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Investment Management & Trust UPDATE



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The modern living trust

The “peace of mind” strategy for wealth management

One of the most useful and flexible wealth management tools is the revocable living trust. Traditionally, we like to point to three basic benefits that these trusts offer.

Professional asset management. After studying your goals and circumstances, our asset-management specialists will map out a diversified investment program appropriate to your requirements. Like many of our customers, you may authorize us to select specific investments on your behalf, confident that we will carry out this responsibility faithfully. (We have no securities to sell, nor do we receive commissions on purchases and sales. Our annual compensation is limited to the moderate fees that we charge as trustee.) Our objective is not only to add to your financial security, but also to give you more opportunity to enjoy it.

Uninterrupted family financial protection. A living trust agreement can instruct us to perform a wide variety of special tasks when the need arises. These tasks might be as simple as paying a world traveler's quarterly estimated taxes while he or she is out of the country . . . or as complex as handling all household financial matters for a customer who has suffered a stroke and needs a housekeeper and nursing home care.

Many of our clients have found this “future protection” aspect of our services especially attractive. With proper planning, living trusts can do much to avoid the financial management problems that arise during a prolonged period of incapacity—problems that might otherwise have to be



dealt with by a court-appointed conservator.

Probate avoidance. Assets placed in a living trust are said to avoid probate because these assets are removed from your “probate estate”—the estate controlled by your will. Trust assets are distributed to beneficiaries, or held in continuing trust, as you direct in the trust agreement. Thus, using a living trust as the core of an estate plan usually leads to reduced settlement costs.

More importantly, delays are avoided. For example, a married person's living trust can simply keep operating, uninterrupted by estate-settlement procedures, for the benefit of the surviving wife or husband. Living trusts also help to keep estate plans private. Unlike probated wills, provisions for the distribution of assets contained in living trust agreements do not normally go on public record.

New perspectives

But living trusts can do more. Among the emerging benefits that have appealed to many:

Minimizing identity theft. The problem of identity theft has exploded in recent years. A funded revocable trust may have its own tax ID number, rather than using the settlor's Social Security number. In the event that the settlor's Social Security Number is compromised, the trust assets still will be protected.

Protecting aging retirees. More and more retirements are lasting longer than 20 years, and more and more elderly are developing some level of cognitive impairment. A living trust can provide for successor trustees as the beneficiary's abilities decline. Checks and balances can be built into the plan, in the form of co-trustees or trust protectors. A care manager plan might also be

included, to provide annual or quarterly assessments of how the beneficiary is doing.

Serving disabled loved ones. A revocable trust may contain special-needs language to provide for an ill relative or incapacitated adult child. The trust also may provide for successor trustees should a caregiver become incapacitated.

Asset protection in divorce. If gifted or inherited assets are segregated into a trust, they won't be commingled with other marital assets. As such, those assets won't be vulnerable in a subsequent divorce proceeding.

Notwithstanding the decline in estate planning attributable to the increase in the federal exemption from estate taxes, the traditional and emerging benefits associated with revocable living trusts will make them an essential part of late-stage life planning for years to come.

To get started

To set up a living trust with us, you give us your instructions in a trust agreement, prepared by your attorney, and transfer the stocks, bonds, investable cash, or other assets that you wish to place in your trust. Because the trust agreement is revocable, you can cancel the arrangement if ever you find it unsatisfactory. You also remain free to add assets, withdraw assets, or modify the terms of the trust.

Can resourceful management and responsive financial services eliminate all threats to financial security? Not quite. Always there remains an element of luck. But as a wise person has said, you can't just hope to be lucky. You have to *prepare* to be lucky.

We look forward to helping you in your preparations. □

Checklist of living trust benefits

- Professional asset management
- Uninterrupted family financial protection
- Probate avoidance
- Family financial privacy
- Minimizing identity theft
- Protecting aging retirees
 - Serving disabled loved ones
- Asset protection in divorce




Who should be your trustee?

To unleash the power of a living trust as a wealth management tool, you need to select the best trustee for your family. Here are seven good reasons to place your trust in our care.

- 1. Group judgment.** Our trust investment committee monitors the investments in the trusts in our care.
- 2. Reliability.** We understand the special responsibilities of a trustee. All trust funds in our care are safeguarded by both internal and external audits.
- 3. Experience.** Trusteeship is our business.
- 4. Responsiveness.** Financially successful individuals and their families expect personal atten-

tion and responsive service. We deliver.

- 5. Objective investment guidance.** Unlike investment advisors who are compensated mainly by sales commissions, we earn our trustee's fee by providing our trust clients with unbiased, personalized guidance.
- 6. Convenience.** From bill paying to retirement planning, we can provide or obtain just about any convenience or special service that our trust clients desire.
- 7. Neutral arbiter.** When trust provisions permit discretionary invasions of principal in specified circumstances, our neutral judgment in exercising fiduciary powers may help smooth disagreements among beneficiaries.



On the declining importance of estate and gift taxes

Last March the Congressional Joint Committee on Taxation released a summary of the current state of federal taxation [JCX 9-19]. The sources of federal revenue were identified and ranked. As has been true for many years, the federal estate, gift, and generation-skipping transfer taxes were bringing up the rear. One of the arguments for repealing federal estate taxes entirely is that they are inefficient, in that the compliance and enforcement costs are large for a relatively small amount of federal revenue.

The report included appendices that put the various revenue sources into historical context.

The income tax has long been the primary driver, at 45% to 50% of total collections over the years. Despite the tax reductions for many taxpayers in the Tax Cuts and Jobs Act of 2017, 2018 proved to have record personal income tax collections, at \$1.683 trillion, an increase of nearly \$100 billion over 2017. The increase is attributable to the growing economy. The trillion-dollar mark was first breached in 2000, and again in 2006–2008. The recession contracted income tax collections below \$1 trillion for the next two years.

2018 was the first year that personal income taxes provided more than 50% of federal revenue. The share touched 43% in 2004, and it never has

Federal receipts by source,
as a percentage of total revenues

Year	Personal income tax	Social insurance taxes	Corporate income tax
1969	46.7%	20.9%	19.6%
1979	47.0%	30.0%	14.2%
1989	45.0%	36.3%	10.4%
1999	48.1%	33.5%	10.1%
2009	43.5%	42.3%	6.6%
2018	50.6%	35.2%	6.2%

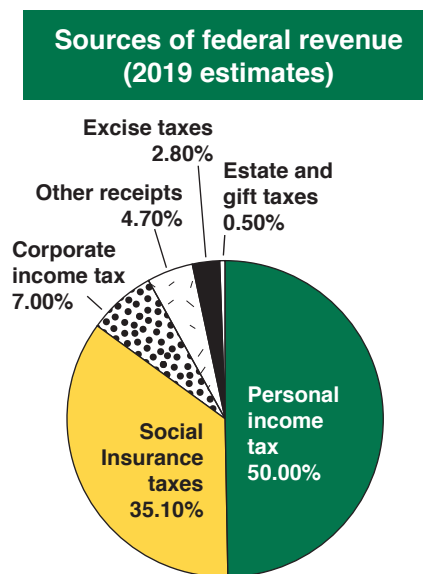
Source: JCX 9-19; M.A. Co.

been below that figure since 1969, the first year of the report.

Social insurance taxes come next, with a record \$1.170 trillion paid in 2018. Social insurance taxes have provided roughly 30% to 35% of total federal revenue. The highest share was 40.0% in 2010, the lowest 20.9% in 1969. In 2018 the share was 35.2%

The share of each of these has been fairly consistent despite the many tax law changes that have occurred over the years. Corporate tax collections have been more volatile, as they are more sensitive to the economy generally. In 2006, for example, corporations paid 14.7% of total federal taxes. This fell by roughly a third, to 9.0% by 2017, the year before the reforms of the Tax Cuts and Jobs Act of 2017. The estimate for 2018 is 6.2%—the same as it was in 1983.

Above is a table of the contribution share of these three taxes to federal revenue for selected years.



Source: JCX 9-19; M.A. Co.

Transfer taxes

In contrast, federal estate and gift taxes provide a scant 0.7% of total federal revenue. Their share was over 2% in 1971–1973, and it has hovered near 1% since 1990. The relative insignificance of estate and gift taxes likely will worsen, as this report covers periods before the doubling of the amount exempt from such taxes.

Shares are one thing; dollars are another. The amount of estate tax revenue collected has been growing, despite the substantial increase in the exemption amount. Some \$22.9 billion in federal estate and gift taxes was estimated to have been collected in 2018. That sounds like a lot. But to put it into perspective, the federal excise tax on gasoline raised \$22.5 billion that year; the excise tax on tobacco brought in \$13.0 billion; and the excise tax on alcohol was worth \$10.6 billion.

The high water mark for transfer tax collections was in 2000, at some \$29 billion. The lowest amount in this report was \$3.4 billion in 1969. Collections fell to \$7.3 billion in 2011, as 2010 was the year when the federal estate tax was optional.

Another way to look at the various taxes is as a percentage of gross domestic product. On this basis, estate taxes were highest in the early 1970s, at 0.3% to 0.4% of GDP. They have not been higher than 0.2% of GDP since 1978, and they were 0.1% in 2018. □

Tax or penalty?

When you owe money to the IRS, does it matter whether it is a tax or a penalty?

That question was put to a bankruptcy court recently. John Chesteen filed for bankruptcy in June 2017. The IRS filed a proof of claim for \$5,100 in taxes owed. The Service later amended the claim to add \$695 in "shared responsibility payment" because Chesteen had failed to have health insurance.

Chesteen objected that the shared responsibility payment was a penalty, not a tax, and as such it was dischargeable in bankruptcy. The relevant provision of the legislation uses the word "penalty" 18 times, and never uses the word "tax." The bankruptcy court agreed with the debtor.

The IRS appealed that decision to a District Court, which has reversed the decision. The Court "looked beyond the labels" to determine that the payment for failure to have health insurance, although intended to spur people to buy such insurance, really functions more as a tax, intended to raise revenue for the government, than as a penalty. "The shared responsibility payment is less than the price of insurance, will be collected through the normal means of taxation, and contains no negative consequences except for a payment to the IRS, which is allowed in the law."

The bottom line for Mr. Chasteen is that the penalty for failing to have health insurance that he couldn't afford because he was on the verge of bankruptcy still will have to be paid after the bankruptcy proceedings are complete.

Note that the shared responsibility payments expired on December 31, 2018.

IRS forgives rollover mistake

Grandfather's family noticed that he was mentally declining in year 1. It may have been the onset of dementia. In year 2, Grandfather withdrew funds from his IRA, apparently intending to roll the money into a new IRA. Because of his medical condition, Grandfather never completed the rollover.

Son was later appointed guardian for Grandfather. Son discovered that not only was the rollover not completed, but Grandfather also never had filed a tax return for year 2! Son promptly filed the return and reported the distribution. Then he asked the IRS for a waiver of the 60-day rule that applies to IRA rollovers, so as to allow the rollover to be completed after Grandfather's death.

In a Private Letter Ruling, the IRS granted the waiver. Events beyond the reasonable control of the taxpayer caused the problem.

The IRS is not always so forgiving of taxpayer errors, but the facts in this unusual case must have been very compelling. □



The "peace of mind" strategy for wealth management

**Ask us about how a living trust might
benefit you and your family.**



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