

**Wills and trusts**

Nuts and bolts of estate planning  
The federal estate tax  
in perspective  
Hazards of executorship

**Portfolio planning**

Health care reform and your  
investments

# Investment & Trust Newsletter

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## Nuts and bolts of estate planning



*What do these presidents  
have in common?*

*Abraham Lincoln  
Andrew Johnson  
Ulysses Grant  
James Garfield*

*Each man died **without** a will.*

**D**o you have a will? If not, you are in the majority. A recent survey done for Lawyers.com revealed that only 42% of Americans reported that they have taken this first step in estate planning. More surprising, another survey revealed that 30% of those with \$500,000 or more in financial assets have no will. These people have far more at stake, and their families are less financially secure should they die intestate (the legal term for having no will at death).

Excuses for not having a will are legion, from superstition to a misunderstanding of the true costs and consequences. This year there is a somewhat more legitimate reason, as federal estate tax law is in a period of unprecedented uncertainty. At this writing, there is no federal

estate tax. The federal gift tax remains in place, with a reduced tax rate, when total lifetime gifts exceed \$1 million. Next year, as the law stands, the federal estate tax exemption falls to \$1 million, and top tax rates (including surtaxes) will shoot as high as 60% for some larger estates. (See "The federal estate tax in perspective" on page 2 for more details on this history.)

However, having just one estate plan is not likely to be optimal for both this year and next. What's more, many in Congress have stated that they would like to restore the federal estate tax for this year, perhaps retroactively to January 1. In this environment, it is easy to see why a first visit to an estate planner might be postponed.

### ***If you die without a will***

Tax planning is only one element of estate planning, and in many estates it is the least important factor. The larger issue is *who* will inherit and *what* they will inherit.

In the absence of a will, each state has a plan to distribute property to heirs. There is surprising variability from state to state. If there is a surviving spouse and no children from a prior marriage, the surviving spouse inherits everything in 16 states. Other states provide one-third or one-half for the surviving spouse, with the balance divided equally among the children. Mississippi, on the other hand, divides the estate equally among a



surviving spouse and children. If there are four children, for example, the estate will be split into five equal portions.

What if there is no surviving spouse or children? Siblings, parents and more remote relatives may then lay claim to a share of the estate. If no relatives come forward, the assets will pass to the state.

**Will substitutes**

A will controls only a portion of one's property at death, the part that goes through probate. Property with named beneficiaries may pass to them automatically. Examples of such property include:

- Jointly owned property, such as real estate, bank accounts and brokerage accounts
- Pay-on-death accounts
- Life insurance
- Qualified retirement accounts, such as IRAs and 401(k)s
- Revocable living trusts established for lifetime financial management

Understanding the role of such assets in the composition of the estate is an essential element of will planning.

**Estate settlement**

One critical function of a will is the nomination of an executor (called *personal representative* in many states) to manage the estate and bring one's financial affairs to an orderly conclusion. (See "Hazards of executorship" on page 3 for more information on the considerations to make when choosing an executor.)

**Advanced planning with trusts**

In addition to identifying heirs and their inheritances, a will can provide a financial management plan for that inheritance. This may be achieved with a trust. For example, there are:

- Marital trusts for surviving spouses
- Qualified terminable interest property trusts for spouses and children from prior marriages
- Qualified domestic trusts for spouses who are not American citizens
- Credit shelter trusts for maximum protection from federal estate taxes, in the years when that tax applies
- Testamentary trusts to protect a child's inheritance from creditor claims
- Charitable trusts to meld philanthropic and private interests

**Get started**

If you don't have a will, plan on an early appointment with your lawyer to discuss developing one. If you do have a will, you still may need a consultation, given the uncertainty of today's tax laws. In either case, if you would like more information about estate settlement and trust planning, we invite you to make an appointment with one of our officers. This is part of our core expertise, which we will be pleased to share with you. □



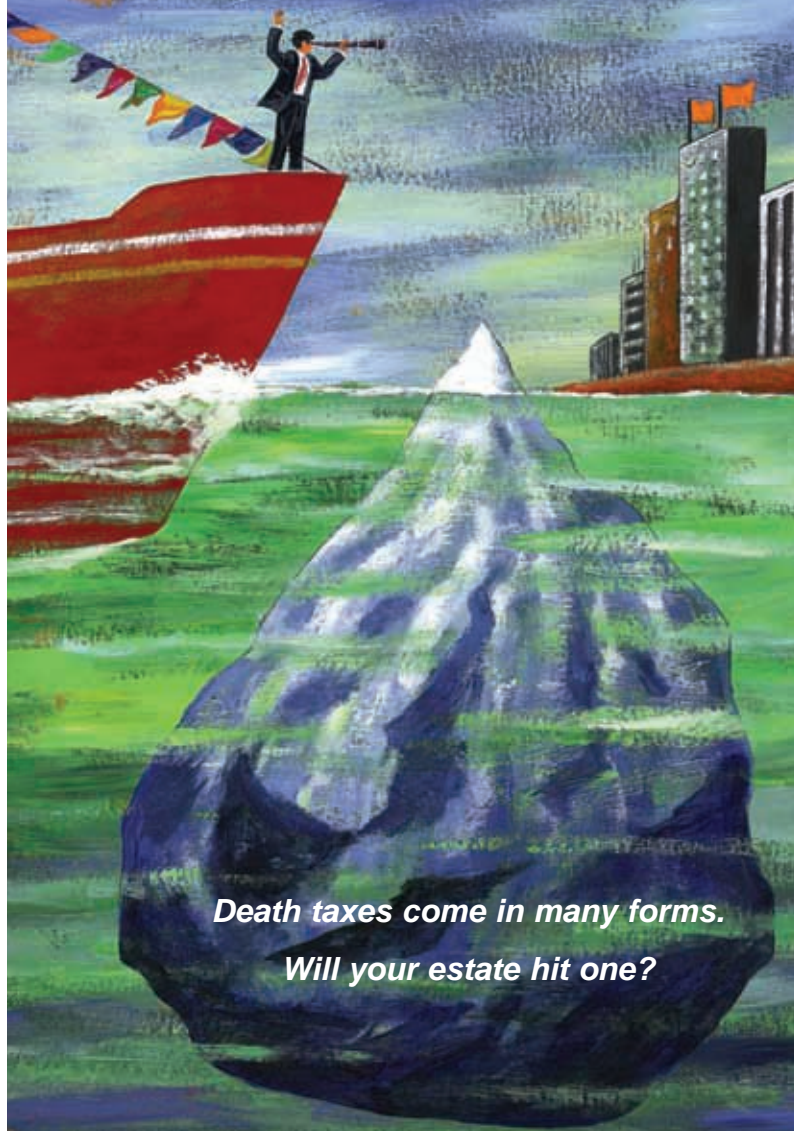
**The federal estate tax in perspective**

In nominal dollars, the federal exemption from estate taxes has ranged from \$40,000 to \$3.5 million. In inflation-adjusted dollars, the variation has been much less.

Year	Nominal estate tax exemption	Inflation-adjusted exemption (2008 dollars)	Comment
1916	\$50,000	\$988,073	Modern estate tax begins.
1929	\$100,000	\$1,259,646	When the great crash depressed asset values, the exemption became more valuable.
1945	\$60,000	\$718,000	World War II ends.
1976	\$60,000	\$227,135	Share of estates subject to federal tax soars due to no inflation adjustments for 34 years.
1987	\$600,000	\$1,137,676	Real estate tax exemption crosses the \$1 million mark after 56 years below it.
2009	\$3,500,000	\$3,414,634	Highest exemption ever.
2011	\$1,000,000	\$928,599	Roughly the same real exemption as in 1992.

Source: M.A. Co.; Joulfaian, David, *The Federal Estate Tax: History, Law, and Economics* (March 28, 2010). Available at SSRN: <http://ssrn.com/abstract=1579829>.

# Hazards of executorship



*Death taxes come in many forms.  
Will your estate hit one?*

James Guyton sold his Florida chicken farm on January 20, 2000, for \$190,000. After paying off two mortgages, he placed the net proceeds of \$99,735 into a joint checking account with his son, Timothy.

Guyton died on June 17, 2000. Another son, James, Jr., was named the executor of his father's estate. In that capacity, he was required to file a final income tax return and pay any income taxes due. The following year, he filed the return, showing a tax liability of more than \$132,000. Partial payments totaling more than \$113,000 were made through 2004. In 2005, the IRS demanded the rest, with interest and penalties.

James told the IRS that it needed to collect the capital gain tax on the sale of the farm from Timothy, not him, because the sales proceeds "never went through the estate." What's more, James argued that because the sale was "income in respect of a decedent," the primary tax obligation fell on Timothy. Finally, James produced a written agreement in which Timothy and other siblings promised to contribute to paying the taxes.

All irrelevant, ruled a federal district court, and the Eleventh Circuit Court of Appeals recently agreed. A pre-death sale is not income in respect of the decedent but,

instead, gives rise to a tax obligation of the decedent. What happened to the proceeds does not matter, and the IRS is not bound by agreements to which it is not a party. As the estate's executor, James, Jr., must pay these income taxes.

## **Self-representation**

We do not know from the court record just how large the Guyton estate was, but it appears that there was no federal or state estate tax or inheritance tax due. However, the case shows that income taxes after death also can be problematic in the absence of a plan to provide a means for payment.

Through three court proceedings, James, Jr., represented himself. Experts do not generally recommend this approach.

The larger point is that nearly ten years have elapsed since the senior Guyton's death, and his estate still isn't finally settled.

## **Whom should you choose as executor?**

The impulse to choose a family member for the job of estate settlement is understandable, and for smaller estates, it may work out fine. Unfortunately, estate settlement is more difficult than most people realize, and there can be unexpected pitfalls. Here are some of the questions to consider as you evaluate the candidates for settling your estate

- **Experience.** Have the individuals or organization 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 executor candidate familiar with modern portfolio theory? How about the "prudent man rule"? Will investment management issues be a problem, or can they be handled routinely?
  - **Availability.** Will the proposed executor 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 have a financial interest in the estate? Will all parties consider the executor fair and impartial? Can the executor play a constructive role in settling any disputes that arise among beneficiaries?
- Choosing an executor is similar to hiring an employee, but the stakes are much higher.

## **We can help**

Estate settlement is one core aspect of our daily business. If you choose us to settle your estate, you will know that there won't be any "on-the-job" learning involved. To learn more about our executor capabilities, make an appointment soon to meet with us. □

## Health care reform and your investments

During the Congressional debate on reforming health insurance, the focus was on expanding access. Health care reform actually is made up of two new laws: the Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act of 2010. The Patient Protection Act, crafted largely in the Senate, sets out the general framework of health care reform. The Reconciliation Act was prepared in the House to modify the Patient Protection Act, especially in the areas of tax credits and cost sharing for individuals to help make coverage more affordable.

Now, attention is shifting to the impact that some elements of the new law will have on portfolio planning. Many of the provisions have delayed effective dates, which makes strategic planning more important. For example:

- Individuals who earn more than \$200,000 for the year (\$250,000 for married couples) will be paying an additional 0.9% in Hospital Insurance (Medicare) tax, starting in 2013.
- Individuals whose adjusted gross income for the year exceeds \$200,000 (\$250,000 for joint filers), whether from wages or otherwise, will be paying an additional 3.8% Medicare tax on net investment income, also beginning in 2013.

These changes need to be understood in the context of the expiration of the Bush administration's tax cuts at the end of 2010. Taxes on dividends and capital gains are slated to rise. Although there has been movement in Congress to preserve some of those tax cuts for lower- and middle-income taxpayers, they may be allowed to expire for the same group hit by higher tax exposures for health care reform.

What might this mean for investors? There are no firm answers yet, but here are some possibilities:

*Tax-free municipal bond income will become more valuable.* Prices of muni bonds could rise, if investors have confidence in the financial stability of the issuers.

*Dividend-paying stocks could suffer.* Recently, many investors have favored dividend payers, both because of the preferential tax treatment of qualified dividends and because prices for such stocks may be less volatile in uncertain economic times. Should the after-tax value of the income stream decline sharply, demand for such stocks could fall.

*Roth IRAs may be more attractive.* Distributions are not required from Roth IRAs after age 70½. Mandatory IRA distributions have a way of pushing taxpayers into unwanted high tax brackets. What's more, Roth IRA distributions have the potential to be completely tax free, so they might not push the taxpayer's other taxable income into the realms where the new Medicare tax applies. □



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More and more men and women who take investing seriously look to us for objective guidance and seasoned judgment. Personalized investment management is our business.

Schedule an exploratory meeting this month. We look forward to hearing your needs and sharing our expertise.

Call our trust professionals for an appointment.

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