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## Estate Planning: A Priceless Step Toward Preserving Wealth

*Last Year, at Least 37,700 Households in The County Were Worth More Than \$1M*

By PAT BRODERICK

So many millions, so many choices, so little time.

How are 21st century rich folks minding the mint? If they're wise, they are tending to their estates on a regular — and timely — basis, and keeping up with both new options in the marketplace, as well as the ever-shifting tax laws.

That's the consensus of some San Diego-area estate planners, who have accumulated a fair number of cautionary tales. Consider these gems:

There once was a very rich fellow, who also was a very private fellow, especially about his business affairs. But, after his death, his estate ended up in probate, leaving his considerable assets wide open for everyone to see.

"He had had some very sophisticated estate planning done, and had his will and trust in place," said

Jacqueline Parks, an associate with San Diego-based law firm Best, Best & Krieger, and a specialist in estate planning. "But he failed to transfer his assets to the trust, which keeps them out of probate — a very public, very open process. It's public record."

Some estate planning attorneys in the Ohio town where Parks used to work joked that the gentleman must be rolling over in his grave.

"Newspapers could have printed all of his assets in the newspaper if they had wanted to," said Parks. "He had a really good business attorney, but didn't have an estate planning attorney. People have advisors they know and trust with their business, and they ask, 'Will you do my will for me?' A lot of attorneys get asked that, right out of law school."

Louis A. Mezzullo, a partner in the Rancho Santa Fe office of Luce,

Forward, Hamilton & Scripps LLP, and a nationally recognized estate planning attorney, and immediate past chair of the American College of Tax Counsel in Washington, D.C., has seen his share of missed opportunities, too.

"I have had several situations where a client procrastinated and it cost the family money," he said.

One client had two marriages, and had named his daughter by the first marriage as executor. But, the client died before he signed the will.

The daughter went to the courthouse, and so did the second wife, and the court appointed both as co-executors.

"I'm not sure if the estate has ever been settled," said Mezzullo.

In another case, an entrepreneur planned to divide his business between his son and son-in-law. *(continued)*

But, before he could put the plan in place, he arrived at work only to be shot by a burglar. The son and son-in-law couldn't agree on terms, so the business was sold for half of what it was worth.

"It's never too soon to start planning," said Mezzullo, who also is past chairman of the American Bar Association Section of Real Property, Probate and Trust Law.

Chris Meacham, chief executive officer of Rancho Bernardo-based Cornerstone Wealth Management LLC, frets over wealthy clients who won't take the time to tend to their estates.

"We have some we can't get to come in and spend a couple of hours to go over their affairs, because they are working so hard running their businesses," said Meacham. "I say, 'Isn't this part of what you're working for?'"

This is the most frustrating thing I run into with clients. They're probably the same people who aren't seeing their doctors."

Carol Schaner, a certified tax specialist with the law firm of Gordon & Rees LLP in San Diego, takes to tasks clients who view estate planning more as a one-time transaction, rather than a process that needs to be adjusted as time passes.

"Not everybody is well-positioned to serve as an executor, and there are people who shouldn't be named into those positions," said Schaner. "Situations change."

### **World Of Wealth**

What doesn't seem to change is that the rich keep getting richer. In 2006, there were more than 37,700 households in San Diego County worth more than \$1 million, a 1.8 percent rise from 2005, and these households are expected to grow by more than 51 percent in the next five years, according to Claritas Inc., a San Diego-based market research firm.

In North America, high-net worth individuals — with at least \$1 million in assets — rose by 10 percent in 2006, with combined assets totaling \$11.3 trillion; while globally, high-net worth individuals rose 8.3 percent. This, according to the 2007 World Wealth Report, released in June by New York-based Merrill Lynch & Co. Inc. and Capgemini, an international consulting, technology and outsourcing services company.

The growth was spurred by a strong global economy, according to the report, including strong corporate profits, declining oil prices in the second half of the year, and increased investor and consumer confidence.

"Real estate did play a partial role for this group of people," said Ajay Gupta, vice president, and wealth management advisor for the Merrill Lynch Global Private Client Group in downtown San Diego.

They also took a global perspective to hedge their bets.

"With the weakening of the U.S. dollar, they benefited from having assets spread across the globe," he said. "More and more investors, even those sitting on large cash balances, also include non-U.S. dollars — short-term investments — with euros, yen, Canadian dollars. They don't want to lose purchasing power on a global level."

Gupta described San Diego as a "very diversified market," compared to some other regions.

"In Texas, you have oil or energy," he said. "But, in San Diego, there are a lot of local entrepreneurs, who own businesses that have done well."

### **Element Of Uncertainty**

In any U.S. market where the wealthy dwell there is an "element of uncertainty" when it comes to the federal tax laws, which changed substantially in 2001 as part of President Bush's tax cut plan.

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Immediately prior to that, people who died owning less than \$675,000 were exempt from the tax. But after 2001, the bill arranged for a structured phase-out of the estate tax, reducing it gradually until 2010, when the tax would be entirely repealed.

The current threshold is set at \$2 million, going to \$3.5 million in 2009, with a zero estate tax levied in 2010. The bill provides for a sunset provision that would reinstate the tax on Jan. 1, 2011, and reset its 2001 levels to \$1 million, said Parks.

“Many attorneys think that Congress will act between now and 2010 to freeze the exemption amount at \$3.5 million, or to otherwise reinstate the tax for the year 2010 and beyond,” said Parks.

Either way, she added, “There is a state of uncertainty. Elections are coming up in 2008. What’s going to happen? Who is going to be president, what is their position on estate taxes going to be, will Congress have a big enough majority to overcome the sunset?”

This presents a dilemma for some semi-wealthy folks, said Parks.

“If you have a \$10 million estate, you will do sophisticated planning,” she observed. “But if you are in the middle, how much money are you going to spend

on attorney fees to do sophisticated plans only to find out that Congress will wipe it out, and you never would have to pay estate tax. So, do you plan, how much do you plan, or do you not plan?”

Planning ahead always is a good idea, said Mezzullo.

“We’re not talking about spending hundreds of thousands of dollars for advice,” he said.

Depending on the size of the estate, fees can range from \$10,000 to more than \$50,000 for more sophisticated strategies, he said.

In any event, Mezzullo isn’t optimistic that congressional Democrats or Republicans will be willing to compromise on the estate tax issue. But whatever happens, he said, “Most people would agree that it’s not going to go away. There is such a small group of Americans who are affected by the estate tax, it would be unbelievable that the majority would want to eliminate an estate tax they would never have to pay. I think there will be an estate tax.”

Rick MacDonald, senior financial planner and principal for the Boston office of Mintz Levin Financial Advisors LLC, also doubts that the estate tax will disappear altogether.

“The government can’t afford to let the estate tax disappear,” he said.

But if it comes back at the \$600,000 level, it would “wreak havoc,” said MacDonald, noting that “a huge percentage of the middle-class could be liable for the estate tax.”

Some clients are what he calls “middle class wealthy,” with \$1 million to \$3 million of investment assets, and they are less focused on asset planning than retirement, he said.

“A \$2 million portfolio gives someone significant cash flow, but will not make them rich,” said MacDonald. “But, combined with Social Security and a modest pension, they can live a very good lifestyle, but they won’t be buying private planes or part of a sports team.”

Then, there are clients with more money than they can ever spend in a lifetime, he said.

“The focus shifts, and almost everybody agrees that they don’t want to pay any more estate tax than they need to, so you work to limit the estate tax,” he said.

Most of Schaner’s clients also believe that the estate tax is here to stay.

“We are taking a hard look at how they are protecting their assets,” she said. “And, estates are larger, because a lot of clients are starting to inherit.”

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## **Weighing The Options**

According to the World Wealth Report, in 2006, high-net worth individuals shifted their money away from alternative investments, including hedge funds, structured products, foreign currencies, commodities, private equity/venture capital and derivatives, to gain higher returns from real estate opportunities.

But, the reported added, “We do not interpret this as a sign that this investment class is falling out of favor.

We believe that this dip is a temporary tactical move by investors pursuing the higher performance currently yielded by real estate. We project an increased allocation to alternative investments in the coming year.”

In fact, Meacham has noticed a growing trend toward nontraditional investments that go beyond stocks and bonds, that include real estate, trusts, commodities, managed futures, hedge funds and private equity.

“Hedge funds have become a bigger part of larger endowments over the years,” he said.

The downside to all of this?

“Complexity,” said Meacham. “With that kind of diversification, you’ve got a lot of statements coming your way,

and paperwork. You have to track a lot of things. You really need to have the breadth of knowledge across the spectrum, which we have.”

But Cornerstone doesn’t identify the investments, said Meacham.

“We are more like a general contractor in building a custom home and finding the right subcontractors,” he explained. “We don’t have to be an expert in every one of those areas, but we have to understand all of those areas.”

With complexity can come red flags that ignite the attention of the Internal Revenue Service. But, said Parks, there are many legitimate options to safeguard assets.

“You try to shift assets down to the next generation, so that the kids have the appreciation, and not the parents,” she said.

One option that can carry a red flag is the practice of transferring a business, commercial real estate or marketable securities to a family limited partnership or a limited liability company, and making gifts of the partnership or membership interests.

“It’s a very common thing to do, but it involves audit risk,” said Parks. “A lot of attorneys don’t do it because of that audit risk. The IRS attacks the amounts of discounts taken. ‘Has the parent really

given a gift away to the child, and did the parent try to pull those assets back into the estate?’ ”

Attorneys should tread carefully when forming these partnerships, said Parks.

“I would be wary of anything that will fix how your assets will be distributed, based on the current \$2 million exemption,” she said. “It’s risky, because the law will change. Attorneys should build flexibility into a plan based on how it is going to change.”

Mezzullo agreed that any successful planning technique requires careful preparation.

“Almost every estate tax return is going to be audited, anyway,” he said. “But if a family limited partnership is structured properly it should withstand any attack by the IRS.”

The key is to set up such a partnership for reasons other than tax purposes alone, he said, including protecting assets from children’s spouses or creditors.

“If the client says this is only for taxes, and they don’t care about other reasons, it probably won’t work,” he said.

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## Avoiding Pitfalls

Another trend that Schaner has spotted is clients who are paying more attention to their domestic assets.

“People are starting to access their estates, because they want to keep what they have,” she said. “They think they may live a long time, and are wondering, ‘Is there anything I can do better that I haven’t done?’ A lot feel that they are going to live a long time. They are feeling good, and not working 80-hour weeks anymore, and they are enjoying their lives.”

And while they love their kids, she added, their attitudes are becoming, “‘Not so fast with the gifts to the children.’ There is a definite trend to really preserve and nurse what they have, while keeping a closer finger on gifts. It’s not that they aren’t doing gifts, but they are not jumping in as soon as they might have.”

But when they do jump, they should be looking where they leap, said Angelo Esposito, principal of CUSTOMatrix Inc., whose services are designed to help clients build wealth.

“The wealthy tend to neglect tax implications of passing money along, especially setting up trusts improperly, and not taking account of the tax hit that

the estate or the person inheriting money will get,” said Esposito.

His advice: Build a solid portfolio, “rather than throwing a huge chunk of money on a high-flying stock that could crash and burn.”

And beware of potential conflicts of interest.

“I advise against taking any one broker’s advice on anything, especially if they are affiliated with a large company,” he said. “Remember that this person has a vested interest in selling you their firm’s mutual funds and stocks. This is where they get their commission, and it might not be best for your situation.”

Once a year, clients should engage a fee-only advisor to review their portfolios, and compare them to what their brokers are telling them, said Esposito.

“In some cases, the fee-only advisor might suggest a different mix of investments that the broker might not be able to offer out of his stable of services, or won’t advance, because the commission won’t be as large,” he said. Esposito also is miffed by clients who take a “laissez faire” attitude.

“They think, ‘The broker will take care of me,’ but, unless they have assets in the millions, they won’t get the attention that their portfolio should,” said

Esposito. “A fee-only advisor will make sure what they are doing is appropriate.” That’s not to say that what the big name companies are advising are necessarily bad investments, he added.

“They might be good for Donald Trump, but is it good for you?” he asked. “An oil field in Paraguay might be perfectly fine, but do research and get a second opinion about the upsides and downsides.”

Cornerstone also is concerned with potential conflicts, said Meacham, whose typical clients have assets between \$2.5 million to \$3 million, and an upper end group worth \$5 million or more. But a new division caters to the \$100,000 to \$1 million market, which he considers especially vulnerable.

“I hated turning them away,” said Meacham. “This is an underserved market, and there can be a lot of abuse in that area. We try to determine an efficient way to help those people.”

By abuses, he means a lack of service, or selling products that will reap the manager commissions, whether or not they make sense for clients.

“We think that is inappropriate,” he said. “We try to eliminate conflicts of interest and sit on the same side of the table, and provide objective advice.”

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### **High Anxiety**

While the rich might be getting richer, some of them also are growing more wary about the world they live in — from the uncertainty of Social Security and Medicare, to the war in Iraq, said Meacham.

“They are more cautious than they were 10 years ago,” he observed. “This plays into how we handle clients. We tell them on the front end that we do not try to predict the future, or where interest rates are going, or where the stock market is going. We are not going to make bets in that area, because everything could change tomorrow — a terrorist attack could change the investment world in the U.S. overnight.”

But, again, this is where diversification can save the day, he said. “By diversifying your portfolio, it hedges against a major concern, a terrorist attack, a Depression,” said Meacham. “You can weather the storm, and reduce the risk and increase the return on your portfolio.”

Other pitfalls to avoid?

Meacham cautions clients against “chasing returns,” and looking back at what had performed well in the past. “You shouldn’t be driving in the rear-view mirror,” said Meacham.

Then, there are clients who invest emotionally, which Meacham defines as “psychological entrapment.”

He recalled a wealthy client who had one stock that represented 90 percent of her portfolio.

“Her parents gave it to her, and said, ‘Never sell the stock.’ I don’t care what the stock is, this is high risk and terrible. But she was so psychologically trapped, that it was emotionally difficult for her to let go. But, she did, thank goodness.”

Some wealthy parents, trying to head off financial meltdowns, are sending their heirs to places like the Financial Boot Camp. Presented by Merrill Lynch’s Private Banking and Investment Group, in partnership with the Wharton School of the University of Pennsylvania and IFF Advisors LLC, a global consulting firm, the camp is designed to prepare young adults for “the responsibilities of wealth now and in the future.”

“They want to find significant ways to educate the next generation to make sure that their legacies continue,” said Gupta, who added that some major West Coast universities are now being considered for the program. “They are trying to take it around the country.”

### **From Sinful To Sustainable**

Many of the rich are becoming more socially responsible when it comes to sharing their wealth, according to the World Wealth Report, noting that, “They are looking to invest in companies and financial products that share their concerns.”

For instance, more investors and corporations are looking for investments in Earth-friendly, green technologies — not only for their social impact, but because they are providing returns, said the report.

The wealthy also are boosting their philanthropic donations, with the new generation wanting to give back to society through a broader range of activities than in the past.

According to the report, this group tends to strategically manage the money they donate in order to raise its impact, using leveraging tactics similar to those they have used successfully in their businesses.

One emerging trend is “sustainable investing,” not to be confused with the more traditional “socially responsible investing,” said Jan Schalkwijk, principal of downtown San Diego-based **JPS Global Investments**.

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What's the difference? Socially responsible investing tends to avoid the so-called "sin" stocks that involve tobacco, alcohol or firearms — a negative approach, said Schalkwijk. But with sustainable investing, it's more about what clients do invest in, rather than what they don't invest in.

"Sustainable investing is looking for companies that have a sustainable business model, are aware of the environment, have strong corporate governance," said Schalkwijk, adding that it's also about getting good returns.

"If you have a business model that will work five years from now or 10 years from now, you have a sustainable business," he said. "If you don't have good relationships with all of your stakeholders — suppliers, customers, the community, the environment, the stockholders — you don't have a sustainable business."

Sustainable investing tends to attract women — more than half, who are

well-educated, and tend to be younger, from 30 to 49 years old.

"It's flip-flopped," said Schalkwijk. "The traditional investment profile is 60 percent men, 40 percent women."

Schaner has observed a "high level of philanthropy" among her wealthier clients in the form of private foundations and charitable trusts.

"The market is up, and some of these clients, after many years, have sold their businesses, and feel that they have more than they need," she observed.

"And people are reading about it more, reading about Bill Gates."

### **Open Minds**

When all is said and done, said Mezzullo, a lawyer's job is to determine what the client wants.



"It's coming up with a plan that carries out the client's desires and minimizes taxes, but not distorting what the client wants to do," he said. "The tax tail should not wag the dog. Common sense is very important, from the client and attorney's standpoint. The estate planning attorney's role is to point out the options available, and make recommendations, but not to persuade the client to do something. That's not my place. And, if the client hasn't bought into it, it wouldn't work, anyway."

Anything else?

"You have to have an open mind," said Mezzullo, recalling a joke he had heard. "The only lawyer with an open mind is a lawyer with a head wound."