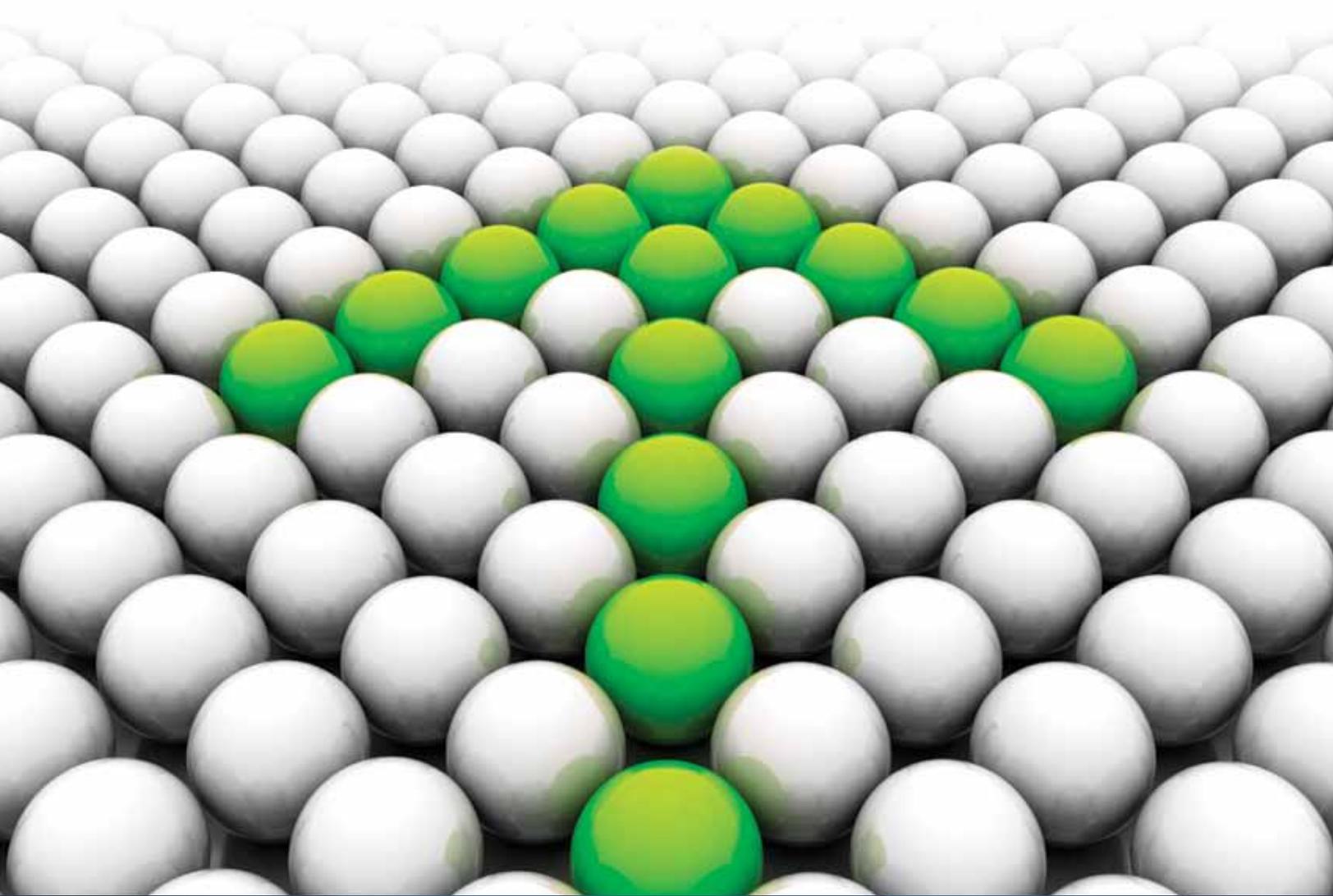


The CPA's Guide to

Financial and Estate

PLANNING

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The CPA's Guide to Financial and Estate Planning Volume 1 of 4

About the AICPA Personal Financial Planning Section

The AICPA's Personal Financial Planning (PFP) Section is the premier provider of information, tools, advocacy and guidance for CPAs who specialize in providing estate, tax, retirement, risk management and investment planning advice to individuals and closely held entities. The primary objective of the PFP Section is to support its members by providing resources that enable them to perform valuable personal financial planning services in the highest professional manner. Members of this section broaden their technical expertise, improve their professional competence and receive resources to deliver high-quality, profitable PFP services. For more information and education on many of the topics covered in this publication, visit our [PFP web seminar archive](#), [PFP Practice Center](#), [Advanced PFP Conference recordings](#), and the AICPA PFP Section homepage at aicpa.org/PFP.

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Chapter 1

The Art of Financial Planning

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¶101 Overview

Financial planning is the process of setting financial goals and objectives during life, designing strategies to achieve them, and monitoring progress toward achieving them. Financial planning includes investment planning, college planning, insurance planning and risk management, employee benefits planning, retirement planning, income tax planning, and estate planning. This publication addresses each of these areas of financial planning and gives special emphasis to estate planning.

Estate planning is setting goals and objectives and developing strategies for disposing of assets and providing for family members, friends, and charities at death. Estate planning is a part of financial planning because estate planning goals, objectives, and strategies affect the financial planning process during life.

Although people often think of estate planning as being important for the wealthy, anyone who owns property or has money has an estate. Estate planning includes more than tax implications. The federal and state governments regulate the use of property. However, generally the property owner decides what to do with the property—whether to keep it, sell it, exchange it, or give it away. The property owner may devise or bequeath the property upon his or her death or allow the state to determine the property's disposition under state law. Asset protection planning, regardless of tax issues, is an important element of financial planning. For business owners, succession planning is an essential element of the financial planning process.

Although a financial planner may concentrate in one of the highly interrelated areas of financial planning, the financial planner needs a working knowledge of all areas. The goals of financial planning include avoiding potential problems and fulfilling the client's wishes. Financial planning is an art because it is a skill obtained by study and experience.

Investment planning includes developing investment strategies. These strategies could include designing a systematic investment plan and developing an asset allocation strategy. Investment planning is a major part of retirement planning. College planning includes saving and investing for future college costs of the client's children or other family members. Insurance planning and risk management include analysis and evaluation of risks, choosing which risks to insure, and obtaining the right kind of insurance to protect against such risks. Life insurance is often a major part of estate planning. Employee benefits planning includes the evaluation of group insurance plans, employee stock options, and other employee benefit programs. The financial planner should consider income taxes and estate taxes in developing employee benefit plans, investment plans, insurance plans, and retirement plans. Some strategies require the planner to consider tradeoffs between income taxes and estate and gift taxes.

Financial planning requires the client to make value judgments. The individual's personal investment philosophy toward potential returns and risks is an important consideration in making these value judgments. The individual must also consider family, emotional, and religious considerations. The financial planner should be careful not to impose his or her values, philosophy, or personal feelings upon the client. The role of the financial planner is to inform the client about alternative financial strategies and the potential consequences of those strategies.

State laws, the federal estate tax, and state inheritance and estate taxes affect any estate plan. The estate and gift tax exacts a toll for transferring property of substantial value.

Gifts and transfers at death are taxed as part of an integrated system with a unified federal estate and gift tax schedule. The law allows various deductions, exclusions, and credits in computing the estate and gift taxes. One of the allowable credits against the estate tax is the unified credit that corresponds to an applicable exclusion amount. The unified tax credit is equal to the estate and gift tax rates¹ multiplied by an applicable exclusion amount.

At present, this system is in a state of flux so a brief review of the last several years may prove beneficial. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), gift and estate taxes were gradually reduced in stages through 2009. The applicable exclusion amount for gift purposes was equal to \$1 million for gifts made from 2005 through 2010.² Under EGTRRA, the applicable exclusion amount³ for estate tax purposes was equal to the following for estates of decedents dying during the years indicated:

2008	\$2,000,000
2009	\$3,500,000

Once the amount of the taxable estate or taxable gifts exceeds the applicable exclusion amount, the tax rates apply to the excess. For 2007 through 2009, cumulative gifts in excess of the \$1 million exclusion amount were taxed at rates that began at 41 percent and rose to a maximum of 45 percent. For decedents dying in 2007 through 2008, estates in excess of \$2 million (the exclusion amount) were taxed at a maximum rate of 45 percent.⁴ For 2009, the maximum 45 percent rate applied to estates in excess of the \$3.5 million exclusion amount.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Tax Relief Act") created a federal estate tax "choice" for 2010. Either the tax was applicable with a \$5 million exclusion and a maximum rate of 35% tax (and an heir's basis in inherited property is adjusted to equal the decedent's date of death or alternate valuation date value of such property) or an election could have been made for 2010 decedents to "opt out" of the federal estate tax and be subject to the modified carryover basis rules of Code Section 1022. The federal gift tax exemption for 2010 remained at \$1 million, with a 35% maximum tax rate. For 2011 a person's lifetime gift exemption was increased to \$5 million. With an inflation adjustment, the maximum exclusion for 2012 is \$5,120,000. The exclusion from estate tax for persons dying in 2011 was also \$5 million, with the 2012 amount being adjusted for inflation for purposes of the federal estate tax to \$5,120,000, the same exemption as is available for the gift tax. The maximum tax rate for transfers made in 2011 and 2012 (whether by gift or as the result of death) is 35%.

Per the Tax Relief Act of 2010:

2010	estate tax reinstated with an exclusion of \$5 million, or, if elected, repealed for 2010 only
2011	\$5,000,000
2012	\$5,120,000
2013 and thereafter	\$1,000,000

¹ IRC § 2001.

² IRC § 2010.

³ IRC § 2404(a)(1).

⁴ IRC § 2001.

For persons making gifts in 2010 through 2012 who made total lifetime gifts above \$500,000 for years prior to 2010, it will be necessary to recompute the amount of the unified credit they have used in prior years due to the reduction in gift tax rate from 45% to 35% (Code Section 2505).

The 2010 Tax Relief Act also introduced the concept of “portability” of exemptions between spouses (allowing the unused exemption of a deceased spouse to carry over to a surviving spouse) and also modified the generation-skipping transfer (GST) tax rules, both of which topics will be addressed in detail in subsequent chapters.

Unless Congress acts before January 1, 2013, the far less generous pre-EGTRRA tax structure (a federal estate tax exemption and a federal gift tax exemption of only \$1 million, with tax rates as high as 55%—even 60% for estates and transfers between \$10 million and \$17 million) will be reinstated in 2013 under EGTRRA’s “sunset” provisions. As a result, financial planners must keep a close eye on developments in Washington and alert their clients if future tax law changes require revisions in the clients’ estate plans. If the law becomes less favorable in 2013, financial planners should act in 2012 to maximize planning advantages for their clients before the “Golden Age” of estate planning comes to an end.

Planning Pointer. Proactive Planning in Preparation for 2013 Toolkit

2012 presents an unprecedented opportunity for you to differentiate your firm and services, and show that you provide significant value to your clients by having all of their financial planning needs in mind. With so many unknowns in 2013 compounded by the 2012 election year and the scheduled expiration of the 2001 tax laws and the so-called “Bush Tax Cuts”, your clients need to take advantage of many financial planning avenues now to avoid missing crucial opportunities to protect their nest egg and increase their net worth. It is important that you start modeling now to be able to help your clients make critical decisions at year-end. Use the following resources (available at aicpa.org/PFP/ProactivePlanning) to help educate your clients and proactively plan now for the potential changes in 2013:

- The “2012 Capital Gains Harvesting Chart” and many other planning flowcharts by Robert Keebler
- Seminar recordings and slide decks for “Proactive Planning in Preparation for 2013” web seminar series
- Customizable client communication resources
- Podcasts
- More than a 50 percent discount for PFP/PFS members on *Preparing Your Client for the 2013 Tax Increases: Tools, Tips, and Tactics* by Robert Keebler (includes a calculator to determine whether gain harvesting makes sense for your clients)

Resources will continually be added to this toolkit as they are available.

The financial planner and client must also consider state estate and inheritance taxes. The law previously allowed a limited credit against the federal estate tax for state estate and inheritance taxes.⁵

Congress repealed the state death tax credit and changed it to a deduction for the years 2005 through 2012. For years 2013 and thereafter, the state death tax credit reverts to the amount allowed prior to EGTRRA.

Many states have a state estate tax equal to the amount previously allowed as a credit against the federal estate tax. Some practitioners call these state taxes “pick-up taxes” or “sponge taxes”

⁵ IRC § 2011.

because they pick up (or soak up) the taxes the estate would otherwise pay to the federal government. The financial planner should check the applicable state law to determine the nature and extent of a particular state's estate or inheritance tax. Some states only apply this tax when the federal credit for state death taxes is effective. Other states have "decoupled" from the federal system, and have instituted their own tax exemption, often at an amount lower than the federal exemption, which varies from state to state. The financial planner must be sure to advise a client that a federally tax-free estate plan does not necessarily also mean a state tax-free estate plan.

The costs of the probate process exact another toll on the estate. The costs of probate vary from state to state and with the size of the estate. The principal costs are the attorney's fees and executor's fees. These fees may be based on the value of the gross estate and not on the taxable estate. Thus, exclusions and deductions from the gross estate would not reduce the amount of attorney's fees and executor's fees. The gross estate includes assets that pass to beneficiaries outside the provisions of a will or trust by operation of law, but the probate estate does not include these assets. Attorney's fees and executor's fees might be in the range of eight to nine percent for a small estate of \$100,000, decreasing to about four percent or less for an estate of \$10,000,000. It is not unreasonable to expect an attorney to charge a fee based upon the amount of time actually expended, rather than to pay a fee based solely on a percentage of the estate. The nature of the estate assets will certainly influence the amount of work that needs to be done to complete the administration of the estate. Complications due to a poorly drafted will or trust, unhappy heirs, or a challenge of the competency of the testator can cause the professional fees to be much greater.

The estate may also incur substantial accounting fees. If the client sets up trusts, the client must pay fees for setting up the trusts and trustees' fees for administering the trusts. Annual fiduciary income tax returns must be prepared for the trusts included in the estate plan. If the client has minor children, he or she may need to appoint a guardian in his or her will to safeguard the interests of his or her minor children. If the decedent failed to appoint a guardian, the court will appoint a guardian for minor children with no living parent. The choice of the court may not reflect the parent's wishes or values. In any case, the fees of the guardian exact another toll on the estate. In addition to the major visible costs of transferring property at death, the estate will incur miscellaneous costs such as court filing fees and routine expenses.

The estate can also incur hidden costs. If the estate must sell assets quickly, it may not receive the fair market value of the assets. The estate may have to settle accounts receivable at deep discounts. The better the advance planning for these issues, the less likely problems will be encountered.

The gross estate may include more property than the property transferred at death. Property transferred during life will be included in the decedent's gross estate if at the time of death the decedent retained a life interest in the property.⁶ Revocable transfers are included in the gross estate.⁷ In addition, property over which the decedent held a general power of appointment is included in the gross estate.⁸ If the decedent made a gift of properties over which a revocable power or general power of appointment had previously been held within three years of the date of death, the value of the properties will be included in the gross estate.⁹ Any gift of a life insurance policy within three years of the decedent's death is included in the gross estate.¹⁰ The gift tax paid on any gift the decedent made within three years of the date of death is included in the decedent's gross estate.¹¹

Generally, if the decedent held property as a joint tenant with right of survivorship at the time of death, the full value of the property is included in the decedent's gross estate.¹² If the only other

⁶ IRC § 2036.

⁷ IRC § 2038.

⁸ IRC § 2041.

⁹ IRC § 2035(a).

¹⁰ IRC §§ 2035(a)(2) and 2042.

¹¹ IRC § 2035(b).

¹² IRC § 2040(a).

joint tenant is the decedent's spouse, only one half of the full value of the property is included in the decedent's gross estate. The law allows an exception to reduce the inclusion in a decedent's estate if the executor can prove that a surviving joint tenant other than the decedent's spouse contributed to the property's acquisition cost. Proving what took place perhaps years ago is difficult without access to the appropriate records. These examples are only some of the examples of how the gross estate can include property not actually owned by the decedent at the time of death.

The law may impose the estate tax on what appear to be "phantom" values. Proving the fair market value of stock in a closely held corporation to an IRS agent may be quite difficult. Chances are the executor and the IRS agent will have valuations that are vastly different. If the executor does not agree with the agent's determination, the executor can request a hearing with an IRS Appeals Officer. If the executor cannot negotiate an acceptable compromise with the IRS Appeals Officer, the estate will receive a statutory notice of deficiency.¹³ Such a notice allows the executor 90 days to file a petition with the U.S. Tax Court.¹⁴

The executor could pay the proposed tax assessment and sue for a refund in a U.S. District Court or the U.S. Court of Federal Claims. Filing an appeal of an IRS agent's determination with the IRS Appeals Division and litigating the issue can be very expensive. However, the cost of disputing a proposed tax assessment by the IRS is reduced somewhat because these costs are deductible in computing the taxable estate.¹⁵ The executor may need to file an amended return to claim these expenses in computing the taxable estate. Thus, in effect the IRS might be paying a substantial portion of the costs incurred by the estate for challenging a proposed tax assessment.

The estate generally bears the burden of proof that the proposed IRS assessment is incorrect.¹⁶ Although the law now allows the taxpayer to shift the burden of proof to the IRS in certain cases, meeting the requirements for shifting the burden of proof is often difficult.¹⁷

The executor often settles for a higher valuation than the executor believes to be fair because of the time and expense of litigation with uncertain results. The higher valuation has another effect on top of the additional tax. Higher valuations generally increase administration costs because the size of the estate often serves as a base for determining administration costs.

In addition, the hidden costs often continue after the probate court closes the estate. The unlimited marital deduction allows an individual to transfer the entire estate to the surviving spouse free of estate taxes.¹⁸ However, this provision operates more as a means of estate tax deferral rather than a permanent saving of estate taxes. This result occurs because all the assets owned by the surviving spouse are included in the surviving spouse's gross estate, who, of course, has his or her own applicable exclusion available at death. Unless the surviving spouse remarries and transfers assets at death to the new spouse, no marital deduction will exist upon the surviving spouse's death.

The transfer of property at death can be very expensive. The costs of transferring property at death include estate taxes, state inheritance and estate taxes, and probate costs. The estate may also receive less than the fair market value on a sale of its assets. Reducing or eliminating these costs is an ample reason for financial and estate planning.

However, financial and estate planning involves much more. Financial and estate planning is concerned with providing for the welfare of individuals and the protection of their interests through trusts and other means. Estate planning is concerned with the disposition of an estate, but it also involves the acquisition and preservation of an estate during the client's life. Estate planning includes building tax-sheltered retirement benefits, a whole range of employee and executive compensation

¹³ IRC § 6212.

¹⁴ IRC § 6213.

¹⁵ IRC § 2053(a).

¹⁶ Tax Court Rule 142(a).

¹⁷ IRC § 7491(a).

¹⁸ IRC § 2056(a).

benefits, investments, and reducing the family's income tax. Thus, estate planning is an integral part of personal financial planning.

¶105 The Financial and Estate Planner

The estate owner is the person who must take the responsibility for planning his or her own estate. However, the estate owner will need professional help to do so. No one can expect a layperson to understand the complex law involving the federal income tax, estate tax, gift tax, and generation-skipping transfer tax without professional guidance. Anyone who attempts to do so is placing his or her estate plan in serious jeopardy and endangering the financial security of his or her family and others for whom he or she is responsible.

To assist individuals in planning their financial affairs and estates, the financial planner must approach estate planning with a breadth of knowledge and experience. Some financial planners may possess all of the necessary skills in formulating an estate plan. More typically, estate planning requires a team approach. Estate planning often involves accountants, appraisers, attorneys, financial planners, life underwriters, and trust officers.

At its 2012 level of \$5,120,000, the unified credit provides an exemption from federal estate taxes for the estates of many clients. The unlimited marital deduction allows for deferral of estate taxes for married individuals until the death of the second spouse. Nevertheless, the financial planner must consider the federal estate tax even if the client's estate is apparently not subject to that tax in the current tax year. The client's estate could increase significantly due to an unforeseen event. The client's marital status could change due to marriage, divorce, or the death of his or her spouse. The law may change and provide for a less generous exemption from the federal estate tax. The financial planner must ask if making full use of the unlimited marital deduction makes sense because the marital deduction only defers estate tax. If the applicable exclusion amount is insufficient to avoid all estate taxes, the financial planner should consider strategies such as lifetime gifts to take advantage of the annual exclusion from taxable gifts.¹⁹ The financial planner must consider the need of the estate for liquidity, especially if the estate consists of valuable but illiquid assets (such as family businesses, real estate holdings, artwork, etc.). The financial planner or estate planning team should discuss these issues with the client and provide the client with valuable input toward making the decisions regarding planning options.

The financial planner must also consider state property laws, family law, and probate procedures in formulating an estate plan to recommend to the client. In addition, the financial planner must examine the income tax consequences of the estate plan for the client, his or her estate, and for the family. Factors the financial planner should consider include the following:

- Basis of assets
- Legal title of assets
- Income in respect of a decedent
- Life insurance
- Retained incidents of ownership
- Assignments
- Beneficiary designations and settlement options
- Annuities
- Employee benefits
- Executive compensation
- Charitable giving

¹⁹ IRC § 2503(b).

- Income splitting within the family
- Alternative minimum tax
- Income taxation of trusts

Special considerations apply to an individual who is a business owner either as a shareholder in a closely held corporation, a member of a limited liability company, a partner, or a sole proprietor. The financial planner may need to address how corporate and partnership law, securities law, and accounting practices affect the estate plan.

For tax years through 2012, the highest marginal income tax rate is 35 percent. In 2013 and thereafter, absent further legislation, the highest marginal income tax rate will revert to the 39.6 percent rate that was in effect for 2000. High federal income taxes combined with high employment taxes and state income taxes have created demands on financial planners to develop strategies to minimize these taxes. Planners should be mindful of the words of Judge Learned Hand: “There is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right. Nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions.” Planners have a positive duty to maximize tax-saving opportunities that goes beyond the words of Judge Hand.

The financial planner must be aware of tax-advantaged or tax-sheltered investments, including the exclusion from gross income for gains on certain small business stock which may range from 50 percent to 100 percent, depending upon when the stock was acquired.²⁰ The financial planner should be familiar with the complex rules that limit deductions for passive losses²¹ and the need for passive income to absorb passive losses. The financial planner should know the basic types of investments such as real estate, stocks and bonds, mutual funds, tax-exempt bonds, Treasury securities, annuities, and limited partnerships. The planner should know what types of assets produce net capital gains²² taxed at lower rates.²³ Under the Tax Increase Prevention and Reconciliation Act (hereinafter “TIPRA”), the tax rate on qualified dividends and long-term capital gains is 15 percent through 2012. That is less than half the maximum tax rate on ordinary income. Those rates are scheduled to increase to levels as high as 39.6 percent and 20 percent respectively for 2013.

Knowledge of the client’s investment portfolio will take on increased importance in 2013 when the new 3.8 percent Medicare tax on net investment income becomes effective. The new tax will apply to the net investment income of single tax return filers with adjusted gross income in excess of \$200,000 and married persons filing joint returns with adjusted gross income in excess of \$250,000. Married persons filing separately will face this new tax when their adjusted gross income exceeds \$125,000. Planning is possible in several areas, namely developing strategies to minimize income that will be treated as “net investment income” (such as increasing investment in municipal bonds) and reducing income that will be included in adjusted taxable income (such as by converting traditional IRAs to Roth IRAs in 2012 to avoid having required distributions from traditional IRAs be included in adjusted gross income in 2013 and subsequent years).

²⁰ IRC § 1202.

²¹ IRC § 469.

²² IRC § 1222.

²³ IRC § 1(h), as amended by the 2006 Tax Increase Prevention and Reconciliation Act (hereinafter “TIPRA”), Sec. 102.

Planning Pointer. Resources to Plan for the Medicare Surtax

In light of the Supreme Court's [ruling](#) to uphold portions of the Patient Protection and Affordable Care Act, including the Medicare tax on investment income in Sec. 1411, below are resources available to PFP/PFS members to help you plan properly for the 3.8% Medicare surtax, which becomes effective January 1, 2013:

- [Podcast](#) with Robert Keebler describing personal financial planning strategies in wake of the Supreme Court decision, including the 3.8% Medicare Surtax, taking effect January 1, 2013
- [Seminar recording](#) and [presentation materials](#) from Robert Keebler's May 2012 web seminar, *Planning Strategies in Wake of the New 3.8% Medicare Surtax*
- [Understanding the Health Care Surtax](#) chart from Robert Keebler
- [Newsletter](#) on planning for the new Medicare surtax from *The Kitces Report*
- [Forefield Alert](#) entitled *What Does the Supreme Court Ruling on the Health-Care Reform Law Mean for You?*, which you can customize and send to your clients
- Resources will continue to be added to help CPA financial planners properly plan for the 3.8% Medicare surtax and communicate with their clients on this issue

The financial planner must also be alert to the impact of the increasingly significant alternative minimum tax (AMT). Once only a concern of the wealthy, the AMT is now affecting many middle-class individuals. This shift has occurred for a number of reasons. For example, the AMT exemptions have not kept pace with inflation. Since the AMT applies only when it exceeds the regular income tax, the reduction in the regular income tax rates has placed more taxpayers in AMT territory. In any case, financial planners must be careful to consider the AMT when mapping income tax strategies. Pay attention to whether a "patch" to the AMT is enacted in 2012 to avoid even more taxpayers being subjected to the AMT rules.

The financial planner needs to be aware of how current economic trends, such as inflation and interest rates, affect the financial plan. While no one can predict the future with certainty, the financial planner must make a reasonable forecast of the overall economy. The financial planner must also be aware of pending tax and legal changes that could affect the financial plan. Financial planning is an ongoing process, and the financial planner should reevaluate the plan periodically in light of changing circumstances.

The financial planner also needs good human relations skills. The financial planner needs to be sensitive to the needs of the client and the client's family. In addition, the financial planner must be able to work with other professionals on the financial and estate planning team. Communication skills, especially the ability to listen intently, are very important.

No one can know everything about financial and estate planning. Perfect financial planners and perfect plans do not exist. However, the law does not require perfection. Although the financial planner may feel that he or she needs to be highly knowledgeable about all aspects of financial and estate planning, the law holds the financial planner only to a standard of reasonable skill and competence. The financial planner should make clients aware of any limitations in the financial and estate planning process. In addition, the financial planner should recognize his or her own limitations. The financial planner should suggest the inclusion of other professionals when he or she cannot serve the client's entire needs effectively.

Financial and estate planning is often a team effort that requires the joint effort of the lawyer, the accountant, the life underwriter, the trust officer, and the investment counselor. Practitioners often recognize the need for teamwork, even with respect to clients with smaller amounts of wealth. These practitioners seek to build mutually beneficial relationships with other practitioners

or informal networks. These relationships and networks allow planners to tap the specialized expertise needed to safeguard the interests of their clients and themselves in developing a plan of any complexity.

However, in the real world, cost and time factors may preclude or limit the use of a true team effort. The distinction between the separate functions of each team member is becoming less clear. Accountants are obtaining licenses to sell insurance and securities, and securities firms are acquiring accounting firms. However, financial planners who are not lawyers need to be careful not to engage in the unauthorized practice of law. For example, only a lawyer may prepare a will or trust for a client.

The public needs to have reasonable confidence in the professional competence of those holding themselves out as financial and estate planners. Most professional planners recognize the public interest involved. The big question is how best to protect the public interest: through governmental regulation, self-regulation, or some mixture of the two as one can find in the legal and accounting professions. The American Institute of Certified Public Accountants (AICPA) has developed the Personal Financial Specialist (CPA/PFS) designation for its members who meet its examination, experience and education requirements. The American College has a similar program in which its graduates earn the designation Chartered Financial Consultant (ChFC). The Certified Financial Planner Board of Standards assures some measure of competency by conferring the Certified Financial Planner™ certificate designation (CFP®) upon candidates who satisfactorily complete its requirements.

In many cases, the accountant can best identify financial and estate planning opportunities for clients. The accountant typically has access to the client's books, records, tax returns and financial statements. Lawyers, life underwriters, bankers, and investment counselors may also be privy to financial conditions of their clients or prospects that present planning opportunities.

The CPA's Guide to Financial and Estate Planning is a guide to many of these opportunities, with warning lights around the pitfalls. This Guide is intended to serve as a road map to the financial and estate planning process. It shows practical ways of building, preserving, and transferring wealth.

¶110 Staying Ahead of Tax Law Changes

Over the last two decades, Congress has revised the tax law many times. This level of change makes the financial planner's job much more difficult, but also much more important. Although tax laws seem to change almost every year, the financial planner can rely on some general guidelines.

A competent individual may revoke or revise a will at any time. The same rule applies to a revocable trust. Accordingly, a lawyer should draft a will and trust documents based on the current tax law. If the tax law changes, the financial planner can urge the client to review these documents. The lawyer can then make any needed revisions. A will or trust based on an anticipated change in the tax law that never materializes may lead to undesirable results. Generally, an individual should plan a will or revocable trust as though it would soon take effect.

A gift, an irrevocable trust, or a sale of property requires a different strategy. Because the client cannot change the documents after these transfers, the financial planner should conduct a careful review of tax law changes under consideration. The financial planner should communicate the likely impact of the proposed changes upon the client's financial and estate plan.

Obvious uncertainties surround predictions of future tax rules. Therefore, the financial planner should carefully document plans and their purposes. When the financial planner considers future tax rules or deliberately ignores them, the financial planner should keep adequate documentation. File memoranda and letters to the client should fully document whether the financial planner considered future tax rules and indicate who (the financial planner or the client) made the final decision. The more documentation that exists, the more the financial planner will be insulated from

legal liability should the client or his or her beneficiaries or heirs later allege malpractice. In addition, the more explanation given to the client, the better the opportunity the client has to evaluate the alternatives and make the best possible decisions. For example, when the financial planner makes projections of future tax consequences, the planner should inform the client that the financial planner is basing the projections on the current tax law. If possible, the financial planner should show the client additional projections based on anticipated and known tax law changes.

The 2001 EGTRRA is a good case in point. EGTRRA made numerous changes in the tax code, such as a reduction of the income tax rates, a lowering of the estate tax, and a liberalization of the limits on retirement plan contributions. But, under EGTRRA's sunset provisions, these changes will vanish—and the old rules will be reinstated—after 2012. So, depending on the situation, the financial planner may want to make alternate projections based on (1) the sunset of the EGTRRA changes, (2) an extension of the EGTRRA changes through Congressional action, and (3) some combination of (1) and (2). For example, at the time of this writing, it is possible that Congress may allow the EGTRRA income tax cuts to expire for higher-income taxpayers but leave them in place for middle-income taxpayers after 2012. By the same token, the reversion of the estate tax to pre-EGTRRA law in 2013 may or may not actually go into effect.

Another case in point is the new 3.8 percent Medicare tax on net investment income becoming effective in 2013 (see ¶105, above). The new tax will apply to the net investment income of single tax return filers with adjusted gross income in excess of \$200,000 and married persons filing joint returns with adjusted gross income in excess of \$250,000. Married persons filing separately will face this new tax when their adjusted gross income exceeds \$125,000. The financial planner can assist the client to take steps to possibly change the mix of investments or find ways to reduce the amount of adjusted gross income to avoid liability for this new tax.

Hindsight is 20/20 in pointing out past errors in financial and estate plans. Reconstructing the situation at the time the financial planner gave the advice is much more difficult. The financial planner should guard against potential liability with thorough documentation. Focusing on the current tax law and pointing out the changes under active consideration can help prevent future complaints. Thorough documentation also helps the client make the best possible decisions. The next chapter provides guidance on the documents the financial planner should gather in the estate planning process.

¶115 Getting Started: Using Your Clients' Tax Returns

Author's Note: The material in this Section 115 and the Chart which follows were adapted from material provided by Lyle K. Benson, Jr., CPA/PFS, CFP® at the 2011 AICPA Advanced Personal Financial Planning conference.

A good way for a financial planner to get started in the planning process is to begin with the information contained in a client's federal individual income tax return. Many financial planners began with an accounting and tax preparation background, and many continue to serve in that capacity, as well as in the role of financial planner. Use the client's tax return as an easily accessible roadmap to begin to understand the client's personal financial situation.

With your client's permission, look at the client's tax return to understand the client's cash flow and income and expense issues. When the tax return is reviewed in conjunction with the client's personal balance sheet (See the discussion in Chapter 2 regarding the personal balance sheet) the financial planner gets an excellent look at the personal finances of the client. Perhaps this will enable the planner to uncover planning opportunities that may have been previously overlooked.

The section of Form 1040 that lists dependents will give the planner a snapshot of the "family tree" of the client—at least with respect to those persons being supported. This will create an awareness of issues addressing education of children, as well as possibly the support of elderly

parents. The listing of income and its sources will help identify whether the clients are employees or self-employed. This can lead to a discussion of retirement planning savings and contributions. Issues such as Roth IRA conversions and possible recharacterization can be raised in this context. Are the clients collecting social security? If so, are there possibly some strategies to employ for them that would help them maximize their benefits and possibly reduce the income tax impact of receiving those benefits?

Examine the Schedule B of Form 1040 that lists dividend and interest income. This gives the financial planner important clues about the client's investment strategies and risk tolerance. Is there a sufficient safety net of savings as a possible emergency fund available? Is the client properly diversified? Is cash flow sufficient? How are the assets owned—primarily by one spouse or the other, or primarily in joint names? Do married clients reside in a community property state? Once this is determined, it will be possible to make some estate planning recommendations regarding separation of the ownership of the family assets. Look at the amount of tax-exempt income being reported. How does this category of income fit in with the client's effective tax bracket?

Look at the Schedule D of Form 1040 where capital gains and losses are reported. Is there a capital loss carryover which can be used to offset aggressive trading gains? Should long-held positions be liquidated, especially if that will generate loss harvesting that can be put to positive use with a better flow of investments? If the 2013 tax rates for capital gains will be less favorable than the 2012 rates, consider gain harvesting in 2012 to take advantage of the more favorable 2012 capital gain rates. What is the client paying for asset management and/or trading activity? Perhaps the financial planner can suggest a more attractive arrangement.

Schedule E of Form 1040 reports information from rental property activities, as well as investment income from partnerships, LLCs and S corporations. Does the client have passive income or losses? Are there carryovers that can be used advantageously? Have the client explain the status of various investments. Which are marginal and candidates for replacement, and which are performing well? Schedule E also is the place on Form 1040 where income from trusts and estates is reported. What is the client's interest in such income—is it a short or a long-term interest? How valuable is the interest, and will the client receive principal from the interest as well as income?

Form 1040 may or may not list income from pension plans, IRAs, annuities and similar sources. That would depend on whether the client is presently receiving distributions from these sources. If so, work with the client to determine how much is being withdrawn from retirement assets annually to determine if the underlying assets are sufficient to sustain the client throughout retirement. As age 70½ approaches—or if it has already been reached, make certain that the client is aware of the requirement to take required minimum distributions from his or her retirement plan.

Turn attention next to the itemized deductions reported on Schedule A of Form 1040. Each category of Schedule A contains valuable information that can be discussed with your client. The listing of medical expenses leads to a discussion of the client's general health, as well as to issues involving health insurance coverage, health savings accounts, long-term care insurance, and similar issues. If the client is at or approaching age 65, is he or she registered for Medicare, and has consideration been given to an appropriate supplemental Medigap policy? The listing of state income and property taxes may allow the planner to raise issues of residency and the possible change of domicile to a more tax-friendly jurisdiction, if that is something the client is willing to consider. Does the client maintain residences in more than one state? If so, that could possibly lead to complexity in the event of death if both states claim sufficient contact with the client to assert the state's transfer taxes at death. The planner can point out the effect of state and local tax deductions on the client's alternative minimum tax calculation.

Interest expenses will be reported on Schedule A, but only the interest arising from home mortgage obligations and investment interest expense. Has the client refinanced recently to take advantage of lower interest rates? Is the client in a position to carry more debt if that will lead to a more successful investment picture, or should the client reduce debt and eliminate the monthly carrying

charges the debt requires? The client may, of course have other obligations requiring the payment of interest that is not reflected on Schedule A. This could be business interest reported elsewhere, such as on Schedule E if associated with business or investment properties, or personal and non-deductible interest expense from items such as consumer loans, car loans, credit card debt, etc. The financial planner should be certain to address these expenses, as well.

The listing of a person's charitable deductions on Schedule A of Form 1040 is another clue for the planner as to the client's intentions. How are the charitable goals being realized—by cash contributions, or by contributions of appreciated property? Is the client obtaining the required acknowledgements from the charitable organizations for the contributions being made? Is the client using a "device" for contributions such as a donor advised fund or a split-interest charitable trust? Does the client have any charitable contribution carryovers? If the client has reached age 70½, is the client aware of the opportunity to have a contribution to charity made directly from the client's IRA, and have the contribution avoid being taxed to the client as income and also counting towards the client's minimum required distribution (assuming this opportunity is extended by Congress for 2012 tax returns)?

The miscellaneous itemized deductions reported on Schedule A offer additional clues as to the client's financial situation. What the client is paying for investment management advice and tax return preparation services is typically listed there. Is the client taking advantage of possible deductions for expenses incurred as an employee? What is the relationship between the deductions being claimed and the limitation of these deductions because of the two percent of adjusted gross income rule? Can anything be done to improve the client's situation here, such as moving some of these deductions to Schedule C if that is appropriate given the client's circumstances?

Check to see if the client has reported liability for the alternative minimum tax (AMT). It may be possible to suggest some changes in the timing of receiving income or paying for deductible expenses that will have the effect of reducing AMT liability over several tax years. If the client has paid AMT, might an AMT credit carryover be available, and what can the planner suggest to utilize that carryover?

If the client is self-employed and filing Schedule C of Form 1040, examine the income and deductions being reported. A number of suggestions may be possible here—such as employing family members, adopting a medical reimbursement plan, maximizing retirement plan contributions, claiming a home office deduction, etc.

The above suggestions address items that will emerge from the tax returns of many clients that the financial planner encounters. Of course, not every issue will arise on every tax return, and a client with special circumstances may have issues addressed on his or her return that are not suggested in the above discussion. The point to be made here is that Form 1040 can be viewed as a comfortable and understandable starting point for the financial planner—a way to get acquainted with the client's situation and begin to offer suggestions that will make a difference for the client's circumstances.

Many CPA financial planners added financial planning services to their tax practices because their clients asked questions that went beyond taxes, including educating children, transferring wealth, protecting assets, selecting investments, funding retirement, etc. These CPAs have built their financial planning practices off of their existing tax practices, and take a holistic approach in the delivery of financial planning services to ensure all of their clients' needs are met, including tax, estate, retirement, investments and insurance. If you are interested in adding financial planning to your existing tax practice, visit aicpa.org/PFP/Pathway for additional resources and archived Web seminars from the AICPA's PFP Division to help you make this transition.

In addition to a myriad of other resources available at aicpa.org/PFP/Pathway, you will be able to access the customizable, [AICPA Personal Finance Report Card](#). The Personal Finance Report Card was developed as an interview tool with new clients and as a way of periodically reviewing

client progress: not only does it help identify important issues, but it also is a great motivational tool, encouraging the client to take actions that will raise the score at the next meeting. To complete the report card, have your client assign themselves a score in each of the 25 categories. Included with the report card are assessment questions to ask in each category in deciding how many points to assign. Discussions could lead to other billable services such as the creation of a comprehensive or segmented financial plan, or could simply be used as an informal coaching opportunity with your clients.

Additionally, the checklist provided in Exhibit 1 can be used to help CPA practitioners integrate financial planning into existing tax services.

Exhibit 1 AICPA Personal Financial Planning Division (aicpa.org/PFP) Analysis of a Tax Return for Personal Financial Planning

The following checklist was developed by leading CPA financial planners to help you find personal financial planning opportunities in your tax practice. This checklist will help you analyze and identify key issues to consider as you prepare, review and discuss your individual tax returns with your clients.

<i>Done</i>	<i>Dependents and Filing Status</i>	<i>Notes</i>
	Does the client have children?	
	Understand any education planning opportunities.	
	Discuss gifting opportunities with the client.	
	Consider income shifting to take advantage of the children's low tax rate.	
	Have gift tax returns been filed?	
	Do the number and ages of dependents indicate that income continuation needs are likely to be high?	
	Does the client have elderly parents whom they care for?	
	Discuss estate planning with the client.	
	Review the dependency rules to be sure the parents can be claimed.	
	Discuss the future financial commitment of this care with the client.	
	Is the client divorced?	
	Consider filing status and dependency exemptions in divorce situations.	
<i>Done</i>	<i>Income</i>	<i>Notes</i>
	What is the source of the client's income?	
	Understand their sources of income—wages, self-employment, partnership, etc. Does any of the client's income constitute "net investment income" that may be subject to the new 3.8 percent Medicare tax becoming effective in 2013?	
	Are there any income deferral opportunities available given the client's investment income source?	
	Discuss the benefits of saving through 401(k), 457, 403(b), SEP, or IRA's.	

<i>Done</i>		<i>Income</i>	<i>Notes</i>
	Does the client have income from a retirement plan still held with former employers?		
	Discuss rollover of funds to an IRA or consolidating IRA's with the client.		
	Does the client have social security income?		
	Consider whether any of the social security income maximizing strategies might apply.		
	Is the family income dependent on one wage earner?		
	Are maximum 401(k) contributions being made?		
<i>Done</i>		<i>Schedule B</i>	<i>Notes</i>
	What are the sources of the client's interest income?		
	If it's taxable, does it come from bonds, CD's, savings accounts, etc?		
	If it's tax-exempt, understand the state tax impact.		
	If the source is savings accounts, consider the FDIC limits.		
	If the source is municipal bonds, consider the safety of the bond.		
	Does investment income indicate a liquid fund has been established for emergency needs?		
	What are the sources of the clients dividend income?		
	Is it mostly from mutual funds or stocks?		
	Consider if the client is too highly concentrated in one stock.		
	Understand the types of stocks or funds generating the dividend income.		
	Are there alternatives to the investments you see here?		
	How are assets custodied?		
	How are the assets titled?		
	Consider the tax efficiency of the investments.		
	What would be the impact of a market downturn on these investments?		
	Does the investment income indicate a concentration of investments?		
	Has the dividend or interest income dramatically increased or decreased since last year? If so, why?		
	Consider the amount of interest income compared to dividend income and how this represents the underlying portfolio.		
	Review the tax impact of investment income and the impact of potential legislation changes to the tax.		
<i>Done</i>		<i>Schedule C</i>	<i>Notes</i>
	Does the client have Schedule C Income?		
	Discuss succession planning related to the business with the client.		
	Consider the use of different types of retirement plans for a self-employed individual.		

<i>Done</i>	<i>Schedule C</i>	<i>Notes</i>
	Determine the income shifting opportunities among family members.	
	Discuss range of options to structure the business for risk management—Compare LLC, Corp, LLP, etc.	
<i>Done</i>	<i>Schedule D</i>	<i>Notes</i>
	Does the client have capital gains/losses reported on Schedule D?	
	Does the client have loss carryforwards?	
	If there is substantial trading activity, discuss with client the fee/ expenses related to this.	
	Consider the benefits of loss harvesting as a part of ongoing wealth management.	
	Is there a coordinated tax plan in the sales?	
<i>Done</i>	<i>Retirement Plans/Distributions</i>	<i>Notes</i>
	Does the client have any retirement plan distributions?	
	Were any RMD's taken, if they are required?	
	Consider NUA (net unrealized appreciation) election from the 401(k) if the client has substantial employer stock—should there be distributions?	
	Discuss with the client his or her beneficiary elections and make sure they are all correct.	
	Consider which retirement accounts the client should be taking distributions from.	
	Analyze whether a Roth conversion might be beneficial for the client.	
	Understand the clients' cash flow needs to see if they have a sustainable withdrawal rate.	
	Determine if the withdrawal rate is sustainable.	
<i>Done</i>	<i>Schedule E</i>	<i>Notes</i>
	Is there income flowing through from an LLC, S-Corp or partnership?	
	Consider any valuation issues that could be associated with these activities.	
	Discuss with the client the IRS' challenge of family entity discounts.	
	How do any hedge funds, venture capital, or other alternative investments fit into their overall investment allocation?	
	Are there rental real estate properties being reported here?	
	Consider risk management with the client (i.e. consider single member LLC ownership).	
	Discuss the ownership of the rental properties with the client.	
	Discuss the estate planning impacts of the properties with the client.	
	Consider the passive activity loss rules.	
	Does insurance expense appear reasonable in relationship to property characteristics?	

<i>Done</i>	<i>Schedule E</i>	<i>Notes</i>
	Is there income flowing through from a trust?	
	Understand what assets are being managed in this trust.	
	Discuss the trustee selection with the client.	
	Find out from the client what the purpose of the trust arrangement is.	
	Are there any potential tax liabilities arising from negative basis?	
<i>Done</i>	<i>Itemized Deductions</i>	<i>Notes</i>
	Does the client have substantial charitable deductions?	
	Consider having the client make contributions with appreciated securities.	
	Consider the timing of contributions to decide how to maximize the benefit.	
	Discuss CRATs, CRUT's, Private Foundations and Charitable Lead Trusts with the client.	
	Understand Donor Advised Funds and consider whether these might apply.	
	Consider the use of an IRA distribution direct to charity if client is over 70½ (watch for updated legislation).	
	Does the client have a significant state tax deduction?	
	Discuss with client the growing importance of state taxes.	
	Determine if the client has any residency issues. (multiple residences, etc).	
	If the client has multiple state residency discuss the opportunities and pitfalls.	
	Discuss potential tax liability in other states with the client.	
	Are there substantial medical expenses being deducted?	
	If there is a deduction for long term care insurance, discuss this policy with the client.	
	Discuss with the client his or her current health insurance coverage.	
	Understand the Medicare rules and their impact on the client.	
	Explain to the client the issues related to elder care.	
	Do the expenses indicate inadequate health insurance coverage or special needs?	
	Does the client itemize miscellaneous deductions?	
	Determine if the investment fees are reasonable or excessive.	
	What are the other expenses deducted?	
	Explain to the client the 2% of AGI limit.	
	Consider planning opportunities to avoid the loss of deductions.	
	Does the client have interest expense that is being deducted?	
	Explain the benefits of the mortgage interest deduction to clients.	
	Consider planning and refinance opportunities related to mortgage interest.	

<i>Done</i>	<i>Itemized Deductions</i>	<i>Notes</i>
	Be sure that the client is not exceeding the limits on mortgage interest.	
	Understand the investment interest expense carryover rules and what qualifies as investment interest expense.	
	Consider the various types of loans for education.	
<i>Done</i>	<i>AMT</i>	<i>Notes</i>
	Are the clients in AMT or have they been in the past?	
	Understand why the client owed an AMT liability.	
	Consider any planning opportunities that can be used to minimize the AMT impact.	
	Explain to the client the rules of exercising ISO's and the planning opportunities available.	
	If there is a minimum tax credit carryforward identify when it was generated and consider its implications.	
	Is the client potentially losing the AMT credit carryover?	
<i>Done</i>	<i>Credits</i>	<i>Notes</i>
	Consider the education credit alternatives.	
	Consider the available energy credits.	
<i>Done</i>	<i>Occupation</i>	<i>Notes</i>
	Does the occupation indicate special coverage needs? (such as adequate disability insurance for a surgeon).	

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