John Hancock
LIFE INSURANCE

Dynasty Trust

People often think about the Rockefellers or the Kennedy family when they think of family dynasties. Both were wealthy and politically active. However, you do not have to run for political office or have vast wealth to establish a Dynasty Trust.[1] A dynasty trust can be a tax-friendly way for you to provide financial security for your children and their families.

WHAT IS A DYNASTY TRUST?

A Dynasty Trust is an Irrevocable Life Insurance Trust (ILIT) that has been drafted to use each grantor's generation-skipping transfer tax (GSTT) exemption. This means that unlike a regular ILIT, this trust will continue for generations, while remaining outside of the beneficiaries' taxable estate. In some states, the trust can last forever.[2]

WHAT IS GSTT?

GSTT is a flat tax imposed on all transfers that "skip a generation."[3] For example, a transfer between a grandparent and a grandchild may be hit with GSTT, while a transfer between a parent and a child will not. Creating a dynasty trust and allocating GSTT exemptions to it can help avoid this tax.[4]

WHAT IS A GSTT EXEMPTION?

The GSTT exemption is a cumulative amount established by the federal government that may be used to avoid GSTT. The key to effectively leveraging the exemption is to allocate it to assets that offer maximum leverage, such as life insurance.

HOW DOES A DYNASTY TRUST WORK?

One or more grantors creates the Dynasty Trust and makes lifetime gifts to it. The grantor allocates his or her GSTT exemption to the gifts to the trust on a federal gift tax return. The trustee will purchase a life insurance policy. This policy is usually on the life of the grantor or a survivorship policy on the lives of a husband and wife as joint grantors. As long as the GSTT exemption covers all of the lifetime gifts made to the trust, the entire trust, including the life insurance death benefits and any other assets in the trust, will be exempt from GSTT.

EXAMPLE

John and Alison Smith, both age 60, have two children, ages 36 and 33, and two grandchildren, ages 4 and 1. John and Alison are currently making annual exclusion gifts to their children and grandchildren, but they have not used their applicable credit amounts or their GSTT exemption amounts. They have a $5,000,000 estate and they want to ensure their legacy for generations to come. Their financial advisors recommend that they set up a dynasty trust funded with a survivorship life insurance policy. John and Alison will make gifts to their trust and allocate both their GSTT exemptions and applicable exclusion amounts, thus avoiding gift taxes. Upon the deaths of John and Alison, the trust will receive the death benefit from the life insurance policy and, since they allocated their GSTT exemptions to the trust, John and Alison can ensure that their family will be taken care of for years to come.

BENEFITS OF USING LIFE INSURANCE IN A DYNASTY TRUST

- Life insurance proceeds are usually received by the trust free of income and estate taxes.[5]
- Leverage GSTT exemptions with the purchase of life insurance.

DISADVANTAGES OF USING LIFE INSURANCE IN A DYNASTY TRUST

- Trust assets may be held for multiple generations, thus restricting direct access for future generations.
- The total premiums cannot exceed the grantor's available GSTT exemptions.

SUMMARY

A Dynasty Trust is an excellent way to increase the value of the inheritance that your beneficiaries will ultimately receive by reducing taxes in future generations. Life insurance is an ideal way to use GSTT exemptions effectively.

For more information on Dynasty Trusts or to see a Dynasty Trust proposal run on John Hancock's Solutions Dynasty Trust module, please contact your local John Hancock representative or call the Advanced Markets Group at 888-266-7498, option 3.

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1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Twenty-two states have abolished the Rule against Perpetuities and trusts can either have unlimited duration or last for a longer term of years. These states currently include Alaska, Arizona, Colorado, Delaware, Idaho, Illinois, Maine, Maryland, Missouri, Nebraska, New Hampshire, New Jersey, Ohio, Rhode Island, South Dakota, Virginia, Washington, D.C., Wisconsin, Wyoming (trusts can last for 1,000 years), Utah (1,000 years), Florida (360 years), and Washington (150 years).
3. If the donors of the trust allocate their GSTT exemptions to cover all lifetime gifts to the trust, the entire death benefit should be free of GSTT.
4. The GSTT exemption amount is $1,500,000 in 2004 and 2005. It will gradually increase up to $2,000,000 in 2006-2008 and to $3,500,000 in 2009. However, if the 2001 Tax Act is not extended after 2010, the GSTT exemption will return to $1,060,000 per person in 2011.
5. If the ILIT is properly drafted and administered, the trust should receive life insurance proceeds free from income and estate taxes. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.

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IM1291CP 01/06 MLI1118044840