SUMMER 2012

COVENANT TRUST

While many of us may answer that question in the affirmative, the number who could answer "yes" to the question "Are you a Millionaire?" is much smaller. Nevertheless, there are plenty of times and circumstances which call for planning with trusts for clients who are not necessarily ultra-wealthy. So who among us can benefit from trusts?

PERSONS WITH CREDIT RISK

These persons can benefit from asset protection trusts designed to protect the grantor or the trust owner from his or her creditors. The grantor may retain certain rights of payment of income and possibly earn estate savings or federal gift tax savings if structured properly. They are useful for medical and dental professionals, executives, business owners and other individuals subject to potentially costly lawsuits. These are also useful for pre-nuptial planning. Tennessee and South Dakota both have legislation allowing a person to establish a trust for his or her own benefit (called "self-settled" trusts), with South Dakota having among the most favorable asset protection trust laws. Asset protection trusts can be established by third parties—often spouses (in the form of QTIP trusts), parents, or other family members (such as a traditional spendthrift trust or a Beneficiary Defective Inheritor's Trust).

INDIVIDUALS WITH CHILDREN

When estate planning for those with children, it almost always makes sense to provide that a child's inheritance will be held and managed in trust for the child's benefit in the unfortunate circumstance that the child inherits while still young. Take, for example, a young couple with children ages 10 and 7. They have $50,000 of equity in their home, $50,000 of cash, investments and retirement money, and $250,000 each of term life insurance. If something happens to Mom & Dad at the same time, children stand to inherit $300,000 each—and it's probably not a good idea to turn over $300,000 to a 7 or a 10 year old. Those children need their inheritance to be held for them until such time as they are able to wisely handle it themselves. Depending on family dynamics and circumstances, this responsibility could be given to a friend or family member—otherwise a professional trustee would be needed.

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ENTREPRENEURS

Enterprising business owners who are in the process of establishing successful, growing businesses can position themselves for tax minimization, and future business succession planning by utilizing trust structures after their business is established, but before its value balloons their estate. And while business entities such as LLCs can protect the business owner from the creditors of the business, trust ownership can protect the business from the creditors of the entrepreneur.

SPECIAL NEEDS BENEFICIARIES

Many of us have people in our lives with special needs, and caring for those needs can be expensive. Federal and State governments have established insurance programs to assist those persons—but some of those funds are "means tested," meaning that if a special needs beneficiary suddenly comes into even a modest inheritance, that government assistance could be stopped. Rather than risk interfering with that aid, planners will establish special needs trusts to inherit on behalf of the special needs individual, thus preserving state aid, and providing trust funds to supplement the other sources of support. But administering Special Needs Trusts can be tricky—if your trustee makes a wrong move the plan could be undermined.

> You don't have to be a millionaire to use a trust or need a trustee.

SPENDTHRIFT BENEFICIARIES

Every family has at least one—the prodigal son who treats money like a hot-potato and spends everything he has (and often more) as soon as he gets it (and often before). Clients want to provide for these beneficiaries after their deaths, but know that any money left outright will be quickly used. Trusts with appropriate restrictions (whatever the client decides those are) on access to inherited funds for these beneficiaries are a great solution. This can cause family tension, however, if other beneficiaries have received funds outright, especially if those persons are in charge of enforcing the restrictions put in place by the now-deceased donor. A neutral, objective trustee can often preserve family harmony while simultaneously honoring the decedent's instructions.

INHERITANCE - NOT A BURDEN

Estate planners see it over and over again—one spouse of a long-married couple of average wealth has recently passed away. The surviving spouse is all at once simultaneously grieving—devastated from losing a life's companion—and overwhelmed at the prospect of handling the family finances. "Herman," the spouse might say to you, "always took care of all the business—he always took care of everything. I don't know what I'm going to do without him." Wouldn't it be great to say to her, "Herman took care of this too—you don't have to worry. He has lined up some folks who know what to do and who can handle everything for you." You could say that to her if, during Herman's life, you had planned for an ongoing trust for the benefit of the surviving spouse.

Thus, there are various planning scenarios which prove that the answer to the question "Do I have to be a millionaire?" to use a trust or need a trustee like Covenant is clearly "no."

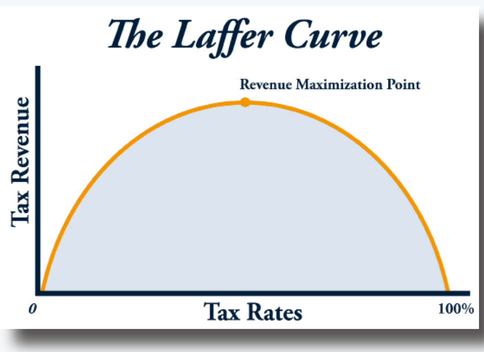
David A. Greene, JD is Covenant's primary trust officer. He specializes in estate planning and administration, as well as individual and fiduciary tax compliance.

Why *Tennessee* Repeals Gift & Inheritance Taxes

On May 21, Governor Haslam signed legislation that repeals the Tennessee gift tax as of January 1, 2012, and phases out the state's inheritance tax over the next four years. Beginning January 1 of next year, the inheritance tax exemption increases from $1,000,000 to 1,250,000. In 2014 the exemption moves to $2,000,000, and then to $5,000,000 in 2015. The law repeals entirely the state death tax for persons dying on or after January 1, 2016.

HISTORY AND BACKGROUND

Much of the political posturing and support for the repeal was developed by Arthur "Art" Laffer, former economic advisor for the Reagan Administration and namesake of the graph showing the relationship between government revenues and tax rates known now as the Laffer curve. Known as a proponent of the concept of taxable income elasticity—or the notion that taxable income will change in relationship to the rate of taxation, Mr. Laffer moved to Tennessee six years ago. In November, in cooperation with the Beacon Center of Tennessee and Wayne Winegarden, he co-authored a study entitled "The Economic Consequences of Tennessee's Gift and Estate Tax." He presented the study to lawmakers in November, and continued to communicate its findings to Tennessee's movers and shakers through April. The study clearly indicates that Laffer has not strayed far from his notion that the relationship between taxes and behavior is dynamic—not static: "finding an appropriate tax code would be relatively straightforward if only people would stop changing what they do when the tax code changes. It's like dodgeball; if only the other guy wouldn't duck when you threw the ball at him it would be easy to win. But, the other guy does duck and he almost always ducks just when you're throwing the ball at him."



LAFFER'S STUDY FINDINGS

The study found that had Tennessee eliminated its gift and estate tax 10 years ago:

- Tennessee's economy would have been over 14% larger in 2010
- There would have been 200,000 to 220,000 more jobs in the state
- More robust economic growth would have [added] between $7 billion and $7.3 billion to state and local coffers

Other findings of the study:

- The average taxable estate in Tennessee is consistently smaller than the U.S. average
- In 2010, it was almost 25% smaller–or $1,350,000 less
- In 2010, Tennessee had over 20% less federal estates filed per capita than the U.S. average. People really do leave Tennessee because of Tennessee's gift and estate tax.
- Tennessee's gift and estate tax has lowered the state's asset base by at least $16.6 billion to $48.3 billion reducing the size of Tennessee's economy, as measured by gross state product, by between $6.1 billion to $18.2 billion
- Between 2001 and 2010, states without estate taxes saw overall economic growth 8 percentage points higher than states with an estate tax
- Employment in the non-estate tax states grew 2% over the 2001 through 2010 time period; employment declined 2% in the estate tax states

The study defended the payers of the tax as citizens states should want to attract, not repel: "Tennessee's gift and estate tax discriminates against a very small group of citizens whose productivity greatly exceeds the state's average. These people are job creators, taxpayers, arts supporters, and capital formers. These people allow future generations to advance far beyond the accomplishments of their own generation. And yet for no benefit to the state, they are faced with a punitive gift and estate tax found nowhere else in America."

Legislators were receptive to the arguments presented in the study, drafted and passed the legislation to eliminate these taxes which was signed by the Governor in May.

Covenant Trust

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WHY YOU NEED A TRUST - PAGE 1

A common misconception among the public is that an individual must be ultra-wealthy to need a trust, when in fact there are many situations that would be well-served by trust planning, such as people with credit risk, individuals with children, entrepreneurs, special needs beneficiaries, spendthrift beneficiaries, and those wishing to leave an inheritance instead of a burden to their surviving spouse.

Read the cover article "Who Wants to Be a Millionaire?" for more information about individuals whose interests can best be served by trusts.

GOLDEN OPPORTUNITY - PAGE 3

The unique opportunity for Federal Estate tax planning that exists until December just got more attractive for Tennesseans. Earlier in the year, Tennesseans planning to take full advantage of the favorable federal tax provisions in place were facing nearly a half-million dollar tax bill payable to Tennessee. The new law allows those same clients to do Federal tax planning without the substantial burden imposed by their state.

See page 3 for why Tennessee repealed Inheritance and Gift Taxes and how a Reagan administration advisor was instrumental in this legislation.

COVENANT AS A RESOURCE

Covenant is available as a resource to the planning community. Feel free to call us to discuss planning challenges. To name Covenant Trust in a document, please use the following language:

"Covenant Trust, LLC, currently located at 801 Sunset Dr., Johnson City, TN 37604"