WINTER 2013

COVENANT TRUST

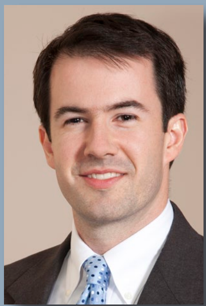
Following weeks of posturing and negotiations, the Senate and House agreed to and passed a "fiscal cliff" avoidance measure: The 2012 American Taxpayer Relief Act (ATRA). Consistent with human nature, Congress waited until the last minute (and actually slightly longer) before finalizing the legislation on January 1, 2012, which President Obama signed into law on January 2. The bill was politically divisive, passing 89-8 in the Senate, but faring worse in the House with a vote of 357-167. Regardless of one's political position with respect to the measures in the bill, it at least provides some certainty in important areas of the law. It is that certainty which provides planners the opportunity to do their jobs. What follows are some key provisions in the legislation involving estate and income tax provisions (making no mention of payroll tax changes or non-tax provisions) and some early thoughts on post-cliff tax planning.

ESTATE TAX PROVISIONS

The transfer taxation system that has been in place since 2011 has been made permanent. The bill extends a 2010 law which provided for a $5 million exemption that is indexed for inflation. For 2013, the exemption amount is $5.25 million per person. The law provides portability of estate taxes for spouses. Portability refers to the ability of the estate of a decedent who is survived by a spouse to make a portability election to permit the surviving spouse to utilize the decedent's unused exclusion amount. For example, if the decedent has an estate of $2,000,000, his exemption would have an unused amount of $3,000,000 left over. Portability allows the decedent to transfer this $3,000,000 of unused exemption to the surviving spouse, giving her $8,000,000 to use for her own estate when she passes away. The ATRA has made such portability permanent. The bottom line is that married couples can pass $10.5 million free of estate tax. While much of the legal gymnastics typically utilized by planners to fully utilize both spouses' exemptions should not be necessary for estate tax avoidance following the ATRA, there are other reasons why this type of planning may still be advisable. However, no portability is available for the generation skipping transfer tax, which is imposed at a flat 40% rate on generation skipping transfers in excess of $5.25 million. The law does preserve the unification of the gift and estate taxes. The method for calculating estate taxes results in an effectively flat rate on the excess (any asset in a taxable estate in excess of the exemption amount), which increased from 35% to 40%. Although unrelated to the ATRA, also of interest in 2013 is an increased annual exclusion amount for gift taxes of $14,000 (up from $13,000).

Continued on page 2

MEET OUR PEOPLE



Covenant's primary Trust Officer in the Tennessee office is David A. Greene, JD, CPA. David has experience in estate planning and administration as well as individual and fiduciary tax compliance.

Myra O'Dell is the Operations Officer of Covenant. She is a CFP® and is experienced in financial operations and wealth management services.

Jeff Blackburn, CPA, PFS is a manager of Covenant. He has many years experience in estate and personal financial planning as well as taxation and consulting.

Wade H. Farmer, CPA is the Treasurer and a manager of Covenant. His practice concentrates on estate and trust services, income tax, family limited partnerships and personal fianancial planning.

More info is available on the website: www.covenanttrustllc.com/about.html

THE DUST SETTLES: THE

Continued from page 1

ESTATE TAX PLANNING

Now that the federal exemptions and rates are known, it appears Federal Estate Tax will not be of concern for most families. A myriad of compelling non-tax reasons exist for engaging in estate planning, and as is always the case with tax planning, the devil is in the details. For example, the portability described earlier only applies to the Federal Estate Tax and not Generation Skipping Tax, which can cause a disaster when assets transfer to the next generation without proper planning; the discrepancy between the Tennessee and Federal exemption amounts; and state and local income taxation of trusts. However, for individuals or couples who are in excess of the exemption, lifetime planning can still save substantially on the final tax bill. Annual gifting programs, extraordinary gifting of certain assets, sales to trusts and other trust transactions, and charitable provisions (as discussed in further detail later, with respect to income tax planning) can all yield tremendous tax savings. Discounts for family owned businesses are still available. Trusts and other family business wealth planning still provide considerable tax advantages for estate and exit strategies, and even more so in a high tax environment. Consider that a number of compelling estate and exit strategies were a result of Clinton-era taxation. Taxpayers approaching the exemption limits are in a great place to do tax planning, as it may be possible to structure future growth in ways that are exempt from estate tax.

Comprehensive tax planning is not a "one trick pony" but it can yield significant savings over time. Tax savings, asset protection, and liquidity all result from a comprehensive strategy addressing SALT (state and local tax) issues, income (including payroll taxes, alternative minimum tax, Affordable Care Act taxes, and capital gains taxes), estate, gift and generation skipping transfer taxes. When planning, taxpayers should be mindful that the tax system is complicated, and that there is no "silver bullet." Also, remember that although the ATRA does not contain the shifts and automatic sunsets planners have been dealing with for the past dozen years, even the "permanent" provisions are still subject to Congressional caprice, and could be altered at any time.

INCOME/AMT TAXES

Incomes over $400,000 for individuals and $450,000 for married couples will now be taxed at a rate of 39.6% (an increase from 2012's rate of 35%). Capital gains rates for these taxpayers increase from 15% to 20%. Also, recall that the Patient Protection and Affordable Care Act calls for an additional 3.9% Medicare Contribution Tax on investment income from those taxpayers earning at least $200,000 or couples earning $250,000 or more. Itemized deductions will be capped and the personal exemption phased-out for individuals making more than $250,000 and couples earning more than $300,000. The bill also provides for 5 year extensions of the child tax credit, earned income tax credit, and a credit for higher-education tuition. Of particular interest to Tennesseans, the deduction for state sales taxes (rather than income

Fiscal Cliff FALLOUT

taxes) was also extended for one year.

The ATRA also ends the yearly emergency caused by the Alternative Minimum Tax. Originally designed to ensure that the wealthy paid some minimum amount of tax, its anachronistic provisions annually jeopardized 30 million middle class families with thousands in additional taxes–only to be resolved by last minute tax legislation. The Fiscal Cliff measure includes permanent resolution to the issue retroactive to 2012. This is done by means of indexing the AMT exemption amounts for inflation and allowing nonrefundable personal credits to the full extent of the individual's regular income tax and AMT.

INCOME TAX PLANNING

On the business side of the income tax, the legislation provides one-year extensions of accelerated "bonus" depreciation for purchases of new equipment, the work opportunity credit (which rewards employers that hire individuals from certain groups, such as veterans), the research and development credit, the credit for renewable energy and a number of other credits and items such as the new markets tax credit, 100% exclusion for gain on sale of qualified small business stock, and the charitable donation of property by S corporations. Section 179 depreciation, which was set to be $139,000 for 2012 and $25,000 for 2013, has been increased to $500,000 for both years. The treatment for qualified leasehold improvements to be depreciated over fifteen years has been extended for 2012 and 2013.

> Typical ideas for tax planning still apply, especially to high earners who now have 4.6% to gain or lose.

It looks like the typical ideas for income tax planning are as relevant as ever, especially for higher earners, who now have an additional 4.6% to gain or lose. The general principal is to defer income and accelerate deductions. Retirement contributions can be utilized to defer income. Accelerating deductible expenses, such as charitable giving, can provide a benefit. The ATRA did not change the law regarding deductibility of charitable contributions, so charitable trusts, in conjunction with a robust estate plan, can also be utilized by the philanthropically inclined to maximize the tax benefits (both income tax and estate tax) of giving to charity. Taxpayers can utilize long-term deferral of income through the use of Private Placement Life Insurance (privately offered life insurance where premiums are invested by the insured and the gains inside the policy are shielded from tax, as well as the death benefit to the beneficiaries).

Businesses can also defer income (and achieve other objectives) by offering employee benefits, such as 401(k) plans. Bonus depreciation was extended for 2013, so businesses needing new assets should consider purchasing those assets in 2013 and accelerating the deductible expense. Businesses with excellent risk-management should consider captive insurance as a mechanism to profit from properly managed risks. Captive insurance often has the pleasant side-effect of substantial tax benefits.

OUR ADVANTAGES

Covenant provides expert fiduciary services, including personal trust services (administration of Revocable Living Trusts, Life Insurance Trusts, Testamentary Trusts, Asset Protection Trusts, and Charitable Trusts), estate administration (both probate and as trustee of a will-substitute trust), and consultation on planning issues. Among Covenant's Advantages are:

- Covenant Trust is a local company, dedicated to serving the needs of clients locally. We are not managed from a corporate office in a big city, so we will continue to serve our community here in East Tennessee.
- Because of its heritage and oversight, Covenant, though new, has access to decades of experience and expertise in the field. As a result, Covenant is able to handle traditional trust assets with care and skill, and is also positioned to administer non-traditional assets in trust as well.
- Covenant has offices in both Tennessee and South Dakota.
- Covenant is committed to providing service that is excellent as well as cost-effective. Our clients benefit from this in the form of highly competitive fee structures.

COVENANT TRUST

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TEAM APPROACH

In our experience, before clients realize their need for professional fiduciary services they have usually established relationships with various professionals such as attorneys, CPAs and financial advisors. Many times those relationships are long-standing and a high degree of trust and mutual respect has developed between client and professional. Thus Covenant has chosen not to take an active role in investing assets, and we work with our clients' attorneys, CPAs, wealth managers and others with the goal of providing quality fiduciary services (not otherwise provided by the client's other advisors) and to create win-win scenarios for the client and all members of the professional team.

NAMING COVENANT AS TRUSTEE/EXECUTOR

It is Covenant's goal to serve as a resource to the planning community. Covenant's advisors assist other professionals with various aspects of client service. Examples include brainstorming estate plans for challenging fact patterns, discussing income taxation of retirement plans, answering questions about existing trusts and duties of fiduciaries or income/gift/estate tax preparation support. Covenant is also available for presenting on various topics, including estate planning, tax legislation and planning, trust planning and charitable giving. Feel free to contact us for assistance with anything related to our services or to schedule a presentation. To name Covenant Trust in a document, please use: Covenant Trust, LLC, currently located at 801 Sunset Dr., Johnson City, TN 37604.