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Trust UPDATE

Stillman BANK

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Questions we are asked about trusts

Trusts for the management of wealth have a long and storied history. At one time they were the strategy of choice for the rich—and they still are! But you don't need to have megawealth to benefit from a trust-based wealth management plan. Thanks in part to advances in technology, trust benefits are available and affordable for the families called by marketers the "mass affluent."

Here are questions that we hear frequently, and our answers.

What can a trust do for me and my family?

Trusts provide a structure for family financial protection; they deliver financial resources to multiple beneficiaries over a span of time. See page two for a listing of some of the uses of trusts.

Are trusts different from other investment accounts?

Trusts have much in common with ordinary investment accounts, but 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.

What is "fiduciary duty"?

This question comes up because the Department of Labor has proposed that the duty of care that financial advisors owe to their clients with retirement accounts should be changed. The highest such level is "fiduciary duty," and it is the level that *always* has applied to the trust industry. In a nutshell, to fulfill our fiduciary duty to our clients, we must put their interests ahead of our own.

We are very comfortable working within the legal strictures set by fiduciary duty, given our daily experience of it.

How much income does a trust generate?

Using a trust doesn't necessarily change the amount of income that a portfolio generates. In a traditional trust, "income" means collected interest and dividend payments. With that approach, as interest rates and dividend yields rise and fall, income changes with them. Changes in asset values—growth in stock prices, for example—accrue to the remainder beneficiaries.

Some trusts today take alternative approaches, defining income as a percentage of trust assets, or as a fixed dollar amount every year, or as a dollar amount adjusted

for inflation—there are many alternatives to consider. However, if a fixed percentage is used to determine distributions, and the income falls short, the trustee will have to invade the principal to make up the difference.

Are trust assets secure?

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. The bank has no access to its trust assets. It 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.

Each trust in our care is managed in accordance with an investment plan matched to the desires of the trust's creator and the needs of the beneficiaries. The trust managers use a disciplined process of diversification, sometimes called *asset allocation planning*, to balance investment risks and rewards.

Does that mean that the value of trust assets can't go down? No, it does not. Trusts are subject to the same market forces as any other investment account. There's no point in sugarcoating it—when the bottom falls out of the market, it falls out for everyone.

How old should you be to set up a trust?

There is no "best age" for setting up a trust. Many young entrepreneurs have used trusts for their wealth management once they achieve early success. 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.

What is probate? Should I want to avoid it?

Probate is the court-supervised implementation of a person's last will and testament, and it is necessarily a public process. The process takes time, at a moment when family members may be financially vulnerable.

To avoid publicity, many wealthy families rely extensively upon trusts, which are not normally made public. Trust administration and distributions typically will continue throughout the probate process, without the need to consult the probate court.

We generally recommend using a revocable living trust with a corporate trustee, such as us, when probate avoidance is an important objective.

Can I be my own trustee?

Yes, you can be the trustee of your trust, or you can have a trusted family member be the trustee. But that's not a course we would recommend. Some very important reasons to let us be trustee of your trust are:

- To gain access to professional management of your assets.
- To have someone available to stand in your financial shoes should illness or incapacity strike.
- To provide financial support for your loved ones during your lifetime and beyond.
- To put all the chores of trust administration into experienced hands.

Can I change my mind about my trust, or is it permanent?

Many people begin with a revocable trust, which can be amended or terminated at any time. That way they can give the trust idea a "tryout" to see how they like it.

How can I learn more about trusts?

Make an appointment to meet with one of our trust professionals at your earliest convenience. We will be pleased to tell you more. ☐

Trust advantages—A checklist

No single trust can do everything, but for almost any imaginable need, there is a matched trust solution. How many of these objectives do you have?

- ☐ Continuous financial management in the event of incapacity
- ☐ Professional investment management
- ☐ Financial privacy
- ☐ Probate avoidance
- ☐ Asset management for inheritances
- ☐ Creditor protection for heirs
- ☐ Lifetime financial protection for a surviving spouse
- ☐ Inheritance for children from an earlier marriage
- ☐ Protection from current and future estate taxes
- ☐ Lifetime protection for a disabled child
- ☐ Future legacy for charity
- ☐ Current income for charity, keeping assets in the family at lower cost
- ☐ Providing financial support for a special needs person

Gifting hurdles

Donating art to a museum is not as simple as one might think.

"Even for Philanthropists, Museums Can Make Art a Tough Give," reported *The New York Times* in August. Museums are becoming more and more careful about what they are willing to accept. Provenance and authenticity always have been important, but now so is the "fit" with the rest of the museum's collection. Unless a proposed donation "fills a hole" or is very highly valued, the giver can expect some resistance.

That pushback may be in the form of a request for funds to accompany the donations, so as to cover storage costs for pieces that are not on regular display. Storage costs can run to thousands of dollars per year. If the requested donation seems high, the collector may want to consider donating to a smaller, regional museum where his or her gift may have more prominence.

Once a museum has accepted a donation, there is the matter of the tax deduction. The value of the gift will have to be documented with an appraisal by qualified professionals. For items worth more than $50,000, the value may be checked by the IRS' Art Advisory Panel, which consists of 25 experts in the field who serve without compensation. The Panel's purpose is to ensure accuracy, not to knock down the value of claimed deductions. In fact, in fiscal 2015 (most recent report) the Panel recommended increasing the value of the deduction for 44% of the pieces that it examined, and decreasing it for only 21%. Overall, the Panel increased the total deductions allowed to taxpayers by more than $114 million that year.

If a museum has accepted a work of art in furtherance of its public purpose, the value of the piece may be challenged but there is no question that a tax deduction is allowed. That's not how it works in Canada.

Annie Leibovitz

Renowned photographer Annie Leibovitz began her career with *Rolling Stone* magazine in 1973. Her portraits for that magazine, *Vanity Fair*, *Vogue*, and others, have become cultural icons. However, Leibovitz' prodigious talent did not, apparently, extend to financial management.

In 2013 Leibovitz sold 2,070 of her photographs to a Canadian citizen, Harley Mintz, for $4.75 million. Mintz intended all along to donate the collection to the Art Gallery of Nova Scotia in Halifax. He reported that Leibovitz wanted this collection to go to a smaller museum, where it would have a greater impact. The collection includes images of The Blues Brothers—John Belushi and Dan Ackroyd—with their faces painted blue—as well as the *Rolling Stone* cover of Yoko Ono and John Lennon.

Annie Leibovitz
at her 2008 SF exhibition

Robert Scoble from Half Moon Bay, USA

Appraisals done by experts for the museum valued the collection at $20 million, and that is the tax deduction claimed by Mintz. That figure gave the Canadian taxing authorities pause.

The Canadian Cultural Property Export Review Board must certify donated works as "of outstanding significance and national importance" before any tax deduction is permitted. The rationale seems to be that the government is, in effect, buying the work for the public by granting the tax deduction. The Board also establishes the price that the government is willing to pay.

To date, after four examinations, the board has approved tax deductible status for only 762 photos, at a value of only $1.6 million.

Breaking down the values per photograph, Mintz paid $2,295 per item, and he claimed a value of $9,662 each. The tax men conceded a value of $2,100 for those photographs that had national significance.

Why would Leibovitz sell her photographs at a 75% discount? Because selling a large amount of art from one artist in a short time frame often does depress values, the market can absorb only so much at a time.

However, Leibovitz has received only half of her payment. The sales contract included a contingency. The rest of the money is not payable until the government agrees that the entire collection gets favorable tax treatment. ☐

Time and taxes

As a general rule, the IRS has three years after a tax return is filed in which to assess a deficiency. This is so even if no taxes are payable, rendering the return only informational. However, there is no time limit for assessing a deficiency if a tax return hasn't been filed.

In 2002 two corporations merged, Old Capital and New Capital, with New Capital surviving. The transaction was intended to be a tax-free reorganization. Old Capital did not file a tax return for 2002, but all of Old Capital's income was reported to the IRS on New Capital's return for that year, because it was the surviving company. A notation was included on New Capital's return indicating that it was the "final return" for Old Capital.

In 2012 the IRS concluded that the transaction did not qualify as a tax-free reorganization and assessed a deficiency. The Service argued that the three-year rule did not apply because Old Capital hadn't filed a return for 2002.

The Tax Court rejected the argument. Even if the wrong Form was used to report the income, the IRS had sufficient notice to begin the running of the three-year limit.

Compare the result in an estate tax context. Frank died in 2012. His estate elected the deceased spousal unused exclusion (DSUE), in an amount of $1.2 million. An estate tax return was filed showing no estate tax due, and the IRS sent a closing letter to the estate.

Frank's surviving spouse, Minnie, died in 2013. Even with the additional exclusion, her estate was large enough to trigger a federal estate tax of over $700,000. Minnie's estate tax return was selected for audit. She and Frank had made taxable gifts of nearly $1 million about ten years before they died. The gifts had been reported properly on gift tax returns when they were made, but apparently the taxable gifts were not handled properly on the estate tax returns. More than three years after Frank's death, the IRS took another look at his estate tax return, and it determined that the DSUE should have been much lower, by about $1 million. That didn't change the estate tax for Frank's estate, but it did boost taxes for Minnie's estate, to the tune of another $788,165.

Before the Tax Court, Minnie's estate argued that the IRS was barred from reexamining Frank's estate tax return, either because of the three-year rule or because a closing letter had been issued. Neither reason is applicable in this case, the Tax Court held. The section of the tax code that grants the taxpayer's right to claim an unused exclusion amount also explicitly gives the IRS the power to re-examine the facts giving rise to the exclusion without regard to any time limits whatsoever. The estate tax deficiency was upheld.

The advent of the DSUE has been a boon to married couples in their estate planning, as they can double the amount of the federal exclusion without resorting to multiple trusts. However, the lack of finality over the value of the DSUE is a lingering problem that deserves legislative attention. ☐