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Through the Green Visor

A Holistic Approach to Estate Planning

The world is about to experience the largest wealth transfer in history. The past 20 years of worldwide wealth creation is expected to be followed by the transfer of $2.1 trillion over the coming 20 years—and our country will see an estimated $1.1 trillion that wealth.

This coming wealth transfer will certainly impact the goals and values of those who receive it. Which means advice will be needed for all areas of financial advisory (income tax planning, estate planning, retirement planning, investment planning, etc.) in assisting with this wealth transfer.

A wealth transfer of this magnitude between generations indicates an obvious need for estate planning, not only to minimize inheritance taxes (which are not always applicable) but also—just as important—to support transfer goals, both charitable and non-charitable. Enter the CPA, whose role in this planning will become more important than ever.

Each CPA will have to determine the level of involvement they're comfortable with, ranging from being a financial coach working between the client's attorney and the client (assisting clients in understanding legal advice and making decisions) to assisting in the process (especially with the CPA's intimate knowledge of the clients' situation, both financial and personal) to being the primary adviser and suggesting estate planning tools that make sense given a client's situation

Uniquely Qualified

We, as CPAs, are uniquely qualified to assist in the financial aspects of estate planning. For example, the concept of "excess assets" (when someone has more net worth than they will need to support themselves the rest of their lives) can be measured, evaluated and monitored by a client's CPA. Further, the dispositive provisions of an estate plan can be evaluated by CPAs to determine whether they make sense (e.g., "Does the client have sufficient wealth for certain provisions in their will or trust?").

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CPAs, as primary financial advisers involved on a continuous basis with clients, are able to coordinate the estate planning with other areas of financial planning. The CPA can judge whether proposed or existing estate plans make sense for the client (estate plans are highly personal documents, often prepared by attorneys who do not really know the psychology of their clients). For example, planning for the ultra-wealthy differs completely from planning for those just trying to get by—yet both need estate plans.

Estate planning also involves coordination with income tax planning. For example, in planning for an inheritance we often try to reduce estate taxes. However, it's also possible that paying estate tax (with the tax rate so similar to income tax rates)—combined with basis step-up issues and state income taxes—could prove the best financial decision for a given situation. Gifting will freeze the value of the gifted asset, but there's no step-up in basis with a gift, as opposed to leaving the asset in the estate and having it inherited. Thus, tax (estate vs. income) planning should focus first on assets that would likely be sold during life. Decisions regarding gifting now have considerations intersecting with both the income and estate tax world. And CPAs are in the right position to take on this type of analysis.

Retirement projections are a key in estate planning, as these projections can estimate the excess assets (how much more the client will have at the end of their lives than they need to support their overall costs of living) that a family will have. Of course, these projections also are used to determine potential future shortages for family finances. In any case, this type of analysis requires a significant number of assumptions and financial calculations, which is, again, something most appropriate for a CPA to handle.

As CPAs, we're in a position to advise clients who have excess assets to consider prioritizing the personal enjoyment of those assets over other goals. In our office, this is called "bucket list estate planning." We ask our clients to prepare lists (for married couples, we suggest that they complete these lists separately) of personal experiences they want to enjoy during their lifetimes. Then we can work with them to estimate the costs of these experiences. It's surprising how many people have not thought about this type of planning for the use of their wealth.

Pondering Pensions

Clients (especially those with living trusts) should be careful when planning for their pension (including IRA and similar type plans) versus non-pension assets. For estate planning, and estate transfer purposes, pension assets are generally not subject to the dispositive provisions of living trusts. Pension assets may not be available to fund the sub-trusts commonly created by living trusts. Caution is important in planning for situations with significant pension type assets. Pension assets will not receive a basis adjustment at death. Further, pension assets are controlled by beneficiary designations not wills or trusts. It's important to review beneficiary choices with the client's attorney and the client to find the best choice. One possibility might be to have a trust beneficiary designation when properly coordinated with the estate plan (and as concluded with the attorney).

The final consideration for pension type assets is the total value of property intended to go to non-charitable beneficiaries. An inheritance of pension type assets will generally include deferred income taxes, while other assets may not. Thus, a consideration in the asset transfer determination should include the effect of deferred taxes on the inheritance.

Estate & Financial Planning From a CPA's Perspective

Solutions to liquidity and income replacement are usually found in life insurance. If a taxable estate contains illiquid assets, such as real estate or royalties, life insurance might be a solution to providing liquidity to pay estate costs, including estate taxes. The use of a life insurance trust to own the insurance in this situation should be considered to avoid the insurance from becoming subject to the tax that it is intended to pay. Life insurance is also commonly used for income replacement for families that are dependent on the income earner.

An important consideration for the CPA advising married clients, with respect to their estate planning, includes the use of portability elections, which allow the surviving spouse to use the full unused exemption of the decedent. It's advisable to file an estate tax return, even where not required, just to elect portability. Failure to consider this can be considered malpractice by future generations who might be negatively impacted by such a failure.

Portability elections can be a trap for the unwary, though, and files must include evidence that this issue was discussed with clients. Even better would be a letter to the client asking them to sign their indication that this has been discussed and their decision.

Even more complicated can be the consideration as to whether a client can ignore provisions in their estate plans if the use of a portability election might be more beneficial than following the estate planning documents (primarily because of basis adjustment issues). Technically, this could be a violation of the client's fiduciary duty. Also, the use of sub-trusts from an estate plan can provide creditor protection that ignoring the documents would not. However, where the benefit to the beneficiaries is sufficient and they all agree, this consideration is worth reviewing. This type of advice should not come from the CPA, but can be raised by the CPA to the client's attorney. The attorney, then, should make this decision and give related advice.

More advanced estate planning for larger estates involves legacy planning. This type of planning can be as simple as teaching family values to children or as complicated as generation skipping trusts to continue the family's values to society. Often, long-term trusts, or large current gifts are used to continue the societal goals of the family.

Conclusion

CPAs are suited to advise clients with respect to financial aspects of their estate planning, as well as other areas of financial planning, and are in a position to judge whether a client's plan is appropriate. Further, CPAs can monitor the progress and assist with following up on implementation of the financial plans of clients.

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