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a business, tax, and financial newsletter

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A Trust Primer

Many of us may perceive **trusts** as a complex subject better left to our attorney. However, a trust is simply a contract initiated by a **grantor** who agrees to transfer assets to a **beneficiary**, who then receives the assets as stipulated in the trust contract. A **trustee**, who may also be the grantor, manages the trust assets and ensures the stipulated terms of the trust are faithfully executed.

A trust is designed to help individuals manage a variety of family and tax-related estate planning concerns. Here are a few ways in which trusts can be used:

Revocable Living Trust. A revocable living trust is an estate planning trust that deeds property to an heir but allows the grantor to retain control over the property during his or her lifetime. Upon the grantor's death, the property passes to the beneficiary, avoiding **probate**, which is the judicial process wherein a court appoints an executor to carry out the provisions of a will. While the revocable living trust does not provide tax savings for the grantor during his or her lifetime, the trust becomes "irrevocable" upon death, and the beneficiary is then entitled to tax advantages. This is one way that the revocable living trust may be used but isn't the only way it may be used. Also, beneficiaries may not necessarily enjoy any tax benefits.

Irrevocable Living Trust. An irrevocable living trust is an estate planning trust wherein the grantor does not retain control of assets or property. Through the transfer of assets or property into the trust, the grantor may be eligible for certain tax savings. An irrevocable living trust may also be used to avoid probate.

Irrevocable Life Insurance Trust (ILIT). An irrevocable life insurance trust is designed to provide tax savings through the ownership of a life insurance policy. Assets in the trust are generally not considered part of the grantor's estate. ILITs may be funded or unfunded. With a *funded* ILIT, income-generating assets are transferred into the trust, and the generated income is then used to pay the premiums on the life insurance policy. With an *unfunded* ILIT, the grantor makes yearly gifts to the trust, and this money is then used to pay the premiums on the life insurance policy.

Credit Shelter Trust. A credit shelter trust, also called a **bypass trust**, is an estate planning tool used to protect assets from successive estate taxes. While current law permits an unlimited amount of assets and property to

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The Reality of Early Retirement

Is early retirement on your wish list? Do you envision a relaxing lifestyle in a warmer climate or the leisurely pursuit of a personal hobby? Unfortunately, retiring later than anticipated, rather than sooner, is becoming more and more commonplace. But some people are still managing to retire early. You may be asking yourself, "How do they do it?"

The key is to be *proactive* in your retirement planning. Of course, the sooner you begin planning and saving, the better your chances are for early retirement. Keep in mind that a general rule of thumb is that you may need as much as 60% to 80% of your preretirement income to meet your expenses and maintain your desired lifestyle in retirement.

Redefining Retirement

Multiple factors are redefining how Americans approach retirement. Due to financial necessity, or perhaps too much leisure time, some retirees are reentering the workforce. Many retired executives start their own part-time consulting businesses; others trade in their 70-hour work week for semiretirement, during which they work less and spend more time with their families. Part-time work during retirement can be an important income supplement, especially if you plan to retire early from your full-time job.

Longer life expectancies are also changing the retirement landscape. Although your chances of a longer retirement are certainly greater if you retire early, relying solely on Social Security, for example, may be more difficult over time. This program was originally designed as a safety net, and not intended to provide perpetual income. Further, traditional pension plans have been generally discontinued by most companies and replaced by employer-sponsored retirement savings vehicles, such as company 401(k) plans.

The shifting of the responsibility for retirement planning from *employers* to *employees* has put more of an emphasis on the importance of maximizing contributions to your workplace retirement savings plan and taking full advantage of the company match, if available. As a result of these factors, your retirement assets, as well as your personal savings, may have to work harder to meet your objectives, no matter when you retire.

An often overlooked aspect of retirement planning is managing your personal finances while you are retired. To help ensure enough assets for decades of retirement income, your money may have to continue working for you throughout your retirement years. Inflation—along with the amount of income withdrawn from your retirement plan—will have a direct effect on how long you will be able to meet your expenses. Therefore, personal savings will continue to be an overall part of your financial plan.

Budgetary constraints can also determine your lifestyle choices in retirement. In order to determine whether you will be able to maintain your current or desired lifestyle if you retire early, it can be helpful to estimate your retirement income and expenses. Unfortunately, these estimates are difficult to project, as you will need to consider everything from fitness center fees to out-of-pocket health care costs. In addition, you must factor in inflation and how your financial needs may change over time.

Remember, for those who wish to retire early, it is important to realize that certain tax penalties may apply for early withdrawals from retirement plans. Be sure that you review all of your options with a qualified financial professional.

Even in a challenging economic climate, early retirement remains a possibility. By planning ahead and maximizing your retirement plan contributions and personal savings, you may increase your chances of reaching your early retirement goals.

The Four Forms of Property Ownership

Owning property with another individual or partner can be complicated. Consulting with your legal professional can help you establish the form of ownership that will benefit you and your heirs. The four forms of co-ownership are the following:

Tenancy in common is a form of co-ownership often used between unrelated individuals. Tenants in common may own unequal shares of property; however, shares between partners are said to be "undivided," which means each owns a proportionate interest in the entire property. For example, if two individuals are equal tenants in common to a parcel of land, it is inaccurate to describe one co-owner as owning the west half and the other as owning the east half. Rather, both own a one-half interest in the entire parcel.

Joint ownership is a specific type of co-ownership where each owner's legal interest is equal to the interest of every other joint owner. For example, if there are three joint owners, each owns an equal, undivided, one-third interest in the entire property. In addition, joint ownership carries the **right of survivorship**. When a joint owner dies, the surviving joint owners automatically succeed in ownership of the deceased joint owner's interest. Survivorship rights of a joint owner are given precedence over the claims of the decedent's creditors.

Tenancy by the entirety is a unique form of joint tenancy solely for married couples with one significant difference: The creditor protection of joint ownership extends to the lifetime creditors of the tenants by the entirety.

Community property applies to married couples who own property in any of the following nine states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Regardless of whose name is on any ownership paperwork, any property acquired during the marriage is "owned" by both parties.

Remember, splitting property, for any reason, can be difficult. So, the decision to purchase property with another party is one that requires careful consideration. ■

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pass to a surviving spouse without being subject to Federal estate taxes, assets passing to children and other beneficiaries valued in excess of the applicable estate tax exclusion amount, which is $5.45 million per individual in 2016 is subject to Federal estate tax. Note that the estate pays the tax, not the beneficiary. If a married couple wishes to take advantage of a credit shelter trust, they generally arrange for certain assets to pass into the trust for the benefit of the surviving spouse, rather than passing all assets directly to the spouse. This trust, which would *not* be considered part of the surviving spouse's estate—and generally does not exceed the applicable exclusion amount—may pay the surviving spouse income for life and then, upon his or her death, may pass to a beneficiary, such as a child, free of estate taxes if under the exclusion limit. In addition, the gross estate of the surviving spouse upon his or her death could pass to the same beneficiary, and up to $5.45 million in 2016 would be free of estate taxes. Even with the advent of portability which passes the unused applicable exclusion amount to the surviving spouse, this is still a valuable estate planning tool.

Charitable Remainder Trust (CRT). A charitable remainder trust is an arrangement in which assets are donated to a charity but the grantor continues to use the property and/or receives income from it. The grantor pays income tax on the income stream they receive. A CRT may allow the grantor to minimize capital gains taxes on highly appreciated assets; receive an income stream based on the full, **fair market value (FMV)** of those assets; receive an immediate charitable deduction; and ultimately, benefit the charity of his or her choice.

Dynasty Trust. This trust is often used by individuals to pass wealth to their grandchildren *free* of **generation-skipping transfer taxes**.

A trust can be an effective way to accomplish your long-term estate planning goals, but often involve complicated tax laws. Consult with your tax and legal professionals about your particular situation and how a trust may enable you to share your wealth with family, friends, or charities. ■

Touching All the Bases with Policy Ownership

While many of us think of **life insurance** planning in relation to *type* and *amount* of coverage, a more complete analysis also includes **policy ownership**. In many cases, the proceeds of a life insurance policy may be unnecessarily included in your estate—unless you plan ahead.

Without insurance, many estates fall below the level at which they are subject to Federal estate taxes. For 2016, the **applicable exclusion amount** is $5.45 million per individual (annually indexed for inflation). Estates that exceed this amount are subject to Federal estate taxes at a top rate of 40% in 2016. The proceeds of life insurance can increase the value of your estate to a level where it could become subject to Federal estate tax.

Fortunately, you can prepare for the possibility of Federal estate taxes. There are two ways to keep insurance proceeds out of your estate:

1. Transfer ownership of your insurance policies to someone else, generally your **beneficiary(ies)**
2. Transfer the policies to a **trust**

Either option, if executed properly and in a timely manner, can decrease your Federal estate tax. You may not have to change ownership of a policy that names your spouse as the **sole beneficiary** because the **unlimited marital deduction** allows your spouse to inherit the policy proceeds without estate taxation. However, you may benefit from transferring your policy out of your estate if the purpose of the insurance is to help pay estate taxes or provide for heirs other than your spouse.

The paperwork involved in changing insurance policy ownership is relatively simple. You do have to sign away all rights to your policies, however, making this decision ***absolute*** and *irrevocable*. Also, you cannot change your beneficiaries, and in the case of policies with **cash value**, you no longer have the right to borrow against them or surrender them for their cash value.

Keep in mind that if the transfer is done within three years of your death, the policy proceeds are generally still considered part of your estate, regardless of ownership. Therefore, proper planning is necessary to help ensure that you achieve your desired results.

Ownership of an individual group insurance policy can generally be transferred to anyone who is old enough to handle money. Depending on your particular circumstances, it may be advisable to transfer a policy directly to a beneficiary or, in the case of a minor, to a **trust** that is designed for the benefit of a child.

Before signing away insurance, it is important to carefully review the consequences. Gifting insurance may have **gift tax** consequences if the transfer is to anyone other than your spouse. In 2016, the **annual gift tax exclusion** is $14,000 per gift to any single donee, and $28,000 for gifts made jointly by a married couple.

For those in higher tax brackets, one useful technique to shelter large policies from estate taxes—and to protect the interests of minor beneficiaries—may be to transfer ownership to an **irrevocable life insurance trust (ILIT)**. When you die, the **trustee** named by you can distribute income to your beneficiaries or, if necessary, use the proceeds to pay estate taxes. For specific guidance, be sure to consult with your qualified tax, insurance, and legal professionals.

The decisions you make regarding policy ownership are no less important than the decisions you make regarding what type of policy and how much insurance you need to fulfill your overall objectives. So, when planning your insurance strategy, make sure to cover all the bases. ■

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