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Create a Lasting Legacy with a Dynasty Trust

An underused estate-planning tool could benefit your descendants down through the generations—or even the centuries. Dynasty trusts, sometimes called perpetual trusts, shield assets from threats including estate and gift taxes, creditors, litigation and divorce. But while a typical trust distributes its assets and stops providing protection within a few decades, a dynasty trust theoretically can continue without end. Your heirs can access the assets in your dynasty trust if they need to...or they can leave those assets in place—safe from estate taxes and other threats—for their children and beyond.

The term "dynasty" suggests that these trusts are appropriate only for the ultra-wealthy. But in fact, anyone whose estate is mid-seven figures or up should consider one.

YES, YOU SHOULD WORRY ABOUT ESTATE TAXES

The federal estate-tax exemption is $12.92 million in 2023—so high that many people who have millions in assets assume that they don't need to worry about estate taxes or set up trusts to obtain estate-tax protection. But there are three reasons why estate taxes could affect you and your heirs even if your estate comes in well below that $12.92-million threshold...

The estate-tax exemption is slated to be cut roughly in half in 2026. As the law stands, the exemption will fall to around $6 million starting less than three years from now. It isn't possible to provide a precise figure because this new exemption will be indexed for inflation.

There's talk of lowering the exemption even further and faster than that. Multiple candidates in the last Presidential election proposed slashing the estate-tax exemption to $3.5 million or less. The current administration or one that follows could enact such a policy.

Your current estate could grow significantly before you die. Example: If your assets enjoy an annual rate of return of 7.2%, they will double in value in 10 years.

Bring those three reasons together, and the true estate-tax risk becomes more obvious. Someone with $4 million in assets today might feel completely safe from estate taxes given the $12.92 million exemption—but if this person lives another decade, his estate might grow to $8 million and the exemption might fall to $6 million or even further.

Also, while avoiding estate tax is an important benefit of dynasty trusts, it's not the only benefit. These trusts are excellent tools for keeping assets out of the hands of former spouses in divorces and plaintiffs in lawsuits. It's like setting up prenuptial agreements and lawsuit protection for your descendants—even those not yet born. And dynasty trusts do this while still providing those heirs with considerable access to the assets.

It is also important to understand your state's estate-tax laws. Twelve states and the District of Columbia impose >>

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>> their own estate tax, which is in addition to the federal estate tax. Six states impose an "inheritance tax," which is to be paid by the inheritors. One state—Maryland—has a state estate tax and a state inheritance tax. While important to understand and integrate into any plan, these tax rates are modest compared to the 40% federal estate-tax rate.

SETTING UP A DYNASTY TRUST

Six things to consider when you discuss dynasty trusts with your attorney...

It might make sense to set up the trust in a state other than your own. Your dynasty trust doesn't have to be based in your state of residence. All that's typically required to set up a trust in a different state is to name a trustee based in that state, such as the trust department of one of that state's banks. *Why this is important:* A few states, including South Dakota, Nevada, Alaska, Delaware, New Hampshire, Tennessee and Wyoming, have tax and trust rules that are extremely favorable to dynasty trusts.

Example: South Dakota and Alaska are two of seven trust-friendly states that have no state income tax, including on capital gains and dividends... no state estate taxes...very strong trust privacy and asset-protection laws...and no dynasty trust expiration dates. In other states, there are rules that restrict the duration of dynasty trusts, in some cases to as little as 21 years. Some have taken "middle ground" approaches. Duration of such trusts are limited to 365 years in Nevada, 360 years in Tennessee and 1,000 years in Wyoming.

Naming your children as trustees can cause problems...even if your kids are trustworthy. Naming the adult child who is a beneficiary of a trust as trustee seems like a reasonable choice—it gives this beneficiary added control over the assets...and saves the annual fees charged by professional trustees, which typically come to a fraction of a percent of the trust assets each year.

But there are downsides...

First, choosing your child as trustee is likely to cost you the option of setting up the dynasty trust in a trust-friendly state such as South Dakota or Nevada, as described above, unless the child happens to live in one of those states.

What's more, a beneficiary who also is trustee could easily lose out on the trust's divorce, litigation and estate-tax protections if he/she fails to follow potentially confusing trust rules. *Example:* A man is trustee and sole heir of a dynasty trust set up by his parents. This trust's language specifies that its assets must be used for only the personal expenses of the beneficiary and his descendants. Over the years, this man uses assets from the trust to pay his wife's expenses—incorrectly assuming that because they're married, her expenses are *his* expenses. If this man and his wife later divorce, his wife's divorce attorney is likely to argue that his earlier misuse of trust assets means that the remaining trust assets now should be treated as marital assets and divided. And if the IRS audits the trust and discovers the misuse of funds, it might demand the payment of estate taxes.

You can postpone funding your dynasty trust until after your death—but there are downsides to doing so. Some people fund their dynasty trusts as soon as they set them up...others delay funding them, potentially until after they die—their wills or other estate-planning tools direct that assets be transferred into the trust. Neither of these options is perfect.

If you fund the dynasty trust during your lifetime, you lose access to assets that you might need.

If you wait to fund your trust, you delay its asset protection. *Example:* If you were sued, assets not yet placed in the trust could be vulnerable.

Funding a dynasty trust promptly also serves to lock in current estate-tax rules and thresholds—if you shift $12 million in assets to the trust under current rules, you don't have to worry whether the exemption will fall to $6 million or lower in future years. But funding the trust sooner rather than later essentially locks the value of the assets transferred as well. *Example:* An entrepreneur who has a history of starting successful businesses is launching his latest enterprise. He funds a dynasty trust in part with his shares of this new company—shares that are not yet tremendously valuable, because it's a start-up years from profitability. His heirs are protected from future estate taxes even if the business is worth billions by the time this man dies—but only the value of the shares at the time they were placed in the trust counts toward his exemption.

Your dynasty trust can provide for your spouse. Married couples often worry that if one spouse funds a dynasty trust but the other lives many more years, that surviving spouse could outlive his/her remaining resources. A variation of a dynasty trust called a *Spousal Lifetime Access Trust* (SLAT) can solve this problem. The spouse is the primary beneficiary of a SLAT, with the trust serving as a dynasty trust for future generations only after this spouse has died.

It's possible to transfer as much as $16 million to $18 million into a dynasty trust without facing estate taxes. Typically, the most you can transfer into a dynasty trust without facing gift and estate taxes is the exemption amount, now $12.92 million. But if you want to put more into your dynasty trust, there are strategies for doing so that have been deemed acceptable by the IRS. *Example:* Assets could be transferred into a Limited Liability Company (LLC), then a portion of that LLC could be transferred into the dynasty trust. Under certain circumstances, assets in LLCs can be assigned discounted values compared with the values those same assets held outside of the LLC, making it possible to transfer perhaps $16 million to $18 million in assets into a dynasty trust without exceeding the $12.92 million exemption. An estate-planning attorney could help with this.

Legal fees can vary. An estate-planning attorney might charge anywhere from $4,000 to more than $20,000 to set up a dynasty trust, depending on the complexity of the trust, whether it's part of a larger estate plan and other factors. Discuss costs with the attorney before moving forward. BLP