Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1636
Date: 05-May-10
From: Steve Leimberg's Estate Planning Newsletter
Subject: **A Practitioner's Risk Assessment Checklist**

"Without gauging risk factors at the outset of our plans, including the client's willingness and ability to administer an estate plan, it's impossible to advise a client whether to utilize one planning technique over another or to engage in any sophisticated planning at all. An equally critical issue is the impact of the planning on the estate administration.

Therefore, we should all consider creating and using a risk assessment checklist at the outset of each estate plan to help us determine which planning techniques, if any, to recommend and then monitor that checklist throughout the planning process.

There is no "one size fits all" approach, and too many of us are probably guilty from time to time of tying a particular planning technique to the client, instead of placing more emphasis on the client's wishes and goals. Every client is unique and should be treated accordingly. After the planning is implemented, we should then review the checklist one final time and continue to monitor it on an annual basis."

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Here is his commentary:

EXECUTIVE SUMMARY:

As estate planners, we often find ourselves thrust into a role that transcends legal and tax implications and which compels us to act as family counselors to our clients despite a lack of formal training for this. In fact, this critical role is often overlooked and misunderstood. Yet, arguably, it is more critical (and often more difficult) than the complicated tax planning, asset preservation advice, and legal services that we provide to our clients.

This commentary addresses some of these problems – and provides a checklist of potential solutions.

COMMENT:

WHY SHOULD A PLANNER BE CONCERNED?

As an impetus to writing on this topic, the author, over only a *two-day* period last year, found himself in all of the following situations: meetings with two different client families mediating estate disputes; client second marriage (before which he performed significant pre-marital planning); client funeral; *shiva* (seven day Jewish mourning period) for a deceased client; hospital signing of "deathbed" estate planning documents; and a client charity's fundraising event. These "activities" are not uncommon to all of us who practice in this field; yet are we really prepared and trained to handle them properly?

Due to the tremendous responsibility we have as estate planners and our unique capability to foster family harmony or, unfortunately, wreck havoc on family dynamics, I think that all estate planning attorneys should be more sensitive to "client care" related subjects, such as, mediation, pastoral care, basic psychology of family dynamics, etc. With the aging of the "baby boomers" and more and more assets passing to the next generation each year potentially subject to estate litigation and conflict, now is the time to raise awareness and ability to act on these issues.

Furthermore, we are all painfully aware of increased Internal Revenue Service scrutiny and audits of our plans and documents. Yet, the success or failure of the estate plan generally lies with the client and her accountant

properly implementing the plan once the structure is in place. Without gauging "risk factors" at the outset of our plans, including the client's willingness and ability to administer her estate plan, it's impossible to advise a client whether to utilize one planning technique over another or to engage in any sophisticated planning at all. And equally critical: the impact of the planning on the estate administration.

Therefore, we should all consider creating and using a risk assessment checklist at the outset of each estate plan to help us determine *which* planning techniques, if any, to recommend and then monitor that checklist throughout the planning process.

There is no "one size fits all" approach, and too many of us are probably guilty from time to time of tying a particular planning technique to the client, instead of placing more emphasis on the client's wishes and goals. Every client is unique and should be treated accordingly. After the planning is implemented, we should then review the checklist one final time and continue to monitor it on an annual basis.

RISK ASSESSMENT CHECKLIST

Here are 25 factors to consider at the outset of each estate plan (and which should be monitored throughout the planning process) to determine which techniques to recommend and provisions to draft to mitigate serious potential later problems, including future estate disputes and litigation, IRS scrutiny and audits, and complaints by clients, beneficiaries, their accountants, and other advisors:

1. **Client's Ability and Likelihood of Follow-Through Compliance:** How many of us recommend plans without first determining whether or not our clients will follow through on critical compliance items such as the mandatory annual GRAT payment or interest payment on the Sale to the Grantor Trust? We need to gauge from the outset of the planning whether or not it is worthwhile to undertake the planning and whether or not we should assist our clients with follow-through compliance.

   Many times we are faced with a difficult decision because if we

undertake the tremendous responsibility to assist with, or to even timely remind our clients of, the follow-through compliance each year, we may have accepted more responsibility than we can or are willing to handle and quite possibly subject ourselves to malpractice if we do not exercise proper due diligence and care. My recommendation is for the attorney to make sure there are "compliance officers" in place from the outset of the planning, who are capable of overseeing the proper implementation of the plan, such as accountants, financial advisors, responsible family members, and trust officers.

2. **Audit Probability and Tolerance:** How many of us have asked our clients and their children whether or not they have the stomach for an IRS audit, even if we feel they will ultimately prevail on audit ? As we are all painfully aware, the IRS is imposing increased scrutiny of our plans and there is substantial risk of audit if we have implemented sophisticated techniques and structures, especially in a second to die situation. We should not be undertaking the planning without first asking this question.

   Our primary obligation is not to save our client tax dollars, but to help fulfill our client's wishes and goals. Many of our clients will not want to incur an audit, *even* if the planning saves significant tax dollars, as audits might be emotionally burdensome, invasive, and costly.

3. **Tolerance for Change/Sophistication and Complexity:** Recently, I completed what I believed to be a creative estate plan for a client, which will in all likelihood save the future estate tens of millions of dollars in estate taxes. However, after the plan was implemented, the client became ill and his spouse had no interest in following the plan requirements. In fact, the spouse wanted to undo the entire plan despite the potential substantial tax savings because it seemed too confusing and overwhelming for her.

   Obviously, there might be ways to remedy this situation, including providing extra assistance and outside help to the spouse, but it was a

real learning experience to realize that saving tens of millions of dollars in taxes may not be the primary care or concern of some of our clients. Simplicity might be.

4. **Participation of Accountants and Business/ Investment/Insurance Professionals:** Perhaps the greatest sin that estate planning attorneys commit is not fully involving the accountants and the client's *other* advisors, such as financial and insurance professionals, from the outset of the planning process.

There are several reasons these professionals must be involved from the start, including:

- These advisors are just as important to our clients as we are (if not more important);

- Other professionals have experience and expertise in areas that attorneys may not. When the attorneys undertake planning and do not involve the other professionals' valuable input, this is a tremendous disservice to our clients.
- The attorneys might be creating conflicts in different areas (in which the attorneys are not aware) as clients are multi-faceted and have much going on in many areas (*e.g.*, see points #6, #9 and #22 below); and

- Estate planning, by its very nature, is a multi-disciplinary practice and best accomplished utilizing a team approach.

Perhaps some advisors don't involve other professionals out of insecurity over losing primary control of the planning and the client relationship. My response would be to "get over it". If one truly cares for the client, the involvement of other advisors, so long as it is a team approach, is the only way to practice.

5. **Outside Restrictions and Necessary Consents for Assets Being Transferred (for example, existing mortgages, consent of managing partners/ members/shareholders, restricted stock options, insider shares, SEC filings):** How many of us have

designed and started implementing an estate plan without first determining if there were existing mortgages on the properties being transferred and, if so, the effect transferring such properties would have on the mortgages (*i.e.*, real property transfer taxes or, worse, causing the bank to call the mortgage, spike the interest rates, or impose penalties)?

Operating and Shareholder Agreements for closely held family businesses must be examined very carefully for transfer restrictions to avoid a later family or shareholder dispute. Also, the IRS might not respect the planning if corporate formalities are ignored.

All of these specific factors must be scrutinized from the outset of the planning process.

6. **Impact on Cash Flow and Financial Statements:** Since many estate planners operate in a small vacuum, we may sometimes fail to realize that estate planning is not the most important part of our clients' financial picture; it is managing and hopefully profiting from their actual businesses, investments, and other assets. If the planning we implement impairs our clients' businesses by impeding cash flow or diminishing their credit worthiness (since their financial statements may change), then the planning is a failure. In fact, this may sometimes occur with classic Family Limited Partnership or GRAT planning. It is important that we always keep in mind our clients and their businesses require cash flow to operate and their credit is vital.

While there are ways to tailor our plans so that the client has unimpeded cash flow and her financial statements are not significantly affected, our analysis and approach must be explained to our client, her accountant, and business advisors from the start of the planning process. This is a further reason to involve the client's accountant and other financial advisors.

7. **Control:** It is my belief that the most critical aspect of estate

planning for most clients is that they always retain some form of control over their assets. This might be difficult when dealing with trusts and family entities and increased IRS scrutiny when the client retains even indirect control over her assets.

However, always bear in mind if a client ever feels that she is losing control over her assets, the planning might be a failure from her perspective; and this is one of the main reasons plans either never get off the ground or fail at some later point in the process. This relates to the psychology of estate planning. Clients want and need to feel they always have some form of control over their assets, especially as they become older and more reliant on others. Of course, there are planning and drafting techniques to accomplish this, but that discussion is beyond the scope of this article.

8. **Ability/Flexibility to Change Mind:** All planning and documents should include "escape hatches" to deal with changing circumstances. Many clients ask us whether or not, once the plan is implemented, it can be revised or tweaked. Sometimes, this can be accomplished with proper document drafting (*e.g.*, providing the Grantor the ability to appoint successor or additional Trustees and LLC Managers, and giving beneficiaries limited powers of appointment, "decanting" provisions, etc.). We should certainly provide our clients as much flexibility as possible within the confines of the law to deal with changing circumstances.

9. **Changes Necessary to Existing Structures (for example, change of property insurance, checks from tenants, effect on salaries, company dividends/distributions):** There are factors we sometimes miss, especially if we are not "business" people. For example, when real estate is transferred and new structures implemented, we must look at the effect on such items as property insurance and tenant rent checks (and as previously mentioned mortgages and financial statements).

Additionally, there are, of course, many tax and non-tax reasons that company distributions are made at different times and in different

forms (*i.e.*, dividends, salaries, redemptions) including retirement plan computations and contributions, cash flow, financial statements, varying tax rates, payroll taxes, and state and local taxes.

We must discuss these considerations in great detail with our clients and their accountants. It might be difficult for us to understand the true impact of our planning if we lack practical experience in business areas and the changes that will be necessary to our clients' existing structures.

10. **Potential and Impact of Estate Dispute:** In every family, even the most harmonious one, there is always potential for an estate dispute. As we are all aware, estate litigation is on the rise and there are several reasons for this, including: an aging population; more clients who die with substantial assets; complicated family structures and dynamics; and willingness to vent frustration and litigate.

    Our planning must focus on trying to minimize disputes. Even if our clients are not concerned, we should always raise with them the issue of potential estate disputes. This is especially true if the assets are not being inherited equally or if there are existing family frictions.

11. **Potential and Impact of Divorce:** We should be mindful that our clients' marital trouble or divorce can occur at any time; and we should be concerned about the significant ramifications of this. This becomes even more complicated since we often represent both spouses, but usually interact more with one than the other, or the assets are not owned equally, as is also often the case.

    There are, of course, professional rules of responsibility in each state that guide our conduct in this area. However, even if we perceive our clients as being happily married, we should consider discussing with them the impact of divorce on their planning and assets because based on statistics it is likely that nearly half of them will divorce at some point in time.

12. **Children from Different Marriages and Complicated Family**

Structures: There is greater potential for estate disputes and unhappiness over our planning in complex family structures. Estate planners have a tremendous opportunity to foster family harmony and should be careful not to exacerbate existing frictions.

Unfortunately, these are some of the most stressful situations for estate planners because we are neither licensed psychologists nor are we properly trained to handle these situations. We must work together with psychologists, mediators and other professionals when necessary (see point #20 below). We can all become proficient tax planners. That is the relatively easy part of our practice. Dealing with complicated family dynamics is far more difficult. As previously mentioned, I advocate more emphasis and highly recommend training for all estate planning attorneys in the basic psychology of family dynamics.

13. **Health/Longevity:** This ties into the client's desire to control her assets as long as she is competent, as well as the greater potential for disputes because clients are living longer (but may not retain complete control of all their faculties). Also, the client's health and potential life expectancy must always be taken into account to understand and plan for the client's current and future financial needs**.**(See **Steve Leimberg's "**Longevity Curve Report - Life Expectancy Analysis - What Every Estate Planner Absolutely Positively Needs to Know" Estate Planning Newsletters **#** 1426 and 1427 and **Bob LeClair's** "Ten Trends in Longevity", Finance and Markets Newsletter **#** 545**.)**

We must feel comfortable enough with our clients to discuss these issues with them. It is my experience that insurance professionals can be very helpful with this since they have the client's health information and the client may be willing to permit its disclosure to the attorney.

14. **Mental Capacity**: Many times we are asked to provide planning for clients who have some form of diminished mental capacity.

Obviously, issues of undue influence and necessary testamentary capacity arise; and we must be careful to avoid furthering or fostering a family dispute or future estate litigation. These situations, and the solutions to them, are very fact specific and beyond the scope of this article, but recognizing these situations as they arise is a start.

15. **Disability:** If a client or beneficiary is disabled, this must be taken into account from the outset of the planning to properly meet the needs of such client or beneficiary. Additionally, we should always keep in mind the potential for the unanticipated disability of a client or beneficiary and our documents should have provisions dealing with this. The client or beneficiary may require money, care, caretaker and successor trustee sooner than anticipated. "Hope for the best, but plan for the worst," as the expression goes.

16. **Set-up and Annual Fees:** An important part of our practice that many of us loathe is fee discussions and negotiations. However, addressing this very specifically in writing at the *outset* of the planning can only help avoid later issues.

Never assume the client understands the fee arrangement. Attorneys are notorious for not providing full disclosure regarding ongoing and annual fees partly, in my opinion, because attorneys, especially in estate planning, enjoy the practice of law and helping our clients; the discussion of fees is uncomfortable and perhaps undermines our concern for the clients' well-being. Also, estate planning attorneys are generally paid from the client's personal checkbook and not by corporate entities, which leads to greater uneasiness and complexities. This is another reason estate planning is generally not considered a "large firm" area of the law; there are far more lucrative practice areas.

17. **Personal Characteristics of Client (angry, sad, pleasant, generous,** important that we recognize personality signs and traits right from the outset of the first client meeting to avoid later problems. How many of us have received the "warning signals", but failed to recognize or heed those signals, accepting the representation of a client that later turned out to be stressful and problematic?

Additionally, and as previously mentioned, every client is unique. When working with the client, we really must learn to understand our specific clients' backgrounds and dispositions. Careful listening and being empathetic are essential keys.

18. **Origination - Who Referred Client:** It is important to always keep in mind who referred the client to us, both in terms of being comfortable that our client is someone we wish to represent and also because we might be caught in the situation with a referral source, who wants us to undertake a particular planning approach or technique that we do not think is prudent. For example, if an insurance advisor refers a client to us, it is only natural and proper that the insurance advisor will expect the client to purchase an insurance product she recommends.

However, we may be caught in a conflict between serving our client and the person who referred the client to us. Also, as a matter of professional courtesy, we should be mindful of who referred the client to us, because if the client later asks us for other professional recommendations, we should perhaps mention to the client if she also wants to ask the referring party for a recommendation.

19. **Client's Stated Wishes and Objectives:** Clients will state their wishes and objectives regarding the disposition of their assets, but the documents we draft may not always accurately reflect those wishes because we might try to fit our clients into one of our standard plans and documents for expediency purposes. We must listen to our clients first; and only after we have listened, should we formulate a plan tailored to meet those very specific wishes and objectives.

However, we should not heedlessly listen to our clients. If we feel our client is making a mistake, we should voice our concerns. In fact, I sometimes will refuse to draft certain documents and provisions if I feel strongly the client is making a mistake and will regret it later (perhaps in her grave). For example, this might apply to choices of fiduciaries or cutting a child or grandchild out of an

estate plan during a period of anger or disappointment that will likely pass at some later point.

20. Necessity for Other Advisors (investment, life insurance, psychologists, mediators): Other advisors will be necessary with almost every estate plan. In fact, frequently, it is the investment professionals, life insurance representatives, and accountants who refer the clients to us. (Estate planning attorneys may not always be in a position to adequately reciprocate because, typically, the estate planning attorneys are the last advisors brought onboard. Most clients have existing businesses and investments, and have previously filed tax returns, but not all clients have engaged in sophisticated estate planning.)

As previously mentioned, we must recognize when we are faced with complex client situations, and it will be necessary to involve psychologists and mediators; the key is recognizing and accepting when we need help, which might be difficult for us if we haven't been trained in these psychological and "client care" related areas.

21. Necessity for Other Attorneys (corporate, real estate): Estate planning attorneys should be very careful not to engage in any planning that extends beyond their core area of legal practice without proper oversight; much of our planning involves not only our clients' personal and investment assets, but their companies and real estate as well. We should be mindful that the involvement of other attorneys might be necessary, including corporate and real estate attorneys. We may not even be aware of all the potential legal issues associated with our plans, including SEC reporting, mortgage restrictions, and potential breaches under shareholder agreements, which could create major problems for our clients.

22. Impact on Client's Investments: Very often our clients will have investment strategies in place that our planning could negatively impact. For example, if we undertake planning that requires mandatory annual payments to the client, such as a GRAT or Sale to Grantor Trust, there must be enough liquidity to make those payments without threatening the investments. (Also, there are income tax issues to consider. See point #23 below.) Our planning

should not disrupt our client's investments, and from the start of the planning process we must discuss with our client's investment advisors and accountants the effects of our planning.

23. Effect on Existing and Future Income Tax Planning and Estate Administration:

We sometimes fail to take into account the *income* tax consequences of our estate planning. A good example of this is the "negative capital account." If we implement a GRAT, Sale to Grantor Trust, or even an outright gift, and transfer a partnership interest with a "negative capital account", our client may have forgone the opportunity to have the partnership interest receive a step-up in basis upon her passing and cure the negative capital account (note there are different opinions about the tax consequences when transferring negative capital accounts which is beyond the scope of this article). Another example is the transfer of a commercial annuity to a family limited partnership, which might trigger income taxes.

State and local taxes must also be considered, especially in today's rising state income tax rate environment. Furthermore, if estate planners do not also practice estate administration law, or are not well versed in estate administration, they may not understand the potential negative tax ramifications of their estate planning on the future estate administration. For example, potential deferral of estate taxes for certain closely held businesses might be lost if various lifetime transfers are made without understanding the impact on the estate administration.

24. Planner's Ability to Handle the Client (expectations, timing, personality, understanding meeting of minds): An attorney at my firm has made the following observation: "Nice clients choose nice attorneys and difficult and arrogant clients choose difficult and arrogant attorneys". (Perhaps similar to the "pet owner theory"; *i.e.*, pet owners and their pets bearing a resemblance). Similarly, my grandmother had a doctor who once told her that even though he was one of the foremost heart specialists in the country, he might not be the right "messenger" for her because there was a lack of meeting of the minds and they were having a difficult time understanding each

other.

We all have different personalities and varying outlooks on life. The client and estate planning attorney need not agree on all points, but must understand each other and have a meeting of the minds for the attorney to satisfy the client's expectations and help the client achieve her goals.

25. Use a Planning "Closer" to Review This List and Make Sure Nothing Was Missed!

Once estate planners become too deeply embroiled in the estate plan, we can lose focus on the specific details, even though the devil lives there (especially today with increased audits, scrutiny and conflicts). Many of us have files we are afraid to examine for fear that we are not sure of the exact details of what transpired and where the planning veered off-track. There are many reasons that certain plans do not achieve the intended results, including changes in circumstances, delays and lack of follow-up by the client or her other advisors, and our own neglect. Therefore, in addition to using a checklist at the outset of the planning, the checklist should be monitored as the planning moves forward and reviewed on an annual basis.

CONCLUSION

The tax planning portion of our practice is the easier part to master. Dealing proficiently with the unique and complex personal, family, and business issues of our clients, which extend beyond the scope of the law, is by far the more difficult part of our practice. However, it is in the latter more than the former where we can distinguish ourselves and truly make a positive difference in the lives of our clients and generations to follow. Unfortunately, there does not seem to be enough emphasis, training, and focus on these big picture areas. As previously stated, with increased IRS scrutiny and estate litigation on the rise, we should be focusing more on the points brought up in this article and strive harder to help our clients achieve their estate planning goals; utilizing this checklist might be a good place to

start.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Avi Z. Kestenbaum

CITE AS: