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DYNASTY TRUSTS

Protecting Your Wealth for Generations

Most parents give their children their inheritances directly. Others think multigenerationally. Instead of giving their wealth to their children directly, they give it in “dynasty trusts” – trusts that benefit one generation of family members after another without being taxed in any family member’s estate. Wealth that is never taxed grows far more than wealth that is taxed at every generation, especially when that wealth is protected from creditors and failed marriages.

Dynasty trusts are a golden opportunity for your family. By planning for children, grandchildren and even great-grandchildren, you can give you family many generations of tax-protected, creditor-protected, failed marriage protected wealth.

Consider this tale:

A Tale of Two Families

The Knight Family. John Knight inherited \$1 million from his parents directly. His inheritance was titled in his own name. He *owned* it.

The Day Family. William Day didn’t inherit his \$1 million from his parents. They left his \$1 million to a trust that named him as the trustee and beneficiary. William could *control* the \$1 million as the trustee and could *enjoy* the \$1 million as the beneficiary, but he did not own it. His trust did.

You might think that John, who inherited his \$1 million directly, would be happier than William, who inherited his \$1 million in trust. But if the Knight family knew what the Day family knew, he would not be. If John could see the future, he would rather *control and enjoy* his wealth than *own* it.

Let’s compare the Knight family’s future to the Day family’s future to see why:

The Knight Family

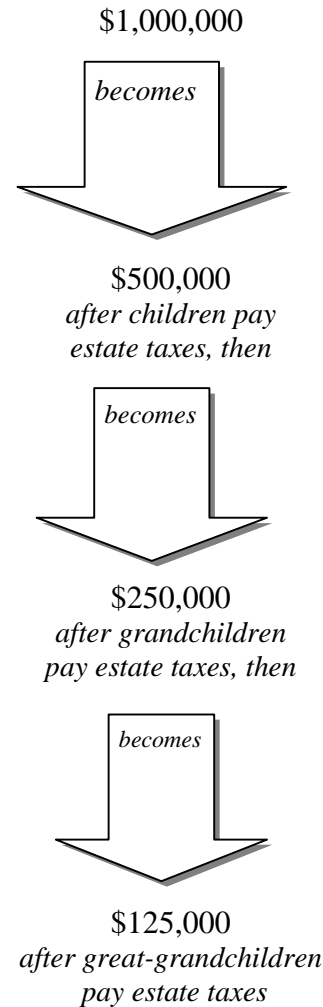
ESTATE TAXES. Estate tax rates begin at 37% once estates reach \$1,000,000 and rise to 50% when estates reach \$3 million and over. Since the government taxes everything we own at death, John would pay estate taxes on his \$1 million because he owns it outright. If his descendants inherit their wealth outright, the government will tax their wealth each time they pass it from one generation to the next because each generation will own what they inherit.

Q: Assuming no investment growth, what will happen if everyone in the Knight family is in the 50% estate tax bracket?

A: John's \$1 million will shrink by 50% to \$500,000 when it passes to his children, will shrink by 50% again to \$250,000 when it passes to his grandchildren, and will shrink still further to \$125,000 when it passes to his great-grandchildren. In three generations, over 85% of John's wealth will be paid to the government, leaving less than 15% for John's family.

CREDITOR CLAIMS. To make matters worse, anything a member of the Knight family owns can be collected by lawsuit creditors. Lawsuits can wipe out inheritances long before estate taxes do.

SPOUSAL CLAIMS. Other risks come from within the family. Unless each family member diligently keeps inherited property separate from marital property, a soon-to-be-ex-spouse can claim half of it in a divorce, adding financial loss to a family member's personal one.



The Day Family

CONTROL AND ENJOYMENT WITHOUT OWNERSHIP. Unlike John Knight, William Day's \$1 million is owned by his dynasty trust, not by William. Even if William can spend all trust income, can enjoy the use of trust assets, and can control the trust as trustee, he will not be deemed to own the trust's \$1 million if the trust's provisions sufficiently limit his access to trust principal and his choice of future beneficiaries. Even the slightest limitations can be sufficient to cause trust assets to be owned by the trust rather than by William – limitations so slight that William will regard the trust's assets as his own, even though they legally are not.

In a dynasty trust, \$1,000,000 remains \$1,000,000 for generations.

YOU CANNOT LOSE WHAT YOU DO NOT OWN. Being the beneficiary of a dynasty trust is like having a millionaire uncle who gives you everything you need, whenever you want it. Though your lifestyle reflects your uncle's wealth, you are not wealthy. Your uncle is.

If you lose a lawsuit or suffer a failed marriage, your judgment creditor or spouse cannot make claims against your uncle's wealth. They are your creditors and spouses, not your uncle's. When you die, the government cannot tax your uncle's wealth in your estate because you never owned it.

The Generation-Skipping Transfer Tax

There's a catch, of course. The estate-tax-free nature of dynasty trusts did not go unnoticed by Congress. In 1976, Congress enacted a 55% generation-skipping transfer tax that applies whenever dynasty trust assets pass to a new generation free of estate taxes. In 1986, Congress gave everyone a one million exemption from this onerous tax. In 1997, Congress again blessed this exemption, and will now allow it to grow annually by the inflationary index. You can contribute, at most, up to \$1,100,000 in the year 2002 to a dynasty trust without triggering the generation-skipping transfer tax. This amount may increase over the years based upon the Federal inflationary rate. Today, a husband and wife can contribute \$2,200,000 combined. This effectively puts a \$1,100,000 limit - (\$2,200,000 for a married couple) - on how much you would want to contribute to a dynasty trust in the year 2002.

Growing Your Exemption Trust Tax-Free. If your parents put \$1,000,000 into a dynasty trust, it could grow to almost \$80 million as it passed through three generations of family members, all without paying estate taxes.¹

All of this wealth would be exempt from taxation, not just the original \$1 million. The \$1 million plus whatever it grows into remains exempt both from estate taxes and from generation-skipping transfer taxes. This is why you would prefer to inherit your wealth or bequeath it in dynasty trusts. This is the Day family's plan.

If the Knight family were to invest the same \$1 million, at the same rate of return, for three generations, they would have approximately \$7 million after paying estate taxes three times.²

After three generations, the Days will have more than ten times as much as the Knights – eighty million versus seven.

¹ DAY CALCULATIONS: At a 7% rate of growth, \$1,100,000 would grow to almost \$100 million in the years it would take for it to pass through four generations if we assume a 25-year age difference between generations.

² KNIGHT CALCULATIONS: Using the same assumptions as for the Day family in the preceding footnote, \$1,100,000 would grow to only \$7.2 million if 50% is paid as estate taxes when it passes to the next generation of family members in years 25, 50, 75 and 100.

Term Limits

The longer your dynasty trust lasts, the more generations of taxation it will escape. However, just as federal tax law limits the amount you put into your dynasty trust, state laws limit how long it can last. Most states have a “Rule Against Perpetuities” statute that limits the duration of dynasty trusts to between 90 and 120 years. Fortunately, this is a long enough period to pass your wealth through three, four or five generations free of estate taxes.

The Choice: Distribution Or Dynasty Trust?

Whenever your will, living trust, or irrevocable trust provides for an outright distribution of wealth to your heirs, consider distributing to a dynasty trust instead. You can include dynasty trust protections in any estate plan. They can be included in any will, living trust, or irrevocable trust. They always should be considered when you establish a life insurance trust to tax-proof your life insurance policies.

You can generate many generations of tax-protected, creditor-protected, failed marriage protected wealth by making the right choice between outright distributions and dynasty trusts. They are as different as night and day.