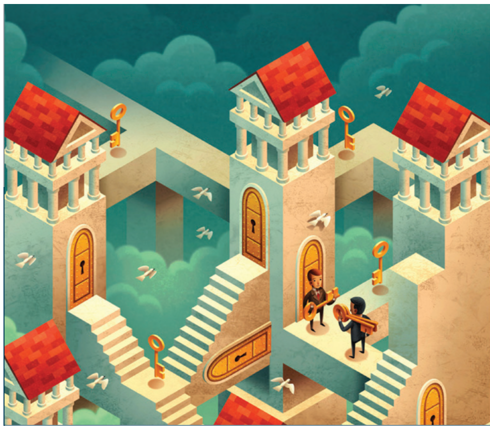

KLINGENSTEIN FIELDS
WEALTH ADVISORS

VIEWPOINT

JULY 2020

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Wealth Strategies in a Changing World

The first half of 2020 has been filled with unprecedented and unexpected events. From the rise of a global pandemic to widespread protests for social change, our lives have been impacted on every level.

This is a historic inflection point that we hope will lead to more positive developments in years to come. Nevertheless this time of extreme change has acted as an impetus for individuals, families and organizations to get their financial house in order and re-examine goals, opportunities, and strategies of interest. Developing a well-thought-out plan and strategy can help investors avoid making emotional decisions that may be detrimental to achieving their long-term objectives.

At Klingenstein Fields Wealth Advisors, our Wealth Planning team continually evaluates the current and potential future landscape in order to identify relevant planning areas of interest. For many, 2020 has been a reminder of how quickly a situation can change dramatically. Subsequently, clients have realized the importance of having up-to-date plans, strategies, and legal documents that will help them fulfill their goals for their wealth. This includes revising dated estate plans or signing updated documents that may not have previously been top priority. Some of the most frequent areas of focus that we have been working with clients on are:

- **Trust planning**, specifically, asset transfer strategies such as a Grantor Retained Annuity Trust (GRAT)
- **Cash flow management**, particularly in times of rapidly shifting circumstances
- Strategies to effectively reduce or utilize **concentrated stock holdings**

Trust Strategies

Trust planning is an extremely timely topic. With a trust, one can set aside assets during one's life or after death, and stipulate the terms of distribution. In a trust, a grantor, settlor, or trustor (the one funding the trust) may control aspects of when, what, and how the beneficiaries will receive assets. Each trust also has a trustee, who adheres to the language of the trust in making decisions about the beneficiary's ability to enjoy trust assets. There are a multitude of trusts used to provide a safety net for children, protect assets, and fund future generations. Moreover, they can also be used for support or incentive via disposition of income and principal.

Using a GRAT for Giving

A well-publicized trust used to shift appreciation of assets to beneficiaries, free of gift and estate tax, is called a **Grantor Retained Annuity Trust (or GRAT)**. To engage in a GRAT strategy, the client must have an irrevocable trust drafted with appropriate language. Assets with appreciation potential to meet growth goals are then transferred into the trust, which subsequently pays the client an annuity over the term of the trust. The term of the trust is often less than ten years to maximize the likelihood that the Grantor survives the term, which is required in order for the remainder to flow to the beneficiaries.

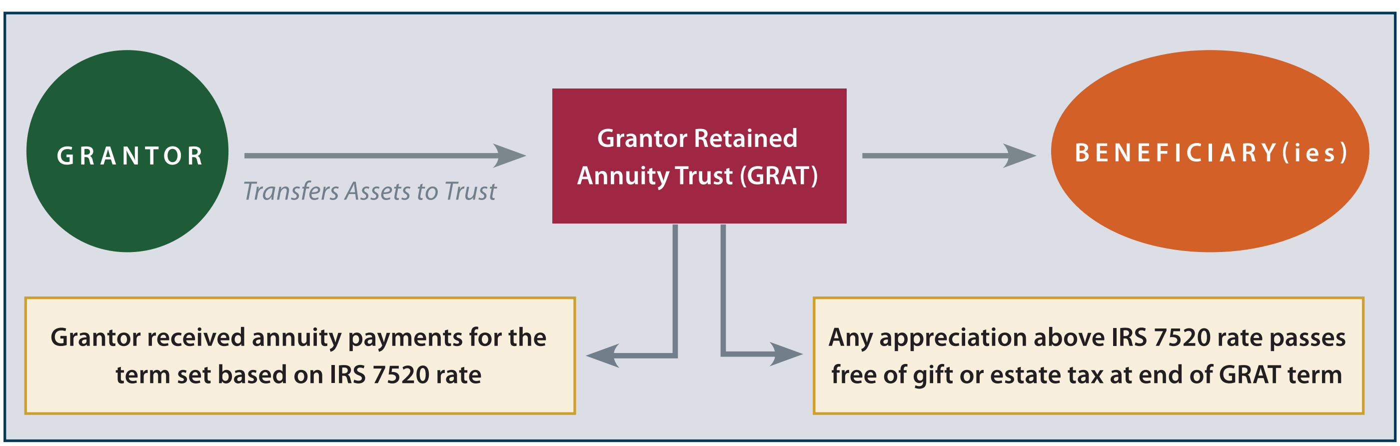
Often, a GRAT is set up so the present value of the annuity stream equals the amount that was contributed to the trust. The annuity rate is set by the IRS in the month you initiate the strategy and each year, you would get back a portion of assets you originally funded into the trust plus the applied IRS rate.

Once the term is over, if the assets in trust have appreciated at a faster pace than the annuity rate set by the IRS, the remaining assets can pass to heirs (outright or via further trusts). Using this approach, the client using the GRAT can pass on appreciation of a diversified portfolio, business interest, or specific sector/asset class, or stock concentration at the modest cost of drafting the trust. Furthermore, the IRS 7520 rate, which is the hurdle rate for GRATs, has been historically low for the past several months, creating an unusual opportunity for clients who want to pass wealth while avoiding significant transfer taxes.

Considerations in Cash Flow Management

At any given time, there are three trajectories for your net worth; it is growing, depleting, or staying constant. During a crisis, like the current pandemic, the disruption from the status quo provides opportunities through cash flow management.

Through two statistics we can see the divisive nature of this pandemic—at the bottom in April and May, in the U.S., there were more than 40 million jobs lost. On the flip side, the personal savings rate reached 33% in April, an all-time high. This creates two major categories: those that have excess cash and those who are in a cash crunch. As we begin to return to a new normal, taking time to review your personal finances could help you be better prepared for the long term, no matter in which category you find yourself.



Strategies for Surplus Funds

Without the discretionary purchases that often come with socialization, like travel, dining out, and shopping, many Americans have found they have a large cash surplus. Leveraging that surplus can help you fund long-term goals, like an earlier retirement or a greater ability to pass on wealth to future generations or charitable causes. However, where you put your savings depends on what you might need all or part of the funds for and what you want to achieve with the remainder.

First, allocate a portion of those funds to a liquid account equal to six plus months of expenses to help cover any unforeseen expenses and avoid tapping into longer-term investments. Next, try to pay down or refinance any outstanding debts with high interest rates (such as a mortgage). Rates have been cut significantly which provides leverage for your existing loans.

Addressing Reduced Income

Finally, if you have funds remaining after taking those steps, apply them to your long-term investment accounts. If possible, invest in ways that provide a tax benefit, including your 401(k), IRA, 529s, and HSA accounts — **then** add to your taxable accounts.

For those that have suffered a job loss or reduced income, there are ways to effectively navigate the coming months. If you find that you need additional cash flow, first utilize any liquid savings you have built up in taxable accounts for an emergency fund.

Another area to focus on is your budget and monthly transactions. Often, small monthly purchases that can be easily eliminated can have a material impact on your spending. This includes subscriptions, memberships or other items, that you may not be utilizing anymore, but which are automatically debited from your account every month. During a period of uncertainty, creating a financial "diet" that eliminates unnecessary purchases will increase the longevity of the assets you have at your disposal.

Often, financial wealth is created and maintained through small decisions. When you compound the strategies outlined above, you will find that they can have a significant effect.

Concentrated Stock Strategies

Whether you have inherited a large holding, exercised options to buy your company's stock, sold a private business, or accumulated stock as part of your compensation over the years, you may have significant concentrated wealth into a single or small number of stocks. While the cause of the concentration(s) may vary, risk management is vital given what the exposure may represent within your overall portfolio or greater net worth. Many clients engage in a concentrated stock strategy to diversify holdings over time while finding ways to utilize these positions in a tax-efficient manner to accomplish goals.

Developing a strategy to reduce the risk associated with a concentrated portfolio can be extremely complex. Issues related to tax considerations, holding period, legal lock-up agreements, daily trading volume, or emotional attachments must all be factored into the decision-making process. There are multiple strategies an investor can use to manage taxes and diversify their portfolio when owning a concentrated position.

Diversification through Strategic Selling

Selling your position over time, little by little is the simplest way to manage capital gains tax and avoid paying a large sum of taxes in one year. A multi-year divestiture plan frees up capital that can be used in order to invest in other sectors and across existing smaller holdings to diversify your portfolio.

Many also use their stock as collateral for lending needs. For example an individual might borrow against their account, use the proceeds to invest in other positions, or utilize the funds for short-term cash needs as a bridge.

An Effective Giving Tool

For those with philanthropic interests, low basis stock represents an effective way to provide a direct charitable donation to a cause while divesting of an asset with embedded unrealized gains. Donating concentrated stock held for over a year allows the giver to claim an income tax deduction for the stock's fair market value subject to IRS limitations, aid a charity, and avoid selling the stock, which could incur a tax liability, to give the cash equivalent. This strategy would reduce the concentration and fulfill philanthropic goals.

In addition, one might consider donating the shares to a charitable remainder trust (CRT). A CRT is a split-interest trust that provides an income stream for the grantor or grantor's heirs, with the remainder of trust value at termination distributed to the charity. As it relates to process, a grantor places highly appreciated stock into the vehicle, which is often sold with the proceeds reinvested without paying capital gains tax. However, the donation is irrevocable and upon the trust's termination, a charity gets the remainder of the assets in a CRT. These trusts can be initiated during life or death and also provide charitable or estate deductions.

Complex Structures for Reducing Concentrated Holdings

There are many other sophisticated and complex strategies that can be employed to reduce concentrated positions, depending on a number of factors regarding your situation and the type of concentrated holdings. For example, if your concentrated position consists of restricted shares, you could set up a 10b5-1 plan. This allows you to sell your shares over time and, because the dates, prices and amount of each sale are predetermined, avoid insider trading implications. Or you may consider pooling your shares with other investors owning concentrated positions through an exchange fund, allowing you to diversify your holdings and postpone taxes until you sell the prorated portion of the portfolio that you are entitled to after being a part of the exchange fund for a certain number of years.

These areas represent just a few of the conversations that the Wealth Planning team is having with Klingenstein Fields Wealth Advisors' clients. Whether the breadth of engagement surrounds traditional planning pillars (retirement, insurance, estate planning, or philanthropy, etc.) or more complex and/or specific concepts, like business succession or caring for an ill parent, our team looks forward to aiding in the review of alternatives and formulating an appropriate course of action.

To learn more about Klingenstein Fields Wealth Advisors wealth planning strategies, please contact us at (212) 492-7000 or visit us online at klingenstein.com

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