



PERSONAL FINANCIAL PLANNING

Very wealthy clients have special goals and objectives.

The Rich Truly Are Different

BY CYNTHIA HARRINGTON

EXECUTIVE SUMMARY

- **CPAs WILL FIND THAT ULTRAWEALTHY CLIENTS DEMAND** a broader range of services and skills than the merely wealthy. To serve this group, CPAs will need to tailor their offerings and sharpen their estate planning and investment management skills. Most financial planners define the truly rich as families with more than \$25 million in net worth.
- **THE DISTINCTION BETWEEN THE MERELY RICH** and the truly rich rests on two pillars—the amount of the client’s net worth and his or her goals for using it. The ultrawealthy ones generally plan that their assets will outlive them and need help transferring these funds to their heirs or to charity.
- **CPAs WHO WORK WITH ULTRAWEALTHY CLIENTS** have several options for meeting their needs. Some choose to add a variety of services to their offerings, including bill paying, account aggregation and due diligence. Others elect not to provide these services and instead refer clients to specialists. Those who expand their range of offerings are typically operating a family office or providing personal CFO services. CPAs who work with more than one such client form a so-called multifamily office.
- **PLANNING FOR MULTIPLE GENERATIONS DEMANDS** that CPAs be familiar with specific tools to advise their clients properly. This includes knowledge of certain strategies and techniques such as private foundations, charitable remainder trusts and family limited partnerships.
- **CPAs INVOLVED IN MANAGING THE WIDE RANGE** of issues very

wealthy clients face should be prepared to draw heavily on their counseling skills. CPAs may need to educate parents about making distributions from trusts to younger family members. In some instances they may need to offer more money-handling advice to families with newer money as opposed to those with second- or third-generation wealth.

CYNTHIA HARRINGTON, CFA, has been a money manager specializing in domestic stocks for high-net-worth individuals and small institutions. Now a full-time journalist, her work appears in *Bloomberg Wealth Manager*, *Plan Sponsor* and *Entrepreneur* magazine. Her e-mail address is cynharrington@mindspring.com.

Most of the financial advisory clients CPAs work with require a full range of products and services to meet their investment needs. The ultrawealthy client, however, demands broader services and skills than the merely wealthy one. Because the number of ultrawealthy families is growing at a rate of 12% a year, more CPAs face the happy prospect of serving this market. To do so they will find themselves tailoring services and sharpening their skills in estate planning and investment management to meet the special needs of the very rich. This article outlines the unique character of the ultrawealthy client and the new skills and services CPAs need to assist this growing demographic group.

TRULY RICH OR MERELY RICH?

In today's world of the millionaire next door, the definition of what it means to be wealthy has changed. In 2004 even average Americans need to be millionaires—in 401(k) plans, IRAs or personal savings—simply to ensure a comfortable retirement. For CPAs, recognizing the difference between the comfortably wealthy and the ultrawealthy is the first step in providing the right services.

The distinction between the merely rich and the truly rich rests on two pillars—the amount of the client's net worth and his or her goals for using it. The ultrawealthy expect their assets to outlive them and thus need help transferring these funds to their heirs or to charity. The merely wealthy expect to spend their assets and leave only a modest inheritance. Most CPA financial planners define the truly rich as families with more than \$25 million in net worth. But some clients with net worths of \$5 million or \$10 million act like the ultrawealthy while others worth more than \$25 million don't qualify as truly rich, depending on the composition of their assets—illiquid real estate vs. cash and securities.

The Growing Wealth Management Industry

- The number of families with intergenerational wealth is increasing at a rate of 12% a year.
- Over 3,500 U.S. families have dedicated family offices.
- More than 50 institutions or families have started multifamily offices (MFOs).

Source: Family Office Exchange, www.foxexchange.com.

Lifestyle issues such as an affinity for art, photography, convenience flying in an executive jet or an extravagant second home raise the amount the client needs to spend on his or her own needs. Longer life expectancies also increase the amount required. “At \$5 million to \$10 million we begin to see ‘ultrawealth’,” says Thomas Tracy, CFA, CFP, of Kochis, Fitz, Tracy, Fitzhugh & Gott Inc., in San Francisco. At Kochis Fitz 2% of its client base qualifies as ultrawealthy, representing 25% of the firm’s assets under management. But sometimes even the ultrawealthy don’t have much to give to charity or leave to their heirs. Tracy says “some clients’ lifetime projected cash needs top \$7 million for their personal use.”

Ultrawealth can vary with location because of differing costs of living and lifestyle expectations. “Here in central Ohio you find more clients with net worths of \$5 million to \$10 million looking for high-end services,” says Peggy Ruhlin, CPA/PFS, CFP. Ruhlin’s Columbus-based firm, Budros & Ruhlin, counts clients in the ultrawealthy category as 15% of its client base, representing 40% of the assets under management. “These are the quietly wealthy who live below their means and have charitable inclinations.” (See the box on page 36 for charitable-giving resources.)

Whatever the number, at some point on the wealth scale the client’s circumstances demand different services, planning approaches and investment management techniques. CPAs differ in how they choose to deliver that advice to wealthy clients.

PRACTICE MANAGEMENT FOR THE ULTRAWEALTHY

The business model for dealing with ultrawealthy clients varies. Some CPAs opt out of adding services and simply refer high-end clients to specialists. Others provide some services such as bill paying, account aggregation and due diligence on investments and refer out financial planning, asset allocation and actually investing the client’s money. (With account aggregation CPAs gather information about a client’s assets from all sources and “aggregate” it into one statement.) Yet others expand to offer all services under one roof.

This one-stop shopping approach is referred to as a “family office,” since a distinguishing factor of ultrawealthy clients is the transfer of wealth to succeeding generations. Family offices come in all sizes and shapes. Sometimes the family itself sets it up and hires the necessary professional and administrative staff. In other

Family Office Issues

- What scope of services will you provide to the family members?
- What governance structure is appropriate for the family?
- Which family members are interested in serving in a leadership capacity?
- What are the family values they want to see maintained?
- What are the assets the family wants to enhance or preserve?
- What is the time period for working together on wealth management issues (how long is “long-term”)?

Source: Family Office Exchange, www.foxexchange.com.

instances professionals such as CPAs and attorneys will set up a family office either for one family or several.

Tracking the details to form an overall picture of a client's assets is an important core service CPAs can provide to very wealthy individuals and families. Sometimes called personal CFOs, such advisers provide family office services ranging from data collection, general ledger accounting, workpaper files, cash-flow analysis and investment performance reporting to due diligence on investment alternatives, asset allocation and actually making investments.

According to the Family Office Exchange, personal CFOs are a growing field. While some families with net worths above \$100 million establish these services on their own, those with smaller fortunes demand less than full-time coverage and outsource the work to multifamily offices (MFO), which provide services to two or more wealthy families. In deciding how to access this kind of help, a family faces certain issues other than cost. CPAs who don't provide such services themselves can coach clients through the process of choosing an MFO using the questions provided by the Family Office Exchange at www.foxexchange.com (see [exhibit](#) above).

CPAs choosing to set up their own MFO might employ a full staff of bookkeepers, financial advisers, asset managers, attorneys and psychological counselors. Instead of assembling such a costly staff, other CPAs work as the quarterback of a team of independent specialists.

Tanager Financial Services of Waltham, Massachusetts, chose to set up two separate divisions to serve wealthy and ultrawealthy clients. The family office division serves clients with above \$25 million in net worth and handles the full spectrum of needs from administrative tasks to actually investing assets. A client with a minimum of \$2 million qualifies to open an account with the other division, which offers planning and investment services. Tanager invests clients' assets in traditional markets such as stocks and bonds and offers in-house limited partnerships in alternative investments and real estate. "We



PRACTICAL TIPS TO REMEMBER

- CPAs planning to set up multifamily offices (MFO) should understand the full range of staff members they will need to hire to do the job properly, including bookkeepers, financial advisers, asset managers, attorneys and psychological counselors.
- When considering opening an MFO, CPAs should be aware of the wide variety of tasks they may be called on to perform for clients and see how they match their own training, expertise and career goals.
- Before taking on the special needs of ultra high-net-worth clients, CPAs should familiarize themselves with the special tools and techniques that will be beneficial to this group, including private foundations, charitable remainder trusts, family limited partnerships and other charitable and asset transfer strategies.
- CPAs who want to work with very wealthy

may oversee everyday services such as bill paying or approving expenditures as well as direct decision making in all our clients' financial affairs," says Tanager's Glenn Frank, CPA/PFS, CFP, "but with the family office group, we're more likely to actually perform the function rather than just see that it gets done."

clients and their families should be as comfortable with the role of counselor as they are offering financial and investment advice.

Some advisers, such as Dallas CPA Carol A. Cashman, specialize in oversight and reporting. Cashman's firm serves about 20 clients, from a minimum of \$2 million net worth to a handful "way above \$75 million." In working with these clients she describes her role as that of a facilitator but not a decision maker. She accounts for and reports on her client's entire asset picture, performs due diligence on investments and advises other specialists involved in the process on tax and accounting issues. CPAs who choose the facilitator model would hire efficient bookkeepers and effective client communications personnel, but would only coordinate the legal and investment work performed by outside specialists.

THE CHALLENGES

Running a single or multifamily office practice isn't for everyone. CPA Jeff Diercks of Tampa, Florida, established an MFO but ultimately found he preferred to do only a narrow part of this work—researching and managing hedge funds for high-net-worth investors.

Diercks set up InTrust Advisors as an MFO, initially serving a \$100 million client. He added several other clients with \$20 million and above. But in the process of digging deep into hedge funds on behalf of his clients, Diercks found he preferred the analytical work in the unregulated field of alternative investments owned or acquired by many very high-net-worth clients. "I started doing the due diligence on hedge funds for my larger client," says Diercks. "I realized I enjoyed the technical challenge of working out how alternative investments fit with other strategies more than looking at tax structures."

Diercks maintains his family office practice for current clients but has closed the door to new ones for the time being. To service additional clients he would have to add both staff and services—a commitment he is unwilling to make at the present time. "The MFO is a low margin business that's difficult to market," says Diercks. "The newly wealthy are more likely to choose an established relationship, for example the investment bankers that handled the sale of the family business that generated the client's liquid wealth."

PLANNING FOR PERPETUITY

CPAs will find that planning for multiple generations demands new skills and tools, in addition to an overarching understanding of how the different pieces of the plan work together. Planning for wealthy families might include trusts, private foundations, gift programs and family limited partnerships. With so many moving

parts, investment and tax planning become more complex. Managing the multiple needs and personalities of a family also calls on the CPA to be a skilled counselor and communicator.

The basic planning process for the ultrawealthy is similar to that for any client. The adviser determines the client's goals and investment horizon and reviews his or her current holdings. But since the focus is on transferring wealth, the actual plan will be different than for a merely wealthy client. "For the 'less rich' the goal of wealth preservation strategies is to help clients not run out of money before they die and minimize income taxes," says Ruhlin. In contrast, ultrawealthy families have to "worry about how to give their money away to charity or heirs and need to minimize estate and gift taxes."

Here are some strategies CPAs can recommend to high-net-worth clients to help lessen the estate tax burden on future generations.

Private foundation. Clients can set up this entity to save estate taxes and leave ultimate control for specific charitable goals in the hands of family members. Foundation assets are exempt from taxes and contributions are tax deductible. The strategy usually is reserved for the very wealthy who are assured of never needing the assets they put in a foundation for their personal use. "The general consensus is that families with less than \$1 million shouldn't establish a private foundation," says Tracy. "This group would be better served with a planned-giving program that offers greater flexibility."

Charitable remainder trust (CRT). This is a way for taxpayers to transfer assets out of their personal estate. It usually is funded with appreciated stock. The trust beneficiary is a charitable organization, but the income stream from the trust can be paid to the client or another family member during his or her lifetime. Upon the income beneficiary's death, the full value of the assets in the CRT passes to the charity without estate tax liability.

Family limited partnership. Similar to the CRT this strategy transfers assets out of the estate and into the hands of family members, who own part of the assets in the form of limited partnership interests.



RESOURCES

Membership in the AICPA personal financial planning section is open to all AICPA members, www.aicpa.org/pfp.

Conferences

- AICPA Conference on Tax Strategies for the High Income Individual
April 19 and 20, 2004
The Mirage, Las Vegas
- AICPA Advanced Investment Management Conference
May 20 and 21, 2004
Fairmont Hotel, New Orleans

CPE

- Financial and Tax Planning for High Income Clients. CPE self-study course (# 732248JA).

The client retains decision-making control. CPAs should, however, be aware of the impact of a 2003 Tax Court case, *Estate of Albert Strangi*, on the use—and abuse—of family limited partnerships.

Each of these vehicles has unique legal and tax ramifications. Some such as the private foundation and charitable remainder trust require minimum annual distributions; others require annual contributions. CPAs can help oversee the annual cash management and tax-planning process to meet the requirements these complex arrangements impose.

■ **The Family Limited Partnership: Saving Taxes and Protecting Clients.** CPE self-study course (# 734449JA).

Publication

■ *Planning for the Affluent* by Donald R. Levy and Richard H. Mayer, Aspen Publishers (# 017236JA). Available at a special member price.

For more information, to register or to make a purchase, go to www.cpa2biz.com or call the Institute at 888-777-7077.

INVESTMENT MANAGEMENT DIFFERENCES

The legal and tax implications of private foundations, charitable remainder trusts and family limited partnerships also affect how assets are invested. CPAs must address the client's portfolio as a whole, choosing investments that provide a desired return with the least risk possible. Allocating assets to the different structures is as much an art as a science. For instance, trusts require annual income distributions and private foundations must have liquid assets for required giving. "After we've made the overall asset allocation decisions, we have to go back and fit the investment vehicles into the different buckets as best we can," says Tracy.

Personal preferences enter into the allocation process as well. Some clients prefer to take less risk with the capital they manage on someone else's behalf. Clients might choose to place the bond portfolio in the charitable remainder trust and keep the investment in emerging-market equities in their personal account, for example. Other times wealthy clients might make an investment with little regard to the planned allocation process. "The ultrawealthy sometimes invest for reasons other than just making money," says Frank. "He or she makes the investment for the enjoyment of being on the board of the company or using his or her personal expertise to advance the company's fortunes."

Resources for Charitable Giving

■ Foundation Source, private foundation services, www.foundationsource.com.

■ Giving Capital, provides charitable-giving solutions for clients of financial services firms, www.givingcapital.com/home.adp.

- Social Welfare Research Institute, author of the Wealth Transfer Report, January 2003, www.bc.edu/research/swri/features/wealth.

A NEW RANGE OF SKILLS

CPAs will find that effectively managing the multitude of issues for very wealthy clients draws heavily on their counseling skills. For example, Cashman once had to convince a client of the wisdom of distributing cash from a trust to a 17-year-old family member. She demonstrated an overall reduction in the family's tax bill of \$13,000 because of the relative tax brackets in trusts vs. personal accounts. "I spend 20% of my time educating parents who are scared to death their kids don't understand that part of the distribution is their inheritance and spend it," she says.

In another instance one 18-year-old family member arrived at Cashman's office, planted her hands on her desk and demanded to know why she was being bothered with her first car insurance bill. The role of explaining to the client's daughter that her financial affairs now were her responsibility was left to Cashman. "Sometimes the emotional issues are the hardest part," she says. "In most instances these are people who have grown up in an affluent environment and don't understand the value of a dollar."

Ruhlin says she spends more time educating rich clients who made the money themselves as opposed to those with second- or third-generation wealth. Clients who are already rich have experienced the tradition of making gifts and handling money from an early age. The so-called self-made millionaires, Ruhlin says, are "frightened of losing control. It's all new to them."

Training. CPAs who want to upgrade their skills in dealing with very wealthy clients have many resources available to them. Membership in the Family Office Exchange grants access to a broad range of educational opportunities. In addition to the regular updates in newsletters, members learn about industry trends and issues; about maximizing families' human, intellectual, financial and social capital; and about family office best practices. FOX tracks its own seminars and webcasts as well as those sponsored by other organizations. An updated schedule is available on its Web site at www.foxexchange.com/public/fox/calendar/conf_calendar.asp.

PLANNING TO STAY WEALTHY

Despite expectations that the ultrawealthy can't spend their considerable fortunes, staying rich is not guaranteed. Consider the fortunes made and lost in the recent tech boom. Investors who followed professional advice and took some money off the table before the crash still maintain their "ultrawealth" standing. Most of those who didn't diversify fell out of the top ranges. Tracy at Kochis Fitz describes the assets concentrated in a single stock or in illiquid real estate as "suspicious excess capital." He says, "That's why we stay conservative with clients in the \$5 million to \$10 million range and don't use irrevocable situations such as foundations and trusts for them, just in case."

Families that don't look well into the future also risk moving down the wealth scale. "The family might be ultrawealthy today but tomorrow its assets get split among five

children, who each have five children, and estate taxes are taken out,” says Cashman. “Pretty soon the fortune is spent.”

Prudent investment advice also is a cornerstone for staying rich. “Clients with \$40 million invested at 5% can live just fine,” says Cashman. “But I have to dissuade them from some of the things they want to do such as buying a golf course or putting money in a risky oil and gas businesses venture. I remind clients that maybe they can’t spend all of their money, but with poor performance they certainly can invest it away in a nanosecond.” ■



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