Trust Company *of* Vermont Quarterly Update

January 2018

Brattleboro ♦ Burlington ♦ Rutland ♦ Manchester ♦ St. Albans

Employee-owned & Vermont-based www.tcvermont.com

Will Charitable Giving Fall in 2018?

Christopher G. Chapman, TCV Principal

A big question raised by the new federal tax legislation is, what will be its effect on charitable giving? The blizzard of changes wrought by the tax bill cross the landscape of the economy, but notably, it has left the rules on charitable deductions unchanged.

Despite being spared from the new law's attention, charitable organizations everywhere are worried. The main reason is the roughly doubling of the standard deduction to $12,000 for individuals and $24,000 for couples in 2018. Non-profits are worried that fewer people will itemize deductions as a result. They are concerned that individuals as a group, whose contributions make up nearly three quarters of charitable giving, may donate less going forward.

In essence, the uncertainty prompts a much deeper inquiry about donors' cultural values. That is, what actually motivates people to support institutions and causes that make up the educational, social, health-care, literate, artistic and religious aspects of the social fabric? Is it tax savings for contributions? Or is it something more?

The budgets of non-profits are in the balance. In 2016, total giving in the United States totaled approximately $290 billion, equal to an amazing, record 2.7 percent of the overall economic activity, according to Giving USA 2017, The Annual Report on Philanthropy. Not quite two-thirds of that amount came from individual giving, or about $281.6 billion. (That statistic does not include bequests, which if added to the giving of the living would make individual donations 80 percent of all charitable giving.)

The widely respected Tax Policy Center in Washington, D.C., estimates that the 46 million itemizing tax filers will drop to less than 20 million as a result of the increased standard deduction.

For perspective, however, it is helpful to recall one observer saying years ago that, to find a society's actual cultural values, look at its tax code. The United States laws favoring charitable giving are the most generous in the world. It is also notable that U.S. citizens have historically also been the most generous worldwide. In addition, Americans are in the midst of the largest transfer of wealth in the history of civilization, and assets have never been more liquid, or easily transferable.

With both the facts and fears in mind, we are curious to see how the tax law will influence charitable giving. As the sage and experienced among us frequently say, "We'll see."

The "Act"

Estate Planning in Vermont and the impact of the "Tax Cuts & Jobs Act" signed into law on December 22, 2017

Jack Davidson

The Income Tax

Some good news for our clients and "complicated" news for our non-profits

As a result of the significantly higher standard deduction, non-profits may fear the impact on contributions. But there is one case where both the donors and the non-profits will discover good news.

Donors age 70 ½ may make charitable donations through their IRAs, (including rollover IRAs, inherited IRAs, and SEP or SIMPLE IRAs that are no longer active and receiving ongoing employer contributions). In the past, many donors itemized their deductions and the charitable donations were attractive "bottom line" deductions. Many taxpayers will now find that they plan on taking the standard deduction of $12,000 or, if married, $24,000, rather than itemizing the deduction. Diverting taxable income from the IRA amounts to an "above the line" charitable deduction. Our clients can still have the benefit of charitable deductions and take the standard deduction as well, as long as they are 70 ½ and we make the distributions from their IRA. At the Trust Company of Vermont, we have designed a system for our clients to facilitate charitable gifts from their IRAs.

The Estate Tax

Some "complicated" news for some of our clients and "complicated" news for our non-profits

The Act increased the federal exemption to $11.2 million as of 2018. Technically, it simply doubled the federal exemption of $5 million, set in 2010, indexed to inflation, which would have been $5,600,000 in 2018. Prior law also included portability of the exemption for married couples so that a $22.4 million estate would not be subject to estate taxes. This is complicated news for nonprofits. There is less incentive to take charitable deductions. Vermont's exemption remains unchanged at $2,750,000. Vermont does not have portability, but a good estate planning attorney will help save a Vermont tax for married couples under $5.5 million. The Vermont tax is currently 16% of the amount above the exemption, and may be attractive enough to ease the fears of the non-profits.

Some "complicated" news for some of our clients

Anyone with estimated estates above $5.6 million may still want to visit their lawyer sooner than later. There may be a high probability that the tax bill will sunset in 2025 and revert to the $5 million base, indexed. Outright gifts and gifts in trust may save more than 40%. When the law sunsets, some may need to be in the race with the grim reaper and the IRS. One or the other may win, and your lawyer will work to have you win the race.

No Thank You, Mr. Buffet

Steve Singiser, Portfolio Manager

There is universal acceptance that Warren Buffet is one of a very small group of professional investors whose advice is worth paying attention to. And he is one of the 'good guys' who can be trusted for his genuineness. Would you want him to manage your investments, if he was available to do so?

I don't think so, but let me explain.

As I am sure you are aware, Warren Buffett is a multi-billionaire. His net worth is calculated to be over $80 billion. His massive wealth has been created by his disciplined, conservative approach to investing. Typically, he makes large commitments in a limited number of companies. By commonly accepted standards, his investments are under-diversified. This works for him in no small part because his investment resources are so large. Mr. Buffett can live with a relatively high level of volatility; current income is not a priority.

Your investment resources, and mine, are more modest than his. For us, wide market swings (i.e. volatility) are not well-tolerated, and most of us require a certain level of spendable income. Having limited resources sets us apart from Mr. Buffet, and our objectives are vastly different.

Safety, diversity, quality, and consistency are words that comfort us, particularly when market values are declining. During these periods, your Trust Company of Vermont manager is available to discuss with you what we can do to protect your investments and reduce your anxiety. We share your pain.

Calling you our client or customer does not adequately define our relationship. It is important we get to know you on a more personal level. How else can we determine your present tolerance for risk or need for current income? How else can we evaluate future events that change your priorities? An obvious list would include retirement or loss of employment, a new job opportunity, or an unanticipated inheritance. Sometimes we can advise you as to preferred sources of funds for large expenditures such as a home purchase, college tuition, or unexpected medical bills. It would be unrealistic to expect Mr. Buffett to fill this roll. Getting to know you is not just part of our job. It is the best part. Let's stay in touch!

As a complement to this article I want it clearly understood that I am a very big booster of Warren Buffet. He has consistently contributed to my world of investment management. Much of this is through his clever and witty comments at the time of the Berkshire Hathaway Annual Meetings.

I clipped the following shareholder letter in 1987. It is a Warren Buffet gem, but it requires repeated readings to grasp the subtle messages. I have read it many times during the past nearly thirty years. It is excerpted on the next page and entitled "Taking Advantage of 'Mr. Market'".

We quote here from the 1987 Berkshire Hathaway Annual Report, where Chairman Warren Buffet talks about his Columbia University mentor, Professor Benjamin Graham:

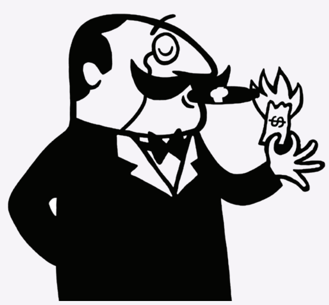
Taking Advantage of Mr. Market

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be the most conductive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market, who is your partner in private business. Without fail Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems.

At times, he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of his imminent gains.

At other times, he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions, he will name a very low price, since he is terrified that you will unload your interest on him.



Mr. Market has another endearing characteristic: he doesn't mind being ignored. If his quotation is uninteresting to you, he will be back to you with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to ignore him or take advantage of him, but it will be disastrous if you fall under his influence.

Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, you're the patsy."

- Warren Buffet

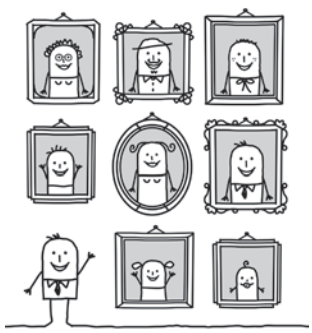
Kenny Rogers had the right idea, when he sang, "You got to know when to hold 'em, know when to fold 'em." If only it was that easy.
- Steve Singiser

HOW THE GUN TAUGHT ME ABOUT EVOLUTION

Jack Davidson

My role at Trust Company of Vermont is to review estate plans and collaborate with others who also do estate plans .....trust officers within the company, and lawyers and accountants. My preferred method of communication is storytelling, which has its benefits.....rarely am I asked to make public presentations.

In the past, estate planning often involved strategies to save estate taxes. Now that estate tax exemptions are significantly higher, far fewer estates are currently subject to the complex estate tax rules. Now, planners can truly focus on how to transfer wealth to others, and the impact on those receiving inheritances. Sometimes my view of tax saving plans are GMOs (genetically modified) and plans to take care of family members are Naturally Organic. Fortunately, in my world, I do not have to take a position on whether GMOs are harmful. GMOs in our tax code are simply unavoidable, and they have not gone away. And we still have to deal with another GMO: the income tax.



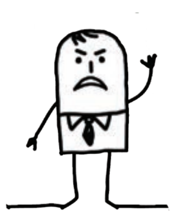
In the past, estates were populated by assets held outright. Now the biggest challenge is the IRA and the 401(k), and the tax implications. Planning an estate using very complex tax rules can save significant income taxes, and many planners are suffering from IRS rules that are evolving, rather than stable enough to plan with certainty. Often planners come from different states, or different frames of mind. In Vermont, lawyers need to know the Vermont law but may not have experience with the income tax laws that affect estates, and accountants may not know the legal rules that have an impact on tax strategies.

Often when I think of evolution, I think of tribes. Sometimes I see 3 tribes in the estate planning world: trust officers, lawyers, and accountants. Our goal is to have all tribes work as one for the client,

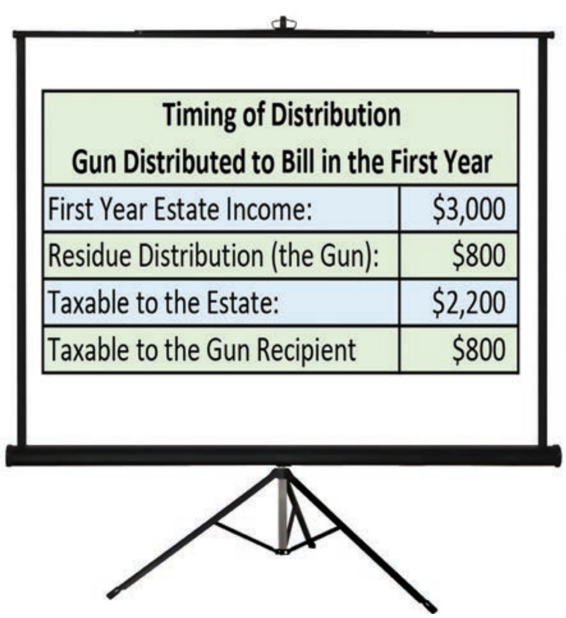
while addressing the evolution of learning, both increased understanding of laws, as further defined by case law and regulations, as well as changes in the law.

I grew up on Long Island. I never met anyone who owned a gun. I arrive in Vermont. Everyone has guns. Some don't use them, but their parents or grandparents hunted, and they inherited the guns and the culture of hunting. The guns are simply part of the family history that evolved from the need to hunt to survive; to the need to experience hunting.

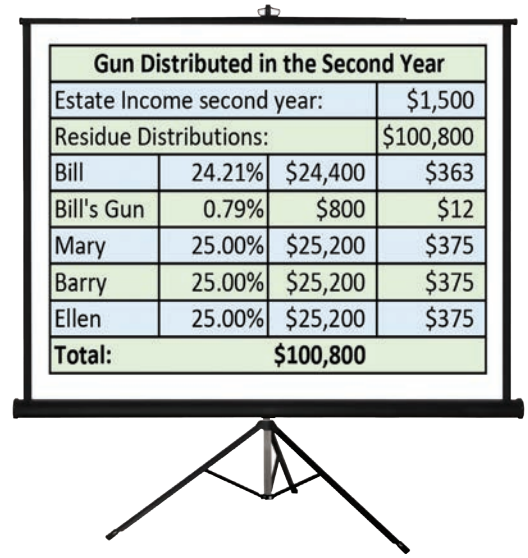
I WAS HANDLING AN ESTATE IN THE EARLY 70S. The estate included one gun. One of the beneficiaries came into my office and asked for the gun as part of his share. I gave him the gun. The gun was worth $800. A few months later I sent him a tax letter to tell him to report $800 as taxable income. He was not happy. The Estate probably only had taxable income for the year of less than $3,000. Taxable income often goes out based on distributions for the year. In this example, $800 was taxed to the beneficiary and $2,200 to the Estate. If I had made the distribution in the next year, when I made final distributions from the Estate, the tax would have been spread among all the beneficiaries and the tax letter may have been $12.



SOMETIMES, WHEN ASKED TO LECTURE, I tell the story that involved this gun and the tax implications. My presentation consisted of two slides.



Timing of Distribution Gun Distributed to Bill in the First Year	
First Year Estate Income:	$3,000
Residue Distribution (the Gun):	$800
Taxable to the Estate:	$2,200
Taxable to the Gun Recipient	$800



Gun Distributed in the Second Year			
Estate Income second year:			$1,500
Residue Distributions:			$100,800
Bill	24.21%	$24,400	$363
Bill's Gun	0.79%	$800	$12
Mary	25.00%	$25,200	$375
Barry	25.00%	$25,200	$375
Ellen	25.00%	$25,200	$375
Total:		$100,800	

Then one day my slideshow changed. I added a new slide. I had evolved. I should have evolved sooner.

WHAT WAS I THINKING? I FOCUSED ON THE TAX IMPLICATIONS. I DID NOT FOCUS ON THE GUN!

UNDER THE EXISTING LAW, if I had distributed a gun to a felon, I could be criminally liable. I don't want any of my colleagues to focus on timing distributions and discover that our next meeting will be in jail. Guns are regulated at both the federal level, such as the Gun Control Act ("GCA") and the National Firearms Act ("NFA"), as well as the State laws and regulations. The laws governing weapons are complex and need to be addressed with the attorney. Tax strategies may be the least of our worries.