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WHAT IS WEALTH PLANNING, REALLY?

Wealth planning is a commonly used term among investors and advisors. But what's it all about? Discover the key aspects that make up an effective approach to wealth planning—and how it may fit into your financial picture.

KEY TAKEAWAYS

- Wealth planning looks beyond the basics of investments to examine your larger financial picture.
- Trusts, partnerships and life insurance are three strategies that often are used as part of an overall wealth planning effort.
- True wealth planning also adheres to seven core principles that drive strategy and decision making.

As you're probably aware, it can be all too easy to focus on just one aspect of your financial life—and in doing so, miss opportunities as well as incur unnecessary risk.

That's where wealth planning comes in. Wealth planning is a term you've likely heard before. But what does it actually entail?

Wealth planning is all about examining your full financial picture—not simply investments, although they're included, but also your advanced needs. These might include wealth protection, tax mitigation, wealth transfer (also known as estate planning) and charitable giving.

Armed with a full view of your situation and goals, you can set out to consider and examine a wide variety of financial and legal strategies that might be good options for you.

Here's a look at some key aspects of wealth planning, and why they can be so important to affluent families looking to make smart financial decisions.

CRITICAL TOOLS AND TECHNIQUES

Wealth planning's foundation is exceptional technical expertise—it takes superior capabilities to examine, coordinate and address the many aspects of your financial life. All capable wealth planners and their teams are knowledgeable about and adept with a wide array of legal strategies and financial products.

The basics of wealth planning include legal strategies and financial products that are readily recognized and generally appropriate for most wealthy families. Here are three examples.

1. TRUSTS

In many ways, trusts are cornerstone solutions for many successful individuals and families. A trust is nothing more than a means of transferring property using a third party—the trust. Specifically, a trust lets you transfer title of your assets to trustees for the benefit of the people you want to take care of (your designated beneficiaries). The trustee will carry out your wishes on behalf of your beneficiaries.

Trusts can be flexible wealth planning tools. You can use them in all sorts of ways to transfer your wealth and determine how it is to be deployed. Trusts also can prove to be very useful in shielding your assets from plaintiffs and creditors. Depending on the kind of trust, there are different tax consequences. For example, a trust could enable you to sell appreciated assets without paying any taxes on the increase in the value of those assets from the time you acquired them.

In crafting a trust, you are limited only by your own imagination, the technical skills of your wealth planner and—very important—the law. As long as you do not establish a trust for an illegal purpose, you generally have a significant amount of freedom.

Broadly speaking, there are two types of trusts: living (established while you are alive) and testamentary (created by your will after you've passed). Additionally, there are two fundamental trust structures:

- A ***revocable trust*** allows you to retain full control over the assets in the trust. You can add money to the trust or withdraw money from it, as well as change the terms of the trust.
- An ***irrevocable trust*** is one to which you cannot make any changes. To obtain the tax savings that can accompany this type of trust structure, you must relinquish control of the trust while you are alive. When you transfer control of assets to an irrevocable trust, you place those assets outside your estate. That means you no longer own them—the trust does.

2. PARTNERSHIPS

As with trusts, there are various types of partnerships. They can determine how the partners address ownership issues, and they have varying tax benefits. For example, within the business world, disharmony among family members or unrelated business partners can mean a higher tax bill if the owners are forced to divide assets among the partnership's members. Through the use of certain partnership structures, business owners can divide their companies' assets in ways that can eliminate taxes.

Consider two partners who each owned 50 percent of a manufacturing business and 50 percent of a trucking company. Infighting and friction led to irresolvable discord between them that impaired their ability to run the companies.

They decided that the only answer was for each of them to take over one of the businesses so that they would no longer have to work together. Both businesses were very successful and were roughly equivalent in value, and their respective values were in excess of their tax basis. If each partner had sold his business interests to the other, there would have been a sizable taxable gain for both.

To avoid the partners having to pay the taxes, a wealth planner formed a specialized partnership for them that gave one partner 100 percent control of the manufacturing company and the other partner 100 percent control of the trucking company—thus achieving the desired separation between the two. The partnership could be liquidated at a future time without triggering a gain or a tax liability for either partner.

3. LIFE INSURANCE

Death and taxes are certainties for everyone. The very wealthy, for instance, face hefty taxes on their estates when they pass away. And while there are ways to mitigate estate taxes through wealth planning, most are underutilized.

One area that has captured the interest of the affluent is the use of life insurance policies to help pay estate taxes. While life insurance can cover estate tax liabilities, this does not mean the estate taxes will not still need to be paid. Options such as extensions and loans to pay estate taxes can be very useful. However, these approaches can be problematic, especially if the situation involves extensive family businesses and significant non liquid assets.

For some, life insurance is a significant component of their overall approach to paying estate taxes. By using life insurance in estate planning, they can more effectively orchestrate the transfer of assets and better protect the family's wealth (and their legacy for future generations).

That said, life insurance can be complicated and somewhat opaque—making it an area where mistakes are common. A widespread mistake we see is buying more life insurance than necessary. Another frequent mistake is not having the life insurance integrated well enough with the estate plan (in situations where the purpose of the insurance is to pay estate taxes).

In other instances, people have life insurance policies that are simply wrong for their situations. A permanent policy is sometimes the best option; other times, a term policy is the better choice. It is critical for the type of life insurance to address the particular needs of your situation as precisely as possible.

THE CORE PRINCIPLES OF WEALTH PLANNING

But effective wealth planning isn't exclusively about technical expertise. Any wealth planner you enlist for help or guidance should adhere to seven ideals, all of which work together and should be treated as prerequisites in any situation:

- **Flexibility**
- **Discretion**
- **Transparency**
- **Cohesiveness**
- **Cohesiveness**
- **Risk sensitivity**
- **Cost-effectiveness**

Flexibility

Effective wealth planning is able to change and adapt to your evolving circumstances, as well as to shifts in the financial and legal environments. Successful elite wealth planners are flexible, accommodating, well-informed, and capable of quickly identifying and analyzing the range of anticipated scenarios.

Discretion

A high degree of discretion is a requirement for any professional working with the wealthy. As it relates to wealth planning, discretion regarding specific legal strategies or financial products can help avoid unwanted attention, unnecessary levels of questioning and retroactive changes to rules.

Transparency

In many situations, neither you nor a wealth planner would benefit from sharing the intricacies of a sophisticated or customized legal or financial solution. Nonetheless, it is important for each solution to be as transparent as possible and open to scrutiny by appropriate authorities. Moreover, operational transparency is a necessity.

Cohesiveness

While the legal strategies and financial products of wealth planning can be employed on a stand-alone basis, a certain degree of integration and coordination should inform all wealth planning. This can help ensure that your goals and objectives remain the focus of all efforts—and potentially enable various legal strategies and financial products to work in concert with each other for better outcomes.

Risk sensitivity

The spectrum of wealth planning solutions ranges from the plain vanilla to the truly exotic. Without stepping over any legal boundaries, there is still ample room to be creative. It is therefore critical that you and your other trusted advisors understand the level of assertiveness associated with a particular solution and consider it in the context of your capacity for taking risk.

Cost-effectiveness

There are times when the cost of a possible solution is much greater than the benefits it is likely to deliver. That's when more mainstream solutions may be sufficient. An effective wealth planner will carefully weigh the benefits of a recommended course of action against both its financial and psychological costs.

Legitimacy

Wealth planning should never incorporate tools or techniques that are—or may be perceived to be—illegal or even unethical. Considering how much good can be accomplished while operating fully within the law, there's no reason to cross the line. Doing so shows greed, ego or stupidity—or all three.

Mark Wade
President and Director of Wealth Management

ADOPT BEST PRACTICES

By and large, the self-made Super Rich have proven that they know what to do—and what not to do—in oder to create, grow and maintain sizable wealth. By avoiding major slipups on your own path to wealth creation, you can potentially encounter fewer financial potholes along the way.

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