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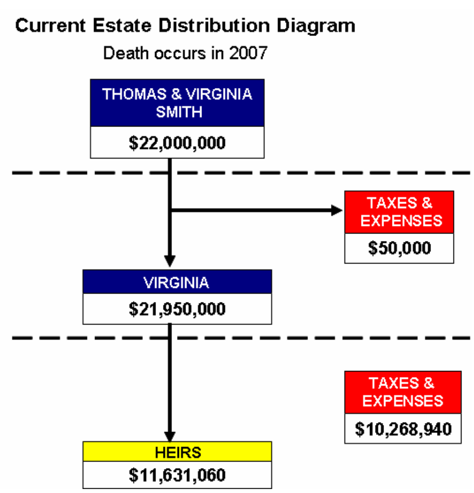
Integrated Wealth Management
A Registered Investment Advisor

How the Smiths Integrated Twelve Tax Planning Tools to Minimize Taxes and Maximize Benefits for Retirement, Family, and Favorite Charities.

So that you can appreciate how a typical family benefits from a Family Wealth Blueprint®, this article describes how Thomas and Virginia Smith used the Blueprinting process to lower taxes dramatically while generating more wealth for their retirement, their family, and their favorite charities. Initially the Smiths had a net worth of more than $22 million with substantial tax exposure because, like many wealthy couples, they had done no significant planning.[1] As shown in the graphics at the bottom of this article, the Smiths developed a plan to enhance after-tax income, eliminate more than $10 million of taxes, transfer tax savings to a family foundation, and give more than $20 million to their children. The Smiths realized millions of planning benefits for a relatively modest cost. More important than the financial benefits, however, was the peace of mind that came from knowing that the Smiths had projected a secure after-tax retirement income while establishing mechanisms to transfer the right amount of assets and income to heirs at the right time.

Before the Smiths began the Family Wealth Blueprint process, they were wasting $10.3 million on taxes and transferring only $11.6 million of their $22 million to heirs. The baseline flowchart at the right shows the Smiths estate distribution diagram before the planning began. The Smiths were paying substantial unnecessary taxes while failing to use appropriate trusts to transfer control, management, and ownership of assets to beneficiaries at the right time. In fact, like many wealthy individuals, the Smiths had a plan that transferred assets to heirs only when Thomas and Virginia died. Because of this failure to plan, the Smiths were not heeding the wisdom to "do your giving while you're living so you know where it's going."[2]



By developing a basic estate plan, Thomas and Virginia put in place the AB trust (tool 1 of 12), which lowered their estate taxes on four million of their estate, but left the balance of their estate taxable. They knew that they wanted to use a series of irrevocable trusts to zero-out unnecessary taxes on the $18 million of their estate that was subject to taxation, but they also knew that they needed to take their time with designing irrevocable trusts. Before transferring their business, home and other key assets to

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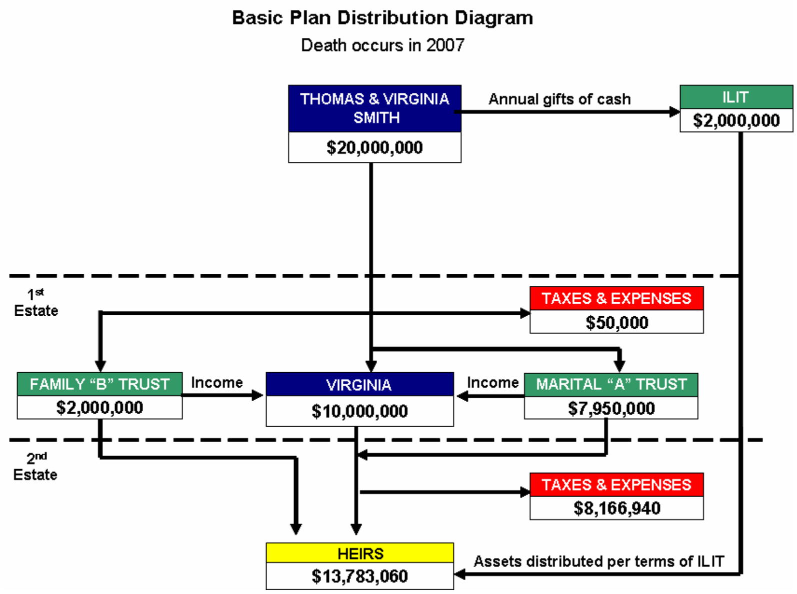
[1] The $22 million net worth used in this example may seem high or low to you. $22 Million is a surprising common net worth if you consider the value of a client's business and real estate holdings. You may e-mail dave.jones@selectportfolio.com for examples of tax reduction plans for clients that have lower or higher net worth.

[2]Andrew Carnegie

irrevocable trusts, the Smiths wanted to think through how to transfer ownership, management and control to their children at the right time in the right way.



While waiting to transfer their primary assets to irrevocable trusts, the Smiths were willing to put a safety-net in place by putting insurance in an Irrevocable Life Insurance Trust (tool 2 of 12). The insurance was a second-to-die policy guaranteeing that if either Thomas or Virginia died with a taxable estate the heirs would pay the taxes with the death benefit from the insurance paid to the insurance trust. The trust was funded with a gift and loan from Thomas and Virginia's estate. The Smiths had four married children, each of whom had two grandchildren who were eligible for annual gifts of $12,000 each from Thomas and Virginia. Because there were a total of eight second generation heirs and eight third generation heirs, a total of 16 heirs could benefit from the life insurance trust. Thomas and Virginia could therefore contribute $12,000 per year for each of the 16, meaning they could give a total of $192,000 to the trust each year as a gift without any current gift taxes. The $192,000 contribution allowed Thomas and Virginia to maintain an insurance policy with a $10 million death benefit.

The insurance death benefit would not only pay the estate tax even if there was some growth in the estate, but the policy would allow for the Smiths to accumulate cash value. Thomas and Virginia elected to have the cash value grow in a way that would let them make tax-free wash loans from the trust. The trustee provisions of the ILIT were designed so that the loans could be paid to Virginia throughout her lifetime if she needed retirement income in the event of Tom's premature death. This added feature of providing retirement income appealed to the Smiths because they could accumulate retirement funds tax efficiently using their annual exclusion gifts to let the money grow tax efficiently within the trust, and then take the money out tax efficiently as a secure source of retirement income. The Smiths realized that accumulating money in the life insurance trust was more tax efficient than accumulating money through a traditional qualified retirement plan because traditional plans are subject to large potential taxes on distributions.

As the Smiths were working with their lawyer to draft the life insurance trust, their attorney asked them if they wanted to add dynasty trust (tool 3 of 12) provisions. In effect, the attorney would be using generation skipping tax provisions to allow the wealth to accumulate outside of the estate of not only Thomas and Virginia and their children, but also their grandchildren and great-grandchildren. The trust could break into separate shares at a later time for each of the living descendants. Each separate dynasty trust could have special incentive trust provisions to

encourage the descendants to use the money tax efficiently. The Smiths greatly appreciated this opportunity to design their irrevocable trusts to give the right amount of asset ownership and cash flow to their beneficiaries at the right time while transferring management and control responsibilities to the most responsible heirs. The Smiths had much greater comfort about moving assets to irrevocable trusts when they saw how the trusts could reflect their dreams for each of their children and grandchildren.

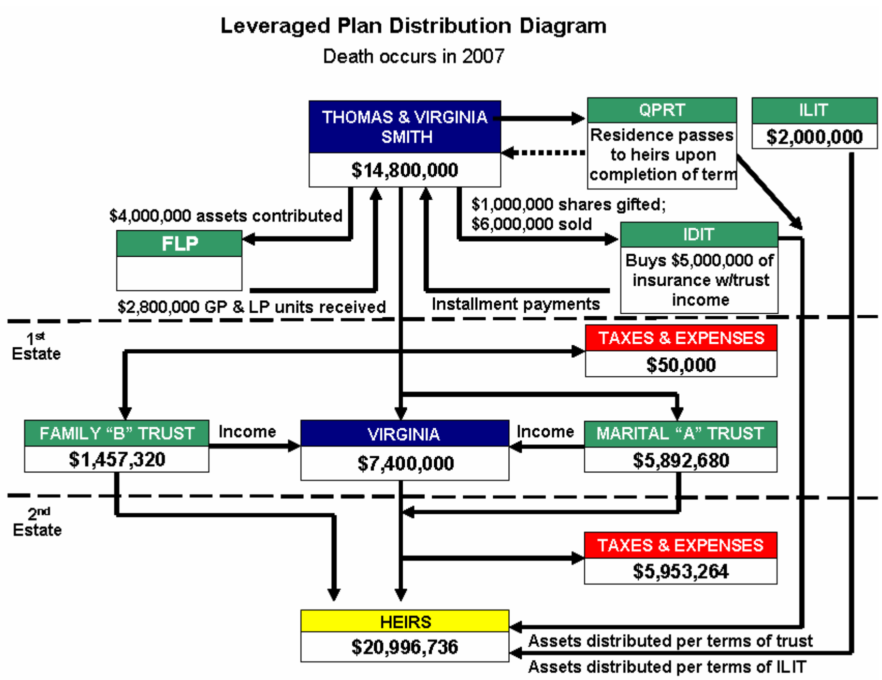
A basic plan with just an AB Trust, ILIT, and Dynasty Trust provisions lowered taxes from almost $10,300,000 to under $8,200,000. Moreover, the plan allows the heirs to receive almost $2,200,000 of additional inheritance. The grid at the right shows how the projected inheritance for the heirs increases from $11,600,000 on the original plan to almost $13,800,000 on the basic plan. Although drafting the AB Trust, ILIT and Dynasty cost might cost $10,000 or more, the total expense is a small fraction of the expected tax savings. In fact, as is typical with advanced tax planning, the legal expenses should be less than 1% of the increased inheritance to the heirs.

Comparison of Benefits
If Death Occurs in Current Year

	CURRENT PLAN	BASIC PLAN
HEIRS RECEIVE IMMEDIATELY	$11,631,060	$13,783,060
FAMILY FOUNDATION	---	---
ESTATE TAX	$10,268,940	$8,166,940

	BASIC PLAN SUMMARY
INCREASED NET TO HEIRS	$2,152,000
INCREASE TO FAMILY FOUNDATION	---
ESTATE TAX SAVINGS	$2,152,000

After funding the insurance trust with appropriate policies, the Smiths sought to reduce taxes and reduce annual insurance premiums by developing a leveraged plan. The leveraged plan could increase the inheritance to the heirs to almost $21 million and reduce estate taxes to a little over $6 million. The leveraged plan added the QPRT, FLP, and IDIT.



To transfer their home out of their estate tax efficiently, the Smiths created a Qualified Personal Residence Trust ("QPRT"). The QPRT (tool 4 of 12) allows the Smiths to live in their home throughout their lives but then transfer the homes to heirs with minimal transfer taxes. After a term of years, determined by the Smiths, the Smiths can start to pay rent to their children and therefore make tax efficient transfers to children without the usual gift tax planning challenges.

The Smiths appreciated how the QPRT leveraged reduced estate taxes by compressing the value of their estate using various discounting techniques. Their advisers then showed the Smiths how they could establish a Family Limited Partnership ("FLP") for business purposes that would have the ancillary benefit of creating discounts for limited partners. When creating the FLP (tool 5 of 12), the

Smiths moved their marketable securities and income producing real estate into a family limited partnership that was divided into a general partnership interest which they retained, and limited partnership interest, which they began giving to trusts for the benefit of their children. The limited partnership interests were subject to a variety of liquidity, marketability, and fractional share discounts that justified appraising the limited partnership interest at 65% of the value of the underlying assets.

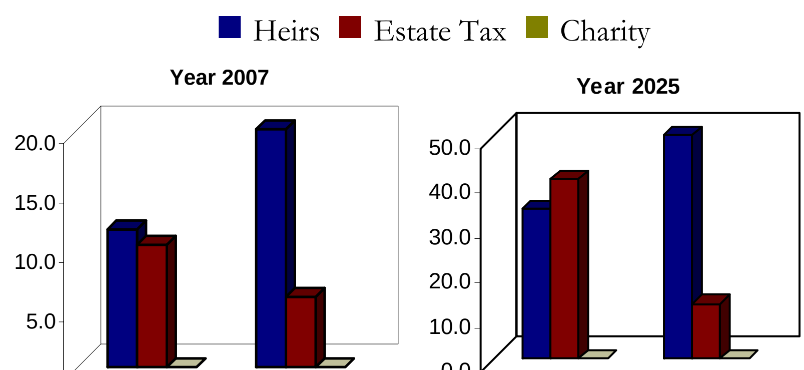
After the appraiser issued his appraisal opinion regarding the FLP value, the interests were sold to an intentionally defective irrevocable trust ("IDIT"). By selling to the IDIT (tool 6 of 12), the Smiths were able to move most of the assets outside of their taxable estate, thereby freezing what was left in the taxable estate. Moreover, the Smiths had the satisfaction of knowing that future growth on their primary assets would occur outside of their estate, inside the family limited partnership interest that were owned by the intentionally defective trusts.

When creating the intentionally defective trust, the Smiths realized four significant tax benefits. First, they wanted to circumvent the gift taxes that would result from just gifting their limited partnership interests to the trust, so instead of gifting interests to the trust, they sold the interests to the IDIT. By doing the sale, they avoided gift taxes, but because the trust was a defective trust, they also avoided recognition of capital gains taxes upon the sale. Moreover, the Smiths knew that the future growth of their estate would be outside of their taxable estate, thereby avoiding estate taxes. To minimize ordinary income taxes, the Smiths took back a note when the trust bought their assets. This note made regular monthly payments throughout their lifetime. Normally, such a note generates ordinary income; however, in this case, the Smiths had all the note interest paid from the tax-sheltered rent from their real estate. Therefore, interest on the note was taxed at a much lower tax rate.

Adding the three leveraging tools (the QPRT, FLP, and IDIT) to the three basic tools (the AB Trust, ILIT, and Dynasty Trust) let the Smiths realize the benefits of the leveraged plan shown in the two diagrams below. The leveraged plan dramatically improves on the current plan by generating the increased transfers to heirs and the estate tax savings shown in the box below.

Comparison of Benefits

If Death Occurs in Current Year

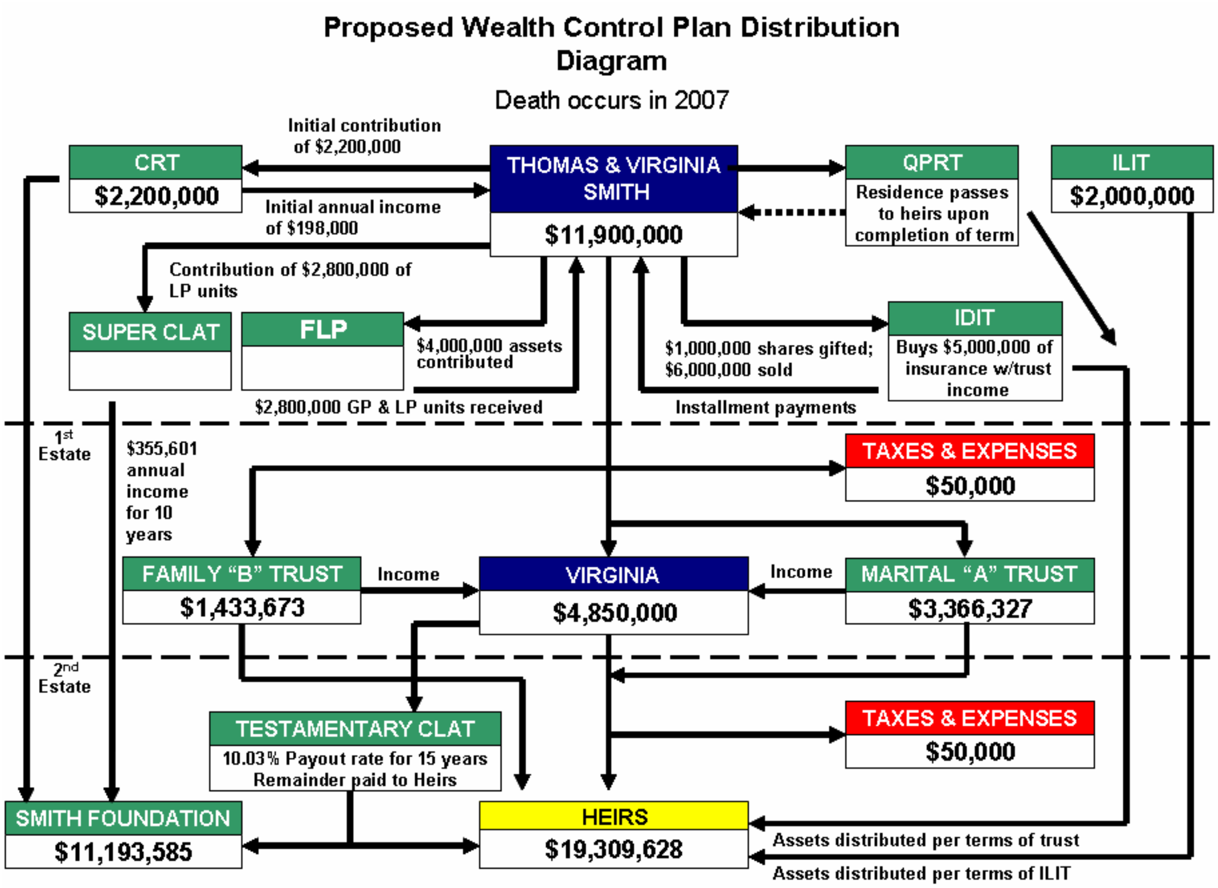


	CURRENT	LEVERAGED		CURRENT	LEVERAGED
HEIRS*	$11,631,060	$20,996,736		$33,500,000	$60,300,000
ESTATE TAX	$10,268,940	$5,903,264		$40,200,000	$12,300,000
CHARITY	0	0		0	0

	LEVERAGED PLAN SUMMARY
INCREASED NET TO HEIRS	$9,365,676
INCREASE TO FAMILY FOUNDATION	-
ESTATE TAX SAVINGS	$4,365,676

The basic and leveraged plans reduced the Smiths transfer taxes and increased the inheritance for the children but did not generate significant income taxes benefits. Because the Smiths wanted to redirect all of their tax money to their favorite causes, they talked with their advisers about reducing estate and income taxes more significantly by using a total wealth control plan. This plan improves upon the leveraged plan by adding a CRT, TCLAT, Super CLAT, and Public Family Foundation. The flowchart on the following page shows how these four new charitable tools have been added to the three tools used in the leveraged plan and the three tools used in the basic plan.

Integrating these instruments in the total wealth control plan increases (from the current plan) the inheritance to heirs to $19.7 million, eliminates estate taxes, and redirects $13.1 million of tax money to charity. In addition to providing the future elimination of estate taxes and larger inheritance for the heirs, the total wealth control plan produces immediate income tax deductions. As you can see from the charts on the next page, the Smith family receives more than $3,000,000 of income tax deductions from the charitable tools. The Smiths can use these tax write-offs this year and in the subsequent five years.



To generate a substantial lifetime income, the Smiths sold appreciated securities in a Charitable Remainder Trust ("CRT"). The CRT (tool 7 of 12) gave them four significant tax benefits. First, it gave the Smiths a deduction against their income tax in the current year and up to five subsequent years. Second, it allowed them to sell appreciated securities assets tax-free. Third, the Smiths were able to accumulate their wealth in a tax-efficient environment, thereby allowing them to generate ordinary income or short-term capital gains without paying current income taxes. Fourth, the Smiths arranged to take money out of tax efficiently so that they could live on income taxed at capital gains rates, or even tax free income, during their retirement years.

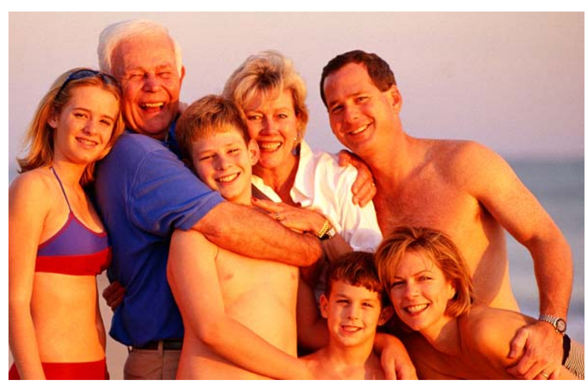
The Smiths designed the CRT to pay them substantial payments each month. This gave them assurance that they would have ample retirement income for as long as they lived. Once they had secured this lifetime income, the Smiths began to realize that they did not need all of their wealth. The Smiths considered giving a portion of this wealth to their charities and to their children. The Testamentary Charitable Lead Annuity trust ("TCLAT") allowed the Smiths to transfer money tax-efficiently to their children while redirecting wealth to charity that would have just been spent on taxes. The TCLAT (tool 8 of 12) complemented the charitable remainder trust, because the two tools had very different but fully complementary structures.

As the Smiths recognized the power of the TCLAT as a technique to eliminate transfer taxes, they asked if they could use the TCLAT as a lifetime technique instead of a testamentary vehicle. They were delighted to learn that the lifetime version of the TCLAT can provide not just transfer tax reduction but income tax reduction as well. The lifetime CLAT, known technically as an Inter Vivos CLAT, has been referred to as a "Super CLAT" by advisers because of how it reduces both estate and income taxes. The Super CLAT (tool 9 of 12) works especially well for clients who give a large portion of their income to charity. A properly designed Super CLAT can help a client maintain an existing annual giving plan while transferring more wealth to non-charitable beneficiaries.

Whereas the Charitable Remainder Trust gave lifetime income to the Smiths and transferred the principle to charity, a Charitable Lead Trusts gave the income to the charity and transferred the principle to the family. Because of how these tools complemented each other, it was possible for the Smiths balance their desire to have secure lifetime income with a desire to help family and favorite charities.

The CRT and CLATs produced significant gifts for charity. So that the Smiths could retain maximum control over the management and disbursement of charitable funds, they created a Public Family Foundation (PFF), (tool 10 of 12). Their attorney drafted the Public Family Foundation to include Smith family members on a board that would decide how to invest the money, how to pay the money through salaries to board members, and how to disburse money at the right time to charities that best upheld ideals from the grant-making policy of the Smith family.

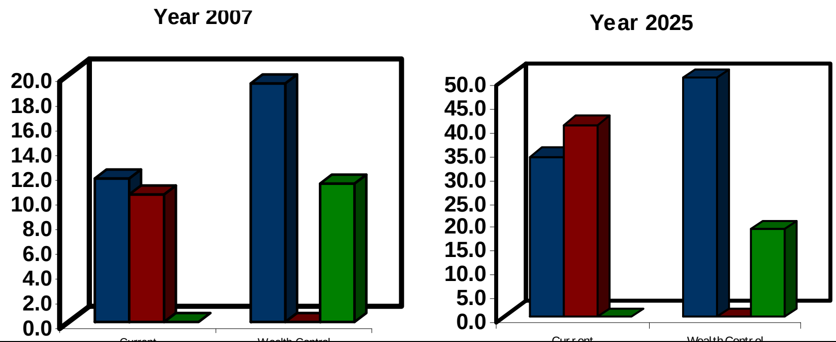
Adding the four total wealth control tools (the CRT, TCLAT, Super CLAT, and PFF) to the three leveraging tools (the QPRT, FLP, and IDIT) and to the three basic tools (the AB Trust, ILIT, and Dynasty Trust) let the Smiths realize the benefits of the total wealth control plan shown in the two diagrams below. The total wealth control plan dramatically improves on the current plan by generating more after-tax income, increased transfers to heirs, and the estate tax savings shown in the boxes on the next page.



Comparison of Benefits

If Death Occurs in Current Year

Heirs Estate Tax Charity



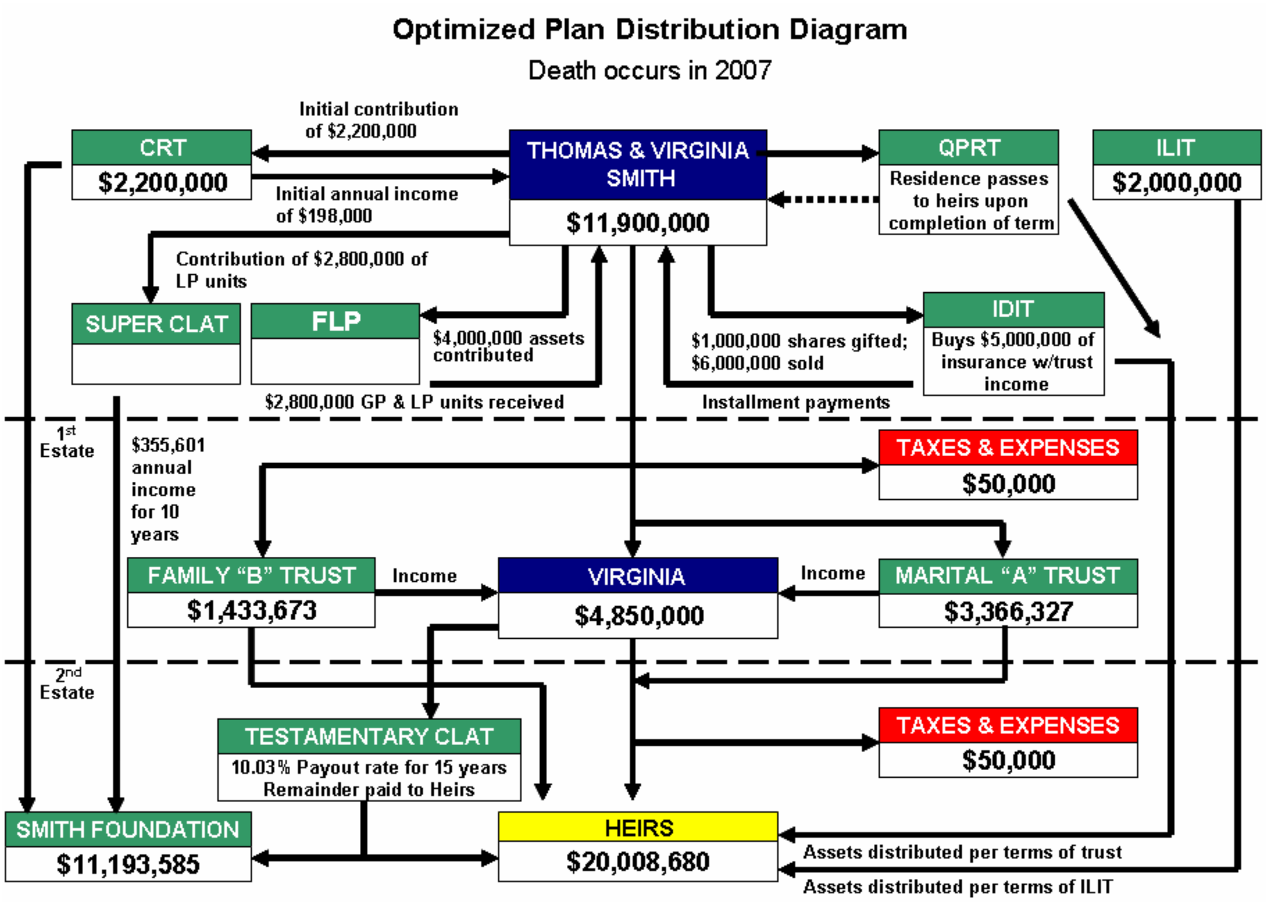
	CURRENT	WEALTH CONTROL		CURRENT	WEALTH CONTROL
HEIRS*	$11,631,060	$19,309,628		$33,500,000	$ 55,400,000
ESTATE TAX	$10,268,940	---		$40,200,000	0
CHARITY	0	$11,193,585		0	$18,300,000

	CURRENT PLAN	WEALTH CONTROL PLAN		WEALTH CONTROL PLAN
INCOME TAX DEDUCTIONS	---	$3,057,050	INCREASED INCOME TAX DEDUCTIONS	$3,057,050
HEIRS RECEIVE IMMEDIATELY	$11,631,060	$13,867,345	INCREASED NET TO HEIRS	$7,678,568
PV OF FUTURE BENEFITS TO HEIRS FROM CLATS	---	$5,442,282		
FAMILY FOUNDATION	---	$11,193,585	INCREASE TO FAMILY FOUNDATIONS	$11,193,585
ESTATE TAX	$10,268,940	---	ESTATE TAX SAVINGS	$10,268,940

After the Smiths committed to the legal instruments in the basic, leveraged, and total wealth control plans, they began to wonder how they could enhance their overall plan by finding the optimal combination of the ten different estate planning tools that they were considering. They realized that the design of each of the tools depended upon several different mathematical variables that were subject to many different possible outcomes. The Smiths realized they needed a financial adviser who could run numbers to show them different ways to design each of their trusts.

They therefore found an attorney who had expertise with estate optimization (tool 11 of 12). The attorney reviewed each of the Smith's trusts and suggested ways to change the return of the trust that had not yet been fully implemented, and by adjusting the return on the assets funding the trusts, and adjusting the pay out, it was possible to change the overall tax benefits and benefits to the Smiths and their heirs. By running a series of different numbers, the attorney showed the Smiths how they could get the right balance of tax efficient lifetime income, transfers to heirs, and transfers to their family foundation.

The attorney realized that the estate optimization depended very much on how assets were invested inside each of the portfolios. In fact, all nine of the proposed estate planning tools in the basic, leveraged, and total wealth control plans required an Investment Policy Statement ("IPS"). The IPS used portfolio optimization techniques (tool 12 of 12) to generate different rates of return under different market conditions in order to achieve the cash flow objectives of each of the trusts. After calculating how much cash flow would be paid from the trust, the IPS showed how remaining cash would accumulate within the trust to maximize wealth available for heirs and charity. The IPS helped the Smiths understand how to get the best return after fees, after taxes, after trading decisions and after inflation. By maximizing the return after fees, taxes, trading decisions and inflation, the Smiths could have the most confidence that they had the best portfolio and by putting their desires in a written Investment Policy Statement the Smiths could have a clear standard by which to judge the decisions of their investment advisers.

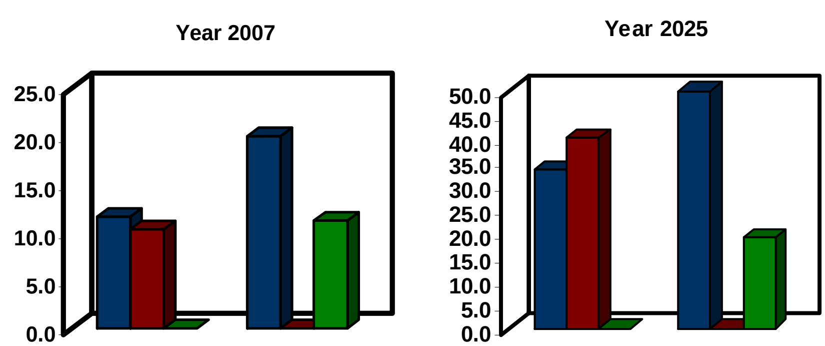


As shown above, the Smiths used estate optimization and portfolio optimization methodologies to achieve true wealth optimization. By using wealth optimization software, planners can enhance the total wealth control plan to generate almost $3.1 million of income tax deductions, zero-out estate taxes, transfer $20 million to heirs, and redirect almost $11.2 million of tax money to charity.

Comparison of Benefits

If Death Occurs in Current Year

■ Heirs ■ Estate Tax ■ Charity



	CURRENT	OPTIMIZED PLAN		CURRENT	OPTIMIZED PLAN
HEIRS*	$11,631,060	$20,008,680		$33,500,000	$ 57,100,000
ESTATE TAX	$10,268,940	---		$40,200,000	0
CHARITY	0	$11,193,585		0	$19,200,000

The table below shows the incremental benefits attendant to adding additional planning tools as the client progresses from the basic plan to the leveraged, total wealth control and optimized plans. The table shows only numerical benefits. As explained on the following pages, adding tools to a plan can produce numerous non-financial benefits as well. Nonetheless, if looking at just the financial benefits, it is obvious that the benefits of planning can exceed the costs by many millions of dollars. In fact, as is typically the case, the tax savings exceed the planning costs by at least 100 to 1.

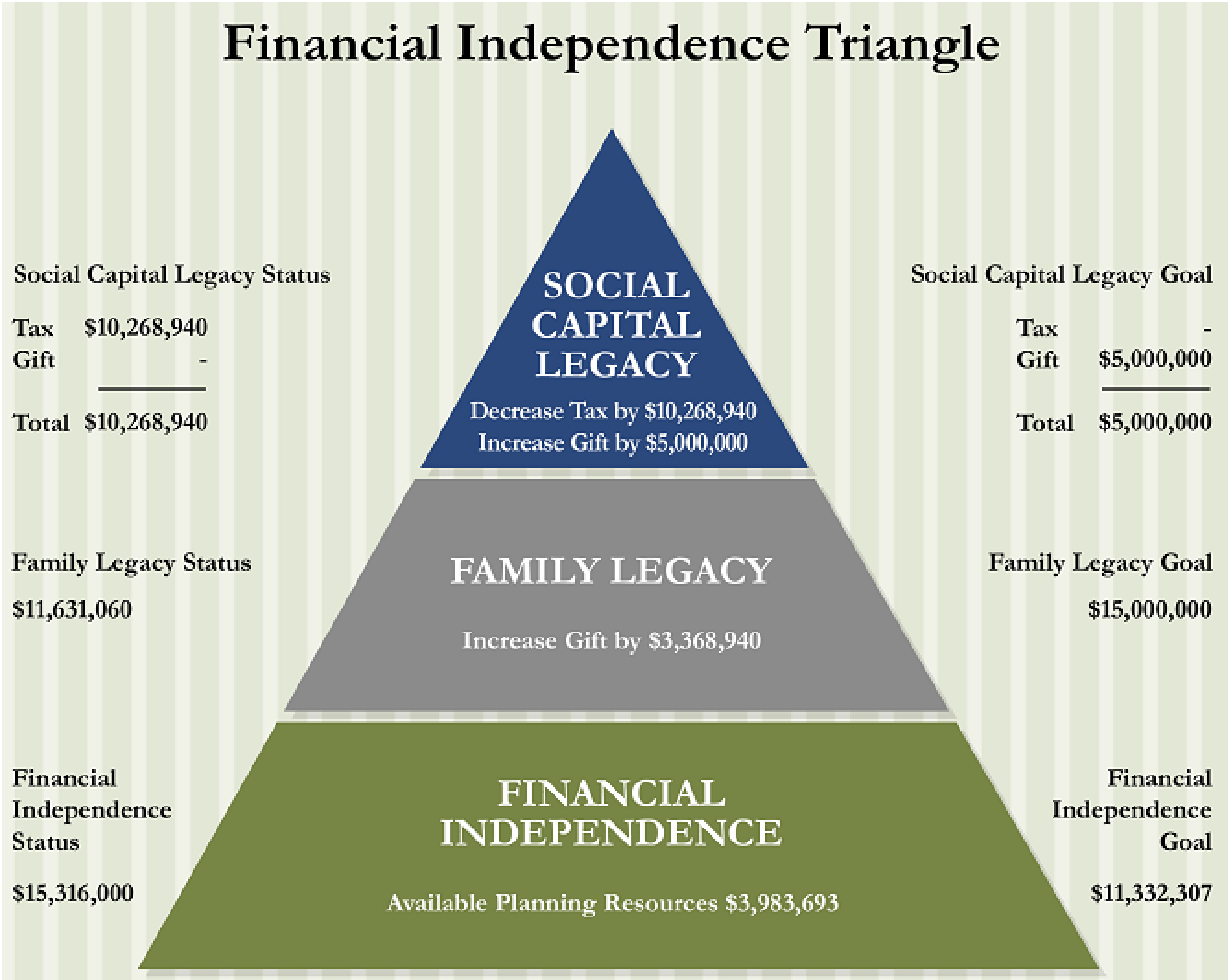
	CURRENT PLAN	OPTIMIZED PLAN
INCOME TAX DEDUCTIONS	---	$3,057,050
HEIRS RECEIVE IMMEDIATELY	$11,631,060	$13,867,345
PV OF FUTURE BENEFITS TO HEIRS FROM CLATS	---	$6,141,335
FAMILY FOUNDATION	---	$11,193,585
ESTATE TAX	$10,268,940	---

	OPTIMIZED PLAN
INCREASED INCOME TAX DEDUCTIONS	$3,057,050
INCREASED NET TO HEIRS	$8,377,620
INCREASE TO FAMILY FOUNDATIONS	$11,193,585
ESTATE TAX SAVINGS	$10,268,940

The process of adding tools allows the Smiths to see clearly how they move from their original plan to their proposed plan. A pyramid, like the one pictured at on the next page, shows how developing the proposed plan can help the Smiths lock in financial independence from more after tax cash flow, use extra wealth to increase the inheritance for heirs, and ultimately redirect social capital to charity instead of to taxes.

Please note that all of the above numbers are in current dollars. A full Family Wealth Blueprint® will typically project the net worth, inheritance amounts, and cash flow numbers out for several decades. The benefits accumulating across time on the above four plans are typically much larger than those described in the above paragraphs and illustrated in the table below.

	CURRENT	BASIC BLUEPRINT	LEVERAGED BLUEPRINT	TOTAL WEALTH CONTROL BLUEPRINT	OPTIMIZED BLUEPRINT
HEIRS RECEIVE	$11,631,060	$13,783,060	$20,996,736	$19,309,628	$20,008,680
CHARITY RECEIVES	0	0		$11,193,585	$11,193,585
ESTATE TAX SAVINGS	$10,268,940	$2,152,000	$4,365,676	$10,268,940	$10,268,940
INCOME TAX SAVINGS	0	0	0	$3,057,050	$3,057,050



The benefits shown in the above case study provide clear documentation of how the Smiths benefit greatly from progressively adding more planning tools to their plan as they move from their original plan to the basic plan and then enhance the basic plan to create leveraged, total wealth control, and optimized plans. More important than the tax savings, the Smiths have the satisfaction of knowing that their hard earned wealth will not be wasted on unnecessary taxes. Most important, the Smiths can delight in knowing they have put in place trusts that will transfer their values as well as the value of what they own in a manner that maximizes retirement security, gifts to family, and donations to favorite charitable causes.