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PRACTICAL PLANNER

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YOUR PLANNING TEAM

Summary: Fostering a coordinated financial and estate planning team is one of the most important steps that you can take to assure that your planning is properly handled. My apologies if some portions of this article ruffle feathers, but that's far better than the adverse consequences that can happen when your team is not coordinated. Some of the most significant planning opportunities, and some of the most costly planning problems, don't fall squarely within the purview of your attorney, CPA, wealth manager, or trust officer, but rather in the less well demarcated overlap between the various disciplines. Remember those Venn Diagrams from grade school with the three overlapping circles? The point where the three circles intersect, the issues of tax, law, and finance that draw on your CPA, attorney and financial planner, often is the sweet spot. In most cases your lawyer cannot advise you how to optimally operate a trust without consideration of which assets are held by the trust. That's an asset "location" (not allocation) decision. And if your attorney and financial adviser try the task alone, without the insight of your CPA on income tax considerations, they'll miss the mark. Remember how mom always told you that "two heads are better than one?" Well they are, and three and four heads on a planning team are exponentially better still. There is another important reason for coordinating your team: checks and balances. Some advisers are incompetent, and a few are downright scoundrels. So insisting on coordinating the team will protect your financial and legal affairs. No adviser can know everything, not even the top in their field. So coordinating your team will permit other advisers to overlap and help compensate for an adviser that lacks the skill or insight to address a specific issue. When the team functions well, everyone watches your back and you benefit. So if a coordinated planning team is the cat's meow, why doesn't it always happen?

It Costs Too Much: Number 1 on the Letterman top 10 list of why advisory teams don't function properly is a classic case of "penny wise and pound foolish." The benefits of a coordinated team will almost assuredly outweigh the costs, often dramatically so. People worry that it will cost too much. "If my CPA talks to my attorney they'll both bill me!" True. But if they both talk your planning might actually work. The better answer is to minimize the costs of the team functioning, not avoid it. Permit advisers to interact directly without your involvement. They can talk more openly, and use technical jargon that will expedite the process. The cost of copying other advisers on emails is negligible.

Emperor's New Clothes: Many folks think they have a "team" because they have a CPA, an attorney and a financial adviser. The emperor may have had pants, a shirt and underwear in his dresser drawer, but he was still au natural. The fact that you have the component parts is good, but unless they operate as a team, you're missing out. You as the client have to authorize and direct your advisers to communicate. Many advisers are reluctant to reach out to other team members because they've been chastised by clients in the past for doing what they know is right.

Adviser Arrogance: Coordination often doesn't happen because of adviser arrogance. The attorney assumes that he or she knows everything necessary to create a plan and irrevocable trust and doesn't communicate with your CPA. But after the 2012 tax act, for most taxpayers the income

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CHECKLIST: NEW TAX WORLD

Summary: After the 2012 tax act most folks will never face a federal estate tax. If you're a married couple under the $10.5M wealth level, or a single individual under $5.25M (and those amounts will be adjusted upward for inflation in future years), then what do you do with existing planning? In some cases you might just be best off eliminating planning that was done previously, but in most cases you can retool prior planning to make it work better under the new tax rules. Before zapping Consider the following:

√ **Family Limited Partnership (FLP) or Limited Liability Company (LLC)**: Many of these entities, holding family investment assets, were formed to take advantage of discounts that would reduce estate taxes. Now, however, if your estate is not likely to be subject to an estate tax, you might not see the point of keeping that FLP/LLC around and paying annual fees to your CPA for the income tax return, legal fees, complexity and more. But before you zap that FLP/LLC consider how you can still benefit. The entity might provide valuable asset protection. In most states if you own only a portion of the interests in the entity it can be quite difficult for a claimant to re-

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tax is far more important than a federal estate tax. Most attorneys simply don't have the income tax knowledge CPAs have. And even of those attorneys that do, even fewer have the experience CPAs do preparing tax returns. While some lawyers may look down on tax return preparation as an inferior tax "activity," understanding how to report a transaction is a critical part of the planning process. This also works in reverse with many CPAs presuming that an attorney will add nothing to the review of the gift or income tax returns they prepare. For the first year of a new entity or trust, or if the underlying planning is quite novel or complex, involving the attorney who prepared the documents can be critical to properly reporting the transaction. Some large wealth advisers and institutional trustees have estate planners, CPAs and other professionals on staff. That can be a great backstop and second opinion for a plan, but too often some in the wealth management community view their internal staff as all that is necessary to handle trust administration or even planning. That too is a mistake. A CPA, even if less technically proficient than the staff accountants at the trust company, may have a decades long relationship with your family and may better understand your goals. Often, CPAs and attorneys working "in the trenches" have a different perspective then those working for a trust company. So even if the wealth management firm's staff has more technical knowledge, they won't necessarily have the same insight. Adviser arrogance is easily resolved. You as the client have to make it clear that you expect a coordinated team effort. When wealth advisers, CPAs and attorneys work in concert the team will play beautiful music.

Adviser Ignorance: Some advisers, e.g. an adviser you may have outgrown years ago, naysay anything a new or more sophisticated adviser recommends. Instead of admitting ignorance or discomfort with a document, plan or product, they simply negate it. There are several ways to assure that this common roadblock doesn't happen. Encourage advisers to review planning as a team without your involvement. An adviser who doesn't understand a technique will be more willing to ask questions freely if not embarrassed in front of you. Welcome new ideas from your team, and if another adviser shoots an idea down, ask them to explain.

Adviser Control: The more one adviser can control your planning, the more they think they can gain from your relationship. But their gain is not necessarily your gain. If a bank prepares income tax returns for a trust, and provides estate planning services, that's great if they have the returns reviewed by your CPA before filing, and the estate planning recommendations vetted by the team. If not, they may be seeking to enhance the perceived importance they have to you at the expense of the rest of your advisers. Insist on full cooperation that strengthens the team, not one adviser's position.

Adviser Greed: If a "financial planner" suggests you buy a product, but recommends that you don't need to speak to your other advisers, be like Uncle Martin on My Favorite Martian and raise your antennae. The stories of high commissioned products being sold when obviously inappropriate is legion. So too are the incidences of advisers milking an elderly or ailing client that is too feeble to protect themselves. Did the elderly person name their attorney as sole executor because of a long term relationship, or as a result of overreaching and manipulation? If any adviser insists that a new plan or major decision doesn't need to be discussed with your other advisers, that is the sign that you must.

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Compartmentalization: A common occurrence is for clients to tell each adviser something different. When your advisers each openly share information, each is likely to be better informed about your facts. Yes, more cost, but your planning will improve.

Yes Men: Some folks just love to hear what they want to hear. Some advisers are only too happy to say whatever those magic words are to keep a client happy, on board, and paying their bills. That destroys the free flow of ideas from a team. Encourage the free flow of ideas, especially dissenting ideas. The dissenting opinion might just be the most valua-

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alize any benefit. In divorce, the entity might avoid commingling immune assets with marital assets and protect a child who has received gifts or inheritances outside of trust. If you want to avoid basis minimizing discounts have the partnership agreement (LLC operating agreement) revised to eliminate the restrictions that previously created discounts. That way, on death, the absence of discounts will mean a greater step up in tax basis and lower capital gains for your heirs. Be cautious in the changes made to accomplish this as you don't want to excessively undermine the asset protection the FLP/LLC provides while eliminating the discounts. If you've given away interests in the FLP/LLC to heirs, it may be possible to reinforce or even create retained interests that for estate tax purposes might bring the entire FLP/LLC back into your taxable estate for basis step up purposes. That could be a better result than liquidating since only your interests would then get a basis step up. Finally, so long as you meet the tax rules of Code Section 704(e) you can use the FLP/LLC to shift income to lower bracket family members.

√ Bypass Trust: Many widows and widowers had bypass trusts formed when their spouse passed away. These trusts may have made a lot of sense at the time (and even until last year when there was worry of the estate exemption dropping to $1M), but do they make sense now? Does the cost of filing a tax return, dealing with an attorney, and the complexity still pay to keep? If you assuredly won't face a federal or state estate tax, it may not. If the assets in the bypass trust have appreciated (e.g., stocks held for years) your heirs won't receive a step up in income tax basis on death to the fair value of those assets. So they will face a larger capital gains tax. That capital gains tax may outweigh any state estate tax your estate will bear. The trustee might have authority to distribute appreciated assets to the spouse, even if the trust is not liquidated. The trust might be able to provide significant income tax savings if all your descendants are named beneficiaries by distributing income each year to the beneficiaries in the lowest income tax brackets. In some cases, unless the asset protection (lawsuit protection) benefits of the trust remain meaningful, you might just want to terminate the trust and distribute all assets (if the trust terms permit this).

√ QPRTs: Qualified Personal Residence Trusts are special trusts to which you may have given your house to remove it from your estate in a tax advantageous manner. If you did this when the exemption was much lower, you may no longer need the QPRT to save estate tax (but watch out for state estate tax). If a QPRT succeeds the house is outside your estate which means no increase in tax basis (the amount on which gain or loss is calculated when heirs sell after your death). That could be costly. If you don't face a large enough estate tax the income tax cost your heirs will face may outweigh the estate tax savings (if any). Consider unraveling the tax effects of the QPRT (you probably cannot unravel the QPRT since the trust is irrevocable). By holding a tax prohibited "retained interest" you will cause estate tax inclusion and provide your heirs with a basis step up. Consider signing a lifetime lease for $1 a year. Watch trustee liability! ℙℙ

RECENT DEVELOPMENTS

Buy-sell Agreement: Every business should review their buy-sell agreement to be sure it is current. Caution - the tax laws contain tough rules as to when a family buy-sell will be respected for setting value for estate tax purposes. If you have an old pre-October 8, 1990 buy-sell agreement you've never updated, be careful that a change might subject that agreement to the stringent IRC Sec. 2703 rules that it be comparable to arm's length agreements between unrelated parties. See PLR 201313001.

Is the 4% Rule Dead: Financial planners have used a 4% rule for years—if you don't spend more than 4% of your principal annually you'll never run out of money. So if you planned on retiring with $5M in savings you could safely spend 4% = $200,000/year. There's a growing chorus expressing concern that in the current market environment 4% may be too high. While rules of thumb are only as good as the thumb you're using, the bottom line is that caution is advisable. Everyone should review their budget and financial plan at least annually to be sure they remain on course. Many wealthy people view budgets as something for the proletariat. Not so. No matter how big your nest egg, there are limits to how much you can spend. It is amazing how many people stress over how they'll divide up their estate, without first assuring they'll have an estate at the end of the line. See: "The 4 Percent Rule is Not Safe in a Low-Yield World," by Michael Finke, Wade Pfau and David Blanchett.

Can't Always Use Your CPA as an Excuse: An estate's CPA filed an extension for the estate tax return and told the executor it was a 1 year extension when extensions are really only for 6 months. The IRS zapped the estate and the Court would not let the executor use the CPA's bad advice as a get out of jail free card. That

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Disclaimer Trusts are the Rage But Should You Disclaim? A disclaimer bypass trust may become the most common estate tax planning approach (for married couples in a first marriage) with the new high $5M inflation adjusted exemption. You leave everything outright to your spouse (great in a 3rd marriage or if your spouse is a physician worried about malpractice risks, but alas that is another story). Then your surviving spouse can disclaim (renounce) any portion of that bequest which will then pass into a bypass trust which she/he has access to, but which won't be included in her/his estate. This is a great way to use the benefits of hindsight to determine if a bypass trust should be used and how much to put into it. But in many cases there is a better option. Most bypass trusts are, and will likely remain, less than optimal vehicles. Most are simply not drafted using modern trust drafting techniques. Why settle for a Big Mac if you can have a steak at Ruth Chris steakhouse (I'm a vegetarian, but that sounded like a good analogy)? Don't disclaim (unless you're imminently going to be sued). Accept the inheritance and immediately set up a modern, state of the art, irrevocable trust and gift the assets you just inherited (and more if you wish) to that trust. The trust should be set up in one of the trust favorable jurisdictions (Alaska, Delaware, Nevada or South Dakota). It should be a grantor trust (you pay income tax on the trust earnings to further reduce your taxable estate). This also permits you to swap assets, without paying capital gains tax, to pull appreciation back into your estate. That will get a step-up in tax basis at death. The trust should be a long term or perpetual trust so you can lock in the tax and asset protection benefits for yourself and all your heirs. You can be a beneficiary of the trust which makes the trust a "self-settled" trust. This does create some risk, which you should evaluate with your advisers. This approach may enable you to avoid multiple trusts (e.g. a bypass trust and a marital trust from your late spouse, and a trust for your estate planning). If you live in a state with an estate tax exemption lower than the federal exemption amount (e.g., NY, NJ) you can greatly enhance the state estate tax savings with such a plan (except in CT and MN which have a gift tax, but even then it might still be beneficial). Yes, these are

Practical legal stuff... in plain English