

The New Nevada 365-Year Dynasty Trust: Nevada Becomes a Leading Dynasty Trust State

By Steven J. Oshins

On October 1, 2005, certain provisions of Senate Bill 64 (SB 64) from the 2005 Nevada legislative session became effective. Those provisions amended Chapter 111 of the Nevada Revised Statutes to change Nevada's rule against perpetuities to 365 years. This new law creates an opportunity for Nevada residents, as well as residents of other states, to pass assets through a Nevada dynasty trust, shielding those assets from estate taxes, creditors and divorcing spouses of the trust beneficiaries for 365 years.

Prior to the passage of the new law, the rule against perpetuities under NRS Chapter 111 limited the duration of a trust under Nevada law to the greater of 90 years or "lives in being plus 21 years." This generally allowed a trust to continue for approximately 90 to 120 years before the trustee would have to distribute the trust assets to the beneficiaries. This distribution moved the assets from an estate tax,

creditor and divorce-protected environment to one which exposed the assets to estate taxes, creditors and divorcing spouses.

Because 17 states and Washington, D.C currently have laws allowing trusts to continue perpetually with no estate taxes, prior to passage of the new law, Nevada had been at a huge disadvantage and was losing significant revenue and jobs to the more favorable jurisdictions. Now that trusts can be created under Nevada law for up to 365 years, very few Nevada residents will choose to create trusts under the laws of the other states, and non-residents who otherwise would have created trusts under the laws of other states will now choose to domicile their trusts in Nevada. Nevada is now one of only a few states with a long perpetuities law as well as no state income tax.

History of the new law

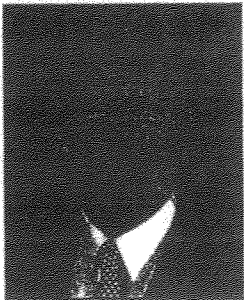
Nevada's Constitution at Article 15, Section 4 limits a trust's duration by imposing a rule against perpetuities on all Nevada trusts except those created for charitable purposes. In 1987, the Nevada Legislature codified this rule against perpetuities by enacting the Uniform Statutory Rule Against Perpetuities Act (USRAP), NRS 111.103 to 111.1039, prohibiting trusts from lasting perpetually.

The original bill written for the 2005 Nevada legislative session was authored by Steven J. Oshins and sponsored by the Judiciary with the help of Senator Dina Titus as Senate Bill 382 (SB 382). That bill, if passed as originally written, would have increased Nevada's rule against perpetuities to 1,000 years. However, it passed and was signed into law by the Governor on May 26, 2005, effective October 1, 2005, with provisions extending Nevada's rule against perpetuities to only 150 years.

Because of the inferiority of the new law as passed under SB 382 in comparison to the laws of a number of other jurisdictions, the backers of SB 382 were able to move the language of SB 382 verbatim to SB 64, a bill sponsored by Senator Dean A. Rhoads, within a few days of the passage of SB 382. The number of years was negotiated from 150 to 365 in SB 64 and signed into law by the Governor on June 6,

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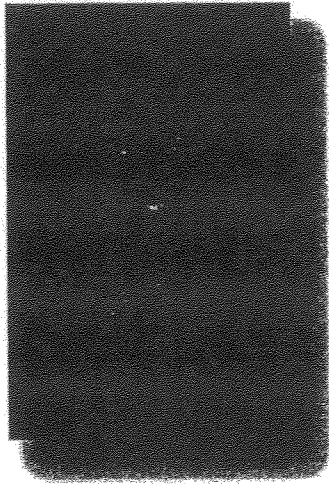
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2005, thus marking one of the most significant changes in the history of Nevada trust law.

What is a dynasty trust?

A dynasty trust is an irrevocable trust that leverages the estate, gift and generation-skipping transfer tax exemptions for as many generations as applicable state law permits. Most trusts provide for mandatory distributions to the grantor's children at staggered ages (e.g., one-third at age 25, one-half of the balance at age 30, and the balance at age 35). In contrast, a dynasty trust is drafted to encourage the trustees of the trust to keep the assets in trust for the benefit of the beneficiaries and to allow the beneficiaries to "use" the trust property, rather than receive it outright where it will be subject to estate taxes, creditors and divorcing spouses.

For estate tax purposes, it is not sufficient to plan for only one generation at a time. The potential estate taxes that the clients' children's estates may face as a result of such inferior planning are often not given enough consideration by the attorney in drafting the trust. As of 2006, the tax code allows each person to transfer up to \$2 million without any federal generation-skipping transfer (GST) tax. Meanwhile, the exemptions in 2006 for federal estate and gift taxes are \$2 million and \$1 million, respectively.

Interestingly, the estate and gift tax exemptions are utilized in nearly every estate plan, yet all too often attorneys do not draft their trust agreements to utilize the GST tax exemption. Failure to use an individual's GST tax exemption is a horrific economic waste over the course of time. Most likely, this failure is a result of the attorney using a canned "form" agreement that may be more suited for a very small estate but is not appropriate for a medium or large sized estate.

Designing the dynasty trust

Most dynasty trusts are designed as Beneficiary Controlled Trusts. The beneficiaries usually become trustees of their own trust upon reaching the age at which most attorneys' trusts would distribute the trust assets outright to the beneficiaries. There are two general classifications of Beneficiary Controlled Trusts—discretionary trusts and support trusts.

Discretionary Trusts. For maximum creditor and divorce protection, an independent trustee is used to make discretionary distributions and other tax sensitive decisions. The primary beneficiary can be given the power to remove and replace the independent trustee with or without cause. Additionally, the primary beneficiary can be the investment trustee, thereby able to make all investment decisions over

his trust assets. Thus, the primary beneficiary has the control over and use of the trust property as though he owned it free of trust. However, by having a correctly drafted dynasty trust as the owner, the assets are protected from estate taxes and from the beneficiary's creditors, including divorcing spouses. This co-trusteeship, although slightly more complex than having just one trustee, provides the ultimate combination of control, estate tax savings and creditor protection.

Support Trusts. Alternatively, the primary beneficiary can be the sole trustee. With this option, the beneficiary can only distribute assets to himself for his health, education, maintenance and support. This is often called a "support trust," as opposed to a "discretionary trust" which uses an independent trustee for discretionary distributions. Although a support trust is simpler to administer than a discretionary trust, certain creditors of the beneficiaries of a support trust may access the trust assets, so it is less protective than a discretionary trust.

The types of creditors that may access the assets in a support trust depend upon which classes of creditors the court allows as exceptions to the general rule that a spendthrift trust is protected from creditors. Some examples of these "exception creditors," as defined in the Restatement Second of Trusts, include (1) alimony or child support, (2)

necessary services or supplies rendered to the beneficiary (such as medical services), (3) a claim by the U.S. or a state to satisfy a claim against a beneficiary (such as a tax lien), and (4) services rendered and materials furnished that preserve or benefit the beneficial interest in the trust (such as attorneys' fees to protect a trust).

Conclusion

The passage of SB 64 has made Nevada one of the most favorable jurisdictions in the country in which to create a dynasty trust. Nevada residents, as well as non-residents, can use this new law to protect assets from estate taxes, creditors and divorcing spouses for up to 365 years. The combination of the new perpetuities law with Nevada's lack of a state income tax makes Nevada an ideal jurisdiction. These attributes make this one of the most historically significant changes to Nevada trust law. **■**

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