

# Can Comprehensive Planning Create Opportunities to Reduce Income Taxes?

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DIVERSIFIED TRUST CASE STUDY - FAMILY EDUCATION | MAY 2017

**SCENARIO** Selling a family business can be the culmination of a life's work, the opportunity to reap what you have sewn and retire comfortably. But it can also bring significant tax consequences that can eat into hard-earned wealth. The Jacksons, a couple in their early 50s with net worth in excess of \$25 million, faced such a situation when they sold their manufacturing business. They live in North Carolina, where they are in the highest tax bracket in a state with particularly high income tax rates.

The Jacksons turned to Diversified Trust for a strategy to minimize their tax exposure.

**OUR APPROACH** After meeting with the couple to understand their objectives, we reviewed their recent income tax filings to put together a comprehensive picture of their income sources and deductions. Next, we reviewed their existing investment portfolio to determine their asset allocation, asset location, fee structure, asset turnover patterns and general tax attributes. We found they had approximately 30% of their investments in taxable fixed income mutual funds and 70% in a mixture of individual equities and equity mutual funds.

We also examined the North Carolina tax code to see if the Jacksons might be able to take advantage of any tax credits and incentives, and we looked at the current legislative climate to see if there were any potential changes on the horizon at the local and federal levels.

Finally, based on projections for taxation in future years, we developed a set of recommendations for the Jacksons, which we reviewed with their tax advisor to make sure we were in agreement on a course of action.



**RESULTS** Our planning process identified several opportunities for reducing the Jacksons' income tax burden, which collectively amounted to meaningful annual savings.

First, we restructured their investment holdings to gain tax advantages. We migrated tax-inefficient assets into tax-deferred accounts. In their taxable account portfolio, we replaced national bond funds with more tax-efficient alternatives, including a North Carolina individual municipal bond portfolio. We reduced exposure to capital gains by incorporating managers that emphasize low turnover.

We also identified solar tax credit investment opportunities that were unique to the state of North Carolina and assessed their appropriateness for the Jacksons. The investment resulted in the pre-payment of North Carolina tax at a discount of 20% to the extent of the credits purchased.

The Jacksons' commitment to supporting charitable organizations created another opportunity to reduce their tax exposure. They had planned to make annual charitable gifts of approximately \$500,000 over five years. However, our tax projections revealed that strategy would not have allowed the Jacksons to receive the full tax benefit from their donations, because of much lower taxable income in the years after the sale of their business. As an alternative, we recommended a one-time \$2.5 million gift to a donor-advised fund in the year of the sale, allowing them to receive the full tax benefit of \$750,000. We further recommended funding the gift using stocks with significant appreciation, resulting in the avoidance of future capital gains taxes on those stocks.

Our comprehensive program not only resulted in immediate tax savings, but will continue to create significant tax savings over time. The Jacksons feel satisfied knowing they'll keep more of the wealth they've earned to support their retirement lifestyle and the charities that mean the most to them.

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