

CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 28679

This is a summary of a Settlement Agreement entered into at the June 2014 hearings of the Disciplinary and Ethics Commission (“DEC”) of Certified Financial Planner Board of Standards, Inc. (“CFP Board”). The conduct at issue in this case occurred prior to January 1, 2009. The Rules in effect at that time under the *Code of Ethics* were Rules 101 through 703.

I. Issues Presented

Whether a CFP® professional (“Respondent”) violated CFP Board’s *Standards of Professional Conduct* when he: 1) failed to have his wife file a tax return for the 2005 tax year and therefore did not report a possible gain based on the differential between the remaining debt on the promissory note and the adjusted tax basis of a property; 2) failed to generate records to sufficiently document his mother’s intentions as proof of the legitimacy a 2003 tax deferred exchange; 3) failed to seek a formal independent third-party review of the 1031 exchange; and 4) provided financial guidance and assistance to his mother in 2003 regarding Medicaid planning although he lacked the requisite knowledge regarding Medicaid and did not seek an independent third-party review of his plan.

II. Findings of Fact

In April 2011, Respondent’s sister, DS, filed a complaint against him with the State Board alleging that he committed tax fraud in 2003 concerning a 1031 exchange involving Respondent’s mother, BS (“Mrs. S”), and Respondent’s wife, CS. According to DS, Respondent arranged to purchase his mother’s residence in 2003 and return the property to her in 2005. The two transactions were designed to avoid paying taxes on the sale of an investment property in 2002. When DS filed her complaint, Mrs. S was residing in a nursing home and had been declared incompetent in 2010. At that time, Respondent had been appointed Mrs. S’ guardian with the consent of each of his siblings except for DS.

In December 2012, the State Board issued its Report of Investigation (“Report”). In May 2013, the State Board issued to Respondent a Notice of Hearing (“Notice”). In October 2013, Respondent finalized a Settlement Agreement with the State Board. In October 2013, Respondent provided a copy of the Settlement Agreement to CFP Board.

State Board of Accountancy Investigation

In its May 2013 Notice, the State Board alleged that transactions involving CS’ purchase of Mrs. S’ residence in 2002 and the gifting of the property by CS to Mrs. S in 2005 were not properly reported on Respondent’s joint tax returns with his wife. The State Board scheduled a hearing to determine whether Respondent committed professional misconduct and, if so, impose sanctions.

In August 2002, CS sold an investment property in State (“Property 1”) for \$285,000. The proceeds from the sale were deposited into a qualified trust entitled the “Tax Deferred 1031 Trust” in anticipation of completing a tax-deferred exchange pursuant to Section 1031 of the Internal Revenue Code. In October 2002, within the required 45-day notice period, CS notified the trustee of her intent to acquire Mrs. S’ property (“Property 2”) as her replacement property. In December 2002, CS signed a purchase and sale agreement to acquire the Property 2 for \$225,000 from Mrs. S. Respondent witnessed the agreement. In February 2003, CS finalized the Property 2

purchase by paying Mrs. S \$150,000 in cash and issuing her a 10-year promissory note for \$75,000 at a 7% interest rate. The payments on the note were approximately \$870.00 per month.

Prior to the sale to CS, Mrs. S had owned and occupied the property for more than 20 years. Mrs. S continued to live in Property 2 after the sale and paid CS an \$850 monthly rent. Mrs. S has seven children and 10 grandchildren, including Respondent's three children. However, after the sale, Mrs. S deposited \$135,000 of the proceeds into three qualified education or 529 Plan accounts to benefit Respondent's children only. During his November 2012 interview with the State Board, Respondent's brother #1 stated that he was not aware of his mother ever making large gifts to family members, including his children.

On Respondent's 2002 joint federal income tax return, he reported the Property 1 sale as a Like-Kind Exchange on IRS Form 8824. The Form 8824 indicated an approximately \$253,000 gain on the Property 1 sale, of which approximately \$54,000 was recognized. The remaining \$199,000 was not recognized because of the tax-deferred exchange. The State Board alleged that Respondent did not report the \$54,000 gain recognized on his 2002 federal return to the State Department of Revenue.

According to the State Board, in June 2005, 28 months after purchasing Property 2, CS gifted it back to Mrs. S subject to the remaining unpaid balance of approximately \$62,000 on the promissory note. In July 2005, the 529 plan education accounts were transferred from Mrs. S to CS as custodian. According to Respondent's 2005 gift tax returns, the adjusted tax basis for Property 2 in June 2005 was approximately \$25,000. According to federal tax law, a gift of property that is subject to a liability, such as an unpaid promissory note, is considered a sale to the extent the transferor's liability exceeds the adjusted tax basis of the property. CS' remaining liability of \$62,000 exceeded the adjusted tax basis by over \$37,000. Respondent and CS failed to report the \$37,000 gain on their 2005 federal income tax return and to the State Department of Revenue.

Mrs. S' net worth was \$335,000 immediately following the sale of Property 2 to CS and prior to transferring the \$135,000 into the 529 plans for Respondent's children. By purchasing Property 2 from Mrs. S in February 2003, Respondent and CS deferred \$199,000 of the gain they realized on the Property 1 sale. After CS gifted Property 2 back to Mrs. S, Respondent and CS did not report the \$199,000 gain from the Property 1 sale on their 2005 tax returns.

In Respondent's initial May 2011 response to DS' complaint to the State Board, he stated that CS transferred Property 2 back to his mother subject to the promissory note because Mrs. S had second thoughts about renting rather than owning. Respondent also stated that he and CS chose to make the transaction as a gift to Mrs. S instead of a sale and filed the appropriate gift tax return. In his initial response, R did not disclose that his mother had transferred \$135,000 into 529 plans for his children soon after she received the \$150,000 from CS.

According to the State Board, the specific issues to be determined were:

1. Whether Respondent committed professional misconduct by failing to pay federal and state income taxes on the \$199,000 gain from the Property 1 sale?
2. Whether Respondent committed professional misconduct by treating CS' purchase of Property 2 as an eligible purchase of replacement property under section 1031?
3. Whether Respondent committed professional misconduct by failing to report the recognized gain of \$55,000 from the Property 1 sale on his 2002 or 2003 State tax return?
4. Whether Respondent committed professional misconduct by failing to report the \$37,000 gain from the transfer of Property 2 back to his mother?

Respondent's Response to CFP Board's Notice of Investigation

Respondent stated that his sister DS filed the complaint with the State Board because she is in conflict with the rest of the siblings. Respondent also stated that DS is angry and resentful that the Probate Court appointed Respondent as Mrs. S' guardian in September 2010, rejecting her request to be appointed her mother's guardian. The Probate Court subsequently restrained DS from filing any other complaints against Respondent regarding the performance of Respondent's guardianship duties.

According to Respondent, in December 1998, he transferred his interest in a three-family apartment building to his wife, CS in contemplation of establishing a financial services firm. In August 2002, CS sold the building and transferred the proceeds into a 1031 exchange trust. The original plan was to purchase an office building for Respondent's new business, but the search was unsuccessful and they decided to purchase Mrs. S' Property 2 and rent it back to her. All the other siblings were aware of the transaction and signed a statement to that effect. Respondent's brother #2 attested to the fact that DS also knew. Respondent discussed and reviewed the details with brother #1, a CPA with a masters in taxation, who approved the transaction.

Respondent stated that there were two major reasons for the transaction: 1) Mrs. S no longer wished to be tied down to City 1 and wanted to spend more time at her City 2 beach home and in State 2 during the winter months; and 2) Respondent wanted to assist Mrs. S in taking proactive steps for Medicaid planning because of the difficulties they experienced with their father when his health began to fail.

The purpose of the 529 Plan accounts was to start the clock ticking on the Medicaid look-back period for Mrs. S. Mrs. S did not want to pay for long-term care insurance, which meant she would have to self-pay or qualify for Medicaid. However, she needed to retain enough assets in order to afford to select the long-term care facility of her choice. After exhausting her assets, Medicaid would automatically kick in and take over and she could stay in her preferred facility.

Respondent stated that he did not intend to benefit from the 529 Plan accounts to the exclusion of his siblings. However, in 2005, Mrs. S informed Respondent that she wished to rescind the 2003 transaction. Respondent also stated that if his mother had not changed her mind about the transaction, Respondent's plan had been to reimburse any monies withdrawn from the accounts in equal shares to his siblings upon his mother's death. Respondent concluded that the transfer to CS' name did not constitute a gift to her because Mrs. S had recorded and reported the 529 Plan accounts as gifts to her grandchildren in 2003. Respondent stated that his use of the 1031 exchange was a legal means of minimizing taxes.

Respondent stated that the State Board investigator did not interview Respondent until two years after the complaint was filed and six months after the State Board issued its Report. Respondent, therefore, believes that the Report presented an erroneous interpretation of the 1031 exchange. According to Respondent, the investigator believed that Respondent was being deceptive in his response to the State Board because he did not voluntarily provide information about the 529 Plan accounts. Respondent, however, stated that the investigator did not request any information from him about the 529 Plan accounts.

Respondent and his counsel met with an assistant attorney general and the investigator in June 2013 to set the record straight. Respondent stated that, although he acted properly, he recognized that he could have handled the transactions better to avoid the appearance of wrongdoing. Respondent provided the State Board supplemental information supporting his position that the 1031 exchange was legitimate, including a letter from a former president of the State Board.

According to Respondent, after Respondent and his counsel's meeting with the assistant attorney general and the investigator, their position shifted and they began to have settlement discussions. Respondent and the State Board settled the matter in October 2013.

The State Board Settlement Agreement

The State Board made the following findings:

1. Respondent's wife did not file a State Business Profits Tax ("BPT") return for the 2005 tax year and therefore did not report a possible gain based on the \$37,300 differential between the remaining debt on the promissory note and the adjusted tax basis of Property 2.
2. In providing financial guidance and assistance to his mother in 2003 and 2005, Respondent failed to generate records to sufficiently document his mother's intentions as proof of the legitimacy of the 2003 tax deferred exchange.
3. In providing financial guidance and assistance to his mother in 2003 and 2005, Respondent failed to seek a formal independent third-party review of the 1031 exchange.
4. In providing financial guidance and assistance to his mother in 2003, Respondent lacked the requisite knowledge necessary to provide Medicaid planning for his mother and did not seek an independent third-party review of his plan.

The State Board determined that Respondent was responsible for the above-described acts and that, by engaging in such conduct, Respondent violated State law by his failure to comply with a provision that obligates licensees to obtain sufficient relevant information as a prerequisite to making recommendations when providing professional services.

Respondent acknowledged that his conduct constituted grounds for the State Board to impose disciplinary sanctions against him and consented to the following sanctions, among others: 1) reprimand; 2) \$7,000 administrative fine; 3) \$14,000 administrative costs; 4) eight hours of Continuing Professional Education ("CPE") credits with a focus on tax and Medicaid planning to be completed within 12 months of the date of the Settlement Agreement; and 5) an agreement to ensure that his wife files State BPT returns with the State Department of Revenue for the 2002 and 2005 tax years within three months of the date of the Settlement Agreement.

In April 2014, Respondent provided evidence that he paid the fine and costs, filed the BPT returns and completed the required CPE.

III. Rule Violations

- A. *Rule 201 – A CFP Board designee shall exercise reasonable and prudent professional judgment in providing professional services.*

Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when he failed to: 1) have his wife file a State BPT return for the 2005 tax year and therefore did not report a possible gain based on the \$37,000 differential between the remaining debt on the promissory note and the adjusted tax basis of Property 2; 2) generate records to sufficiently document his mother's intentions as proof of the legitimacy of the 2003 tax deferred exchange; and 3) seek a formal independent third-party review of the 1031 exchange. Thus, Respondent violated *Code of Ethics* Rule 201.

- B. Rule 302 – A CFP Board designee shall offer advice only in those areas in which the CFP Board designee has competence. In areas where the CFP Board designee is not competent, the CFP Board designee shall seek the counsel of qualified individuals and/or refer clients to such parties.*

Respondent failed to offer advice only in those areas in which he had competence and failed to seek the counsel of qualified individuals when he provided financial guidance and assistance to his mother in 2003 regarding Medicaid planning although he lacked the requisite knowledge regarding Medicaid and did not seek an independent third-party review of his plan. Thus, Respondent violated *Code of Ethics* Rule 302.

- C. Rule 606(a) – A CFP Board designee shall perform services in accordance with applicable laws, rules and regulations of governmental agencies and other applicable authorities.*

Respondent failed to perform services in accordance with applicable laws, rules and regulations of governmental agencies and other applicable authorities when he: 1) failed to have his wife file a State BPT return for the 2005 tax year and therefore did not report a possible gain based on the \$37,000 differential between the remaining debt on the promissory note and the adjusted tax basis of Property 2; 2) failed to generate records to sufficiently document his mother's intentions as proof of the legitimacy of the 2003 tax deferred exchange; 3) failed to seek a formal independent third-party review of the 1031 exchange; and 4) provided financial guidance and assistance to his mother in 2003 regarding Medicaid planning although he lacked the requisite knowledge regarding Medicaid and did not seek an independent third-party review of his plan, in violation of State law. Thus, Respondent violated *Code of Ethics* Rule 606(a).

- D. Rule 606(b) – A CFP Board designee shall perform services in accordance with applicable rules, regulations and other established policies of CFP Board.*

Respondent failed to perform services in accordance with applicable rules, regulations and other established policies of CFP Board when he: 1) failed to have his wife file a State BPT return for the 2005 tax year and therefore did not report a possible gain based on the \$37,000 differential between the remaining debt on the promissory note and the adjusted tax basis of Property 2; 2) failed to generate records to sufficiently document his mother's intentions as proof of the legitimacy of the 2003 tax deferred exchange; 3) failed to seek a formal independent third-party review of the 1031 exchange; and 4) provided financial guidance and assistance to his mother in 2003 regarding Medicaid planning although he lacked the requisite knowledge regarding Medicaid and did not seek an independent third-party review of his plan, in violation of State law. Thus, Respondent violated *Code of Ethics* Rule 606(b).

- E. Rule 607 – A CFP Board designee shall not engage in any conduct which reflects adversely on his or her integrity or fitness as a CFP Board designee, upon the marks, or upon the profession.*

Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP® professional, upon the CFP® marks and upon the profession when he: 1) failed to have his wife file a State BPT return for the 2005 tax year and therefore did not report a possible gain based on the \$37,000 differential between the remaining debt on the promissory note and the adjusted tax basis of Property 2; 2) failed to generate records to sufficiently document his mother's intentions as proof of the legitimacy of the 2003 tax deferred exchange; 3) failed to seek a formal independent third-party review of the 1031 exchange; and 4) provided financial guidance and assistance to his mother in 2003 regarding Medicaid planning although he lacked the requisite knowledge regarding Medicaid and did not seek an independent third-party review of his plan, in violation of State law. Thus, Respondent violated *Code of Ethics* Rule 607.

F. Rule 701 – A CFP Board designee shall provide services diligently.

Respondent failed to provide services diligently when he: 1) provided financial guidance and assistance to his mother in 2003 regarding Medicaid planning although he lacked the requisite knowledge regarding Medicaid and did not seek an independent third-party review of his plan; 2) failed to generate records to sufficiently document his mother's intentions as proof of the legitimacy of the 2003 tax deferred exchange; 3) failed to seek a formal independent third-party review of the 1031 exchange. Thus, Respondent violated *Code of Ethics* Rule 701.

IV. Discipline Imposed

The Commission found grounds for discipline under Article 3(a) of CFP Board's *Disciplinary Rules and Procedures* ("Disciplinary Rules"). Article 3(a) of CFP Board's *Disciplinary Rules* provides grounds for discipline for any act or omission that violates the *Code of Ethics*. The Commission found grounds for discipline under Article 3(a) because Respondent violated *Code of Ethics* Rules 201, 302, 606(a), 606(b), 607 and 701. The Commission and Respondent entered into a Settlement Agreement in which Respondent consented to the Findings of Fact and Rule Violations. Based on the terms of the Settlement Agreement, the Commission issued to Respondent a Public Letter of Admonition, pursuant to Article 4.2 of the *Disciplinary Rules*.

In aggravation, the Commission considered that Respondent did not initially disclose the \$135,000 in 529 plan contributions made by his mother after his wife gifted the property back to his mother and that he received a reprimand and sanctions from the State Board of Accountancy.

The Commission considered in mitigation that:

1. Respondent had no prior disciplinary history;
2. Respondent accepted responsibility for his acts and misconduct;
3. Respondent disclosed the misconduct to CFP Board in a timely manner; and
4. Respondent exhibited full cooperation in CFP Board's investigation.

In reaching its decision, the Commission consulted Anonymous Case Histories 16145, 24272 and 27478 as well as *Sanction Guidelines* 11 (Diligence) and 30 (Securities Law Violation).