**Protecting Against Estate Planning Fraud:**

**A Tutorial for Financial Planners**

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**ABSTRACT**

*As financial planners are expected to overlook all facets of their clients’ financial affairs, familiarity with estate planning is an essential part of the services these professionals provide. Unfortunately, estate planning fraud is likely to be a concern for financial planners and their clients in years to come. Fraudulent activities related to wills and trusts are already on the rise, and with an unprecedented amount of assets likely to transfer to heirs in North America in the next few decades, this trend is likely to continue.*

*This paper provides a tutorial on the different types of estate planning fraud, presents practical ways that financial planners can identify a possible fraudulent situation, and suggests ways that can help prevent this type of fraud from occurring in the first place. Educating financial planners as well as the public about estate planning fraud is essential in the fight against this type of fraud, especially since estate planning fraud is difficult to detect and fraud schemes are becoming more complex. Collecting, keeping, and communicating the appropriate type of information is instrumental in detecting and preventing estate planning fraud as well as avoiding professional liability for financial planners.*

**INTRODUCTION**

Financial planners are expected to overlook all facets of a client’s financial affairs and are often instrumental in guiding clients in their estate planning needs. Unfortunately, *estate planning fraud* is likely to be a concern for many financial planners and their clients in years to come. Fraudulent activities related to wills and trusts are already on the rise. The Internal Revenue Service (the “IRS”) states that trust and estate matters are the third highest growth area among the top CPA firms (Internal Revenue Service, 2015, 1), and estimated that by 2015, $4.8 trillion in wealth had been transferred or inherited from one generation to the next (Internal Revenue Service, 2015, 2). While most wealth transfers are legitimate, the government has detected an increase of abusive evasion schemes involving wills and trusts in the past few years. (Internal Revenue Service, 2014, 3) With an unprecedented additional estimated $30 trillion in assets transferring from Baby Boomers to their heirs in North America alone in the next three to four decades (Accenture Consulting, 2016), the rise of estate planning fraud is likely to continue. These schemes can target wealthy individuals, small business owners, and professionals like doctors, CPAs, and lawyers, all of which are likely clients of financial planners.

Moreover, estate planning fraud can be difficult to detect and prosecute, and fraud schemes are likely to become more complex in the future. Unfortunately, even in the cases where fraudsters are caught, unless the victim is part of a class action suit, formal assistance can be hard to come by. (Moody, 2008) Understanding the basics of estate planning fraud and developing an effective approach for protecting against estate planning fraud is therefore imperative.

The purpose of this paper is multifold: it demonstrates some methods in which fraud can perpetrate estate planning, it presents practical ways that can help financial planners to identify a possible fraudulent situation, and it offers tools that can help prevent this type of fraud from occurring in the first place.

**TYPES OF FRAUD AFFECTING WILLS AND TRUSTS**

Many different types of fraud exist that involve wills and trust. One of the main types of estate planning fraud is caused by “undue influence.” This can affect both will and trusts. Other types of fraud are “tax evasion” fraud through either domestic or foreign trusts and “creditor” fraud.

**Undue Influence in Wills**

Undue influence is a fraud committed against the testator of a will or the settlor of a trust. It occurs when a person is coerced into doing something against his best judgment and deprives the testator of his free will causing him to substitute the will of another for his own. Undue influence is characterized by a type of coercion, force, or deception so that the free agency of the testator is destroyed. (Blum, 2015) Undue influence will typically invalidate a will or trust in whole or in part.

**Tax Evasion Fraud using Domestic and Foreign Trusts**

Pursuant to the Internal Revenue Code, all income received by a trust is taxable to the trust, the beneficiary, or the grantor of the trust, whether from foreign or domestic sources. (Internal Revenue Service 2, 2015) To reduce taxable income, a trust is allowed to deduct distributions to beneficiaries, with a few modifications. Consequently, trusts can significantly reduce or completely eliminate income by making distributions to other trusts or other entities as beneficiaries. (Internal Revenue Service 2, 2015)

While most of the wealth transfers are legitimate, the IRS has detected an increase of abusive trust tax evasion schemes in the past few years. In sophisticated trust tax schemes, fraudulent expenses and non-existent deductions are charged against trust income to reduce reportable income. The remaining income is distributed to another trust using rental agreements, fee for services agreements, purchase and sale agreements, and beneficiary distributions. This process is repeated numerous times, creating a layering effect that involves several sham trusts to move and conceal assets of the taxpayer. These abusive trust arrangements attempt to hide the true ownership of assets and disguise the true nature of transactions pertaining to the trust. (Internal Revenue Service 2, 2015) Generally, there are two types of schemes: abusive “domestic” schemes and abusive “foreign” schemes. While domestic schemes only involve entities that are based domestically, foreign schemes are often formed in foreign countries that are known to be “tax havens.” These countries typically impose little or no taxes on trusts and provide financial secrecy. (Internal Revenue Service 2, 2015) Offshore bank accounts and/or asset management companies (AMC) and International Business Corporations (IBC) are employed in conjunction with offshore trusts in order to access funds concealed in these entities.

**Creditor Fraud**

Trusts can be a vehicle for committing fraud against creditors in an estate planning context. Trusts may allow for assets of a decedent to pass to heirs outside of probate and, therefore, escape creditor security mechanisms present in probate. A typical sign of a trust intending to defraud creditors occurs when the trust is created shortly in advance of either a judgment or a collection event. However, these trusts are sometimes not executed with the formalities necessary to create a trust and, as a result, fail for a variety of reasons. Many of these transfers into a trust are void for simply failing to create a valid trust from a technical standpoint. (Bogert, 1973)

**POTENTIAL RED FLAGS SIGNALING ESTATE PLANNING FRAUD**

Although it is hoped that the financial planner will never encounter fraud in wills and trusts, potential situations or red flags exist that could lead to fraud. While an individual red flag does not necessarily signal trouble, the occurrence of multiple red flags may indicate fraud and call for further investigation by the financial planner. A list of potential red flags includes:

1. *Client is elderly and/or has mental capacity issues* *and wishes to have a will or trust written or changed.*
2. *Death is imminent and a will is re-written.*
3. *A will excludes people that should be the beneficiaries and/or benefits people or organizations that are not typically beneficiaries.*
4. *Decedent’s estate does not match what is written in the will or trust.*
5. *Clients or heirs are specifically stating that they are trying to “evade” taxes.*
6. *Client asks the financial planner for bogus actions.*
7. *Financially stressed client is a debtor and sets up a trust.*
8. *Client engages professionals who sell estate planning services using phony “titles.”*
9. *Client attends bogus seminars, often offering a “free lunch.”*
10. *Pre-Printed Documents and Trust “Mills.”*

**HOW TO PROTECT AGAINST PROFESSIONAL LIABILITY**

If financial planners fail to help their clients avoid estate planning fraud, the consequences could be grave. They range from embarrassment and loss of credence, to disciplinary action by a certification board and/or any state or federal securities regulator, and even to potential civil and criminal charges. The following is a list of actions financial planners can take to protect themselves from liability for possible professional negligence or wrongdoing with regards to estate planning fraud.

* *Use a detailed and clear engagement letter:* This letter includes a specific statement in the engagement letter that the financial planning services will or will not include estate planning assistance.
* *Avoid defective referrals*: The financial planner should avoid any “defective referrals” which are referrals to other professionals (such as lawyers, insurance agents, and CPAs) without the formal scrutiny of competency.
* *Warn client about selection of professionals based on looks, their golf game, and affiliation in clubs or religious organizations.* Unfortunately, this behavior is very prevalent. (Moody, 2008)
* *Serve as the “quarterback”:*Ideally, the financial planner should be considered the “quarterback” of the professional financial team and oversee any major activities and changes. In this role, the financial planner has close contact with the professional team, has access to the team members’ contact information, and can therefore react quickly if any suspicious activity is observed.
* *Collect initial information:*If a client questionnaire is used by a financial planner, the financial planner should specifically inquire if the client has made or intends to make any estate planning changes so that the financial planner can better serve the needs of the client.
* *Consult with the client and collect information:* The financial planner should consult with his/her clients privately if there is any suspicion of *undue influence* by others regarding estate plans. If the financial planner suspects any sort of fraud, additional information should be collected. It should be in writing, signed by the client, and kept for future reference.
* *Report fraudulent activity*: Any estate planning scheme promoters and any schemes that involve tax evasion should immediately be reported to the IRS or the state’s attorney general’s office.
* *Continuing Education:* In order to recognize estate planning fraud, it is imperative for the financial planner to keep up with recent changes in estate planning legislation and to learn about any new types of schemes that are being investigated.
* *Educate the public:* Last but not least, educating the public about estate planning fraud is another important tool for the detection and prevention of estate planning fraud. A suggestion is the creation of an educational “estate planning fraud booklet” by either a certification body (like the CFP board) or a regulatory entity (like the Treasury Department).

**SUMMARY AND CONCLUSION**

Many types of fraudulent activities associated with estate planning exist. This analysis highlighted some of the different types of estate planning fraud to help financial planners identify when a client might be in a troublesome situation, the corresponding red flags, along with recommended actions on how to avoid professional liability. As financial planners have the best interest of their clients in mind and essentially take on the role of the “quarterback” with regards to their client’s financial affairs, they need not only be aware of the different types of estate planning fraud schemes but also have a “feedback loop” with the other professionals on the client’s financial team. A recommendation is made to improve the awareness of estate planning fraud among the members of the public. This entails the creation of an *estate planning fraud informational booklet* by a regulating body. In conclusion, education and prevention lie at the heart of the fight against these types of frauds. Financial planners should stay informed, know the warning signs, keep track of communication, and act swiftly should any suspicion occur.

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