CORRALES & CO.

10 TAX PLANNING TIPS FOR HIGH NET WORTH INDIVIDUALS

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When it comes to tax planning for high net worth individuals, we first should establish what that level is. The financial industry considers someone to be a high net worth individual if he or she has liquid assets that can be stacked higher than the $1 million mark. The industry also tends to see wealthy people in the range of roughly $5 million to $30 million as a separate group, and it further categorizes the over-$30 million set as ultra-high-net-worth.

At certain levels, the power of wealth takes a noticeable leap and the financial planning that people require climbs dramatically. The losses in taxes can be astronomical and certain tax sheltering strategies open up. Wealthy families need expert advice and careful planning to hold onto their assets and preserve them for their heirs.

In this article, we'll give rudimentary descriptions of a few tax planning tips. None of these ideas should be considered in a vacuum and the best way to apply any of them is through a trusted tax professional as part of a wide-ranging plan.

For one thing, taxes affect different types of assets in different ways. One person or family can face taxes on salaries; equity compensation, like stock options; retirement income, like pensions and 401(k) withdrawals; and the returns from any number of investments. Each tax filer's circumstances are different. For another thing, the stakes are very high, and the Internal Revenue Services will be checking their math.

HOW DO HIGH NET WORTH INDIVIDUALS REDUCE TAXES?

The acronyms might be off-putting, but these tax planning strategies can unlock great benefits.

CLTs and CRTs

There are two basic types of irrevocable trusts that place assets into charitable organizations: Charitable Lead Trusts (CLTs) and Charitable Remainder Trusts (CRTs). These are valuable tools for minimizing estate taxes.

With an irrevocable trust, the terms can't be changed without the permission of the beneficiary. The person setting up the trust relinquishes control of an asset and it is removed from his estate. However, he gains tax benefits, including a tax write off and smaller estate, while helping a charity. (A revocable trust, on the other hand, allows the grantor to modify the trust, but doesn't have the same benefits.)

With a CRT (where the "R" stands for remainder), the donor gets income from the trust for a set number of years, or for life, and the charity gets the remainder of the assets when the trust period ends. The donor receives an immediate income tax charitable deduction when the CRT is funded, based on the present value of the assets that will eventually go to the named charity.

With the less common CLT (where the "L" stands for lead), an irrevocable trust is set up to send income to a charity for a certain period. The high net worth individual gets tax benefits for the donation. When the period is over, the assets go to the beneficiaries of the high net worth individual.

CRAT, CRUT, CLAT and CLUT

These are forms of CRTs and CLTs.

In a CRAT (charitable remainder annuity trust), the high net worth individual places assets in a trust that pays a fixed, predictable annual amount to a beneficiary through an annuity. The annuity is based on the initial value of the trust's assets, and the payout must be 5% or more. When the donor dies, the remaining assets go to a charity.

In a CRUT (charitable remainder unitrust) the donor and/or her beneficiaries receive an annual, variable income that is a fixed percentage of the value of the trust's assets, which is evaluated every year. When the donor dies, the remainder goes to the charity.

A CLAT (charitable lead annuity trust) can be seen as the opposite of the CRAT. In this case, the annuity income goes to the charity. When the donor dies the rest goes to donor's heirs.

A CLUT (charitable lead unitrust) could be called the opposite of the CRUT, because it pays the charity an annual, variable income – a fixed percentage of the asset's value – for a set amount of time and then sends the rest to the heirs.
Which one of these would be best for you? It depends on your assets, tax situation and goals. Each one of these trusts, and many similar variations, are designed for specific purposes.

DAF

A donor-advised fund (DAF) is a private fund created to manage charitable donations for an individual, family or organization. A high net worth individual could hire a financial services company to set up a DAF, which could hold donations of cash, stock, and many other assets. The donor or donors keep a great deal of control over the distribution of the money to charities while enjoying tax benefits. The benefits include federal income tax deductions of up to 50% of adjusted gross income for cash contributions and up to 30% of AGI for appreciated securities, while also avoiding capital gains taxes. Savvy financial advisors also can help clients to combine DAFs with the charitable trusts that we just described to provide better flexibility.

GRAT and GRUT

A grantor retained annuity trust (GRAT) is another form of irrevocable trust that can help to minimize estate taxes. They are particularly useful for assets that are expected to see quick and significant appreciation, like a pre-IPO stock or hedge fund investment. The individual puts assets into a fixed-term trust that will pay her an annuity for that time period. Then, the assets go to the individual's beneficiaries, usually her children, with little or no gift tax cost. If the assets do not perform up to a certain level, they are returned to the grantor.

A grantor retained unitrust (GRUT) is like a GRAT, except that instead of receiving a fixed annuity payment, the person who sets up the trust receives an annual payment based on a fixed percentage of the fair market value of the assets.

IDIGT and IDGT

An intentionally defective irrevocable grantor trust (IDIGT, and more commonly called IDGT) allows individuals to move assets out of their estates for estate tax purposes but still possess them in terms of income taxes, which they pay. They are called intentionally defective because they are designed to blend aspects of a revocable trust into an irrevocable trust. IDGTs are used to pass on to children or grandchildren assets that have grown without the erosion of income taxes. An IDGT also enables the grantor to lower his or her taxable estate.

ILIT

Life insurance can help wealthy families concerned about heirs having trouble with the estate taxes that might come with receiving real estate, a business or some other illiquid asset. With an irrevocable life insurance trust (ILIT) the beneficiaries can use the death benefit to pay estate taxes. ILITs also can help with gift taxes, protecting heirs' government benefits and minimizing the effects of the generation-skipping transfer tax (GSTT), which can kick in when someone tries to leave assets to grandchildren.

FEWER ACRONYMS, MORE WAYS TO SAVE MONEY

Bunching charitable donations

The Tax Cuts and Jobs Act that got rolling in 2018 greatly increased the standard deduction for federal tax filers. That, in turn, made it less advantageous for many people to itemize their deductions. One way to minimize taxes is bunching two or more years' worth of charitable giving into one year. That allows them to itemize deductions in the first year and use the standard deduction in following years. When planned properly it can reduce their tax burden overall for those combined years. This strategy also can be paired with the use of a DAF (donor-advised fund).

Donate stock, keep cash

It's nice to support a good cause, and it's not a bad thing to minimize taxes too. Donate stock instead of cash and you won't have to pay capital gains on the stock. And neither will the charity. Plus, you can claim a charitable deduction on your taxes for the fair market value of the stock. This is another tactic that can be paired with a DAF (donor-advised fund).

Intrafamily loan

When it is structured properly, an intrafamily loan enables someone to loan a relative money, perhaps to start a business, buy a home or make an investment, while employing a powerful estate-planning tool. The loan can be made at rates well below the commercial market; the IRS sets minimal rates, called applicable federal rates. If the borrower earns a better return on the money than the AFR, she can pocket that return without paying a gift tax or generation-skipping transfer tax (GSTT).

This tactic also can be paired with an irrevocable grantor trust to increase the benefits.

Tax-loss harvesting

Folks who invest in the stock market are happy to see their picks do well. But they also know that can mean big capital gains taxes. If they notice that some of their stock investments have lost ground, they might engage in tax-loss harvesting. That means selling losers and using the loss in capital gains to offset the tax burden from the winners' capital gains. As with all these strategies, it should be considered in the larger context of a person's tax and investment strategies. The tax consequences are not necessarily the best reason to sell an asset – even one that's down.

THE BOTTOM LINE

Wealth management is a complex endeavor. The professional financial advisors at Coralles & Co. have the experience and expertise to help high net worth individuals enjoy the present and plan for the future.