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Mystified by trusts?

Here's a nontechnical introduction.

Your living trust guide



Personal trusts are among the most useful tools ever devised for the management and distribution of family assets. Unfortunately, many people are intimidated by trusts or assume that only the super-rich can benefit from a trust-based management plan. Trusts serve a wide range of functions and may be appropriate for a variety of family financial circumstances.

If you are affluent, sooner or later you'll need to consider a trust. "Sooner" may well mean setting up a trust during your lifetime, a revocable living trust, in contrast to a testamentary trust established by a will. To make that contemplation a reality, we offer the following guide to living trusts.

Players

To create a *living trust*, the following are necessary:

- A trust *grantor*, which is you, the key to the planning process.
- *Assets* – usually stocks, bonds, mutual funds or other investments – although you may place all sorts of property in trust.
- *Written instructions* that tell the trustee the trust's purposes, how to manage the investments, and how to distribute income and principal to the beneficiaries.
- One or more *trustees* who will accept the responsibilities listed in the trust agreement. You may choose an individual or a trust institution.
- *Beneficiaries*, which may include you as the first and foremost beneficiary for the remainder of your life. Other family members will likely be identified as successor beneficiaries.

Living trusts have become basic financial tools for good reason. They offer a unique combination of advantages and uses.

Purposes

Key functions that a living trust may fulfill include:

Professional asset management. When a corporate fiduciary (such as a bank trust division or a trust company) is used as the trustee, investments receive continuous supervision in accordance with the plan spelled out in the trust agreement. The grantor may be relieved of a range of minor investment chores that are routine for a professional trustee.

Protection upon incapacity. The terms of a living trust may instruct the trustee to provide full management of personal finances – household bills, taxes and so on – in the event that the creator of the trust becomes incapacitated. As a personal financial manager, a trustee carries more clout than someone acting under a power of attorney. Even if incapacity is prolonged, a living trust may eliminate the need to have a conservator appointed by a court.

Probate avoidance. Assets placed in a living trust may avoid probate when the trust creator dies. "Probate" is

the legal process required when an estate is transferred under the terms of a will. By avoiding probate, you may reduce the delays and, perhaps, the costs associated with estate settlement.

Financial privacy. Avoiding probate may also keep your estate plan private, shielded from the prying eyes that scan wills when they are made public, an inherent part of the probate process. Normally, the terms of a trust do not need to be publicized.

Consolidated financial protection. When children are involved, a business or professional person typically carries quite a bit of life insurance. He or she can have the insurance proceeds paid directly to the living trust, to be invested as part of a unified “family financial security fund” for the children.

Using a living trust to designate beneficiaries doesn't entirely eliminate the need for a will, because you're not going to put everything in trust. Most likely, though, you would need only a brief and unrevealing will to tie up the loose ends of your estate.

Choice of trustee

Once you've decided that a living trust is right for you and your family, the next important decision is selecting the right trustee. That's where we come in, of course. This is work that we do every day. When we manage trusts, our services are always objective, personalized and comprehensive.

Objective. To remove any chance of conflict between our organization's interests and our client's interests, we

do not work on commission. Instead, we charge moderate annual fees that are based upon the market value of our clients' holdings. When the dollar value of a client's account grows over the years, we receive more dollars of compensation. If a client's account shrinks in value, so does our compensation.

Personalized. As we see it, our business is not simply managing investment programs. Our business is helping people – helping our clients achieve their financial goals. We've learned that serious investors can't settle for a “one size fits all” approach. We see each of our clients as possessing a unique mix of financial facts, family circumstances and personal goals. The better we understand each client's unique situation, the better our chances of retaining that client's business for many years to come.

Comprehensive. In addition to providing our investment clients with unbiased guidance, we keep accurate records, submit detailed statements and safeguard securities under strict audit control – all for moderate fees that may be lower than those for all-inclusive accounts offered by other firms.

Act sooner rather than later

We believe that our personal trust service makes living trusts economical and practical for a wide range of individuals and families. If you are not already among our clients, we invite you to put us to the test. We are at your service. □

Six reasons to take advantage of our living trust service

Planning to set up a living trust? Already have a trust of the self-trusteed variety? Here are good reasons to place your trust in our care:

1. **Group judgment.** Our trust investment committee monitors the investments in the trusts in our care.
2. **Reliability.** We understand the special responsibilities of a trustee. All trust funds in our care are safeguarded by both internal and external audits.
3. **Experience.** Trusteeship is our business.
4. **Responsiveness.** Financially successful individuals and their families expect personal attention and responsive service. We deliver.
5. **Objective investment guidance.** Unlike investment advisors who are compensated mainly by sales commissions, we earn our reasonable trustee's fee by providing our trust clients with unbiased, personalized guidance.
6. **Convenience.** From bill-paying to retirement planning, we can provide or obtain just about any convenience or special service that our trust clients desire.

2010 gift planning

Congress decided that 2010 would be the year that everyone could prepay his or her retirement income taxes. This year marks the removal of the \$100,000 cap on who is permitted to make a taxable conversion of a traditional IRA into a Roth IRA, securing the possibility of complete freedom from future taxes on investment income and gains.

Congress did not decide upon a parallel course for the estate tax, but it could turn out that way. At this writing, there is no federal estate tax itself, but there is a gift tax. This year, the gift tax applies at the historically low rate of 35%, when lifetime taxable gifts exceed \$1 million. Next year, the rate is scheduled to zoom back up to 55%, in tandem with the return of the estate tax.

The opportunity to “prepay the estate tax” comes about through making very substantial taxable gifts this year, locking in the low rates.

Do the math

In fact, the potential for transfer tax savings this year is even larger than it first appears. The gift tax does not apply to the payment of the gift tax itself, but the estate tax does apply to the amount of the estate tax itself.

Imagine an individual who is already in the top transfer tax brackets as a result of prior taxable gifts. He or she has \$10 million to transfer. A taxable gift of \$7,407,407 will trigger a gift tax of \$2,592,592 at the 35% tax rate, consuming a total of \$9,999,999. In contrast, at the same individual's death, the estate tax on the \$10 million would come to \$5.5 million, leaving just \$4.5 million for heirs. The gifting approach undertaken this year delivers nearly 65% more financial assets to the heirs.

What's more, a gift in 2010 fixes the value of the transfer, and many asset values currently are depressed. Future appreciation will accrue to the heirs untaxed.

However, for the strategy to work, the donor must survive for three years. Gift taxes paid within three years of death are brought back into the estate, and the estate tax applies in full.

Gifts from marital trusts

One candidate to consider for gifting this year is an interest in a large marital deduction trust. For example, a \$10 million marital deduction trust will be fully subject to estate tax at rates up to 55% if the spouse survives to 2011 or later. A gift of the income or remainder of the trust, or both, would trigger only a 35% gift tax this year, to the extent that the value of the transfer exceeds the \$1 million gift tax exemption.

Timing the gift

The possibility of a retroactive change to the estate and gift tax later this year cannot be ruled out entirely. Accordingly, for those who are considering major gifts to take advantage of this year's low tax rates, a delay in



Transfer tax costs

A top-bracket taxpayer plans to transfer \$1 million to an heir but will pay the resulting gift or estate tax before transferring the funds. How much will the heir receive?

	2010 gift	2011 gift	2011 bequest
Tax rate	35%	55%	55%
Tax	\$259,259	\$354,839	\$550,000
Net proceeds to heir	\$740,740	\$645,161	\$450,000

State taxes are not included in this example.
Source: Internal Revenue Code; M.A. Co.

the completion of the gift until late in the year may be advisable. However, one downside to keep in mind is that it also delays the start of the three-year rule for estate taxation of gift taxes paid.

Will people take advantage of this opportunity to prepay their estate taxes? Only time will tell, but the Congressional Budget Office is optimistic. It projected a record \$14 billion in gift tax revenue for 2010, which suggests that taxable gifts could total nearly \$50 billion this year. □

SOI nuggets

In its *Statistics of Income (SOI)*, the IRS recently released a comprehensive report on individual tax returns from 2008, with data going back to 2004 for comparison. The recession began in December 2007, so that year was a growth year, while 2008 was continuously weak. The tax data make this picture very clear.

“I’m proud to be paying taxes in the United States. The only thing is – I could be just as proud for half the money.”

– Arthur Godfrey

- Net capital gains were down 47.9%, as the stock market collapsed. 2008 saw the lowest net capital gain in the five-year period of the study. Even so, net capital gain came to over \$466 billion. More than 20 million taxpayers reported capital gains or losses, down 7.8%.

- Taxable interest fell by 16.7% but was higher than it was in 2006 and earlier years. Tax-exempt interest rose 0.6%.

- Wages grew by 1.9%, despite the recession, to \$5.95 trillion. However, on an inflation-adjusted basis, wages fell 1.9%. Unemployment benefits rose by 48.5%, as the number of taxpayers reporting such benefits rose 25.1%. Why would benefits paid rise so much faster than the number of people claiming them? Perhaps because the period for being unemployed has been so much longer in this recession.

- There was a 5.8% increase in the number of returns reporting IRA distributions and a 13.9% increase in total distributions, to \$12 billion. Social Security benefits received rose by 8.7%, as many workers opted for early retirement.

- Total Social Security benefits received came to over \$415 billion. Of that amount, \$168 billion were taxable.

- More than 400,000 fewer taxpayers paid self-employment tax, a drop of 2.4%.

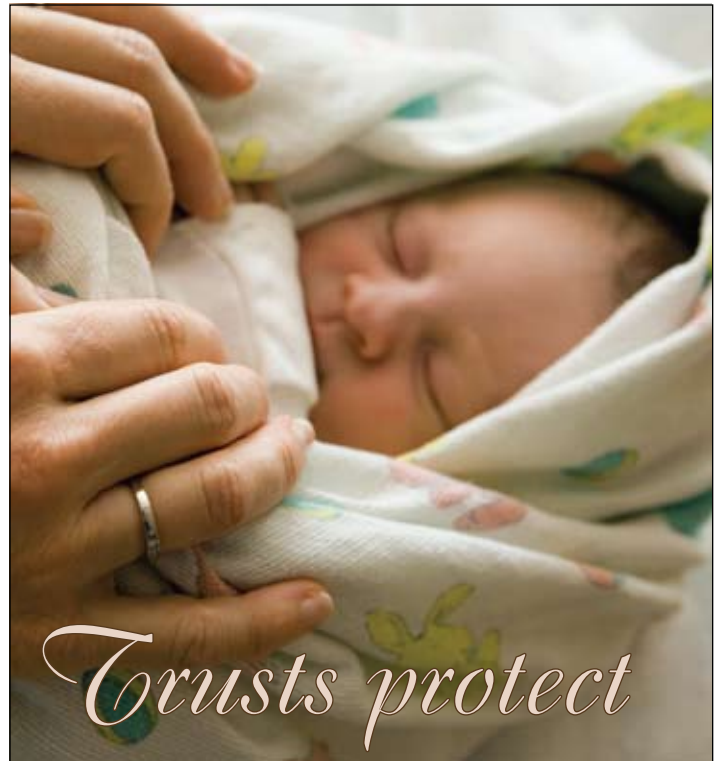
- Although wages were up, Adjusted Gross Income was down 4.9%.

- Farmers reported a net loss in every year of the study. Farmers had a worse year in 2006, with \$15.3 billion in losses, than they did in 2008, with \$14.8 billion lost.

- The alternative minimum tax affected 4.2% fewer taxpayers, but the total AMT paid rose by 6.4%.

- Health savings accounts surged by 41%, with gross contributions leaping 47.2%.

- In 2008, there was a first-time homebuyer tax credit that has to be repaid to the IRS. 1,203,566 taxpayers took advantage of that credit. □



Trusts protect

Our trust services provide continuous family financial protection, from one generation to the next.

Stop by soon to learn more about how we may be of service to you.

Call our trust professionals for an appointment.

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