



## Taxing Thoughts

### California CPA: March/April 2013

*Tax Time is the Perfect Time to Discuss Estate Planning With Your Clients*

By Michael B. Allmon, CPA

Tax season is one of the few times of the year that many people really think about taxes, even if thoughts are generally focused on income taxes. But maybe we should be thinking of other taxes that we can actually do something to reduce, such as estate tax, which is the largest tax some people will ever pay. Once we are focused on reducing estate taxes, the subject of estate planning in general is appropriate. Tax return preparers are in a perfect position to discuss a client's estate planning status.

#### **It's Tax Season, What Can I Do About Estate Planning Now?**

This is a perfect time for CPAs to assist clients with estate planning. Because CPAs deal with our client's financial records each tax season, we already have much of the most basic information needed to assist our clients with estate planning. Keep in mind that estate planning is a team sport and often includes an estate tax attorney, valuation experts and investment advisers, among others.

#### **Filing Status**

One of the first lines on a tax return is the filing status, which can tell us whether our client qualifies for the estate taxes "unlimited marital deduction." A married couple qualifies for this deduction; a single person does not.

The estate tax is applied to the "taxable estate," which—albeit oversimplified—is a tax on net worth with several adjustments, such as "plus life insurance" owned by the decedent. However, a married couple is allowed a deduction for property that is inherited by a spouse so that there is no tax if the spouse inherits the proper amount of property.

A married person has a choice to "fund a trust" (put assets into a trust) to preserve a share of the lifetime exemption to pass that much property without estate tax to the next generation.

Alternatively, it might make sense to elect "portability" for this transfer. Portability is a less formal arrangement than a trust and is elected on the estate tax return. It has the advantage of being simple. The alternate choice of trust funding has advantages, including creditor protection. However, a full discussion of the differences between these choices is beyond the scope of this article.

If the tax return is for a married couple and they are married filing separate, determine if there are also separate property considerations that can affect the marital deduction. If, for example, the couple has a prenuptial agreement, it's possible that the less wealthy spouse might waste some of their lifetime exemption. Some estate tax planning opportunities can conflict with basic family law (separate property that is not left to the spouse will not qualify for the marital deduction, for example).

#### **Taxpayer ID**

If this number (usually a Social Security number) begins with a 9, it indicates that the person is likely not a U.S. citizen and cannot benefit from the unlimited marital deduction. However, there is an alternative—the Qualified Domestic Trust—that provides a cure for such a person. Much of our estate planning work as CPAs is recognizing opportunities for

estate tax reduction or elimination, rather than solving the problem. This is one of those areas. We cannot create a trust for a client (because that would be practicing law without a license), but we can advise clients as to available choices regarding estate tax savings.

### **Guardians and Dependents**

One of the most important (and often difficult) non-tax aspects of estate planning is the determination of guardians for the children. Even in an estate that does not have a potential for an estate tax because it's too small, this can be a concern. A guardian is the person who would be responsible for the care of the child.

Dependents are not always children. Sometimes, our clients are supporting their parents, who may possibly be dependents for tax purposes. In this case there are several estate planning questions to ask.

For example, if our client is independently wealthy, it's possible that any inheritance coming from the parents will just be enriching Uncle Sam. It could make sense to suggest that our client consider having the parents leave their property to the clients' children. If this makes sense, consider the generation-skipping tax, a technical area that is beyond the scope of this article, but one worth discussing with the client's estate planning attorney.

### **Wages**

When we focus on wages, is there a need to replace this income if the breadwinner dies? How about if that person is disabled? Should we consider life or disability insurance to help our clients? Is our client self-employed? If so, is there a business succession plan to allow the business to continue beyond the death or disability of the client? These are all important estate planning related issues.

### **Interest and Dividends**

These details tell us how well-organized the client might be. For example, numerous small accounts can be a problem for ease of management during life and upon death. What is the title on these accounts? Should the title be a living trust? Such trusts are created for several purposes, including avoiding the costs and privacy concerns relating to the public probate process. If there is a living trust, is it funded—are all accounts in the name of the trust? If not, which is not unusual, the trust will be ineffective on the unfunded accounts.

### **Capital Gains**

Regarding capital gains, should your elderly clients consider not selling appreciated property? Sales of property by elderly will cause capital gain income. If they hold the property at death the capital gains will likely disappear because the person who inherits the money will generally inherit at the "date of death" value, thus wiping out any gains without incurring any income tax.

Consider like-kind exchanges: continue to exchange real estate investments rather than sell them to avoid income tax and get step-up in basis at death. This requires some delicacy when discussing the choices, but I find most clients are receptive.

### **Properties, Partnerships, S Corps and AGI and Beyond**

If there are rental properties on the tax return, are they titled properly? As we are starting to think about beneficiaries here, is there appropriate investment diversification? Is there sufficient insurance, including liability and personal umbrella? If co-owned, how is the title held?

When it comes to partnerships, S corps, trusts, etc., ask your clients if they understand their investments. If they have questions, we can generally step in and help. If they have a trust K-1, do they know the terms of the trust? Do they know the trustee? Do they have a copy of the trust? Even if you are not comfortable reading the trust, you can advise them to have you talk to the attorney for the trust to be sure that you understand its terms. Are any of the K-1s from active businesses? If so, is there a business succession plan and has it been reviewed recently?

If you see your client has a large AGI on the income tax form, this could indicate a need for advanced planning, such as the use of entities for estate tax reductions, maybe a gifting program or maybe some charitable planning. Advanced planning requires an attorney with advanced planning skills. The first step is often the determination of "excess assets." As CPAs, we can usually assist in gathering the data used by investment professionals for Monte Carlo simulations of

potential outcomes over the remaining life of the client. This software is called “retirement planning” but, to an estate planning CPA, this is a great tool for getting a rough idea of what the excess assets are—the amount likely to be left at the date of death.

This amount would be the subject of dynasty planning, charitable planning or whatever the client believes the purpose of the excess money is to be used for. Often clients have not thought about this.

Finally, the deduction for charitable contributions section of the income tax form might indicate that charitable entities could be appropriate for estate planning. If the deduction is significant, there may be several types of entities (private foundations, charitable trusts, legacy trusts, etc.) that could be considered. Although this is advanced planning, it could be the subject of a phone call to the client’s estate planning attorney for more information.

Tax season is the perfect time to review a client’s estate planning and assist with advancing the quality of that planning for any client. Whatever the client’s needs, there is a role for us.

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