ARE SOUTH AFRICAN FINANCIAL ADVISOR ADDRESSING THE ESTATE PLANNING OBJECTIVES THAT ARE IMPORTANT TO THEIR CLIENT?

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Abstract

Estate planning is an important aspect of any effective financial plan. When preparing an estate plan several objectives identified by the individual planner, as well as several pieces of legislation have to be considered. In South Africa the actions of financial advisors are regulated by the Financial Advisory and Intermediary Services Act. The act aims to ensure that the financial advisor act in the best interest of his / her client. If the act meets its set objectives there will be an alignment of objectives set by a financial advisor and his / her client. This study investigates the existence of an expectation gap between the estate planning objectives considered to be important by the financial advisor and the importance allocated to these factors by the clients. The study found that there was an expectation gap for three of the objectives that should be considered in the estate plan.

Keywords: South Africa, Financial Advisor, Estata Planning

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1. Introduction

The Financial Advisory and Intermediary Services Act, 37 of 2002 were introduced to ensure that there is a better alignment in the objectives of financial advisors and clients (individual planners). This article investigates the importance assigned to different estate planning objectives by financial advisors and individual planners in order to determine if the new succeed in its objective of reducing the expectation gap between financial planners and their clients.

Financial planners and their clients are not only faced with the legal requirements set out in the Financial Advisory and Intermediary Services Act but depending on the nature of the assets and liabilities in the estate an additional 18 pieces of South African legislation could also apply. Although estate planning is an essential part of any comprehensive financial plan, the effectiveness of the estate plan can only be measured after the person's death (Casner & Pennell, 2013). This implies that effective communication between financial planners and their clients are critical to ensure that the client's objectives are met when the financial plan is prepared and executed after their death. This paper contributes to the body of knowledge as it determines if the objectives identified as important by individual planners (clients) when doing estate planning are the same as those deemed to be important by financial planners that prepare financial plans.

Every person that owns assets should have an estate plan. At the very least a person should prepare a will to set out how his assets should be divided amongst his heirs (King & Victor, 2013). This article firstly identifies the estate planning objectives which could be addressed as part of an estate plan from the literature. In the second part of the article a comparison will be made between the importance allocated to each of these objectives by individual planners and financial advisors. The comparison will identify a possible expectation gap that exists when an estate plan is prepared by a financial advisor. The results of the article will assist policy makers in determine if the legislation that is aimed at aligning the objectives of financial planners and clients have met at least in part met its objective.

2. Research Objectives and Method

Research objectives

In order to achieve the aim of the article, namely to identify if an expectation gap exist between South African financial planner and their client in relation to estate planning objectives, the following objectives have been set:

o Describe the estate planning objectives that can be met by an estate plan; and

o Determine if there are significance differences in the importance allocated to each estate planning objective by individual planners and financial advisors in South Africa.

Research method

The research methodology applied to meeting the primary research objectives of the study is explained in this section. In the first phase of the study a comprehensive literature review was performed to identify the possible objectives that could be addressed by the estate plan of a South African planner. Similar objective were then combined to prepare a list of estate planning objectives that was used in the primary data collection phase of the study.

The study population consisted of two groups, namely users of financial services and financial advisors. Currently no comprehensive data base of users of financial services exists in South Africa. Following the approach applied by Jordaan (2007), individuals to be include the in sample were identify by using the online directory for residential telephone number (TDS Directory Operations (Pty) Ltd), a stratified-random sample were selected. As the most basic form of estate planning is the preparation of a will it was used as selection criteria it should however be noted that in terms of South African legislation only persons 16 years of age or older may prepare a valid will (Wills Act, 1953). The respondents were therefore limited to people above 16 years of age.

The Financial Services and Intermediary Act, 37 of 2002, requires all South African financial service providers to register with the Financial Services Board. Using the Financial Services Board's online search function a random sample of registered financial advisors was selected.

A 32,1% response rate was achieved for the users of financial services survey and a 24.4% response rate for the financial advisory survey. The reliability of the responses received was tested using the Cronbach's alpha test. The users of financial services survey had a 0.875 alpha value and financial advisor survey a 0.743 alpha value. These values indicate that the data is reliable (Pallant 2007:95). A statistician was consulted to perform statistical analysis on the data and to determine if the respondent of the users of financial services survey had a comparable profile to the clients of the respondents of the financial advisor survey. The results of the Pearson's Chi-square analysis indicated that the results of the two surveys were comparable.

3. Literature Review

In this section the estate planning process is investigated. During the estate planning process the financial advisor obtain information regarding the planner, his assets and his wishes. This information is used to prepare an estate plan that can meets as much of the planners estate planning objectives. There are various techniques and vehicles that can be considered when preparing an estate plan. The technique or vehicle used in the plan will be determined by the estate planning objectives that must be met.

The process of planning an estate

Olivier & Van der Berg describes the estate planning process as a process that takes place in three phases (1991:13). During the first phase information is gathered about the planner, his family and his assets and liabilities (Price & Donaldson, 2008). The aim of this phase is to understand the planner's family situation and the assets he has available which can be used for planning purposes. The second phase of the estate planning process is only applied if there are basic problems that can be addressed in the short term. This phase is used as a bridging phase until a complete estate plan has been prepared, for example the drawing up of a will.

The last phase of the process consists of various steps that should be taken to be in a position to provide the planner with an appropriate estate plan. The first step is determining what the planner's objectives are, for example who does he want to inherit his assets (Clifford, 2013). Having identified the objectives with which the plan must conform, the next step will be to determine what vehicles or instruments can be used to meet the set objectives, for example prepare a will; donations; use of insurance; use of a trust; use of a company; investment allocation; and specifically identified needs (Botha, 2010).

The third step during the last phase is to identify problems that will still exist with the proposed plan or problems in general relating to the planner or his family. (Olivier & Van der Berg, 1991:20) This step also includes an analysis of the estate's potential liability for estate duty and other estate costs; this will provide an indication of possible liquidity problems in the estate (Botha, 2010). Reasons why all the planner's wishes cannot be complied with should be discussed to determine to what existent these wishes can be complied with.

The final step is to implement the plan agreed upon and regularly revisit the plan to ensure that all changes have been accommodated (Oliver & Van der Berg, 1991:23).

Objectives of estate planning

The factors that influence the effectiveness of an estate plan are numerous and varied. These factors range from totally unpredictable factors, for example economic growth and changes in legislation, to more fixed and definite factors, for example the objective to protect assets against claims from creditors. The following objectives must be considered when preparing a estate plan.

Flexibility of estate asset

Flexibility refers to the ability of the estate plan to change when there is a change in the legal environment, personal and family circumstances of the estate planner or economic environment. Rigid estate plans can result in serious problems and unnecessary hardship and misery for dependants of the planner. Flexibility does not only refer to the structure of the plan, but also to the use of the tools in that plan (Davis *et al.*, 2013). The flexibility of an estate plan is always subject to the ideas and concerns of the planner.

Minimisation of estate duty

Although minimising estate duty is often seen as the major objective of an estate plan and the reason why most people do estate planning, it is only one of the building blocks of the estate plan. Meeting all the objectives or as many as possible of the objectives of estate planning should be the overriding aim of the plan. If this results in a saving of estate duty it should be seen as a bonus (Huxham & Haupt, 2013). In order to implement a plan that results in a reduction of the estate duty payable, all the provisions of the Estate Duty Act, no 45 of 1955, should be considered.

Minimisation of tax liabilities on estate assets

There are different types of taxes that should be considered when preparing an estate plan:

- ***Income tax:*** When preparing an estate plan the implications of income tax must be considered. Not only must the possible implication for the planner be considered but also what the possible income tax implications for the beneficiaries are (Venter *et al.*, 2013). The Income Tax Act, no 58 of 1962, has various tax avoidance rules that results in a person being taxed on income he does not receive himself. One of the sections that normally apply as a result of estate planning is section 7 of the Income Tax Act, which deems income received as a result of a donation to be taxable in the hands of the donor.
- ***Capital gains tax***: With the introduction of capital gains tax on 1 October 2001, a major new liability was introduced that should be considered when preparing an estate plan (Viljoen, 2006:3). When assets are transferred from the estate planner to another entity it could result in a capital gains tax liability. Certain transitions of events can also result in capital gains tax being payable (Income Tax Act 1962:Eighth Schedule par. 11-12, 74-83). Normally the plan will attempt to prevent the introduction of any adverse effects of capital gains tax rather than make a conscious attempt to reduce capital gains tax (Stein, 2011).
- **Other taxes**: Different assets attract different types of taxes, for example the transfer of fixed property is subject to transfer duty and the transfer of listed shares is subject to marketable securities taxes (Botha, 2010). Careful planning are therefore required to limit the tax and cost that must be incurred to comply with the tax regulations. When dealing with international assets the minimisation of foreign taxes is often extremely important. In addition, a forward-looking approach is critical to achieve this objective. Attempts should be made to identify taxes which may be introduced in the future, the impact of these taxes should as far as possible be anticipated in the estate plan (King & Victor, 2013).

Provision of liquidity in estate

Sufficient cash should be available to meet the estate duty and other liabilities following the planner's death. In order to achieve this objective estate planners usually make use of life assurance policies (Walzwnski & Jack, 2013). If there is not sufficient liquidity in the estate of the planner to meet the liabilities, assets will have to be disposed of. This disposal could take place at the wrong time and at relatively low prices. (Huxham & Haupt, 2013)

Dependants of the deceased will also need money during the period when the estate is being wound up. This problem is obviously particularly acute where the bulk of the estate consists of one or more large assets which should preferably not be disposed of, for example a farm or where shares are held in private companies which may not be readily saleable (Susman, 2013).

Liquidity might also be required in terms of a buy-and-sell agreement between partners or co-shareholders. This contract allows the partners or shareholders to buy the deceased's share in the partnership or company at a determine price over a specified period (Botha, 2010).

Provision of retirement capital and income

Planning for retirement is obviously an important objective in the planning process, if a planner transfers assets to his beneficiaries the possibility exist that he could retire with insufficient capital and therefore become dependant on his beneficiaries for survival (Trachtman, 1965). This is especially relevant in South Africa where the general view is that the South African retirement market lack cost effective methods to meet the need of low and middle income households (National Treasury 2004:5).

In many structures the planner's growth assets are legally separated from him. Before executing the plan it is important to ensure that normal commercial considerations are kept in mind, for example who will be able to make decisions to sell an asset (Cooper, 1990:52). Where growth assets are transferred it is important to ensure that the future growth potential of the assets are not restricted or limited in any way (Botha, 2010).

Assets should be protected against the insolvency of not only the planner, but also his future beneficiaries and spouses of beneficiaries. The plan must not be vulnerable to such events and beneficiaries must not be in a position to endanger the position of other beneficiaries or to deprive them of long-term benefits which might have been planned for (Huxham & Haupt, 2013). Where the planner or one of the beneficiaries plans to emigrate proper planning should be in place (Davis *et al.*, 2013).

Where the planner has business interests care has to be taken to protect the business. Special attention should be given to ensuring business continuity and making retirement provisions for employees and directors (Financial Planning Association, 2006).

The Yankelvich Partners Inc. study found that 85% of Americans optimistic about their financial future with 24% expecting a higher standard of lining after retirement. The study found that only 7% were concerned about out living their capital (Anon, 1998:14). Culter identified the following factors that impacts on a person's perspective of the adequacy of his retirement income:

- perception of personal mortality;
- personal health;
- economic factors, such as inflation; and
- increases in heath care cost. (1994:43)

Provision of capital and income for dependants

Capital that was accumulated during the life of the planner should be used to produce sufficient income for dependants after his death, especially where a regular income such as a salary or pension ceases on death. This problem often arises in relation to private companies, where the major part of the assets in the estate consists of shares in and loan accounts to private companies it normally cannot generate sufficient income for the dependants. The reason for this is the growth requirements of companies that cannot adequately service the debt without prejudicing the company. Where the planner is involved in the company and receives income from it, servicing of the debt is normally not required; the problems arising after death should be addressed (Waldman & Dymond, 2013).

The protection of the assets against the intervention of third parties who become involved in the family is often high on the list of priorities of estate planners. The planner normally wants some control over the use of assets after death, due to the fear of dissipation of the assets after death through inept administration or the spendthrift ways of succeeding beneficiaries. (Davis *et al.*, 2013)

Cost of implementation of the plan

Any potential saving of taxes (normally estate duty) must be carefully considered against the cost that has to be incurred immediately. If assets are transferred at less than market value, donations tax (currently at 20% of the value of the donation) could be payable within six months. Where fixed assets are transferred transfer duty and legal fees will be payable before the transfer takes place. If shares are transferred there might be brokerage fees over and above the securities tax that needs to be paid. If the planner you collective investment units there will probably be commissions payable. (Botha, 2010)

Facilitation of the administration of the estate

This is one of the most important objectives. It aims to ensure that any duty levied is duly provided for and paid without any problems for dependants. The smooth administration of the estate during the lifetime of the planner and after his death should be considered when the plan, is drawn up. Attempts should therefore be made to simplify the plan as much as possible. It is of critical importance where the spouse and/or dependants are not able to take control of the assets (Stein, 2011).

Summary

In this section the estate planning objectives that should be considered in an estate plan was discussed. In the following section some of the instruments that be used to achieve these objectives will be discussed.

4. Empirical Study

Estate planning objectives

When preparing an estate plan there are various objectives that can be considered and specifically planned for. A list of the objectives as identified during the literature review was compiled and respondents were asked to indicate how important each of the objectives was to them. Table 1 indicates how important respondents in the users of financial services survey rated different estate planning objectives.

Table 1. Importance of estate planning objectives - users of financial services survey

Estate planning objective	Score (percentage) (1 = not important to 5 = very important)				
	1	2	3	4	5
Flexibility of estate plan	1.5	1.5	24.6	43.1	29.2
Minimisation of estate duty	0.0	6.2	16.9	30.8	46.2
Minimisation of taxes	0.0	4.6	15.4	29.2	50.8
Provision of liquidity in estate (i.e. enough cash)	0.0	1.5	7.7	41.5	49.2
Provision of capital for dependants	4.6	4.6	15.4	30.8	44.6
Provision of retirement capital for myself	0.0	3.0	12.1	22.7	62.1
Provision of retirement income for myself	0.0	1.5	4.6	20.0	73.8
Provision of income for dependants	0.0	4.6	21.5	33.8	40.0
Cost of implementation of the plan	0.0	7.7	30.8	23.1	38.5

Respondents indicated that the most important objectives when drafting an estate plan is the provision of retirement income and retirement capital for themselves.

When a financial advisor prepares an estate plan for a client he has to decide which of the objectives would be important for clients. Using the previously described list of objectives financial advisor respondents were asked to indicate how important each of the objectives was when preparing a financial plan. Table 2 indicates how important financial advisors respondents rated different estate planning objectives.

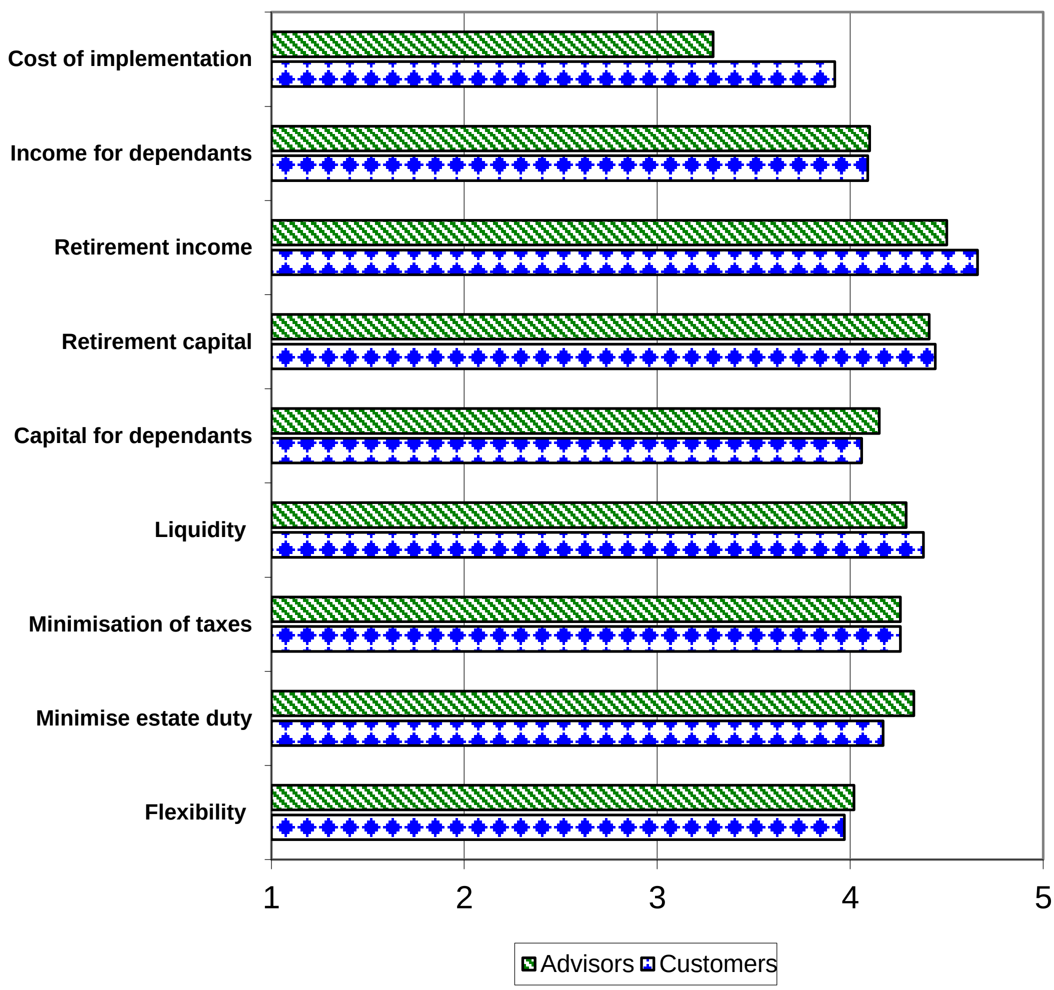
Table 2. Importance of estate planning objectives – financial advisors

Estate planning objective	Score (percentage) (1 = not important to 5 = very important)				
	1	2	3	4	5
Flexibility of estate plan	0.0	0.0	21.4	54.8	23.8
Minimisation of estate duty	0.0	2.4	4.8	50.0	42.9
Minimisation of taxes	0.0	0.0	9.5	54.8	35.7
Provision of liquidity in estate	0.0	0.0	11.9	47.6	40.5
Provision of capital for dependants	0.0	0.0	17.1	51.2	31.7
Provision of retirement capital for myself	0.0	2.4	4.9	41.5	51.2
Provision of retirement income for myself	0.0	2.4	2.4	38.1	57.1
Provision of income for dependants	0.0	0.0	31.0	28.6	40.5
Cost of implementation of the plan	7.1	16.7	31.0	31.0	14.3

Respondents also indicated that the most important objectives when doing an estate plan was provision of retirement income and retirement capital for themselves.

The mean score given by both groups for each of the objectives are provided in figure 1.

Figure 1. Estate planning objectives comparison



I visual inspection of the results indicate notable differences between the two groups in rating provided for certain estate planning objectives. In order to determine of there are any statistically significant differences statistical analysed using Pearson's Chi-square tests was performed, the results are provided in table 3.

Table 3. Analysis of estate planning objectives

Factor	Pearson's Chi-square Test		
	X^2	df	p
Flexibility of estate plan	1.404	2	.496
Minimisation of estate duty	6.375	2	**.041***
Minimisation of taxes	7.288	2	**.026***
Provision of liquidity in estate	0.819	2	.664
Provision of capital for dependants	4.435	2	.109
Provision of retirement capital for myself	4.765	2	.092
Provision of retirement income for myself	3.234	1	.072
Provision of income for dependants	0.434	2	.805
Cost of implementation of the plan	10.480	3	**.015***

** p<0.05 significant*

The statistical analysis indicated that three factors had statistically significant difference (at 95% confidence level) namely:

- cost of implementing an estate plan (p=0.015)
- Minimisation of taxes (p=0.026)
- Minimisation of estate duty (p=0.041)

For clients the cost of implementing the plan was much more important than the rating given to it by financial advisors. 23.8% of advisors indicated that cost was not important when preparing an estate plan compared to only 7.7% of users.

50.8% of users indicated that is were very important to save on other taxes whilst only 35.7% of financial advisors indicated that it was very important. Interestingly 23.1% of users indicated that saving estate duty was not important when doing estate planning compared to only 7.7% of financial advisors.

Having identified the estate planning objectives that should be met the next step is to identify the correct estate planning instrument to use.

Conclusion

This article makes a new contribution to the literature by analysing the importance of different estate planning objectives for individual planners (clients) and then comparing the importance of these factors when financial planners (advisors) prepare financial plans for clients.

The estate plan forms an integral part of the financial plan that a financial advisors should develop for clients. In this study the different objectives that can be addressed by a well defined estate plan was identified and investigated.

This theoretical framework was developed from the literature and used to in a questionnaire testing the importance of different estate planning objectives and instruments. The survey was conducted amongst users of financial instruments and registered financial advisors that advise users on financial matters.

Despite the introduction of the Financial Services and Intermediary Act, the survey amongst the two groups found that there were statistically significant differences for three of the nine estate planning objectives being investigated. The most important of the differences that were identified was the cost on implementing the estate plan with clients being much more price sensitive than what advisors think. Clients must therefore ensure that they understand the cost associated with the proposed plan before they agree to implement the plan.

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