BALLENTINE PARTNERS

Investment Research

Improving Investment Returns by Reducing Taxes

BALLENTINE PARTNERS | AUSTIN POIRIER, MSFP, CFA | AUGUST 2015

This article is a case study based on an actual Ballentine Partners client family. While the strategies and results described are real and verifiable, the details of the clients' background information have been altered to maintain confidentiality.

The article describes best practices for maximizing client after-tax returns using a number of techniques, including asset allocation planning, asset location planning, and active tax management of portfolios. For example, in the case of the clients described in this case study:

During the period of 2007-2014, the clients received about $7.5 million of interest and dividend income, but paid tax on only about $2.5 million of interest and dividend income. The $5m balance of the income that would have otherwise been subject to current taxation was sheltered from tax through our asset location and active tax management strategies. The majority of this income was generated through tax-exempt municipal bonds or within tax-deferred accounts. There was no tax audit risk associated with this.

During the market crash of 2008, we generated tax benefits worth about $1.5 million to be used in future years. Those tax benefits reduced the impact of market losses during 2008 and more than offset all capital gain tax liabilities in all years since 2008 combined. The client still has a tax benefit of about $500,000[1] to use in future years.

Through our asset location planning, the client was able to transfer about $1.25 million tax-free to future generations. We were able to achieve this in spite of the fact that the clients had previously exhausted their lifetime gift allowance. The successful wealth transfer strategy avoided about $500,000 of gift tax that otherwise would have been due immediately, and avoided a much larger estate tax that would have eventually applied if the assets had continued to grow inside the clients' estate.

By strategically locating assets in a tax-aware manner and realizing losses throughout each year (rather than waiting until the end of year), Ballentine Partners added over $1,000,000 of value on top of the reported investment returns we generated during the period. The value added from this integrated advice offset 76% of Ballentine Partners' advisory fees.

[1]Our analysis accounts for the full tax benefit on realized capital losses in the year they are generated in order to quantify their value, which is consistent with the industry's accepted methodology for measuring after-tax returns.

About the Clients

Colin and Madeline Sullivan[2] are long-time clients of Ballentine Partners. Colin, now retired, was the founder and CEO of a successful, publicly traded company. The Sullivans have a large family with many children and grandchildren. Their wealth management objectives are to:

1. Ensure that Colin and Madeline have sufficient income to sustain their lifestyle for their lifetimes.
2. Transfer wealth to their children and grandchildren during the lifetimes of Colin and Madeline in a manner that is tailored to the specific needs of each recipient. (Some gifts are in trust, and others are outside of trusts.)
3. Cover the education expenses for all generations of the family from grade school through graduate school.
4. Make generous gifts to charitable organizations and other causes the family cares deeply about.
5. Minimize estate and gift taxes by integrating estate planning and investment strategies.
6. Surround the family with a highly capable team of professional advisors. Work diligently with that team to maximize the value of their advice and other services.

[2]Actual client names have been changed for privacy purposes.

The Results

The analysis covers the period from January 2007 - December 2014, and the results reported in this article are for the entire period unless otherwise noted. The Sullivans' investment objective during the entire period was to generate growth and income through a strategy that balanced capital appreciation and current income, with the goal of earning a long term after-tax return exceeding the rate of inflation. This objective was ultimately met on a pre-tax and post-tax basis. The Sullivans are able to tolerate substantial short-term fluctuations in value. Their investment assets are as follows:

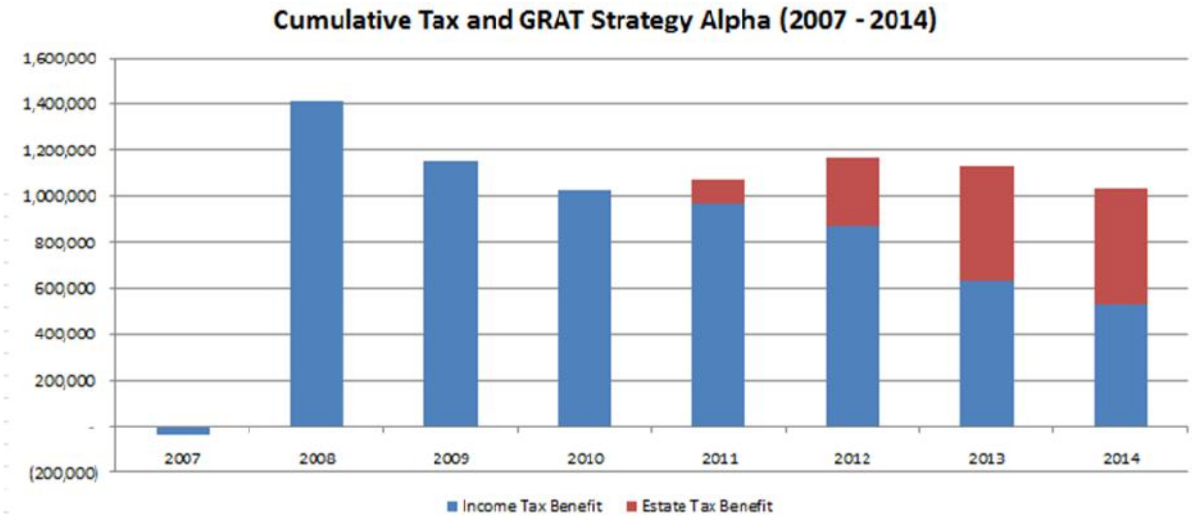
Owner	Value as of 12/31/14	Equity	Asset Allocation Targets: Real Assets	Alternatives	Bonds	Cash
Personal Taxable Accounts	$10,500,000	44.0%	17.0%	4.0%	31.0%	4.0%
Tax-Deferred Accounts	$10,500,000	44.0%	17.0%	4.0%	31.0%	4.0%
Charitable Remainder Trust	$1,800,000	55.0%	12.0%	8.0%	20.0%	5.0%
Family Trust #1	$1,200,000	38.0%	12.0%	10.0%	35.0%	5.0%
Family Trust #2	$8,000,000	60.5%	12.0%	5.0%	17.5%	5.0%
Family Trust #3	$2,500,000	60.0%	12.0%	5.0%	18.0%	5.0%
Family Foundation	$1,500,000	57.0%	13.0%	7.0%	18.0%	5.0%
	$36,000,000					

The family also has several million of private investment partnerships that are included in the asset allocation targets but excluded from the investment return calculations since they were direct investments selected by Colin based on his contacts in the investment world.

Chart 1 on the following page shows the cumulative value we added to the Sullivans' investment returns over the period 2007 - 2014. The sources of the added value were:

- Income tax savings
- Gift and estate tax savings

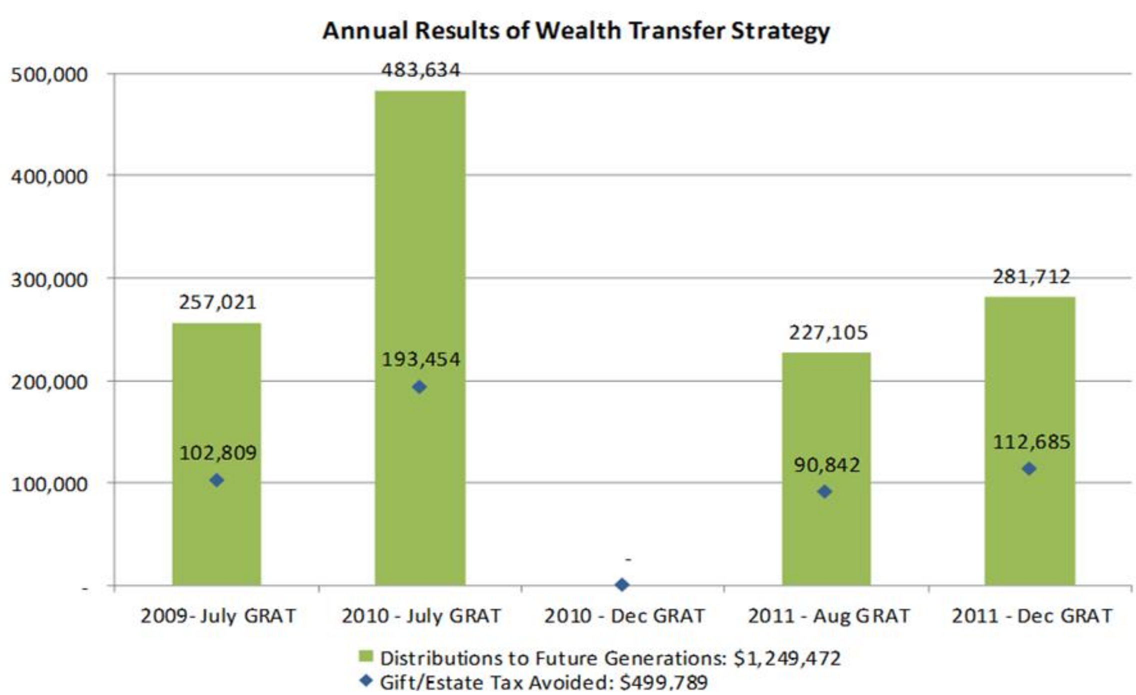
Chart 1



The gift and estate tax savings were achieved through the use of a series of two-year termed Grantor Retained Annuity Trusts ("GRATs"). A GRAT is a trust to which the grantor transfers an asset in exchange for the right to receive a fixed annuity for a fixed number of years. If the trust's value grows in excess of the fixed payments due to the grantor, the excess is allowed to pass gift-tax free to the trust beneficiaries. Therefore, it is generally desirable to fund GRATs with equities or other growth assets. The 2008 credit crisis period was an optimal time to implement GRAT strategies because both asset values and interest rates were low compared to what we expected they would be as the market recovered. As illustrated in Chart 2, four of the five GRATs were successful, allowing Colin and Madeline to transfer $1.25m tax-free to future generations avoiding a gift tax of about $500,000.

This wealth transfer strategy did not result in the Sullivans losing any of their contributed investment capital or having to change their asset allocation. We simply transferred their existing stock investments from their personal accounts into the GRATs. The December 2010 GRAT that failed did not cost them anything.

Chart 2

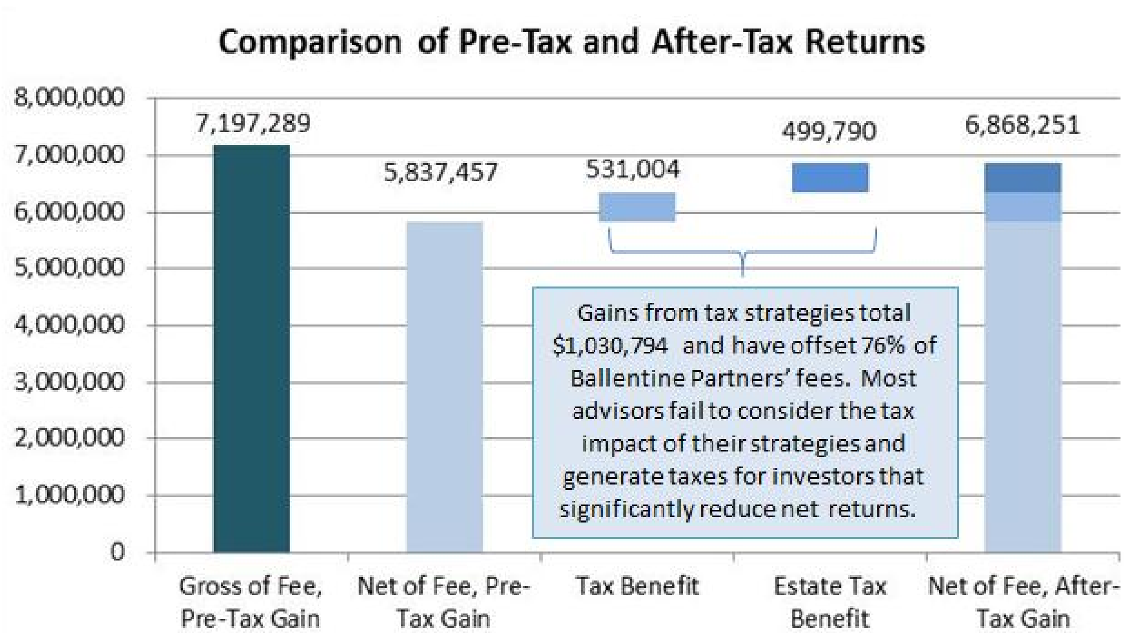


Conclusion

As is illustrated by the Sullivans' situation, the benefits associated with integrated investment and financial planning advice come from a variety of sources. Locating investments tax efficiently, tax loss harvesting, and transfer of rapidly appreciating assets are all examples of how the Sullivans benefited from integrated advice. In the case of the Sullivans, roughly 76% of advisory fees were offset by our tax efficient investment decisions, thus reducing our net cost to about 0.13% per year for all of the other advice and services we provided to the family. Notably, these strategies represent incremental value created over and above asset allocation and manager selection decisions that are also part of Ballentine Partner's integrated investment process.

While the facts described here are unique to the Sullivan family, the investment management and wealth planning strategies are representative of those used throughout our practice. In addition to focusing on making smart investment decisions, we develop strategies for optimizing our clients' after-tax returns. While the after-tax results realized by each client will vary based on the client's specific circumstances and the behavior of the investment markets, our goal is to deliver value above and beyond investment returns.

See Appendix for additional information.



About Austin Poirier, MSFP, CFA

In addition to his client responsibilities as a Senior Investment Advisor, Austin oversees investments in hedge funds and commodities, including public and private energy managers. Within these asset classes, Austin is responsible for formulating the firm's investment strategy, evaluating public and private investment opportunities and monitoring trends within the markets.

APPENDIX

1. We selected January 2007 as the starting point for this analysis because that is when the Sullivans' investment portfolio became fully diversified. Prior to that time, their investment portfolio was highly concentrated in the stock of the company founded by Colin, and their investment results were dominated by the performance of that single stock. (The strategies and tax costs generated by the sale of this concentrated position are not included in this analysis.)

2. Annual tax rates used in analysis. Assumes all income and gains are taxed at the highest marginal Federal tax rates. Client was in AMT from 2008 – 2012.

Marginal tax rates	2007	2008-2012	2013 - 2014
Client in Alternative Minimum Tax?	No	Yes	No
Are advisory fees deductible?*	Yes	No	Yes
Ordinary Income & Non-Qualified Dividends			
Federal	35.00%	28.00%	39.60%
State	5.30%	5.30%	5.25%
Total	**38.45%**	**33.30%**	**42.77%**
Short-Term Capital Gains			
Federal	35.00%	28.00%	39.60%
State	12.00%	12.00%	12.00%
Medicare	-	-	3.80%
Total	**42.80%**	**40.00%**	**50.65%**
Long-Term Capital Gains & Qualified Dividends			
Federal	15.00%	15.00%	20.00%
State	5.30%	5.30%	5.30%
Medicare	-	-	3.80%
Total	**19.51%**	**20.30%**	**28.04%**

* Advisory fees in 2007, 2013 and 2014 are deducted from ordinary income/non-qualified dividends.

3. Gift tax savings are credited in the year that each GRAT expires.

4. Annual portfolio returns:

Year	Pre-Tax Returns (Gross of Fees)	Ballentine Partners Fees	Pre-Tax Returns (Net of Fees)	Income Tax (Liability) / Benefit	Gift/Estate Taxes Avoided	After-Tax Returns (Net of Fees)	Difference between Net and Gross Returns
2007	896,788	(158,562)	738,226	(36,367)	0	701,859	(194,929)
2008	(9,549,150)	(178,919)	(9,728,069)	1,445,404	0	(8,282,665)	1,266,485
2009	4,991,883	(162,223)	4,829,660	(256,985)	0	4,572,675	(419,208)
2010	3,427,318	(166,277)	3,261,041	(126,098)	0	3,134,943	(292,375)
2011	(594,414)	(167,567)	(761,981)	(55,468)	102,809	(714,640)	(120,226)
2012	2,971,658	(173,616)	2,798,042	(103,035)	193,454	2,888,461	(83,197)
2013	4,034,037	(174,271)	3,859,766	(237,594)	203,527	3,825,699	(208,338)
2014	1,019,169	(178,397)	840,772	(98,853)	0	741,919	(277,250)
Cumulative	**7,197,289**	**(1,359,832)**	**5,837,457**	**531,004**	**499,790**	**6,868,251**	**(329,038)**

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