

## Tax Haircut?

(Continued from page 3)

If Doris converts the IRA to a Roth IRA, paying \$200,000 in income taxes, her taxable estate will be reduced by that same amount. That's a \$120,000 reduction in estate tax exposure. What's more, the Roth IRA distributions to the grandchild will be tax free for life.

Think of it this way. If you paid your child's income taxes, you'd be making a taxable gift. When you prepay the income tax by converting a traditional IRA to a Roth IRA, you are making an enormous tax-free gift to the account beneficiary. And there's no limit on how large the gift can be.

### Downsides

The conversion of a traditional IRA to a Roth IRA triggers a new five-year holding period to avoid tax penalties, so those with an immediate need for the money may want to consider partial conversions instead. A wide variety of credits and deductions may be affected by the conversion decision, so it's important to get professional tax advice before moving ahead.

Still, it's not too soon to be looking at your choices and developing a plan that meets your needs and those of your family.

© 2009 M.A. Co. All rights reserved.

inside  
next issue:

Meet Our Staff

Ask A Trust Officer

Celebrating  
50 years of banking excellence!



**CoreFirst  
Bank & Trust**  
Member FDIC • CoreFirstBank.com

**CoreFirst Bank & Trust**  
Investment Management Group  
3035 SW Topeka Blvd.  
Topeka, KS 66611

INSIDE: 



Should your IRA take a tax haircut?  
PAGE 3



Investment Corner:  
Back to the 'Old Normal'  
PAGE 3



Ask A Trust Officer.  
Trust advice for newly blended families  
PAGE 2

**CoreFirst Bank & Trust**  
Investment Management Group

# Sound Investments

ISSUE NO. 5  
WINTER  
2009

## GRATs

The Grantor Retained Annuity Trust (GRAT) has been getting quite a bit of attention from estate planners recently. The reason is that low market interest rates create a window of opportunity for passing assets to heirs without incurring much, if any, estate or gift tax.

The GRAT is established for a set number of years. During the term of the trust, the grantor is paid an annuity, a fixed dollar amount, every year. When the trust terminates, the assets left in the trust pass to the grantor's heirs. A gift tax, due when a GRAT is funded, is imposed upon the actuarial value of what the heirs will receive when the trust terminates. Estate planners can use two factors to reduce that tax exposure almost to zero: They can lengthen the term of the GRAT, or they can increase the annuity retained by the grantor.

The value of the retained income interest and the value of the remainder for the heirs must take current interest rates into account. If the trust earns more than the IRS tables predict it will earn, the excess will pass to the heirs free of estate or gift tax. During a period of very low interest rates, such as we have today, the chance of

beating the IRS interest rate is very good.

On the other hand, if the trust's investments underperform, it may be exhausted before the end of the term, leaving nothing for the heirs. Finally, if the grantor dies before the trust comes to an end, the assets will be included in the grantor's estate, defeating the estate planning objectives.



### Future considerations

The advantages of GRATs have become so pronounced in the current market environment that the President's tax proposal to Congress earlier this year included a new restriction for such trusts in the future. They will have to have a trust term of at least ten years in order to be effective for federal tax purposes.

If such a change to the tax code is made, it very likely will be part of a larger estate tax reform plan that keeps the federal exempt amount at \$3.5 million, freezing the estate tax rates at 2009 levels. For married couples, that means \$7 million can be sheltered from federal estate tax with some basic planning. Such a move could limit the need for more sophisticated strategies, such as GRATs, for wealthier families.

© 2009 M.A. Co. All rights reserved.



## Ask A Trust Officer

**DEAR TRUST OFFICER:** I'm planning to remarry, and I know that means I should take a look at my will. Right now I've left my property to my kids from my first marriage. I'd like to include my new spouse in my plan, yet I don't want to cut out the children completely. Is there an easy solution?

**-Starting Over**

**DEAR STARTING OVER:** In situations such as yours, we've seen a lot of interest in the *Qualified Terminable Interest Property Trust*, or more commonly, *QTIP Trust*. The trust is "qualified" for the marital deduction from the federal estate tax, provided the surviving spouse is a U.S. citizen. The trust is "terminable" because it ends at the spouse's death, and the spouse usually doesn't have the right to change who gets the property at that point. In other words, the inheritance for your children is secure.

Another benefit of the QTIP trust is that the executor can elect a full or partial marital deduction, depending upon what's best for tax purposes. That flexibility is especially welcome during these times when the federal estate tax may be undergoing major changes.

*Do you have a question concerning wealth management or trusts? Call (785) 267-8704.*

## Investment Corner

We have been saying for some time that we believe this market is on course to rally through the end of the year on stronger-than-expected U.S. and global economic growth, stronger-than-expected corporate earnings and stronger-than-expected consumer spending. Toss in the market's typical end-of-the-year seasonal strength and the high level of cash still on the sidelines, and our target for the S&P 500 reaching 1,200 seems reasonable. Along the way, we have been comforted from a contrarian's point of view that the market consensus continues to revolve around the so-called "New Normal," i.e., that excess leverage has killed the consumer for this cycle and as such, economic recovery is unlikely.

Interestingly, the Federal Reserve itself appears to believe in, or at least is sufficiently concerned with, the prospects for a "New Normal" period of substandard growth. Chairman Ben Bernanke's comments at a recent Economic Club of New York luncheon reiterated similar messages being sent to Wall Street in both formal and informal settings: that future growth will be slowed by the dual "headwinds" of consumers' debt overhang and banks' unwillingness to lend. With this perspective, the Fed has been resolute in assuring markets that it will keep historically low interest rates right where they are for a "considerable period" of time.

### Fed helps set stage for a bull—and maybe a bubble

Of course, if U.S. economic growth next year is closer to our 4% expectations than the consensus 2.5% to 3%, we wouldn't be surprised if the Fed attempts to bring some normality to monetary policy with a 75 to 100 basis-points hike in the federal funds target rate sometime late in next year's second quarter. But given the Fed chairman's repeated comments on the outlook—and his extensive study of the overly tight monetary policies of both the Great Depression Fed in the 1930s and the "Lost Decade" Bank of Japan in the 1990s—we wouldn't view such a move as a sign of sizable and prolonged tightening on the horizon. Fed officials have made clear they believe substantial labor and industrial resource slack argues strongly against the need for aggressive action on rates anytime soon.

Bernanke underscored these points emphatically in his remarks yesterday.

The upshot of all this could very well be a Goldilocks II scenario of cheap money and solid if unspectacular economic growth for 2010 and beyond. Ironically, with other central banks also keeping their monetary pedals to the metal, with emerging countries entering strong V-shaped recoveries and with fiscal deficits in developed countries at record highs, this also could set the stage for a new bull market—even a bubble—in equities as the wall of money filters into stocks. Sounds a lot like the "Old Normal" to me.

*Views are as of November 17, 2009, and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security.*

## Meet Our Staff

### Four CoreFirst Bank & Trust Officers Receive CTFA Designations



**Kirk Johnson**



**Nancy Goodall**



**Roger Aeschliman**



**Alicia Rothe**

Kirk Johnson, Nancy Goodall, Roger Aeschliman and Alicia Rothe recently received their Certified Trust and Financial Adviser (CTFA) designation.

The certification distinguishes individuals who demonstrate excellence, experience and a depth of education in the wealth management industry. Advisors provide customized financial solutions including fiduciary responsibilities, trust activity, ethics, personal finance, insurance planning, estate planning, and tax and investment management.

The CTFA program is administered by the Institute of Certified Bankers, a subsidiary of the American Bankers Association. An advisory board of wealth management and trust professionals who are recognized experts in one of the CTFA knowledge areas oversees the certification.

The CTFA exam covers many areas, including fiduciary responsibilities, trust activities, ethics, personal finance, insurance planning, estate planning, and tax and investment management. Once certified, individuals must fulfill continuing education requirements in order to maintain their certification.

## Should your IRA take a tax haircut?

In the debate over which is better—the immediate tax deduction for contributing to a traditional IRA or the potential for tax-free income from a Roth IRA—the answer tends to turn on one's assumptions about tax rates. Conventionally, one expects to be in a lower tax bracket during retirement, perhaps dramatically so. That favors the traditional IRA. These days, however, those at higher income levels have been told repeatedly that their tax rates will be going up in the future, perhaps sharply. If so, the advantage shifts to the Roth IRA.

Those who are convinced that they will face higher tax rates in the future may want to consider converting their traditional IRAs to Roth IRAs, locking in at today's relatively lower income tax rates. Conveniently, Congress has made that possible for everyone, beginning January 1, 2010.

For 2009, only those whose adjusted gross income does not cross the \$100,000 barrier (single or married filing jointly) are eligible to convert to Roth IRA status. The income cap comes off January 1, 2010.

What's more, taxpayers who make the conversion during 2010 have an additional choice. The amount of the conversion may be reported as taxable income for the 2010 tax year, or 50% may be reported in 2011 and the remaining 50% in 2012. Normally, deferring the payment of a tax obligation is greatly to be desired. However, the 2011 and 2012 tax rates will be the ones applied to the deferral, so if those rates are raised, the delay could boost the ultimate tax obligation.

In addition to the possibility of tax-free account growth, the Roth IRA is exempt from the required minimum distributions at age 70½ that apply to traditional IRAs. Roth accounts give the retiree maximum flexibility in shaping and controlling income tax obligations during the year.

### The estate planning dimension

Paying income tax on a large account all in one year is quite a haircut, one that will present an understandable psychological hurdle to many. One way to get over the hurdle may be to consider the estate tax savings that go with the conversion to the Roth IRA.

Imagine that Doris has a \$500,000 IRA, that her income puts her in a 40% combined federal and state income tax bracket, that she is unmarried (so her estate won't get a marital deduction) and that she will be in the top federal estate tax bracket at her death. The IRA will pass to a grandchild.

If Doris does nothing, the federal estate tax on the IRA will be \$300,000. State death taxes may apply as well, depending upon where Doris lives. Despite that reduction in account value, distributions from the IRA to the grandchild will be taxable income, further reducing the financial benefit of the account. *(Continued on page 4)*

