AICPA® Personal Financial Planning Section

# New Planning Opportunities for Tax and Financial Planners

**4 Change Factors Transforming the Planning Landscape**

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## Introduction

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
- And most important, reorient their thinking

This article will provide concrete and practical examples of what tax and financial planning practitioners, from solos to the largest firms, can do to adapt and thrive. The role CPAs can play in a client's estate and financial team has never been more significant. All we have to do is capitalize on the myriad of opportunities.

## Redefine "Estate" Planning

While the federal estate tax may not be an issue, other planning topics remain important. Practitioners must redefine what had become "estate tax minimization" planning into a much broader "estate, financial, retirement and related" planning.

- State estate tax planning in a decoupled state.
- Succession planning for family and closely held businesses, including reviewing all existing plans focusing on estate tax concerns that may no longer be relevant.
- Asset protection planning; regardless of the status of the estate tax, the litigious nature of society has and will not change, so some degree of planning is appropriate for most clients.
- Divorce planning has, and will remain, a priority for many clients. This will often entail the use of trust planning similar to that used to minimize estate tax, but perhaps with a different goal or emphasis.
- Retirement planning has will remain inter-related with estate planning. This includes not only planning for retirement plan distributions, but most importantly the basic budgeting and financial planning most clients are loath to do.
- 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 to have continued relevance after ATRA, or to liquidate or wind them down if they do not.

The CPA's role is more essential than ever because none of these issues is likely to be addressed if the client is not motivated to have an estate planning conversation. Even intelligent and well-informed clients will require education and encouragement by their CPAs to address planning.

**New Planning – Less Costly But More Sophisticated**

While some estate planners assert that clients living in decoupled states will continue to benefit from sophisticated planning techniques to save state estate tax, that argument won't be nearly as powerful a motivator for planning as the federal estate had once been. Consider the following:

- Although 21 states and the District of Columbia decoupled from the federal estate tax system, the exemptions in some decoupled states is relatively high, and most states still have no estate tax.
    - In decoupled states different planning may be warranted. The use of life insurance trusts, irrevocable trusts to grow assets outside the taxable estate, etc. may be advisable. Many of the clients facing a state estate tax, however, will not face a federal estate tax. For these clients, the income tax cost of a loss of basis step-up may exceed the value of the state estate tax savings. This can make planning even more complex than under prior law.
    - Planning will have to be more cleverly crafted so that planning can be implemented more cost efficiently in light of the lower savings. For example, a single irrevocable trust might be designed to serve the purposes previously served by an asset protection trust, insurance trust and even bypass trust.
- Many clients move their residences to save state income and estate taxes.
    - If moving could eliminate any state estate tax benefit that costly and complex planning might provide, will clients pursue the planning? Practitioners should guide clients on how to bolster whatever position is determined.

There's no doubt that planning will continue, and, in many instances, state estate tax planning will justify some advanced planning. In most situations, planning will have to be done creatively, simpler, and at lower cost to persuade clients to proceed.

What might some of this planning entail? One technique that is likely to be more commonly used will be gifts to lifetime trusts. Clients in some states, who transfer adequate wealth to trusts pre-death, can avoid state estate tax. Since few clients will put wealth out of their reach, these trusts will have to 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.

**4 Change Factors**

We've all been through lots of tax changes, but this is 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. While identifying general trends is helpful, delineating specific planning implications is more useful. However, identifying specific planning action steps practitioners can take is most useful of all. That is the focus of the discussion following.

**Changing Tax Paradigm**

As practitioners we've all seen higher and lower income and capital gains tax rates, varying estate tax exemptions and more. But for most clients, for the first time ever, the estate tax is either not applicable, or if applicable at a rate that is not assuredly greater than the income tax rate. Thus, the entire focus of estate planning on minimization of transfer taxes has for most clients shifted to focus on:

- Maximizing the step-up in income tax basis on death.
    - Estate planning should not focus on bypass trusts as it so often had in the past. 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). If the client is comfortable providing this person with a general power of appointment over the trust assets (or in giving a third party the right to create a narrow general power of appointment in favor of that beneficiary) the entirety of the 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.
- Managing distributions from trusts to minimize current income taxes.
    - 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.
    - For all this to occur the trust has to be properly planned. This means CPAs have to be proactive in the planning process and not relegate this function to the attorney drafting the trust instrument. Encourage clients to consider including a broad class of beneficiaries in non-marital trusts. Too often only a surviving spouse was named beneficiary of a credit shelter trust. 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. While state law may permit

this, it might be preferable to have tax-oriented distribution language right in the instrument.
    - 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. Few clients who made the effort to create trusts to protect beneficiaries would want every penny of income distributed to minimize current income tax without regard to the impact of those distributions on the recipient beneficiaries. Practitioners can certainly help guide trustees using tax and financial projections. But practitioners who truly step into their roles as the "trusted adviser" and advise trustees based on their knowledge of the family and client's wishes, not only on tax savings, will shine. Don't view this as a matter within solely the purview of the family attorney. The attorney who drafted the trust may only meet the client once every three to five years. You may have had annual or more frequent meetings with the client for decades. Use the knowledge gleaned from that relationship to help the trustee carry out what you know to be the client's intent.
- Minimizing, when still applicable, estate taxes.
    - For wealthy clients a permanent estate tax means the hopes of death tax repeal are no longer realistic and planning must be pursued. For estates large enough to dwarf the exemption amount, a 40% federal estate tax is dramatic. Planning for this remaining small number of clients will have to be pursued vigorously. Also, with continual threats to restrict or eliminate the use of grantor trusts, GRATs and other transactions that have formed the foundation of planning for the ultra-high net worth client, this type of planning should be pursued vigorously when necessary.
    - About 20 states still have state estate taxes that are decoupled from the federal system, and millions of clients have estates large enough to face federal estate taxes. Some of the media coverage of post-ATRA estate taxation has resulted in many wealthy clients becoming complacent about tax planning. Practitioners should identify those clients who may face an estate tax and guide them to appropriate planning steps. These steps must be cognizant of the fact that the marginal income tax rates on heirs may in many instances exceed the estate tax rate the parent or other benefactor may face. Thus, the planning objective of the past several decades of simply moving assets out a client's estate is overly simplistic and potentially damaging in the current tax environment. For a wide swath of clients, projections of the growth of their estates, potential state or federal estate taxes, under various assumptions, will be more important than ever to crafting an optimal plan. In the past a client could have simply met with an estate planning attorney who counseled them on moving assets out of their estate.
    - 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.
- Rethinking annual gifts.

    - The annual gift, often of shares in a family business entity that had been a stalwart of annual planning will largely disappear. First, 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.
    - 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.
- Swapping assets with grantor trusts.
    - Most sophisticated modern trusts are structured as grantor trusts. The most popular mechanism to achieve grantor trust status is to incorporate into the trust document the right of the client who created the trust, the settlor, to exchange or "swap" assets with the trust for assets of an equivalent value. So if the 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." Financial planners and CPAs need to educate clients, especially older clients, to make reviewing trusts for highly appreciated assets part of the annual review process. Finally, practitioners need to be proactive to 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.
    - Practitioners need to review client trust planning to identify clients whose trusts are still the simplistic "traditional" trusts that ignore much of this planning. In those instances efforts should be made to at least correct future planning. Existing trusts that were not optimally structure might be improved upon by merging the deficient existing trust, into a new better crafted trust through a process referred to as "de-canting."
- Harvesting gains and losses.
    - While this is supposedly a common planning step, and the increase in income tax rates make it more important, the reality is that this obvious technique is not adequately addressed by many, perhaps most, clients. First, many clients maintain accounts with multiple investment advisers and often make a point of not telling other advisers about these funds. Guiding clients to consolidate investment holdings into as few managers as possible, and assuring that all mangers know the

holdings of the others so investment allocations can be optimized, will also facilitate better year end gain harvesting.
    - There is yet another unfortunate circumstance that undermines better gain harvesting. Simply, some advisers simply don't play nicely in the sandbox. Instead of communicating and cooperating with the client's advisory team they prefer the lone wolf approach as if that will enhance their importance to the client. The future of planning is a team effort where each adviser contributes his or her expertise to the overall betterment of the client's position. As the team approach becomes more standard, practitioners will serve clients well by fostering open interchange with all advisers.
- Reviewing partnership and operating agreements.
    - FLPs and LLCs have been used in many instances to generate estate planning valuation discounts. For the many wealthy clients no longer subject to estate tax those discounts may prove a planning negative. This is because they could reduce basis increases at death with no commensurate estate tax savings. Practitioners should be alert to these circumstances and advise action steps to mitigate this. For example, it may be possible to amend and restate the partnership or operating agreement permitting liquidation or payout of a partner or member's interest in a manner that minimizes discounts.
    - In order for a partner or member to benefit from a basis increase the entity must make an election to adjust the inside basis of assets. Practitioners should review the provisions in partnership and operating agreements and if they are deficient, advise clients to have the entities attorney draft changes, and if necessary, negotiate those changes. For example, it might be advantageous to mandate the election be made. Otherwise an antagonistic manager or general partner might refuse.
    - 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.
- Evaluating all prior planning steps taken to ascertain how they can be repurposed to be useful in the new tax paradigm.
    - Repurpose existing bypass trusts that are no longer needed to save an estate tax. It may be feasible to liquidated the trust or use it to shift income to lower bracket family members. Existing bypass trusts may have been formed and funded primarily to reduce estate tax on the death of the second spouse. Now, however, there may be no estate tax savings, and the inclusion of assets inside the bypass trust may merely eliminate the benefit of a basis step-up on the death of the second spouse. Review the asset location investment decisions, whether the trust can be transformed into an income shifting tool (see above), or perhaps in some instances merely be liquidated.
    - Repurpose existing estate plans with bypass trusts be having the planning revised to reflect the new tax paradigm.
    - Repurpose existing QTIP trusts with an IRC Sec. 2519 election.

- Repurpose and simplify insurance trusts ("ILITs") by simplifying Crummey power mechanisms, exchanging or modifying insurance policies to maximize income tax benefits when the estate tax purpose may no longer remain significant.
- FLPs and LLCs may have been initially planned for discounts. Rather than liquidating entities where this is no longer needed, repurpose the FLP or LLC to shift income. Before FLPs and LLCs were the focus of discount planning they were utilized to shift income to lower bracket taxpayers. With the new emphasis on income tax planning and more progressivity in tax rates, this planning may again be revived as the primary tax focus of these entities. So gifts of FLP or LLC interests that may not be needed for estate tax minimization, may be revisited for income tax planning purposes. Be certain when guiding clients on this type of income tax planning to consider the strictures of IRC Sec. 704(e), the family partnership rules (e.g., capital must be a material income producing factor, etc.).
- A qualified personal residence trust ("QPRT") was a great technique to remove post-gift appreciation of a principal residence, in a discounted manner, from a client's estate. QPRTs were used exclusively to reduce estate tax. Now, many clients who created QPRTs may not be subject to an estate tax (or if so, to much less of one) but the loss of basis step up since the house has been removed from the client's estate could be dramatic. Practitioners might advise clients to intentionally taint the QPRT by retaining a life-estate under a lease or executing a lease below fair market value, or both. These are factors that the IRS uses to argue to force estate inclusion of a house transferred to a QPRT. Caution should be exercised, however, in that any transaction must consider the fiduciary obligations of the trustee. Some clients might simply have the trustee deed the hose back to them if there is no tax benefit. This could jeopardize the ownership (title) to the house and set the trustee up for a suit for violating his or her fiduciary duties.
- Repurpose existing pension plans when appropriate to own life insurance.

This is all a dramatic departure from historical planning, but it is only part of the planning story.

**<u>Changing Demographics</u>**

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 as they have moved up the age continuum. Planning will not be the "SALY" same as last year, with an overlay of some new tax changes. Boomers' "needs," and more important, "wants", are very different then prior generations. While it was common for prior generations of planning clients to be primarily concerned with minimizing estate tax, the boomer client is more likely to be 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, while it affects fewer people than COPD and other health challenges, has become the poster child of boomer later life worries. All 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.

- Review budgets, asset allocations and overall planning.
  - If Boomer client's funds are to suffice over their growing life expectancy planning is vital. Many clients divide wealth between multiple firms, brokers, products and so forth. Often, only the CPA in the context of preparing an income tax return really sees the entire picture. Use this opportunity to guide the client to the benefits of consolidating and coordinating overall 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. A client that is overspending by even a moderate amount today, if not corrected may well be in financial distress in a few decades. Identifying the issues currently, and recommending what might often be simple remedial steps, might suffice to provide the client with a high level of financial security.
  - 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.
- 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. CPAs meet clients at minimum once per year, financial planners hopefully more frequently. 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.
- Guide a client to creating safeguards and checks and balances on their planning.
  - While attorneys draft documents like powers of attorney or living trusts, 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. The CPA, in the role of trusted adviser, can be charged with receiving duplicate copies of statements, entering financial data into a bookkeeping program, generating reports to the agent and others. This can create a check and balance on what is happening. For example, 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.
    - This approach has not been the norm in the past but should be so in the future. With clients living longer, and the incidence of chronic disease, dementia and other challenges greater at more advanced ages, these steps become quite important.

**Changing Technology**

Merely becoming paperless, cloud based, or adapting some other technological innovation, although all that must be done will not suffice. Harnessing the dramatic technological advances requires modifying office facilities, changing practice methodologies and more. Without truly adapting your model of practice, merely adding technology might help, but it won't transform your practice thus permitting you to truly profit in the new environment.

- 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.
- 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.
    - 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.

## Change Factor #4: Changing View of Professional Services - 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.

## The CPA as a Catalyst to Planning

Planning will be fundamentally different for clients, even wealthy clients, who are beneath the new high federal estate tax exemptions. CPAs need to understand the impact on the role they play as part of the estate planning team, as well as the varying impact on the other professionals involved in the estate planning process, in order to best target their efforts to serve clients and grow their estate planning practices.

The high exemptions could commonly dissuade a client with a family net worth of perhaps even $3 million to $5+ million as an individual, or even $6 million to 10+ million for a couple, from returning to their estate planning attorney to be certain that their documents and planning are current. The perspective of many clients, even those who have these substantial amounts of wealth, is that they are sufficiently below the exemption amounts. As a result, they may believe that planning is not important for them and they may not need to monitor it to the degree when tax worries were paramount. Unless a natural event such as birth, death, divorce, and marriage occurs, clients are likely to see their estate planning attorney less frequently. All this means a more important role, and more business opportunity, for the CPA.

In the past, many CPAs presumed that the client's attorney was handling estate planning, and therefore viewed their role as more ancillary. While the attorney will continue to draft documents, it will be the CPA, with the annual or more frequent contact with the client that may now be in the central position to start the estate planning discussion with the client. Because of the periodic contact with clients regarding ongoing business planning and tax compliance matters, the CPA will have opportunities to address estate planning and fill the planning void. Simply put, CPAs can, and in many cases should, assume the role of catalyst and quarterback for estate planning that had largely been within the purview of estate planning attorneys in the past.

## Conclusion

Now is an exciting and dynamic time to expand the scope of what might have been a merely estate tax focused estate planning practice, or perhaps no focus at all, to a proactive and broad based approach to estate, retirement and later life planning. Clients will benefit tremendously from the expanding involvement of their CPAs, as their trusted advisers, in this capacity.

Practitioners can make this both a financially and personally rewarding growth component of their practices.