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Trust UPDATE

Stillman BANK

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"Fiduciary" in the news

The Department of Labor released a final version of its fiduciary rule for retirement advisors in April. Roughly $1 trillion is rolled from 401(k) and other employer retirement plans to IRAs every year. There has been concern that retirees have not been getting the best advice on how to handle the money. "This rule protects the retirement investors from improper investment recommendations and harmful conflicts of interest," said Acting Labor Secretary Julie Su.

The rule takes effect on September 23, unless it is delayed by court action. Earlier attempts to extend fiduciary obligations to retirement advisors were struck down or narrowed through litigation.

What is the practical effect of this change? When a financial professional provides investment advice, one of two different standards applies:

1. the recommendation is "suitable" for the client; or
2. the recommendation is in the client's best interest.

To the layman, the difference in these two statements may not seem like much. To lawyers and regulators, there is a world of difference. Standard 1 has been in general use for retirement advisors. Standard 2 is the "fiduciary" standard.

Those in the trust industry, like us, are not affected by this development, for the simple reason that we are already governed by fiduciary standards and always have been. You might say that we were the pioneers of fiduciary responsibility.

What's more, being held to a fiduciary standard in giving investment advice is not the same as being able to exercise fiduciary powers. That is something we, as a "corporate fiduciary," can do, and we do it every day. See *Fiduciary Standards versus Fiduciary Powers* on page 2 for examples.

You might you want to turn to a corporate fiduciary, such as us, for help with your wealth management issues. We offer:

- professional investment management;
- experience in estate settlement; and
- unbiased trust administration.

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***"THIS RULE PROTECTS** the retirement investors from improper investment recommendations and harmful conflicts of interest," said Acting Labor Secretary Julie Su.*

When should you consider a trust?

Trusts can be used to achieve some or all of the following objectives:

- Provide lifetime financial protection for a surviving spouse.
- Establish inheritance management for minors, and incapacitated or disabled family members.
- Protect assets from creditors.
- Reduce or eliminate transfer taxes.
- Increase financial privacy and confidentiality regarding wealth distribution.
- Implement a program of philanthropy.
- Protect an estate plan from claims by disgruntled heirs.
- Provide complete financial management in the event of your own incapacity.

Whatever the reason for creating your trust, the next question is crucial: Whom should you choose as your trustee? Who has the qualifications to see to it that your trust plan will succeed? Where would you look for the right trustee?

Typically, a trust grantor is deciding between a corporate fiduciary (a company that has been granted the legal right to act as a trustee, such as us) and an individual, such as a family member, friend or business associate. Factors that should be considered include:

Judgment and experience. Inexperienced trustees may dissipate the trust or make administrative mistakes that result in delay or other problems.

Impartiality. A trust typically has current income beneficiaries and future or remainder beneficiaries. The interests of both types of beneficiaries must be balanced carefully. Conflicts need to be resolved by a trustee that all the beneficiaries can respect.

Being judged according to fiduciary standards is not the same as being able to exercise the powers of a fiduciary. Two quick examples:

Balancing current and future interests. A marital trust provides current income for a surviving spouse, with principal to pass to children at the spouse's death. Trust assets may be invested to maximize current income for the spouse, or to target asset growth for the children. The trustee owes a fiduciary duty to all the trust beneficiaries, and must strike a balance when making investment decisions.

Exercise of discretion. A family trust includes a provision allowing for principal distributions to beneficiaries under certain circumstances, ranging from medical emergencies to education and career advancement. The trustee has the fiduciary power to determine when the conditions have been met, and how large a trust invasion for any beneficiary is appropriate.

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Investment sophistication. The Uniform Prudent Investor Act and other laws governing the investment of trust assets must be adhered to. The trustee should be able to increase returns or reduce portfolio volatility, and must be able to diversify the portfolio.

Permanence and availability. Many trusts are expected to last a decade or more. Corporate trustees have the advantage of perpetual existence.

Sensitivity to individual beneficiaries' needs. Understanding the individual needs of trust beneficiaries is very important, and on this issue many will assume that the friend or family member has the advantage. This is not necessarily the case, but sometimes an individual will be made co-trustee to handle such decisions. Even so, a corporate trustee might be brought into the process for an objective voice and to prevent unreasonable distributions.

Accounting and recordkeeping. Detailed trust records are required, and few individuals are equipped to handle this chore properly.

Fees. There is a chance that the fees charged for trust administration will be lower when a friend or family member is named as trustee. However, when a trustee is serving for little or no compensation, it becomes hard to give the trust the attention that it deserves.

In the usual case, the trust assets consist of ordinary investment assets, such as stocks, bonds or mutual funds. In that situation, a corporate trustee is likely to be a very cost-effective alternative.

Special considerations

In addition to the personal characteristics, there are situations in which having an independent and professional trustee will be important.

- ***Potential for self-dealing.*** Will the trustee be purchasing assets from related parties or affiliates? The trustee should not be on both sides of these transactions, and many states have statutory restrictions on self-dealing.
- ***Power to allocate gains to income.*** The Uniform Principal and Income Act, which applies in many states, permits (but does not require) the trustee to allocate realized capital gains to income. In a trust that distributes all of its income every year, such as a marital deduction trust, the trustee will be greatly favoring the income beneficiary by allocating gains to income. Such a decision should not be made by a party with an interest in the trust.
- ***Discretionary distributions.*** If the goal of the trust is to provide for long-term protection against the squandering of an inheritance, the best course may be to have an independent corporate trustee with wide discretion over distributions.

Can we tell you more?

We are well qualified for all the tasks of trusteeship. It is a job that we do every day, with our full attention. We are staffed for it, experienced, and always ready to serve.

When you are ready to take the serious step of including a trust in your long-term financial and wealth management plans, please call upon us to learn more about how we may be of service to you.☐

How to handle an inherited IRA

Once upon a time, distributions from an inherited IRA could be spread over the beneficiary's lifetime. For young beneficiaries, the RMDs might be small enough that the inherited IRA would continue to grow handsomely. This changed with passage of the SECURE Act in 2019.

In general, an inherited IRA will have to be distributed by the end of the tax year that includes the tenth anniversary of the owner's death. That works out to 11 tax years for receiving and reporting the IRA distributions. Subject to one critical caveat explained below, there is no requirement for annual distributions during the ten years—they may be front loaded, back loaded, or paid roughly equally over the period, which should provide the greatest tax efficiency.

Only "eligible designated beneficiaries," as defined in the new law, are allowed to stretch the IRA payouts over their life expectancies, rather than ten years.

There are five categories of those who can continue to have lifetime IRA RMDs:

Surviving spouses. The surviving spouse may use the life expectancy tables to take RMDs over his or her lifetime. A surviving spouse continues to have the option of making an inherited IRA his or her own. With that approach, RMDs won't be required until the spouse reaches age 73, and then they may be spread over the life expectancy.

Minor children of account owner. Until they reach the age of majority, the RMDs for minor children may be determined from the actuarial tables. Once they reach the age of majority the ten-year rule kicks in.

Note that the minor must be the account owner's child not simply a minor. This tax treatment is not available to grandchildren, nieces, or nephews.

Disabled beneficiaries. If the designated beneficiary is disabled within the meaning of IRC §72(m)(7), RMDs may be stretched over the lifetime. Entitlement to Social Security disability benefits may be a litmus test for eligibility. Note that eligibility is determined at the account owner's death. If an able-bodied heir who has been receiving IRA distributions under the ten-year rule becomes disabled in, for example, year five, there is no ability to switch over to the life expectancy payouts.

Chronically ill beneficiaries. A chronically ill designated beneficiary, as that condition is defined in IRC §7702B(c)(2), may stretch the payouts over his or her lifetime. Again, at this beneficiary's death the ten-year rule kicks in.

Less than ten years younger than the account owner. Life expectancy may be used if the heir is less than ten years younger than the account owner, such as a sibling. However, a blood relationship is not required.

The caveat

After the SECURE Act was enacted, estate planners debated how to handle distributions for those in the ten-year category. Should they be deferred until the tenth year, for maximum tax-deferred buildup? Or should a program of taking 10% each year for ten years be better, as it avoids pushing the beneficiary into a higher tax bracket?

When the IRS proposed regulations to implement these new rules, the Service pointed out that most everyone had overlooked another rule. If the account owner was already taking required minimum distributions (RMDs), then the beneficiary also had to take distributions at least that fast. Failure to take an RMD results in a substantial excise tax.

The proposal caught planners and financial institutions by surprise, so the IRS responded by waiving penalties for failure to take an RMD from certain inherited IRAs in 2021, and again in 2022 and 2023. In IRS Notice 2024-35, issued last month, the penalties are again waived for 2024. The Notice suggests that this is the last year for such forbearance.

The Notice affects only those who inherited an IRA in 2020 or later from someone who was then old enough to be required to take RMDs.

If you might be affected, see your tax advisor to learn more. ☐

Sample payout periods for inherited IRAs

Over the life of the beneficiary	Over ten years	Over five years
Spouse	Adult children or grandchildren	Charities
Persons less than ten years younger than the owner	Successor beneficiary of account inherited before 2020	Estates
Disabled persons	Trust with non-spouse beneficiary	Some trusts
Chronically ill persons		
Minor children until they reach the age of majority		

Source: IRC; M.A. Co.

DNA search leads to complications

Carmen Thomas turned to 23andMe in search of information about her birth father. She learned that Kali and Abigail Brown were likely her half-sisters. Their father, Joseph Brown, had recently died. For one month, the three women corresponded happily, getting to know each other, but then Kali said that a break was needed.

As it turned out, the reason for the break was that the Brown sisters had filed a medical malpractice claim for their father's death. At trial, the jury awarded the estate $1 million and the sisters $9.5 million each. The case was later settled for an undisclosed amount.

Upon learning of the settlement, Carmen Thomas felt that she was entitled to share in it, as a biological heir, even though she never met or knew her biological father. A lawsuit has been filed alleging "unjust enrichment, conversion, interference with inheritance expectancy, and breach of fiduciary duty." The case is pending.

"All relatives" may include one's children

In Oklahoma, children who are not mentioned in a will are entitled to receive an intestate share of the estate unless it clearly appears from the will itself that the omission was intentional. Priscilla Shepherd signed a holographic will, that is, one drafted in her own handwriting. It's not clear what legal advice she had in preparing her estate plan. The will left her house to her granddaughter, Amber, and it did not specifically leave anything to her three children. The final line of the will was "All moneys owed by anyone is forgiven. This is my desire and will to be for all relatives."

Two daughters objected to the will and applied for their intestate share, arguing that there was no clear intent in the will to disinherit them. The district court held that although they were not named, they were among the "all relatives" identified in the final line of the will. A divided intermediate appellate court agreed that the statute for pretermitted (unnamed in the will) children did not apply in this case.

A dissenter pointed out that the will was ambiguous at best, and that it failed to provide convincing evidence of intentional omission of the children, as required by state law to avoid application of the statute.

A handwritten will may be better than no will at all, but the better course is to invest in a meeting with an estate planning attorney. The expense of professional estate planning is small compared to the costs of litigation over an estate, as experienced by the heirs of Priscilla Shepherd. ☐

Our Trust & Wealth Management Team

J. Joseph McCoy, JD
Trust Officer
(815) 332-8871
josephm@stillmanbank.com

Jeffrey Hartle
Senior Vice President
(815) 332-8843
jeffh@stillmanbank.com

Jessica Schrader
Trust Operations Officer
(815) 332-8864
jessicas@stillmanbank.com

Eric Haugdahl
Associate Portfolio Manager
(815) 332-8851
erich@stillmanbank.com

Contact us today for a no-cost, no-obligation consultation.

Stillman BANK

Trust & Wealth Management
8492 E. State Street • Rockford, IL 61108
815-332-8850
www.stillmanbank.com

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