

Wealth Management For Your Future



Trust & Investments

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Will New Estate Tax Rules Lull You Into Inaction?

At long last, Congress passed meaningful federal estate tax relief at the end of 2010.

Among myriad other tax law provisions in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, there's a generous \$5 million estate tax exemption, and the top estate tax rate has been cut to 35%—the same as the top rate for ordinary income. The law also coordinates other estate tax breaks for wealthy families.

But there's a downside to these favorable estate law alterations—they're scheduled to expire after 2012. So there's only a small window of opportunity before the next crucial crossroads for estate planning, and because it's impossible to know what will happen next—or to guess what estate rules will be in effect at your death—the positive aspects of the new law could end up having a negative impact. Families whose wealth falls below the higher exemption amount may be lulled into doing nothing, but that's a risky approach.

It took Congress almost a decade to revisit the subject of estate taxes, and it only finally happened because *not* acting would have had a dramatic result. In 2001, the estate tax was repealed—but only in a very gradual way, and only temporarily. During the years that followed, the exemption level rose gradually to \$3.5 million and the top estate tax rate inched down to 45%. Then, in 2010, the tax was truly

gone, but only for a year. Without the 2010 law, passed as the clock wound down on a lame-duck session of Congress, 2011 would have reinstated an exemption of just \$1 million and a top tax rate of 55%. Finally, as part of an 11th hour tax compromise brokered by the Obama administration between congressional Republicans and Democrats, the new two-year estate law came into being.

Though the \$5 million estate tax exemption and the 35% tax rate have gotten most of the attention, the new law also included other significant changes. The individual exemption is now "portable" between spouses, so that a surviving spouse can utilize any unused portion of a deceased spouse's exemption. That effectively lets married couples exclude \$10 million from estate tax liability—but only if both die before 2013. The new law also again gives heirs a "step-up" in the cost basis of inherited assets—an advantage they didn't have in 2010—and reunifies the rules for estate and gift taxes so that they share the \$5 million exemption. That amount in total can now be transferred from your estate either before or after your death without incurring either kind of tax.

With these changes in effect, estate planning may seem easier than it was before, particularly if you have less than \$5 million—or less than \$10 million, between you and your

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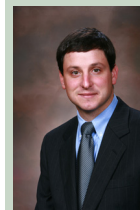


Let's Get Ready For 2012 As The Old Year Winds Down

As another year begins, many people reflect on what they have done in the past year and what they would like to do in the coming year. Now is the perfect time to review or establish your financial goals. Here are a few ideas to help you get started:

1. Set a budget. This process will force you to analyze your expenses and savings.
2. Review your goals. This is a perfect time to see how you are doing or to set new ones.
3. Review all of your insurance policies. Make sure coverage still makes sense and be sure to check your beneficiaries on life policies.
4. Tax planning. Consider IRA contributions, Roth conversions, and increasing your employee benefit deferrals.
5. Schedule a time with your financial advisor to review your long-term financial plan and investment allocation.

We would be pleased to provide you with a full review of your financial plan today.



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Do You Have An Administrative Trustee?

There are many kinds of trusts, and many ways they can be used to provide benefits to you and your family, now and for years to come. A trust might protect your assets from creditors, delay cash distributions to your children until they're mature enough to handle the money, or minimize estate taxes when you die. Whatever its purpose, a trust will need one or more trustees to manage its assets and make crucial decisions about how assets are used. For example, a trust's primary trustee may be called upon to decide when to let a beneficiary receive early or additional distributions. But a trust might also benefit from having an "administrative trustee" for tasks that do not require judgment or discretion yet are time-consuming and essential.

Your trust's regular trustee may be a family member, friend, or advisor; in some cases, you might even choose to fill the role yourself. An administrative trustee—normally an institution with long experience in trust administration—can work hand in hand with your designated trustee to achieve your

goals. The benefits of having an administrative trustee may include:

- **Professional experience.** If you enlist the services of a reputable firm such as Charles Schwab or Fidelity, you can reasonably expect to work with administrators who are competent and knowledgeable. They should be able to handle the often complex tasks of trust administration.



- **Wide-ranging services.** A financial firm hired to work as an administrative trustee can collect dividends and interest, distribute income or principal, prepare federal and state fiduciary income tax returns, and handle various other accounting and record-keeping duties.

- **Continuity.** Using a well-established administrative trustee can help ensure that your trust will be properly administered for as long as it lasts, perhaps for generations into the future.

- **Special advantages.** An experienced administrative trustee can help realize the tax or asset-protection advantages of establishing a trust in such states as Delaware or Alaska.

You can have language inserted into your will nominating a financial firm to be the administrative trustee of a designated trust and allowing your heirs to replace that trustee if necessary. The cost of the service is normally based on a percentage of trust assets, though no fees will be due until the trust comes into existence, often after your death. It's important to remember that an administrative trustee isn't

a replacement for the primary trustee responsible for managing trust assets and handling other crucial tasks. Instead, the firm you choose as an administrative trustee is there to facilitate the operation of the trust so that it can meet the objectives you've set for it. ●

Modern Portfolio Theory Is Alive And Well

For more than 50 years, Modern Portfolio Theory, or MPT, had been an article of faith for investors. The basic idea was that you could keep investment risk and reward in balance by choosing a diverse mix of assets. But then came the bear market of 2008 and 2009, during which nearly every kind of stock, bond, and most alternative investments plunged simultaneously. That led some analysts to pronounce Modern Portfolio Theory dead. What good is diversification, they asked, if everything sinks together?

But Modern Portfolio Theory never asserted that asset classes couldn't fall at the same time. Moreover, a look back over the past decade shows that investors who stayed

diversified, continuing to rebalance during the downturn, enjoyed healthy returns. In fact, the market meltdown has proven a powerful validation of MPT.

MPT asserts that the best way to maximize returns while minimizing risk over the long term is to allocate your money among diversified classes of investments and periodically rebalance to keep the proportions in line with original targets.

MPT attempts to build a portfolio of asset types that won't necessarily move together in response to changes in the economy. The hope is that when one portion of your portfolio—say, large-cap stocks—falls in value, another part—commodities, for instance—will rise. Rebalancing lets you

"buy low and sell high," because to keep allocations at proper levels you end up selling assets that have gained in value and buying others that have lost ground.

For long-term investors, one of the most distressing aspects of the 2008 economic crisis was the unprecedented way that nearly all asset classes—bonds, stocks, commodities—lost value at the same time. The notion that diversification ensures gains in some sectors despite losses in others seemingly lay in tatters. But diversification can't, in fact, ensure that outcome, and MPT never suggested it could. It can merely increase the likelihood of that result.

And even when, inevitably, there are times when every part of a portfolio loses

4 Retirement Plans For Self-Employed

When you're self-employed, it's often difficult to set aside money for retirement because every dollar is coming out of your own pocket. Yet if you don't invest in your future, no one else will, so it's important to make retirement saving a top priority. You can use one of several saving and investment vehicles whose features can help you gradually build a substantial nest egg. Consider these four retirement plans that are specifically geared to the self-employed.

1. Simplified Employee Pensions (SEPs): The main attraction of SEPs is that they are, indeed, simplified. For one thing, SEPs are generally exempt from stringent tax reporting requirements that apply to most other plans. As a "defined contribution" plan, deductible contributions for the 2011 tax year are limited to 25% of your compensation or to \$49,000 (\$54,500 if you're age 50 or over), whichever is less. The maximum compensation taken into account for these purposes is \$245,000.

Contributions to an SEP are discretionary, so you're not locked into a specific amount for any year. However, if you have other employees, you have to make contributions on their behalf if they have worked for you for at least three out of the previous five years and earn more than a minimum level of compensation (\$550 for 2011).

value for a while, MPT has great potential value. According to economist Fritz Meyer, a global portfolio using 12 asset classes managed according to MPT principles would have earned a compound annual growth rate of 8.4% during the volatile decade ending in 2010, compared with a 0.4% gain for a portfolio holding only stocks (represented by the Standard & Poor's 500 index).

The secret is in the rebalancing, Meyer says, because disciplined rebalancing forces you to ignore macroeconomic considerations and keep emotions out of the process.

As we embark on another decade of

Like other tax-advantaged retirement plans, SEPs generally don't permit distributions before you reach age 59½ (you'll be assessed a 10% penalty and owe income tax on early withdrawals) and you must begin taking annual required minimum distributions, or RMDs, after age 70½.

2. Savings Incentive Match Plans for Employees (SIMPLEs): Many tax rules for SEPs also apply to SIMPLEs, which are likewise exempt from the usual tax reporting rules. But unlike SEPs, which let you contribute even if your business has another retirement plan, a SIMPLE must be your sole retirement savings vehicle, and SIMPLEs also have lower ceilings for tax-deferred contributions. For 2011, the maximum is \$11,500 (\$14,000 if you're age 50 or older). But your business can elect to provide matching contributions to the plan, subject to nondiscrimination rules. You'll have to contribute on behalf of any employee who has earned at least \$5,000 during the preceding two years and who is expected to earn at least that much during the current year.

The general tax rules for early withdrawals and RMDs also apply to SIMPLEs. But there's a 25% penalty on withdrawals made within the first two years of participation.

3. Keogh plans. At one time, if you were self-employed, the Keogh was the

only retirement plan in town, but its popularity has waned now that there are other, generally simpler alternatives. The amount you can put into a Keogh each year depends on whether it's set up as a defined-contribution or a defined-benefit plan. For 2011, the maximum deductible amount for a defined-contribution Keogh is the lesser of 20% of earned income or \$49,000 (\$54,500 if you're at least 50 years old).

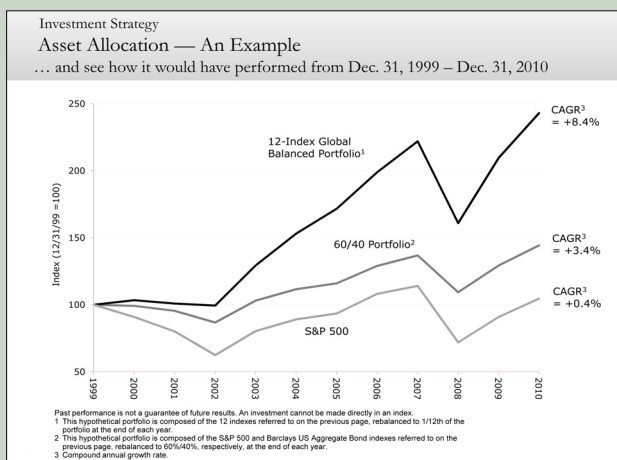
If you have a defined-benefit Keogh, your annual contributions will be computed actuarially to deliver a specified amount of retirement income. The plan may provide an annual retirement benefit equal to 100% of the average income earned during your three highest-paid years, or \$195,000, whichever is less. Rules on RMDs also apply to Keogh plans.

4. Solo 401(k) plans. This staple of retirement planning for the employees of large companies used to be pretty much off limits to the self-employed, who were deterred by prohibitively high administrative costs. But now it's feasible to operate a 401(k) for just one person (or for a sole proprietor with a few employees).

The maximum tax-deductible salary deferral allowed for 2011 is \$16,500 (\$22,000 if you're at least 50). A major advantage of this plan for the self-employed is that it lets you combine contributions as an employee with matching contributions as an employer. This lets you reach the \$49,000 maximum for retirement plans this year (\$54,500 for those 50 and over).

Most other rules relating to contributions and distributions from defined-contribution plans also apply to solo 401(k)s. But if you're the only employee, you don't have to worry about tough nondiscrimination rules that normally apply to 401(k)s.

Any one of these retirement plan options might work for your business, but finding the best fit means taking a closer look at the details of each and considering its pros and cons for your enterprise. We can help you explore the options. ●



economic and market uncertainty, we will continue to design portfolios that are properly diversified and regularly rebalanced, allowing MPT to work for you. ●

Estate Tax Exemptions Survive Longer

Maybe you can't take it with you, but under the Tax Relief Act of 2010, you can give it to your spouse. In this case, "it" isn't your assets but rather the portion of your federal estate tax exemption that's not needed to shield your property from estate tax. Under the old rules, any part of your exemption not used at your death would be lost. Now, the exemption is "portable," and that creates estate-planning opportunities—at least through 2012, after which this new tax break is scheduled to expire.

Under the old estate tax law, the size of the individual exemption grew from \$1 million in 2001 to \$3.5 million in 2009, and the top tax rate on assets exceeding the exempt amount fell gradually from 55% to 45%. The estate tax then disappeared entirely in 2010 but was scheduled to return in 2011 with the 2001 exemption and tax rate. The Tax Relief Act, passed at the 11th hour, instead brings a whole new set of rules.

Now, there's a \$5 million exemption (the highest ever) and a flat 35% estate tax rate. And, assuming an estate makes an election before a

deadline, a surviving spouse can take any unused portion of the exemption from the estate of the first spouse to die. This enables a married couple to shelter up to \$10 million of assets from estate tax, regardless of which spouse dies first.

Suppose John Smith owns assets currently valued at \$3 million and his wife Mary owns \$6 million. John dies in 2011, so his exemption shelters the entire amount. The excess \$2 million of the exemption can be carried over to Mary's estate. Let's assume she dies in 2012, and that her assets have increased in value by then to \$7 million (or \$2 million above the \$5 million individual exemption amount). With the benefit of John's unused \$2 million exemption, her estate also owes no estate tax. (The \$5 million exemption

will be indexed for inflation in 2012, so the total exemption for couples could exceed \$10 million.)

If a surviving spouse outlives more than one spouse, the exemption that can be carried over is limited to the lesser of \$5 million or the unused exemption of the latest spouse to die. So, for instance, if Mary remarries and her new husband leaves her \$1 million of unused exemption, Mary's exemption would be capped at \$6 million.

The big sticking point, however, is that these favorable tax

rules are guaranteed to remain in effect only through 2012. Flexibility could be built into an estate plan for potential estate tax law changes including a potential decrease in the exemption amount, but families with substantial assets should stay vigilant in creating and revising their estate plans. ●



New Estate Tax Rules

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spouse—to transfer to your heirs. Doing nothing at all now may seem like a reasonable option. But the biggest problem, again, is that the new rules are guaranteed to hold sway only through the end of 2012. If Congress then reduces the exempt amount—and, in the meantime, your wealth has grown—you might have to scramble to get a new estate plan in place.

What can you do in the meantime? One effective strategy is to continue to take advantage of rules for yearly giving that can reduce the size of your estate. Under the annual gift tax exclusion, you can give anyone assets valued at up to \$13,000—\$26,000 if your spouse joins in the gift—and you

can make such transfers to as many people as you like each year. You can also avoid the issue of future estate tax rates by using your current \$5 million credit to transfer additional wealth while you're alive.

You can also pay attention now to estate issues that have nothing to do with taxes. It's important to decide how to divide assets among your children, for example, and how to protect your wealth from creditors. Making provisions for the care of a disabled child, perhaps by establishing a special needs trust, could also be crucial. Indeed, trusts of various kinds might help you support your family and

philanthropic organizations long into the future, regardless of what happens next to the political football of the estate tax laws.

For now, the latest big changes make this a good time to take stock of your estate plan, making any adjustments that may be needed in terms of how it is structured and in the

language of your will and other documents. And, until a long-term law is in place, it's a good idea to review your estate plan every year or two. We can work with you and your attorney to make sure you're taking advantage of today's opportunities. ●

