September 2020 | Volume 10, Issue 3

Sentinel Trust
Together, families prosper℠

OnWatch

In This Issue:

Window for Estate Planning Opportunities MAY BE CLOSING

HILARY H. LANE, JD
Wealth Planner

Wealthy individuals should always consider the implications of a prospective change of administration as it relates to their wealth transfer and estate plans — this year is no exception. While most commentators that we follow don't expect every proposal being made on the campaign trail to be adopted, it is prudent for families that have the flexibility to adjust their transfer plans and timing to take advantage of the current favorable environment before some of the current opportunities are gone. If there is a change in administration, tax law changes could be effective next spring or even as early as the beginning of the new year. Estate planning attorneys and other advisors may be hard pressed to help all of their clients react in that short time window, so we recommend that wealthy families begin the process as soon as possible to assure that they have the time and assistance necessary to fully understand their alternatives and implement appropriate actions.

Following are examples of currently available planning strategies that might be restricted or eliminated if you don't take advantage of them before future law changes.

About Sentinel Trust Company

Sentinel Trust Company, LBA is an independent wealth management firm and multi-family office that provides comprehensive wealth and succession planning, fiduciary, investment management, philanthropic, and family office services to a select group of affluent families and their closely held entities and foundations. Founded in 1997 as the successor to two 40-plus-year old single-family offices, Sentinel Trust currently serves more than 30 multi-generational families nationwide and is responsible for approximately $4.2 billion in assets as of December 31, 2019.

Learn more at
www.sentineltrust.com.

Use Your Gift Tax Exemption

The Tax Cuts and Jobs Act (TCJA) doubled the estate tax exemption amount from $5 million to $10 million (indexed for inflation), making the exemption amount $11.58 million for 2020 (double that amount for a married couple). The TCJA "sunsets" (expires) at the end of 2025, returning the exemption amount to $5 million indexed for inflation. A change in administration may lead to the sunset of the higher exemption much sooner and it might be reduced further. Either way, if you don't use the higher exemption amount before the sunset, you lose the opportunity.

For those who are leery of transferring that much wealth to your heirs, that is what trusts are for! And, while we are talking trusts, note that the generation skipping exemption (which enables you to transfer wealth to grandchildren and later generations without additional gift and estate tax) is tied to the gift tax exemption so making gifts in trusts that might move wealth down multiple generations also should be seriously considered. Furthermore, there have been discussions of restrictions on how long those trusts can continue without the imposition of additional gift or estate taxes. Presumably, if you make a gift to a longer-term trust before a future law change, your trust will be grandfathered from those prospective new taxes.

For those who are leery of giving up that much wealth, talk to your advisors about so-called "spousal limited access trusts" (SLATs). A SLAT is a trust created by one spouse for the benefit of the other spouse and their descendants. The SLAT is designed to avoid estate taxation in both spouses' estates but the assets remain available for the support of the beneficiary spouse: a backdoor way to retain access to the assets and the income they generate.

Estate Freezes

For families with very substantial wealth, a simple gift using the gift exemption is not sufficient to put a meaningful dent in future estate taxes. One approach is to create and fund a trust (using your gift tax exemption) and then sell additional assets to it in exchange for a note. Given today's low interest rates, the note (which will be subject to future estate taxation) essentially "freezes" your estate's value while the trust benefits from the assets' subsequent income and appreciation. The trust is designed so that the sale does not trigger an income tax. There have also been discussions about eliminating this kind of trust in the future so your opportunity to take advantage of this major planning strategy may be limited.

Loss of Basis Step-Up at Death

Another tax change under discussion is the elimination of the step-up in income tax basis of assets held by a decedent at death. Current law favors retention of low-basis assets until death so that beneficiaries will inherit them without the inherent capital gains tax. While we won't suggest that you accelerate your demise to get the tax-free step up, the possibility that it will be eliminated raises a question as to whether your existing strategy of holding appreciated assets primarily to avoid triggering capital gains tax should be re-examined. That is especially true given the likelihood that the next move in income and capital gains tax rates with a change of administration will be up. In that vein, you might also begin analyzing whether to consider accelerating other types of income before year-end (e.g., through converting traditional IRAs and 401(k)s into Roth IRAs and Roth 401(k)s).

These are a few of many estate and income tax planning strategies available for consideration in the last quarter of the year. Since we can't predict the future, and given how rapidly the future is approaching, you should begin your planning as soon as possible in order to retain as much control over it as possible.

After the Closing Dinner, What Comes Next?

LIFE AFTER LIQUIDITY

D. FORT FLOWERS, JR., CFA
Executive Chairman

After years of living on a salary and having much of your wealth tied up in the business, you finally reap the rewards of your efforts and sell it. For the first time, you find yourself with truly liquid wealth or perhaps with a substantial block of some other company's stock. Unfortunately, at the same time you likely are losing access to many of the benefits and support systems that exist for a company's leaders. This article discusses some of your new issues and needs, as well as some of those corporate benefits you likely will want to replace.

Your issues will depend in part on your plans for the future (a leisure retirement, another CEO position, or a new venture with your family, etc.). Taking some time to develop and reflect on your new objectives may inform your decisions.

Investment Reality Check

Selling a business does not necessarily imply that equity is immediately converted to cash. Rather, a sizeable single-stock position may remain if part of the sales consideration consists of the buyer's stock. Similarly, a retiring CEO may continue to own significant stock options and other equity positions. Several questions arise, including:

- Does it make sense to continue to have such a large portion of your wealth at risk to the fortunes of a single company, especially one in which you are less involved and that is being run by someone else?
- What are the tax implications of diversifying your portfolio?
- Are there restrictions on your legal rights to sell all or part of your position?
- What would you do with the proceeds if you do sell?

The last bullet point is perhaps the most challenging. Too often, we see business sellers and retiring CEOs deciding that their previous success guarantees that they will be successful in new ventures. They plough large portions of their sales proceeds into one or a few new businesses, sometimes with disastrous results. Your success in the business you left does not mean that you know and understand other businesses. We urge caution here:

- There can be a big difference between investing money in a business in which you are directly involved – in which you invest your blood, sweat and tears – and one in which you are a passive investor dependent upon someone else to determine whether the business succeeds or fails.
- Not everyone is a serial entrepreneur, at least not a successful one. Sometimes the stars align and sometimes they don't.
- Consider whether you have the energy and the years necessary to see the new investment through to a (hopefully) successful conclusion. Starting or taking over a new business requires hard, dirty work. It's very similar to what you endured in your last gig. You're not as young as you were when you started out in the business you just sold. Are you up to it?

Don't get me wrong: launching a new career can be exciting and rewarding, both emotionally and financially, but you should carefully consider the risk-reducing benefits of a diversified portfolio versus the increased risks associated with making big bets on one or a few new business opportunities.

If the decision is to put all or part in a diversified portfolio, understand that investing in the stock market, private equity, hedge funds and the like requires vastly different skill sets from what were required to run your business.

If the decision is to make new significant bets on one or a few businesses, you may need to identify knowledgeable advisors who can help evaluate and honestly assess opportunities, assist in the performance of financial and operational due diligence, create and analyze legal documentation, and identify needed talent. A built-in network from a trusted firm can help fill these needs.

Focusing on the Bigger Picture

Understanding the trade-offs (liquidating a single-stock position, taxes, new business ventures, passive portfolio investing, etc.) and developing an overall wealth strategy suggests an immediate need to work with advisors who have experience with these issues and can help you think through their ramifications.

These types of advisors often are very different from the type who have served the executive prior to retirement or the liquidity event. Income taxes may be front of mind, but most wealth creators also need to plan to reduce or eliminate gift and estate taxes. These wealth transfer plans are often complex and can involve multiple entities (like partnerships and trusts) that will require care and maintenance. Some of the most powerful planning involves coordinating the income tax and transfer tax planning so as to optimize both. Since your wealth potentially will outlive you, your new advisors need to be well-versed in building permanent portfolios that will serve the family for multiple generations and educating those future generations how to handle that wealth responsibly.

Administrative and Lifestyle Support

The transition out of an operating business typically means losing benefits, access to experts, and administrative support. A typical CEO not only has access to corporate benefits but is surrounded by high-quality employees who are happy to make the CEO's life easy. Things that were taken for granted may no longer be easily available like technology support, travel coordination, paying bills, keeping books on family entities, and management and coordination of domestic staff.

Health insurance is often top of mind after separation from a company. COBRA often bridges the gap until a long-term plan can be put in place but ultimately some form of permanent insurance for the executive and family is necessary.

A stand-alone, single-family office may provide the most efficient answer but that typically is not economically feasible for families with under $500 million of assets. In other cases, engaging a multi-family office can be the best way to efficiently replace these services. Multi-family office firms are used to providing so-called "concierge services." They typically have more experience in these areas than single family offices because of the larger number of client families that are served.

Preparing Your Heirs

While life as a CEO often comes with amazing perks, it does not necessarily rival the advantages of the liquid wealth that follows a business transaction. The impact of this new liquid wealth also extends to the CEO's family.

Wealth creators often worry about how to benefit descendants without destroying their incentive to make their own success. Another concern is how to educate heirs to be good stewards of the hard-earned wealth.

Proactive and continual wealth education, combined with clear discussions of expectations, are keys to achieving wealth-related family goals. There are numerous programs to help families with this education. However, many families have found that the most effective educational experiences and conversations happen within the family itself, rather than in a classroom with other families. A key is to have an effective moderator to help plan and facilitate the discussions.

Families with philanthropic intent often fund a family foundation at a time close to the liquidity event. Working together with common goals and philanthropic vision offers an excellent way for next generation members to actively develop and utilize their stewardship skills.

Congratulations on your successful conclusion of your prior business endeavor! Your new-found liquidity offers you the ability to pause and reflect. We hope that you are able to take some time to relax, recuperate, and enjoy an extended period without the pressures and distractions of work. Take time to reconnect with family and friends. Experiment with and develop some new interests. Then, assemble a team of family, friends, and advisors who can help you transition to the next stage of your life. Enjoy! ■

Preparing Children for FINANCIAL INDEPENDENCE

SARA SCHULTZ
Client Service Associate

There is no age too young to begin learning the value of money and the importance of budgeting. From instituting allowances for chores to teaching piggy-bank savings for nonessential expenditures, there are numerous ways to solidify your children's concepts of spending, saving, investing, and giving.

In her book Raising Financially Fit Kids, Joline Godfrey recommends introducing basic money skills and instituting an allowance as a tool for teaching money management. According to Godfrey, the key to successful use of an allowance is communicating that the allowance is not an entitlement or salary, but rather a tool for learning money management. To simplify the concept of money management with children, parents may communicate that an allowance serves as a way to help improve independence. When the child learns and does well managing the allowance, more financial responsibilities and privileges will come. A structured use of an allowance should help your child accomplish several money goals, namely: counting, earning, saving, sharing, growing, and spending.

Godfrey outlines the stages at which each of these goals should be accomplished. Counting money should be initiated across ages 5-8, continuing through ages 9-12. Basic understanding of money earned and the concept of savings should begin with ages 9-12 and continue through adulthood. Sharing, growing, and spending money may begin as young as ages 5-8 and also continue into adulthood. Early introduction of spending categories (wants vs. needs) will further facilitate improved understanding of financial ethics and the time value of money. Similarly, sharing and growing money concepts, when instituted early, will help kids connect their allowances to tangible goals and improve adolescent and adult savings, ideally perpetuating economic self-sufficiency.

Some of these money-goal concepts may seem daunting to implement with your child. Fortunately, in our increasingly technological age, there are useful web-based and cell phone/tablet applications designed to assist with family budgeting and allowances. One such program that some of our clients have found useful is BusyKid (available in the Apple app store and Google Play).

BusyKid allows parents to utilize Godfrey's principle of segregating allowance into the following buckets: spending, giving, and saving. Using this application, parents may set up an allowance as a direct deposit into their child's account and stipulate what portion is allocated to each of the three categories. As the child accumulates funds in the spending bucket, the parent may request a debit card for the account, which can be used to make purchases and promote the adolescent's responsibility to budget against their available balance. Additionally, the application allows children to select charities they care about to receive the proceeds of their giving buckets. Finally, the savings bucket may be used to simply accumulate cash, or be linked to a stock account to invest in companies the child selects. Utilizing the stock purchase function may facilitate conversations around investment management principles, such as dollar cost averaging, diversification, fees, and income taxes (on appreciation).

Whatever tools a parent uses, active and regular communication about financial principles is paramount in providing a foundation for children's future financial management success. Children and grandchildren of extraordinary wealth creators benefit from learning not only how the wealth was created, but the financial values that underpinned their family's success. Their understanding and application of these values as children, complemented by sound budgeting principles like those espoused by Joline Godfrey, provide a path to their financial and personal independence.

Godfrey, J. (2013). Raising Financially Fit Kids, Revised. New York: Ten Speed Press.

Sentinel Trust Company is a family-owned, multi-family office focusing on the unique needs of affluent families and their closely held companies and foundations. Sentinel Trust provides advice on investment, tax, and estate strategies, serves as corporate trustee, and provides lifestyle services with a personal touch.

Together, families prosper SM

Founded in 1997 as the successor to two established, investment-focused single family offices, Sentinel Trust offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office, and the in-house technical skills of independent planning and investment management firms.

Sentinel Trust SM

2001 Kirby Drive, Suite 1200 | Houston, Texas 77019-6081
sentineltrust.com