TRUST ARTICLES

Country Club Trust COMPANY

Ask a Trust Officer –Qtip Trusts

DEAR TRUST OFFICER:

I'm financially secure, and have married for a third time. Lately my kids (from the first two marriages) have been asking about their inheritances. They seem to be concerned that my spouse—or perhaps a future spouse—might freeze them out. How might I allay their concerns?

—THIRD TIME'S THE CHARM

DEAR THIRD:

In situations such as yours, we recommend looking into the Qualified Terminable Interest Property Trust, or more commonly, QTIP Trust. The trust is "qualified" for the marital deduction from the federal estate tax, provided the surviving spouse is a U.S. citizen.

The trust is "terminable" because it ends at the spouse's death, and the spouse typically doesn't have the right to change who gets the property at that point. In short, the inheritance for your children would be secure.

Another benefit of the QTIP trust is that the executor can elect a full or partial marital deduction, depending upon what's best for tax purposes. That flexibility is especially welcome during these volatile times when asset values can change suddenly, and the amount exempt from federal estate tax is scheduled to drop in 2026.

Do you have a question concerning wealth management or trusts? Send your inquiry to trust@countryclubtrust.com

Retirement Checks Should be Cashed Promptly

An employee was due a $900 distribution from his employer's qualified plan. The plan withheld income taxes and sent the employee a check for the balance. The distribution must be included in taxable income for the year in which the check was cut. For unknown reasons, the employee never cashed that check, nor did he attempt to roll the distribution into an IRA.

Failure to cash the check during the tax year that the distribution occurs does not avoid any income tax, the IRS holds in a new Revenue Ruling [2019-19]. The tax result would be the same if the employee kept the check, sent it back, destroyed it, or cashed it in a subsequent year. Nor does the employee's action change the employer of withholding or reporting responsibilities.

Receiving a distribution from a qualified retirement plan is not routine for most people, which is why they may be unfamiliar with the tax rules for such situations. If you are uncertain about the best way to handle your distributions, seek the advice of a qualified tax professional.

Six Predictors of Happiness in Retirement

A study of adult development has been carried out at Harvard for roughly the last century. Three groups have been tracked: 268 Harvard graduates born about 1920; 90 middle-class gifted women born about 1910; and 456 social disadvantaged men from inner cities born about 1930. Some of the results of the study were reported in Business Insider [https://www.businessinsider.com/things-that-make-people-live-longer-happier-lives-2018-8].

Data on these three groups were collected throughout their lives. As they reached their 70s, the retirees were classified as "Happy-Well," "Sad-Sick," or "Prematurely Dead." What life events made a person more likely to fall into one category or the other? What did those in the "Happy-Well" have in common?

No smoking or drinking. Heavy smokers were ten times more likely to be prematurely dead, where "heavy" means three packs of cigarettes a day. However, the effects on health could still be discerned among pack-a-day smokers even if they quit by age 45. Drinking was found to create stress in one's life, rather then relieving it.

More education. Some of the inner city men went on to college, despite their disadvantages. Interestingly, their health at age 70 was roughly the same as the Harvard grads. Those who did not pursue their education aged prematurely; their health at age 70 was similar to the Harvard grads at age 80.

A happy childhood. Whether a mother made a child feel loved was a better predictor than class of achieving a high income. Having a strong, stable father figure (in contrast to an impoverished father) tended to inoculate men to future pain.

Strong relationships. Some of the men and women who started out with wealth and talent nevertheless were not doing well in their 70s. Those who succeeded often had greater emotional intelligence, an aptitude for building and maintaining the relationships in their lives.

Coping skills. Having mature responses to life's challenges was found to be common among the "Happy-Well" and almost absent among the "Sad-Sick." Among the mature responses are altruism, suppression (turning lemons into lemonade), and humor (not taking oneself too seriously). Poorer outcomes came from being passive-aggressive, living in denial, acting out, and retreating into fantasy.

Generativity. Giving back to the community enriches the giver as much as it enriches the community. From the study:

"Among all three samples generative men and women at 50 were three to six times as likely to be among the Happy-Well in old age as among the Sad-Sick ... In all three Study cohorts mastery of Generativity tripled the chances that the decade of the 70s would be for these men and women a time of joy and not of despair."

All of these observations seem unremarkable, intuitively clear, but it's nice to have the science behind them.

When the Future Takes a Turn

One of the major issues for keeping wealth in the family has long been the federal estate and gift tax. The tax rate today is 40%, but historically has been as high as 70%. The exemption amounts were far lower in the past than they are today. To gain control over this tax exposure, some families have created irrevocable trusts for the younger generation. Funding such a trust will trigger federal gift tax exposure, but it freezes the value of family wealth for these tax purposes. Subsequent asset appreciation may pass to beneficiaries without additional transfer taxes.

If an irrevocable trust has been established, there is another strategy to be considered. The trust may be designed so that the grantor of the trust remains responsible for the trust's income taxes. Why do this? Because the IRS has held that even though the payment of the trust's income tax obligation will enrich the trust beneficiaries, it will not be a taxable gift to them. In effect, millions more may be transferred to beneficiaries tax free.

This strategy appealed to Norman Millstein. He created two irrevocable trusts for his children, the Kevan Millstein trust in 1988 and the Al-Jo trust in 1987. Kevan was the trustee of both trusts. Perhaps to maximize the amount passing to the children free of federal estate and gift taxes, these were designed as grantor trusts, which meant that Norman remained responsible for paying the income taxes associated with them.

All was well until 2010, when Norman's wealth was diminished to the point that he could no longer pay the income taxes. He asked Kevan for reimbursement of the tax payments, which was refused. Kevan did arrange for a modification of the Kevan Millstein trust to relieve his father of future income taxes, but the beneficiaries of the Al-Jo trust were not similarly generous.

Norman filed suit, asking for equitable reimbursement of federal and state income taxes. He had paid over $5.2 million in income taxes for the Kevan trust in 2013, and $1.2 million for the Al-Jo trust in 2013-2015.

The lawsuit was dismissed for failure to state a cause of action upon which relief could be granted. Ohio trust law is clear that such relief is not permitted without the cooperation of the beneficiaries or the trustee. What's more, said the Court, "Even if we were to allow appellant to use equity to circumvent the clear intent of the legislature, it is well established that equity will not aid a volunteer." Norman brought this on himself.

It's important in estate planning to remember that "irrevocable" means "forever." Perhaps in 1987 Norman thought he would never run out of money. But 22 years later he did just that.

Country Club Trust COMPANY

1 Ward Parkway, Kansas City, MO 64112 | www.CountryClubTrust.com