Dynasty Trust
Create A Trust That Can Span The Ages

Do you want to leave a legacy for your family? Besides passing along prized heirlooms, you can arrange a long-lasting transfer of wealth through multiple generations by using a dynasty trust. Not only can such a trust avoid tax, it may provide various other benefits and protections for families for an extended period of time — perhaps forever.

A Brief History Lesson

The roots of dynasty trusts can be traced back to the common law principle known as the “rule against perpetuities.” This rule prohibited trusts from lasting indefinitely and was incorporated into law in most states. Typically, state law would require a trust to end within 21 years of the death of the last potential beneficiary at the trust’s creation.

However, some states, such as California, have adopted a simplified version that limits the trust’s duration to 90 years. And even better, more than half the states have lifted restraints on trust durations, paving the way for the increased use of dynasty trusts. And a handful of states — including Delaware, Alaska and Florida — encourage outsiders to set up dynasty trusts in their jurisdiction.

The Complete Tax Story

Previously, dynasty trusts were primarily used to minimize transfer tax between generations. Without one, if a family patriarch or matriarch leaves assets to adult children, the bequest is subject to federal estate tax at the time of the initial transfer to the second generation, and then taxed again when the assets pass from the children to the grandchildren, and so on. Although the federal gift and estate tax exemption can shield the bulk of assets from tax for most families, the top federal estate tax rate on the excess is 40% — a hefty amount.

Furthermore, the generation-skipping transfer (GST) tax applies to certain transfers made to grandchildren, thereby discouraging transfers that skip a generation. The GST tax exemption and 40% GST tax rate are the same as they are for regular gift and estate tax.

With a dynasty trust, assets are taxed just once, when they're initially transferred to the trust. There's no estate or GST tax due on any subsequent appreciation in value. This can save some families millions of tax dollars over the trust's duration.

When the assets are subsequently sold, any gain will be taxable. Note that the basis of the assets will be determined at the time of the initial transfer, although depending on the circumstances, the "step-up in basis" rules may help to reduce the taxable amount.

Other Benefits

Regardless of the tax implications, there are many nontax reasons for wealthy individuals to set up a dynasty trust. For example, you can designate the trust's beneficiaries spanning multiple generations. Typically, you might provide for the assets to follow a line of descendants, such as your children, grandchildren, great-grandchildren, etc. You can also impose certain restrictions, for example, limiting access to funds until a beneficiary graduates from college.

Look Before You Leap

A dynasty trust creates a legacy that will live on long after you're gone. Be aware, however, that a dynasty trust is irrevocable. In other words, you can't undo the arrangement if you have a sudden change of heart. If you're going to chart the course for future generations, you must have the courage of your convictions. Rely on your estate planning advisor for guidance.

SIDEBAR: Dynasty Trust Q&A

Here are the answers to some common questions regarding dynasty trusts:

How do you set up a dynasty trust? It can be established during your lifetime, as an inter vivos trust, or part of your will as a testamentary trust. With an inter vivos transfer, you'll avoid estate tax on any appreciation in value from the time of the transfer until your death. Generally, though, with an inter vivos transfer the assets won't be eligible for step-up in basis at your death.

What assets should you transfer to the trust? Because the emphasis is on protecting appreciated property, consider funding the trust with securities, real estate, life insurance policies and business interests. Naturally, you should retain enough assets in your personal accounts to continue to enjoy your lifestyle.

Who should act as trustee? While it may seem natural to choose a succession of family members to act as trustee, that may not be the best route. Instead, consider a professional trustee, often referred to as a fiduciary.

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