because an investor swaps shares with the fund, no sale actually occurs. This allows the investor to defer the payment of capital gains tax until he or she sells the fund's units.

  There are both private and public exchange funds. The former deals with companies that are not publicly traded, providing investors with a way to diversify private equity holdings. The public funds offer investors portfolio shares containing publicly traded firms.
- http://www.fa-mag.com/component/content/article/992.html?magazineID=1&issue=49&Itemid=73

Forward Sale

- **Prepaid Variable Forwards (PVF) -** Although similar to a collar, with PVFs the investor receives an up-front payment (typically 80-90% of value) in exchange for delivery of a variable amount of shares or cash in the future. A floor in the forward contract protects the investor from some decline in the stock's price and also still allows forward contract holders the benefit of stock price appreciation.
- http://fc.standardandpoors.com/sites/client/tda/tdap/article.vm?siteContent=5224&topic=5054

Shift Income to Capital Gains, Benefits, or Deferred Tax

- Stock Options – Keeping Income Low
- Disability Insurance
- Benefits
- Retierment
- Health
- Life Insurance
- Maximize 401K and other above the line contributions

Land – Maximize Tax Write offs

- Tree farming
- Cow Farming
- Lease to farmers
- Building and Improvements
- Lease the land to create business.
- Triple Net Leases

Structured Products

- **What are structured products?**
  Structured products are designed to facilitate highly customized risk-return objectives. This is accomplished by taking a traditional security, such as a conventional investment-grade bond, and replacing the usual payment features (e.g. periodic coupons and final principal) with non-traditional payoffs derived not from the issuer's own cash flow, but from the performance of one or more underlying assets.
- Usually has a protected or guaranteed principal with some income and some upside exposure to some market..

Business travel

- Deductible travel expenses while away from home include, but are not limited to, the costs of:
- Travel by airplane, train, bus, or car between your home and your business destination. If you are provided with a ticket or you are riding free as a result of a frequent traveler or similar program, your cost is zero.
- Using your car while at your business destination,
- Fares for taxis or other types of transportation between the airport or train station and your hotel, the hotel and the work location, and from one customer to another, or from one place of business to another
- Meals and lodging & Tips you pay for services related to any of these expenses.
- Dry cleaning and laundry.
- Business calls while on your business trip. This includes business communications by fax machine or other communication devices.
- Other similar ordinary and necessary expenses related to your business travel. These expenses might include transportation to and from a business meal, public stenographer's fees, computer rental fees, and operating and maintaining a house trailer.
- http://www.irs.gov/taxtopics/tc511.html

Variable Life

- **What Does *Variable Life Insurance Policy* Mean?**
  A form of whole life insurance, variable life insurance provides permanent protection to the beneficiary upon the death of the policy holder. This type of insurance is generally the most expensive type of cash-value insurance because it allows you to allocate a portion of your premium dollars to a separate account comprised of various instruments and investment funds within the insurance company's portfolio such stocks, bonds, equity funds, money market funds and bond funds. In addition, because of investment risks, variable policies are considered securities contracts and are regulated under the federal securities laws; therefore, they must be sold with a prospectus.

Variable Annuity

- **What Does *Variable Annuity* Mean?**
  An insurance contract in which, at the end of the accumulation stage, the insurance company guarantees a minimum payment. The remaining income payments can vary depending on the performance of the managed portfolio.
- Tax Deferral - variable annuities are **tax-deferred**. That means you pay no taxes on the income and investment gains from your annuity until you withdraw your money.
- Protection - variable annuities have a **death benefit.** If you die before the insurer has started making payments to you, your beneficiary is guaranteed to receive a specified amount
- http://www.sec.gov/investor/pubs/varannty.htm#wvar
- http://www.investopedia.com/articles/04/111704.asp

Whole Life

- **Investopedia explains *Whole Life Insurance Policy***
  As the most basic form of cash-value life insurance, whole life insurance is a way to accumulate wealth as regular premiums pay insurance costs and contribute to equity growth in a savings account where dividends or interest is allowed to build-up tax-deferred.

401 K for Small Business Owner SBO

- **SBO 401(k) Plan Components**
  There are two components to the SBO 401(k) plan: salary-deferral contributions and profit-sharing contributions. *Salary Deferral*: You may make a salary-deferral contribution of up to 100% of your compensation/income, but no more than the salary-deferral limit for the year, which is $16,500 for 2010.
- *Profit-Sharing Contribution*: The business may contribute up to 25% of your compensation (20% of your modified net profit for unincorporated businesses), but no more than $49,000 for 2010.
- The combined salary-deferral and profit-sharing contributions must not exceed $49,000 for 2010. However, if you reach age 50 by year-end, you may contribute an additional $5,500 for catch-up contributions as salary deferrals.
- http://www.investopedia.com/articles/retirement/03/100803.asp

Plan Comparison

http://www.investopedia.com/articles/retirement/03/100803.asp

Account	Salary Deferral	Maximum Employer Contribution	Catch-Up Contribution
SBO-401 (k)	$16,500 (for 2009)	25% of compensation or 20% of modified net profit for unincorporated business owners	$5,500 (for 2010)
SEP IRA	Not Allowed	25% of compensation or 20% of modified net profit for unincorporated business owners	Not Allowed
Profit Sharing or Money Purchase Pension Plan	Not Allowed	25% of compensation or 20% of modified net profit for unincorporated business owners	Not Allowed
SIMPLE IRA	$11,500 (for 2010)	3% of compensation/income	$2,500 (for 2010)

Rollovers and Taxes

http://tax.cchgroup.com/legislation/Small-Business-Jobs-Act-7-23-10.pdf

There may be advantages to rolling over accounts in 2010.

PLANNING NOTE. *Like many recent tax bills, the small business bill provides incentives but does not make most of them permanent. Some have a very short lifespan. For example, enhanced Code Sec. 179 expensing is available for 2010 and 2011; bonus depreciation is generally available only through the end of 2010; and rollovers within 401(k) and other elective deferral plans to designated Roth accounts are entitled to a special two-year tax deferral only if done in 2010.*

Business Investment

- **Section 179 Expense Deduction**
- The maximum amount of equipment placed in service in 2010 and 2011 that businesses can expense was increased to $500,000. And the annual investment limit was raised to $2,000,000. Thus, you won't begin to lose the benefit of expensing until you place more than $2,000,000 of assets in service in 2010 and 2011. The allowance drops to $125,000 for tax years beginning in 2012.

Charity

- Donating appreciated assets, real estate, or stock to charity will become popular again. Capture the deduction if possible

- http://www.ehow.com/how_2162747_appreciated-stock-bigger-tax-savings.html
- http://lawprofessors.typepad.com/trusts_estates_prof/income_tax/

Appreciate Stock

- Donate your appreciated stock. You get a deduction for the fair market value without having to declare the appreciation as a taxable capital gain.
- Transfer your appreciated stock to a relative in a lower tax bracket so that the gain is taxed at a lower rate, if anything at all.
- Hang on to your appreciated stock until your death. Unless you die in 2010, your beneficiaries will get a step up in basis.
- Community versus Common Law.

References

- TurboTax http://turbotax.intuit.com
- http://www.investopedia.com
- www.irs.gov
- http://www.sec.gov/investor/pubs/varannty.htm
- http://turbotax.intuit.com/tax-tools/tax-tips/IRS-Tax-Return/Summary-of-Federal-Tax-Law-Changes-for-2010-2017/INF12041.html