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# Trust Topics®



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## The top ten questions about trusts

What do you think of when you hear the words “trust fund”? Many people will associate those words with the Kennedys, the Rockefellers, or the financial titans of the 19th century. But more and more affluent families these days are exploring the unique financial management and financial protection advantages of trusts. Here are questions that we hear frequently, along with our answers.

**1. Aren't trusts out-dated today? Aren't they fading away?**

Quite the contrary. Consider this August 2009 headline from

*InvestmentNews*: “More advisory firms expected to start trust companies.” The article suggests that step is being explored as advisors try to differentiate themselves — in a crowded marketplace for investment services — by offering this enhanced level of service.

But it's not a trivial process. The article continues, “On the downside, advisors who start trust companies must confront a raft of unfamiliar legal responsibilities, more work and regulation . . . .” Not to mention that they also must assume the role of fiduciary, a status that some advisors have actively resisted.

We, of course, are already very familiar with the tenets of fiduciary duty and the regulatory apparatus that attends it.



*A traditional tool for financial management is flourishing.*

**2. Trusts are for the rich, aren't they?**

You certainly don't need Buffett's or Gates's levels of wealth to benefit from employing a trust in your planning. Most of our clients don't think of themselves as “rich.” But they are affluent, and they do have a significant sum that needs management. Fortunately, modern technology has made trust planning accessible and affordable to a much wider segment of the population than was true in the past.

**3. Why do people set up trusts?**

Trusts provide a structure for long-lasting family financial protection. This can be especially valuable when the

family includes beneficiaries from more than one generation. See “A Trust Sampler” below for examples of the situations in which a trust can be most useful, and the types of trusts that may be considered.

**4. Must I have a trust to take advantage of your services for investors?**

No. Many people begin with our investment advisory and management services, with a later upgrade to full trust service as needed.

**5. How old should you be to set up a trust?**

There is no “best age” for setting up a trust. As a practical matter, a great many people first give serious consideration to establishing a trust as they approach retirement or when they do their estate planning.

**6. How are trusts different from other investment accounts?**

A trust has an independent legal existence. That makes it more durable than an ordinary investment account because the trustee continues to perform its duties upon the disability, or even the death, of the trust's creator.

**7. Will a trust protect assets from creditor claims?**

State laws vary on this question. In general, one cannot use a trust as a shield against one's creditors, past or future.

On the other hand, all states allow trusts to be used to protect a beneficiary, who is not the trust creator, from creditors' claims. Perhaps the most common example is to use a trust to protect a child's or grandchild's inheritance in the event of a future divorce.

**8. If I'm not an estate tax target, do I still need the trusts that I set up in my will?**

Probably yes. For most people, the property management benefits of trusts are a sufficient benefit to justify having a trust.

Don't jump to the conclusion that you are not an estate tax target. Yes, under current law, there is no estate tax in 2010. However, that law is under active review at this writing. At the same time, current law calls for only a \$1 million federal estate tax exemption in 2011 and later years.

**9. If a bank fails, what happens to the trust accounts?**

Unlike bank deposits, which become assets of the bank on its balance sheets, the assets of trust accounts are held completely separate from a bank's own assets. If a bank fails, the creditors of the bank have no access to trust department assets. The bank cannot borrow against the value of trust assets, nor can it lend the assets themselves for any purpose. In the unlikely event of a bank failure, its trust accounts would be transferred to a healthy bank under the supervision of government regulators.

**10. Who should be my trustee?**

Experience counts. Look for a trustee who has managed many kinds of trusts in all sorts of financial markets. Also, you'll want a trustee who can be fair and impartial, one whose judgment will be respected by all the trust beneficiaries.

In short, look to us. We will be pleased to tell you more about our qualifications for handling this important job for you and your family. □



Given the flexibility that comes with trust planning, no single vocabulary has emerged for describing the different types of trusts. The same trust with the same function can go by different names because different estate planners have created multiple monikers. Here is an introduction to some of the types of trusts that you might want to explore.

If you need to provide for:	Look into the:
Yourself, or yourself and your spouse	Revocable living trust
Your spouse, after your death	Marital deduction trust
Your noncitizen spouse, after your death	Qualified Domestic Trust (QDOT)
Your children, after your death	Family trust
Your spouse, plus children from an earlier marriage	Qualified Terminable Interest Property trust (QTIP trust)
Full federal estate tax benefits	Bypass trust
Yourself or other individuals for some time, and a charity in the future	Charitable remainder trust
A charity for a period of years, then assets for family members	Charitable lead trust
Protection of retirement assets	IRA rollover trust

## When the cap comes off Roth IRA conversions

If you have a traditional IRA, one for which you've taken tax deductions, distributions from the IRA generally will be taxed as ordinary income. Distributions from a Roth IRA, on the other hand, generally are tax free. If you have a traditional IRA but would prefer a Roth IRA, you can convert. However, the price is steep, as income tax at ordinary tax rates applies to the conversion (except for nondeductible contributions). What's more, the strategy has been off-limits to upper-income taxpayers. Only those with adjusted gross income of \$100,000 or less (before the conversion), whether single or married filing jointly, have been eligible for this tax treatment.

That rule is scheduled to change on January 1, 2010.

On that date, the income limit for conversions to Roth IRAs will be eliminated. By some estimates, \$1.4 trillion will become eligible for conversion on that day.

### **Bonus benefit**

What's more, a special tax-deferral rule applies only to 2010 conversions to Roth IRAs. The income tax due on 2010 conversions may be split, with half payable on 2011 returns and the balance paid with 2012 returns. Having released the pent-up demand created by the income cap, Congress added this tax incentive to push as many taxpayers as possible in the Roth IRA direction.

### **Advantages**

Beyond the benefit of tax-free withdrawals from the Roth IRA, owners of traditional IRAs should keep these points in mind:

- Many IRAs have fallen in value in the current market environment, which could reduce the tax cost of the conversion further.
- Unlike tax-free municipal bond income, the tax-free distributions from a Roth IRA don't increase the amount of income tax due on Social Security benefits.
- The minimum distribution rules that force money out of IRAs when the account owner reaches age 70½ don't apply to Roth IRAs. Thus, these accounts can continue to grow tax deferred indefinitely, becoming a significant estate asset.
- The money used to pay the income tax on a Roth IRA conversion avoids federal estate tax.
- Many observers believe that income tax rates are at a historic low point and that higher rates are inevitable in the future, perhaps even for retirees.

- If the market drops precipitously after the conversion, an IRA recharacterization is allowed for undoing the change. However, that will also forfeit the tax deferral opportunity allowed for 2010 only.

### **Disadvantages**

There are also disadvantages with a Roth conversion to consider. The most important is finding the funding source to pay the income tax. If the tax bill is paid from the IRA, a 10% penalty tax will apply if the owner is under age 59½.

Someone who is very confident of being in a lower tax bracket in a few years may not come out ahead with the conversion. This is more likely to be the case if the conversion will boost the taxpayer's income so much that other income tax credits or deductions are lost. Thus, before making the decision to convert to a Roth IRA, it is especially important to consult a professional tax advisor. □



## Estate settlement sagas

**The long road of the Kerouac estate.** When he died in 1969, Jack Kerouac's estate was rich in potential, short on cash. He made his mother, Gabrielle, his sole heir. She, in turn, left his entire literary estate to Kerouac's third wife, Stella Sampas, in a 1973 will. Sampas left the assets to her siblings when she died in 1990. However, Kerouac's only daughter, Jan (whose mother was Kerouac's second wife), believed that her grandmother Gabrielle's will was a fraud, the signature forged. She contested that will, filing a lawsuit in 1994. When Jan died two years later, at age 44, the suit was continued by Paul Blake, Jr., a Kerouac nephew.

*Latest development.* In July 2009, the saga reached what should be the beginning of its end, when a Florida Court agreed that Gabrielle's last will and testament was indeed a forgery. The attorney for Mr. Blake reportedly will seek an accounting of the remaining Kerouac assets still held by the surviving family of Stella Sampas.

**A mother younger than her daughter?** Olive Watson, daughter of Thomas Watson, Jr., and granddaughter of IBM founder Thomas Watson, agreed in 1991 to create a more formal legal relationship with her "longtime companion," Patricia Spado. In those days, civil unions for same-sex couples were not an option, let alone marriage. The couple was advised that their best choice, adult adoption, was permitted in three states, among them Maine. As it happened, the Watson family owned a summer home in Maine. The couple went to live there for several weeks and filed the adoption papers.

Because one purpose of the arrangement was to create financial security for Spado, she was the adopted daughter, and Watson was the adopting mother, even though Spado was older than Watson. The Maine probate court approved the adoption. The couple stayed together for only another year, breaking up in 1992. Watson provided Spado with a written assurance that she never would challenge the adoption.

Although Watson was open with her family about the relationship with Spado, she did not inform her father about the adoption. Thus, he did not know that in some legal sense Patricia Spado might be considered his granddaughter, entitled to a share in the trusts for the grandchildren created under Watson's will. That is exactly the claim that Spado later made.

A probate court in Greenwich, Connecticut, ruled in 2006 that Spado should not be considered a grandchild for purposes of the Watson trusts.

*Latest development.* A unanimous Maine Supreme Court has upheld the Spado adoption. There was no fraud on the Maine probate court when Spado claimed to live in Maine at the time of the adoption. The action now returns to the Connecticut courts for additional litigation and perhaps two more rounds of appeals. □



If you have children or grandchildren to provide for, come talk to us. From gifts or inheritances in trust to UGMA custodianships to 529 plans, we can help *you* help *them*.

Learn why a thoughtfully planned trust may be the best possible way to safeguard a young beneficiary's financial future.

Our experience as trustee is at your service.



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*For more information, please contact:*

**Trust Department  
7800 West 95th Street  
Hickory Hills, IL 60457  
(708) 598-7400**

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