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Trust UPDATE

Stillman BANK

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The peacemaker

Family feuds over money and estate management are nothing new. Some of the heirs of Michael Jackson were in the news recently, first arguing that the will admitted to probate was fraudulent, then withdrawing the allegations. Among the famous family fortunes that have triggered lawsuits are those of Brooke Astor, Jay Pritzker, H. L. Hunt, Robert Wood Johnson and James Brown.

Smaller estates are not immune from controversy. A loved one may have promised certain jewelry or family heirlooms to an heir, or perhaps several heirs, and never put the bequest in writing. One child may have received financial assistance that others believe should be counted as an advance on an inheritance. Long-term sibling rivalries may play out in the context of dividing an inheritance. If there's a family business, there could be tension between those who are active participants and those who simply want to share in the profits.

Then there's the situation where the problem develops over time. The following fictitious anecdote is an amalgam of several family situations that we've seen. Some of the facts are unusual, but every family is unusual in its own way.

Lawyer X was a very successful divorce attorney. He had three grown children, all professionals, all successful. X created a family trust, naming himself and the oldest child, Y, as cotrustees. The trust, funded with more than $1 million in securities, was to provide income for Lawyer X's wife for life and then be divided among the children at her death. When X died unexpectedly, Y became the sole trustee.

That was ten years ago. For many years, Y did just fine as trustee, even though he lived out of state and saw his mother infrequently. More recently, however, Y has become somewhat erratic and has been fighting with his siblings. He has challenged some of his mother's routine expenses as being unnecessary. He's been late with the trust accounting. Y even has asked his siblings to agree to change the terms of the trust—they are horrified by the idea. Perhaps the worst is that Y seems to be less engaged in his professional practice, but has withdrawn growing amounts from the trust for himself as "management fees." X's widow has become somewhat frail and won't stand up for her own needs. Y's siblings are uncertain what to do next.

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The value of an impartial third party

When family conflicts are rooted in financial matters, it may be valuable to bring in a neutral professional as a peacemaker. A corporate fiduciary, such as us, for example, can be invaluable for estate settlement and trusteeship. We are constrained by the principles of fiduciary duty to treat all beneficiaries and potential beneficiaries impartially and fairly.

The impulse to name a family member as executor or trustee is understandable—after all, why pay an outsider if it's not really necessary? The better course, however, is to plan for the unexpected, as well as the expected. That's what Lawyer X didn't do; he did not foresee the possibility of his son's loss of objectivity over time. His family would have been better served had he named a corporate fiduciary.

What else does an executor do?

Even if there is no family discord, the job of estate settlement is not an easy one. Among the tasks:

- Prepare inventory.
- Manage assets.
- Collect debts.
- Raise cash.
- Pay taxes.
- Make distributions.
- Prepare accounting.

When there is family discord, every one of these tasks is an opportunity for an argument. That's when it's most valuable to turn to the services of a trust professional.

We are ready to serve you

Whom should you choose to settle your estate or be your trustee? We have the skills, the experience and the knowledge to handle these jobs properly. We are available, and we are impartial. We understand the nature of fiduciary responsibilities, and we know how to discharge them.

And for all this, our fees are generally comparable to what an inexperienced individual would receive. In some cases our experience will help to reduce estate shrinkage, increasing the amount available for beneficiaries.

Would you like to learn more? Please call on us for more details about our fiduciary services. ☐

Review your estate plans

If your estate plan includes one or more trusts, here are three important questions to raise with your estate planning advisor.

1. Have tax law changes altered your trust's effectiveness? The amount exempt from federal estate tax has risen recently, to $5.12 million for those who die in 2012. Next year, current law provides that the exemption will fall to $1 million and the tax rates will rise. There are few estate plans that can be optimal in both of those tax environments.

2. Should the trust beneficiaries be changed? Family and financial circumstances can evolve dramatically over time. New objects of your bounty may appear. The named beneficiaries of your trust may change in health, in maturity, in financial circumstances, in loyalty, in personality and in character. Such factors will influence the purpose of the trust, and they may affect the nature of each beneficiary's trust interest.

3. Who will be the trustee? You'll want to have an experienced, professional trustee to discharge the fiduciary obligations associated with trust management. In the usual case, this will be the same organization that you selected for settlement of the estate—why change horses in midstream? Using one fiduciary creates continuity of financial protection for the beneficiary that will last well beyond the estate settlement period.

Questions to ask your fiduciary

Here are a few key characteristics to look for as you evaluate the candidates for executor and/or trustee:

• **Experience.** Have the individuals or organizations settled estates before? Is it part of their daily business routine? Have they been exposed to a wide range of estate settlement issues over the years?

• **Skills.** Is the candidate familiar with modern portfolio theory? Will investment management issues be a problem, or can they be handled routinely?

• **Availability.** Will the proposed candidate be ready to take on the job at any time? Is there a chance that illnesses, vacations or career issues will interfere with the job of estate settlement?

• **Impartiality?** Does the prospective executor or trustee have a financial interest in the estate? Will all parties consider the trustee fair and impartial? Can the trustee play a constructive role in settling any disputes that arise among beneficiaries?

Choosing a trustee is similar to hiring an employee, but the stakes are much higher.

Gifts in trust in 2009

The Spring 2012 edition of the IRS' *Statistics of Income Bulletin* included a study of gift tax returns filed in 2010 for the 2009 tax year. A federal gift tax return is required to be filed when the aggregate amount of gifts to one person exceeds the annual gift tax exclusion ($13,000 this year). Just because a gift tax return is filed doesn't mean that a gift tax will be payable. Everyone has a lifetime exemption from the gift tax. Only when the exemption is exhausted by total taxable gifts does tax become payable. In 2009 the lifetime exemption was $1 million; this year it is $5.12 million; next year it is scheduled to go back down to $1 million.

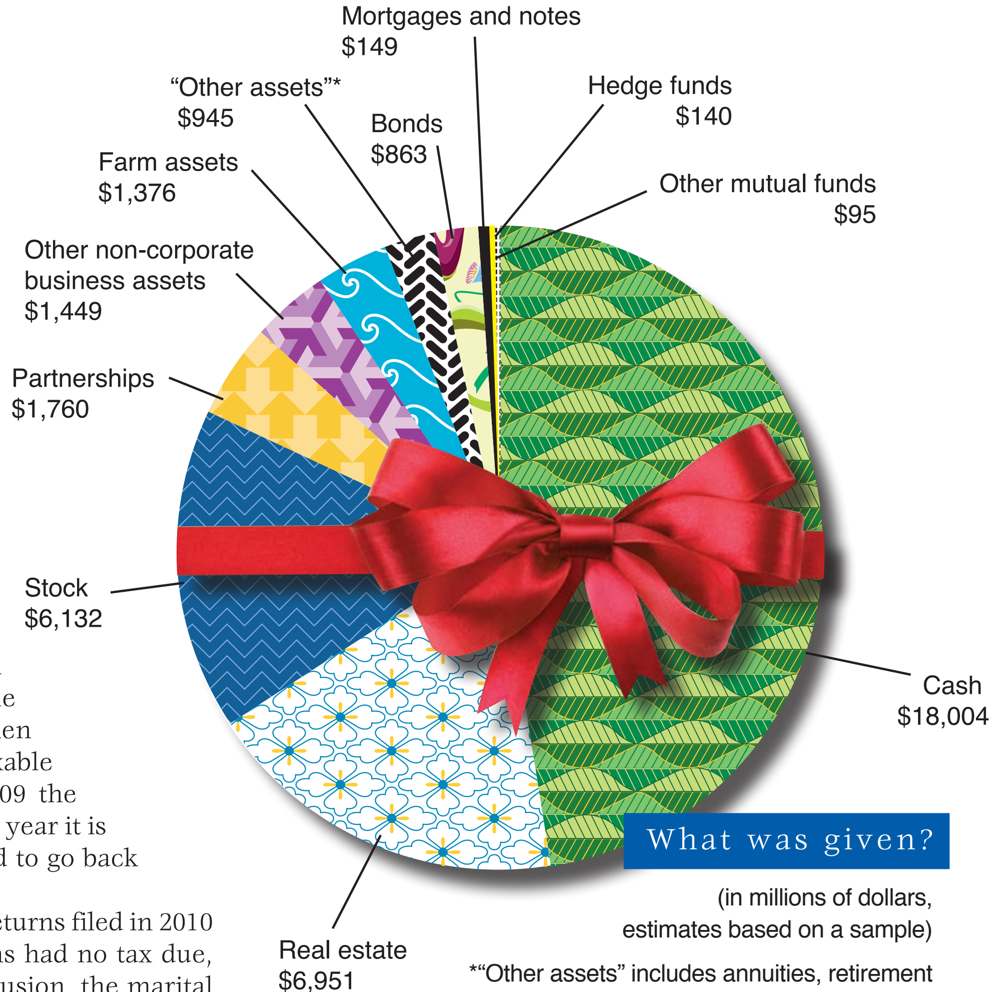
There were 223,093 federal gift tax returns filed in 2010 for 2009. More than 95% of the returns had no tax due, from a combination of the annual exclusion, the marital and charitable deductions, and the use of the lifetime exemption. Only 9,645 returns paid gift tax, according to the report. Interestingly, women filed 54.9% of all returns and 63.3% of the taxable returns. Apparently, women take more seriously the idea of getting one's estate plan under way during life.

The total value of the taxable gifts came to $37.9 billion. Cash constituted a shade less than half of the value of the property given away, and real estate and stocks were in the second and third position. (See the pie chart above for more detail.) Keep in mind that real estate and stock prices were depressed in 2009, as the recession that began in 2007 was just ending then.

Roughly one-third of the 2009 gifts were transfers to trust, the study reported. This aggregate value of $12.5 billion set aside in irrevocable trusts would not include the value of transfers to revocable living trusts, because those transfers are not subject to gift tax. By value, roughly three-quarters of what was transferred to trusts was done without the need for payment of gift tax.

Using up the lifetime gift tax exemption has important estate tax ramifications. On the downside, the estate tax exemption available at death is reduced dollar for dollar by the gift tax exemption that has been consumed. On the upside, appreciation in the value of gifted property avoids estate tax in the future.

See a trust officer if you have questions about whether a program of gifting should be part of your wealth management strategy. ☐



What was given?

(in millions of dollars, estimates based on a sample)

*"Other assets" includes annuities, retirement assets, futures, face value of insurance policies, art, depletable/intangible property, and other assets.

Source: Internal Revenue Service, *Statistics of Income Bulletin* (Spring 2012)

Value of gifts by transfer method, including trusts

(in millions of dollars, estimates based on a sample)

Direct gifts	$ 25,491
Family trusts	2,784
Simple trusts	1,527
Split-interest trusts	901
Qualified personal residence trusts	688
Other types of trusts*	6,478

*"Other types of trusts" include insurance trusts, marital trusts, 529 trusts, grantor retained annuity trusts, generation-skipping trusts and unknown trusts.

Source: Internal Revenue Service, *Statistics of Income Bulletin* (Spring 2012)

Identity theft and taxes

Identity thieves have opened up a new front: theft of tax refunds. A new audit by the Treasury Inspector General for Tax Administration (TIGTA) revealed that for tax processing year 2011 the IRS detected nearly 940,000 suspicious tax returns, claiming $6.5 billion in fraudulent refunds. Unfortunately, another 1.5 million returns, claiming $5.2 billion in potentially inappropriate refunds, slipped through the net. Some $21 billion could be at risk over the next five years, according to the report, unless changes are made at the IRS.

Identity thieves use the same address to file hundreds or thousands of refund claims. For example, just five addresses were used to file almost 5,000 returns claiming an aggregate of $8.1 million in likely fraudulent refunds.

National Taxpayer Advocate Nina Olson has testified before Congress several times on this subject. One problem she identified is public access to the Social Security Administration's Death Master File. This is a list of recently deceased individuals that includes their full name, Social Security Number, date of birth, date of death, and the last legal address on record. Originally, this file was made public as a way to prevent fraud. It allowed pension funds to identify when a beneficiary died so that they could stop benefit payments. Today, according to Olson, the Death Master File is being used to commit tax fraud, so there is a sound public policy reason to restrict public access.

Both the TIGTA report and Olson's testimony identified several factors that make it difficult for the IRS to spot identity thieves. The most important is the pressure to get refunds out quickly. The average refund is several thousand dollars, which is an important lump sum for many working families. Delaying refunds by several months to give the IRS more time for fraud checks is politically unpalatable. Another issue is that the shift to greater electronic tax filings and direct deposit of refunds has made fraud more difficult for the IRS to detect.

Olson concluded: "At a fundamental level, we need to make some choices about what we want most from our tax system. If our goal is to process tax returns and deliver tax refunds as quickly as possible, the IRS can continue to operate as it currently does—but that means some identity thieves will get away with refund fraud and some honest taxpayers will suffer harm. If we place a greater value on protecting taxpayers against identity theft and the Treasury against fraudulent refund claims, we may need to make a substantial shift in the way the IRS does business." ☐