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Ideas from leading experts in financial planning

AICPA

American Institute of Certified Public Accountants

WHAT'S INSIDE

Estate Planning Strategies: The Top Ten List

By Dean Mioli, CPA

At the 23rd Annual AICPA Advanced Estate Planning Conference in Boston, July 24–26, Evelyn M. Capassakis, JD, LLM, of PriceWaterhouseCoopers, LLP, New York presented her top ten list for estate planning strategies. In the following article, Dean Mioli, CPA, technical manager on the AICPA PFP team, summarizes five of the top ten.

Evelyn Capassakis started her presentation by offering some thoughts on a topic on the mind of many financial planners: estate tax repeal. Clients are starting to ask why they should do estate planning if the estate tax is going away? Capassakis pointed out, however, that the legislation awaiting the President's signature is not a repeal but a phase-out over ten years. In addition, since almost all clients do not know when they will pass on, numerous useful techniques will be available to them over the next ten years to remove assets from their estates.

Capassakis believes that an outright repeal of the estate tax currently on the books will require election of a republican President. Furthermore, even if the tax is repealed, a future Democrat president could reverse what the previous administration did.

If you are working with elderly clients, the probability of their dying within the next ten years is high. Planning, therefore, needs to take place.

The first five of the ten estate planning techniques Capassakis covered are

1. Lifetime gifts.
2. Insurance trusts.
3. Dynasty trusts.
4. Qualified personal residence trusts.
5. Grantor retained annuity trusts.

Lifetime Gifts

Many taxpayers can accomplish meaningful estate planning objectives by simply taking advantage of lifetime gift-giving. This includes making use of the annual exclusion, making lifetime use of the applicable exclusion amount, and making lifetime taxable gifts.

Under IRC section 2503(b) every taxpayer can convey up to $10,000 each year to a limitless number of donees, free of estate, gift and generation-skipping transfer (GST) taxes. For example, suppose a

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TRENDWATCH

Online marketplaces are changing derivatives trading. For one thing, the "facelessness" of business conducted on the Internet suits derivatives trading in which anonymity is usually part of the transaction. The Internet also increases accessibility to trading markets as well as creates opportunities to attract traders.

Another online advantage is transparency. The derivatives market traditionally has been considered illiquid. As a result, traders are uncertain whether they're getting a good price. Internet trading allows traders to see what others are paying for particular products.

Online trading also increases liquidity. Position guarantees are usually hard to come by and very expensive when available. As Internet accessibility brings more

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TRENDWATCH

(continued from page 1)

participants to the market, however, the better are buyers' and sellers' chances of finding other buyers and sellers.

The expectation is that market efficiency and price stability will cause technology to replace the middleman and will also foster much more product diversity.

Laura Sullivan, "The New Evolution of Derivatives Trading," *Risk Management* (August 2000), page 45.

When the bear market comes, employees will blame their employers for "bad" investment options in 401(k) plans. So say experts in fiduciary liability. ERISA requires companies that undertake fiduciary responsibility for employee pensions and retirement plans to manage plan assets in employees' best interests. Despite this responsibility, a survey of members by the Chicago-based Profit Sharing/401(k) Council of America reveals that many small and medium-sized businesses have passed up liability insurance. Those who have fiduciary responsibility, however, are at risk because they are liable to the full extent of their personal wealth. Most companies designate fiduciaries from human resources or executive financial managers. The law states, however, that anyone with discretionary authority over employee pensions is a de facto fiduciary.

Furthermore, many companies have mistaken beliefs concerning the risks involved. One mistaken belief is that their fiduciary liabilities are relieved if they switch from defined benefit plans to defined contribution plans in which employees select investments from several different options. Plans that give employees more choices may actually increase risk because employees may claim there were too many choices to evaluate them sufficiently. In addition, retaining an outside consultant to advise on investments may not reduce fiduciary liability. Courts have ruled that employers, having picked the third party handling the retirement plan, are as liable as the adviser.

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Estate Planning Strategies: The Top Ten List

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client with two married children and six grandchildren gives $10,000 to each of these 10 donees, for a total of $100,000. This saves the client $55,000 in estate taxes if the client is in the 55% estate tax bracket. The growth in the asset value after the transfer date is also outside the estate.

If both the client and the client's spouse are U. S. citizens or residents, the client can double the gifts by electing to split gifts with the spouse on a timely filed gift tax return. Gift-splitting applies to all gifts made during the year to third parties.

Another technique utilizes the 5/5 rule, a technique, Capassakis pointed out, that is underutilized by planners. The annual exclusion is not normally used between spouses. Let's say a taxpayer sets up a trust for his or her spouse and deposits $5,000 into the trust each year. The spouse has the right to withdraw annually the greater of 5% of the value of the property or $5,000. If the spouse does not exercise the right and lets the right lapse, there is no gift tax on the lapse. Not using the marital deduction is intentional.

If a taxpayer started to put $5,000 in a trust beginning at 45, after 30 years the trust assets grow to an enormous amount. The right of withdrawal amount would increase from $5,000 a year to 5% of the trust assets.

Keep in mind that the annual exclusion is on a first-in first-out basis. The very first transfer to the spouse is the one that qualifies for the annual exclusion.

Ms. Capassakis went on to explain other gifting techniques. A client can make an unlimited amount of tuition and medical payments to an unlimited number of beneficiaries, according to IRC section 2503(e). The transfers must be made directly to the educational institution or the medical care provider to qualify for this exemption. At a 55% maximum estate tax rate, these transfers can provide significant savings in estate and gift taxes.

A client also can achieve substantial benefit by using the applicable exclusion amount. Each U. S. citizen or resident can transfer up to $675,000 of property in 2000 without the imposition of the estate tax. The applicable exclusion amount will increase to $1,000,000 by the year 2006.

Sometimes paying gift tax can be a good thing. By making lifetime taxable gifts, the client can achieve significant estate tax savings. If the donor survives the gift date by three years, the donor's gross estate will not include the gift tax paid.

CPA/PFS Full-Page Ad to Appear in *Worth* Magazine

Worth magazine will run a full-page color advertisement educating people about the value of working with a CPA/Personal Financial Specialist in its November and December issues, as well as in its "financial advisers" issue in the spring. The informational ad demonstrates how the CPA/PFS is the premier financial adviser that consumers should seek out when exploring personal financial planning options. The ad appeared in the magazine last year as well.

PLANNER, September–October 2000, Volume 15, Number 3. Publication and editorial office: AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

William Moran
Editor

Phyllis Bernstein, CPA
Director

The imposition of gift tax is on a tax exclusive basis. The tax base does not include the money used to pay the tax. Note also, if the GST tax applies, the gross estate does not include the GST for estate tax purposes.

Lifetime giving techniques work for all taxpayers though generally favoring the smaller estate. As with all lifetime transfer techniques, removing property with significant appreciation potential from the estate is the objective. Note that with most gifts the donee receives the basis that the donor had in the property, which is also known as carryover basis.

Insurance Trusts

The insurance trust is one of the main building blocks of an estate plan. Either the insured or someone else creates an irrevocable trust. The trust then purchases insurance on the life of the insured. Sometimes an existing policy is transferred to the trust. When the insured dies, the trust owns the policy and the policy proceeds are generally not included in the insured's estate for estate tax purposes.

If any of the following situations exists, the insurance proceeds can be included in the decedent's estate:

- The insured retained "incidents of ownership" in the policy at the time of death. Incidents of ownership include the right to designate a beneficiary of the policy or any right to the economic benefits of the policy by the insured's estate.
- The insured relinquishes such rights within three years of death.
- The insurance is payable to the insured's estate or is available for payment of the taxes, debts or other expenses or charges of the insured's estate.

It is preferable for the insurance trust to purchase the policy directly. A policy transferred to a trust as well as the future payment of premiums by the insured is a gift for federal gift tax purposes. Therefore, to avoid payment of gift tax, either withdrawal powers (Crummey powers) or use of the annual exclusion amount is necessary to cover the gift.

If GST tax is applicable, consider allocating the GST exemption so that distributions to skip persons are not subject to GST tax.

The insurance trust works for a broad spectrum of clients. A rule for individuals is that if the combined estates of the insured and insured's spouse, including the insurance, could exceed the combined applicable exclusion amounts, then creating an insurance trust could be worthwhile.

An insurance trust can satisfy liquidity needs or fund a cross-purchase agreement for the acquisition by the surviving shareholders of a deceased shareholder's closely held stock.

In addition, insurance can be used as a wealth replacement vehicle for the value passing to charity at the termination of a charitable remainder trust.

Ms. Capassakis pointed out that it is a good idea to draft an "escape hatch" into an insurance trust. If it becomes undesirable to continue a policy within the trust, a mechanism should be in place to get it out of the trust with minimum cost.

Dynasty Trusts

Grantors with sufficient means to plan for more than one generation of heirs should consider creating a dynasty trust. A dynasty trust is used to pass significant wealth through multiple generations without the imposition of additional estate, gift and GST taxes. The client pays tax just once.

The trust structure is designed to give successive generations the beneficiaries' interests in income and principal of the trust at the discretion of the trustee, usually for the maximum term permitted by law, sometimes in perpetuity. The dynasty trust assets are protected from divorce actions and creditor claims.

The dynasty trust works for the client who has sufficient wealth that setting aside the amount of GST exemption in a separate trust for future generations will not impede the overall estate plan. Family heirloom assets such as art and real estate are good candidates for a dynasty trust.

Trust duration is the first point to consider, explained Capassakis. To obtain maximum advantage, consider setting up the trust in a state with no rule against perpetuities. Several jurisdictions have abolished the rule against perpetuities, such as Alaska, Delaware, Florida, Illinois, New Jersey, South Dakota, and Wisconsin. A regular requirement is a connection with the state, nexus.

The next point to consider is the choice of trustee. Typically a bank or a trust company is an obvious choice. An individual can act as a co-trustee. Planning trustee succession is an important issue.

Keep in mind that from an income tax perspective the trust will inherit the grantor's basis in the assets transferred. Finally, the structuring of trust distributions is an important consideration.

The GST exemption is maximized by using the exemption early and placing assets with significant appreciation potential into the trust.

Qualified Personal Residence Trusts

A qualified personal residence trust (QPRT) is a vehicle statutorily prescribed in IRC section 2702(a)(3)(A)(ii) whereby a grantor can transfer a personal residence to heirs at a reduced transfer tax cost while continuing to use the property for a specified term. The QPRT works for clients that desire to keep the residence in the family and there is property appreciation potential. Clients who employ the QPRT appreciate having a clear understanding of the process and benefits and being able to follow the rules.

The planning considerations related to QPRTs include carryover basis, term length, generation skipping tax, interest rates, mortgaged property, renting the residence after the term expires, split gifts, partial interests and grantor trust status.

The grantor is subject to mortality risk. If the grantor dies during the term of the trust, the trust principal is included in his or her estate, negating the benefit of creating the trust.

Capassakis noted that President Clinton's budget for both the fiscal years ending in 2000 and 2001 has included proposals to repeal the QPRT provision.

Grantor Retained Annuity Trusts

Grantor retained annuity trusts (GRATs) are a favorite technique for transferring appreciation in assets to heirs. A GRAT is a trust to which the

Continued on page 8

Differentiation: The Key to Sustaining a Competitive Edge

By Suzanne Lowe

A variety of forces have dulled the competitive edge many CPAs have enjoyed in the past. These firms are being challenged by the commoditization of services and the entry of new players into the arena, along with clients seeking new services to help cope with ever-changing markets.

Most firms—large, mid-size, or small—are well aware of these challenges. Many are responding to them, and some have succeeded in regaining a competitive edge. But it hasn't been easy.

In response to the challenges, many firms have pursued differentiation. Their success so far—and going forward—depends on several variables, according to the findings of a recent survey of professional service firms by Concord, Massachusetts-based Expertise Marketing.

The report, *Differentiation: How Are Professional Service Firms Using It to Compete?* presents detailed findings related to the four industries with the largest number of survey respondents (accounting, architecture/engineering/construction, consulting, and general contractors). Accounting firms most frequently used the following differentiation approaches last year:

- Hiring specialized individuals (67%).
- Improving or evolving current services (61%).
- Increasing prices (60%).
- Adding new services that blend into the services of another industry (for example, providing litigation services) (58%).
- Reorganizing practices or lines of business (53%).

(See the table on this page for a list of the differentiation approaches used last year and the percentage of accounting firm respondents selecting each.)

What Worked

The report does not detail the success of accounting firms in using these differentiation approaches. Instead, the report presents all survey respondents' estimates of the success of the differentiation approaches used. Survey respondents rated only one of the approaches most frequently used by accounting firms (adding new services that blend into the services of another industry) as a "high success" approach.

Commenting on differentiation choices made by survey participants, the report concluded: "The actual impact of any differentiation approach depends on the situation. . . . The greatest market impact will be obtained from differentiation approaches that create a sustainable uniqueness that has true value for the client." The objective most often cited by respondents in choosing differentiation approaches was "to look distinct against competitors." The approaches most frequently selected suggest they are making "substantial" changes that will effect "real changes," the report concluded.

Going Forward

The differentiation approaches used by accounting firms require other approaches to follow up and sustain the effort. Accounting firms indicated most frequently that they would continue to hire specialized individuals (56%), increase their training of professionals to follow their proprietary methodologies (56%), and continue to improve or evolve current services (55%). Firms

Use of Differentiation Approaches in the Past Year (Accounting Firms)

Differentiation Approaches	Accounting
Improve or evolve current services.	61%
Reorganize practices or lines of business	53%
Enter into joint ventures, alliances, or referral networks with firms that extend our services.	49%
Hire specialized individuals.	67%
Add new variables to our prices.	44%
Repackage current services.	39%
Use new techniques and tools to "deliver" our services.	33%
Train professionals to follow our proprietary methodologies.	40%
Develop a new positioning.	42%
Add new services that are within our industry.	45%
Create a new visual identity.	42%
Communicate our firm's positioning through a new motto or tag line.	42%
Implement a formal relationship management program to strengthen our bonds with current clients.	23%
Embark on a public relations campaign.	23%
Increase our prices.	60%
Increase the speed of our service delivery.	23%
Create new divisions of subsidiary companies.	53%
Embark on an advertising campaign.	28%
Add new services that blend into the services of another industry.	58%

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Preliminary Agenda

Recommended CPE: 20 credit hours

SUNDAY, JANUARY 7, 2001

10:00am–5:00pm **Registration and Message Center Open**

Pre-Conference Workshops

1:00pm–5:00pm **101. Managing Your Office Efficiently With Technology** (additional fee)

11:00am–12:00pm **Vendor Sessions** (Select one — **FREE**)
- **102.** Manager Search, Due Diligence and Selection
- **103.** Managing Your Professional Liability Exposure
- **104.** Increasing Profitability Through Specialization

1:00pm–2:00pm
- **105.** Active vs. Passive
- **106.** Retirement Planning
- **107.** Private Client Portfolio Management

2:00pm–3:00pm
- **108.** Active vs. Passive (continued)
- **109.** End-to-End Learning
- **110.** Tax Challenges Affecting High Net Worth Investors

6:00pm–8:00pm **Welcome Reception at Birch Aquarium, La Jolla** (See Registration Form)

MAIN CONFERENCE — MONDAY, JANUARY 8, 2001

7:00am–5:30pm **Registration and Message Center Open**

7:00am–8:00am **Continental Breakfast and Exhibits**

8:00am–8:30am **1. Welcome/PFP Division Update**

8:30am–9:30am **2. Mutual Funds: Business or Profession?**

9:30am–10:15am **Refreshment Break and Exhibits**

10:15am–11:55am **Concurrent Sessions** (Select one)
- **3.** Mathematics of Wealth Planning
- **4.** Life Insurance for Closely Held Businesses
- **5.** Senior Executive Compensation (To be continued in session 11)
- **6.** Behavioral Finance
- **7.** Stock Options for Start-Up Companies

11:55am–1:15pm **8. Lunch and Luncheon Address – A Look at the XYZ Designation**

1:15pm–2:55pm **Concurrent Sessions** (Select one)
- **9.** Charitable Giving: The Explosion of New Options
- **10.** Divorce and Taxes: How to Avoid the Pitfalls
- **11.** Senior Executive Compensation (Continuation of session 5)
- **12.** Social Security: The Top Ten Client Mysteries
- **13.** Mathematics of Wealth Planning (Repeat of session 3)

2:55pm–3:40pm **Refreshment Break and Exhibits**

3:40pm–5:20pm **Concurrent Sessions** (Select one)
- **14.** Financial Planning and Investment Advisory Services Software
- **15.** Analyzing and Purchasing Life Insurance
- **16.** Averages, Draw-Downs and the E-World: Facts and Assumptions Collide on the Efficient Frontier
- **17.** Behavioral Finance (Repeat of session 6)
- **18.** Stock Options for Start-Up Companies (Repeat of session 7)

5:20pm–7:00pm **Reception**

REGISTRATION FORM

2001 AICPA Personal Financial Planning Technical Conference

January 8–10, 2001
Sheraton Harbor Island • San Diego, CA

When ordering by mail, please return this entire page.

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Welcome reception at Birch Aquarium and hotel reception: $50.00 per guest/spouse

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SUNDAY, January 7, 2001
Pre-Conference Workshops
1:00pm–5:00pm ☐ 101 (additional fee)

Vendor Sessions (Please select one from each time period)

11:00am–12:00pm	☐ 102	☐ 103	☐ 104
1:00pm–2:00pm	☐ 105	☐ 106	☐ 107
2:00pm–3:00pm	☐ 108	☐ 109	☐ 110

MONDAY, January 8, 2001
Concurrent Sessions (Please select one from each time period)

10:15am–11:55am	☐ 3	☐ 4	☐ 5	☐ 6	☐ 7
1:15pm–2:55pm	☐ 9	☐ 10	☐ 11	☐ 12	☐ 13
3:40pm–5:20pm	☐ 14	☐ 15	☐ 16	☐ 17	☐ 18

TUESDAY, January 9, 2001
Optional Session
7:00am–7:50am ☐ 19

Concurrent Sessions (Please select one from each time period)

8:00am–9:40am	☐ 20	☐ 21	☐ 22	☐ 23	☐ 24
10:15am–11:55am	☐ 25	☐ 26	☐ 27	☐ 28	☐ 29
1:15pm–2:55pm	☐ 30	☐ 31	☐ 32	☐ 33	☐ 34

WEDNESDAY, January 10, 2001
Optional Session
7:00am–7:50am ☐ 36

Concurrent Sessions (Please select one)
9:20am–11:00am ☐ 38 ☐ 39 ☐ 40 ☐ 41

REGISTRATION INFORMATION

2001 AICPA Personal Financial Planning Technical Conference

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Pre-Conference Workshops			
(100) **Vendor Sessions**	Free	Free	Free
(101) **Managing Your Office Efficiently**	**$225**	**$225**	**$225**

Spouse/Guest Tours: San Diego City Tour, Monday, January 8, 2001: $28.00 per person La Jolla, January 9, 2001: $28.00 per person

Spouse/Guest Fee: Welcome Reception at Birch Aquarium at the Scripps Institution of Oceanography, January 7 and at the hotel, January 8, 2001: $50.00 per person

Credit hours are recommended in accordance with the Statement on Standards for Continuing Professional Education (CPE) programs. Your state board is the final authority for the number of credit hours allowed for a particular program. In accordance with the standard of the Quality Assurance Service, CPE credits have been granted based on a 50-minute hour.

Conference Fee includes all sessions, conference materials, 3 continental breakfasts, 2 luncheons, refreshment breaks and a reception. Fee for workshops include all conference materials, lunch and refreshment breaks. Hotel accommodations and other meals are not included. Please note there is no smoking during conference sessions. Suggested attire: Business casual.

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For further information, call the AICPA Meetings and Conferences Team at (201) 938-3232 or e-mail to confreg@aicpa.org

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TUESDAY, JANUARY 9, 2001

7:00am–5:30pm	**Registration and Message Center Open**
7:00am–8:00am	**Continental Breakfast and Exhibits**
7:00am–7:50am	**Optional Session (Free CPE)** **19.** Investment Advisory Center
8:00am–9:40am **Concurrent Sessions** (Select one)	**20.** Charitable Giving: The Explosion of New Options (Repeat of session 9) **21.** Analyzing and Purchasing Life Insurance (Repeat of session 15) **22.** Developing an Investment Advisory Practice **23.** Issues and Trends in Investment Adviser Compliance **24.** Life Insurance for Closely Held Businesses (Repeat of session 4)
9:40am–10:15am	**Refreshment Break and Exhibits**
10:15am–11:55am **Concurrent Sessions** (Select one)	**25**. Advanced Estate Planning **26.** Creating the Family Office **27.** Developing an Investment Advisory Practice (Repeat of session 22) **28.** Social Security: The Top Ten Client Mysteries (Repeat of session 12) **29.** Tax Aspects of Financial Products
11:55am–1:15pm	**Luncheon**
1:15pm–2:55pm **Concurrent Sessions** (Select one)	**30.** Advanced Estate Planning (Repeat of session 25) **31.** Creating the Family Office (Repeat of session 26) **32.** Averages, Draw-Downs and the E-World (Repeat of session 16) **33.** Prudent Investing: Investment Policy Statement **34.** Tax Aspects for Financial Products (Repeat of session 29)
2:55pm–3:35pm	**Refreshment Break Exhibits**
3:35pm–5:15pm	**General Session** **35.** Coaching Dialogue — Mastering Communications With Clients

WEDNESDAY, JANUARY 10, 2001

7:00am–11:30am	**Registration and Message Center Open**
7:00am–8:00am	**Continental Breakfast and Exhibits**
7:00am–7:50am	**Optional Session (Free CPE)** **36.** Becoming a PFS: New Gateways to the Accreditation
8:00am–9:00am	**37. Optimization — What's Wrong With Diversification?**
9:00am–9:20am	**Refreshment Break and Exhibits**
9:20am–11:00am **Concurrent Sessions** (Select one)	**38.** Coaching Dialogue — The Art of Listening **39.** Development of Practice Standards for the Investment Adviser **40.** Divorce and Taxes: How to Avoid the Pitfalls (Repeat of session 10) **41.** Financial Planning and Investment Advisory Services Software (Repeat of session 14)
11:00am	**Conference Adjourns**

PFP Section Members and PFS Designees
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Praise From Past Attendees

"I rely on this conference for new issues in financial planning and a sense of direction."
— Albert D. Eck, Jr., Eck, Schafer & Punke, LLP, Springfield, IL

"Super presentation and materials. The best I have ever attended."
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— Mark H. Barker, Financial Concepts, San Diego, CA

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— Gerena Parker, Crisp Hughes Evans LLP, Dillsboro, NC

SPOUSE/GUEST TOURS

WELCOME RECEPTION at the Birch Aquarium at Scripps Institution, La Jolla

SUNDAY, JANUARY 7, 2001 • 6:00PM–8:00PM. Buses depart at 5:30pm

Sponsored by Investment Consulting Group, Inc., Fidelity IBG and Fidelity Charitable Gift Fund

The Birch Aquarium at Scripps Institution of Oceanography is on a spectacular location overlooking the Pacific Ocean. A dazzling variety of marine life in realistic habitats is on display. Experience thousands of sea creatures in 34 special exhibits, including a two-story kelp-forest tank containing fishes and giant marine plants. Explore the nation's largest marine science museum to learn about the history of oceanography and the latest developments in global research. Enjoy your drink with the breathtaking ocean and sunset views. There will be guided tours of the aquarium, and divers in the kelp tank can communicate with the audience.

This evening reception is free to conference participants, but you must sign up on the registration form. Space is limited.

SAN DIEGO CITY TOUR

MONDAY, JANUARY 8, 2001 • 9:00AM–1:00PM

See the highlights of "America's Finest City": Old Town – the first commercial, political and social center of San Diego • Balboa Park – considered one of the most beautiful, diversified and culturally enriching parks in North America showcasing Spanish architecture • San Diego's Historical Gaslamp Quarter • Horton Plaza – a shopping mall with a whimsical architectural design • Seaport Village • the Embarcadero and Coronado. There will also be a stop in Old Town to browse and sightsee. *Price: $28.00 includes tour escort, transportation, all taxes and gratuities*

LA JOLLA – THE JEWEL OF SAN DIEGO

TUESDAY, JANUARY 9, 2001 • 1:00PM–5:00PM

La Jolla has long been a cherished haven for visitors and residents alike. Its jagged coastline is a marvel to those who visit the shores of La Jolla Cove. This seaside community is a potpourri of high-fashion boutiques, first-class restaurants, museums, galleries and theaters. Other points of interest include the magnificent cliffs of Torrey Pines and the Gliderport area. *Price: $28.00 includes taxes and gratuities, tour escort, transportation and free time (over 2 hours) in La Jolla to shop and sightsee.*

Join Us At Both Receptions:

Sunday, January 7, at the Birch Aquarium in La Jolla

&

Monday, January 8, at the Sheraton Harbor Island.

also plan to enter into joint ventures, alliances, or referral networks with firms that extend their services (51%) and will use new techniques and tools to "deliver" services (49%). The latter approach and other "image burnishing" approaches, the report concluded, are logical follow-ups of more effective approaches used in the last year and can be "highly effective" for firms "with a sustainable, advantageous uniqueness." However, "in the absence of a sustainable uniqueness, their effectiveness may be questionable" because service delivery techniques are easily copied.

Solving Problems

Asked what was the single most difficult problem encountered in implementing differentiation plans in the past year, 65% of respondents indicated three problems:

■ Required more time and effort to implement than expected (29%).

■ Never got fully integrated throughout the organization (21%).

■ Was more difficult to communicate to outside publics than thought (15%).

To implement a differentiation approach, it "must be credible and powerful to clients," the report concluded. Incomplete or incorrect assumptions or information will cause roadblocks. "The very nature of a professional services firm—with people as the 'product'—requires a rigorous internal consensus-building and communication effort."

In implementing differentiation, survey respondents advised patience, persistence and realism. A plan with a timetable is needed and progress must be monitored. All elements of the organization must buy into the plan. Resources must be allocated with the expectation that more money probably will be needed. ◆

A Case Study

Habif, Arogeti & Wayne, the largest regional CPA firm in the Atlanta area, offers traditional accounting services to individuals and businesses. Anticipating aggressive competition from major accounting companies, the firm decided to develop new services to preempt this competition and create new sources of revenue.

At an "advance" (new term for retreat) early in 1999, the firm's principals brainstormed new service offerings that would build on the firm's existing expertise. The group developed about 20 seemingly viable ideas, eventually focusing on three to implement as new offerings.

Starting Off

The first new offering was a money management service primarily for existing business and individual clients. In essence, the service is fee-based asset management managed by a money manager newly hired to the firm. The firm recruited an experienced investment adviser rather than wait for a current staff member to be trained. For years, the firm counseled clients on selecting money management tools, giving away this advice without charging a fee.

The goals for the new service are to:

1. Create an additional high value service that helps retain and satisfy valuable clients.

2. Create a new source of revenue.

For clients, the new service provides the following value:

■ Investors can take advantage of investment vehicles that otherwise would be unavailable because of minimum investment levels.

■ On behalf of clients, the firm selects and oversees management of the investment vehicles to ensure best possible performance.

■ The firm matches individual investment vehicles with client needs and risk profiles based on deep understanding of clients through the relationship developed over time in providing accounting services.

Annette Duwell, marketing director, expects the service to be very popular and help create a barrier to inroads from competitors in the firm's basic accounting business. According to Duwell, the key areas of expertise that support the new service offering are:

■ Relationship building and relationship management.

■ Knowledge of investment vehicles and their managers.

■ Formal process for due diligence in qualifying investment choices.

■ Knowledge of tax law and the personal tax situation of clients.

■ Ability to provide one monthly statement for all firm services.

Differentiating the Service

Habif, Arogeti & Wynne was one of the first CPA firms in the area to offer money management services. In addition to this early start and to hiring an experienced investment adviser, the firm differentiated itself in the way it approached prospective clients. Recognizing that trust-building is a key element in providing financial services, the firm involved prospective clients in structuring and developing the new service. Twenty or so key prospects were invited to discuss what the new service would provide them. Later, a reception and a dinner helped to introduce the new service to clients.

The success of the new service is due in part to taking an approach that involved clients. The new service, like most of the firm's services, relies on strong relationship building and management for support. Duwell points out that the service a firm offers finally may not be much different if a different approach is used to develop it, but clients' response will be different—more positive—if they are involved in development. ◆

The ABCs of Disability Insurance

By John E. Ryan, CFP

Most financial planners consider disability insurance the most important insurance product a client can own: A 40-year-old earning $4,000 a month who expects a 5% annual increase in income will earn nearly $2.3 million before age 65. Future earnings capability is the cornerstone of future financial plans and insuring that income should be a top priority.

Disability insurance, or income-replacement insurance as it is sometimes called, provides a monthly income when the insured is disabled. Benefits are usually payable if the insured is sick or hurt and his or her ability to work is reduced, and if loss of earnings exceeds 20%.

Mortgage lenders report foreclosures due to disability occur 16 times as often as they do for death. The chance of being disabled for three months or longer before age 65 is about three times the chance of dying. A 40-year old has a 42% chance of experiencing a 90-day disability before age 65. The probability that one disability will strike increases to 75% when two people work in the same business, and 84% that one in three individuals in the same business will become disabled before age 65.

Small Businesses Vulnerable

A disability of a small business owner often has a more devastating impact than that experienced by other professionals. Here are a few reasons why:

■ *The one-revenue producer.* In larger businesses, multiple producers can cover for each other during short-term absences. Only one producer runs most small businesses, however, so revenues drop immediately if he or she cannot work. This means single-producer businesses suffer great financial setbacks if they are inadequately insured.

■ *Expense-revenue ratio.* Most business expenses equal about two-thirds of revenue, leaving one-third for the owner's income. This means if revenue is $30,000 per month, the owner's income is about $10,000. What happens if production falls by 20%, to $24,000 per month, for six months because the owner has a heart attack or develops cancer? Normally, expenses stay about the same and the owner's income decreases to $4,000 per month, a 60% loss of net income. In other words, a small decrease in production can result in a big decrease in the owner's income. In this case, a 20% reduction in production causes a 60% loss in the owner's net income.

Alternative Solutions

There are ways other than using insurance to compensate for income lost because of disability, but none is as reliable or cost-effective as disability insurance.

■ *Rely on savings.* This works sometimes. However, if a client saves 5% of earnings, it would take 10 years to recover from just six months of disability.

■ *Borrow.* Banks lend money only to those with the ability to repay. Ability to repay is determined primarily by ability to work, not by assets that can be pledged.

■ *Rely on Social Security.* More than 70% of initial Social Security claims are rejected. To qualify, a client must be unable to work in any job, have a disability that looks as if it will last one year or terminate in death, and satisfy a five-month waiting period.

■ *Spouse can work.* Who will take over the spouse's present responsibilities? Who will take care of the disabled person? At what cost?

■ *Rely on charity from family and friends.* For most people this is unacceptable.

Group vs. Individual Insurance

In general, two types of disability coverage are available to business owners: group insurance and individual insurance. With group coverage, a "master policy" is issued to an employer, a professional association, or a trust. Certificates are then issued to insure individuals.

The selection of waiting periods, benefit periods, monthly benefits and other features of group insurance is normally limited. This means that it may be difficult to design a plan that serves individual needs.

Also, future premiums are not guaranteed by the insurance company and, therefore, usually are predicted to be lower than if guaranteed.

Another characteristic of group insurance is that the insurance company, without the approval of the individual insured, can alter provisions in the master policy, thereby reducing certain benefits.

Individual certificates of group insurance can be canceled if the insured is no longer an employee or member of the group or association, leaves the place of employment or enters another occupation. Some group policies allow the company to cancel without cause at any plan anniversary. Other group policies allow the policy to be canceled only under certain conditions.

In any event, the power to cancel the policy rests with either the insurance company or the policyholder, not with the insured. A disability policy is merely a promise to pay.

Individual Policies

Individual policies, also called noncancelable policies, are issued directly to the insured. These policies offer a wide range of monthly benefits, waiting periods, benefit periods and optional benefits, such as cost-of-living adjustment and future purchase option riders.

Premiums are guaranteed until age 65 and are typically higher than nonguaranteed premiums. After age 65, premiums can be adjusted on a class only basis. The insurance company cannot change provisions within a noncancelable policy once it has been issued. This means benefits cannot be reduced and contract provisions cannot be changed.

A noncancelable policy cannot be canceled before the end of the guaranteed term under any circumstances. This means the insured person can change occupations, move from state to state, develop a personal health problem and still not lose his or her coverage for any reason.

What About Costs?

The CPA can help a client to place costs in perspective with the following example. Consider an executive who is offered a job with XYZ Corp. The president makes available a choice of two types of compensation. Type A will pay the executive $7,000 per month when he or she is well and working, but nothing if he or she is sick or hurt and unable to work. Type B will pay $6,860 a month when the executive's working and $4,200 a month if he or she is disabled. Which type would you take?

A quality individual disability insurance plan should cost between 2% and 3% of the insured individual's income, depending on age, occupation and health history. A 40-year old executive earning $100,000 per year could expect to pay about $2,000 for comprehensive individual disability coverage. A 50-year old may spend $3,000 a year.

Female professionals who are more than 2% owners in a C corporation can purchase individual disability insurance at about a 30% discount. The reason is generic or unisex rates must be used in a corporate-sponsored disability plan rather than sex-specific rates whereby men usually pay 30% less than women.

Group long-term disability insurance usually costs about 1% of earnings initially. The premium rate will increase over time as the insured ages and as claims experience dictates.

A 30-year old who buys today will spend less on premiums during his or her career than if he or she waited ten years to buy the same coverage. Policy premiums will be that much higher in 10 years because of increased age, and industry-wide rate increases for new business are likely to occur.

Finally, and perhaps most importantly, the 40-year old may have developed a health problem during the last 10 years making it difficult, if not impossible, to purchase a quality disability insurance contract. ◆

Disability Insurance Policy Checklist

	Yes	No
1. Does my insurance company have a Comdex rating of at least 80?	____	____
2. Is my policy noncancelable?	____	____
3. Are the premiums guaranteed?	____	____
4. Does the definition of total disability protect me in my occupation?	____	____
5. Are part-time and full-time return-to-work income replacement benefits included and payable to age 65?	____	____
6. Can I receive benefits without first being totally disabled?	____	____
7. Does my policy exclude residual income earned prior to my disability in determining the amount and starting time of benefits?	____	____
8. Can my earnings loss be averaged to generate a greater benefit?	____	____
9. When I am on claim, are my policy benefits adjusted for inflation?	____	____
10. Can I increase my monthly benefits even if I am uninsurable?	____	____
11. Can these increases be made (and are they payable) during an existing claim?	____	____
12. Does my policy pay benefits for my lifetime if I am totally disabled?	____	____
13. Do I have a policy (Business Overhead Expense Disability Plan) to cover my business expenses if I am disabled?	____	____
14. Do I have a policy (Reducing Term Disability Plan) to cover my business loan payments?	____	____
15. Do I have maximum benefits based on my current income and fixed business expenses?	____	____

Note: It is advisable to review your disability insurance policies once a year with a qualified specialist.

Ryan Insurance Strategy Consultants

TRENDWATCH

(continued from page 2)

John Conley, "Bear Fright: Market Volatility Strikes Fear in Fiduciaries," *Risk Management* (September 2000), page 28.

Baby boomers struggle to care for aging parents. Many of these boomers may well be good prospects for Eldercare services provided by CPA firms to help them meet their parents' needs. According to a recent survey by the Kaiser Family Foundation, many seniors turn to their family members for advice and help with health and financial decisions. Many of the adult children they turn to, however, lack basic information needed to advise on these matters. The survey results are discussed in the November 2000 issue of *Family Circle* magazine. Information about Eldercare services is available on the AICPA Web site (**www.aicpa.org**). ◆

Estate Planning Strategies: The Top Ten List

Continued from page 3

grantor transfers assets and retains the right to a specified annuity from the trust for a set term. At the end of the term the assets pass to or in trust for the grantor's specified heirs. If the grantor survives the term, then none of the assets are included in the grantor's estate. If the grantor does not survive the term, part or all of the trust assets may be included in the grantor's gross estate.

The basic idea of a GRAT is this: You create a trust; you execute a bona fide sale of an asset to the trust; but you do not retain an interest in the asset. You sell the asset for an interest bearing note that usually has a balloon payment at the end and interest only during the note period. The interest rate used is the IRC section 7520 rate.

The GRAT works for grantors with assets expected to grow significantly, so that the earnings and growth potential combined will exceed the IRC section 7520 rate.

The GRAT is a technique used by conservative clients who want the assurance that if they follow the rules they will receive the benefits.

Capassakis stated that GRATs have numerous technical requirements that the trust must satisfy "from the creation of the trust." The issues that the planner and client need to address when considering a GRAT include mortality risk, interest rates, minority interest discounts and the GST.

The Final Five

The other five estate planning techniques covered by Capassakis will be in a future issue of *Planner* along with an estate tax legislation update. ◆

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