By Avi Z. Kestenbaum

Risk Assessment

Do it at the outset of all estate planning

Financial professionals do it. Insurance professionals do it. Actuaries certainly do it. Yet we, as tax and estate planning professionals, all too often recommend techniques and strategies without doing it. And that "it" is risk assessment.

Time to change. We all should use a risk assessment checklist at the outset of estate planning to help us determine which planning techniques to recommend and then monitor that checklist throughout the planning process. After the planning is implemented, clear the checklist one final time and then monitor it on an annual basis. (See "Risk Assessment," p. 54.)

Ignoring Risk Factors

What are some of the risk factors we may ignore? For starters, we may fail to consider the increased likelihood of receiving and prevailing on an Internal Revenue Service audit. We may not focus on our clients' and beneficiaries' tolerance for such an audit. We may not consider the probability that our clients and their accountants will adhere to the necessary planning follow-up and compliance after the planning structure is set up (because even good plans fail if the client doesn't follow proper procedures). We also may fail to consider the significant effect of our planning on the future estate administration. We may neglect to think about the chances of an estate dispute and the impact of the planning structure on that potential dispute. We may also ignore risk factors associated with estate plans that are economic (that is to say, the impact on our clients' assets and investments); legal (such as the restrictions on control and decisions); and psychological (for example, the effect on family relationships and dynamics). In general, we should always ask ourselves the question of whether the particular client can really handle the complexity and burden of the plan and whether our planning is in fact really a disservice to them.

All too often we debate the merits of one planning approach with another without properly assessing their risk factors. For example, we evaluate the pros and cons of a grantor retained annuity trust (GRAT) against an installment sale to a grantor trust; we compare foreign asset protection trusts to domestic ones; and in light of the estate tax repeal, we advise our clients to take immediate action with their estate plans—or not deal with their plans at all, given the uncertainty in the current environment and the potential for retroactive enactment of the estate tax. A better approach, however, is to recognize that each client's situation is unique and may call for a different estate planning structure. Generalizing planning approaches is counterproductive.

Our Reasons

What are some of the reasons estate planners don't take risk factors into account? Perhaps some of us are natural academicians who chose our field because of our general interest in law and the legal developments of the rules in our field. Many of us may have majored in history, political science, or English—but not in business. We tend to associate the concept of risk factors with actuaries and financial professionals who are commonly thought of as "numbers" or business people. And there are those of us who chose this field not because of our interest in economics, but rather because we innately want to help people cope with complicated family dynamics, death, and preserving family prosperity (although we also lack the proper tools to deal with these issues because most of us are not trained in psychology).

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Risk **Assessment**

A checklist

Here are 25 factors to consider at the outset to determine which planning techniques to recommend.

1. Ability and likelihood of follow-through compliance
2. Audit probability and tolerance
3. Tolerance for change/sophistication and complexity
4. Participation of accountant and other advisors
5. Outside restrictions and necessary consents on assets being transferred (for example, existing mortgages, consent of managing partners/ members/shareholders, stock options, SEC filings)
6. Impact on cash flow
7. Control
8. Ability/flexibility to change mind later
9. Changes necessary to existing structure (for example, property insurance, checks from tenants, salaries, dividends/distributions)
10. Potential and impact of estate dispute
11. Potential and impact of divorce
12. Children from different marriages and complicated family structures
13. Health/longevity
14. Mental capacity
15. Disability
16. Set-up and annual fees
17. Personal characteristics of client (angry, sad, pleasant, generous, frugal)
18. Origination/who referred client
19. Client's stated wishes and objectives
20. Necessity for other advisors (investment, life insurance, psychologists, mediators)
21. Necessity for other attorneys (corporate, real estate)
22. Impact on client's investments
23. Effect on client's existing tax planning, future tax planning and estate administration
24. Planner's ability to handle the client (expectations, timing, personality, understanding/meeting of minds)

AND. . .

25. Use a planning "closer" to review this list and make sure nothing was missed!

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In fact, even the commercial estate and tax planning software and programs that we use to calculate the economic and tax impact of our planning do not take into account the risk factors mentioned above. Software and available programs also don't quantify many "big picture" critical items like a clients' and beneficiaries' current and potential federal, state, and local income tax brackets and rates; carryover losses; negative capital accounts; built-in gains and losses; corporate level tax attributes; and the availability or limitations to fully utilize charitable deductions.

Moreover, it is the client (and perhaps her accountant) who will be charged with administering the complex estate plan that we have put in place. For example, it's generally the client who must insure that: 1) timely payment is made on the GRAT, private annuity, self-canceling installment note, installment sale, and charitable lead trust; 2) the family limited liability company (LLC) makes pro rata distributions to its partners; 3) the family LLC isn't used as the client's personal checking account; and 4) *Crummey* notices are sent.

Bottom Line

The success or failure of the estate plan typically lies with the client properly implementing the plan once the structure is in place. Yet without gauging the risk factors at the outset, including the client's willingness and ability to administer her estate plan, it's impossible to advise a client whether to use one technique over another or to engage in any sophisticated planning at all. And equally critical: don't forget to consider the impact of planning on the estate administration.