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PBT Trust & Financial Services

INSIGHTS

Trust, Estate & Investment News

March 2026



Top ten questions we are asked about trusts

When you have a product or service that you hope to provide to the public, your job of selling is easier, when the public is already familiar with your line of work. Everyone knows what an automobile is for or what a barber does. When unusual new products burst upon the scene, potential buyers have to be shown the uses and benefits before they become interested.

In the financial services marketplace, there can be a bit of consumer confusion. That's why an important part of our daily routine consists of listening to and answering questions from our clients and those who might become our clients. The benefits of trust-based wealth management plans are not easily reduced to bullet points or sound bites. Here are the questions that we heard most often in the last year.

❶ What is the purpose of setting up a trust?

A trust provides for family financial protection. It creates a structure for delivering financial resources to multiple beneficiaries over a span of time, sometimes generations. Current beneficiaries receive the trust income, and others receive the trust principal in the future, when the trust terminates. Many trusts also authorize the distribution of principal to current beneficiaries in some circumstances.

Within this framework, trusts can be remarkably flexible. See the "Checklist of possible trust purposes" on page 2 for a partial list of objectives that trusts may meet.

❷ What is a living trust? I've seen lots of advertisements about them. Are they popular?

Living trusts are so named to distinguish them from testamentary trusts, which are created with a will and take effect after death. A living trust goes into operation during life. Usually, such trusts are revocable and created for the benefit of the grantor. Living trusts are popular for four key reasons:

- ***Sound asset management.*** The trustee will provide professional supervision of the portfolio, consistent with the grantor's vision.
- ***Protection in the event of incapacity***. Trust management continues, even if the grantor becomes unavailable for any reason, such as a medical condition.

Continued on next page

- ***Probate avoidance.*** Estate settlement may be a public process, and it can be a lengthy one. Living trusts normally avoid probate completely. They continue to function, providing financial resources to beneficiaries, while the estate settlement process continues under the supervision of the probate court.
- ***Financial privacy.*** The terms of a will become public during the probate process, while the terms of a trust normally are not publicized.

❸ How is a trust different from other investment accounts?

A trust has an independent legal existence that makes it durable. It can survive the incapacity or death of its creator. The trustee continues to manage the trust according to its stated purposes, stepping into the shoes of the person who created the trust.

❹ How much income does a trust generate?

Using a trust doesn't necessarily change the amount of income that an investment portfolio generates. In a traditional trust, "income" means collected interest and dividend payments. With that approach, as interest rates and dividend yields rise and fall, income changes with them. Changes in asset values—growth in stock prices, for example—accrue to the remainder beneficiaries.

Some trusts today take alternative approaches, defining income as a percentage of trust assets, or as a fixed dollar amount every year, or as a dollar amount adjusted for inflation—there are many alternatives to consider. However, if a fixed percentage is used to determine distributions, and the income falls short, the trustee will have to invade the principal to make up the difference.

❺ Does a living trust eliminate the need for a will?

As a practical matter, no. One still needs a will to dispose of assets not placed in the trust and to tie up loose ends. Keep in mind that even a modest probate estate can have advantages. Once probate proceedings have given any alleged creditors their day in court, later claims against the estate are generally barred.

❻ Will a trust protect assets from creditors?

As a general rule, one cannot use a trust to shield assets from one's own past or future creditors (although a few states are experimenting with changing these laws as to future creditors).

One can, however, use a trust to protect assets from the claims of beneficiaries' creditors. The traditional example is the wayward son-in-law. A concerned parent might designate a daughter and grandchildren as beneficiaries to avoid giving the son-in-law a chance to squander the fortune. But the roles could easily be reversed to, for example, protect a son's inheritance from divorce claims.

❼ When I set up a living trust, do I lose control of my assets?

No, not unless you make your trust irrevocable. When your living trust is revocable, you're in the driver's seat. You can change successor beneficiaries, add more assets, withdraw assets, and make any other adjustments that you wish to make from time to time.

❽ Can I be my own trustee?

Yes, you can be the trustee of your trust, or you can have a trusted family member be the trustee. But that's not a course we would recommend. Some very important reasons to consider us to be the trustee of your trust are:

- To put all the chores of trust administration into experienced hands.
- To have access to professional management of your assets.
- To provide financial support for your loved ones during your lifetime and beyond.
- To have someone available to stand in your financial shoes should illness or incapacity strike.

❾ Is trust service expensive?

Not when you select us as your trustee. People are often surprised to discover their annual fees compare favorably with the annual fees of other investment managers, notably hedge funds. As one of our trust customers put it recently, "Do you know, I really feel like I'm flying first class for the price of coach!"

❿ How can I learn more about trusts?

Make an appointment to meet with one of our wealth consultants at your earliest convenience. We will be pleased to tell you more.

Checklist of possible trust purposes

No single trust can do everything, but for almost any imaginable need, there is a matched trust solution. How many of these objectives do you have?

- ❑ Continuous financial management in the event of incapacity
- ❑ Professional investment management
- ❑ Financial privacy
- ❑ Probate avoidance
- ❑ Lifetime financial protection for a surviving spouse
- ❑ Asset management for inheritances
- ❑ Creditor protection for heirs
- ❑ Inheritance for children from an earlier marriage
- ❑ Lifetime protection for a special needs child
- ❑ Future legacy for charity
- ❑ Current income for charity, keeping assets in the family at lower cost
- ❑ Protection from current and future estate and inheritance taxes

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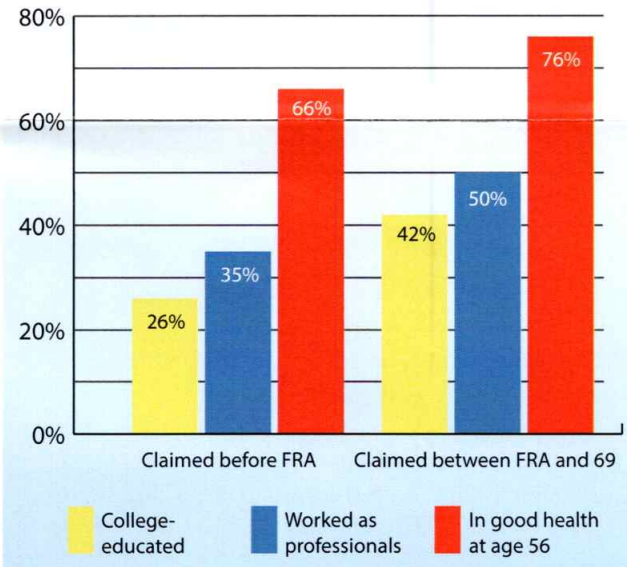


Partial retirements

About 40% of those who claim their Social Security benefits continue to have earned income, according to a recent study by the Center for Retirement Research at Boston College [crr.bc.edu/who-works-after-claiming-social-security]. This is not a new phenomenon. To take a deeper dive into the characteristics of those who work while claiming benefits, the researchers looked at the longitudinal Health and Retirement Study covering the period from 1992 to 2022.

Only 1% of retirees wait until age 70 to claim their Social Security benefits, taking full advantage of the 8% annual boost in benefits for delaying. Some 31% claim after full retirement age (FRA), while 68% claim before full retirement age. Those who claim after reaching full retirement age are somewhat more likely to be college educated, worked as professionals or managers, and more likely to report being in good health. However, the differences are not dramatic—see Figure One.

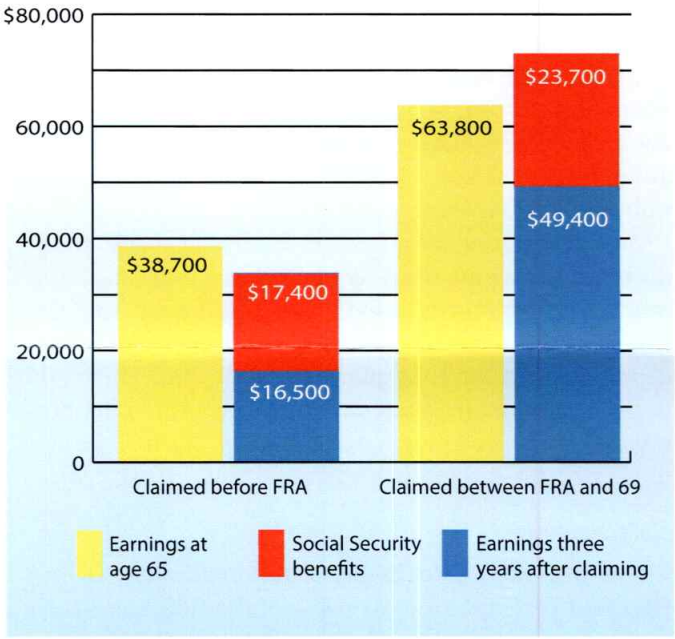
Figure One:



Source: crr.bc.edu/who-works-after-claiming-social-security

Half of those who begin benefits before full retirement age work part-time, and 18% work full-time, despite the earnings test that applies to them. For those who wait until full retirement, a similar 18% work full-time, but only 13% work part-time. Early claimers tend to have lower incomes before and after beginning their benefits—see Figure Two.

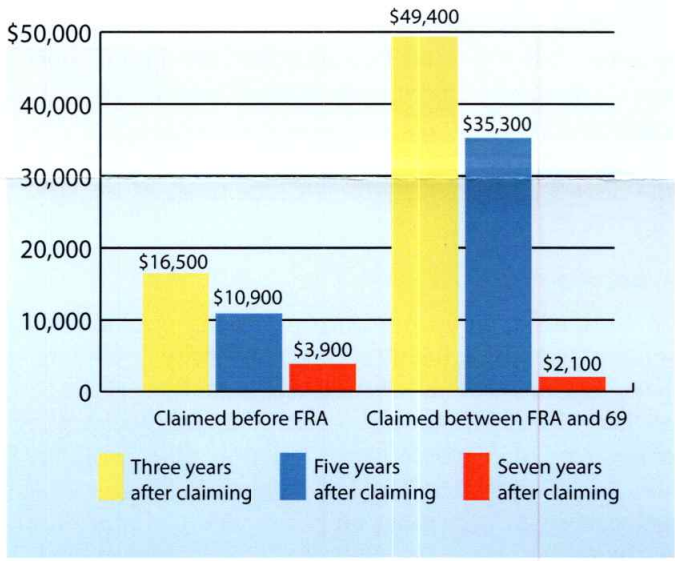
Figure Two



Source: crr.bc.edu/who-works-after-claiming-social-security

Finally, earnings taper off during retirement and are largely end seven years after beginning benefits, as shown in Figure Three.

Figure Three



Source: crr.bc.edu/who-works-after-claiming-social-security

How will your retirement compare? If you have questions about managing your retirement income, bring them to us for a consultation.

Estimated taxes

Among the many transitions that occur as one enters retirement is the need to estimate federal income tax payments. As an employee, taxes are withheld automatically, typically more than enough to cover the April 15 obligation and provide for a refund. Retirement brings income sources that don't have automatic tax withholding. Failure to pay taxes on time results in penalties and interest. According to the IRS, in tax year 2024, those penalties came to $1.3 billion for about 3 million taxpayers earning between $200,000 and $500,000. That was triple the penalties collected for the 2021 tax year.

Several factors are at work: more gig work, more investment income from rising financial markets, higher interest rates on overdue taxes, and the fact that the rules are complicated. Let's say that Bob has a $10,000 capital gain in the first quarter of this year. He needs to pay the estimated income tax on that gain in the first quarter to avoid a late payment penalty. It's not enough to pay the taxes due on the gain within the tax year.

Safe harbors

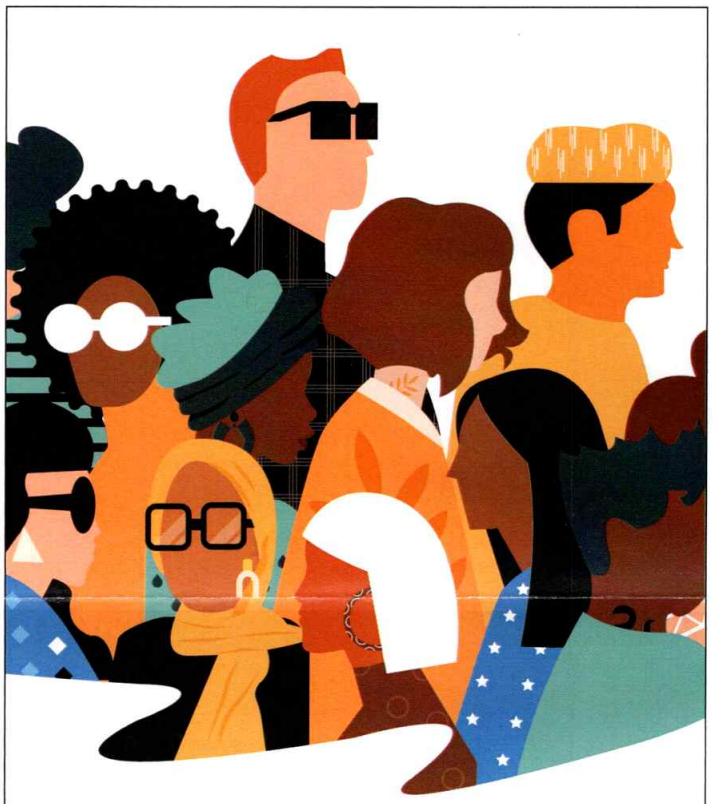
There are two "safe harbors" for avoiding the late payment penalty. First, pay 90% of the final tax due in equal installments throughout the year. Withheld taxes are treated as having been collected equally throughout the year.

Alternatively, pay 100% of the tax due from the prior year. If income is over $150,000, the safe harbor is 110%. Being in this safe harbor protects the taxpayer from penalties even if there is a windfall triggering a large tax due. *Example:* Mary's tax bill last year was $60,000, so she pays estimated taxes of $16,500 per quarter—$66,000 total. That puts her into the safe harbor. If she does a conversion of an IRA to a Roth IRA, triggering an additional tax bill of $30,000, she is still in the safe harbor and free of the late penalty. However, in the next year, her safe harbor will be 110% of $96,000, or $105,600.

Work around

Some sources of income are optionally eligible for withholding taxes, including Social Security payments, pensions, and taxable withdrawals from IRAs. Writing in *The Wall Street Journal*, Laura Saunders suggested a strategy that avoids estimated tax filings without the risk of a penalty. The idea is to make a large IRA withdrawal in December but have 90% or more of it withheld for taxes. The withdrawal should be enough to cover the projected tax obligation for the year, and the withheld portion will be treated as having occurred equally through the year.

See your tax advisor to learn more about the ins and outs of estimated taxes.



No two investors are alike.

Ask about our customized trust and investment management service.

PBT Trust & Financial Services

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Trust & Financial Services

McPherson
822 N. Main St. • McPherson, KS 67460
620.241.5023

Hutchinson—30th St.
601 East 30th St. • Hutchinson, KS 67502
620.669.9809

www.peoples.bank/trust