Financial Advisor

Tax Reform Makes It A Good Time To Use Dynasty Trusts

June 25, 2018 • Jeff Stimpson

Though President Trump's tax form increases the amount that can be passed to heirs, these thresholds expire in 2025—if a new federal administration doesn't change them first. High-net-worth clients might look to longer-lasting vehicle to pass on wealth: dynasty trusts.

According to the American Institute of CPAs, with a dynasty trust a taxpayer transfers assets to the trust. The trust assets move from generation to generation with no corresponding transfer of taxes.

Before the Tax Cuts and Jobs Act, the first $5 million of transferred property was exempt from estate and gift tax. For 2018, that amount is $11.18 million, $22.36 million per married couple, said attorney Ronald Finkelstein, a national co-partner-in-charge of the trusts and estates practice group at Marcum LLP in Melville, N.Y. These thresholds expire after 2025.

The generation-skipping transfer tax (GST), intended to prevent avoidance of estate and gift taxes when a client passes assets to the next successive generation, also increases to an exclusion of $11.18 million, Finkelstein said.

As long as the estate tax and GST lifetime exemptions are applied to the assets placed in the trust, the assets and their growth are out of the estate of the grantor and they can pass to multiple generations free of estate tax and GST. Said Stephanie Sandle, a CFP/CPA and managing director at MAI Capital Management in Cleveland, "Without the trust, the assets and their growth would remain in the estate of the grantor and their value in excess of the lifetime exemption would be subject, upon death, to estate tax (currently 40 percent) and GST (also currently 40 percent)" if the assets pass to a beneficiary who is more than one generation below the grantor (e.g., grandchildren).

"If the trust is set up as a grantor trust, the grantor will pay all income taxes assessed on the trust assets," Sandle added. "This allows the trust to grow income tax-free and also creates 'estate burn' for the grantor [to lower] the total assets that remain in their estate through paying the income taxes."

The best first step is to assess how much the grantor needs to live comfortably the rest of his or her life, according to Tony Panebianco, a CPA and director of family office services with Grassi & Co. in New York. "This should account for investment strategy and market fluctuations, factoring the client's risk tolerance," he said. "After the Great Recession, many clients still worry about not having enough."

Sandle's firm provides projections for clients to estimate their financial future with their current estate plan versus what it would look like if they use their lifetime exemption in such a vehicle as a dynasty trust. "The second step is to ensure that the client is OK with losing control of the assets," she added. "Once the trust is funded, control is passed on to the trustee and any other designated advisors."

Dynasty trusts have other potential problems:

- "Some states have an unlimited duration [for trusts]. Other states have shorter durations," Finkelstein said. "A state like Delaware has an unlimited trust duration if [the client] meets the necessary state requirements." The client isn't limited to creating a trust in the state in which he or she resides.
- Beneficiaries have limited access to assets. "Dynasty trusts are set up to allow discretionary distributions, which means the assets remain in the trust unless the trustee allows them to be distributed," Sandle said.
- "Since a dynasty trust is used to provide a trust for many future generations, it can cause friction with the next generation possibly not being able to access all of their parents' wealth," Panebianco said. "Deciding whether to transfer more to trusts, and how to do it, can be a complex discussion."