The trusts established by Joseph Kennedy still provide for his descendants' welfare.

Descending Value

Dynasty trusts can protect your heirs from estate taxes for generations.

BY MIKE ROBBINS

There's long-term financial planning, and, then there's long-term financial planning. With an estate-planning tool known as a dynasty trust, those with substantial estates (roughly $3 million and up) can effectively protect a portion of their assets from death taxes, spendthrift descendants, and the threat of lawsuits forever.

"If you want your assets or family business to last more than one or two generations," says Les Carter, managing director of personal trusts at First Union Corporation Delaware, "this is about the best way to do it."

A Lasting Legacy

A major benefit of dynasty trusts is control. "The purpose [of these trusts] isn't necessarily tax avoidance," says attorney Ralph M. Engel of Rosen & Reade, LLP, in New York City and Greenwich, Connecticut. Just how much access to the assets you provide your heirs is up to you. For example, you could establish a dynasty trust that allows the funds to be used only for your descendants' "health and welfare," defined as you (or your trustee) see fit. Thus, the trustee could prevent your great-grandson from draining the trust to buy expensive cars. And if his wife leaves him, the divorce lawyers won't be able to touch the trust assets since this wealth belongs to the trust, not to him. The trust also protects assets from other lawsuits and can ensure professional management.

With a dynasty trust, the distribution scheme largely is up to you. However they're structured, these trusts will not help you avoid immediate gift and estate taxes—you'll either have to use some or all of your $675,000 onetime gift-tax exemption (the exemption will gradually increase to $1 million per person by 2006; for couples, this year's $1,350,000 exemption will increase to $2 million by 2006) to fund the trust. If you've already used your exemption or part of it—for example, by giving away an asset like a vacation home to an heir—you II have to ante up to the government when the trust is established.

A dynasty trust is subject to more than a gift tax. For those who leave money directly to or in trust for grandchildren, it is also subject to a generation-skipping transfer (GST) tax. Just as the $675,000 gift-tax exemption lets you make limited gifts without facing taxes, the GST exemption allows people the option of giving up to $1,060,000 ($2,120,000 for a married couple) to grandchildren or great-grandchildren—or to a dynasty trust—without facing the GST. Any amount given to the trust above the GST exemption is subject to a flat tax rate of 55 percent. A trust that falls within these limits could still turn into a very substantial legacy. Supplied with such potential high-growth assets as stocks, a share of a privately held business, or a single-payment life insurance policy that makes a substantial payout at your death, the trust could grow to be worth tens of millions of dollars. And once the trust has been properly established and you take the GST exemption, its assets will never again face gift, estate, or related taxes (investment profits remain subject to income and capital-gains taxes) even though many generations of your descendants might receive benefits.

In a world of hefty estate taxes, that's a pretty neat trick. Currently, gift and estate taxes as high as 55 percent are due when large estates pass from one generation to the next, and the government may get another 55 percent with each succeeding generation. But will dynasty trusts make sense if the estate tax is repealed? The estate-planning attorneys haven't given up on dynasty trusts just yet. "The government already has [done away with] the estate tax twice before—and it's come back each time," says attorney Nathaniel Clement of Nathaniel E. Clement & Associates in Chapel Hill, North Carolina. "Even if this administration does repeal it again, it's a sure bet that some future administration will ... bring the thing back."

Take It Slowly

The best advice? Caution. Until the rules are settled under the Bush administration, don't fund a dynasty trust with more than the current gift-tax or GST exemption. And whatever happens on the tax front, individuals will know they've done their part to help their descendants reduce the impact of estate taxes.

Finally, make sure your lawyer includes adequate "bail out" provisions so the trust can be ended if changing tax laws render it obsolete. This can be done by including a "power of appointment" provision, in which a friendly party is authorized to direct the trust property to a beneficiary or another trust; or by naming a "trust protector," someone with the power to discontinue the trust if doing so is in the beneficiaries' interests.

Mike Robbing's work has appeared in Mutual Funds *magazine and* People.

ESTABLISHING A DYNASTY TRUST

Few states allow dynasty trusts to continue indefinitely—for example, only Rhode Island does in New England. In order for these trusts to have an infinite life, a state must have altered or abolished something known as the Rule Against Perpetuities, a legal concept older than America itself that limits the length of time that a trust can run. But trusts don't have to be established in one's home state. Most large banks with trust departments have affiliates in states that do allow dynasty trusts, such as Delaware or South Dakota, where state taxes and the laws governing dynasty trusts are particularly favorable. (Connecticut residents will have a hard time escaping state-income taxes even with an out-of-state trust.) Just name the bank's affiliate as the trustee, and you should qualify.

How much does it cost to establish a dynasty trust? Expect to pay an attorney $5,000 to $10,000. A trust company will charge annual administration costs of 0.5 percent to 0.75 percent of the total amount of the assets as well. Annual costs could be higher, as much as 1.5 percent of the amount in the trust if investment management is included in the arrangement. A nationwide bank and trust company can recommend qualified attorneys to draw up the documents.

The estate tax may soon be history. But for now, the dynasty trust remains the ultimate long-term way to provide for one's family.