AICPA
New Planning Opportunities for Tax and Financial Planners

4 Change Factors Transforming the Planning Landscape

By: Martin M. Shenkman,
CPA, MBA, PFS, AEP, JD

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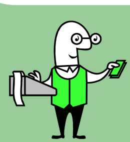

Introduction

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Estate Planning Post-ATRA

- The personal planning environment faced by CPAs and financial planners is undergoing a major transformation. For practitioners to excel during these evolutionary changes they need to:
  - Expand the scope of their services
  - Adapt new technologies
  - Change their approach to marketing and client communication
  - Reorient their thinking

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New Planning Opportunities for Tax and Financial Planners

Redefine “Estate” Planning

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Redefine "Estate" Planning

- State estate tax planning in a decoupled state.
- Succession planning for family and closely held businesses.
- Asset protection planning.
- Divorce planning.
- Retirement planning.
- Budgeting and financial planning.
- Maximizing basis step-up at death to minimize capital gains, with consideration to the state (if any) and federal (if any) estate taxes.
- Repurposing existing trusts and entities in light of all changes.

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New Planning Opportunities for Tax and Financial Planners

New Planning – Less Costly But More Sophisticated

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New Planning – Less Costly But More Sophisticated

- Planning will have to be done creatively, simpler, and at lower cost to persuade clients subject only to limited or no federal estate tax to proceed.
- Gifts to lifetime trusts will become more common to protect assets and to save state estate tax in some decoupled states.
- These trusts will more commonly be structured so that a spouse, or even the client himself or herself, can access the assets. This latter type of trust, referred to as a self-settled, because the client set up the trust and is a beneficiary, will have to be established in states such as Delaware that permit these trusts. As this planning becomes more commonly used, it will become more readily accepted by clients, more standardized, and less costly.

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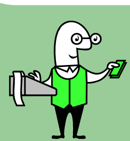

4 Change Factors

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4 Change Factors

- We've all been through lots of tax changes, but these are qualitatively different.
- Merely adapting by learning the changes in the law enacted in 2010 and 2012 will not suffice as it may have for prior tax act changes.
- The new paradigm is changing in far more radical ways as the discussion of the four key change factors below makes clear.
  - Tax changes
  - Demographic changes
  - Tech changes
  - Perspective changes (commoditization)

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New Planning Opportunities for Tax and Financial Planners

Change Factor #1: Changing Tax Paradigm

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Tax Changes - Maximizing the step-up in income tax basis on death

- Even clients not facing an estate tax can benefit from creative trust planning.
- Guide clients to include additional beneficiaries, e.g. an elderly family member, who have modest estates in testamentary trusts (e.g., a family trust formed on the first spouse's death).
- Provide this person with a general power of appointment over the trust assets (or give a third party the right to create a narrow general power of appointment in favor of that beneficiary).
- Trust assets will be included in that person's estate, benefit from a step up in income tax basis, and all capital gains will be eliminated at no cost.
- This is a much broader planning view than merely planning to maximize income tax basis on the death of the second spouse.

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Tax Changes- Maximizing the step-up in income tax basis on death

- Include additional beneficiaries, e.g. an elderly family member, who have modest estates in testamentary trusts (e.g., a family trust formed on the first spouse's death).
- Give this person a general power of appointment over the trust assets (or give a third party the right to create a narrow general power of appointment in favor of that beneficiary) so the entire trust will be included in that person's estate, benefit from a step up in income tax basis, and all capital gains will be eliminated at no cost.
- This is a much broader planning view than merely planning to maximize income tax basis on the death of the second spouse.

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Tax Changes- Managing trust distributions to minimize income taxes - 1

- At first blush trusts are a rather inefficient income tax tool given the compressed tax rate structure reaching maximum tax rates and surtax levels at about $12,000 of income. But this negative might obscure the income tax power of trusts to shift income, in a deliberate manner, each year, to the lowest bracket family members. Trusts, unlike individuals, are not restricted by the assignment of income doctrine. The trustee may be able to simply choose which beneficiary to make a distribution to, and that beneficiary will recognize the income tax costs associated with that distribution. Further, trusts can make these distributions up to 65 days after the year end, with the benefit of hindsight, individuals cannot. With higher income tax rates, non-grantor trusts can provide tremendous planning opportunities.

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Tax Changes- Managing trust distributions to minimize income taxes - 2

- Trusts have to be properly planned. Be proactive and don't relegate this solely to the attorney drafting the trust instrument.
- Encourage clients to consider including a broad class of beneficiaries in non-marital trusts, not just the surviving spouse.
- Many attorneys still draft trusts for children instead of including all descendants.
- Unless there is an overarching reason to limit the class of beneficiaries, don't.
- The trustee must have the authority to include capital gains in trust accounting income so capital gains can flow out to beneficiaries.

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Tax Changes- Managing trust distributions to minimize income taxes - 3

- Trusts can make these distributions up to 65 days after the year end, with the benefit of hindsight, individuals cannot.
- The biggest challenge facing those seeking to minimize the income tax consequences of trusts is the pressure beneficiaries will exert on trustees to make distributions using the hammer of income tax savings as a requirement of the trustee's duties. This pressure will provide a valuable business opportunity for CPA practitioners and financial advisers to guide trustees using tax and financial projections.
- Practitioners who truly step into their roles as the "trusted adviser" and advise trustees, based on their knowledge of non-tax factors including the client's wishes, not only on tax savings, will shine.

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Tax Changes- Minimizing, when still applicable, estate taxes

- For wealthy clients a permanent estate tax with a 40% rate planning remains essential. Grantor trusts, note sale transactions, GRATs and other techniques that have formed the foundation of planning for the ultra-high net worth client, should be pursued vigorously before they are legislatively emasculated.
- About 20 states still have state estate taxes that are decoupled from the federal system, and many clients still face these taxes.
- Planning steps must be cognizant of the fact that the marginal income tax rates on heirs may exceed the estate tax rate.
- The CPAs role in creating projections to guide that process, and updating the projections periodically to monitor the position of the client's estate relative to the inflation adjusted exemption, should be a central focus of planning for many.

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Tax Changes - Rethinking annual gifts - 1

- Annual exclusion gifts, that had been an a cornerstone of planning, should largely disappear. Most clients will simply not be subject to an estate tax so the benefit of shifting assets outside their estates may no longer be relevant.
- Assets subject to the annual gift will not benefit from a basis step-up on the client's death.
- For clients whose estates are on the cusp of the federal (or perhaps a state) estate tax exemption, monitoring the size of their estate and capping growth in the value of their estate with the judicious use of annual gifts, for a small segment of clients, will remain valuable.

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Tax Changes - Rethinking annual gifts - 2

- For these clients who will benefit from gifts, practitioners must remain conscious of the basis adjustment issues. It might be advisable to gift cash instead of family business interests, or to have the client borrow funds and gift the proceeds rather than gift low basis assets. Again, all this is quite different from past practices.
- For every client review gift provisions in their power of attorney and living trust. This is not a task to relegate to lawyers, it is very tax driven and most documents will no longer serve your client's needs.
- If a client doesn't need gifts to save tax why include gift provisions in a power of attorney? It may only serve as a spigot for elder financial abuse.

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Tax Changes - Swapping assets with grantor trusts

- If a grantor trust owns interests in the family business that have appreciated substantially the client can swap cash for stock and cause the stock to be included in her estate to obtain a basis step-up.
- This planning can be quite valuable but takes more than a trust document including the requisite boilerplate.
- The client and trustee must understand the planning. That is a vital role CPAs can fulfill.
- The client/settlor must have cash resources available to effectuate a swap. Few settlors have addressed this. Practitioners can assist these clients in creating lines of credit to be "at the ready."
- Analyze trusts for highly appreciated assets part of the annual review process.
- Assure that if a swap is done that the terms of the trust are followed so that the transaction is in compliance with its requirements.

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Tax Changes - Reviewing partnership and operating agreements - 1

- FLPs and used for discounts may now be detrimental because they reduce basis increases at death with no commensurate estate tax savings.
- Identify FLPs/LLCs and have counsel amend partnership or operating agreements permitting liquidation or payout of a partner or member's interest in a manner that minimizes discounts.
- Review the provisions in partnership and operating agreements governing 754 basis adjustments. It might be advantageous to mandate the election be made.

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Tax Changes - Reviewing partnership and operating agreements - 2

- As the reach of the estate tax declines, the relative importance of the asset protection benefits of FLPs and LLCs will grow. As aging clients seek to safeguard their savings for what is perceived as decades, not merely years, of post-retirement living, the use of FLPs and LLCs for this purpose may grow.

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New Planning Opportunities for Tax and Financial Planners

Repurpose Old/Existing Planning

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Repurpose existing Bypass Trust - 1

- Existing bypass trusts may no longer be needed to avoid estate tax on surviving spouse's death (in a non-decoupled state).
- May be feasible to distribute assets and terminate trusts thereby simplifying and reducing costs.
- But is the loss of control, asset protection, assurance who will inherit, the risk of future taxes, worthwhile?
- May be able to use existing bypass to sprinkle income to lower bracket taxpayers or to decant into a successor trust that will permit this thereby repurposing an intended estate tax savings into an income tax savings.

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Repurpose Existing Plans with Credit Shelter Trusts - 2

- Credit shelter could have provisions permitting distribution of highly appreciated property. Distribute highly appreciated property to the surviving spouse to get a basis step on his/her death.
- Name surviving spouse and all descendants as permissible current beneficiaries in contrast to past practice of naming only spouse. This permits spraying income to family members in lowest bracket each year.
- Permit inclusion of capital gains in trust accounting income so that capital gains can be distributed out to, and taxed to, beneficiaries in lower income tax brackets then the trust.
- Use powers of appointment to cause inclusion in surviving spouse's estate, or another family member well under $5M, to garner a basis step up.

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Repurpose Existing Plans with Credit Shelter Trusts - 3

- Consider including right to grant general power of appointment over highly appreciated assets to cause estate tax inclusion in surviving spouse's estate.
  - Will limitation to creditors of surviving spouse provide comfort?
- Invest Credit Shelter Trust assets in a manner that does not generate significant appreciation. Modify investment language to permit this.
  - Permanent life insurance.
  - Bond portion of portfolio – family asset allocation may remain unchanged, but asset location decisions may change.

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Repurpose Existing QTIP Using Section 2519 Gift to Use DSUE

- Example, H died and QTIP funded. If W remarries DSUE may be lost. Use it without emasculating protections of QTIP.
- W gifts Income Interest in the QTIP Triggers 2519 – gift of entire interest in the trust that allows DSUE to then be used.
- Survivor Can Remain a Discretionary Beneficiary of Corpus after 2519 income disclaimer without estate tax inclusion.

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Repurpose and Simplify ILITs

- **No Annual Written Crummey**. Crummey powers have proved daunting to most mere non-professionals. Might it now become practical to actually draft ILITs *without* Crummey powers? For taxpayers with moderate wealth estates, why burden them with annual homework they don't want?
- **Sign Off**. While practitioners might have such a taxpayer sign off acknowledging that the ILIT won't include Crummey powers and that a gift tax return will be required each year to allocate exemption since the trust won't qualify, is that really unreasonable for a $2 million estate? What about for a married couple with a $5 million estate inclusive of insurance?
- **One-Time Crummey**. Perhaps there is another alternative that few practitioners would have proffered prior to ATRA, but may be the practical (although certainly not the technically optimal) approach post-ATRA. Consider having beneficiaries sign a one-time statement. Review existing ILITs they may permit this flexibility now.

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Repurpose Family Limited Partnerships and Limited Liability Companies

- **Don't Dissolve**. Taxpayers do not enjoy the formalities of maintaining LLCs or FLPs. If they view the estate tax as no longer applicable to them, moderate wealth clients might well want to dissolve these entities. Bad move for most.
- **Benefits Remain**. FLPs will continue to be vital to control assets, protect assets from creditors and irresponsible heirs, and more. Even if the federal estate tax benefits wane, these entities should remain the cornerstone of many plans.
- **New Income Tax Benefits**. The restrictions on itemized deductions many high income taxpayers will find deductions disappearing. The creative and careful use of LLCs and FLPs to shift income (subject to the family partnership rules of IRC Sec. 704(e)) and perhaps shift qualifying deductions to their LLC or FLP, may provide valuable income tax benefits. LLCs and FLPs that had been intended for estate tax discounts may be repurposed into *income* tax planning tools.
- **Eliminate Discounts**. Change terms of agreement to argue against discounts if clients below federal estate tax threshold.

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Repurpose QPRTs

- **Unneeded QPRT**. If you created a QPRT when the estate tax exemption was $2 million, and now with a permanent inflation adjusted $5 million exemption will never be subject to estate tax, perhaps on the termination of the QPRT term the opposite advice of what you have customarily been given might be appropriate under the new estate tax paradigm.
- **Old Advice**. Conventional advice would be to deed the house from the QPRT to the children or a remainder trust (which might well have been structured as a grantor trust for further tax burn that is no longer needed). Then that successor in interest would execute a written lease agreement with the parent/donor who typically would want to continue to live in the house. Likely you would advise the children or trustee to secure a written estimate of the fair rent for the property from at least a real estate broker, if not from an MAI appraiser.
- **New Result**. But alas, at this point properly carrying out the QPRT plan might assure that the house will not be included in the donor/parent's estate, won't achieve a step up in tax basis, and the estate tax savings will be nil.
- **New Plan**. After the QPRT term ends, no lease should be signed and no rent paid. Arguably the house should be included in the parents estate and subject to estate tax, which won't happen for a moderate wealth taxpayer (state estate tax aside) and a basis step up on death could be realized.

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Repurpose Pension with life insurance

- Using pre-tax retirement plan dollars to fund life insurance purchases has been problematic because of the concern over estate tax inclusion of policy proceeds when the pension sub-trust concept became more of a concern.
- With a permanent high inflation adjusted exemption, many moderate wealth clients can use pre-tax pension dollars to fund insurance premiums with little concern of ever being subject to a federal estate tax. Those wealthy clients looking for income tax advantage pension ownership of life insurance may see a resurgence.
- For clients subject to state estate tax, it may be preferable to have an ILIT own the policy to avoid state estate tax, but now, for the first time, the current income tax benefits may outweigh the future state estate tax cost of this type of an arrangement.

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Change Factor #2: Changing Demographics

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Changing Demographics

- 5 million baby boomers a year are retiring and retired baby boomers are reshaping retirement, estate and financial planning as they have transformed every aspect of American society.
- Boomers' "needs," and more important, "wants" are very different then prior generations.
- The boomer client is concerned about the risk of running out of money during what they anticipate to be decades of post-retirement living.
- There is growing focus on minimizing the impact of health challenges that increase with aging. Alzheimer's disease is a major later life worry.
- This will have a profound impact on the services planners can and should offer.
- This single change factor, more than any other, will provide the CPA, as the independent and trusted adviser, the opportunity to assume the mantle of leadership of the client's estate and financial planning team.

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Changing Demographics - Review budgets, asset allocations, etc. - 1

- If Boomer client's funds are to suffice over their growing life expectancy planning is vital.
- Guide clients to consolidate and coordinating investment planning.
- In too many instances financial projections are so generic as to be dangerous. Many projections are based on assumed expenditures because those creating them don't spend the time to collect and analyze actual expense data for the client. By refining these generic plans practitioners may identify planning steps that will make the difference between real projections and financial security, and what otherwise might be a rather theoretical exercise.

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Changing Demographics - Review budgets, asset allocations, etc. - 2

- Another fallacy of many projections is that they are single point projections assuming one estimated inflation rate and one rate of return. The power of Monte Carlo simulation to generate large numbers of outcomes to evaluate what might happen in different inflation and market conditions is really essential.
- Practitioners should endeavor to identify these large gaps in client financial plans and assist them in correcting them.
- If a client has a known health condition have the client obtain a care plan from a care manager so that actual input as to the costs and other consequences of that health challenge can be dollarized and integrated into the plan.

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Changing Demographics - Be certain clients have the appropriate planning steps in place for aging

- It is certainly the attorney's responsibility to prepare a power of attorney, living trust, health proxy and other key documents for a client. But if the client has not seen his or her attorney in decades, or has never addressed these issues, no attorney can help.
- Include as regular questions in any annual review checklist inquiries as to whether clients have these documents.
- Instead of merely asking if the client has a will, as who the executor is and when the will was signed. A bit more specificity may prevent the client from giving a quick "yes" to deflect the issue. It may also identify that the client has neglected updating the documents for far too long.

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Changing Demographics - Create safeguards and checks and balances on planning

- Who is monitoring the actions of the fiduciaries? Where are the checks and balances in the system?
- Some of the most egregious instances of elder financial abuse occur from an agent under a power of attorney or a successor trustee under a revocable trust simply diverting client assets.
- CPAs, in the role of trusted adviser, can be charged with receiving duplicate copies of statements, generating reports to the agent and others. This can create a check and balance on what is happening.
- A power of attorney or living trust could mandate that a CPA receive duplicate copies of all statements and checks and generate a report each quarter that is sent to several designated persons, especially someone independent of whoever is serving as agent or trustee. Without such reports it may be impossible to identify defalcation until it is too late.

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Change Factor #3: Changing Technology

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Technology

- Really use the available technologies to better serve clients in a more efficient and cost effective manner.
- Web conferences can often substitute for in person meetings. They tend to be more to the point and hence less costly for clients. For younger clients facing pressure of work and family, the efficiency may be greatly appreciated. For older clients, avoiding the physical difficulties of an office visit if not necessary, may be the motivator to pursue more planning.

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Technology

- Assist clients in computerization and other steps that can safeguard them as they age.
- Every client wants to remain in control of their finances, but the reality is that few do much to achieve this objective. CPA practitioners are a key to many of the simple steps that can make a tremendous impact on this. For example, if a client has no centralized computerized financial recordkeeping (e.g. all checks, investments and other financial accounts being recorded in a program like Quicken) help the client transition to that type of arrangement. The potential for the destruction of critical records do to fire, weather or other risks, should be mitigated. Computerization with automatic back up procedures can achieve this. Scanning key legal, financial, tax and personal records can similarly insulate a client from this component of the devastation from fire or other hazard.

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Technology

- More important than just physically safeguarding records, destroying unnecessary old financial and tax documents will minimize the risk of those records being stolen by a home health aide or repair person and being used to commit elder financial abuse, which had grown dramatically in recent years.
- As a client ages it becomes more difficult to remember key bills and other deadlines. Setting up reminders in the client's computerized checkbook program is a simple and assured way to minimize the fallout from oversight. Helping clients create these safeguards before they are really needed is prudent and should be a regular component of service offered to older clients.
- While the above sound simplistic, perhaps even trite, to practitioners, many clients do not have the skill or comfort to take these and similar steps. CPAs setting up and advising clients on implementing the appropriate steps might well prove one of the most important safeguards for a client's later decades of life.

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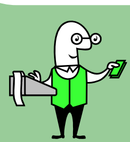

Change Factor #4: Commoditization

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Commoditization

- Clients more and more do and will continue to view services as standard or “commoditized.” If your tax return, financial projections or other traditional “product” is viewed as a commodity, clients will increasingly become unwilling to pay as much or place the same value on it.
- As this trend continues the one factor to distinguish one adviser from another will be service. Many of us had relied on the perceived 50% estate tax savings for any planning to cover-up inefficiencies or other shortcomings. Those days are over for most clients.

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New Planning Opportunities for Tax and Financial Planners

Conclusion

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Conclusion

- Recent tax law changes are a game changer. While the initial reaction of many CPAs is a reduction in estate planning work, the opposite in fact is likely to be true.
- To capitalize on what is a business development bonanza, practitioners need to rethink how they market estate planning services, what services they offer, how they network with allied professionals (like estate planning attorneys), and more.
- It's not only taxes – demographics, technology and other factors are transforming the planning environment.

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Additional Information

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- See the resources at the PFP web page: http://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/Membership/Pages/PFPMemberBenefits.aspx
- See the power point of this presentation, and a companion article, posted to the above page.

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