Norway Savings
ASSET MANAGEMENT GROUP

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Ask a trust officer

When you have a product or service that you hope to provide to the public, your job of selling is easier when the public is already familiar with your line of work. Everyone knows what an automobile is for, or what a barber does. When new products burst upon the scene—for example, in the consumer electronics arena—potential buyers have to be shown the uses and benefits before they become interested.

In the financial services marketplace, there is quite a bit of consumer confusion. That's why an important part of our marketing efforts consists of listening to and answering questions, from our clients and those who might become our clients. The benefits of trust-based wealth management plans are not easily reduced to bullet points or sound bites. Here are the questions that we heard most often in the last year.

How's the trust business these days? Has your business collapsed now that the federal estate tax exemption is so high?

The trust industry is doing very well, thank you for asking. Trust industry assets at the close of 2017 stood at a record $122 trillion, according to *Trust Performance Report 2018.* Average weighted growth in 2017 was 11%.

> **A trust creates a structure for delivering financial resources to multiple beneficiaries over a span of time, sometimes generations.**

This growth continued despite the refocusing of the federal estate tax on the very wealthy. The increase in the federal estate tax exemption, coupled with the abandonment of all death taxes (inheritance and/or estate taxes) by most of the states, has changed some of the dynamics of estate planning. The importance of having a will to govern the orderly disposition of property after death hasn't changed, however, and all of the non-tax benefits of trust plans remain in place.

So, trusts aren't just for those with estates of $10 million or more?

Almost everyone with a net worth over $10 million will have considered a trust, and most will employ them. With new technology, trust services also can be efficiently delivered to the "mass affluent." These are folks with investable assets of $500,000 and up. Many of these families will derive substantial benefits from a trust-based plan, even though they are no longer in danger of owing death taxes.

What is the purpose of a trust?

A trust provides for family financial protection. It creates a structure for delivering financial resources to multiple beneficiaries over a span of time, sometimes generations. Current beneficiaries receive the trust income, and others receive the trust principal in the future, when the trust terminates. Many trusts also authorize the distribution of principal to current beneficiaries in some circumstances.

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Trust glossary

Routine trusts and their uses

- **Revocable living trust.** Manage assets, including in the event of the grantor's incapacity, and avoid probate.
- **Special needs trust.** Provide financial support to a disabled individual without compromising access to government benefits.
- **Grantor trust.** Leverage gift tax exemptions by making a gift in trust whose income remains taxable to the grantor.
- **GRAT.** A *grantor retained annuity trust* provides current income to the grantor and principal to a remainder beneficiary at a specified future date.
- **Charitable remainder trust.** Make a future gift to charity while retaining the income for oneself or another person.
- **Charitable lead trust.** Make a current gift of income to charity, with assets passing to private heirs at a future date.
- **Marital deduction trust.** A trust for the life of the surviving spouse, that pays all the income to the spouse. Typically, the spouse has the power to change the remainder beneficiaries.
- **QTIP trust.** *The qualified terminable interest property trust* is a marital deduction trust in which the surviving spouse does not have the power to change the remainder beneficiaries.

How is a trust different from other investment accounts?

A trust has an independent legal existence that makes it durable. It can survive the incapacity or death of its creator. The trustee continues to manage the trust according to its stated purposes, stepping into the shoes of the person who created the trust.

What sort of investment return will a trust deliver?

No simple generalizations are possible about investment returns from trusts, because trusts may invest in anything. The fact that assets are being managed through a trust tells one nothing about the assets themselves.

In the typical case, a trust will contain a diversified portfolio of stocks, bonds, and mutual funds. An *asset allocation plan* will be developed for the trust, consistent with the purposes of the trust.

What is a living trust? I've seen lots of advertisements about them. Are they popular?

Living trusts are so named to distinguish them from testamentary trusts, which are created with a will and take effect after death. A living trust goes into operation during life. Usually, such trusts are revocable and created for the benefit of the grantor. Living trusts are popular for four key reasons:

- ***Sound asset management.*** The trustee will provide professional supervision of the portfolio, consistent with the grantor's vision.
- ***Protection in the event of incapacity.*** Trust management continues, even if the grantor becomes unavailable for any reason, such as medical reverses.
- ***Probate avoidance***. Estate settlement is necessarily a public process, and it can be a lengthy one. Living trusts normally avoid probate completely, creating a zone of financial privacy. They continue to function, providing financial resources to beneficiaries, while the estate settlement process continues.
- ***Financial privacy.*** The terms of a will become public during the probate process, while the terms of a trust normally are not publicized.

I understand that married couples no longer need a trust plan for maximum protection from the federal estate tax. True? Something about "portability"—what is that, anyway?

It's true. There's an important estate planning option for married couples now. When a spouse dies and leaves all property to the surviving spouse, there is no estate tax—thanks to the marital deduction. However, under the old law that approach "wasted" the estate tax exemption of the first spouse to die. To preserve two exemptions, estate planners invented the "bypass trust" or "credit shelter trust."

Now, a surviving spouse may inherit any unused federal estate tax exemption from a deceased spouse. All that's needed is an election on the federal estate tax return of the deceased spouse.

Still, the marital deduction trust isn't obsolete, even if it isn't mandatory for tax benefits. Such a trust also offers professional asset management and creditor protection. In the case of a QTIP trust (qualified terminable interest property trust), it also fixes the inheritance of family assets after the surviving spouse dies. Many families find that these benefits are quite sufficient to justify having a trust plan.

Can I change my mind after I create a trust?

That depends upon what sort of trust we're talking about. A charitable trust is normally irrevocable and can't be modified. A trust in a will can be changed simply by amending the will.

Usually, this question arises about revocable living trusts, and in that case the answer is yes; you remain in full command. You can change the beneficiaries, add assets, withdraw the assets, even terminate the trust should you decide that it is not right for you and your family.

Whom should I choose as my trustee?

Choose us. We have the financial strength, the investment capability, and the experience that you need to make implementing your trust plan a success. You want a trustee who will be fair and impartial, and, more importantly, you want the beneficiaries to recognize and respect that impartiality. That's us. Your trustee needs to manage your trust all year long, not be away on vacation or dealing with other pressing business. Again, that's us—focusing on trust management every business day, all year long.

Do you have other questions?

We hope that this brief summary has stimulated your thinking and triggered more questions about how trust planning might benefit you and your family. One of our officers will be pleased to meet with you to discuss your situation and assemble the information that you need to move ahead with a trust of your own. ☐

A surprising problem upon turning 100

Last century, when life insurance companies calculated premiums needed to fund a whole life policy, they expected that no one would live beyond age 100. Accordingly, most whole life insurance issued then includes a termination date. When the insured reaches age 100, the policy has matured.

As life expectancy grew, the insurance industry updated their actuarial tables to provide coverage to age 121. However, this change took place in 2001. Policies issued before 2001 may still include termination provisions.

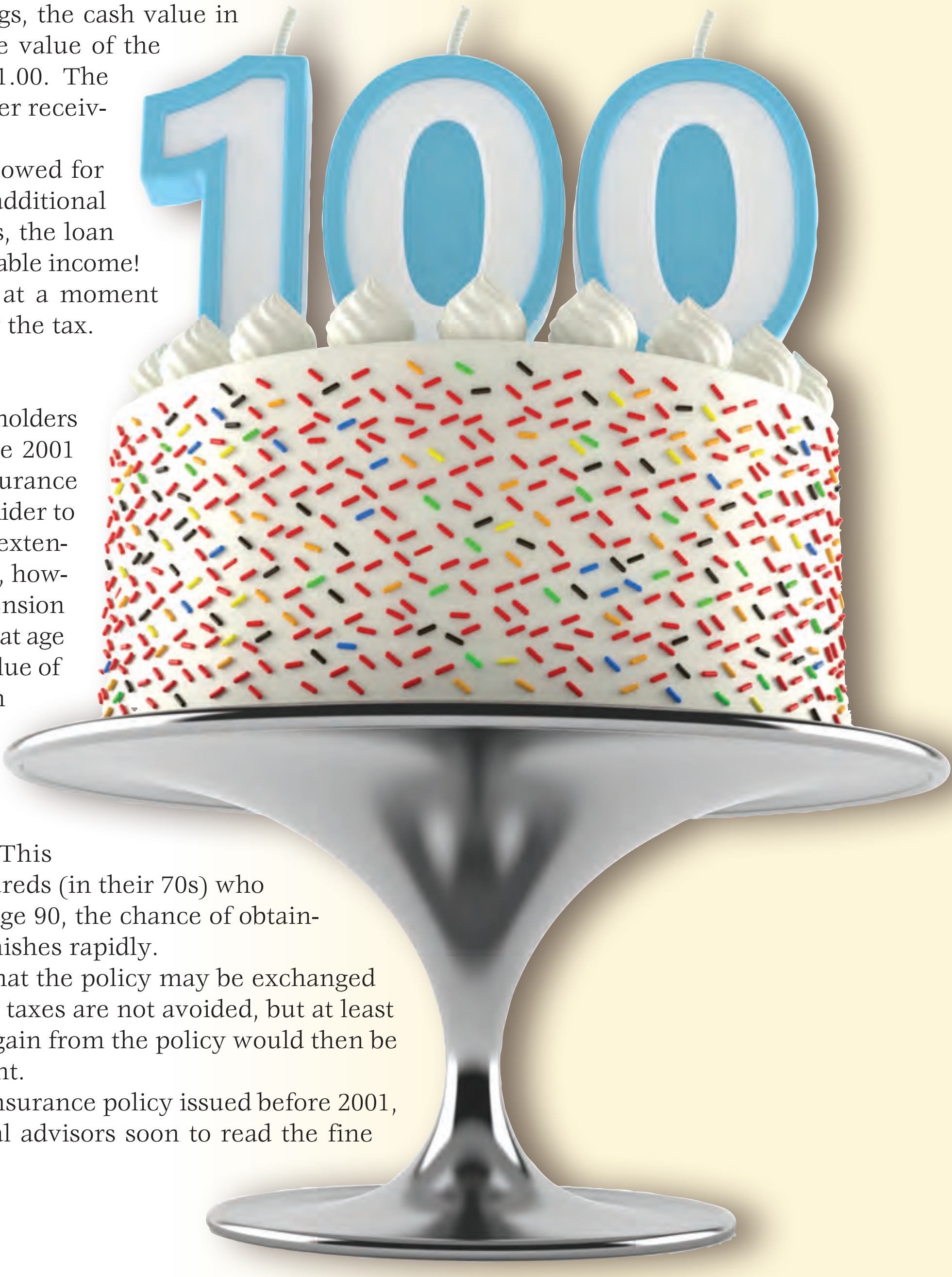
This phenomenon was explored and explained by financial planner Barry Flagg in his recent article, "What Happens to My Life Insurance at Age 100, and What Can I Do About it?" (Leimberg Information Services, November 6, 2018).

When the policy terminates

Termination of a life insurance policy is not likely to be welcomed by the insured. At that moment the insurance company pays out the accumulated cash value of the policy, and the insurance ends before the death of the insured.

If the coverage were designed as an "endowment" policy, the cash value would be equal to the face value of the insurance. If the insured amount were $500,000, for example, the entire $500,000 would be paid to the policy owner upon reaching age 100. However, unlike insurance death benefits, which are free from income tax, this payment would be subject to state and local income taxes in the year of receipt.

Endowed policies are the exception, not the rule, according to Mr. Flagg. Given the increases in the cost of insurance in recent years, coupled with declines in policy earnings, the cash value in most policies will be less than the face value of the insurance, and could be as low as $1.00. The insured then loses the death benefit after receiving the cash value.



Still worse are those policies that allowed for borrowing from cash values to pay additional premiums. When the policy terminates, the loan is forgiven—but a loan forgiveness is taxable income! The phantom income could be taxed at a moment when the insured has no money to pay the tax.

Alternatives

There may be a way out for some policyholders who bought whole life insurance before 2001 and who might live to 100. Some insurance companies offer a Maturity Extension Rider to continue the policy. The terms of such extensions need to be thoroughly understood, however. In some cases the value of the extension is defined as the cash value of the policy at age 100—if the cash value is low, so is the value of the continued insurance. Still, at least an income tax has been avoided.

The next best option to consider, according to Mr. Flagg, is to exchange the limited policy for a new one that defines maturity beyond age 100. This approach works best with younger insureds (in their 70s) who are still insurable. As one approaches age 90, the chance of obtaining a new life insurance contract diminishes rapidly.

As a last resort, Mr. Flagg suggests that the policy may be exchanged tax free for a deferred annuity. Income taxes are not avoided, but at least they may be deferred until death. The gain from the policy would then be taxed as income in respect of a decedent.

If you are the owner of a whole life insurance policy issued before 2001, you'll want to meet with your financial advisors soon to read the fine print and explore your alternatives. ☐

How to rescue a tax break

An opportunity for those over 70½ only

Last year's tax reform, the Tax Cuts and Jobs Act, did not impose any new limits on the deduction for charitable contributions. On the contrary, the percentage limit related to adjusted gross income was lifted from 50% to 60%. Nevertheless, tax-exempt organizations are worried that contributions could be down significantly because of other changes to itemized deductions. Many expenses are no longer deductible at all, and one of the biggest expenditures—the deduction for state and local taxes—has been capped at $10,000. At the same time, the standard deduction has been roughly doubled. Bottom line, far fewer taxpayers will be itemizing their deductions than ever before. If you don't itemize, in some sense you have "lost" the tax benefit of making a charitable contribution.

Most people don't contribute to charity to save on their taxes, they contribute to further a cause that they believe in. The tax benefit simply allows them to get a bigger bang for their buck.

However, those who are over age 70½ have the opportunity to retain a tax benefit for their charitable giving. They are permitted to direct the distribution of up to $100,000 per year from an IRA to a charity. There's no deduction for this action, but neither is there an inclusion of the amount in taxable income. In some ways, that is even better than a deduction.

Example. Paul is 72 years old. His IRA, funded with a rollover from his employer's 401(k) plan, was worth $800,000 at the beginning of 2018. Paul must withdraw a required minimum distribution (RMD) this year of $31,250 from the IRA. That amount will be added to his taxable income, which could push Paul into a higher tax bracket, could make more of his Social Security taxable, and could increase his Medicare premiums.

Paul's other retirement income is sufficient so that he doesn't need that IRA distribution to meet his retirement expenses. But leaving that money in the account is not an option. If Paul arranges for the IRA distribution to be paid directly to his favorite charity, he won't have to include it in his income, even though the RMD mandate will be satisfied.

If you think that this strategy might be helpful to you, see your tax advisor first, before taking any action. ☐

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The only way not to think about money is to have a great deal of it.

—*Edith Wharton*