Trust Topics®

STANDARD BANK AND TRUST CO.

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The "ABCs" of trust services

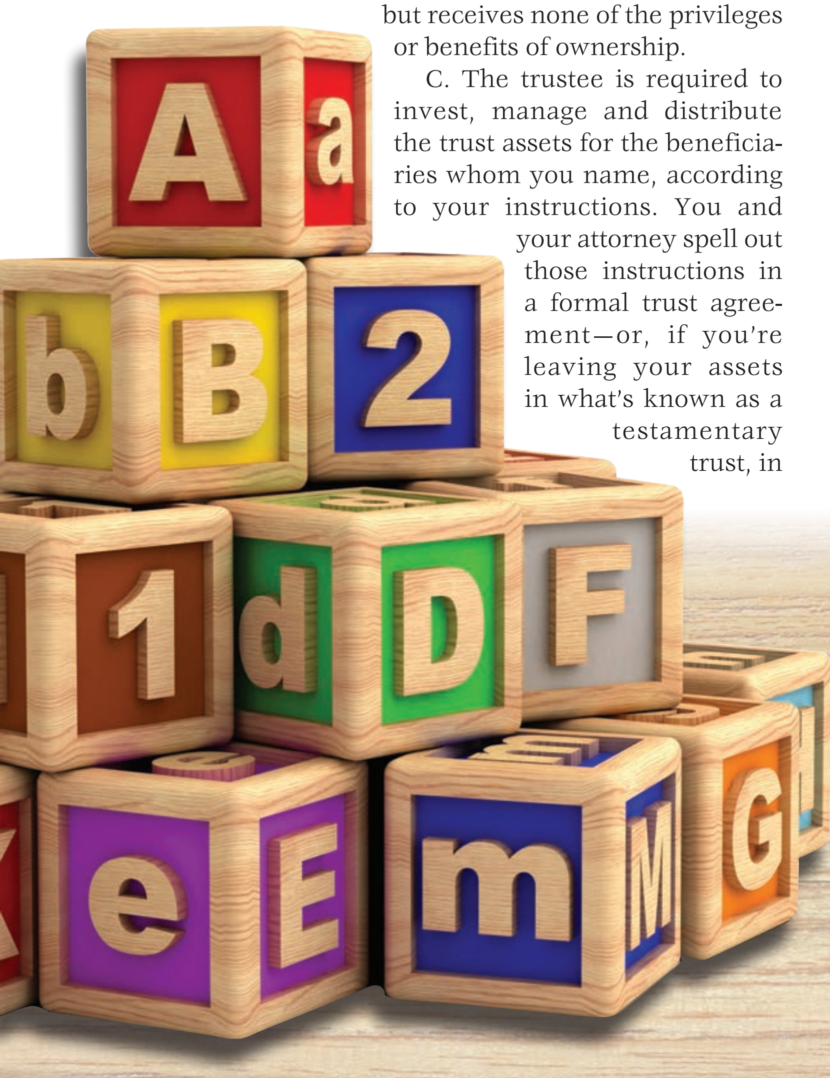
Trusts are not as mysterious as most people seem to think, and technological advances have made trust-based financial planning accessible to more and more families. That's one reason why discussions of trusts seem to be popping up in the popular press more and more.

The ABCs of a trust arrangement are not hard to follow:

A. You, the grantor, or donor, transfer money and/or property to the care of a trustee.

B. The trustee takes legal title to the money or property but receives none of the privileges or benefits of ownership.

C. The trustee is required to invest, manage and distribute the trust assets for the beneficiaries whom you name, according to your instructions. You and your attorney spell out those instructions in a formal trust agreement—or, if you're leaving your assets in what's known as a testamentary trust, in your Last Will and Testament.



A trust can do almost anything that you want it to. Perhaps that's what makes trusts so mystifying to most people. There's no such thing as a "typical trust."

What trusts can accomplish

The most important thing that a trust does is make financial resources available to beneficiaries when needed. When a corporate fiduciary, such as us, is trustee, another automatic benefit is professional investment management. But that is just the start of potential benefits. Among the other objectives that trusts may target:

- income tax savings;
- estate tax savings;
- gift tax savings;
- creditor protection;
- probate avoidance;
- implementation of philanthropic initiatives;
- education funding.

See *Five ways to use trusts* on page 2 for more detailed examples of trusts in action.

21st century trust planning

Trust planning has been getting much more attention from state legislators around the country in recent years.

Continued on next page

Trusts, A through D

Assets. Usually stocks, bonds, mutual funds or other financial instruments, though any sort of property may be placed in a trust.

Beneficiaries. You may be the beneficiary of your living trust, and you may designate simultaneous or successor trustees.

Corporate trustee. That's us. We'll manage assets and administer the trust.

Directions. Each trust tells the trustee what its purposes are, and how income and principal are intended to be divided among the beneficiaries.

Among the more significant changes:

- ***Uniform Prudent Investor Acts*** revise the standards for evaluating the investment performance of trustees. Traditionally, trust investing has been marked by conservative approaches, including evaluating the appropriateness of each individual trust investment. The new laws look at the trust assets as a whole, using principles of modern portfolio theory to evaluate the suitability of the investment plan. These acts also guide development of "total return trusts," which may depart from traditional notions of trust income and principal.
- ***Uniform Trust Codes*** codify the rights and responsibilities of the parties to trust-based plans. The new Codes also may ease the process of correcting trusts that otherwise are not amendable, including division of one trust into several trusts or the combination of several trusts into a single one to reduce administrative costs and increase investment flexibility.
- ***Easing or elimination of "rules against perpetuities"*** in some states allows private trusts to last for many generations. Traditionally, only charitable trusts were permitted to have an unlimited life. A longer-lasting trust has the potential to avoid the imposition of future estate, inheritance and gift taxes on the family fortune.

Trusts have had a reputation for stuffiness and rigidity. The bottom line of recent legislative initiatives is even greater flexibility for this powerful wealth management tool.

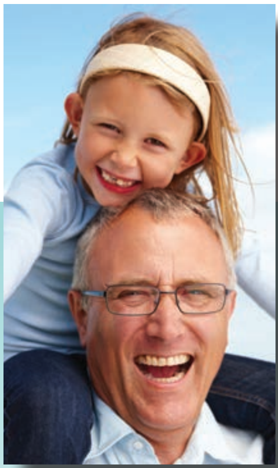
Work with the right trustee

The most important factor affecting the success of any trust arrangement is the choice of trustee to implement the plan. This is a core part of our business. We are a "corporate fiduciary." That phrase means that we are a business organization that is permitted, under the law, to serve as trustee and administer investment programs for individuals, families, businesses and endowments.

For this service we are compensated by reasonable annual fees, tied to the market value of the funds in our care. Our operations are subject to a variety of internal and external audits and oversight.

Most importantly, we enthusiastically accept and operate under a code of fiduciary responsibility. That means we must, by law, put the interests of our customers ahead of our own.

For more information about how trusts may help you to make the most of what you own, please schedule a free consultation with one of our officers. ☐



Five ways to use trusts

1. Trusts to grow on. Trusts can provide professional management for assets set aside for young beneficiaries. The management can continue, if desired, even after a beneficiary reaches age 18 or 21.

2. Continuing help for a disabled individual. With proper planning (qualified legal guidance is a must), a trust can provide extra support and some of life's comforts without disqualifying a disabled person from receiving government assistance.

3. Marital bequest to a noncitizen spouse. Anything that a married person leaves directly to his or her spouse will qualify for the estate-tax marital deduction—unless that spouse is not a U.S. citizen. In that event, a special marital trust is required to preserve the marital deduction.

4. Gaining the marital deduction without disinheriting children. Individuals with children from a prior marriage may qualify assets for the marital deduction by means of a trust that pays lifetime income to the surviving spouse, then passes its assets to the children.

5. True tax savings. There are many ways in which trusts can be crafted to reduce the tax burdens on family wealth, especially estate and gift taxes. With a federal estate tax exemption this year of $5.34 million ($10.68 million for married couples), these taxes won't be a concern for most families. But those with larger fortunes may want to become familiar with the Grantor Retained Annuity Trust, the Crummey Trust, or the Dynasty Trust. Some of these are under review in the tax-writing committees in Congress, so act sooner rather than later if these are of interest.

Is it time to review your will?

Photo: Wikimedia Commons

The cautionary tale of Philip Seymour Hoffman

Actor Philip Seymour Hoffman, who died of an apparent drug overdose in February at age 46, last attended to his estate plans on October 7, 2004. The estate tax laws have changed dramatically since then, as did Mr. Hoffman's personal circumstances. At that time he had one son with his partner, Marianne O'Donnell, but they later had two daughters.

Hoffman's will left all of his property to O'Donnell. His estate has been estimated to be worth roughly $35 million, and the federal estate tax is imposed at 40% of everything above a $5.34 million exemption. Because the couple never married, the marital deduction is not available to defer estate taxes until both spouses have died. Therefore, Ms. O'Donnell could be looking at a $12 million federal estate tax bill. New York State also imposes an estate tax at 16% on assets above $1 million, but that tax payment is deductible when calculating the federal tax. The combined death taxes could come to $15 million, according to some press reports.

The will invites Ms. O'Donnell to disclaim all or part of her inheritance. To the extent that she does so, the property passes to a trust for their son, who was one year old when the will was executed. That trust will pay its principal to the son when he reaches age 25, the balance when he is 30. Unfortunately, the trust makes no provision for after-born children, so the daughters would appear to be disinherited. Ironically, if the will had been silent on what would happen upon a disclaimer by Ms. O'Donnell, the most likely result is that the three children would have shared any disclaimed property equally.

It is possible that Hoffman made other arrangements in trust for the daughters, or his will might have been supplemented by a living trust. It's also possible that he had life insurance, retirement accounts, or other property that won't pass through probate. These would not have to be made public, as a will must be. So it is entirely possible that Hoffman's estate plan is not as inadequate as early press reports have made it out to be. Still, there are lessons for the rest of us here.

What should have been the trigger points?

When Hoffman executed his 2004 will, he was a successful actor, but he probably was not yet rich. The reason for making a will at that time could have been to provide for his son, by leaving his property to the boy's mother. In 2004 the federal estate tax exemption was $1.5 million. It's possible that he was advised at that time of how the marital deduction could reduce the estate tax exposure at his death were he to marry his partner. It's possible that they dismissed this consideration because his wealth was then not close to the federal exemption.

Hoffman won the Academy Award for his performance in *Capote* the very next year. Generally, that recognition leads to a dramatic increase in the fees that an actor commands. Arguably, that would have been a very good time to revisit the adequacy of the estate plan.

In subsequent years the couple had two daughters. Significant changes in family circumstances are usually occasions for will review. Was Hoffman even aware of the fact that his daughters would be disinherited by his 2004 will? Was that outcome ever explained to him?

By 2011 the federal estate tax exemption had grown to $5 million, but Hoffman's wealth had doubtless far outstripped that figure, making his plan obsolete. In 2013 Hoffman entered a recovery program for substance abuse and separated from O'Donnell. With these developments, an estate plan that made sense even a few years earlier might now have a cloud over it.

Much as we might wish it otherwise, estate planning is not something that can be done one time and then put safely in a drawer, awaiting future implementation. Life is too full of changes, up and down, to be able to take an estate plan for granted. Estate planning should be a dynamic and continuing process, with adjustments and perhaps wholesale revisions made as circumstances may warrant.

When was the last time you reviewed your will and estate plans? Below is a checklist of moments that call for just such a review. If you've answered "yes" to any of these check boxes, it would be a very good idea to make an early appointment with your estate planning advisors. ☐

It may be a good idea to review your will if . . .

- Your wealth level changes significantly, up or down.
- You receive an inheritance.
- You sell a business or property.
- You move to another state.
- You get married.
- You get divorced.
- The tax laws change substantially, as they did in 2011.
- Your philanthropic goals change.
- There have been births in the family.
- Any of your beneficiaries has died.

Rollovers: One to a customer

When there's an unexpected financial emergency of some sort, there may be a strong temptation to borrow from retirement savings to meet it. For example, many 401(k) plans have provisions that allow participants to borrow from their accounts. Another possibility, if the need is very short-term, is to exploit the IRA rollover rules to create the equivalent of a very short-term loan from that account. (Note that actual loans from an IRA are not allowed.)

When an IRA owner wishes to move his or her money to another financial institution, a distribution from the IRA will not be taxable so long as it is rolled into the new IRA within 60 days. The 60-day figure likely was chosen for administrative convenience. What's more, the money simply could be redeposited in the original IRA and still preserve this tax treatment. However, taxpayers are permitted only one IRA rollover per year.

Recently, a couple tried to tack a series of IRA rollovers together to create a six-month loan for themselves. Husband withdrew $65,064 from his traditional IRA on April 14, 2008, and another $65,064 from his rollover IRA on June 6, 2008. On June 10, 2008, $65,064 was returned to the traditional IRA. Wife withdrew $65,064 from her IRA on July 31, 2008. On August 4, within 60 days of the husband's June 6 withdrawal, the $65,064 was redeposited in the rollover IRA. Wife made a partial redeposit of $40,000 to her IRA on September 30. The couple treated all of these transactions as nontaxable rollovers, and they reported no taxable IRA distributions.

The plan failed on several fronts, according to the Tax Court. Although the couple assumed that the rollover restrictions apply on a per account basis; instead they apply per taxpayer. The tax code is not ambiguous on the question. So only Husband's first rollover was tax free; the second was not. Wife is entitled to her own rollover, but here the mistake was more prosaic. One might assume that September 30 is within 60 days of July 31, but it is not. In fact, that is the 61st day, so Wife's partial redeposit did not reduce the taxes on her withdrawal either. These were premature distributions, subject to the 10% penalty tax. Failure to report the distributions as taxable led to a significant understatement of tax liability, triggering another 20% penalty. All in all, perhaps the "short-term loan" from the IRA wasn't such a good idea.

Alternate facts. What if a taxpayer wants to consolidate several IRAs into a single account? Does he or she have to spread that consolidation over several years, just moving one account at a time?

No. Account consolidations may be handled as trustee-to-trustee transfers, rather than distributions followed by rollover deposits. If the money is not distributed to the taxpayer, the 60-day rule does not come into play. There is no tax code limit to the number of trustee-to-trustee transfers that a taxpayer may make in a year. ☐