

**Trusts**

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## Seven myths about trusts

If you're in the business of selling cars, just to pick an easy example, you may take it for granted that everyone knows what to do with a car, why he or she needs one, and the advantages that a car offers over alternative means of transportation. These are just the sort of assumptions that we cannot make as we offer our investment and wealth management services to affluent individuals and families, especially our trust services. Trusts are, for many people, simply quite mysterious. We'd like to change that. The more that people know about trusts, how they work and what their benefits are, the happier we are. Here are seven common misconceptions that people have about trusts. There is a kernel of truth behind these myths, but it's important to understand the larger reality behind them.

### **1. Trusts are just for the very rich.**

When you hear a news item with a trust angle, it's often the case that a wealthy family is involved. The Kennedy trusts and the Rockefeller trusts are common knowledge. But trusts are not just for tycoons anymore. Although most very rich families do employ trusts in their wealth management, these families constitute a minority of trust customers. Most of our clients are *not* multimillionaires, and most don't think of themselves as "rich." They do have some significant investment assets that need careful management — proceeds from the sale of a business, perhaps, or a lump sum retirement distribution; an inheritance; or an investment portfolio painstakingly accumulated during a successful career.

### **2. Trusts are expensive.**

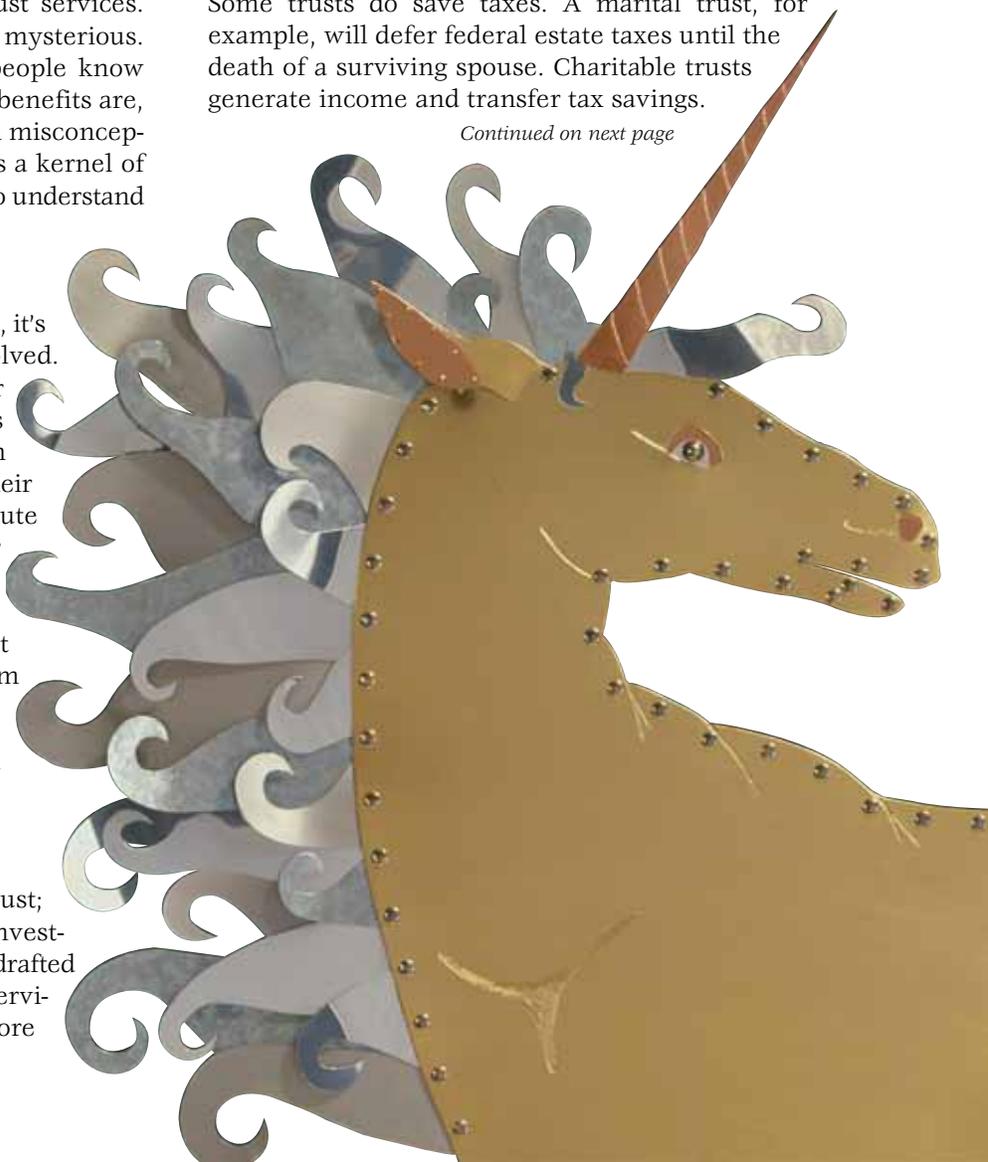
True, there is an expense in establishing a trust; it does cost more than starting an ordinary investment account. The trust documents must be drafted by a lawyer, who will charge a fee for supervision of the creation process. A trust costs more

because it *does* more. Once the trust is up and running, the annual fees for our trust services are competitive with those of investment advisors and with mutual funds. To learn the specifics, please ask for a copy of our fee schedule.

### **3. Trusts are for saving taxes.**

Some trusts do save taxes. A marital trust, for example, will defer federal estate taxes until the death of a surviving spouse. Charitable trusts generate income and transfer tax savings.

*Continued on next page*





## Our investment services compared

Feature	Custody account	Investment management account	Living trust
Recordkeeping	X	X	X
Safekeeping of securities	X	X	X
Development of an asset allocation strategy		X	X
Continuing portfolio supervision		X	X
Personal financial management upon client's incapacity			X
Account may survive the client for support of named beneficiaries			X
Potential for probate avoidance			X

### Seven myths about trusts . . . continued

However, tax savings are not what these trusts are for; that's just an extra benefit. A marital trust provides lifetime financial protection to a surviving spouse. A charitable trust implements philanthropic objectives. The most common sort of trust, the *revocable living trust*, does not have tax advantages at all. Instead, it provides for professional investment supervision, financial management upon incapacity, and the potential for probate avoidance.

#### 4. Assets get “tied up” in a trust.

Another term for “tied up” might be “protected.” Stated that way, the restrictions imposed by a trust might be seen as a benefit, not a detriment. For example, an inheritance trust might be designed to limit access by the beneficiaries' creditors, preserving trust assets for longer-term financial protection.

If you create a revocable living trust for yourself, on the other hand, nothing will be “tied up.” You will be free to amend the trust, change trustees, or cancel the arrangement altogether. In fact, one purpose of having a living trust is to have *more* control, to have the choice of delegating investment duties as needed.

#### 5. Trusts must be funded with publicly traded stocks, bonds, or other investment securities.

Although investment portfolios are likely the lion's share of trust assets overall, trusts may own any sort of property, including real estate and shares of closely held companies. Shortly after Steve Jobs' death, for example, it was revealed that he and his wife had transferred all of their California real estate interests to trusts in the year that Steve had his liver transplant. Those trusts may be the foundation of his estate planning. Or they may not be,

and we may never know. That's because, unlike the terms of a will, the terms of a trust do not normally become a matter of public record.

#### 6. Trusts are invested conservatively, with low return potential.

At one time, trustees tended to be very risk averse with trust assets, which did lead in many cases to very conservative investment policies. In recent years, however, the laws governing the investment of trust assets (the “prudent investor” rules) have been reformed in most states. In most cases, “prudence” is determined today on a total portfolio return basis, not on the riskiness of each individual asset held in the trust.

#### 7. Anybody can be my trustee.

There are few legal limits as to who *can* be a trustee, but the better question is who *should* be your trustee. Your trustee needs to have financial strength, as well as professional investment capabilities. Experience is important — look for someone, or a financial organization such as us, who has handled all types of trusts in every kind of market for diverse sorts of families. You'll also want a trustee who can be fair and impartial in administering the trust, one whose judgment all the beneficiaries will be able to accept. □

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*This article is not intended to be tax or investment advice. Please consult your tax and investment advisors for further information. To find out whether our trust services could help you to take better control of your financial future, talk with one of our officers soon.*

# A nation of investors

The 54<sup>th</sup> annual survey of profit sharing and 401(k) plans, released recently by the Plan Sponsor Council of America (PSCA), provides an interesting snapshot of the state of retirement savings. The report is based upon responses from 820 plans, with an aggregate 10.5 million participants and \$691 billion in assets.

Who is responsible for managing all that money? Overwhelmingly, the plan participants themselves shoulder that burden. Participants make investment decisions for their own contributions in 97.7% of the plans, and they also decide on how to invest company contributions to their accounts in 92.2% of plans. That means there are more than 10 million investment managers in this sample!

The average plan gives the participant/investment manager 18 investment fund options to choose from, up from 11 as recently as 1999. That is a lot of data to pore over. Participants are provided with access to investment advice in 57.6% of the companies. "Advice" may range from basic investment education to in-depth evaluation of individual circumstances. The graph below breaks down the advisory channels.

Oddly, only 22.3% of participants take advantage of free investment advice when it is offered. The utilization

rate is highest, 33.2%, in the smallest companies (those with fewer than 50 employees) and lowest in the largest companies, at 17.3%. When more than one avenue for advice is offered, Internet providers are the most popular, at 45.1%, followed by in-person counseling at 27.7%.

## Chart your own course

Presumably, all this training and practical experience in portfolio management will prepare the plan participants for handling their investment assets on their own when they reach retirement.

Or perhaps not. Amateurs may sometimes beat professionals, but, as a group, the pros generally are going to perform better. We have professional investment managers on our trust team. They spend their careers in this area. They have been trained for it. They have access to the wide universe of investment data that provides the foundation for decisionmaking.

Do you have a significant sum that needs to be protected and nurtured? Perhaps an IRA rollover, an inheritance, or simply a securities portfolio accumulated over the decades of your career? If so, we invite you to take advantage of our experience and expertise in portfolio management. □

## Message delivery

For those profit sharing and 401(k) plans that offer their participants investment advice, how is that advice delivered?

Source: PSCA 54<sup>th</sup> Annual Survey; M.A. Co.

### Advice offered > Percentage of plans offering

One-on-one counseling, in person > 58.9%

Internet providers > 62.0%

Telephone hotline > 55.5%

Web conference > 18.2%

3.2% Other

24/7



## Family loans

Today's very low interest rate environment makes intra-family loans more attractive than ever. To avoid being characterized as gifts or partial gifts, loans to related parties must charge fair market interest rates, as announced monthly by the IRS. These rates have reached historic lows. For October 2011, the rate for loans of less than three years was 0.16%; for three to nine years, 1.19%; and for terms of more than nine years, 2.95%. These low rates translate into lower costs for family borrowers.

**Example.** Sally and Tom soon will be purchasing their first home. Sally's parents, Max and Gretchen, are considering a loan of \$400,000 to the young couple for this purpose. They plan to have a 15-year term. If the loan is interest-only, with a balloon payment of principal at the end of the term, the annual interest payments will be \$11,800, or \$983.33 per month.

**An estate planning twist.** What if Max and Gretchen would like to reduce their future estate tax exposure? They could make an outright gift of the \$400,000 to Sally and Tom, but that would consume a portion of their credit against the federal estate and gift tax. The better approach is to make the loan and forgive the principal over time.

Every taxpayer may give someone up to \$13,000 per year without incurring federal gift tax. In this case, we have two givers and two receivers, so up to \$52,000 of loan principal may be forgiven in one year without owing gift taxes. Max and Gretchen could forgive the entire loan over the next eight years. Alternatively, they could wait a few years to begin loan forgiveness, when they are more confident that the marriage will last.

For such strategies to be successful, they must be supervised by an attorney, and all legal formalities must be adhered to.

Today's low interest rates are favorable for many other financial planning strategies.

- **Grantor retained annuity trusts (GRATs).** Grantor funds an irrevocable trust. Grantor is paid an annuity from trust assets, and the principal goes to heirs when the trust terminates. Typically, the annuity is set high enough to bring gift taxes down to zero. In a short-term GRAT, the grantor may get all the assets back, with the heirs receiving any appreciation in asset values free of transfer taxes. Congress has been considering tightening GRAT rules, perhaps by requiring a 10-year term for them. Accordingly, this strategy should be considered sooner, not later.

- **Installment sales.** When a business is sold on an installment plan and interest rates are low, more of the payments may be treated as capital gains, eligible for the 15% tax rate.

- **Charitable lead trusts.** Similar to a GRAT, but a charity receives the annuity interest, instead of a grantor, and heirs receive the property when the trust ends. The gift tax imposed upon the actuarial value of the remainder interest goes down when interest rates are low. □



## Could we outlive our retirement money?

In this era of low interest rates and volatile stock prices, we are hearing this worry more and more often. When one's expectations about portfolio returns, taxes and inflation are not met, a financial plan may become vulnerable.

Our trust and investment professionals can help you manage your retirement income. Give us a call to learn more.

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