Risk Versus Reward in Golf and in Your Estate Planning

by Jamey Rappis, JD, Tax Principal

My high school golf coach was a priest, and on the course he used to preach “course management” — deciding when the risk was worth the reward — on every shot. Even if you’ve never played competitive golf, you can rest assured that every golfer has had to decide whether to lay up in front of the water on a par five (not so risky) or go for the green in two (considerably more risky).

There are many obvious parallels between taking a risky shot on the golf course and making a risky investment with your money. Both have a big payoff as their goal. A less obvious risk/reward parallel compares golf and estate planning.

Simple and tax efficient

Clients often want two things from an estate plan:

1. Keep things simple
2. Be as tax efficient as possible

In estate planning, as in golf, it often appears easy to keep things simple. On the course, that mid-iron lay up shot always looks straightforward enough, but the execution is usually a different story. Estate planning for someone with significant assets tends to go the same route.

A “simple” estate plan involves several core documents, including wills, powers of attorney, a marital property agreement, and revocable trusts. It is important that these documents are drafted correctly and reviewed often to avoid unintended consequences. However, these documents do not accomplish much when it comes to tax efficiency. In that area, you and your advisor need to go through a risk/reward analysis.

Low risk and modest returns

On the spectrum of estate planning tax strategies, there are relatively risk-free (meaning a low risk of challenge by the IRS) transfer techniques, with corresponding low rewards. Let’s assume that you have a taxable estate for estate and gift tax purposes, and you gift one share of XYZ Corporation stock, a publicly traded company, to your child in 2015 when the stock is valued at $1. If the the stock appreciates to $2 in 2016, you would have saved $0.40 in transfer taxes ($1 of appreciation multiplied by the transfer tax rate of 40 percent).

More risk can mean greater reward

There is no risk in a gifting technique, but there is also little reward. If you put the same share of XYZ stock in a family limited partnership (FLP), and then gift one unit of the FLP to your child, some interesting things happen.

For gift tax purposes, the gift of the FLP unit will be valued at a discount; let’s assume it’s 20 percent. So the $1 of stock will be valued at $0.80, and if the stock appreciates to $2, you would have saved $.48 in transfer taxes ($1 of appreciation plus the $0.20 discount multiplied by the 40 percent tax rate). This technique is not without significant risk; the IRS has targeted FLPs for some time, seeking to disallow discounts for FLPs that are established and maintained incorrectly. But depending on the assets within the FLP, the risk may be worth the reward.

CliftonLarsonAllen's private tax consultants can help you implement FLPs and other advanced tax-saving strategies. In estate planning as in golf, the decisions you make begin with a careful look at risk versus reward.

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