GREENLEAF TRUST

# Perspectives

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## Economic Commentary

Consumer spending in May was a continuation of gains recorded in April. For the month, consumer spending grew by 0.4% following April's 1.1% gain. Not surprisingly, consumer confidence also rebounded to 98.2% from the previous recording of 95.6%. Personal income rose by 0.4% for the third consecutive month, and the savings rate declined to 5.4% from the three year high of 5.9% recorded in March of 2016.

The increase in consumer spending was led by improved sales in durable goods. Auto sales, as well as parts, increased at the strongest pace in two years—and that period, as we know, was very robust for autos. Unit sales volume grew even as the age of fleet stayed stable, fueling the assumption that unit sales have not yet peaked and could well remain stable for some time.

Non-durables grew in the quarter as well. The relatively warm winter has given way to some unseasonably warm spring and early summer months, which translated into lower heating months in February and March that turned to increased energy consumption as air conditioner demand grew rather early in Q2.

April's personal income growth was evidence of a solid increase in employee compensation, as hourly wages as well as hours worked both grew. Consistent improvement in the labor market through four of the first five months of 2016 has created tangible income growth, which was somewhat muted in the first quarter by a rather large jump in the savings rate and reduced non-durable spending by consumers. April and May's data suggest that the savings rate may well be moderating, and the confidence portrayed by consumers in the household surveys is actually translating to activity. Housing and construction data continue to paint a picture of strength. There have been several regions of our country where home price increases are reaching 2006 levels, and there is pretty good evidence to validate that first or starter homes are in short supply.

Most economic forecasting organizations began the quarter with estimates of growth between a low of 2.5% to a high of 2.8%. The data releases of April and May have caused the revision of the forecast to a range now of 2.7% to 3.1%, and these range increases came after the

*Commentary, continued*

Brexit vote became a reality. As a side note, our colleague John Graham, founding member of Rogge Global Partners headquartered in London, has written a wonderful piece on the Brexit vote and its implications (see page 5 of this issue). You might have recalled John's really fine March newsletter article that he wrote for us on the issues leading to the Brexit referendum. If you have not had a chance to read the articles I urge you to do so. You can find both on our website. I think the last paragraph of John's June 29th piece is particularly insightful and important to what is happening in many developed economies, including our own, in the post-recession economic landscape. His thoughts have interesting implications in our political landscape as well, and we will explore those implications as our election campaigns get fully under way later this summer.

"The consumer is employed and their wages are growing, economic forecasts are increasing and the PCE (Personal Consumption Deflator) ticked up…"

The consumer is employed and their wages are growing, economic forecasts are increasing and PCE (Personal Consumption Expenditures) ticked up to 1.1% from 0.8% which was recorded in March. Core PCE was steady at 1.6% which remains the Federal Reserve's target for the end of Q4 and thus we have projections of growth in the + 2.5% range, wage and hours growth, and strong consumer activity, what then are our risks to the positive in place trend?

First, we need to remember that while economic activity seems to be running at a 2.5% pace in the US, there are very few of our trading partners who are enjoying positive GDP growth rates and our growth rate remains vulnerable to the fate of our trading partners. It is too soon to understand many of the implications of Brexit but, on balance, no one of any credibility is suggesting the economic impact will be positive for global growth. Deflation was a constant theme of concern for many developed European countries prior to the referendum in Great Britain, and is more concerning today. Weaker foreign currencies vs. the US dollar will continue to place pressure on S&P 500 companies with respect to earnings, and all US exporters with respect to pricing and demand for goods. Conversely, what is sometimes bad for manufacturers is sometimes good for consumers. Strong US currency valuation vs. importers' currency makes imports cheaper and rewards consumer spending. The environment we have had in the last three years of our recovery has been challenging to manufacturers and exporters, and has resulted in lower business investment and spending. Given an already slow global growth environment and weak currencies within those countries with huge deflationary concerns, we don't see a change to the current uphill environment for US manufacturers or exporters of goods and services.

The lack of business investment has been a concern among many economists. As we have mentioned previously, capital investments in business have everything to do with productivity, yet are rarely done on a speculative basis. In the world of exporters, the profitability environment has been low due to global GDP growth and currency valuations and while it may seem intuitive that investing in productivity enhancements would serve their needs, most businesses are reluctant to take on long term capital expenses in the face of weaker demand. Their solution, especially when faced with a weak job market with plenty of slack in it, is to hire more people — which they have done, but at an obvious cost to productivity. Eventually, productivity matters and business investment activity will pick up but currently our GDP growth is heavily supported by the consumer. While a 70% contribution rate is powerful on the way up, it is also powerful on the way down — and any pullback by the consumer will be heavily felt in the forward half of 2016.

Inflation continues to be benign and, thus, the pressure on the Fed to raise rates has been muted, particularly in the last four weeks, and anyone expecting an increase in rates at the July Fed meeting has probably revised their expectations. While many holders of debt had been calculating higher debt cost expenses for 2016, we don't see evidence that it will accelerate in the second half of the year. This is generally good news for investors, but bad news for savers.

Geo-political events, as always, have the potential to sidetrack any economy with a slow growth rate in GDP. The terrorist-created events of 2016, as well as political turmoil in Europe, certainly add to global instability — which is never a friend to commerce and growth. The 2016 Presidential election will be our own referendum of sorts, and has the potential to either add to or decrease perceptions of confidence, optimism and stability. Do Presidential elections matter with respect to economic growth? To a degree, yes, although less than most would estimate. The President sets an economic agenda and focus on trade policies; however, little happens, as has been evidenced, if the legislative bodies don't act to allow the policies and focus to occur. Party platforms are yet to be formed, and economic speeches by the candidates continue at this point to be campaign-focused rather than policy-focused. More will be learned in the next three months. In the meantime, the consumer is employed, is confident and is spending.

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*Michael F. Odar, CFA*
*President*

"... Greenleaf Trust maintains its independence both in ownership and the services that we provide... freeing us from conflicts of interest and ensuring that our clients' well-being is at the center of everything we do."

# Independence Day

More than 240 years ago, our forefathers began the rebellion against "taxation without representation." The rebels' objective was independence, and they were willing to go to war for the ability to make decisions for themselves and not have those decisions made for them by some distant king. The Fourth of July celebrates the signing of the Declaration of Independence in 1776 and our country's independence.

It's with this same resolve that Greenleaf Trust maintains its independence both in ownership and the services that we provide. Our independence sets us apart by freeing us from conflicts of interest and ensuring that our clients' well-being is at the center of everything we do. This fact is as important to our clients as it is to us. That's because our independence eliminates the possibility of their interests being superseded by the policies of some faraway corporate office. Sound familiar?

We believe independence is part of our fiduciary responsibility to our clients and must be reflected in the services we provide to them. We don't have any products to sell or proprietary funds to invest clients' money into that benefit our own holdings more than theirs. From an investment research perspective, we have the freedom to impartially analyze the best combination of investments for each client's portfolio. Independent thought is a hallmark of our research process. This goes for both Personal Trust clients as well as clients of our Retirement Plan Division where we construct mutual fund menus for their employees to invest their retirement savings into.

It's not uncommon to see financial institutions sold to other financial institutions based on what is in the best interest of the shareholders versus the clients. That will not be the case at Greenleaf Trust. Independence is so important to us that our shareholders took careful planning steps during Greenleaf's creation to ensure the bank would remain so in perpetuity. We will not be bought or sold. That means clients can expect long-term consistent conflict free advice that has their best interests in mind from generation to generation.

# Brexit: An Emerging Reality

*John Graham*
*Guest Contributor*

*Earlier this year, our colleague John Graham contributed an article to our newsletter discussing whether or not the UK would leave the EU and what that decision might mean for our clients. With the Leave vote confirmed, we asked John to share his perspective on the event and its implications. John is a founding member of Rogge Global Partners headquartered in Great Britain and former head of JP Morgan's Multicurrency Asset Management Practice in London.*

As I write to you today from London, the United Kingdom has just been through two traumatic events involving its relationship with Europe. On Thursday, 23rd of June, the country voted by 52% to 48% to enter into negotiations to withdraw from the European Union. While this was a seismic shock, more unexpected and somewhat of a final nail in the coffin for the mood of the country was the defeat by England in football (soccer) Monday night by Iceland, a country of 330,000 people whose coach works normally as a part-time dentist. The loss eliminated England from the European Championship at the final 16 stage, and was the worst defeat in a tournament since the United States beat England 1-0 in the 1950 World Cup. To describe the mood of the country as sombre this week is an understatement.

In March, I wrote an article in *Perspectives* which described the background and process for the EU Referendum which took place on June 23rd.* Looking back at the last three months, there have been a few surprises, though the campaign unfolded much as I and others had predicted. The first surprise was the level of emotion. Though I alluded to the depth of emotion felt by the Leave side, I think we were all surprised at the level of rancour projected by both sides. The volume and nastiness were only stilled, temporarily, by the tragic death of MP Jo Cox, who was murdered in her constituency a week before the election. Many felt that the level of emotion which played out in the press during the campaign contributed to her death by way of upsetting the disturbed person who killed her. The second surprise was the ambiguous and ultimately failed campaign run by the Labour party who should have been fully behind the Remain camp. Instead, the party was badly split and led by an ineffectual Jeremy Corbin who, I was told by several senior Labour party members, was in the Leave camp himself. Lastly, the Remain camp was unable, through the long campaign, to marshal a reasoned argument for staying in the EU. Instead, they fell back on trying to engender fear in the electorate that leaving would be an economic disaster. While they were somewhat successful, the fear of economic disaster was never going to be as strong as the fear and hatred of immigration and the EU, which had built up and festered over the last 40 years.

Still, the result was unexpected. Right up until midnight on the 23rd, the polls, the markets, the bookies and the Leave campaign themselves thought that Remain would win. It was only with the announcement of the result from Sunderland (a city whose economic core is a massive Nissan car plant which manufacturers for distribution all over Europe) showing 62% had voted Leave that the Pound fell from 1.50 dollars to 1.35, and the Remain camp began to see that they were in trouble.

So what will happen now? The key thing to remember is that *no one knows*.

"… the result was unexpected… So what will happen now? The key thing to remember is that *no one knows*."

*See https://greenleaftrust.com/wp-content/uploads/2016/03/Perspectives-March-2016.pdf

*Brexit, continued*

No country has ever left the EU and the mechanism, the now famous Article 50 of the Treaty of Lisbon,** is sketchy on the process, being only specific on the time allowed for negotiating an exit. Clearly, the process will take time and will be fraught with uncertainty. What is required is to unpick all the political, social, financial and economic relationships which bound the UK to Europe. That is no easy task and there is no model which can be used as a guide. However, we can put out some data points which will indicate the decisions which will need to be made, their timing and their potential impact.

### Politics

In the wake of the Referendum, David Cameron, who called the Referendum and led the Remain camp, has resigned. Hence, a new leader for the Conservative party (who will become Prime Minister) must be elected by October, his last leaving date. It is logical, if not necessary, that this person be from the Leave side, but a bridge candidate could also be chosen by the Party. At this time, Boris Johnson, the former mayor of London, is the most likely Leave campaigner to be chosen. However, the "Stop Boris" wing of the party is likely to rally around Theresa May, the Home Secretary, as a bridge candidate, feeling she may be more electable than Boris.

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Jeremy Corbin, the Labour leader, is now facing a revolt in his shadow cabinet. Over the weekend, most of his shadow cabinet ministers, secretaries and officials resigned. On Tuesday, he lost a vote of no confidence among Labour MP's by a margin of 172 to 40. He will likely face a new election for leader. However, as the Labour membership is dominated by left wing union members, he may be able to survive such a challenge. Those opposing him feel that his performance in the local elections in May and the EU Referendum demonstrates that he would be a liability in any coming general election.

As to timing, it is expected that these leadership contests will happen rather quickly so that negotiations with Europe can proceed. What is not clear is whether or not there will be a general election. Britain has a five-year, fixed-term Parliament, meaning that elections are held every five years except in specific circumstances. The Conservatives do not have to call a general election

** The Treaty of Lisbon, 2007, Article 50

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.
   A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.
5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.

until 2020, but in the context of an event this profound, a new Prime Minister may wish to renew their mandate before entering into negotiations with the EU. This would be especially true if they perceive the Labour side to be badly divided and ineffectually led.

### Process

On paper, a straightforward flow chart for the exit process can be drawn.

Step 1 – The UK notifies the EU that it is leaving, invoking Article 50. The remaining 27 countries discuss.

Step 2 – Negotiations begin. A draft deal is then submitted to the EU Council. 20 countries (65%) must approve. The proposal is then ratified by the European Parliament.

Step 3 – After two years, if no draft deal emerges, negotiations can be extended if all 27 nations agree.

Step 4 – If there is no extension, EU treaties no longer apply to the UK after the two year deadline.

Step 5 – The UK leaves and Parliament must repeal the 1972 European Communities Act and replace it with a new agreement.

To begin the process, David Cameron has appointed a cabinet-level group from the Treasury, the Business Office, Foreign Office and Cabinet Office to oversee the complex negotiations to come. From the beginning there will be many competing agendas. Britain will try to retain as much access to the EU as possible while retaining control of her borders and sovereignty. Europe is likely to want a civil divorce, but a settlement which will not encourage a Frexit (France), Nexit (Netherland) or any other exit. The EU's greatest fear is further splintering of both the community and of the Euro. Brexit will have given voice to the millions in Europe who are tired of austerity, fearful of immigration and feel left behind by what economic recovery has happened in the Financial Crisis.

On the sidelines of the coming diplomatic circus are Scotland, Northern Ireland, the labour unions and a host of other interested parties who hope to influence the arc of decision-making. What that arc looks like and its timeframe are the great unknowns and will remain so down to the negotiation wire. In the last 35 years I have lived in London, I personally can't remember any EU decisions which didn't happen in the 25th hour. So, we could easily be well into 2019 before anything is agreed upon and the UK and the EU can go their separate ways.

"In the last 35 years I have lived in London, I personally can't remember any EU decisions which didn't happen in the 25th hour. So, we could easily be well into 2019 before anything is agreed upon ..."

### Implications

The economic implications of Brexit for the UK are uncertain, but unlikely to be positive on balance. The market has pointed toward those who will be short term losers: banks, builders, real estate agents and others dependent on either long term domestic investment or foreign direct investment. Investment hates uncertainty. Balanced against that thought though is the possibility that

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*Brexit, continued*

market repricing of UK assets and Sterling will make the UK an attractive place to invest in spite of its reduced access to the EU. However, the news flow over the course of exit negotiations will create volatility and reduce the desire for global investors to hold UK assets.

For Europe, the same applies. While it is tempting to think that global investors will now pour funds originally destined for the UK into Frankfurt or Paris, Brexit has opened a Pandora's box out of which many unpleasant things may emerge. The possibility of further withdrawals from the EU, pressure on European funding and a continued lack of vision as to what the EU really is will also impact investment plans. European assets may well be subject to the same volatility as UK assets.

"It's my view that Brexit represents the first large scale revolt (fortunately democratic in nature) by people whose expectations around their economic life were damaged by the crash in 2008 and whose expectations for recovery have not been fulfilled."

For the globe, Brexit adds to an already difficult economic picture. The uncertainty created in Europe will likely restrain global growth further. Central Banks, who are already at wits end over how to promote growth via monetary policy, will be further challenged, thus making further monetary easing likely. One has the feeling that new and creative ways of injecting money into the world's economies are about to be tested. At a minimum, those Central Banks who might have been thinking of holding their policy in place or tightening are likely to have their hand stayed. In this kind of environment, investment opportunities will be highly specific. A market of stocks, not a stock market.

Socially, the implications of Brexit are grim. Britain has already become a much more divided society than ever before. Remain versus Leave, North versus South, London versus everyone save Scotland, Young versus Old, and Working Class versus Elites. This vote will not be forgotten for a long, long time. It will be discussed in pubs, sung about on the football terraces and argued about endlessly on talk shows the length and breadth of Britain.

In 1856, Alexis de Tocqueville published a book called *The Old Regime and the French Revolution*. In it, he tried to explain why the bastions of the French Revolution were in areas of long term economic growth. Out of his book and later work, came the theory of the Revolution of Rising Expectations which posits that revolutions and revolts don't happen when people are oppressed or deprived, but when consistently rising expectations of an improving life have been dashed. It's my view that Brexit represents the first large scale revolt (fortunately democratic in nature) by people whose expectations around their economic life were damaged by the crash in 2008 and whose expectations for recovery have not been fulfilled. In almost every developed country, movements of revolt are simmering. The Brexit vote provided an outlet for this built up anger and frustration. Britain will not be the last to see this kind of event.

# The Dark Side of Serving as an Estate Trustee: Personal Liability

*George F. Bearup*
*Senior Trust Advisor*

Estate fiduciaries are often placed in a challenging position where assets pass outside of a probate estate or trust, e.g. life insurance; jointly held property; IRAs; 401k accounts; life insurance trusts; transfer-on-death securities accounts, etc. The fiduciary has no control over those non-probate assets that can cause federal estate tax liability. Without the ability to direct or assume control over these non-probate assets the fiduciary may face both a liquidity problem and the lack of means to satisfy federal estate taxes or the decedent's prior unpaid tax liabilities. Add to those practical realities of estate administration the fiduciary's personal liability if the government is not fully paid first under its Priority Statute, and you have the making for a 'perfect storm.'

### Fiduciary's Personal Liability: The Priority Statute

The tax code imposes personal liability on the personal representative or fiduciary of a decedent's estate for unpaid claims of the United States to the extent of a distribution made from the estate when: (i) the fiduciary distributed assets of the estate; (ii) the estate was insolvent at the time of the distribution, or the distribution rendered the estate insolvent; and (iii) the fiduciary had notice of the United States' claim for taxes or accrued interest. The imposition of personal liability on the estate fiduciary extends to interest and penalties imposed for the decedent's failure to file a tax return or to timely pay the tax owed.

"The tax code imposes personal liability on the personal representative or fiduciary of a decedent's estate for unpaid claims of the United States..."

This personal liability imposed on an estate fiduciary has actually existed since 1789. The federal Priority Statute, as it is currently written, provides: *"A representative of a person or an estate (except a trustee acting under Title 11 [which excludes a trustee who is appointed in a bankruptcy proceeding] paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government."*

If the decedent owed back taxes, e.g. gift or income taxes which remain unpaid at the time of the decedent's death, or estate taxes are due as a result of the decedent's death, the estate's fiduciary is responsible to make sure that those taxes are fully paid before other debts are paid or assets are distributed from the decedent's estate. Federal courts have included in the term debt that should only be paid after the federal government: (i) hospital and medical bills; (ii) unsecured creditors; (iii) state income taxes; (iv) a beneficiary's gift or distributive share of the estate or trust; and (v) satisfaction of the surviving spouse's elective share. Excluded from the term debt for purposes of the same statute is the fiduciary's payment of: (i) a creditor with a security interest; (ii) funeral expenses; (iii) probate administration expenses; (iv) probate

*The Dark Side, continued*

court costs; (v) reasonable fiduciary and attorney fees; and (vi) probate court authorized family and homestead allowances. This Priority Statute gives an unsecured first priority to the United States against the entire estate of the decedent debtor, but not a lien against the assets of the estate.

The statute of limitations that the IRS faces in which to assert and issue a notice of fiduciary liability is the later of one year after the fiduciary liability arises or the expiration of the statute of limitations for collecting the underlying tax liability, which could be as long as ten years depending upon the nature of the tax or the reason why the tax was not timely paid.

"Thus, if… the fiduciary pays any part of an unsecured debt, or distributes assets to estate beneficiaries prior to paying the United States, that fiduciary will become personally liable to the extent of the payment for unpaid claims of the United States."

Thus, if a decedent owes taxes to the federal government, where the decedent or his or her estate is treated as a debtor, and the fiduciary pays any part of an unsecured debt, or distributes assets to estate beneficiaries prior to paying the United States, that fiduciary will become *personally* liable to the extent of the payment for unpaid claims of the United States. In sum, the fiduciary's personal liability arises when: (i) the estate fiduciary; (ii) distributes estate assets before paying a claim of the Government; and (iii) when the estate fiduciary knew or should have known of the Government's claim. "The person who becomes invested with title [to the decedent's property, the estate fiduciary] is thereby made a trustee for the United States, and is bound to pay the debt first out of the proceeds of the debtor's property." *Beaston v. Farmers' Bank of Delaware, 37 U.S. 102, 133 (1838)*. The cause for an estate's insolvency is ignored when courts apply the *Priority Statute*.

The *"should have known"* step in this fiduciary liability analysis may make folks uncomfortable when they are asked to act as an estate fiduciary. An honest belief held by the estate fiduciary that there were sufficient funds available for the payment of the government's claim will not save the fiduciary from personal liability if that belief later proves to be inaccurate. The IRS must only show that the fiduciary either had actual knowledge of such facts as would put a reasonably prudent person on notice as to the existence of the tax debt before making the challenged distribution or payment, *Internal Revenue Manual 5.17.14.7* (July 9, 2012), or the fiduciary possessed information [a missing income tax return; an unfiled gift tax return?] that would put the fiduciary on notice that an obligation was owed by the decedent to the United States. *Internal Revenue Manual, 5.17.14.3* (January 24, 2012)

### Recent Applications of the Priority Statute

In 1995 Mr. Marshall had his Marshall Petroleum, Inc. stock redeemed. Thirteen years later the Tax Court found that the redemption price paid to Mr. Marshall was well below the redeemed stock's fair market value. The result were indirect gifts made to Mr. Marshall's son, daughter-in-law, grandchildren, and a trust that Mr. Marshall had established for his former wife, all of whom were shareholders of Marshall Petroleum, Inc. at the time of the stock redemption. The IRS assessed gift taxes against the recipients of the indirect gifts since Mr. Marshall had died in 1996 not having paid any gift tax after the redemption, frankly not even knowing that he made a taxable gift. The assessment included interest on the unpaid gift tax liability that had accrued for over the 13 years. Shortly after the Tax Court decision Mr. Marshall's former wife died and the fiduciaries of the former wife's estate ignored the IRS assessment of gift tax liability and accrued interest and made distributions of her estate, in effect depleting her estate and rendering it insolvent. The Court found that the former wife's fiduciaries had breached their fiduciary duty in violation of the federal *Priority Statute* by distributing her estate assets while her share of the gift tax liability and accrued interest remained unpaid and held them personally liable for her share of the unpaid gift tax and 13 years of all of the accrued interest on all of the indirect gifts, not just the former wife's pro rata share of the accrued interest. *US v Elaine T. Marshall, No 12-20804, (August 20, 2015) Affirming in Part, Reversing in Part and Vacating, No 12-20804 (Fifth Circuit, 2014)*

In another decision, a Court held that an estate fiduciary could not escape personal liability under the Priority Statute when the fiduciary attempted to delegate its estate tax payment obligation through a Distribution Agreement signed by several estate beneficiaries, all of whom agreed to pay their pro rata share of any federal estate tax liability. In United States v. Johnson, 2012 U.S. Dist. LEXIS 72194 (D. Utah, 2012) the court observed:

*"Thus, in the context of section 3713, insolvency or the inability to pay one's debt is not viewed from the perspective of straight accounting principles, but rather from the perspective of whether the estate has impermissibly attempted to delegate its tax obligations. Section 3731 does not recognize such shifts in liability. In other words, personal representatives cannot divest themselves of statutory liability through contract with others. One of section 3731's purposes is to provide a clear path of recourse when a personal representative distributes assets of an estate before paying estate taxes. Were courts to excuse a personal representative from liability when they secure contribution agreements, the Government would have to bring an action in contract, prove it is a third-party beneficiary of the agreement, and then establish its right of contribution. Section 3713(b) is designed to avoid such complications. It provides a straightforward way to collect unpaid taxes from the very individuals who dispersed the estate's assets without having satisfied the tax liability."*

Family and friends often ask trusted family, friends, or their professional advisors to serve as fiduciaries of their estates, either as personal representatives or a successor trustee of a trust. While it is humbling when a family member or friend expresses that level of trust and confidence, and it is often viewed as an honor to be asked to serve in that capacity, accepting that role carries with it the potential for extraordinary personal liability that should prompt some reflection before saying 'yes.'

"…accepting that role [as fiduciary] carries with it the potential for extraordinary personal liability that should prompt some reflection before saying 'yes.'"

*Carlene R. Korchak, CTFA*
*Vice President*
*Trust Relationship Officer*

“There are basically three categories of beneficiaries — heirs (or other individuals), charities and Uncle Sam. Most clients hope to maximize the benefit to the first two of these categories.”

# The Naming Game

There are basically three categories of beneficiaries — heirs (or other individuals), charities and Uncle Sam. Most clients hope to maximize the benefit to the first two of these categories. How a person selects and names beneficiaries for his or her Roth and Traditional IRAs can have a significant impact on meeting that goal.While tax considerations should not be “the tail that wags the dog,” they are an important factor when deciding how to structure beneficiary designations.

Most clients name their spouse as primary beneficiary to assure the spouse’s needs are met first before considering other options. There are special rules for spouse beneficiaries of IRAs not available to other beneficiaries that allow the ability to rollover or treat the inherited IRA as his or her own, and to name new beneficiaries of that IRA. If the spouse does not need support from IRA assets, if the surviving spouse is considering new beneficiary designation options, or when account owners are considering contingent beneficiaries, the following information may be helpful.

Distributions from traditional IRAs are generally taxed as ordinary income to the recipient, so it often makes sense to name beneficiaries with the lowest income tax rate.

1) For those who are charitably inclined, naming qualified charities as beneficiaries of either a portion or all of a traditional IRA is the most tax efficient choice.
2) In some states, such as in Michigan, the tax rate for traditional IRA distributions is based on the age of the recipient, with older persons taxed less. When considering naming individual beneficiaries, the traditional IRA account owner may want to name an older beneficiary who may benefit from a lower state income tax rate. In Michigan, recipients born before 1946 are exempt from paying state tax on up to $49,811 in private pension and retirement benefits in 2016 if they are single filers, or up to $99,623 if married filing a joint return. For those born between 1946 and 1952, the first $20,000 is exempt for single filers and $40,000 is exempt if married filing a joint return. Recipients born after 1952 are subject to Michigan income tax on all private pension and retirement benefits unless filing jointly with a spouse born prior to 1952. Careful consideration must be given to the older beneficiary’s other “pension income” before making this choice.
3) Directly naming minor children or adults who pay little or no income tax are options that come with two cautions. Naming a minor child can result in probate issues since a guardian or conservator must be named if the beneficiary is a minor at the time of the inheritance. This concern

can be addressed by naming an UTMA (Uniform Transfer to Minors Act) account for the benefit of the minor child and naming a trusted adult custodian for that account, rather than naming the child directly. The second caution is that, while there will be a required minimum distribution each year to a traditional IRA beneficiary, there is no control over the maximum amount that can be taken. Young adults or those with less financial experience or tax acumen may withdraw the full amount at one time from an account that the owner intended to last for a longer term. Not only does this go against the owner's intentions, it might create a sizeable tax bill for the beneficiary, with no "after the fact" remedies available.

4) Naming a trust as beneficiary of a traditional IRA may seem like a reasonable solution for "spendthrift beneficiaries" or in situations where the account owner would like to have some trustee control over distributions in excess of the required minimum. IRS rules regarding naming a trust as beneficiary of a traditional IRA have changed dramatically over the last 15 years. Unless the trust meets some technical "see-through rules," naming a trust as beneficiary of a traditional IRA may be one of the least tax efficient options available. When a trust qualifies as a "see through trust," the required minimum distribution to the trust will be calculated based on the oldest beneficiary's age. If the trust does not qualify as a "see through trust," not only must the entire IRA be distributed to the trust within 5 calendar years of the account owner's death, but trusts are taxed based on highly compressed marginal tax brackets when compared with individual brackets. In other words, if a trust which does not meet the current IRS rules is named as beneficiary, a much higher percentage (as much as about 47%) of the IRA is likely going to Uncle Sam and the State of Michigan.

For clients who want to name a trust as beneficiary of a traditional IRA or for those who have named a trust as beneficiary many years ago, we suggest discussing intentions to assure the trust designation is appropriate and necessary. If it is, then we highly recommend a review and update of the trust document to assure it meets current IRS rules and the client's intentions.

Roth IRAs are unique because once contributions are made, growth within the Roth and all distributions are tax free. The impact of this tax free status can be substantial, around 30% more than a taxable account at a 6% rate of return over 35 years for someone in the 25% marginal tax bracket. When feasible, the best strategy with these types of accounts is to allow the assets to grow tax free over the longest term of years possible prior to final distribution. While distributions from Roth IRAs are not required during the account owner's lifetime, there are minimum required distributions

"For clients who want to name a trust as beneficiary of a traditional IRA or for those who have named a trust as beneficiary many years ago, we suggest discussing intentions to assure the trust designation is appropriate and necessary."

*Naming Game, continued*

after the account owner's death.

5) Naming younger beneficiaries (using an UTMA for minor children as noted above) or a trust that qualifies as a "see through trust" for the benefit of younger beneficiaries makes sense for Roth assets.
6) In certain situations, for clients with substantial traditional IRAs it may make sense to convert all or a portion of traditional IRA to a Roth IRA to leave tax-free benefits to heirs. Income tax will be paid by the client on the converted amount at the client's tax rate, so this is a decision that should be carefully weighed before being made. Roth conversions are "reversible" if done prior to final filing of the income tax return for the year in which the conversion was done.

The rules for IRA beneficiary designations and the corresponding tax implications are complex and do change over time. Personal circumstances and goals also change over time. For these reasons, "set it and forget" can be a costly mistake and we recommend reviewing beneficiary designations at least annually. At Greenleaf Trust, Client Centric Team members are well-versed in these rules and stand ready to assist clients with analyzing goals, whether tax-related or not, and then recommending beneficiary designations to meet those goals.

# Rough Day at the Office?

*Andrew L. Riker, CFP®*
*Vice President*
*Senior Wealth Management Advisor*

I have two computer screen monitors in my office and I often have one monitor dedicated to live stock market quotes. It's always preferable to have more "green" (stocks higher for the day) than "red" (stocks down for the day) on that monitor. In the two days following the United Kingdom's surprising vote to leave the European Union, stocks shed nearly $3.6 trillion in value as the markets took an immediate and swift response to the news. Needless to say, my stock quote screen was pretty much bleeding red those couple of days.

On days such as this, when the market sells off substantially, I frequently receive comments like "I bet you had a rough day at the office." I think some may envision my phone ringing off the hook with panicked clients and frantic selling taking place. In reality, the day-to-day fluctuation of the market (even if substantial) doesn't typically alter my day-to-day routine at the office to a large extent. The main reason for this is because we subscribe to a holistic approach to financial planning and portfolio management. Portfolios' investment objectives are constructed and maintained according to each client's goals, unique circumstances, and needs. If an investor cannot handle a market decline similar to what was experienced in the days following Brexit, it's likely that the investor shouldn't be invested in the market in the first place.

> " In reality, the day-to-day fluctuation of the market (even if substantial) doesn't typically alter my day-to-day routine at the office ..."

On the front end of each client relationship we gather as much information as possible so that we can prepare what we refer to as a customized in-depth wealth management plan. A boiled down version of the wealth management plan lives on in what we call an investment policy statement that we review at least annually with each client. These measures along with our desire to be in frequent contact and develop solid relationships with our clients helps us ensure that portfolios are structured appropriately.

Sections of our investment policy statement along with an explanation and examples are provided below

- Financial Objectives
    - ◊ In this section we list unique client goals and objectives, such as;
        - Efficiently pass on wealth to heirs, or
        - Grow assets to support desired lifestyle in retirement
- Time Horizon
    - ◊ Time horizons are associated with the time periods during which a portfolio is expected to generate returns to meet major financial objectives or life events.
- Risk Tolerance
    - ◊ We list both a willingness and ability to take risk in this section. Willingness is how much risk a client would like to take and ability is how much risk a client can take.

*Rough Day, continued*

"Reviewing investment policy statements doesn't make days like those following the Brexit vote more fun for market participants, but it does help ensure that a client's exposure to the market is appropriate..."

- Demand on Capital
  - ◊ Demand on Capital is a phrase referring to net withdrawal rate given in annual-percentage terms by dividing net withdrawals by the market value of a portfolio.
- Tax Considerations
  - ◊ Here we list any tax consideration that may impact how we manage client assets such as tax-loss carry forwards and marginal income tax rates.
- Investment Objective
  - ◊ Primarily based on the information in the prior sections listed above, we structure an investment objective listing target allocations to stocks, alternative assets, fixed income, and cash.
- Unique Circumstances
  - ◊ Any items that may have an impact on the financial planning process not listed otherwise should be noted in this section. For example,
    - Debt exposure
    - Real estate holdings
    - Insurance coverage

Reviewing investment policy statements doesn't make days like those following the Brexit vote more fun for market participants, but it does help ensure that a client's exposure to the market is appropriate given their unique circumstances and more importantly that their long term financial goals and objective are achieved.

# Common Retirement Saving Mistakes and How to Avoid Them

*Quinn C. McCormick*
*Participant Services Coordinator*

Planning for retirement can be an overwhelming task. Saving is extremely important yet most of us learn very little about it while in school. Many people don't even consider putting money away for retirement until they have a plan through their employer. Even those who do save often aren't saving enough. So what are some of the most common mistakes made when saving for retirement and how can you avoid them?

## Waiting for the "right time" to start saving

We all have our own excuses for when the "right time" to save will be. For many of us we want to wait until our debts are paid off, until our kids are a certain age, or until we get a pay raise. The "right time" is NOW! The earlier you start saving, the easier it will be to reach your retirement goals. According to a national poll by Bankrate, more than a third of Americans have not begun saving for retirement. Don't fall into the trap of procrastinating, start today!

## Cashing out a previous retirement account instead of rolling it over

Each time you leave an employer you have the option to cash out your retirement account or roll it over (to a new employer plan or an IRA). While it can be very tempting to withdraw the funds, it is crucial to your retirement goal that you roll the money over. Cash outs are subject to federal and state taxes as well as a 10% early withdrawal penalty (if applicable). While the extra money may seem appealing now, it will be much more impactful in retirement due to compounding. You planted the seed by contributing to a retirement account; give it a chance to grow!

## Having goals that are too vague

It is easy to picture your life in retirement: relaxing, enjoying, and being stress free. What will it take to get there? How much money will you need to have saved to live comfortably in retirement? How much do you need to save today to reach your goal? There are plenty of retirement calculators available but many have never utilized these tools to get an idea of how much they need to have saved. Those who have used a retirement calculator are much more likely to meet their retirement goals because they know what it takes to meet them. If you don't know how much you will need, how can you ensure you are saving enough?

"There are plenty of retirement calculators available but many have never utilized these tools to get an idea of how much they need to have saved."

211 SOUTH ROSE STREET, KALAMAZOO, MI 49007 269.388.9800

*Saving Mistakes, continued*

### Not taking advantage of free money

Many employers will offer a matching contribution to encourage employees to save. If this is the case for you, take advantage! Even if you have a savings vehicle outside of your employer sponsored plan, make sure you are contributing enough to take full advantage of any employer matching. It is free money available to you as a benefit of working for your company. Not all companies offer a match. If yours does, don't miss out!

### Letting debt get in the way

Debt seems to be an inevitable part of life for many. While most people have debt, it is important to stay on track for retirement in spite of any debts you may be paying off. Create a budget and stick to it so that you are able to continue payments on debt as well as contribute to your retirement account. Make saving for retirement a priority right away. By waiting until you are debt free to save you may be missing out on a lot of compounding. As mentioned, the earlier you start saving for retirement, the better! Compounding is a wonderful thing but it takes time. The power of compounding makes the dollars you save today worth more than the dollars you save tomorrow. Don't let debt stop you from saving today!

> "While most people have debt, it is important to stay on track for retirement in spite of any debts you may be paying off."

### Setting and forgetting your contribution rate

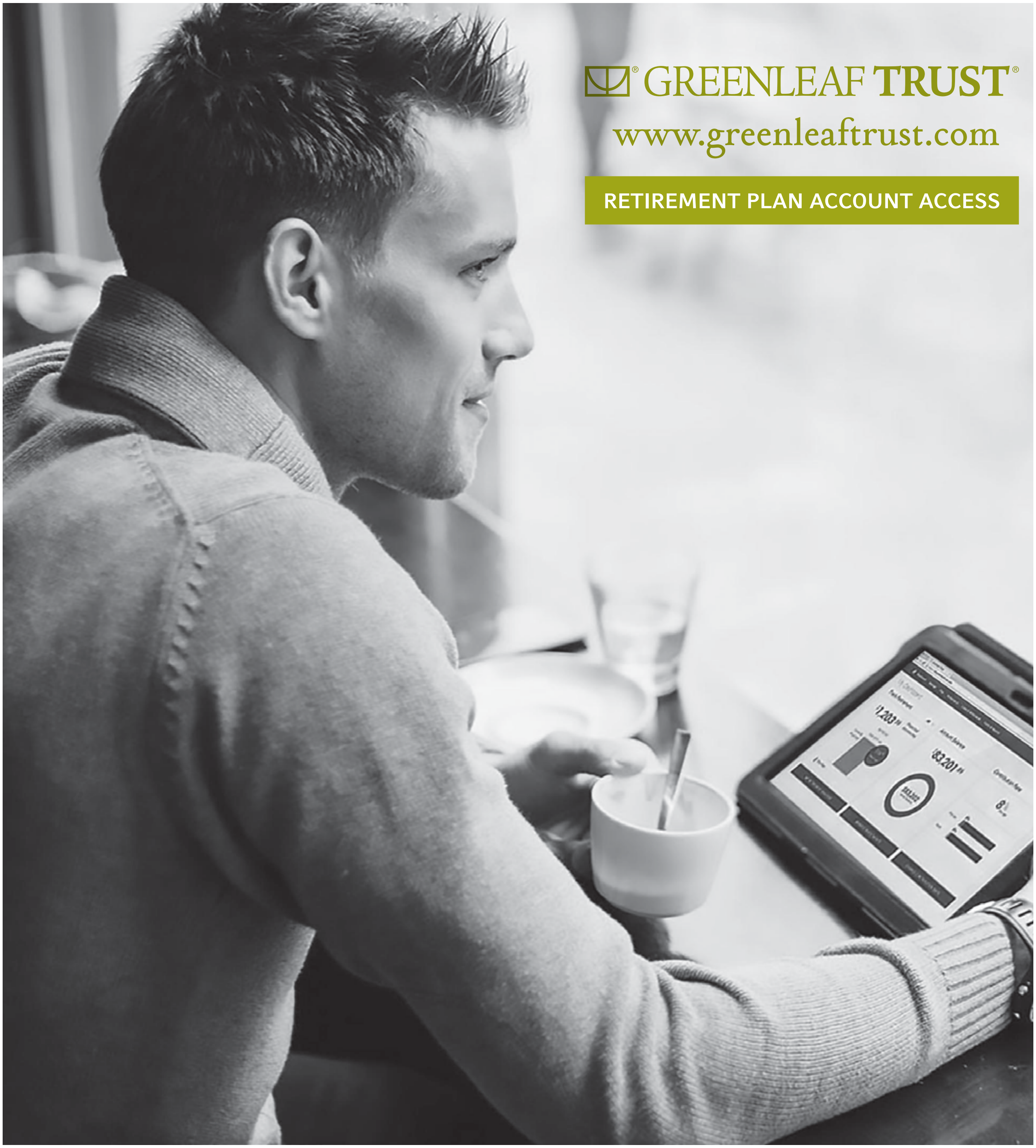
Many people set up their contribution rate for their retirement plan when they start a new job and never increase it. Experts recommend increasing your contribution rate by at least 1% each year. To help yourself remember, set up a reminder on your phone to increase each year, increase on a special date such as a birthday or anniversary, or increase your contribution rate when you receive a pay raise. Whatever works for you, just keep in mind that your contribution rate should not be "set it and forget it."

### Not having a long term investment strategy

Choosing your investments can be a daunting part of your retirement planning. Should you go with a target date fund? Pick your own mix of funds? Whatever your strategy, it is important to make sure you are focused on the long term. An international fund with a 3-year return of 10% may sound appealing but don't put all of your eggs in one basket. Make sure you have exposure to different markets by creating diversity in your portfolio. Keep in touch with your provider and always take advantage of their services when they visit your office to ensure your investment strategy will put you on the right track for retirement.

Whether retirement is just around the corner or decades in the future, it is crucial that you are an active participant in the journey. Staying informed and avoiding these common mistakes are some great steps to make sure you begin your journey on the right foot.

# Managing your Retirement Plan Participant Account should be super simple. And now it is.



## Stock Market Pulse

| Index | 6/30/16 | Total Return Since 12/31/2015 |
|---|---|---|
| S&P 1500 | 485.42 | 4.20% |
| DJIA | 17,929.99 | 4.31% |
| NASDAQ | 4,842.67 | -2.66% |
| S&P 500 | 2,098.86 | 3.84% |
| S&P 400 | 1,496.50 | 7.93% |
| S&P 600 | 708.37 | 6.23% |
| NYSE Composite | 10,489.75 | 3.41% |
| Dow Jones Utilities | 716.52 | 26.17% |
| Barclays Aggregate Bond | 112.62 | 5.30% |

| P/E Multiples | 6/30/16 |
|---|---|
| S&P 1500 | 18.1x |
| DJIA | 17.1x |
| NASDAQ | 20.7x |
| S&P 500 | 18.0x |
| S&P 400 | 19.4x |
| S&P 600 | 19.2x |

## Key Rates

| | |
|---|---|
| Fed Funds Rate | 0% to 0.25% |
| T Bill 90 Days | 0.26% |
| T Bond 30 Yr | 2.30% |
| Prime Rate | 3.50% |

## Current Valuations

| Index | Aggregate | P/E | Div. Yield |
|---|---|---|---|
| S&P 1500 | 485.42 | 18.1x | 2.11% |
| S&P 500 | 2,098.86 | 18.0x | 2.17% |
| DJIA | 17,929.99 | 17.1x | 2.54% |
| Dow Jones Utilities | 716.52 | NA | 3.00% |

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.20%

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