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Trust UPDATE

Stillman BANK

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What you need to know about Social Security

To have a successful, financially secure retirement, one must have enough income to live on. The larger one's Social Security benefit is, the easier it is to meet that need. So it's something of a puzzle that so many individuals are deciding to take their benefits early. A study last year from the Government Accountability Office (GAO) reported that 72.8% of retirees begin their benefits before reaching normal retirement age.

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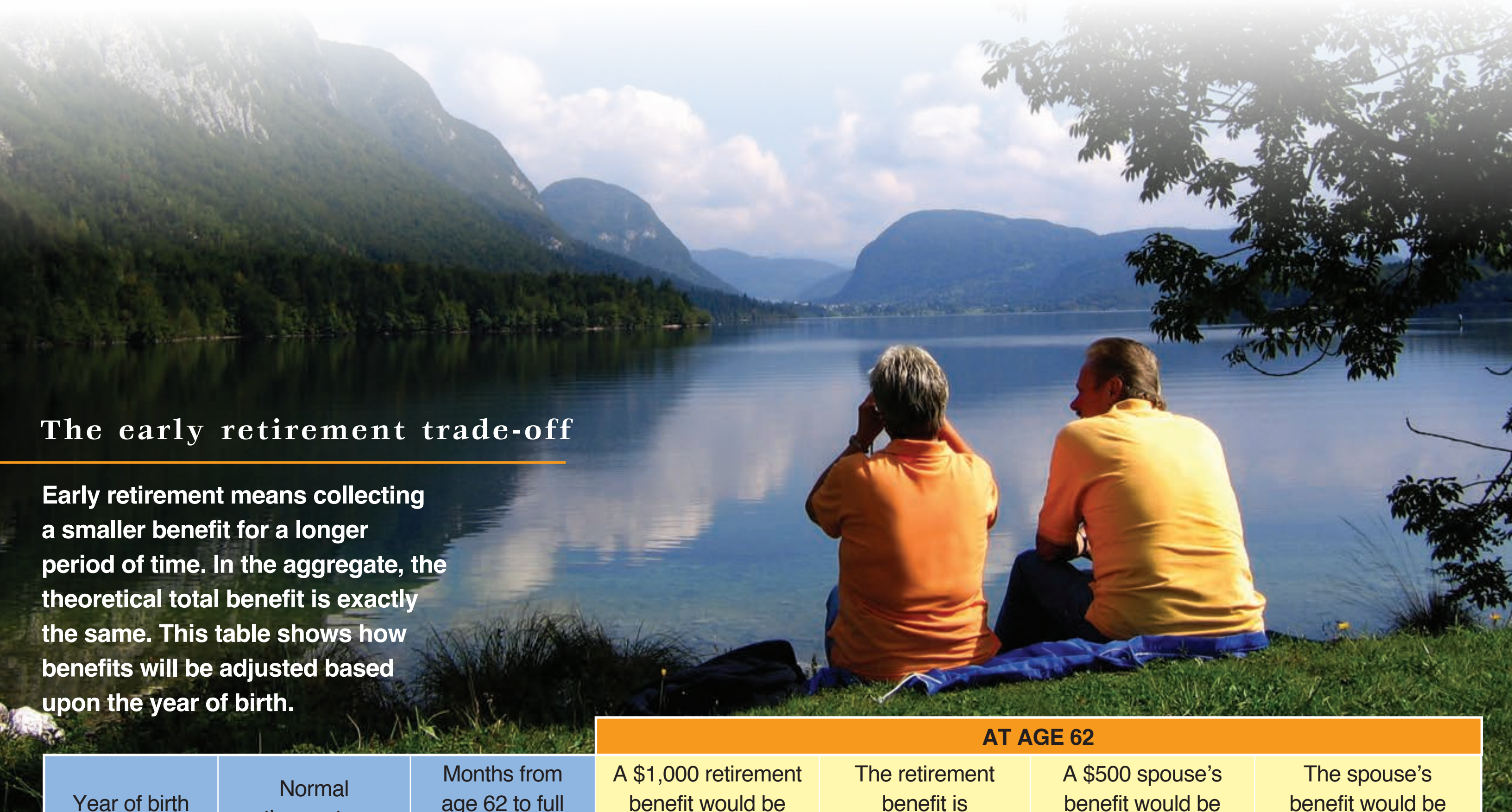

The early retirement trade-off

Early retirement means collecting a smaller benefit for a longer period of time. In the aggregate, the theoretical total benefit is exactly the same. This table shows how benefits will be adjusted based upon the year of birth.

			AT AGE 62			
Year of birth	Normal retirement age	Months from age 62 to full retirement age	A $1,000 retirement benefit would be reduced to	The retirement benefit is reduced by	A $500 spouse's benefit would be reduced to	The spouse's benefit would be reduced by
1943-1954	66	48	$750	25.00%	$350	30.00%
1955	66 and 2 months	50	$741	25.83%	$345	30.83%
1956	66 and 4 months	52	$733	26.67%	$341	31.67%
1957	66 and 6 months	54	$725	27.50%	$337	32.50%
1958	66 and 8 months	56	$716	28.33%	$333	33.33%
1959	66 and 10 months	58	$708	29.17%	$329	34.17%
1960 and later	67	60	$700	30.00%	$325	35.00%

Source: Social Security Administration; M.A. Co.

Early benefits are lower benefits. The table on page one shows just how much benefits will be reduced, based upon the year of one's birth. Note that the spousal benefit also will be reduced, creating the potential of financial insecurity for the widow or widower.

For those in their early 60s this year, normal retirement with full benefits may begin at age 66. Retiring at age 62 triggers a 25% cut in benefits. Looked at another way, one can boost one's Social Security benefit by fully one-third by waiting until age 66 to begin drawing it. What's more, if one continues working from age 62 to age 66, the additional earnings record and Social Security taxes paid also will increase the eventual benefit. That larger benefit will be the basis for future inflation adjustments and so can translate into substantially higher lifetime income.

Still, the thought process of someone who is 62 might go something like this. If I don't take my early benefits, how much am I leaving on the table? How many years of collecting "full" benefits will it take to offset the four years of taking no benefits at all? The answer is 12 years. One needs to live to age 78 to "break even" on the decision to wait for the full retirement age. At age 62, that's pretty far off on the horizon. Perhaps the early retirees are not being so irrational after all.

What about the additional credit for delaying retirement to age 70? Once again, how long will you live? The table on the right offers some comparisons of outcomes.

Longevity and your benefits

If you knew the date of your death, choosing the best date to begin Social Security benefits would be easy. Here are sample calculations for an individual who turns 62 in 2012 and has a monthly benefit of $1,800, above-average but below the maximum possible benefit.

Start Social Security at	62	66 (normal retirement age)	70 (maximum benefits)
Initial annual income	$16,200	$21,600	$29,387
Total benefits by age 70	$129,600	$86,400	$0
Total benefits by age 80	$291,600	$302,400	$293,870
Total benefits by age 90	$453,600	$518,400	$587,740
	Best strategy if you die at 70	Best strategy if you die at 80	Best strategy if you die at 90

Additional earning credits and inflation not taken into account.
Source: M.A. Co.

Another perspective

Some people are under the impression that Social Security is not a good investment. On the contrary. The GAO study referred to above offered an interesting illustration.

Imagine that Don's annual benefit at normal retirement age would be $16,000 per year, and he chooses to begin an early benefit of $12,000 per year at age 62. When he reaches age 66, Don realizes that he really will need $16,000 per year after all. To achieve that, he buys a single-life annuity of $4,000 per year. Could he buy that with the $48,000 in early benefits he's collected? No, he could not, not even close. According to the study, the commercial cost of an inflation-adjusted, single-life $4,000 annuity for a male would be $71,000 (higher for females, who have longer life expectancies).

As a group, retirees are living longer and longer. Most people will live to "break even" on a decision to delay their retirement.

Planning for couples

When a husband and wife each have earnings records, the choices are more complicated, and more important to understand. Each partner has a basic benefit plus a spousal benefit, but may collect only the larger benefit. However, one may begin collecting a spousal benefit and then switch to one's own benefit later, allowing that benefit to grow to its full value or more.

Another strategy is to "file and suspend." For example, a husband might file for his benefits at age 66, but suspend them, allowing the benefit to grow until he reaches age 70. Meanwhile, the wife can go right ahead and collect the spousal benefit based upon the husband's benefit at age 66.

How we can help you

We've worked with a broad spectrum of business owners, executives and professionals to solve the problems—and maximize the opportunities—associated with stepping onto the retirement road. Our experience is yours to draw on. Whether you're retiring early, retiring late or regrouping to start a new career, we stand ready to propose realistic strategies, geared to your personal requirements.

To learn more, make an appointment with one of our asset-management specialists. ☐

Can an investment be biased?

Luther Carter's revocable living trust served as his main estate planning document as well. At his death, the living trust divided into a Marital Trust, a Generation-skipping Separate Trust and a Family Trust. The Marital Trust was of the QTIP variety (Qualified Terminable Interest Property). That means that Luther's widow, Audrey, must be paid all of the income from the trust so long as she lives, while his daughter from an earlier marriage, Tiffany, will receive the trust assets when Audrey dies. No part of the Marital Trust principal may be distributed to Audrey. The Marital Trust was funded with $2 million. The GST and Family Trusts for Tiffany and her descendants each received $1 million.

Audrey was named the trustee of the Marital Trust in 2003, and in that capacity she invested solely in tax-free municipal bonds. That investment approach can be a good one for generating income, but it does nothing to grow the value of the trust. Also, limiting the investments to bonds is not very well diversified.

Tiffany brought a lawsuit alleging that Audrey breached her fiduciary duties with this investment plan. A trustee has a duty to impartially balance the interests of all the beneficiaries, and that balance extends to investment choices. For example, an investment plan that takes excess risks with the trust principal in an attempt to increase current income could run afoul of the rule. On the flip side, a plan to invest only in growth stocks that pay no dividends, to maximize the remainder interest at the expense of the income beneficiary, could similarly be unacceptable.

Tiffany claimed that as a result of Audrey's self-interested investment decisions, the trust was, in inflation-adjusted terms, already worth $300,000 less than when it was funded. What's more, she argued that investing in a single type of asset violated the "prudent investor" rule that applies to trust investing. She asked that Audrey be removed as trustee.

Boilerplate

To resolve this question, the Court needed to determine Luther's intention for creating the Marital Trust, determined in the context of the entire estate plan. A look at the fine print of the trust document was helpful. The trust authorized bond investments, as well as others, "regardless of diversification." That clause lessened the concern over investing in just one asset class. The primary purpose of the Marital Trust was to create a secure income stream for Audrey, while the other trusts provided for Tiffany.

Audrey testified that she believed the municipal bond investments were a conservative approach to delivering consistent income during a period of significant volatility in the financial markets. She said that she monitored the investment choices and discussed them with her broker, her sons and her friends. Someday she might shift some trust investments to stocks, if there are adverse changes to the bond market.

The Court concluded that even if inflation takes a toll on the real value of the Marital Trust assets, that is consistent with Luther's intent of providing financial security for Audrey for her lifetime.

Professional trusteeship

Luther's trust did well by not limiting the trustee's choices for investment management. However, naming a family member as trustee is an invitation to argument. Worse, it can lead to litigation within the family, as it did here. That means one party will win; the other will lose; lawyers will be paid; and family harmony goes out the window.

The better course, we would suggest, is to name a professional trustee, such as us. Providing fiduciary services to affluent families is our business, our only business. We are impartial and, as important, we are perceived as impartial by trust beneficiaries. Call on us to learn more. ☐

Top taxpayer errors

The IRS in August released counts on the various correction notices that it sent to taxpayers through May 31, 2012 (for the 2011 tax year). The report separates corrections for paper returns from those for e-filings, and it also breaks out the corrections for paid preparers. There is surprising variability among these groups.

Top errors, individual filers

Form 1040EZ. For paper filers, the top error was "The amount of tax entered was incorrect based on your taxable income and filing status." In other words, arithmetic. For e-filers, "We have calculated the amount of the repayment installment for the First-Time Homebuyer Credit that is due and added it to your total tax." An oversight, no doubt.

Form 1040A. Paper filers, "We changed the amount of taxable social security benefits because there was an error in the taxable amount." E-filers, "The amount of tax entered was incorrect based on your taxable income and filing status."

Form 1040. The category for paper filers had by far the largest number of errors. The top error was the same as for Form 1040A, a mistake in the amount of taxable social security benefits. For e-filers, "We changed the amount of business income or loss because there was an error on Schedule C.C-EZ."

Top errors, paid preparers

Form 1040EZ, 1040A and 1040. Paper filers, "Based on information provided on your return we have determined you are eligible to claim the Making Work Pay and Government Retiree Credit and have computed the credit for you." One might have thought that individuals would have been more likely to make this mistake than paid preparers. But the paid preparers are better at arithmetic. (To be fair, the total number of errors by paid preparers was low.)

Form 1040. E-filers, "We changed the amount claimed as tax you paid on your Schedule A because it was figured incorrectly."

Most welcome error report. "We changed the amount of tax. The tax rates on qualified dividends and capital gains are generally lower than the standard rates." ☐