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Dynasty Trust Flexibility Regarding Basis in Light of the Big Beautiful Bill

Here's a concise explanation of why, under the One Big Beautiful Bill (OBBBA), one might want to give a trust protector the power to convert a limited power of appointment held by a primary beneficiary (in a dynasty trust) into a general power of appointment under certain conditions particularly when inclusion in the beneficiary's estate wouldn't trigger estate tax, and could result in a more favorable basis step-up for the underlying trust assets.

Key Changes under OBBBA ("Big Beautiful Bill")

- The Act permanently increases the federal estate and gift tax exclusion (basic exclusion amount) to $15 million per individual beginning Jan. 1, 2026, plus inflation indexing. An extremely important difference between this bill and Bush's and Trump's previous bills is that this bill will not sunset. It is not a temporary tax law.
- It also keeps the other estate-tax fundamentals in place: a basis adjustment at death remains intact.

These changes create much more cushion (for most people) before the estate tax becomes a concern.

What are Powers of Appointment & Their Effects?

- A limited (or special) power of appointment allows a beneficiary to redirect trust assets, but within a certain class of beneficiaries that does not include the beneficiary, the beneficiary's creditors, the beneficiary's estate, of the creditors of the beneficiary's estate. This does not cause inclusion in the beneficiary's estate for estate tax purposes, but does not provide for a basis adjustment in the underlying trust's assets at the primary beneficiary's death.
- A general power of appointment is broader. If a person holds a general power, the assets subject to that power will be included in that person's taxable estate. But inclusion in the estate means that those assets will receive a tax basis adjustment upon the person's death—so appreciated assets in the trust could shift basis to their

fair market value on death, reducing or eliminating capital gain if sold shortly thereafter.

Why Give This Power to a Trust Protector Under the New Law?

Given the larger exclusion under OBBBA, many beneficiaries who are under the estate tax threshold wouldn't incur estate tax even if assets are included in their estate via a general power of appointment. So:

- If the trust protector can observe that inclusion wouldn't trigger estate tax (beneficiary's total estate + the trust assets subject under the general power still under the exemption), then exercising (or enabling) general power status could have great value.
- The primary benefit is basis step-up for highly appreciated assets: when the beneficiary dies owning (via the general power) those trust assets, they get a new basis (usually fair market value at death), reducing (or eliminating) capital gains for beneficiaries if they then sell the assets.
    - For example: Parents create a dynasty trust for their daughter who has an unstable marriage and liability issues. $4,000,000 in financial assets are contributed to the trust. Twenty years later the daughter is a widow, has no more liability issues and has an estate of $5,000,000. The financial assets have grown to $8,000,000 and due to inflation, the estate exemption exceeds $25,000,000. If the Trust Protector grants the daughter a general power, at her death whether she exercises it or not, the old $4,000,000 basis is adjusted to $8,000,000 and if the trustee sells the assets for $8,000,000, there would be no capital gains tax.
- It adds flexibility: if tax law changes in the future (e.g. lower exclusion, different rules), the protector can leave things as they are (with limited power) so estate tax concern remains guarded; but with favorable circumstances, convert to general power to capture basis advantages,

Why Use a Trust Protector for This Authority?

- A trust protector is someone (or group) who has discretion under the trust document to make adjustments as laws or beneficiary circumstances change, without needing to amend the trust by court or settlor.

- In this case, giving the trust protector the power to grant a general power of appointment to the primary beneficiary if certain conditions are met (e.g. estate inclusion won't trigger tax, or threshold safe) ensures that the trust plan remains conservative under uncertain law or when the beneficiary's estate is large, but opportunistic when favorable.

Caveats & Considerations

- The beneficiary's total estate matters — one must ensure that + inclusion of trust assets doesn't exceed the estate exclusion. If it does, the estate tax downside may outweigh the basis benefit.
- One must ensure the power is drafted properly — a general power under § 2041 must meet requirements. The timing of exercise/ownership/inclusion must be clearly understood.
- Although Texas has no independent inheritance tax system, some states have decoupled from the federal estate tax system and a state's estate/inheritance taxes may have lower thresholds than federal; even if federal exclusion covers it, state issues may arise.
- For example, Illinois has a $4,000,000 threshold amount.
- The opportunity to get basis step-up only happens at death; for lifetime sales, inclusion doesn't help basis until death.

Summary

In short: Under the new law, many people are now further from estate tax exposure, and this law will not sunset (although a future President and Congress could change it). For those whose total estates will be under the exclusion, giving a trust protector the ability to convert a limited power into a general power of appointment allows one to reap basis step-up benefits without paying estate tax. This built-in flexibility lets families adapt: remain protected when estate tax risk exists, but "opt in" to estate inclusion (via general power) when it's favorable for basis purposes.