Commonwealth

The Advisor's Guide to Advanced Financial Planning Strategies for High-Net-Worth Clients

Landing a high-net-worth (HNW) client can play an important role in your business success and profitability. But what happens after they've signed on, bringing with them an interwoven ecosystem of financial needs? You'll need to consider their multifaceted legal, tax, and other financial issues and offer creative solutions so you can win and retain their business while prospecting for more.

Follow our fictional HNW family, the Thompsons, as a showcase of the issues you may encounter while serving these clients and possible solutions to providing them with comprehensive financial planning.

Financial Assets at a Glance

On the brink of retirement, Janice and Ed Thompson are looking for a new advisor to meet their unique needs. They have clear goals for future income, a strong wish to protect their heirs, and ideas on how they can give back through charitable donations. They also have an outdated estate plan, a variety of evolving income sources, and potential tax issues.

Janice and Ed are both 65 years old and have an approximate net worth of $15 million. They have three adult children and two grandchildren. The Thompsons have minimized debt and expenses as they near retirement and feel $300,000 in gross annual income will be sufficient for their needs.

Because the Thompsons' estate plan is more than 20 years old and their financial picture has changed significantly, there will be additional steps to address their new concerns and goals. Together with the Thompsons, you've identified the following objectives:

1. Minimize estate taxes while maintaining flexibility for potential legislative changes.
2. Provide for their granddaughter.
3. Achieve asset protection for their children and grandchildren.
4. Support children's charities through gifting and charitable giving.

Janice and Ed's Financial Assets		
Janice	**Shared**	**Ed**
Pharmaceutical company executive • Annual salary of $225,000 • Equity compensation through several programs • Restricted stock program, stock purchase plan, and incentive and nonqualified stock options	Home • Located in the Fort Point Channel Landmark District of South Boston • Historic factory building turned into a residence • Valued at approximately $2 million • Sizable art collection	Family electrician business with brother, Bill (age 62) • Annual salary of $200,000 • $250,000 in bonus and dividend income annually • Ed and Bill each own 50 percent • Currently employs 95 people and has several commercial contracts • Set up as a C-corp • Ed has concluded that gifting ownership to sons Chase and Ryan seems like the best course of action
Tanner (maiden name) family limited partnership (FLP) • Created by Janice's parents for the purpose of passing the family's small manufacturing business to their children • Fair market value: $3 million • Local competitors would be interested in purchasing it	Rollover IRAs • Ed: Market value of $750,000 • Janice: Market value of $650,000	
Janice's mother's estate • Janice's mother recently passed and left Janice one-third of her estate • The commercial properties expected to net $4 million after taxes and fees	Social security • Janice and Ed have decided to wait until age 70 to file • Janice's projected benefit: $3,546 per month • Ed's projected benefit: $3,300 per month • Combined yearly benefit projection: $82,152	

1 Challenge 1: Minimize Estate Taxes While Maintaining Flexibility

Clients are often unaware they have an estate tax problem or of what their monetary liability is. Although you can project current liability with some certainty, the same cannot be said about future liability. With the Thompsons, consider taking a bookend approach—showing them the current liability and then a projected future liability based on assumptions about life expectancy, potential growth, and anticipated legislation.

Every scenario is different, and your clients' goals, opinions, and concerns will come into play. By working with their attorney as well as your firm partner (if it offers wealth management consulting support), you can help your clients find the right planning and product solutions to efficiently pass on their wealth. Consider the following strategies:

A/B trusts. The first step is to review Janice and Ed's existing estate documents, which were drafted many years ago, and determine whether they effectively address the estate tax issue.

Adding disclaimer provisions to an A/B trust design is common practice that allows a surviving spouse to decide where assets will go.

If the estate has shrunk at the time of the first spouse's death and there's no estate tax issue, the surviving spouse can simply accept all assets into the A trust using the unlimited marital deduction. In this case, the assets are included in the estate at death and receive a step-up in basis.

If, on the other hand, the estate is exposed to estate taxes, the surviving spouse may choose to disclaim assets to the B trust. Using disclaimer provisions and a "wait and see" approach is also a hedge against changes in estate tax law.

Liquidity through life insurance. Under current federal and Massachusetts estate tax rules, the Thompsons have the potential to owe significant estate taxes at the second spouse's death. The estate could pay this tax burden, but liquidity and timing are factors and few (if any) of their assets could be liquidated quickly. The solution? Create liquidity using life insurance.

You can explore solutions that will provide a death benefit at the second spouse's death to cover the estate tax burden. Costs, guarantees, and flexibility vary, so you'll need to explain their options:

- Second-to-die guaranteed universal life (SGUL)
- Second-to-die variable universal life (SVUL)
- Indexed UL
- Traditional (current assumption) UL
- Second-to-die guaranteed variable or indexed UL
- Second-to-die whole life

For the Thompsons, SGUL offers the largest guaranteed death benefit for the lowest outlay; although they have strong cash flows, other products with large premiums may be a tough sell. Based on their family stability and wealth, product flexibility shouldn't be a concern since the Thompsons' situation isn't likely to change as they move into retirement.

To avoid exacerbating their estate tax problem, the Thompsons' life insurance policy should be owned by an irrevocable life insurance trust (ILIT). With cases like this, be sure to work with your clients' attorney to ensure that the insurance product and ILIT are complementary.

At a Glance

- **Issue:** Minimizing estate taxes while remaining flexible
- **Solution:** A/B trusts, liquidity through life insurance products
- **Don't forget:** Although some clients may be reluctant to buy life insurance, buying death benefit outside of the estate is often a good "investment." Be sure to run the internal rate of return report in the illustration to show them that regardless of whether they end up needing the insurance, it was still a competitive investment.

A disclaimer provision is beneficial if the estate has shrunk at the time of the first spouse's death and that there is no estate tax issue (the surviving spouse can accept all assets into the A trust, using the unlimited marital deduction).

With a disclaimer provision in place, the surviving spouse maintains full control over assets in this trust, but they are included in the estate at death and receive a step-up in basis.

2 Challenge 2: Provide for Their Granddaughter's Special Needs

Another key priority for the Thompsons is supporting their granddaughter, Ally, who was born with disabilities. Ally's parents currently receive aid through programs funded by their town, but she likely won't be able to live independently without assistance from caregivers in adulthood.

While they are living, the Thompsons plan on helping with Ally's financial needs through gifts to her parents. But they're most concerned about relieving the financial burden after they're gone and ensuring that Ally is supported when her parents have passed.

Partnering with corporate trust companies. This company would be named as trustee in a client's estate planning documents. Many allow you to custody the assets with your firm partner or custodian and continue managing them after the special needs trust is funded.

Efficient gifting strategies. Gift tax rules make an exception for expenses incurred for the diagnosis, cure, mitigation, treatment, or prevention of disease, as well as for medical insurance on behalf of an individual.

This exemption may give the Thompsons more flexibility in a year when they make larger gifts to Ally's parents, helping to keep them under annual exclusion amounts. It could also be important if they decide to fund a life insurance trust with Crummey provisions. If they gift premium dollars to the trust and their daughter Katherine is a beneficiary, they might exhaust their annual exclusion amount for gifts to her.

Continued care planning. Ally's condition doesn't compromise her life expectancy, so you must assume she will outlive her grandparents and parents. Because the Thompsons plan to make gifts to meet her support needs during their lifetime, you should discuss testamentary planning.

At a Glance

- **Issue:** Providing for family members with special needs
- **Solution:** Gifting strategies, life insurance trusts, special needs trusts
- **Don't forget:** ABLE accounts, created under the Achieving a Better Life Experience Act of 2014, are special accounts designed for disabled persons who meet certain requirements. With limitation, amounts held in these accounts can grow tax free and be used for qualified expenses without interfering with public benefits.

A special needs trust containing language that makes available assistance programs primary payers for her support needs may be viable. Almost all programs have an asset and income test, so the language would need to shield trust assets from being considered countable. An attorney specializing in this type of planning would understand the programs available to Ally and could craft the trust language appropriately. Prior to meeting with an attorney, the Thompsons need to consider important questions:

- How much money will they use to fund the trust? Because they are projected to have a large estate at death, they can dedicate a piece to fund a special needs trust.
- Who will they name as trustee? Special needs trustees need to understand aid programs and how distributions will affect testing requirements. A corporate trustee with a special needs focus may offer peace of mind.

3 Challenge 3: Achieve Asset Protection for Their Children

Because the Thompsons' goal is estate preservation for their children and grandchildren as well as charitable giving, a long-term care plan is essential to ensuring that their assets won't be diverted to cover unexpected health care costs.

The Thompsons realize they might not have the liquidity to cover the potential cost of care. Although they have substantial assets, selling assets with a low cost basis would trigger capital gains taxes. Using qualified money from tax-deferred IRAs or 401(k)s would result in federal and state taxes as well.

Estate planning. Estate planning isn't typically the first topic financial planners discuss with their clients, but it should be an essential part of the fact-finding process. Ask your clients for copies of their wills, trusts, and powers of attorney when you're collecting their other financial documents. If you're not familiar with these documents, enlist help from your firm partner's wealth management consultants, a lawyer, or an accountant to interpret them.

Long-term care. There are two options to present—traditional long-term care insurance and a linked-benefit long-term care policy. After your comprehensive analysis of their potential long-term care costs, the Thompsons recognize the need for a long-term care plan.

The policies they've selected can provide tax-free cash flow to cover expenses, protect the family, shield retirement income, and help ensure that their financial plan executes as intended. Consult with an insurance brokerage to help identify long-term care products for your clients facing similar circumstances.

At a Glance

- **Issue:** Preserving the family's assets for their children
- **Solution:** Long-term care planning, irrevocable trusts, estate planning
- **Don't forget:** With the passage of the SECURE Act, nonspousal beneficiaries (with some exceptions) are required to liquidate an inherited retirement plan by the end of the 10th year, effectively eliminating the so-called stretch IRA. By naming a charitable remainder trust (CRT) as the beneficiary of the retirement plan, you can replicate the benefits of the lifetime stretch for the clients' heirs.

Irrevocable trusts. Another issue at stake for the Thompsons is protecting their estate in case of divorce. You suggest that when the second spouse passes, each child's share be distributed to an irrevocable trust rather than to them directly. Trustee selection will also be an important consideration, requiring some serious thought on the Thompsons' part (as well as collaboration with their attorney).

They both like their son-in-law, Terry, but they see signs of trouble on the horizon and want to ensure that any money inherited by Katherine is protected. The trust can be drafted with language that protects assets from creditors and from a spouse in the event of divorce. Although this approach would limit their children's control over the assets, irrevocable trusts are a good option if they are truly concerned.

4 Challenge 4: Support Children's Charities

Your HNW clients will often look to continue their legacy through charitable giving. Guiding them through gifting strategies can help clients like the Thompsons unlock value in the form of tax benefits. By thinking outside the box for your HNW clients when it comes to gifting of assets to fund philanthropic goals, you can continue to add value to your relationship by understanding their needs.

Land and real estate assets. The Thompsons' home in South Boston's Fort Point Channel Landmark District is among the couple's most valuable assets. Presumably, however, they have no desire to relinquish ownership, likely aiming to bequeath the home to their children. It would appear the home is off limits for donation, but it's actually a prime candidate for a charitable gift of a historic façade easement.

For clients like the Thompsons, carving off a small portion of land or property ownership would leave them free to control the remainder of the property during life as well as after death and to pass the property along to their heirs.

Similar assets your clients may have include land that is home to rare plants or animals, scenic land, open farmland, and land of historic significance. Your firm partner's consultants can help you work with an attorney to prepare these types of gifts.

Business interests. Janice's interest in the Tanner FLP is valuable and highly appreciated, but she can no longer manage the day-to-day business and is looking to divest. Because of the Thompsons' net worth and the significant appreciation of their business, it's an ideal candidate for a charitable gift. Assets to look for in these situations include ownership of closely held business interests, significant capital gains, and no substantial steps taken toward selling the interest.

Art. Collectibles—including collections of stamps, coins, antiques, and memorabilia—may also be ripe for charitable gifting. The Thompsons' case is less common in that their art collection includes a piece created by Ed himself, which is subject to special rules regarding appraisals and deduction limits. The contributed asset must also be related to the purpose or function constituting the basis for the organization's charitable exemption.

At a Glance

- **Issue:** Charitable giving
- **Solution:** Real estate and land gifting, gifting art, gifting business interests, easements, charitable exemptions
- **Don't forget:** Donor-advised funds are a great way to maximize an up-front charitable deduction while retaining flexibility to decide which charities to support in the future. Clients may also name their children as successor grant advisors, so they can carry on a legacy of giving.

Do you have the right firm partner?

As an advisor and financial planner, you're a trusted partner working to provide solutions for every possible permutation of your clients' lives and goals, but it's impossible to know everything. That's where Commonwealth comes in—your trusted partner with a team of professionals ready to work with and for both you and your clients.

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As a proactive extension of your practice, the Advanced Planning team of subject-matter specialists can round out your expertise so you can cater to your HNW clients' complex needs. With access to our deep bench, you can:

- Focus on building client relationships instead of deciphering legal documents
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Your Firm Partner Established in 1979.

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