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Trust UPDATE

Stillman BANK

This year's top 10 questions about trusts and investments

When you have a product or service that you hope to provide to the public, your job of selling is easier when the public is already familiar with your line of work. Everyone knows what an automobile is for, or what a barber does. When new products burst upon the scene—for example, in the consumer electronics arena—potential buyers have to be shown the uses and benefits before they become interested.

In the financial services marketplace, there is quite a bit of consumer confusion. That's why an important part of our marketing efforts consists of listening to and answering questions, from our clients and those who might become our clients. The benefits of trust-based wealth management plans are not easily reduced to bullet points or sound bites. Here are the questions that we heard most often in the last year.

1. How's the trust business these days? Has your business collapsed now that the federal estate tax exemption is so high?

The trust industry is doing very well, thank you for asking. For example, in the second quarter of 2013 (most recent available data), total industry revenues were up 7% over the year-earlier period, according to *Trust Performance Reports*. The category that includes personal trusts, investment management accounts and employee benefit plans experienced asset growth of 9% in that quarter alone.

The increase in the federal estate tax exemption, coupled with the abandonment of all death taxes (inheritance and/or estate taxes) by most of the states, has changed some of the dynamics of estate planning. The importance of having a will to govern the orderly disposition of property after death hasn't changed, however, and all of the non-tax benefits of trust plans remain in place.

2. So, trusts aren't just for those with estates of $10 million or more?

Almost everyone with a net worth over $10 million will have considered a trust, and most will employ them. With new technology, trust services also can be efficiently delivered to the "mass affluent." These are folks with investable assets of $500,000 and up. Many of these families will derive substantial benefits from a trust-based plan, even though they are no longer in danger of owing death taxes.

3. What sort of investment return will a trust deliver?

No simple generalizations are possible about investment returns from trusts, because trusts may invest in anything. The fact that assets are being managed through a trust tells one nothing about the assets themselves.

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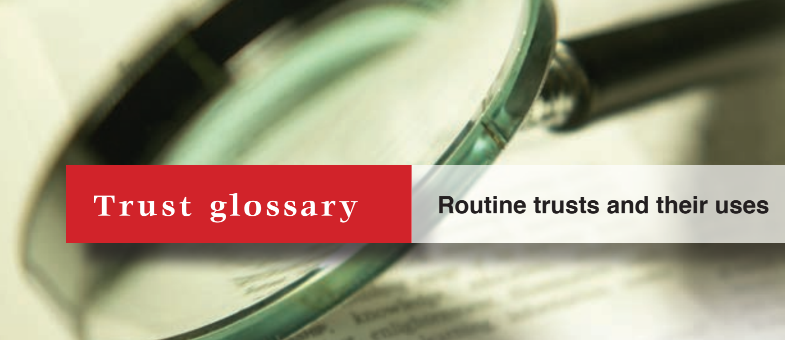

Trust glossary

Routine trusts and their uses

Revocable living trust. Manage assets, including in the event of the grantor's incapacity, and avoid probate.

Special needs trust. Provide financial support to a disabled individual without compromising access to government benefits.

Grantor trust. Leverage gift tax exemptions by making a gift in trust whose income remains taxable to the grantor.

GRAT. A grantor retained annuity trust provides current income to the grantor and principal to a remainder beneficiary at a specified future date.

Charitable remainder trust. Make a future gift to charity, while retaining the income for oneself or another person.

Charitable lead trust. Make a current gift of income to charity, with assets passing to private heirs at a future date.

Marital deduction trust. A trust for the life of the surviving spouse that pays all the income to the spouse. Typically, the spouse has the power to change the remainder beneficiaries.

QTIP trust. The qualified terminable interest property trust is a marital deduction trust in which the surviving spouse does not have the power to change the remainder beneficiaries.

QPRT. The *qualified personal residence trust* transfers a home to heirs at a future date, while the owners continue to live in the home during the trust term. May enable the transfer of very valuable property at significant gift tax discounts.

Top 10 questions . . . *continued*

In the typical case, a trust will contain a diversified portfolio or stocks, bonds and mutual funds. An *asset allocation plan* will be developed for the trust, consistent with the purposes of the trust.

4. What is the purpose of a trust?

A trust provides for family financial protection. It creates a structure for delivering financial resources to multiple beneficiaries over a span of time, sometimes generations. Current beneficiaries receive the trust income, and others receive the trust principal in the future, when the trust terminates. Many trusts also authorize the distribution of principal to current beneficiaries in some circumstances.

5. How is a trust different from other investment accounts?

A trust has an independent legal existence that makes it durable. It can survive the incapacity or death of its creator. The trustee continues to manage the trust according to its stated purposes, stepping into the shoes of the person who created the trust.

6. What is a living trust? I've seen lots of advertisements about them. Are they popular?

Living trusts are so named to distinguish them from testamentary trusts, which are created with a will and take effect after death. A living trust goes into operation during life. Usually, such trusts are revocable and created for the benefit of the grantor. Living trusts are popular for four key reasons:

- ***Sound asset management.*** The trustee will provide professional supervision of the portfolio, consistent with the grantor's vision.
- ***Protection in the event of incapacity.*** Trust management continues, even if the grantor becomes unavailable for any reason, such as medical reverses.
- ***Probate avoidance.*** Estate settlement is necessarily a public process, and it can be a lengthy one. Living trusts normally avoid probate completely, creating a zone of financial privacy. They continue to function, providing financial resources to beneficiaries, while the estate settlement process continues.
- ***Financial privacy.*** The terms of a will become public during the probate process, while the terms of a trust normally are not publicized.

One recent case of the living trust in action was the estate of actor James Gandolfini. There was some negative publicity immediately after his death about the terms of his will, which had been made public. It turned out that the outcry was misplaced, as the bulk of his fortune was controlled by trusts that he had established during life.

7. What do you think of this investment idea that I was pitched recently?

The frauds of Bernie Madoff and other high-profile investment advisors continue to reverberate. As a result, more and more affluent investors are skeptical, and they may come to us for a "second opinion." That's good.

We haven't changed from this philosophy: If it sounds too good to be true, it *is* too good to be true. Madoff's consistent 10%-plus returns, with no down years, were just that—too good to be true.

8. I understand that married couples no longer need a trust plan for maximum protection from the federal estate tax. True? Something about "portability"—what is that, anyway?

It's true, there's a new estate planning option for married couples now. When a spouse dies and leaves all property to the surviving spouse, there is no estate tax, thanks to the marital deduction. However, under the old law, that approach "wasted" the estate tax exemption of that spouse. To preserve two exemptions, estate planners invented the "bypass trust" or "credit shelter trust."

The law was changed temporarily in 2010, and the new rule was made permanent at the start of this year. Now, a surviving spouse may inherit any unused federal estate tax exemption from a deceased spouse. All that's needed is an election on the federal estate tax return of the deceased spouse.

Still, the marital deduction trust isn't obsolete, even if it isn't mandatory for tax benefits. Such a trust also offers professional asset management and creditor protection. In the case of a QTIP trust (qualified terminable interest property trust), it also fixes the inheritance of family assets after the surviving spouse dies. Many families find these benefits are quite sufficient to justify having a trust plan.

9. Can I change my mind after I create a trust?

That depends upon what sort of trust we're talking about. A charitable trust is normally irrevocable and can't be modified. A trust in a will can be changed simply by amending the will.

Usually, this question arises about revocable living trusts, and in that case the answer is yes. You remain in full command. You can change the beneficiaries, add assets, withdraw the assets, even terminate the trust should you decide that it is not right for you and your family.

10. Whom should I choose as my trustee?

Choose us. We have the financial strength, the investment capability and the experience that you need to make implementing your trust plan a success. You want a trustee who will be fair and impartial, and, more importantly, you want the beneficiaries to recognize and respect that impartiality. That's us. Your trustee needs to manage your trust all year long, not be away on vacation or dealing with other pressing business. Again, that's us—focusing on trust management every business day, all year long.

Do you have other questions?

We hope that this brief summary has stimulated your thinking and triggered at least 10 more questions about how trust planning might benefit you and your family. One of our officers will be pleased to meet with you to discuss your situation and assemble the information that you need to move ahead with a trust of your own. ☐

Year-end philanthropy

A popular tax break expires at the end of the year, one that has been dubbed the "charitable IRA rollover." Those who are over age 70½ may want to consider the gift of a direct distribution from their IRAs. Up to $100,000 may be transferred to charity in this manner. Couples may transfer up to $200,000 if each partner has an IRA. In contrast to normal IRA distributions, amounts transferred directly to charity won't be included in ordinary income (and so no charitable deduction is appropriate).

The definition of who is permitted to take advantage of this tax strategy dovetails perfectly with those who must take required minimum distributions (RMDs) from their IRAs. So some taxpayers simply opt to direct their required minimum IRA distributions to charity, because the distribution requirement will be satisfied, even though the amounts distributed don't get taxed.

This tax break might be renewed, as has happened in the past, but in this era of major deficits and talk of tax reform, renewal is far from certain.

In some sense, the income tax exclusion for a transfer to charity from an IRA might not seem like such a big deal. After all, one always has been allowed to follow an IRA withdrawal by a charitable contribution and claim an income tax deduction. However, the full benefit of that deduction is not available to all taxpayers.

- ***Nonitemizers.*** There are a great many taxpayers who do not itemize their deductions, even in the upper tax brackets.
- ***Big donors.*** Percentage limits on the charitable deduction mean that some donors can't take a full charitable deduction in the year that they make a gift.
- ***Social Security recipients.*** An increase in taxable income may cause an increase in the tax on Social Security benefits for some taxpayers. The direct gift from an IRA avoids this problem.

Accordingly, if you are 70½, you should consider a charitable gift from your IRA if:

- You do not itemize tax deductions;
- You live in a state that does not allow charitable deductions for state income tax calculations;
- Your charitable deductions have been maximized; or
- You do not need the additional income made necessary by your required minimum deduction.

As welcome as this tax planning opportunity is, every taxpayer's situation is unique. See your tax advisor before taking any action. ☐

A golden age of philanthropy?

Ten billionaires agreed to speak with TV's *60 Minutes* about their philanthropy, for a show that aired in November. They are among the 115 billionaires who have taken "The Giving Pledge" that has been promoted by Bill and Melinda Gates and Warren Buffett. To make the pledge, your worth must exceed $1 billion, and you must agree to give away at least half of your wealth to charity. So far those who have taken the pledge have promised to make more than $500 billion in charitable gifts.

Interestingly, many find giving away their wealth productively to be almost as difficult as accumulating it. Interviewer Charlie Rose asked if there are occasional failures. Warren Buffett responded: "Well, if you bat a thousand, you're playing in the little leagues. . . . And the problems are major league."

Inflation adjustments

Inflation has been tame this year, so the tax tables won't change much next year. Here is only a partial list of the changes to watch for, most of which help taxpayers.

Estate and gift taxes. The amount exempt from federal estate tax goes up from $5.25 million this year to $5.34 million next year. The annual gift tax exclusion will be unchanged at $14,000.

Social Security. Nearly 63 million Social Security beneficiaries will receive a 1.5% cost-of-living adjustment, beginning in January. The average monthly benefit will, therefore, rise from $1,275 to $1,294. The average for an aged couple, both receiving benefits, will be $2,111, and the average for a widow or widower goes to $1,243. The maximum benefit for a worker retiring at full retirement age goes up from $2,533 per month to $2,642. On the other side of the coin, the maximum amount of earnings subject to Social Security tax rises to $117,000 from $113,700. About 10 million taxpayers are expected to be affected by this increase.

When one retires before normal retirement age, one dollar in benefits is withheld for every two dollars earned above the "earnings limit." The earnings limit will increase from $15,120 this year to $15,180 next year. In the year that an individual reaches full retirement age, the earnings limit rises from the current $40,080 to $41,400.

Retirement savings. The limit for elective deferrals to 401(k), 403(b) and most 457 plans stays at $17,500. The additional catch-up contribution permitted for those aged 50 and older, $5,500, brings their total allowable deferral to $23,000. Effective January 1, 2014, the annual benefit limit for defined benefit plans will be lifted from $205,000 to $210,000.

The phaseout range for the IRA deduction will begin at $60,000 for singles and $96,000 for married couples. The phaseout range for permitting contributions to a Roth IRA will be $181,000 to $191,000 for marrieds, $114,000 to $129,000 for singles and heads of households.

Income taxes. The personal exemption goes to $3,950 next year. For those who do not itemize, the standard deduction will be $12,400 for marrieds filing joint returns, $9,100 for heads of households, and $6,200 for singles and marrieds filing separate returns. ☐

Notable

Did you ever notice that when you put the words "The" and "IRS" together, it spells "THEIRS?"

—*Author Unknown*