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Investment & Trust Newsletter

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On your own

Financial and estate planning for singles

Married couples have financial and estate planning advantages that they may sometimes take for granted. For example, when one spouse becomes ill or incapacitated, the other can “step up” to take over household management. When one spouse dies, generally no federal estate tax is assessed on assets passing to the survivor. No advanced planning is required to activate these benefits (although advanced planning would make it easier still).

What about singles? They do not have the luxury of deferring their financial planning. Single people need a Plan B, and having a Plan C might also be a good idea. In particular, singles need to plan for incapacity. What happens to your finances if something happens to you?

Key documents

To empower someone to take over on your behalf, you will need to cover both the financial and health bases. You may need to execute:

- A health-care power of attorney, with medical instructions to be followed if you are incapacitated
- A Health Information Portability and Accountability Act (HIPAA) authorization so that your agent has full rights to your medical records
- A health-care proxy that may give someone decision-making power at the end of life
- A power of attorney over financial assets

Powers of attorney can be tricky things. The traditional power of attorney conveys to the agent no more power than the principal has, which means that it expires when the principal becomes incapacitated. In the context of disability, the traditional power of attorney becomes useless when it is most needed. Therefore, the *durable power of attorney* was created for this situation, a power that continues while the principal is not available. Another alternative is the *springing power of attorney*, which becomes effective only when the principal becomes disabled. That leaves open the question of how and when the presence of disability will be determined.

Unfortunately, the attorney-in-fact may face some roadblocks when trying



to exercise the power. In general, a power of attorney is most useful at the outset of disability. For long-term financial management, you need something more.

The living trust

A trust arrangement offers comprehensive protection that can last as long as it is needed.

You create the trust now and the trust agreement is *revocable*, meaning that you can make changes to it at any time, even canceling the agreement if you see fit. Initially, the agreement may call for you to be consulted before investment decisions are implemented with regard to the assets placed in the trust.

Our responsibility as trustee includes everyday investment tasks. We buy and sell as you instruct us, collect dividends and interest income for you and maintain accurate records of all transactions. We'll also keep you informed regarding important deadlines that affect your holdings.

If you become incapacitated or upon your request, we spring into action by taking over the full management of your assets, acting as you have directed in the agreement.

In addition to handling your investments, our responsibility may be wide-ranging. You may authorize us to use trust income to employ household help, hire nurses and even pay your monthly bills.

The trust can be integrated into your overall estate planning as well. You can decide that assets that have not been placed in trust during your lifetime will pour over into your trust at your death. You can fashion an agreement that distributes your assets as you wish at your death, taking tax considerations into account.

We have more ideas

Our job as corporate fiduciary is to develop investment and financial management plans for people in a great range of circumstances. We think creatively; we don't approach our clients with preconceived notions of the best way to achieve their unique goals.

Everyone should explore the options and opportunities presented by our trust and investment services. If you have not already done so, we invite you to contact one of our officers soon to learn more. □

Advanced estate planning ideas

Here are two fictitious examples of singles who decided to take steps to assure their legacy.

Grantor Retained Income Trusts.

It is possible to make a gift today that doesn't take place until a date in the future. The gift will be taxed today, but the value of the gift will be reduced to reflect the passage of time that must occur before the gift takes effect.

For example, Robert S. plans to leave his \$1 million securities portfolio to his nieces and nephews in about ten years. He could place these assets in a Grantor Retained Income Trust today, reserving the right to the trust income for himself for ten years. At the end of the period, the assets would pass to his heirs. The value of this gift will depend upon the specific provisions of the trust, as well as the market interest rates at the time that the trust is funded. When the trust terminates, no additional gift tax will be due, even if the trust assets

substantially increase in value.

However, a trust of this sort must be irrevocable to garner tax advantages. Robert can't change his mind in year nine to delay the gift. Also, should Robert die before the trust terminates, its value may be brought back into his estate.

Bypass Trusts. Now change the facts slightly. The portfolio is worth more than \$1 million, but Robert doesn't intend to part with it before his death. Instead, he wants the money to be available to his younger sister Rebecca and her children after his death.



An estate tax will be due at Robert's death, and another estate tax will be owed at the sister's death. The IRS will get two "bites" from the portfolio before the nieces and nephews get anything. The second bite is not necessary.

Robert can provide in his will that the assets will pass to a trust for Rebecca's benefit for her life and then to her children. The death tax savings may be considerable.

When “defective” doesn’t mean broken

In April, *The Wall Street Journal* reported an uptick in the implementation of one of the worst-named estate planning tools ever created, the “intentionally defective grantor trust.” Today’s depressed interest rates and low asset values make this an extraordinary time for these trusts, according to one banker quoted by the *Journal*.

The purpose of this type of trust is to reduce estate and gift taxes on wealth transfers within the family. The “defect” isn’t really in the trust, it’s in the tax code. Irrevocable trusts generally are standalone taxpayers and transfers to them are final for gift tax purposes. However, if the trust creator, the grantor, retains certain powers over the trust, he or she will be treated as owning the trust for income tax purposes but not for estate and gift tax purposes. That means the grantor must pay the income tax, which in turn, means that the amounts in a grantor trust can grow for the beneficiaries on a tax-free basis.

If your child owed the IRS \$50,000 and you paid the tax for the child, you would be making a taxable gift to the child of \$50,000. There was some concern that a similar result might occur when the grantor paid the income tax for an intentionally defective grantor trust. But in a 2005 revenue ruling, the IRS laid those fears to rest. Fulfilling a legal obligation, as when an income tax is paid, will not be a taxable gift, regardless of the indirect benefits that may flow to others.

When the grantor pays the income tax on the trust’s income, two things happen. The grantor’s future taxable estate gets smaller, reducing future estate taxes, and the trust gets bigger faster than it otherwise would have. The table above contrasts the buildup of grantor and non-grantor trusts, all things being equal.

Caveats

The table uses \$1 million as a starting point, because that is the size of a trust transfer that can be made without incurring a gift tax. (The federal credit for lifetime gifts

Growth spurt

This table contrasts the accumulation in \$1 million trusts if the grantor does or does not pay the trust’s income taxes. The table assumes each trust earns 5% every year and pays a composite 30% income tax rate. No specific investment is represented by this hypothetical illustration, only the potential tax advantages.

Year	Trust pays tax			Grantor pays tax		
	Principal	Income tax	Year end	Principal	Income tax	Year end
1	\$1,000,000	\$15,000	\$1,035,000	\$1,000,000	\$0	\$1,050,000
5	\$1,147,523	\$17,213	\$1,187,686	\$1,215,506	\$0	\$1,276,282
10	\$1,362,897	\$20,443	\$1,410,599	\$1,551,328	\$0	\$1,628,895
15	\$1,618,695	\$24,280	\$1,675,349	\$1,979,932	\$0	\$2,078,928
20	\$1,922,501	\$28,838	\$1,989,789	\$2,526,950	\$0	\$2,653,298
25	\$2,283,328	\$34,250	\$2,363,245	\$3,225,100	\$0	\$3,386,355

Source: M.A. Co.

is then used up.) There is no dollar limit on the amount that can be placed in a grantor trust.

The practical limit, however, is that the grantor doesn’t want to be bankrupted by the obligation to pay tax on the trust’s income, should the trust prove more successful than anticipated.

Amounts placed in this sort of trust should avoid federal estate taxation when the grantor dies. For a \$1 million trust, that could mean a savings of \$450,000, more or less, depending upon what Congress does about the estate tax and what the prevailing rules are when the grantor dies. Perhaps more important, the grantor will also avoid gift and estate taxes on accumulated appreciation in the value of the trust’s assets.

At today’s low asset values, a lot more property may be placed in trust without gift tax than was possible a few years ago. □

Things go better with Coke®

In 1902, James Patrick Roddy and Dr. David Hitt Williams joined forces to create the Roddy Manufacturing Company. They started one of the first Coca-Cola® bottlers in the country, with an exclusive franchise for eastern Tennessee and part of Kentucky. They succeeded.

Williams died in 1929, leaving his share of the business in trust to his only daughter, Eugenia. She never had children. Roddy, on the other hand, had two children, three grandchildren and ten great-grandchildren. Eugenia was treated like a family member by the Roddys, and she relied upon them as well. One Roddy family member held her power of attorney, and in 1990, she named two Roddys as trustees of her trust.

Eugenia's will left all her bottling company stock to the Roddy family, and the rest of her estate passed to charities. In 1991, a series of transactions began that ultimately resulted in the sale of the bottling company to Coca-Cola Enterprises for \$130 million. A portion of the sale occurred before Eugenia's death; a portion (the shares owned by her trust) happened afterward. The Roddy family engineered this strategy, and Eugenia did not object, because it preserved their inheritance. Had Eugenia's shares been sold before her death, and assuming that she did not change her will, the proceeds would have passed through her residuary estate to the charities.

After Eugenia's death, the charities sued, not satisfied with the \$24 million that was distributed to them under her will. The charities argued that a contingent sale had occurred before Eugenia's death, so they were entitled to all the proceeds of the stock sale. Alternatively, the charities argued that the Roddys had violated a fiduciary duty that they owed to Eugenia. A settlement fund was created to protect the charities' interest while allowing the stock sale to go forward. Ultimately, a settlement was reached between the estate and the charities.

The estate tax angle

That didn't end the controversy. The estate claimed a charitable deduction for the full amount passing to the charities, which the IRS then resisted. The theory of the settlement became the deciding factor. If the settlement resolved a contingent sale, which is what the parties agreed had happened, the proceeds passed through the estate and were therefore deductible. However, if the settlement rested upon the less likely grounds of tort and violation of fiduciary duty, the deduction could be lost. Following a lengthy review, the Tax Court decided that both theories were behind the settlement, but not in equal proportions. Because 90% of the settlement was attributable to a contingent sale, in the court's view, that portion of the charitable deduction was allowed. □



Time for the
grandparent's
will review?

When planning for your own financial security, you should think about those who rely on you as well. That's why you should talk to us about living trusts. A living trust can enhance your financial security today and help you to do more for your beneficiaries tomorrow.

As trustee, we provide objective investment advice and personal financial services tailored to your needs. Let's talk over your requirements this month!

Call our trust professionals for an appointment.

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