IN THIS ISSUE

**Trust planning**

Complete your financial management with a living trust

Which account is right for you?

**Tax currents**

Q&A on gift taxes

Not-so-innocent spouse

Absent children

# Trust UPDATE

Stillman BANK

August 2018

# Complete your financial management with a living trust

***How can you address your asset management and family protection needs? Look at the benefits of a revocable living trust.***

Celebrated author and journalist Tom Wolfe died in May at the age of 88. He wrote *The Electric Kool-Aid Acid Test* and *The Bonfire of the Vanities*, among many other notable works. Wolfe was survived by a wife and two children. His Will left his tangible personal property to his wife, and his residuary estate to a revocable living trust. The wife was named executor, and successor executors were also identified.

That is all we know about the Wolfe estate, and all we are likely to know. The revocable trust can do many things, and one of the most important—especially for celebrities—is to provide a zone of financial privacy.

### Trust advantage

For generations affluent men and women have turned to trust institutions such as ours for professional asset management. They come to us for investment guidance that is prudent, personalized, and firmly oriented toward long-term performance, not speculation.

These days more and more clients are establishing their accounts as revocable living trusts. In these accounts we act as trustee, guided by instructions contained in the living trust agreement. The popularity of trusts is rooted in the fact that they are just as flexible as financial agency accounts, while they offer major financial planning advantages.

Ask yourself this: Do you need an assistant, one who can take the drudgery out of investment management and faithfully execute your instructions? Or would you prefer a partner, one who is ready to shoulder responsibility for your financial management whenever necessary?

### You retain control

The popular image of trusts is that they "tie up" assets, and, in truth, sometimes trusts are used for just that purpose. For example, "spendthrift trusts" can be used to provide a measure of long-term financial support for debt-addicted heirs. Or a trust may be

*Continued on next page*

used to protect and manage the inheritance of a minor child. Or a trust can be used to divide property interests between private and charitable beneficiaries. There are countless comparable examples of the wealth-preservation uses of trusts.

But as the creator of the trust, there is no purpose in imposing limits upon ***yourself***. You retain the power to cancel the trust, to amend the terms of the trust, or to add or withdraw assets from the trust. In short, you're in full control, just as you would be if we were acting as your investment agent instead of as your trustee.

### Freedom from worry

With an agency account, you continue to own your securities as before. With a revocable trust, your ownership undergoes a subtle change. You and others you name in the trust agreement retain beneficial ownership of the assets while the trust that you control (thanks to your power to amend or revoke) holds legal title. Thus, despite its flexibility, the trust exists as an independent legal entity in the eyes of the courts. It is this status, as an independent entity, that creates additional, powerful planning opportunities.

For example, what happens should a sudden, serious illness prevent you from supervising your finances? Or worse? You become legally incapacitated? Or not nearly so bad, you simply choose to spend six months abroad?

In situations such as these the living trust differentiates itself from ordinary investment accounts. Traditionally, agency accounts must end if the owner of the account becomes incapacitated. A trust, on the other hand, may continue for the benefit of the creator, even though that person is no longer able to act on his or her own behalf.

Many of our clients take advantage of this planning opportunity by authorizing us, in their trust agreements, to provide full personal financial management in the event of their incapacity. That means we'll be able to pay household bills, take care of taxes and, if need be, even arrange for housekeeping help or home health care services. Or we may begin to fulfill these duties in advance of the trust creator's incapacity. The trust may spell out the circumstances, or the trust's creator may simply ask us to take over full financial management responsibilities.

### An estate planning dimension

An agency account must end at your death, and the assets become part of your probate estate, to be distributed under the terms of your will. The terms of every will become public in the probate process. A trust, by contrast, usually avoids probate. Hence, the privacy afforded to the Wolfe estate. In the trust agreement drawn by your attorney, you may instruct that all or some of the trust assets be distributed directly to the beneficiaries that you name. Or you may have the trust continue as a source of income and support for one or more beneficiaries—your spouse or child, for example.

Revocable trusts do ***not*** save estate taxes, and most families will not need to be concerned about federal estate taxes for the next few years. Because you retain the power to amend or revoke the trust, the full value of trust assets will be included in your estate. However, the trust can be integrated into your estate plan to further tax-saving objectives, as well as provide a disposition plan that might otherwise be included in a will.

***A final note.*** Probate may be quick and easy, or it may not be. The validity of a will may be challenged, or it may not be. Living trusts remove some of this uncertainty because they can provide for distributions to beneficiaries immediately following your death. What's more, when a trust has been in operation during your lifetime with your approval, a legal challenge to your testamentary plans is much more difficult to maintain.

### Do you need more information?

Simple, nontrusteed accounts continue to meet the needs of many of our clients. Whether a trust is a better choice for you depends upon your own goals and circumstances. For more information on how trust services can help you and your family, arrange for a conversation with one of our trust and investment officers. ☐

## Which account is right for you?

When the core advantages of ordinary investment management accounts and revocable living trusts are compared, the trust option looks very compelling.

| Feature | Investment management account | Living trust |
|---|---|---|
| Professional guidance in setting investment goals | X | X |
| Development of an asset allocation strategy | X | X |
| Continuing investment supervision | X | X |
| Regular statements | X | X |
| Personal financial management in the event of incapacity | | X |
| At client's death, assets may pass directly to beneficiaries, avoiding probate | | X |
| Account may be structured to survive client for longer-term support of named beneficiaries | | X |
| Opportunity for married couples to minimize estate taxes, keeping more wealth in the family | | X |

Source: Merrill Anderson Company

© 2018 M.A. Co. All rights reserved.

# on gift taxes

**Q.** ***With the federal estate tax exemption over $10 million per person (over $20 million for married couples), I no longer am concerned about that tax. Do I still need to worry about the gift tax?***

**A.** Yes, you do. You are not likely to ever owe federal gift tax, but you are required to file a gift tax return for any year in which you give someone more than $15,000. That's the "annual gift tax exclusion," and it is available each year. If you gave your child $10,000 per year for ten years, no gift tax return would be needed. But if you gave $20,000 in a single year, then a gift tax return would be required.

**Q.** ***How much gift tax would I owe on that $20,000 gift?***

**A.** None, most likely. The excess amount, $5,000, would reduce the amount of your eventual federal estate tax exemption. Nevertheless, the gift tax return must be filed.

**Q.** ***I have three children, so am I limited to $5,000 for each of them?***

**A.** No, the $15,000 is per person.

Say an individual has three children, four grandchildren, and three great-grandchildren. Gifts of $15,000 per year may be given to all ten descendants, removing $150,000 from the taxable estate.

**Q.** ***I paid my child's college tuition this year, over $30,000. So do I have to file a gift tax return on that?***

**A.** No, you don't. Paying someone's tuition directly does not count as a taxable gift, no matter the amount of the payment. However, giving the child the cash to make the tuition payment would be a taxable gift.

**Q.** ***Any other exceptions like that?***

**A.** Direct payment of medical expenses is also not a taxable gift.

Imagine that Mary paid $10,000 directly to health care providers on behalf of her son John this year. She also gave him $12,000 in cash to help him with his household expense. Mary made direct tuition payments for each of her three grandchildren, totaling $90,000. Finally, she gave each grandchild $10,000 cash for "spending money."

Mary has given away $142,000 worth of her wealth to family members, but with this combination of exceptions, she won't have to file a gift tax return.

**Q.** ***What about state gift taxes?***

**A.** Unless you live in Connecticut, you no longer have to worry about gift taxes—all the other states have repealed their gift taxes.

**Q.** ***I'm married. I want to give my son $25,000. Should I just give him $15,000, and have my husband write a check for the other $10,000?***

**A.** That would be the simplest, when the gift is of cash. But what if the gift is a block of stock worth $25,000? In that case, you and your husband may "split" the gift to apply both of your annual exclusions to the transfer. You have to file a gift tax return reporting the transfer to obtain split gift treatment, but it won't affect your eventual federal estate tax exemption.

**Q.** ***I have some stocks that I bought for $5,000 years ago. I can make a gift of that without filing a gift tax return, right?***

**A.** No, your tax basis does not come into play on this question. What matters is the fair market value of the shares today. Are they worth less than $15,000? Then no tax return is needed. But if the market price is $15,001 or more, a gift tax return will be required.

**Q.** ***Why do all this paperwork when I am almost certainly never going to have to pay a gift tax?***

**A.** You'd have to ask your Congressman about that. That phrase "almost certainly" holds the key to answering your question.

What happens if you win the PowerBall, and are suddenly worth $100 million? Then you almost certainly will be paying estate and gift taxes, and the prior gift tax filings will come into play.

There is another possibility. The current large estate tax exemption is set to expire after 2025. That would bring the exemption down to $5 million (plus inflation adjustments). There has long been support in the Democratic party for reducing that exemption to $3.5 million, and perhaps dropping the inflation adjustments, which are a fairly new phenomenon.

Keep in mind also that just 15 years ago, the federal estate and gift tax exemption was only $1 million. You might not be off the hook, after all. ☐

## Not-so-innocent spouse

Phil handled the tax filings in the Coggin household. He did not handle them very well. In 2009 he filed joint tax returns for himself and his wife, Alice, for the years from 2002 through 2007. Phil did not obtain Alice's signature on the returns, preferring simply to forge it instead.

The IRS then sent notices of deficiency for the late filing penalties and interest. Phil died in 2011. Alice has now submitted her own tax returns for the years in question, filing as married filing separately. With these filings she expects to obtain a refund, despite their tardiness, because the income taxes for her part-time work did not amount to much.

A refund will not be available, the Tax Court has ruled. Even though all parties admit that Alice's signature was forged on the joint returns, the facts suggest that Alice intended them to be her tax returns. She never filed separately on her part-time income during the years in question, and delegated the tax preparations to her husband. What's more, the "innocent spouse" relief that is available under the tax code in cases of fraud never has been held to permit a refund of taxes paid.

A trial will go forward on the interest and penalties for the years of late filings. In a footnote, the Tax Court notes that the innocent spouse doctrine may yet come into play in this case.

## Absent children

On their 2015 Form 1040A, Miguel and Elizabeth claimed a $5,360 earned income tax credit, a $103 child credit, and a $1,897 additional child credit. There was just one problem. The couple's parental rights had been terminated in January 2015. Their children lived with an aunt throughout 2015, and the aunt adopted them in September 2015. Although the couple visited the children from time to time, the kids were the dependents of the aunt, not Miguel and Elizabeth.

Accordingly, Miguel and Elizabeth were not entitled to the claimed tax credits, and they had to pay them back to the IRS. What's more, the Tax Court also sustained a $1,650 accuracy-related penalty. Miguel and Elizabeth may have some trouble getting square with the IRS, given that their 2015 joint wage income was only $24,532. ☐

## *Quotable*

Taxation without comprehension is as inimical to democracy as taxation without representation.

*—Lawrence A. Zelenak*

**Thoughtful trust planning can provide your heirs with a lifetime of financial security.**

**Ask us for details.**

**David Bogner**
Vice President & Trust Officer
(815) 332-8864
davidb@stillmanbank.com

**Jeffrey Hartle**
Senior Vice President
(815) 332-8843
jeffh@stillmanbank.com

**Keith Akre, CFA, CFP®**
Trust Officer
(815) 332-8861
keitha@stillmanbank.com

**Stillman BANK**

Trust & Asset Management
8492 E. State Street • Rockford, IL 61108
815-332-8100
www.stillmanbank.com