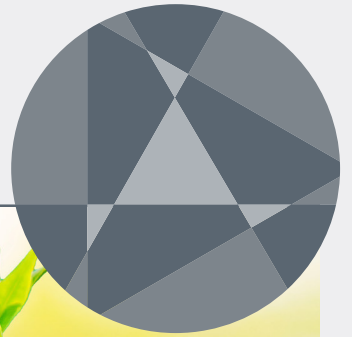


PRESERVING GENERATIONAL WEALTH

IS A LONG-TERM TRUST THE RIGHT TOOL FOR YOUR FAMILY?



Wealthy families use many tools to preserve their wealth across generations. Although we often think of generational wealth as belonging to the “great” families of the past (think Rockefeller, Carnegie, Dupont) and today’s extremely wealthy, you, too, can deploy their tactics to preserve wealth for future generations of your family.

Preserving and growing wealth across many generations requires thoughtful planning, the right legal structures, the ability to minimize taxation, prevention of wealth dissipation and the passage of time. Wealthy families know long-term trusts (commonly referred to as dynasty trusts) are a way to accomplish these goals.

Trusts

Originating in English common law, trusts have been used for centuries to preserve and protect assets of the wealthy. At its most basic, a trust is a form of property ownership that separates beneficial ownership from the legal ownership.¹ The agreement creating a trust appoints a trustee as the legal owner of assets while naming one or more beneficiaries who will enjoy the benefits of the property held in the trust. The person who created the trust and transferred ownership of assets to the trust is known as the grantor or settlor.

The grantor sets the conditions and rules for use of the property owned by the trust (the terms). The trustee carries out those directions for the benefit of the trust’s beneficiaries. With very few



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exceptions, the terms can be as flexible or restrictive as desired. A trust can continue for many years and its beneficiaries can change over time, for instance as one generation of beneficiaries passes on, leaving the next generation to benefit and so on.

In our experience, trusts that last for many generations usually contain flexible terms which allow the trustee to distribute (or not) income and principal of the trust to the trust's current beneficiaries as the trustee determines, in the trustee's discretion (a discretionary trust). Because no one knows what the future may bring, a discretionary trust allows the trustee to review the facts and circumstances existing at the time and use the trustee's judgment to determine whether a distribution is warranted. A trustee that has full discretion to make distributions to or for the benefit of a beneficiary can exercise that discretion to distribute trust income or principal to the beneficiary. The trustee could also use that discretion to make distributions to pay the beneficiary's medical expenses, education expenses, housing expenses and the like.

Not all trusts grant a trustee full discretion with respect to making distributions. Because the terms of a trust are customizable, they can restrict how the trustee uses trust funds. For example, the terms of a trust could restrict the use of funds from the trust to making distributions to provide for the beneficiary's health, education, maintenance, and support.² Other trusts restrict distributions to only trust income. Still others allow distributions only if the beneficiary meets certain conditions.

In the end, the settlor creates the rules governing the operation of the trust. As each family is different, so can the terms of each trust be different. Nevertheless, for trusts that will last many generations, we believe it is better to create a trust that is flexible, so that whatever the future brings, the trustee can operate the trust in the best interests of its beneficiaries.

Time

Benjamin Franklin reputedly said: "Money makes money. And the money that makes money makes



more money.” This pithy statement is nothing more than a description of compound interest and the impact of an exponential function. Let’s take a simple example. Assume you invest \$1,000 and receive 4% every year (ignoring fees and taxes). Then, let’s allow that investment to compound for 250 years, approximately the age of the United States. At the end of that time, that \$1,000 would have grown to \$18,127,371. What happens with a greater return on investment? According to Bloomberg, L.P., since 1926, the S&P 500 (U.S. large domestic equities) has had an average return of 9.4%. So, what would happen if \$1,000 earned a return equal to the long-term return on the S&P 500 over 250 years? In 250 years, that \$1,000 would have grown to \$5,679,766,728,712! Of course, this example is somewhat unrealistic, because income (and sometimes principal) is subject to tax (reducing the compounding base) and because markets don’t simply advance at the average rate of return.

Nevertheless, can you grow wealth this way with investments in a trust? That is, can a trust invest money for 250 years (or more)? The answer is a qualified yes; it depends upon where you create the trust.

Originally under English, and then American law, trusts were required to have an end date. This requirement, known as the *rule against perpetuities*, was derived from the 1682 English common law decision in *The Duke of Norfolk’s Case*.³ Originally applied to estates in real property, the rule also applies to trusts. Generally, the rule against perpetuities requires a trust to end within the lives of people who were living when the trust was created, plus 21 years. In the United States, the laws of the 50 states and the District of Columbia govern interests in property. Accordingly, each state (and the District) has its own rules with respect to the duration of trusts. In some states, like New York, a rule very similar to the original rule against perpetuities applies (so trusts have ending dates). In other states, like Florida, although trusts have ending dates, they are allowed a very long existence of 1,000 years (for trusts created on or after July 1, 2022);⁴ and in other states, like Delaware, the rule has been abolished, allowing trusts to last “forever.”

Taxation

The federal government imposes an estate tax, as an excise tax on the value of assets passing at death. In 2025, each citizen (and resident) of the United States has an exclusion from the federal estate tax of \$13,990,000. In 2025, a married couple has a combined exclusion amount of \$27,980,000. If the value of your “taxable estate” exceeds your available estate tax exclusion at death, an estate tax (with a top marginal rate of 40%) will be imposed on such excess.⁵ Some states also impose taxes upon death, but they are not considered here.

The Generation-skipping Transfer Tax (GSTT) imposes a tax on the transfer of property, either during life or at death, to someone who is more than one generation below the “transferor,” such as a grandchild. The transfer does not have to be made directly to the beneficiary for GSTT to be imposed. Trusts that skip over generations are also subject to the GSTT. For example, if you were to create a trust that paid income to your child, and following the child’s death continued for a grandchild, upon your child’s death the trust would be subject to the GSTT.

The GSTT is a flat tax imposed at the highest marginal estate tax rate in effect in the year of the “skip.” Each individual has an exemption from the GSTT. In 2025, the maximum GSTT



	Ending Value in Year					
	1	50	100	150	200	250
GSTT Exempt	\$1,047,928	\$8,751,157	\$74,706,872	\$637,754,500	\$5,444,355,919	\$46,477,149,732
Not Exempt	\$1,047,928	\$5,250,694	\$27,569,786	\$145,810,247	\$760,092,690	\$3,991,014,053
Exemption Benefit	\$0	\$3,500,463	\$47,137,086	\$491,944,253	\$4,684,263,229	\$42,486,135,678

Source: PNC Private Bank

exemption is \$13.99 million. If you were to transfer property to a trust (by gift or upon death) and allocate your GSTT exemption to the total amount transferred, the property transferred to the trust and all of the appreciation would be exempt from the GSTT (and future estate tax) until the trust terminated (and was distributed to its beneficiaries) or some other power in the trust caused the property to be subject to a gift or estate tax.

The impact of transfer taxation (that is, the tax imposed on gifts, estates and generation-skipping transfers) can negatively impact the ability to build generational wealth. Let's look at the difference in results between transferring \$1 million in cash to a long-term trust exempt from the GSTT and \$1 million in cash transferred outright (otherwise not exempt). Although somewhat artificial, let's assume all of the money is invested and, with the exception of tax payments, none of it is spent.

For purposes of this example, assume that investments return 5.5% per year, of which 1.5% is ordinary income taxed at 40.8%, and 4% is capital appreciation. Further assume the trust turns over 10% of its assets each year, on which a capital gains tax of 23.8% is paid (for ease of illustration, we assume assets sold have a pro rata share of tax basis). Finally, assume an estate tax of 40% would be imposed every 50 years on property that is not exempt from the GSTT. Of course, assets included in the gross estate of a decedent receive a step-up in basis to market value as of the date of death (or the alternate valuation date). Conversely, because assets in an exempt trust are not subject to an estate tax, they would not receive such a step-up. The table above shows the impact of avoiding a transfer tax at each generation.

Other Benefits

Taxes are not the only way family wealth can be diminished. Many other circumstances can cause a person to dissipate wealth. Individuals can make bad investments, lend money to friends who never pay them back, own a business that fails, get divorced, go bankrupt or become addicted to drugs or alcohol, to name some possible pitfalls. Long-term trusts can help preserve and protect inherited assets from future personal and business risks faced by the trusts' beneficiaries.

It is customary for long-term trusts to be made "spendthrift." A spendthrift trust has provisions that prevent a beneficiary's creditors from attaching the assets of the trust to satisfy the beneficiary's debt (including most court judgments). Spendthrift trusts are generally created by a settlor who is not also a beneficiary, although some states, such as Delaware and Ohio, allow spendthrift trusts to include the settlor as a beneficiary and shield trust assets from certain of the settlor's creditors.

If the worst happens, the assets of the trust can help the beneficiary through hard times (for example, by directly paying for substance abuse rehabilitation) while protecting most of the principal from attachment by the beneficiary's creditors.

In 250 Years Will Your Family be Wealthy?

Are you interested in exploring how you can use long-term trusts to build generational wealth for your family? To learn more, contact any member of your PNC Private Bank® team and we will be glad to work with you, and your legal and tax advisors, to implement a long-term trust.

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Endnotes

¹ Although a “trust” is commonly thought of as an entity, it is really a fiduciary relationship between the trustee and the beneficiaries. Nevertheless, sometimes this article uses the emerging modern common terminology. Restatement of the Law, Trusts 3d. § 2 and its Comment.

² This restriction is known as an ascertainable standard. See, Internal Revenue Code §§ 2041 and 2514.

³ 3 Ch. Cas. 1, 22 Eng. Rep. 931.

⁴ Fla. Stat. § 689.225(g). For trusts created after December 1, 2000 through June 30, 2022, the maximum time period allowed is 360 years. Fla. Stat. § 689.225(f).

⁵ Although that is not really how the tax is calculated, it is a convenient shorthand.

For more information, please contact your PNC Private Bank Hawthorn advisor.

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