MORGAN AND DiSALVO, P.C.
attorneys at law

RICHARD M. MORGAN, Esq.
rmm@morgandisalvo.com

LORAINE M. DiSALVO, Esq.
ldisalvo@morgandisalvo.com

OF COUNSEL
DIANE B. WEINBERG, Esq.
dweinberg@morgandisalvo.com

Perpetual Dynasty Trusts
– Maximizing The Benefits Of Trusts By Structuring Them To Last Longer

By Richard M. Morgan & Loraine M. DiSalvo

Disclaimer: This material has been prepared as a tool to assist in a general discussion of the matters discussed herein. These materials should not be relied upon without an attorney being consulted with regard to your particular situation. The interpretation of any laws and rulings should be independently verified by local counsel.

In past issues of *The Passionate Estate Planner*, we have emphasized the benefits which trusts can provide for those who want to transfer assets to their loved ones. To summarize, these benefits include providing protection from a beneficiary's creditors or divorce problems, helping protect a beneficiary from predators who might wish to take advantage of the beneficiary, providing shelter from "wealth transfer" taxes[1] as assets move from the original owner to the intended beneficiaries and then to subsequent generations. Trusts can, if desired, also allow the trust's creator to maintain some degree of control over whether assets remain in the family tree rather than being dispersed to outsiders.

This newsletter revisits a relatively unknown estate planning technique which we discussed in January 2012: the "Perpetual Dynasty Trust." Most people tend to think of a trust as a vehicle to be used to provide protection for a surviving spouse, or to provide protection for younger beneficiaries, such as children. These types of trusts are generally designed to last for a fairly short period of time: just for the lifetime of the surviving spouse, or until the children reach certain ages. At the end of these trusts' intended terms, they usually terminate and disappear, taking the benefits they provide with them. Many of our clients have already seen the wisdom of extending the protective qualities of the trust throughout the lifetime of their children, using our "GST planning" structures. Where the client's children are mature, responsible, individuals, the GST planning will often allow the children to eventually receive a great deal of control over their trusts, providing protections with as few restrictions as possible. A perpetual dynasty trust is simply GST planning designed to last for many generations - potentially for hundreds or even thousands of years. They allow the benefits of the trust to be extended even further: not just to the children, but also to the grandchildren, great-grandchildren, etc. of the original trust creator. As with more standard GST planning trusts, these ultra-long-term trusts can also be designed to give the intended beneficiaries a great deal of control and flexibility, while still providing protections.

[1] The "wealth transfer" taxes are the ones which can apply when assets move from one person to another: the gift, estate, and generation-skipping transfer ("GST") taxes.

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RICHARD M. MORGAN, Esq.
rmm@morgandisalvo.com

LORAINE M. DiSALVO, Esq.
ldisalvo@morgandisalvo.com

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DIANE B. WEINBERG, Esq.
dweinberg@morgandisalvo.com

Perpetual dynasty trusts are a relatively new concept in the estate planning world. Prior to 2001, the fairly low exemptions[2] provided by the gift and estate taxes made it quite costly to transfer significant amounts of wealth from the original owner to his desired beneficiaries, and the fairly low exemption from the generation-skipping transfer ("GST") tax made it difficult and even more costly to move significant assets down more than one generation. In addition, most states and many foreign nations had laws which limited the period of time for which assets could remain in trust (these laws are generally known as "Rule Against Perpetuities" laws), and made it very difficult for assets to remain in trust much past the grandchild level. In 2001, significant, although temporary changes to the federal estate, gift, and GST tax laws were implemented. These changes included significant increases to the federal exemptions from the estate, gift, and GST taxes, and made it much less costly for wealthy persons to transfer significant assets to their loved ones, through gifts or at-death transfers. During the 1990s and 2000s, a separate, but somewhat related, movement resulted in a number of states and foreign nations either getting rid of or greatly extending their Rule Against Perpetuities laws.[3] The exemption increases, combined with the availability of trusts which could last for hundreds or even thousands of years gave birth to the concept of the perpetual dynasty trust.

[2] The federal gift and estate taxes actually do not have exemptions, although the law does mention the concept. Instead of a true exemption, these laws provide each U.S. citizen or U.S. permanent resident with a "unified credit," which applies against both federal gift and estate taxes. The unified credit is applied against federal gift and estate taxes which would otherwise be due on lifetime gifts and transfers at death, and no gift or estate taxes are actually due and payable until the unified credit has been fully exhausted. The operation of the unified credit effectively exempts an amount of assets from federal gift and estate taxes: currently, the effectively exempted amount for 2013 is $5,250,000. The unified credit, and hence the effective exemption, will be indexed for inflation in the future, so this amount should continue to increase. The effective exemption is referred to in the federal gift and estate tax statutes as the "Basic Exclusion Amount."

Unlike the federal gift and estate taxes, the generation-skipping transfer or "GST" tax does have an actual exemption. The GST tax exemption can be used in two ways: (1) to offset GST taxes which would otherwise be due and payable on a transfer which directly benefits a "skip person," or (2) to protect a trust's beneficiaries against the possible application of GST taxes to future transfers from the trust to or for the benefit of a skip person. A "skip person" is essentially someone who would be at the level of a grandchild or younger descendant with regard to the transferring person. If parties are related, the legal relationship generally controls the determination of whether someone is a skip person. If parties are not legally related, the determination is based on the age difference between the donor and the beneficiary of the transferred assets. Under current law, the GST tax exemption is set at the value of the gift and estate taxes' Basic Exclusion Amount, which means it is $5,250,000 for 2013 and will be indexed for inflation in future years. For purposes of convenience, this newsletter will generally refer to both the gift and estate tax Basic Exclusion Amount and the GST tax exemption as "exemptions."

[3] For example, Alaska, Delaware, and South Dakota now allow trusts which could potentially last literally forever, Tennessee and Florida allow trusts to last for as long as 360 years, and Nevada allow trusts to last for up to 365 years.

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RICHARD M. MORGAN, Esq.
rmm@morgandisalvo.com

LORAINE M. DiSALVO, Esq.
ldisalvo@morgandisalvo.com

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DIANE B. WEINBERG, Esq.
dweinberg@morgandisalvo.com

Perpetual dynasty trusts are frequently created by a living creator, in the form of an irrevocable trust which is then funded with lifetime gifts. However, they can also be created under a Will or revocable trust, so that they will take effect and be funded only at the creator's death. They can be created under either the laws of a U.S. state which allows very long term or truly perpetual trusts, or they can be created in one of a number of foreign jurisdictions which allow similarly long-term trusts. In order to provide maximum benefits, they should also be fully exempt from the GST tax, as well as being structured to protect the trust beneficiaries from estate and gift taxes. The intent is not only to provide the benefits of a trust to the intended beneficiaries, but to allow those benefits and the trust to continue for as long as both the law and the trust assets allow it to do so. Ideally, the perpetual dynasty trust should be funded with significant assets. The initial contribution can be maximized using the existing wealth transfer tax exemptions. The trust should ideally also either initially receive or later invest in assets with significant appreciation potential, to help better leverage the benefits of the exemptions used. In many cases, life insurance on the trust's creator can be a good way to boost the initial contributions, but these trusts can and should be designed so that they can own practically any type of asset.

Those who are interested in perpetual dynasty trusts and are willing to consider making significant lifetime gifts have an added incentive to move forward sooner rather than later. Even though the 2012 Tax Act of January 2013 was supposed to have given us permanent estate, gift, and generation-skipping transfer tax laws for the first time since 2001, the federal government continues to consider making various unfavorable changes to the wealth transfer tax laws. Some of these changes, such as reducing the value of the estate and gift tax exemptions, could limit the ability of creators to fund their trusts without immediate federal tax consequences. These changes could be inconvenient, but might not do significant damage to the potential benefits to be gained from dynasty trust planning. However, one of the changes being considered would limit the length of time that GST exemption applied to a trust could protect the trust from GST taxes, by making perpetual trusts subject to the wealth transfer tax system at least every 90 years. This change could significantly reduce or effectively destroy the incredible long term tax benefits of Perpetual Dynasty Trusts. However, most commentators believe that any such change would be implemented only with regard to trusts created on or after the effective date of the change, and that existing trusts created before that date would be grandfathered into the old rules. Therefore, the opportunity to create a perpetual dynasty trust may be a use-it-or-lose-it opportunity.

One concern which prevents many people from taking advantage of the ability to make large gifts during their lives is this: "What if I need the money later?" Properly planned and structured Perpetual Dynasty Trusts, along with other estate planning techniques and good financial advice, can go a long way toward reducing this concern. This type of estate planning should generally include "safety valve" provisions, of which there are a number of different types. When used correctly, these safety valves can help you get assets back if and when you need them, while not preventing you from realizing the transfer tax and other benefits of making the gifts if you don't need the assets. Your advisor should be able to explain these safety valves to you, and to help you set up a plan which lets you give assets away without feeling any significant economic or emotional discomfort as a result of the gifts.

5755 North Point Parkway, Suite 17 • Alpharetta, GA 30022-1143 | ph. (678) 720-0750 | fax (678) 720-0746 | www.morgandisalvo.com

RICHARD M. MORGAN, Esq.
rmm@morgandisalvo.com

LORAINE M. DiSALVO, Esq.
ldisalvo@morgandisalvo.com

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A word of caution: since Perpetual Dynasty Trusts can last for extreme periods of time, they need to be very carefully drafted, to help ensure that they have maximum flexibility and can allow your wishes to be best carried out and potential future problems to be fixed or avoided most easily. You should include very clear statements describing your intent and desire as to how the trust should be used and managed, and as to the kind of benefits you want the trust to provide for your loved ones. These are not “off-the-shelf” documents, and should only be prepared by sophisticated, experienced, estate planning attorneys after extensive consultation.

At Morgan & DiSalvo, we have focused for many years on helping our clients transfer their wealth to their loved ones efficiently and effectively, with flexible and sophisticated planning and lots of safety valves. If you would like to learn more about taking advantage of a Perpetual Dynasty Trust or other planning, please contact us at (678) 720-0750 or sollila@morgandisalvo.comto schedule an appointment to talk to either Richard Morgan or Loraine DiSalvo.