

# Utah CEO

A man in a dark suit, white shirt, and colorful tie is shown in profile, looking out a window. The lighting is warm, suggesting a bright day outside. The background is slightly blurred, showing what appears to be a framed picture on the wall.

## READY TO LEAD

How Lt. Gov. Gary Herbert might influence Utah's economic development.

“ The public needs to know two things: We've got a steady hand on the steering wheel, and the guy driving the bus here is well-prepared, probably as well as anybody who has ever come to this office.”

— Lt. Gov. Gary Herbert, page 37

**PLUS:**

How Web Tools Help Businesses  
Preserving Human Capital  
Legal Ease

**About this article:**

This column is intended to provide guidance for individuals as they navigate the path of personal wealth management.

**Report by:**

The Insight Group, A Registered Investment Advisory Corporation



Planning for these events, whether driven by retirement, a business sale, death, inheritance or market conditions, will **maximize the positive impact of wealth** for your family and community.

# WORKING CAPITAL

## A seemingly good circumstance

Several years ago, Nancy was fortunate to inherit a large stock position worth well into seven figures in a blue chip company. With the high dividend providing her income, she felt no need to diversify her concentrated position in this high-profile company. Besides, why would she ever want to incur the federal and state tax on the sizable unrealized capital gain that had accrued over the many years since she inherited the stock?

## What can and does occur

We often hear that great fortunes are made — and lost — by making bold and narrowly diversified investment decisions. Such is the case with individuals who create great wealth because they have a large single-investment position — whether in real estate, a business, a blue chip stock or stock options. Just look at the early innovators at Microsoft, for example.

However, highly concentrated positions have an embedded risk. What happens in the case of economic disaster? In Nancy's case, her blue chip stock position eroded by 80 percent over a period of nine months. Not only was the investment value lost, but the dividend was reduced to a level that would no longer sustain her lifestyle. As entrepreneurs, business owners and company leaders, we can easily fall in love with our current venture. "It could never fail..." and "Why would I ever want to sell..." are expressions that we often hear. But, with an economic downturn, a concentrated position transforms from a darling into a demon.

## Diversification — a most-admired, least-practiced discipline

"Don't put all of your eggs in one basket" is wise financial advice. The key is diversification. A single concentrated stock holding can be systematically liquidated and redeployed into a well-diversified portfolio. By spreading the liquidation over multiple years, not only will the tax impact be spread over time, but the investor can avoid the possibility of liquidating at the wrong time. We are still in a period of historically low capital gains tax rates with higher rates built into the current tax code under sunset provisions. Now may be a good time to realize the tax impact with the understanding that the trade-off will be a lower-risk portfolio going forward.

## Stock options — manage tax while creating additional opportunities

Stock options are a wonderful tool to give key personnel a stake in the company; however, with their associated

vesting schedules, exercise prices, expiration dates and tax status, an exercise strategy can be more challenging. Due to the nature of stock options, the "in the money" value of those stock options fluctuates disproportionately to the value of the underlying stock. Holding stock options with the intent to exercise them just prior to expiration can result in adverse tax consequences.

Consider a regular stock option exercise discipline. A well-planned exercise strategy could result in a 15 percent tax burden rather than a potential 35 percent should they be exercised just prior to expiration. Without a strategy, the tax burden increases the risk associated with concentrated stock options and limits creative investment opportunities that could further diversify your assets.

## Real estate diversification through a 1031 exchange

Many have amassed wealth through real estate holdings. Some holdings are held for capital appreciation, while others are held for income generation. On occasion, a single holding may be a disadvantage if it has a non-diversified source of income (single tenant) or fails to provide geographic diversification. Using 1031 exchanges, a single real estate holding could be diversified into multiple holdings by selling the original property and buying additional properties which could be in different geographic areas. While a 1031 exchange may have a transaction cost, the continued tax deferral and the option to change the type of real estate holding (i.e. non-income producing to income producing) may be worthwhile.

## Diversify a portion of your company's profits away from your business

A business with good cash flow and profitability can generate significant wealth. Continuing to plow all of the profits back into the business may make good sense. But what happens in an economic downturn or if the competitive environment changes? The business that may represent a significant part of your wealth may quickly deteriorate.

A business owner should consider ways to diversify a portion of their profits outside the core business. Such diversification may be the key to sustainability in an economic downturn or provide the flexibility and resources to sell a business at its peak valuation ... on the owner's terms. Diversifying profits could lead to sheltering against the loss

of losing the goose that lays the golden eggs.

## A long-held asset may be perfect for a charitable gift

On occasion, a concentrated holding with a large capital gain may be the perfect asset for a charitable gift. By making an in-kind transfer to a charitable organization, the capital gains tax can be avoided and the cash that otherwise might have been given as a gift can be invested in a more diversified portfolio, with the bonus of creating a charitable tax deduction.

### Consider...

- **Systematic liquidation** of a concentrated stock holding in the current low capital gains tax environment.
- Establishing an **exercise discipline** for stock options earned through your employment.
- A **1031 exchange** of real estate holdings to continue with tax deferral while creating income-producing assets and diversifying through different geographic or economic exposure.
- **Diversifying** a portion of business profits outside of the core business to protect against a rainy day.
- **Charitable gifts** of capital gains assets that could free up resources for further investment diversification and a welcomed income tax benefit.

## Conclusion

Evaluate your feelings with sentimental stocks, stock options, real estate holdings and business interests that are in concentrated positions, some of which you may have never imagined parting with. With a disciplined approach to diversification, you can continue to hold some of these while realizing greater peace of mind that comes from knowing that you are better positioned to ride through the economic storms that are bound to occur. ■



The Insight Group is a team of financial planning professionals that enable affluent families across the Wasatch Front (and the backside, too) to navigate the impact of wealth-transforming events. Planning for these events, whether driven by retirement, a business sale, death, inheritance or market conditions, will maximize the positive impact of wealth for your family and community.

The Insight Group ... achieving financial wellness for yourself, your family and your community.

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