LONG LIVE THE DYNASTY TRUST!

For a gift that could last forever, the best time to act may be now.

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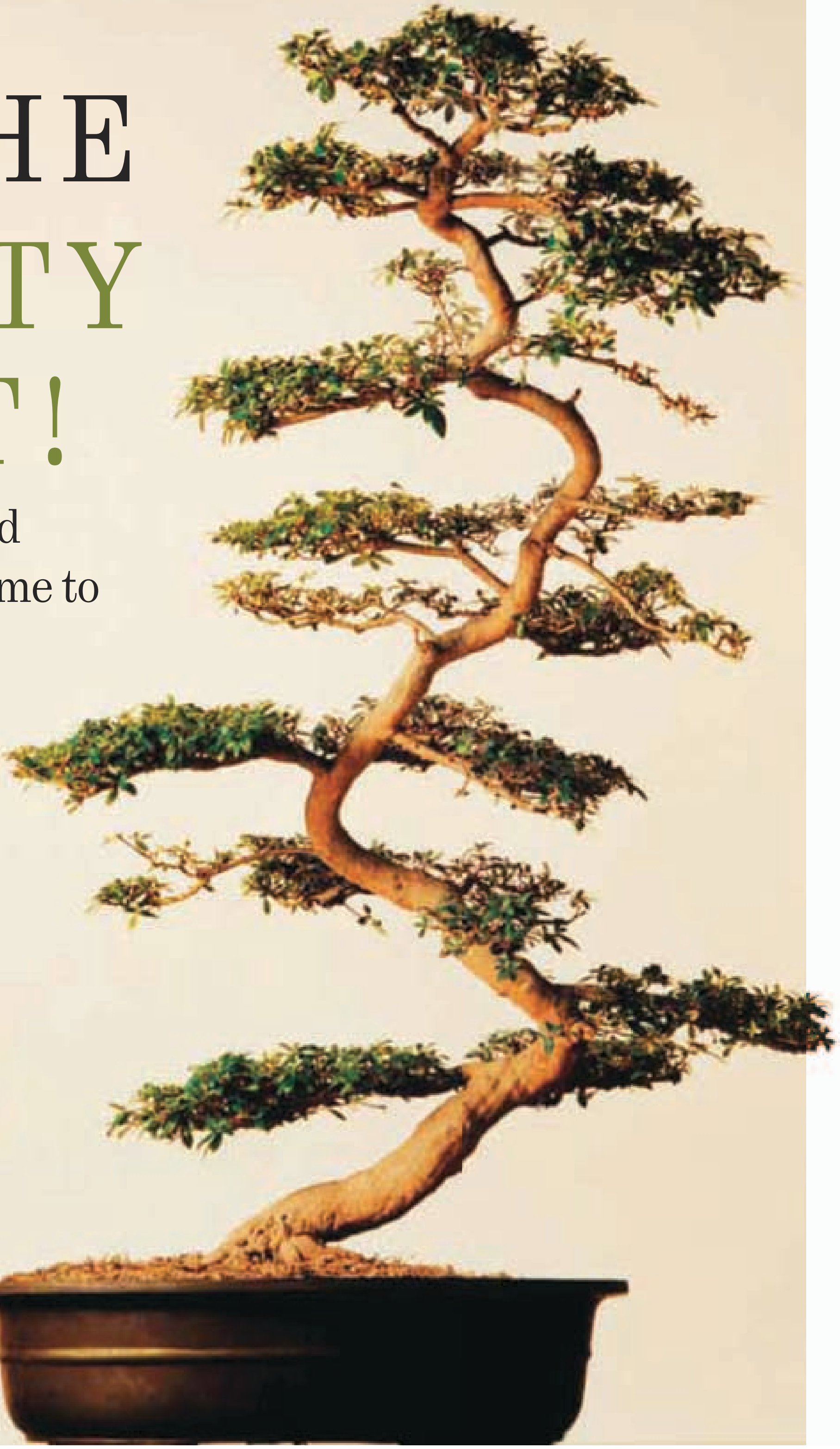

WHO COULD HAVE IMAGINED that a wealth transfer tool — one formulated in the era of the industrial tycoon, no less — would become an estate planning superstar overnight? Yet the long-term (or dynasty) trust, a means to pass on wealth to multiple generations free of estate taxes, recently underwent just such a makeover. And changes in tax laws are the reason.

"Thanks to tax changes that were signed into law in December 2010, the lifetime limit on tax-free gifting quintupled to $5 million in 2011 and $5 million adjusted for inflation in 2012, or double those amounts for married couples," says Mitchell A. Drossman, national director of U.S. Trust's National Wealth Planning Strategies group. "At the same time, the federal exemption for the generation-skipping transfer tax, or GST, which was $3.5 million in 2009 (and effectively unlimited in 2010), rose to $5 million for 2011 and $5 million adjusted for inflation for 2012. This is good news for a number of reasons," Drossman says. "Simply gifting these larger amounts to children will expose those assets to a future estate tax, because the tax is imposed on each generational level. But with the significant increase in the GST exemption, the ability to transfer greater amounts into long-term trusts will keep those assets outside of the estate tax system for potentially multiple generations. That's a benefit." But there is a caveat.

Says Drossman: "If the government does nothing to extend the current maximums, the exemptions will return to the old, lower amounts — $1 million for gifts and about $1.4 million for GST — in 2013." And so, with the fate of the current exemptions up in the air, he adds, "we are encouraging interested clients to act now."

ASSETS IN A DYNASTY TRUST CAN REMAIN EXEMPT FROM ESTATE TAXES FOR MULTIPLE GENERATIONS.

WHAT TO EXPECT

Assets in a long-term trust remain exempt from estate taxes for the duration of the trust — which could be multiple generations. And while the Obama administration has suggested a tax on such trusts, most experts expect no change in the near term, Drossman says. "Yet a long-term trust funded before any rules change would almost certainly be protected forever."

While these trusts are free of estate taxes, there is still federal income tax to be paid on earnings. "If the trust is structured appropriately, that tax can be paid by the trust creator, rather than by the trust itself," Drossman says. "That way the trust can grow undiminished by taxes during the trust creator's lifetime." With many years of

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DYNASTY TRUSTS: 10 THINGS YOU SHOULD KNOW

1 A dynasty trust can benefit multiple generations.

2 With appropriate application of a GST exemption, assets in a dynasty trust are protected from estate and GST taxes for the life of the trust.

3 Many states place no limit on trust duration, but there are other factors to consider.

4 A trust creator can usually establish a trust in a specific state by naming a qualified trustee in that state.

5 If appropriately structured, a trust's assets can be protected from creditors, ex-spouses and spendthrift beneficiaries.

6 The lifetime gift tax exemption and GST tax exemption both recently rose to $5 million — but may drop in 2013.

7 A trust creator can pay income tax on trust earnings so that assets can grow undiminished by taxes during the creator's lifetime.

8 Dynasty trusts can be funded with any assets, even cash. But there are advantages to assets that can grow in value.

9 Most states that have an estate tax do not have a gift tax. A simple lifetime gift transfer, appropriately structured, can keep significant assets free of estate tax.

10 Because dynasty trusts are multigenerational, an established corporate trustee can help ensure accuracy and continuity.

compounding, that can be a tremendous benefit.

The dynasty trust can be a long-term trust or even a perpetual trust. The rules regarding trust duration differ by state. So while a trust may last a very long time, it can be truly perpetual only when organized in a state that sets no limit on duration. Fortunately, no matter where you live, you can create a trust under another state's law and not be restricted to the duration your home state imposes.

"To do so, however, you must have an appropriate connection to the state, such as a corporate trustee located there," Drossman says. "Delaware, where U.S. Trust maintains a separate, state-chartered trust company, U.S. Trust of Delaware, imposes no time limit on trusts created there (other than for certain real estate holdings). What's more, for nonresidents the state imposes no tax on accumulated trust income. (Your state's rules may differ.) Notably, Delaware also offers a high degree of confidentiality and privacy."

Because they are designed to provide for beneficiaries over multiple generations, "dynasty trusts can be drafted to be as restrictive or as liberal as the trust creator chooses," Drossman says. "To deter reckless spending, distributions are often made at the discretion of a trustee."

THE LIFETIME LIMIT ON TAX-FREE GIFTING QUINTUPLED FOR 2011 AND 2012.

FUNDING

Trusts can be funded initially with a lump sum or periodically through annual tax-free contributions of up to $13,000 per beneficiary. "But, only large gifts would take advantage of the current temporary increased exemption amounts," Drossman says.

Almost any kind of asset can be gifted to a trust, including cash, Drossman says. "But ideally it's an asset that has the potential for appreciation."

To find out more about dynasty trusts, clients should talk to their estate planning advisor, tax advisor and other investment professionals. But, with all the uncertainty about GST tax exemptions in 2013, Drossman says, "they probably shouldn't wait too long." CA