Abstract: The Tax Cuts and Jobs Act, signed into law this past December, has brought great changes to estate planning. In doing so, it bolstered the potential value of dynasty trusts. This article explains why these trusts are well worth considering for tax and nontax reasons.

Dynasty trusts are more valuable than ever

The Tax Cuts and Jobs Act (TCJA), signed into law this past December, affects more than just income taxes. It's brought great changes to estate planning and, in doing so, bolstered the potential value of dynasty trusts.

Exemption changes

Let's start with the TCJA. It doesn't repeal the estate tax, as had been discussed before its passage. The tax was retained in the final version of the law. For the estates of persons dying, and gifts made, after December 31, 2017, and before January 1, 2026, the gift and estate tax exemption and the generation-skipping transfer tax exemption amounts have been increased to an inflation-adjusted $10 million, or $20 million for married couples ($11.18 million and $22.36 million, respectively, for 2018).

Absent further congressional action, the exemptions will revert to their 2017 levels (adjusted for inflation) beginning January 1, 2026. The marginal tax rate for all three taxes remains at 40%.

GST avoidance

Now let's turn to dynasty trusts. These irrevocable arrangements allow substantial amounts of wealth to grow free of federal gift, estate and generation-skipping transfer (GST) taxes. The specific longevity of a dynasty trust depends on the law of the state in which it's established. Some states allow trusts to last for hundreds of years or even in perpetuity.

The GST tax is an additional 40% tax on transfers to grandchildren or others that skip a generation, potentially consuming substantial amounts of wealth. The GST tax exemption is the same as the gift and estate tax exemption, $11.18 million for 2018. For a transfer to a "skip" person to be completely tax-free, generally both the GST exemption and the gift or estate tax exemption must be applied.

The power of the dynasty trust post-TCJA is that, assuming you haven't yet used any of your gift and estate tax exemption or your GST tax exemption, you can transfer a whopping $11.18 million to a properly structured dynasty trust. There's no gift tax on the transaction because it's within your unused exemption amount. And the funds, plus future appreciation, are removed from your taxable estate.

Most important, by allocating your GST tax exemption to your trust contributions, you ensure that any future distributions or other transfers of trust assets to your grandchildren or subsequent generations will avoid gift, estate and GST taxes. This is true even if the value of the assets grows well beyond the exemption amount or the exemption is reduced in the future.

Nontax reasons to set up a dynasty trust

Regardless of the tax implications, there are valid nontax reasons to set up a dynasty trust. First, you can designate the beneficiaries of the trust assets spanning multiple generations. Typically, you might provide for the assets to follow a line of descendants, such as children, grandchildren, great-grandchildren, etc. You can also impose certain restrictions, such as limiting access to funds until a beneficiary earns a college degree.

Second, by placing assets in a properly structured trust, those assets can be protected from the reach of a beneficiary's creditors, including claims based on divorce, a failed business or traffic accidents.

Best interests

Naturally, setting up a dynasty trust is neither simple nor quick. You'll need to choose a structure, allocate assets (such as securities, real estate, life insurance policies and business interests), and name a trustee. Your tax advisor and your attorney can help you determine whether a dynasty trust is right for you and, if so, help you maximize the tax benefits.