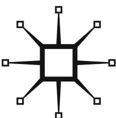
WEALTH

The Ultra-High Net Worth Guide to Growing and Protecting Assets

RICHARD P. ROJECK



Wealth

Richard P. Rojeck

Wealth

The Ultra-High Net Worth Guide to Growing and Protecting Assets

palgrave
macmillan

Richard P. Rojeck
La Jolla, CA, USA

ISBN 978-3-030-24496-5 ISBN 978-3-030-24497-2 (eBook)
https://doi.org/10.1007/978-3-030-24497-2

© The Editor(s) (if applicable) and The Author(s), under exclusive license to Springer Nature Switzerland AG, part of Springer Nature 2019
This work is subject to copyright. All rights are solely and exclusively licensed by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed.
The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.
The publisher, the authors and the editors are safe to assume that the advice and information in this book are believed to be true and accurate at the date of publication. Neither the publisher nor the authors or the editors give a warranty, expressed or implied, with respect to the material contained herein or for any errors or omissions that may have been made. The publisher remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.

Cover image: © Jun/iStock/Getty Images Plus

This Palgrave Macmillan imprint is published by the registered company Springer Nature Switzerland AG
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is distributed with the understanding that the author and publisher are not engaged in rendering legal or tax advice. If legal or tax advice is required, the services of a competent professional person should be sought.

The views and opinions expressed here are those of the author and not necessarily those of Lincoln Financial Advisors. The book is designed for educational purposes only and discusses many strategies and techniques that may not be appropriate for every situation. Please consult with your financial, tax and legal advisors prior to executing any strategy outlined in this book.

Richard Rojeck is a registered representative of Lincoln Financial Advisors Corp., a broker-dealer (member SIPC) and registered investment advisor.

Information presented about tax law is intended to be current at the time of publication and is subject to change.

Preface

This book is written for the wealthy. About that I make no apologies. Definitions of wealthy and related terms such as ultra high net worth or super affluent are as numerous as those who offer them. Labels notwithstanding, these are individuals who have achieved exceptional levels of personal and financial success. And they have contributed significantly to our economy, and often, society as a whole. They also share the distinction of being amongst the top 1% of income earners who will pay over 40% of the federal individual income tax.[1] And they will certainly be in the .2% of Americans whose estates, collectively, are destined to pay an estate tax.[2] Depending upon the direction of the political winds, their tax burden could rise even further. These and other factors give credence to the saying that, "It's easier to make money than to keep it."

This group, while hotly pursued by purveyors of financial advice, in many ways, is underserved. Almost without exception they have retained the services of capable advisors: attorneys, CPA's, investment bankers, trust officers, investment advisors, and insurance experts. And they have assembled many of the components of a financial plan: wills, trusts, business agreements, investment portfolios, and insurance. But these disparate components were implemented at different times, with different advisors, with differing perspectives, are often uncoordinated and often out of date. Frustration by an inability to gain clarity or simply to bring "closure" to their planning is not uncommon.

[1]Source: Tax Policy Center; Urban Institute & Brookings Institution, 2017.

[2]Source: Joint Committee on Taxation, US Congress.

This book stands for the proposition that the best defense against high and rising income and estate taxes and other threats to your wealth emerges from a comprehensive, integrative process, guided by a qualified financial planner. Such an individual will help you see the big picture, help you identify your values and goals, and then work with you to identify and assemble the specific components to best achieve those values and goals and defend your hard-earned wealth. Integral to the process is the creation of a financial model which will be indispensable in evaluating present and forecasting future outcomes. Working with your other advisors, he or she will ensure the plan is coordinated, implemented and updated.

Our journey will cover eight topics in as many chapters. As we visit each I suspect you will read about some strategies with which you are familiar and perhaps which you have already implemented. I also suspect you'll learn about many others of which you weren't aware. I will urge you to consider each in the context of your values and goals and of course how they can be best evaluated through a financial planning process. Chapter 9 addresses the subject of how to select a qualified financial planner. And in Chapter 10 I attempt to draw it all together through a series of questions which I hope you'll find thought-provoking. For the Type A personalities, you may wish to skip to Chapter 10, then work backwards to the corresponding chapters (just don't skip any!).

Let's get started.

La Jolla, USA Richard P. Rojeck

Acknowledgements

It's been said "everyone has a book in them" (with variations including "and in most cases, that's where it should stay"). Seldom mentioned is the gestation and labor process associated with giving birth to it. There are a number of individuals to whom I am grateful for their assistance in the process. Foremost is my niece Danielle Paghorian whose nickname "Starr" is an apt description of her contributions in research and typing (and re-typing as the whimsy of my word selection often required). My administrative assistant, Ashley Green Altick, added the finishing touches. Paul Robinson, PhD, contributed a professorial review for syntax and punctuation. And Mark Russell performed a remarkably painless compliance review. I am also indebted to the many who provided a technical review (while I reserve full credit for any remaining inaccuracies or deficiencies): Nasser Ali, CFP®, CFA, Bob Appel, J.D., LL.M., Paul Dostart, J.D., LL.M., Ben Huddle, CFP®, Tim Johnson, J.D., and Ken Weiss, C.P.A., J.D., LL.M. Finally, I'd like to thank the most important people in my life, Joji, my wife and best friend of 41 years and the joy of our lives, our three children, Jessica, Alexandra and Jason. You make it all worthwhile.

Contents

1 Wealth 1

2 Estate Planning 7

3 Charitable Planning 25

4 Business Succession 37

5 Asset Protection Planning 47

6 Life Insurance 55

7 Investment Management 63

8 Income Tax Planning 93

9 Selecting a Financial Planner 113

10 Tying It All Together 121

Index 127

List of Figures

Fig. 1.1	Utility of wealth	5
Fig. 2.1	Typical estate plan	8
Fig. 2.2	Grantor Retained Annuity Trust (GRAT)	18
Fig. 3.1	Charitable Remainder Trust (CRT)	27
Fig. 3.2	Charitable Lead Trust (CLT)	29
Fig. 3.3	Wealth Management Plan	32
Fig. 4.1	Buy–sell agreement structure	39
Fig. 4.2	Sample business succession structure	42
Fig. 5.1	Spousal Lifetime Access Trust (SLAT)	49
Fig. 5.2	Domestic Asset Protection Trust (DAPT)	51
Fig. 6.1	Permanent insurance	57
Fig. 7.1	Modern portfolio theory	65
Fig. 7.2	Efficient Frontier	66
Fig. 7.3	Thomas Reuters Core Commodity CRB Index	79
Fig. 7.4	Sample portfolio	84
Fig. 7.5	Sample Investment Policy Statement Outline (*Source* Adapted from "Sample Investment Policy Statement – Retirement Plan 3(38)" by Fi360, Inc., 2018. Copyright 2018 by Fi360, Inc. Adapted with permission)	89

List of Tables

Table 2.1 Sale to Intentionally Defective Grantor Trust (IDGT) 16
Table 2.2 GRAT example 18
Table 2.3 Qualified Personal Residence Trust (QPRT) example 19
Table 2.4 Typical structure of partnership freeze 19
Table 2.5 Federal gift and estate tax 21
Table 2.6 Four ways to pay 22
Table 3.1 Charitable Remainder Annuity Trust (CRAT) example 28
Table 3.2 Retained Life Estate with Gift Annuity example 33
Table 6.1 Economics of life insurance 60
Table 7.1 Annual total returns of key asset classes 1999–2018 68
Table 7.2 The penalty for missing the market 69
Table 7.3 Determinance of portfolio performance 69
Table 7.4 Annual returns of key fixed income sectors 1999–2018 75
Table 7.5 Annual returns by property sector 1999–2018 77
Table 7.6 Commodity price changes 1999–2018 81
Table 8.1 Advantage of tax deferral (cumulative value) 94

1

Wealth

In his book, The Affluent Society, American economist John Kenneth Galbraith writes "Wealth is not without its advantages and the case to the contrary, although it has often been made, has never proved widely persuasive."[1] The creation and accumulation of wealth being the natural outcome of an ambitious individual encountering a free-market system, the question remains only "how much wealth is enough?" At the individual level, the answer to "Do I have enough?" can be both a mathematical as well as an emotional issue, and it has very little to do with the traditional notion of retirement. The question, "Do I have enough?" can be translated into "Am I financially independent?"

Of course the answer depends on your desired lifestyle, since we know that there is no amount of wealth that a given standard of living could not consume. People with vast sums of wealth are declaring personal bankruptcy merely because of an out-of-control lifestyle.

The answer also depends on how you define your financial independence, for which I suggest the following definition: "Being able to enjoy one's desired standard of living while engaging in one's desired activities, without regard to the current rewards associated with them." In other words, "I want to be able to do what I want to do when I want to do it and not care about the financial rewards."

As you think about financial independence, it's important that you consider whether it should be built on the endowment or the annuity concept.

[1] John Kenneth Galbraith, *The Affluent Society* (Boston: Houghton Mifflin, 1958).

© The Author(s) 2019
R. P. Rojeck, *Wealth*,
https://doi.org/10.1007/978-3-030-24497-2_1

Let me explain. An endowment is a sum of money sufficient in amount such that the earnings (current income plus appreciation) are sufficient to provide for the need, adjusted for inflation, forever. In other words, your original capital will remain intact and, in fact, will grow at least at the rate of inflation. The point in building an endowment is so you never have to worry about how long you live. Life expectancy becomes irrelevant. I would suggest this is the truest measure of financial independence. And, by definition, at your death, your wealth will pass to your heirs and or to society.

By the Numbers

You have heard about college endowments or endowments for the arts. This is the same concept. The amount of the endowment is deemed sufficient to pay for a college professor's salary, or to augment an opera's performing costs, or an art museum's operations, indefinitely, without consuming the original principal, adjusted for inflation. The process starts by establishing an expected long-term return for its investment portfolio: 7–8% is most common. From this is subtracted the expected rate of inflation, the portion of the return that must be reinvested, to allow the portfolio to grow and offset the future impact of inflation. The U.S. inflation rate has averaged about 3% over the past 100 years. Subtracting 3% from 7% yields the 4% spendable return commonly used. As charities are generally tax exempt, absent from this calculation is an adjustment for income tax. So for example, an endowment of $2.5 million invested at 4% net, would generate income of $100,000 annually to support the organization's operations.

The annuity concept, on the other hand, assumes that a sum of capital is accumulated so that—based upon an anticipated investment return—the principal plus earnings on a declining balance will satisfy the need for a given period of time. In this case, the given period of time is, of course, how long you plan to live. In other words, in addition to consuming all the income, you are also using up an increasing amount of the principal each year until it is exhausted.

The risk here is that you may live too long, exhaust your principal, and wind up on your children's doorstep, tin cup in hand. Given the choice, most everyone would prefer the endowment approach. But like everything else in life, you get what you pay for. Endowment "costs" more, and therefore, has implications on everything else, from how long you must work, how much you must sacrifice in order to save, your future sustainable income, and everything in-between.

Let's look at an example, first taking the endowment approach. Assume your desired lifestyle comes with a $1 million annual price tag after tax, meaning you spend about $83,000 per month. If we use 3% as the assumed after-tax investment return (versus 4% in the case of a tax-exempt organization), dividing $1 million by 3% yields required invested capital of $33.3 million. Of course, invested capital excludes your other, non-income-producing assets such as your home, a second home, furnishings, artwork, cars, a yacht, etc. In contrast the annuity approach would require just $21 million using the same assumptions and a 30-year life expectancy. Results are proportional, so if your lifestyle is $2 million, $3 million or more, simply increase the required sums accordingly.

The mathematics behind this endowment approach is similar to that in valuing income-producing assets, whether they be bonds, oil wells, stocks, real estate, or closely held businesses. The income stream (e.g., interest, dividends, net operating income) is divided by a discount or "cap rate" to yield a "present value" or today's dollar equivalent of the income stream, which yields the price a buyer would pay to acquire it. So in our example above, a buyer would be willing to pay $33 million in order to purchase a $1 million income stream, after tax, paid indefinitely, adjusted for inflation.

While this methodology is broadly accepted and, arguably, straightforward, it does have a shortcoming in that it assumes a consistent investment return. That is, it assumes the investment portfolio earns 7%, inflation is 3%, taxes 1%, every year. But we know this is not the case; investment returns can vary widely from year to year and this can have a big impact on the outcome. In fact a significant body of research supports the notion that the pattern or sequence of returns greatly influences whether your assets will be sufficient to sustain your lifestyle.[2]

To more accurately determine the amount of invested capital necessary, considering the variability of returns, financial planners often use a Monte Carlo simulation. It gets its name from the famous Mediterranean seaside resort known for its casinos and high rollers. Monte Carlo simulation seeks to determine the likelihood of a given outcome by running numerous trials or iterations, typically 1000. It's particularly useful when no mathematical formula exists to precisely calculate an outcome, though as a simulation, the result is a range of outcomes rather than a precise forecast.

[2]Philip L. Cooley, Carl M. Hubbard, and Daniel T. Walz, "Portfolio Success Rates: Where to Draw the Line," *Journal of Financial Planning* 24, no. 4 (April 2011): 48–60.