AVIVA

Dynasty Trusts

Do your clients want to provide financial security for their children and future generations as well? A dynasty trust is a powerful tool that is available to help provide for current and future generations. When a dynasty trust is properly structured, the assets left in trust are not subject to estate taxes when they pass from one generation to another.

What is a dynasty trust?

A dynasty trust is simply a trust designed to maximize the use of the donor's Generation Skipping Transfer (GST) tax exemption. This is typically done during life by allocating the GST tax exemption when creating the trust.

The current GST exemption in 2009 is $3,500,000; however the separate gift tax exemption is $1,000,000. Therefore, to maximize the GST exemption, many individuals will use the $1,000,000 gift tax exemption towards their GST tax exemption during life and then pass the balance of the GST exemption at death.

Another strategy to maximize the value of a dynasty trust is to fund the trust with assets that have the potential for substantial growth, such as interest in a business or life insurance. By doing this, all future growth or death benefit will not be subject to future estate tax.

When a dynasty trust is used, all future distributions of interest and principal are distributed free of the GST tax for the duration of the trust.

Rule Against Perpetuities

A dynasty trust can be created in any state, however many states subject a trust to the "Rule Against Perpetuities". This is a rule that forces a trust to end at some point in time. Many states require a trust to end 21 years after the death of the last beneficiary alive when the trust was created. However, this law is governed at the state level and there are a number of states that have abolished or relaxed this rule. When the "Rule Against Perpetuities" is abolished, the trust does not need to end until the last living descendent of the trust creator dies. In this situation, there is potential for the trust to never end. Additionally, there are states with relaxed laws that allow a trust to continue anywhere from 150 to 1,000 years. To take advantage of another state's rules, it is important to have at least one trustee with significant powers be based in the desired jurisdiction. Many times this is an officer with a bank or trust company.

Creditor Protection

Another key advantage of a dynasty trust is that the assets are usually exempt from the claims of beneficiary's creditors or ex-spouses. This is because the assets of the trust do not actually belong to the beneficiaries. Asset protection is typically achieved by one of two ways: 1) Have a support standard for distributions to beneficiaries. A common written standard is "health, education, maintenance and support". A spendthrift provision within the trust is critical to protect the assets because, without it, a property right could be created for the beneficiary. 2) Have the trust designed as a discretionary trust with an independent trustee. When the trust is fully discretionary with respect to distributions, typically no creditor can access it.

Creating a Dynasty Trust

A dynasty trust is a sophisticated estate planning tool that involves complicated tax issues at both the state and federal level. Regardless, the advantages can provide an effective way to transfer wealth to future generations with minimal tax. In addition, if the trust is created with highly appreciating assets, the tax leverage can be significant. Finally, if the trust is established in a state without termination rules, the dynasty can be created to help provide financial security to all future generations.

The preceding summary is intended to be a general discussion of the topic presented, and is based on our current understanding of applicable tax laws, regulations and rulings. In actual practice, the transaction discussed may be more complex and will require the attention and expertise of professional advisors. In no way should this summary be construed to constitute tax or legal advice. For Advisor Use Only.