A Modern-Day Security Blanket:

THE POWER OF DYNASTY TRUSTS

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High-net-wealth individuals are turning to dynasty trusts, not only to avoid federal estate taxes but also to protect assets from general creditors and spendthrift heirs. Even those who do not have a taxable estate should consider a dynasty trust to preserve and grow wealth while ensuring that their loved ones are protected.

Many people are aware of the advantages of conventional trusts and incorporate them into their estate planning, but they often design the trusts so that assets pass outright to their children when those children attain certain ages or milestones. When a conventional trust distributes assets outright to the beneficiary, the distributed assets are includible in the beneficiary's estate and possibly subject to estate tax when the beneficiary dies. If, after an outright distribution, the beneficiary goes through a divorce or has other creditors, those assets could be at risk. Family assets that are distributed to beneficiaries with no restrictions are often depleted by the third generation due to mismanagement or spendthrift heirs.[1]

Dynasty trusts offer opportunities that conventional trusts with an ending date do not. Despite the benefits, clients often perceive dynasty trusts as only for affluent individuals who want to avoid taxes or rule from the grave. While the tax savings of a dynasty trust are undeniable, it can be used as a security blanket to ensure that assets are managed and distributed according to a family's values while protecting future generations from creditors and predators. In modern-day estate planning, this is a common goal shared by many.

Essentially, a dynasty trust is an irrevocable trust established to set aside assets for future generations. Beneficiaries commonly include children and future descendants of the grantor. Discretionary income and principal distributions can be made for their benefit as determined by the trustee or a trust distribution advisor or committee. Because the beneficiaries do not have control over the trust assets, the assets are not includible in the beneficiaries' estates and are generally protected from

1 James W. Collier, Wealth in Families (2d ed. 2006). The theory that wealth is destined to dissipate is that the first generation makes the money, the second generation preserves the assets, the third generation spends the money, and the fourth generation recreates the wealth. *Id.* at 36. *See also* Jack H.L. Whiteley, *Perpetuities in an Unequal Age*, 117 Nw. Univ. L. Rev. 1477, 1504 (2023) (citing statistics showing that 60–70 percent of wealth transfers fail by the end of the second generation).

creditors' claims. In some states, the assets can continue to be held in trust forever.[2]

TAX BENEFITS

One of the most important advantages of a dynasty trust is the ability to preserve family wealth by preventing the assets from being subject to transfer taxes. If a client uses their federal gift (or estate) and generation-skipping transfer tax exemption to fund a dynasty trust, those assets will never be subject to transfer taxes. Any appreciation on those assets is also removed from the grantor's estate. In 2025, the federal gift, estate, and generation-skipping transfer tax exemption is increased to $13.99 million due to inflation adjustments—the highest it has ever been.[3] Essentially, a married couple could use their combined exemption of almost $28 million to establish dynasty trusts today and shield the entire amount from gift, estate, and generation-skipping transfer taxes. If the sunset occurs, the exemption will likely decrease to approximately $7 million per person (as adjusted for inflation) on January 1, 2026.[4] Thus, the amount that an individual can pass tax-free to their heirs will decrease roughly by half in less than one year, making today the optimal time to do tax planning. Any excess will be subject to a top transfer tax of 40 percent.[5]

Children and descendants can still access the assets in the dynasty trust at the discretion of the trustee, but the assets are not includible in their estates. This allows the family assets to appreciate without being subject to wealth transfer taxes at each generation. Today, high-net-wealth clients have a window of opportunity to lock in their historically high exemption amounts and transfer a substantial amount of wealth using dynasty trusts—but tax efficiency is not the only benefit.

ASSET MANAGEMENT

Another advantage of a dynasty trust is the management and preservation of family assets. Clients who are concerned about children mismanaging or squandering their inheritance can use a dynasty trust, appointing a corporate or professional trustee to consolidate and manage the assets over multiple generations. If the grantor wants the family to be involved in management decisions, a child or beneficiary could be appointed as a trustee or co-trustee of the dynasty trust. Or in jurisdictions that allow directed trusts,[6] an investment trustee or advisor could be appointed to manage the assets to provide continuity in the investment strategy.

CREDITOR PROTECTION

Another important feature of a dynasty trust is the creditor protection it provides. In today's world, a divorce, lawsuit, or catastrophic health event can be financially devastating. The dynasty trust can provide for multigenerational planning with both flexibility and a degree of control that protects heirs from creditors, divorce, and bad luck. A typical dynasty trust includes spendthrift provisions and allows only discretionary income—or even principal—distributions to the beneficiaries. Because the ownership of the assets remains in the dynasty trust and distributions are made only at the discretion of the trustee, the beneficiaries cannot force a distribution, and creditors generally cannot attach to the assets.

INCORPORATING FAMILY VALUES

Some clients criticize dynasty trusts because they do not want their children to become "trust fund babies" who live off their inheritance. A dynasty trust can incorporate incentive provisions and family values to enhance but not hinder a beneficiary's ambition to succeed on their own. For example, the grantor could limit distributions based on a beneficiary's employment status or work ethic to incentivize the beneficiary to engage in productive activities and contribute to their own financial well-being. Distributions could be favored for educational pursuits or health needs, or they could reward those who choose to stay home and raise a family or pursue some other valued life calling. The dynasty trust could further require that certain distributions be made to charities. A family committee or advisory board could be appointed to make recommendations on distributions that promote the family's goals and legacy. The bottom line is that, with careful drafting, a dynasty trust can provide guidance and shape the future of successive generations.

FORUM SELECTION

Individuals who want the enhanced benefits of a dynasty trust should consider establishing them in a top-tier trust

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2 Several states have either abolished the rule against perpetuities entirely or allow near perpetual trust terms. *See generally* Whiteley, *supra* note 1.

3 U.S. Dep't of Lab., Bureau of Lab. Stats., Consumer Price Index Figures (Aug. 2024) [hereinafter *Consumer Price Index Figures]*.

4 Under the 2017 Tax Cuts and Jobs Act, the federal estate and gift tax exemption is scheduled to revert back to $5 million adjusted for inflation on January 1, 2026. Pub. L. No. 115-97, 131 Stat. 2504.

5 I.R.C. § 2001.

6 Several states have enacted legislation that allows directed trusts to enable the separation of investment and administrative powers for the trustee.

jurisdiction.[7] Top-tier jurisdictions have either no rule against perpetuities or near perpetual trust duration; this is fundamental if clients want their dynasty trusts to go on forever or at least for multiple generations. When drafting a dynasty trust that may have unlimited duration, it is also important to choose a situs that has trust-friendly laws that offer flexibility. In top-tier jurisdictions, trust laws make it convenient to change trust provisions if there is a change in circumstances. Some of the best jurisdictions for dynasty trusts include South Dakota, Nevada, Tennessee, and Alaska.[8] Rhode Island, Delaware, Ohio, New Hampshire, Wyoming, and Missouri round out the top ten.[9]

When choosing a situs for a dynasty trust, consider jurisdictions that have statutes or case law authority that allow the following:

Trust protector provisions. A trust protector can be appointed at the outset (or at some point in the future) and can address unanticipated changes in family circumstances or the law. A trust protector is a disinterested party who can, depending on relevant state law, make certain revisions to the trust; add and remove trustees, advisors, or beneficiaries; review accountings; modify or allow a power of appointment; change situs; interpret the trust; or correct drafting mistakes.[10]

Decanting provisions. Decanting allows a trustee to distribute the assets from an irrevocable trust to a new trust with similar (but better) terms. Decanting is often used to fix drafting errors, modernize an old trust, move a trust to a better jurisdiction, or add better creditor protection for beneficiaries. All of the top-tier jurisdictions have flexible decanting laws that make it easier to replace an outdated trust.

Directed trust provisions. Directed or delegated trust provisions provide both flexibility and control by dividing responsibility for certain decisions among trustees or advisors. A corporate or professional trustee is often appointed as an administrative trustee to manage the day-to-day trust matters, and other advisors (or a committee) are named to handle investments and distributions. The advisors then direct the administrative trustee regarding the investments or distributions. This provides the family with a great deal of control over the trust assets.

Modification or reformation of dynasty trusts. Top-tier trust jurisdictions also have modification or reformation statutes that make it convenient, timely, and private to make changes to dynasty trusts. Some offer nonjudicial settlement agreements negating the need for court involvement.

Privacy in trust matters. Most individuals want their trust affairs to remain private for reasons ranging from asset protection to avoidance of family conflict. Top-tier jurisdictions typically allow court matters to remain sealed, keeping the trust matters private, or provide so-called quiet trust provisions to limit information to beneficiaries and third parties. If court approval or action is necessary to make changes to a dynasty trust, it is also desirable to have quick and easy access to the court system.

Asset protection. Compelling asset protection laws are another key feature of the top-tier jurisdictions. Strong spendthrift trust provisions and discretionary trust protection for beneficiaries are crucial so that creditors cannot force a distribution and attach to the assets. In some of the top-tier jurisdictions, clients can even incorporate dynasty trust provisions in a self-settled asset protection trust so that they can protect assets for themselves as well as future generations.

No state income tax on trusts. Another attribute of top-tier jurisdictions is that they do not charge state income tax on the dynasty trust. This is especially important if the dynasty trust will retain some of its income instead of distributing all of it to the beneficiaries.

Virtual representation. Virtual representation statutes are designed to make trust administration easier for multigenerational trusts that have contingent, unascertainable, or unborn beneficiaries. For states with virtual representation statutes, beneficiaries are typically allowed to represent and legally bind other parties with the same interest, such as minors, unborn parties, or unascertained beneficiaries.

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7 *See generally* Daniel G. Worthington & Mark Merric, *Which Trust Situs is Best in 2022?*, WealthManagement.com (Dec. 17, 2021), https://www.wealthmanagement.com/estate-planning/which-trust-situs-best-2022.

8 *See* Steven J. Oshins, *9th Annual Dynasty Trust State Rankings Chart*, Oshins.com, https://www.oshins.com/_files/ugd/b211fb_79b9ea-83b72543e995ad71695279d4e3.pdf (last visited Oct. 10, 2024); *See also* Dan Flanagan, *Best States for Trusts: How to Choose One That's 'Trust-Worthy,'* Kiplinger (Oct. 18, 2022), https://www.kiplinger.com/retirement/best-states-for-trusts-how-to-choose-one-thats-trust-worthy.

9 *See* Oshins, *supra* note 8.

10 Although directed trusts are addressed separately, note that some states' directed trust statutes, for example, 760 ILCS 3/808, address the powers of trust protectors as well as distribution trust advisors and investment trust advisors. The Uniform Directed Trust Act § 2(9) cmt. states: "The definition of a 'trust director' in paragraph (9) refers to a person other than a serving trustee that is granted a power of direction by the terms of a trust. Such a person is a trust director even if the terms of the trust or the parties call the person a 'trust adviser' or 'trust protector' or otherwise purport to disclaim trust director status. A person may be a trust director even if the person is a beneficiary or settlor of the trust, though certain powers of a beneficiary and a settlor are excluded from the application of this act by Section 5."

held business interests due to discounts for lack of marketability and control. Family members can be added as general trust or investment advisors to manage the family business interests. Another way to leverage a dynasty trust is to use the trust assets to purchase life insurance on the life of the grantor. The proceeds are made payable to the dynasty trust and are not includible in the grantor's estate at death. The dynasty trust could also purchase life insurance on beneficiaries' lives to provide liquidity in the future. A dynasty trust can be funded during the client's lifetime or incorporated into a client's revocable living trust to take effect at death. Contributions can be made in a lump sum or spread out over the client's lifetime by using annual gift exclusions[11] (or the increased inflation-adjusted lifetime gift exemption).

Keep in mind that if a jurisdiction other than the client's home state is chosen to establish the dynasty trust, the client will need to choose a trustee who is a resident of or authorized to do business in the state where the dynasty trust is established. To strengthen the nexus, clients should also have some assets located in the jurisdiction.

Flexibility is essential for a long-term trust so that it can adapt to changes in family dynamics, evolving financial needs, and shifting legal or tax landscapes. Although many dynasty trusts are designed to be perpetual, they do not need to go on forever. A grantor can set a time limit or an ending date based on a future event or can allow a trust protector to modify the term or add powers of appointment to allow the beneficiaries to redirect the distribution of the assets. Practitioners can incorporate many innovative features into the design of a dynasty trust, especially in the top-tier jurisdictions.

BASIC CONSIDERATIONS IN ESTABLISHING A DYNASTY TRUST

Not everyone has enough wealth to justify setting up a multigenerational trust given the costs and complexity involved with setup and ongoing administration. There is no hard-and-fast rule on the right amount of initial funding for a dynasty trust, but in my experience, a client should transfer at least $5 to $10 million in assets to the trust to ensure that there are enough assets to provide a return for multiple generations.

Almost any asset can be used to fund a dynasty trust. Liquid assets are often the most economical and easiest to manage, especially if a corporate or professional trustee is used. However, real estate, family assets, and closely held business interests are commonly transferred to dynasty trusts. If clients wish to lower their taxable estates, they should consider transferring assets that are likely to appreciate in value. Clients can leverage their gifting to a dynasty trust by transferring closely

SUMMARY

Individuals in many wealth ranges have a lot to gain by establishing dynasty trusts. While high-net-wealth families have historically used these trusts to save taxes, dynasty trusts have evolved to protect against modern-day threats, including immature or irresponsible heirs, divorce, lawsuits, catastrophic health events, and other misfortunes. These threats do not have an expiration date. A dynasty trust is one of the best ways to secure and preserve family wealth from these threats now and in the future.

11 The annual gift tax exclusion for 2025 is $19,000 per person. *See* Consumer Price Index Figures, *supra* note 3. To enable gifts to qualify for the annual gift tax exclusion, the trust should include Crummey withdrawal provisions. *See* Crummey v. Comm'r, 397 F.2d 82 (9th Cir. 1968) (allowing annual exclusion to be applied to gifts to a trust that allow the beneficiary to withdraw the gift within a specified time period). However, for annual gifts made to dynasty trusts, a grantor will need to allocate their lifetime generation-skipping transfer tax exemption since the transfers do not qualify for the generation-skipping transfer tax annual exclusion under I.R.C. § 2642(c).