

# Dynasty Trusts

Merric Law Firm, LLC

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**Mark Merric, JD, MT, CPA** In addition to being an attorney, Mark Merric holds a Masters of Taxation and he is a Certified Public Accountant, as well as an Adjunct Professor at the University of Denver's, Law School Graduate Tax Program. He has been quoted in Forbes, Investor's News, On the Street, the Denver Business Journal, Oil and Gas Investor, and the Sioux Falls Business Journal. Mr. Merric is a manager for Merric Law Firm, LLC and the Alliance of International Legal Counselor, LLC. Prior to practicing as an attorney, Mark Merric developed a strong business background working for a Final Four Accounting Firm.

Mr. Merric presents nationwide more than 30 times annually. He is honored to have spoken at:

- Regis Campfield's Notre Dame Tax and Estate Planning Institute (2007);
- Lonnie McGee's Southern California Tax and Estate Planning Forum, (2006), (2007), and (2008); and
- Chicago Bar Association (2004), (2007), (2008), and (2009).

Mark Merric has been fortunate to be one of the few authors that have had three, four, and five part series published in Estate Planning Magazine, Journal of Practical Estate Planning, and Leimberg LISI. He is also a co-author of the following three treatises:

- The Asset Protection Planning Guide: A State-of-the-Art Approach to Integrated Estate Planning, Commerce Clearing House (CCH) treatise, first edition;
- Asset Protection Strategies, American Bar Association (two chapters); and
- Asset Protection Strategies Volume II, American Bar Association to be published Apr. 2005 (MM responsible for 1/5 of the text).

# Vesting Options

- **Outright** – Upon my death distribute the property equally (“per stirpes” or “by right of representation”) among my children
- **Age Vesting** - Upon the latter of my death or my spouse’s death distribute 1/3 of the property when my children are age 25; ½ when age 30; and the remainder when age 35.
- **Next generation Vesting** - Income for life to my children; discretionary power to invade principal; remainder grandchildren.
- **Dynasty Trust**

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## A. Vesting Options

As noted in the Beneficiary Controlled Trust Outline, there is a great trend toward using discretionary dynasty trusts for many, if not most, clients. In this case, the generation skipping transfer tax always becomes relevant when transferring assets to a dynasty trust.

# What is a Dynasty Trust?

- **A trust that continues until:**
  - (1) **the rule against perpetuities has been violated or**
  - (2) **the property in the trust has been consumed**
- **All property interests must vest within 21 years of a life in then being.**
- **States have made the following choices:**
  - (1) **Abolish the Rule Against Perpetuities**
  - (2) **Uniform Statutory Rule Against Perpetuities**
  - (3) **Wait and See States**
  - (4) **Strict Rule Against Perpetuities**

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## **B. What is a Dynasty Trust?**

A dynasty trust is a trust that does not have a remainder interest. Property is held in one or more trusts until one of the following two things happens:

- (1) the trust violates the rule against perpetuities; or
- (2) the trust is consumed by the beneficiaries.

### 1. Common Law Rule Against Perpetuities

The rule against perpetuities provides that a property interest is void unless the property interest must vest in someone (i.e., the trust must terminate and the property distributed) within 21 years of a life in being.

### 2. Different State Positions

Different states have taken the following different positions regarding how to deal with the common law rule against perpetuities:

#### *a. Abolish the Rule*

The unquestionable trend, and most likely soon to be the majority position, is to abolish the RAP completely or to create an incredible long period of time the property may remain in trust.

#### *b. Uniform Statutory Rule Against Perpetuities*

The Uniform Statutory Rule Against Perpetuities allows the election of the greater of twenty-one years of a life in then being or ninety years from the date inception. Under USRAP is a wait and see statute.

#### *c. Wait and See States*

Under common law, most states that have not abolished the RAP or adopted the USRAP use a “wait and see” approach. With a wait and see approach, the property vests when the 21 years plus life and then being is exceeded.

# RAP Savings Clauses?

- **Standard savings clause**
  - In order to avoid the application of a strict common law RAP result, almost all trusts contain a RAP Savings Clause.
  - The RAP savings clause provides that all interests in trust will vest within 21 years of a life in being.
- **What if RAP has been abolished?**
- **What if state abolishes RAP in the future?**
- **Standard RAP savings clause forces trust to vest**
- **Contingent RAP savings clause**
  - Do not use in a Strict RAP state

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## *d. Strict RAP States*

There are a few states that follow the common law strict rule against perpetuities. Under the common law of these states, if there is any potential for the RAP to be violated, the trust would be void from inception.

## **C. RAP Savings Clauses**

In response to the Draconian result in a strict RAP state, RAP savings clauses were developed. A RAP savings clause provides for the automatic vesting of all trust interests within 21 years of a life then in being. A sample RAP savings clause is included on the next page.

### *1. Problems With RAP Savings Clauses*

Beginning with South Dakota, states began to repeal the RAP. Presently, 22 states repealed the RAP or provided for long trust periods of time before an interest must vest (i.e., that is 150 years to 1,000 years). Once the RAP has been repealed, theoretically a dynasty trust may continue until the property is consumed or the greatly increased period of time has expired. This would be true unless the RAP savings clause forced vesting.

### *2. Contingent RAP Savings Clauses*

To avoid the automatic vesting by a RAP savings clause, one should consider the use of a contingent RAP savings clause. A contingent RAP savings clause provides that “if this trust is governed by a state that is subject to a RAP,” then the savings clause applies. An example of a contingent RAP savings clause is in the following pages.

**Warning-** never use a contingent RAP savings clause in a strict RAP state. Remember, if there is any possibility at anytime that the trust would exceed the 21 years of a life in being, then the trust would be void from inception. A contingent RAP creates this possibility by changing the governing law.

### **Standard RAP Savings Clause – Complements WealthCounsel, LLC**

Notwithstanding any other provision of this agreement, unless sooner terminated under other provisions hereof, any trust created under this agreement shall terminate upon the expiration of the longest period that property may be held in trust under this agreement without violation of the applicable Rule Against Perpetuities.

In determining the maximum term for trusts the death of the last to die among a group of individuals living on the date of the execution of this document, those individuals shall consist of me, my wife, the descendants of my paternal and maternal grandparents, the descendants of my wife's paternal and maternal grandparents and the descendants of his late Majesty King George VI.

At that time, the remaining trust property shall vest in and be distributed to those persons then entitled to receive mandatory distributions of the net income from the trust property and in the same proportions to which they are entitled to receive the net income. If a group of beneficiaries is eligible to receive discretionary distributions of the net income from a trust, such trust shall vest in such beneficiaries in equal shares per capita.

### **Contingent RAP Savings Clause**

If the law governing this Trust or any trust created hereunder has a rule against perpetuities, then, unless sooner terminated under other provisions of this Agreement, such trust shall terminate at the latest of the following dates described below:

- Twenty-one (21) years after the last to die of any now-living Beneficiary named herein;
- Twenty-one (21) years after the last to die of any now-living child, grandchild, other issue or spouse (estranged or otherwise) of any natural person named as Beneficiary herein or who is a Beneficiary pursuant to the terms hereof;
- Twenty-one (21) years after the death of the last now-living survivor, descendant, other issue or heir of his late majesty King George the Fifth of England;
- Twenty-one (21) years after the death of the last now-living survivor, descendant, other issue or heir (legitimate or illegitimate) of the late Joseph P. Kennedy of Massachusetts, who served as Ambassador to the Court of Saint James and/or Ambassador to Great Britain (or other similar or comparable post) for President Franklin Delano Roosevelt of the United States of America, and who was also father of President John Fitzgerald Kennedy of the United States of America; or,
- If a term of years may be permissibly used, the longest term allowable under governing law, whether said term be for 80 years, 100 years, an indefinite or infinite period of time, or otherwise.

# States Abolishing RAP

- Alaska
- Arizona
- Colorado – 1,000 years
- Delaware
- Florida – 360 years
- Idaho
- Illinois (opt out)
- Maine
- Maryland
- Missouri
- Nebraska
- Nevada – 365 years
- New Hampshire
- New Jersey
- Ohio (opt out)
- Rhode Island
- South Dakota
- Virginia
- Utah – 1,000 years
- Washington – 150 years
- Wisconsin
- Wyoming – 1,000 years

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## D. States Abolishing the RAP

Alaska	Alaska Stat. § 34.27.100
Arizona	Ariz. Rev. Stat. § 14-2901A
Colorado	Colo. Rev. Stat. § 15-11-1102(1)
Delaware	District of Columbia D.C. Code Ann. §19-904(10)
Florida	Fla. Stat. § 689.225(2)(f)
Idaho	Idaho Code § 55-111
Illinois	765 Ill. Comp. Stat. §305
Maine	Me. Rev. Stat. Tit. 33 § 11-102
Maryland	Md. Code § 11-102
Missouri	Mo. Rev. Stat. § 456.025
Nebraska	Neb. Rev. Stat. § 76-2005(9)
Nevada	Nev. Rev. Stat. § 111.1031
New Hampshire	N.H. Rev. Stat. Ann. § 564:24
New Jersey	N.J. Stat §§ 46:2F-9
Ohio	Ohio Rev. Code § 2131.09
Rhode Island	R.I. Gen. Laws § 34-11-38
South Dakota	S.D. Codified Laws § 43-5-8
Virginia	Va. Code Ann. § 55-13.3
Utah	Utah Code § 75-2-1023
Washington	Wash. Rev. Code § 11.98.130
Wisconsin	Wis. Stat. § 700.16
Wyoming	Wyo. Stat. § 34-1-139

# Uniform Statutory Rule Against Perpetuities

- California
- Connecticut
- Georgia
- Hawaii
- Indiana
- Kansas
- Massachusetts
- Michigan
- Minnesota
- Montana
- New Mexico
- North Carolina

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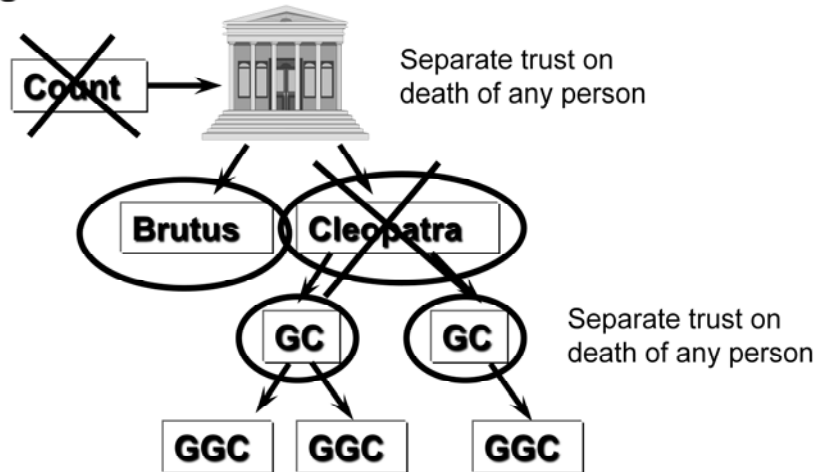
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## E. States Following USRAP

California	Cal. Prob. Code § 21205
Connecticut	Conn. Gen. Stat. § 45a-491
Georgia	Ga. Code § 44-6-201
Hawaii	Haw. Rev. Stat. § 525-1
Indiana	Ind. Code § 32-17-8-1
Kansas	Kan. Stat. § 59-3401
Massachusetts	Mass. Laws ch 184A, § 1
Michigan	Mich. Comp. Laws § 554.72
Minnesota	Minn. Stat. § 501A.01
Montana	Mont. Code § 72-2-1002
New Mexico	N.M. Stat. § 45-2-901
North Carolina	N.C. Gen. Stat. § 41-15

# Structure of a Dynasty Trust

- **Separate Trust at Each Generation When Parent Dies**



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## F. Structure of a Dynasty Trust

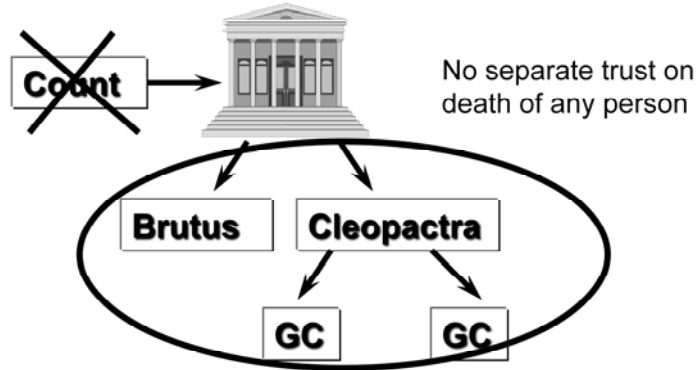
### 1. Separate Trust at Each Generation

Under the beneficiary controlled trust, inheritor's trust, or current model of a discretionary dynasty trust, upon the death of the settlor (or later of the death of the settlor or the settlor's spouse), the trust splits into a separate dynasty trust for each child. The process is repeated when the child passes away. At this time the trust splits into a separate trust for each grandchild.

The purpose of this structure is to avoid fights between siblings by dividing the trust assets at each generational level.

# Structure of a Dynasty Trust

- **Multiple Beneficiary Dynasty Trust – Some planners do not have the trust assets split between the beneficiaries at each generation. Instead they use a “pot” trust**



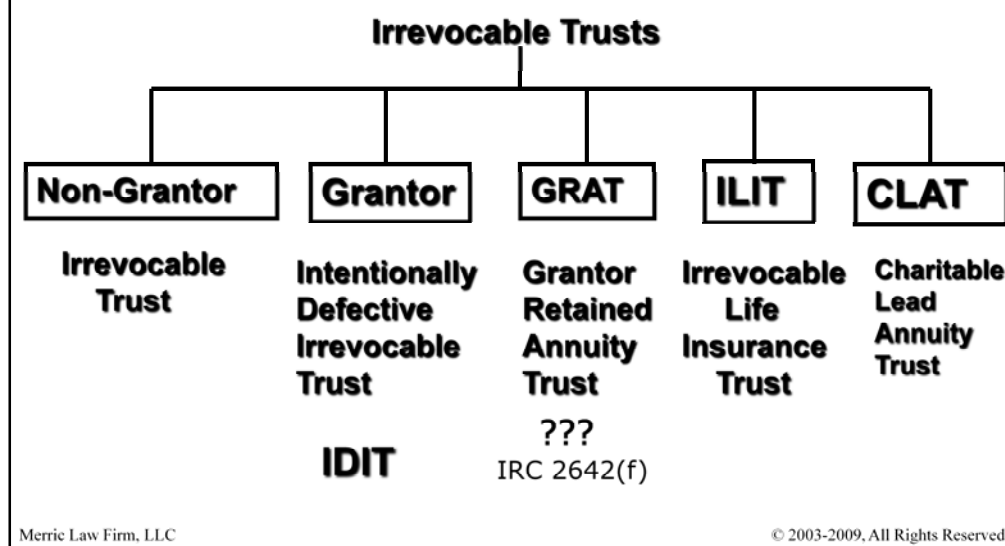
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## 2. Multiple Beneficiary Trust

The older model of a discretionary dynasty trust never divided at generational levels. Rather, all descendants became beneficiaries of the same trust. Many times this type of design is referred to as a “pot” trust. Naturally, this type of an arrangement might create quite a bit of family controversy at each generational level, particularly, if a trustee prefers one sibling over another.

# Dynasty Provisions?



## G. Which Trusts May Contain Dynasty Provisions

As noted in the “Type of Trusts” outline, the primary trusts that are used to reduce a taxable estate are the Irrevocable Trust, IDIT, GRAT, ILIT, and CLAT. However, all but one of these trusts may easily contain dynasty provisions.

While dynasty provisions may be included in a GRAT, generally this is not common practice. This is because a GRAT cannot allocate the GSTT exemption until the end of the estate tax inclusion period (“ETIP”). IRC §2642(f).

# Purpose of a Dynasty Trust

- **Generation Skipping Transfer Tax**
- **Asset Protection**
  - **No remainder interest**

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## H. Primary Purpose For Creating a Dynasty Trust

There are two primary purposes for creating dynasty trusts.

- (1) To the extent the trust is generation skipping transfer tax exempt, it passes to the next generation without any estate tax.
- (2) There is no remainder interest with a dynasty trust. Therefore, there is no property interest that a creditor may attach to.