



# Focus on Trust

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## Practical Trust Plans

### A trust offers professional investment management and financial peace of mind

The two most important long-term financial planning issues for most families are investment management and wealth preservation. No type of asset-management account is better at addressing these issues, or more versatile, than a trust.

That's why people from so many different walks of life have decided to take advantage of our trust services. Some trusts save taxes; others do not, but every trust is individually tailored to meet the requirements of the family that it serves.

To illustrate the personalized nature of our trust services, here are some hypothetical, but typical, examples.

### Lifetime financial management

Ann A. was in her mid-60s and newly widowed when she set up her living trust. She wanted a low-risk investment program and freedom to travel with friends and visit her children, who are scattered around the country. In her living trust agreement, Ann instructed us to provide full personal financial management services if she should become incapacitated by serious illness. Fortunately, that hasn't been necessary. Ann has arranged to simplify her life by having her monthly bills and quarterly estimated taxes paid from her trust.

### Retirement

Brad B. will be retiring next year, and his 401(k) account has grown to "the middle six figures." Fortunately, Brad began shifting out of equities in his 401(k) a few years ago, anticipating his retirement, so the account held up pretty well. He and his wife, Betty, expect to meet most of their retirement expenses through their pensions and their Social Security—the 401(k) money will be their "discretionary fund." To defer income taxes on that fund, Brad asked us about an IRA Rollover. When funds are transferred directly from his 401(k) plan trustee to us as the trustee of the IRA Rollover, there won't be any income tax or withholding tax on the distribution. Brad can control his income tax exposure during retirement by taking as much or as little as he pleases from the IRA Rollover. (He's over 59½.) He'll have to begin a program of periodic withdrawals at age 70½. Until that time, he can let the portfolio grow on a tax-deferred basis.

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## Control Freaks

Duncan Bannatyne is a British multimillionaire businessman and author. He established a trust for his daughters, and each receives the equivalent of \$545 per month from it.

Apparently, Bannatyne is the trustee, and he retains broad discretionary control over the trust. When he discovered that one daughter had begun smoking, he cut off her trust distributions. "She had probably smoked for a couple of weeks when I caught her four years ago. I smelt it in the bedroom and opened her window and saw ash on the windowsill.

"I didn't confront her about it, I just stopped her direct debit. She called me and said her money hadn't come through, and I said, 'I know, I stopped it because you broke the rules of the trust.'"

When the daughter quit smoking after two months, Bannatyne reportedly resumed her monthly stipend from the trust.

Compare that to the last will and testament of a Romanian man who left his surviving wife his house and \$30,000, subject to one condition. She must smoke five cigarettes a day. According to the will, "She could not stand to see me with a cigarette in my mouth [and] I ended up smoking in the bathroom like a schoolboy. My life was hell."

### Wide latitude on trust conditions

The creator of a trust can include any sort of condition for beneficiaries, but some

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## Philanthropy

Carl and Connie C. also were concerned about their retirement income. Their substantial portfolio included highly appreciated stocks that they had held for many years. When we learned that the couple has long been active in a number of charities, we recommended a charitable remainder annuity trust for them. The trust pays them a fixed dollar amount each year, set at 6% of the trust's initial value. They received an income tax deduction when the trust was funded, and they avoided all capital gains taxes on the appreciated securities that they contributed to the trust. After their deaths, the trust assets will be distributed to charitable organizations according to their instructions.

## Portfolio management

Don D. first placed his investable funds in our care because his career left him no time for picking stocks or evaluating bond quality. Don chose to use a living trust for asset management. We developed an asset allocation plan for Don's trust that matched his goals and risk tolerances and then put the plan to work. Don made his life insurance, including the coverage that his employer provided, payable to the trust. Had anything happened to him, our job as trustee would have been to invest the insurance proceeds and manage the augmented trust for the benefit of

Don's wife and children. Today Don's trust has grown into a "living estate plan"—a program that will ensure both Don and his wife a lifetime of financial security as it defers all federal estate taxes until the survivor's death.

## Trust under your will

Eleanor and Edward each had children from earlier marriages when they met. That's why, when they decided to marry, they chose not to mingle their assets. Her property eventually will pass to her children, his to his. To accomplish this while providing financial protection for the surviving spouse, they amended their wills to include a special type of marital trust, the Qualified Terminable Interest Property trust, or QTIP trust. In a nutshell, all income from such a trust must go to the surviving spouse, but the eventual distribution of the trust assets at the spouse's death can't be changed.

## How can we help you?

These brief sketches only scratch the surface of the ways in which trusts help families build and maintain their financial security. Would you like to learn more about how a trust might benefit you and your family? A member of our firm would be glad to help you clarify your goals and options prior to consulting your attorney.

## How flexible trusts adjust to change



- Investment strategy evolves as circumstances dictate. In theory, younger clients want to build wealth, while older clients want to protect and enjoy their money. In practice, most people start with a combination of goals. What's more, the relative weight that they give to those goals changes as new circumstances arise.

- Client involvement with investment decisions is sometimes high for the first year or two, then diminishes as the client gains assurance that we fully understand his or her goals.

- Personalized trust service may be expanded or modified at any time. A client who's out of the country at tax time, for example, might arrange for us to have his or her income tax returns prepared.

- Estate planning adjustments are common, especially for clients in their wealth-building years. As net worth increases, so does the need for estate tax planning. Estate planning adjustments may also be made for nontax reasons, such as changing marital status, needs of beneficiaries or dramatic shifts in asset values. We would be happy to serve as a sounding board prior to your discussion of these matters with your attorney.

# What Women Need to Know About Estate Planning

Because they live longer than men, women are more likely during their lives to have the experience of being an estate beneficiary. They also need estate plans of their own.

## Who needs to have an estate plan?

Everyone who owns property needs to make arrangements for its disposition. Those who fail to take action have delegated their choices to the government, because the law of intestacy will take over for them.

## How is property passed at death?

Property distribution is supervised by a probate court, which is charged with implementing the plan outlined in a decedent's last will and testament. However, property also passes outside the control of the probate court. The example most people think of is life insurance proceeds, as they typically are paid directly to the named beneficiary. Retirement accounts, such as IRAs and 401(k)s, also normally will have a survivor named to receive the balance left when an account owner dies.

Finally, property that is owned jointly will pass automatically to the surviving owner.

## Do married couples need to worry about death taxes?

Many couples do need to plan for death taxes, although some very basic planning will excuse the vast majority of estates from taxation.

In 2009, only estates larger than \$3.5 million are hit by the federal estate tax. The law for 2010 and later years is unsettled as of this writing, but the leading proposal is to freeze that exemption for future years.

For larger estates, everything that passes to a surviving spouse gets the benefit of an unlimited marital deduction from the federal estate tax. (The main exception occurs when the surviving spouse is not a U.S. citizen, in which case the marital deduction is unlimited only for property passing to a Qualified Domestic Trust.) Thus, estate tax can be avoided completely when there is a surviving spouse, no matter how large the estate.

However, the couple probably should give consideration to death taxes when the survivor dies. The exempt amount of \$3.5 million may be doubled, to \$7.0 million, for a married couple with some very basic trust planning.

One more caveat is necessary. Some states have "decoupled" their estate or inheritance taxes from the federal rules—for example, some allow only the first \$1 million to be exempt from death



tax. Planning for married couples in these states is especially complicated, because taking the full marital deduction when the first spouse dies may not be the best approach for long-term protection of the family fortune. See your tax advisor to learn more.

## Is a trust needed to get the marital deduction?

No, the marital deduction is allowed for property that a spouse receives outright, as well as for a marital deduction trust.

## Then why have a trust?

Trusts offer a wide range of benefits, from professional asset management to financial protection in the event of incapacity.

To be qualified for the marital deduction, a trust must pay all of its income to the surviving spouse at least annually. In many cases, the surviving spouse also may control the ultimate disposition of trust assets through provisions in his or her will.

## What is a QTIP trust?

A Qualified Terminable Interest Property (QTIP) trust is a type of marital trust in which the survivor does not control final distribution of trust assets. In a second marriage situation, for example, a husband may want to provide for his second wife for her life, but he may want the remainder interest in the trust to go to the children of his first marriage at her death. A marital deduction is available for a QTIP trust on an elective basis.

## Tax Currents *(continued from pg. 1)*

conditions will not be enforced by a court if they are challenged. It is most unlikely, for example, that a court would agree to deny a bequest or trust distribution on the basis that the beneficiary failed to smoke or refused to do an illegal act.

Similarly, an insistence that a beneficiary not marry someone of another race or religion will not be enforced. A trust income that terminates upon a surviving spouse's remarriage may be enforced, but the trust will not then qualify for the marital deduction.

On the other hand, a trust interest may be cut off if a beneficiary becomes a drug addict or a criminal. Extra trust distributions may be conditioned upon the achievement of certain life goals, such as completing an education or beginning a professional practice. The creator of a trust has considerable power to shape the uses to which the trust assets will be put, provided that those uses are not against public policy.

If you would like to learn more about what can and cannot be done with a trust, we would be pleased to help you clarify your goals and options before you speak to your attorney.

## Taxes and charitable gifts

The President's budget package contemplates a reduction in the value of the charitable deduction for upper-income taxpayers.

Many charities are alarmed that, at exactly the moment that they most desperately need the funds, the government may reduce the incentives for those who are most able to give. A new study reported in *The Chronicle of Philanthropy* confirms the validity of those fears.

Households with more than \$250,000 of income were asked what effect an elimination of the income tax charitable deduction would have on their charitable giving. A majority said that it would have no effect. However, 37% said that they would somewhat decrease their giving, and 10% (up from 7% in 2005) predicted that they would decrease their gifts dramatically. (Of course, "dramatic" is in the eye of the beholder.) Apparently, a significant number of donors evaluate their gifting on an after-tax basis. Presumably, they would decrease their giving by the amount of lost tax savings.

Interestingly, the same survey examined the effect of estate taxes on charitable giving. Again, a majority of respondents said that taxes made no difference to their gift planning. About 25% said that they would increase their charitable gifts if there were no estate tax, and about 12% said they would dramatically increase their gifts in that circumstance. Evidently, once family needs are taken care of, the balance of the estate may go to philanthropy—in effect, they would give away the amount of estate tax that they otherwise might have to pay

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