DYNASTY TRUSTS

DEFINITION

A dynasty trust is a type of trust designed to allow its creator to pass wealth from generation to generation without incurring transfer taxes. By holding assets in a dynasty trust and making specified distributions to each generation, it is not subject to the estate and gift tax as well as the generation skipping transfer tax (GSTT). The trust and its distributions are controlled by the terms and provisions initially established by the grantor. Once the dynasty trust is funded, the grantor neither has the control and access to the assets nor the ability to amend the terms of the trust.

HOW THEY WORK

TRUST PARTIES

The primary party to a dynasty trust is the grantor, who funds the trust as well as provides guidance on its operation and the rules governing distributions. The beneficiaries of the trust are the descendants of the grantor. In addition to current children and grandchildren, the beneficiaries can include descendants who are not yet born. In the case of a trust with no remaining descendants, some trusts will provide for the trust remainder to pass on to one or more designated charities. The last party is the trustee, who handles the day-to-day operations of the dynasty trust, including investment of its assets, administrative issues and distributions. The trustee should not be a beneficiary or the grantor and may best be fulfilled by a professional fiduciary like a bank or trust company, as these trustees will have the ability to survive through multiple generations of beneficiaries.

TAX BENEFITS

Typically, transfers by an individual to beneficiaries other than charities are subject to the estate and gift taxes. For 2015, the current law provides a personal federal estate tax exemption of $5,430,000. Because the federal gift tax and estate tax are integrated into one unified credit, an individual is also able to gift away assets during their lifetime. Any amount above the annual gift tax exclusion amount ($14,000 per person in 2015) is applied toward the unified credit. One of the benefits of a dynasty trust lies in the ability to gift up to the unified credit amount to the trust without incurring transfer taxes. If a husband and wife fund the dynasty trust, the tax-free amount that can fund the trust transfer is doubled. By utilizing the annual gift tax exclusion amount, it further increases the amount that can be transferred tax-free. Lastly, if future distributions are set up in accordance with IRS guidelines, they will also escape the generation skipping transfer tax (GSTT).

TRUST TERM

A central feature of the dynasty trust is its term. In theory, a dynasty trust is intended to last in perpetuity, or as long as the grantor of the trust has descendants. Some states have laws in which the duration of trusts is limited to those trusts where the interests in the trust vested within a period measured by a life or lives in being plus twenty-one years. The laws protect against perpetuities. However, many states have enacted laws that eliminate or modify this rule and permit trusts that continue for very long periods. Under these rules, a trust can potentially last as long as there are descendants of the grantor. This unrestricted term is attractive as it allows the grantor to control the distribution of his or her wealth for much longer than other shorter-term techniques.

CREDITOR PROTECTION

A dynasty trust can offer the potential protection from creditors. Most trusts will include a spendthrift clause, which provides that prior to an actual distribution to a beneficiary, the beneficiary's interest in the trust or possible distribution may not be transferred either voluntarily or involuntarily. This means that creditors will have to wait until a beneficiary actually receives a distribution before they seek any claim on the trust's assets.