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Who Killed the Rule Against Perpetuities?

Grayson M. P. McCouch*

- I. INTRODUCTION
- II. TRANSFER TAX AVOIDANCE BEFORE 1986
- III. TRANSFER TAX AVOIDANCE AFTER 1986
- IV. MARKETING PERPETUAL TRUSTS
- V. UNINTENDED CONSEQUENCES
- VI. CONCLUSION

I. INTRODUCTION

Long-term trusts pose a fundamental challenge both to local property law and to the federal estate tax. For many years, courts and legislatures have struggled to articulate an intelligible outer limit on the length of time that dynastically minded trust settlors should be allowed to tie up beneficial ownership of property. The result, in this country, has been widespread adoption of some version of a common law or statutory rule against remote vesting (known generically as the rule against perpetuities) or a functionally similar rule against suspension of the power of alienation. Despite significant local variations in the form of these rules and a certain ambivalence concerning their underlying justification, the traditional consensus in favor of promoting alienability and curbing perpetual dead-hand control has remained largely intact—until recently.

Long-term trusts also play a key role in tax planning. Ordinarily a gift or estate tax is imposed on each transfer as property passes from one generation to the next. Nevertheless, by leaving property in trust, a settlor can readily shelter property from gift and estate taxes (after the initial transfer in trust) for as long as the trust is permitted to last under local

* Professor, University of Florida Levin College of Law. I am grateful to Paul Caron for organizing the *Tax Advice for the Second Obama Administration* symposium and for moderating the panel on estate and gift taxation. I am also indebted to the late Jesse Dukeminier for suggesting the title of this paper several years ago during a conversation about perpetual trusts. This article is part of *Pepperdine Law Review's* January 18, 2013 *Tax Advice for the Second Obama Administration* symposium, co-sponsored by Tax Analysts.

property law, while providing beneficial enjoyment for successive generations of beneficiaries. To curb this avenue of tax avoidance, Congress enacted a generation-skipping transfer (GST) tax, which operates as a proxy for the gift or estate tax that would have been imposed if property had passed outright from one generation to the next instead of being tied up in trust.¹ The GST tax has significantly limited the use of long-term trusts to shelter unlimited accumulations of wealth from transfer taxes, prompting estate planners to develop new tax avoidance techniques. Their attention has focused on the GST exemption, originally set at \$1 million, which allows an individual transferor to transfer an equivalent amount of property free of GST tax.² An allocation of exemption to a generation-skipping trust initially funded with \$1 million ensures that the entire trust, including unlimited future appreciation, will remain exempt from GST tax throughout the trust term. The primary constraint on the duration of such a trust, and hence on its potential for GST tax avoidance, is found in the applicable rule against perpetuities under local law.

To the extent that the rule against perpetuities represents the last remaining obstacle in an otherwise clear path to perpetual exemption from transfer taxes, it is hardly surprising that the rule has come under attack. What is perhaps surprising is the speed with which efforts to reform and improve the rule have been overtaken by a headlong rush to abolish it altogether. In the space of less than twenty years, at least half the states, responding to intense lobbying by lawyers, bankers, and financial planners, have enacted statutes authorizing perpetual trusts, with the express goal of attracting trust business from other states.³ The linkage between the 1986 enactment of the GST tax—or, more precisely, of the \$1 million exemption from the tax—and the demise of the rule against perpetuities has attracted

1. See I.R.C. §§ 2601–54. Unless otherwise indicated, all I.R.C. citations refer to the Internal Revenue Code of 1986, as amended through January 2, 2013. The current version of the GST tax was enacted in 1986, replacing (and retroactively repealing) the original version enacted in 1976. See Tax Reform Act of 1986, Pub. L. 99–514, §§ 1431–33, 100 Stat. 2085, 2717 (1986); Tax Reform Act of 1976, Pub. L. 94–455, § 2006, 90 Stat. 1520, 1879 (1976).

2. See I.R.C. § 2631. In 2010 the GST exemption was set at \$5 million (indexed for inflation beginning in 2012). See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111–312, § 302(a), 124 Stat. 3296, 3301 (2010); see also American Taxpayer Relief Act of 2012, Pub. L. 112–240, § 101(c), 126 Stat. 2313 (2013) (extending increased exemption for 2013 and subsequent years).

3. A 2011 tally shows twenty-five states and the District of Columbia as allowing perpetual (or nearly perpetual) private trusts, and another four states should be added to the list. See RESTATEMENT (THIRD) OF PROP. WILLS AND OTHER DONATIVE TRANSFERS ch. 27, intro. note (2011); ARIZ. REV. STAT. ANN. § 14–2901 (2012); COLO. REV. STAT. § 15–11–1102.5 (2013); HAW. REV. STAT. § 525–4(6) (2012); WASH. REV. CODE § 11.98.130 (2013). For an excellent analysis of interstate competition for trust business, see Stewart E. Sterk, *Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P.*, 24 CARDOZO L. REV. 2097, 2101–02 (2003) [hereinafter Sterk, *Jurisdictional Competition*].

considerable attention.⁴

It is not entirely clear, however, to what extent the movement to abolish the rule is driven solely or primarily by tax avoidance. Jesse Dukeminier and James Krier argue that: [The rise of perpetual trusts] has little if anything to do with some wish on the part of wealthy people to control the lives of their unknown descendants; rather, it has to do with their interest in saving on federal transfer taxes imposed at the descendants' deaths, and on competition among the states to cater to that interest.⁵

Joshua Tate, however, contends that "while tax concerns are very important, there are many other reasons why a settlor might want to set up a dynasty trust"—for example, to safeguard a family fortune from improvident beneficiaries, to defeat creditors' claims, or to perpetuate the settlor's memory and pass on a set of ethical values to future generations.⁶

In their recent empirical work, Robert Sitkoff and Max Schanzenbach shed additional light on the relationship between the GST tax and the rule against perpetuities. Based on a detailed study of personal trust data, they attribute the decline of the rule directly to the "federal wealth transfer taxes," which they view as having "mortally wounded the once-mighty Rule by reducing it to a mere transaction cost."⁷ The essential thrust of their argument can be summarized as follows: (1) before 1986 there was little demand for perpetual private trusts, even though they were tolerated by local law in at least three states; (2) after enactment of the GST tax in 1986, numerous states enacted statutes abolishing the rule against perpetuities in order to attract trust business; and (3) states that abolished the rule and also

4. For a sampling of commentary, see Ira Mark Bloom, *The GST Tax Tail Is Killing the Rule Against Perpetuities*, 87 TAX NOTES 569 (2000); Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303 (2003); Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining The Rise of the Perpetual Trust*, 27 CARDOZO L. REV. 2465 (2006) [hereinafter Schanzenbach & Sitkoff, *Perpetuities or Taxes?*]; Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005) [hereinafter Sitkoff & Schanzenbach, *Empirical Analysis*]; Sterk, *Jurisdictional Competition*, *supra* note 3; see also RAY D. MADOFF, IMMORTALITY AND THE LAW: THE RISING POWER OF THE AMERICAN DEAD 78–82 (2010); Mary Louise Fellows, *Why the Generation-Skipping Transfer Tax Sparked Perpetual Trusts*, 27 CARDOZO L. REV. 2511 (2006).

5. Dukeminier & Krier, *supra* note 4, at 1314–15.

6. Joshua C. Tate, *Perpetual Trusts and the Settlor's Intent*, 53 U. KAN. L. REV. 595, 617 (2005); *id.* at 613–17 (responding to Dukeminier and Krier).

7. Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 421; see also *id.* at 359 (describing 1986 GST tax as the "driving force"); Schanzenbach & Sitkoff, *Perpetuities or Taxes?*, *supra* note 4, at 2470 (arguing that "the modern perpetual trust is primarily a creature of the federal transfer taxes").

imposed no fiduciary income tax on out-of-state trusts reported disproportionate increases in personal trust assets and average account size. Echoing Dukeminier and Krier, they argue that “the movement to abolish the Rule and the corresponding rise of the perpetual trust reflect strategies to minimize taxes, not a burgeoning desire among donors for perpetual control.”⁸ This account is simple, bold, and powerful, but at best it provides only a partial and selective explanation of the complex interaction between the federal transfer taxes and the rule against perpetuities.

II. TRANSFER TAX AVOIDANCE BEFORE 1986

Understandably, and perhaps unavoidably, the rule against perpetuities is often portrayed as a more or less monolithic and ubiquitous doctrine, immutably embodied in John Chipman Gray’s “classic formulation” of the common law rule against remote vesting, which suddenly fell victim to a frenzy of legislative repeal after 1986 as state legislatures rushed to authorize perpetual trusts.⁹ But this is an oversimplification. Long before the advent of the GST tax, at least three states allowed the creation of perpetual trusts. In Delaware, this could be accomplished by creating successive powers of appointment, thanks to a statutory modification of the common law rule which measured the permissible period for vesting of interests from the date of a power’s exercise rather than its creation.¹⁰ In Wisconsin and Idaho, the technique was different. Both states had adopted statutory rules against suspension of the power of alienation in lieu of the common law rule against remote vesting,¹¹ and in Wisconsin the statutory rule was interpreted to allow perpetual trusts as long as the trustee had a power of sale.¹² In Idaho, the statutory rule was interpreted to require a

8. Schanzenbach & Sitkoff, *Perpetuities or Taxes?*, *supra* note 4, at 2497.

9. Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 364; *see also id.* at 373 (“As a general matter, prior to 1986 there was little significant variation in trust law across the states.”); *cf. id.* at 377 (acknowledging “some doctrinal nuances that we gloss over when we speak of the Rule’s abolition,” including abolition of the rule for trusts where the trustee has a power of sale, abolition for trusts of personal property, extended perpetuities periods, and opt-out rules).

10. *See* 1933 Del. L. ch. 138, § 1. The estate tax loophole exploited by the Delaware statute was eventually blocked by the enactment of the “Delaware tax trap.” *See* Revenue Act of 1942, Pub. L. 77-753, § 403(a), 56 Stat. 798, 942 (1942).

11. The Wisconsin and Idaho statutes, modeled on a New York statute of 1830, supplanted the common law rule. *See* *Becker v. Chester*, 91 N.W. 87 (Wis. 1902); *Locklear v. Tucker*, 203 P.2d 380 (Idaho 1949). Unlike the common law rule against remote vesting, which eventually became established as the “rule against perpetuities” toward the end of the nineteenth century (*see In re Hargreaves*, 43 Ch.D. 401 (1890)), the rule against suspension of the power of alienation prohibits tying up property in unborn or unascertained beneficiaries beyond the applicable perpetuities period. *See generally* LEWIS M. SIMES, *HANDBOOK OF THE LAW OF FUTURE INTERESTS* 298–313 (2d ed. 1966).

12. *See* *Will of Walker*, 45 N.W.2d 94, 97 (Wis. 1950) (“If the trustee has power to sell, which he may exercise within the time specified by the statute, the trust is not void under our statutes even

power of termination in beneficiaries living at the creation of the trust, but that restriction was expressly abrogated for trusts of personal property, leaving no restrictions on the duration of such trusts.¹³ It is worth noting that for many years before 1986 perpetuities law was far from uniform; that trusts of indefinite duration could be created, sometimes in states that still had some version of the rule against perpetuities on the books; that perpetual trusts came in various forms; and, therefore, that one should be careful about equating the availability of perpetual trusts with “abolition” of the rule.¹⁴ Moreover, as we shall see, the peculiarities of local perpetuities law have continuing significance for federal tax purposes.

One obvious question is why the availability of perpetual trusts in a few states did not set off a rush to abolish the rule against perpetuities even before the enactment of the GST tax. (For this purpose, the relevant year is 1976, when the original version of the GST tax was enacted.¹⁵) Proponents of the standard tax-driven explanation might suggest that until the \$1 million GST exemption appeared in 1986, there was no compelling tax incentive to use perpetual trusts, but this ignores the estate and gift taxes. Long before 1976—when estate tax rates were much higher (and the taxable threshold much lower) than in later years—it was possible, at least in Wisconsin and Idaho, to create perpetual trusts that would shelter property indefinitely from estate and gift taxes (after the initial transfer).¹⁶ If the demand for perpetual trusts is driven primarily by transfer tax avoidance, one might expect to discover that Wisconsin and Idaho either captured a disproportionate share of trust business or spurred other states to authorize perpetual trusts. Yet this does not seem to have happened. Finding “little evidence . . . that people valued perpetual trusts prior to the GST tax,” Sitkoff and Schanzenbach infer that “without the GST tax incentive to act as a wedge, few individuals would establish perpetual trusts.”¹⁷ Why should a loophole

though the trust in the converted fund is perpetual.”). See generally Ira Mark Bloom, *Transfer Tax Avoidance: The Impact of Perpetuities Restrictions Before and After Generation-Skipping Taxation*, 45 ALB. L. REV. 261, 274–75 (1981).

13. See 1957 Idaho Sess. L. ch. 54, § 1; *In re Zeb’s Estate*, 189 P.2d 95 (Idaho 1947) (applying prior law).

14. Cf. Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 378 (“For the purpose of this study, all that matters is whether the state’s perpetuities law in effect permits a perpetual trust.”).

15. See *supra* note 5.

16. See Bloom, *supra* note 12, at 290 (“Prior to generation-skipping taxation, there were ample means available for perpetual transfer tax avoidance.”); George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161, 206 (1977) (describing perpetual generation-skipping trust as “the ultimate estate planning scheme”).

17. Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 399. Noting that statutes repealing the common law rule were enacted in Idaho (1957), Wisconsin (1969), and South Dakota

in the GST tax spark a widespread demand for perpetual trusts after 1986 while a similar loophole in the estate and gift taxes failed to do so before 1976?¹⁸

Certainly by 1976 estate planners were well aware of the tax benefits of generation-skipping trusts, which were used almost exclusively by the very rich.¹⁹ Indeed, the original GST tax was enacted in response to the perceived unfairness of a transfer tax system that not only favored generation-skipping trusts over functionally similar outright transfers but also undermined the progressivity of the estate tax.²⁰ Nevertheless, it seems that the vast majority of generation-skipping trusts skipped only one generation; very few skipped more than two.²¹ Until 1976, therefore, it may have seemed entirely reasonable to assume that, with adequate planning, most settlors could achieve their tax and non-tax objectives comfortably within the local perpetuities period. Although the possibility of creating perpetual trusts was well known, the incremental tax benefits of such trusts did not loom large

(1983), Sitkoff and Schanzenbach observe that “the abolition of the Rule Against Perpetuities prior to the introduction of the GST tax had no observable effect on a state’s trust assets.” *Id.* at 398. This is not surprising in the case of Wisconsin, since the 1969 statute merely codified prior law. *See supra* note 18; *cf.* Schanzenbach & Sitkoff, *Perpetuities or Taxes?*, *supra* note 4, at 2473 n.32 (“Wisconsin may have abolished its Rule even earlier (indeed, Wisconsin may never have had the Rule) . . . We need not resolve the status of the Rule in Wisconsin prior to 1969, however, because our data do not begin until that year.”); Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 398 n.117.

18. Sitkoff and Schanzenbach speculate that the lack of interest in perpetual trusts before the enactment of the GST tax may have been due either to ignorance on the part of lawyers or to the prohibitive transaction costs of attracting trust business from other states “in an era before cheap long distance calls, fax machines, and electronic mail.” Schanzenbach & Sitkoff, *Perpetuities or Taxes?*, *supra* note 4, at 2495.

19. *See Federal Estate and Gift Taxes: Public Hearings and Panel Discussions Before the H. Comm. on Ways and Means*, 94th Cong. 1333, 1333–35 (1976) [hereinafter 1976 Hearings] (statement of A. James Casner) (describing structure and operation of generation-skipping trust); Cooper, *supra* note 16, at 205 (“[U]se of [generation-skipping] trusts has been largely limited to the very rich, probably because other estate planning techniques, not involving long-term trustification of property, have been adequate for the less wealthy.”).

20. *See* STAFF OF J. COMM. ON TAX’N, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, at 564–65 (1976) [hereinafter 1976 BLUEBOOK].

21. *See* AM. LAW INST., FEDERAL ESTATE AND GIFT TAX PROJECT: STUDY ON GENERATION-SKIPPING TRANSFERS UNDER THE FEDERAL ESTATE TAX: DISCUSSION DRAFT NO. 1, at 119–20 (Mar. 28, 1984), reprinted in *Generation-Skipping Transfer Tax: Hearing Before H. Comm. on Ways & Means*, 98th Cong. 49, 179–80 (1984) [hereinafter 1984 Hearings] (“[T]estamentary generation-skipping transfers in trust principally skip a single generation . . . [A] properly structured trust may postpone transfer tax incidence until the expiration of the applicable limitation imposed by the rule against perpetuities. Yet when actual trust dispositions are examined, it appears that few testators made these tax minimizing transfers. Multiple generation-skipping did not often exceed two generations.”); Robert Anthoine, *Testamentary Trusts*, in CARL S. SHOUP, FEDERAL ESTATE AND GIFT TAXES 153, 169 (1966) (“[T]he normal family trust today involves a substantial amount of one-generation skipping but little beyond that.”); *see also* 1976 Hearings, *supra* note 19, at 1419, 1421 (statement of Gerald R. Jantscher) (“[T]here are very few trusts created to skip two generations. Few settlors appear to be willing to ti[e] up property past the lives of their grandchildren.”).

and the rule against perpetuities was not perceived as a major impediment.²²

The tax benefits of generation-skipping trusts were prospectively curtailed by the original GST tax in 1976. Although the impact of the tax could be mitigated through careful planning, it was no longer possible to avoid transfer taxes indefinitely by means of generation-skipping trusts.²³ Thus, from 1976 to 1986, even where perpetual trusts were allowed under local law, they offered no greater tax benefits than conventional generation-skipping trusts subject to the rule against perpetuities. Accordingly, when South Dakota enacted legislation in 1983 declaring that “[t]he common-law rule against perpetuities is not in force in this state,” the intent cannot have been to enable avoidance of the existing GST tax (nor, presumably, to take advantage of a \$1 million GST exemption that would not be enacted for another three years).²⁴ Instead, the legislation appears to have been “part of an aggressive campaign to attract trust and banking positions to the State” unrelated to transfer tax avoidance.²⁵

III. TRANSFER TAX AVOIDANCE AFTER 1986

With the enactment of the revised GST tax—or, more precisely, the \$1 million GST exemption—in 1986, perpetual trusts reappeared as a viable technique for indefinite transfer tax avoidance. The situation was complicated, however, by the interaction of the GST tax, the estate tax, and local perpetuities law. To shelter a generation-skipping trust from GST tax under current law, all that is needed is an allocation of GST exemption sufficient to cover the initial value of the property transferred in trust; the entire trust, including all future appreciation, will ordinarily remain completely exempt from GST tax for as long as the trust remains in

22. See 1976 Hearings, *supra* note 19, at 1335 (statement of A. James Casner); *id.* at 505, 509 (statement of David Westfall); Cooper, *supra* note 16, at 206; see also 1984 Hearings, *supra* note 21, at 335, 344–45 (statement of Raymond H. Young).

23. For example, the tax could be avoided—though not indefinitely—by creating separate “layered” trusts for separate generations of beneficiaries. The tax could also be postponed by requiring the accumulation of income or by giving an individual beneficiary a special power to distribute income or corpus to younger generations of the transferor’s descendants. In addition, Congress provided an express exemption for transfers to grandchildren. See generally 1976 BLUEBOOK, *supra* note 20, at 564–83; Ira Mark Bloom, *The Generation-Skipping Loophole: Narrowed, But Not Closed, By the Tax Reform Act of 1976*, 53 WASH. L.REV. 31, 53–61 (1977); Cooper, *supra* note 16, at 206–07.

24. 1983 S.D. Sess. L. ch. 304, § 4. The legislation preserved restrictions on the suspension of the power of alienation, subject to a Wisconsin-style safe harbor for a trustee’s power of sale. See *id.* § 8.

25. Sterk, *Jurisdictional Competition*, *supra* note 3, at 2101–02.

existence. The GST exemption may be jeopardized, however, if the trust becomes subject to estate tax in the hands of a beneficiary.

The most likely trigger for estate tax inclusion is the “Delaware tax trap,” which has emerged from obscurity to play a prominent role in tax planning since 1986.²⁶ Recall that in Delaware a trust could be extended indefinitely through the exercise of successive powers of appointment.²⁷ The Delaware tax trap was originally enacted to prevent indefinite estate tax avoidance through successive powers. Now it serves as an escape route from the GST tax, but its applicability depends on the peculiarities of local perpetuities law. For example, in a state that retains some version of the common law rule against remote vesting or a statutory rule against suspension of the power of alienation, the tax trap may be sprung by exercising a special power of appointment to create another power (including a presently exercisable general power) that might postpone vesting or prolong suspension for a period unrelated to the date the first power was created. Less obviously, the tax trap may be sprung even if the rule against perpetuities has been completely abolished, because in the absence of any limitation on remote vesting or suspension of the power of alienation it is impossible to ascertain a perpetuities period by reference to the date the first power was created.²⁸ In contrast, the estate tax has been held inapplicable to the creation of successive powers where, under the applicable statutory rule against suspension of the power of alienation, the perpetuities period for a future interest or trust created by the second power runs from the creation of the first power, even if the statutory rule is automatically satisfied by a trustee’s power of sale.²⁹

Ironically, then, tax planners have learned that simple repeal of the rule against perpetuities does not necessarily guarantee that a perpetual trust will

26. In its current form, the “Delaware tax trap” subjects a power of appointment to estate tax if it is exercised:

[B]y creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

I.R.C. § 2041(a)(3). See generally Jonathan G. Blattmachr & Jeffrey N. Pennell, *Adventures in Generation-Skipping, or How We Learned to Love the “Delaware Tax Trap”*, 24 REAL PROP. PROB. & TR. J. 75 (1989).

27. Technically, this result follows from a statutory provision which treats interests created by exercise of a power of appointment, for purposes of the rule against perpetuities, as being created at the time of the power’s exercise rather than its creation. See DEL. CODE ANN. tit. 25, § 501 (2012).

28. See Stephen E. Greer, *The Delaware Tax Trap and the Abolition of the Rule Against Perpetuities*, 28 EST. PLAN. 68, 74 (2001); James P. Spica, *A Trap for the Wary: Delaware’s Anti-Delaware-Tax-Trap Statute Is Too Clever by Half (of Infinity)*, 43 REAL PROP. TR. & EST. L.J. 673, 682 (2009).

29. See *Estate of Murphy v. Comm’r*, 71 T.C. 671, 680–81 (1979) (Wisconsin law); Bloom, *supra* note 12, at 284–90.

enjoy complete immunity from transfer taxes. Although it is a relatively simple matter to create a perpetual sequence of life income interests that avoid estate taxation, planners routinely include powers of appointment to make the dispositive plan more flexible and responsive to changing circumstances. Moreover, to achieve maximum flexibility, such powers usually may be exercised to modify the trust and create successive powers. To avoid springing the Delaware tax trap, a perpetual trust should be designed to ensure that interests created by the exercise of successive powers of appointment remain subject to some form of perpetuities restriction (e.g., a limitation on remote vesting or on suspension of the power of alienation) that relates back to the creation of the first power. One way to accomplish this is to create a perpetual trust in a state that has a statutory rule against suspension of the power of alienation under which the permissible period for interests (or successive powers) created by exercise of a non-general power of appointment runs from the creation of the power—even if the rule is satisfied by a trustee's power of sale.³⁰ Alternatively, the trust may be created in a state that retains a statutory rule against remote vesting with an extended perpetuities period (e.g., 1000 years), as long as the period for interests (or successive powers) created by exercise of a non-general power runs from the creation of the power.³¹ Arguably, by blocking the limited but well-established tax benefits of conventional generation-skipping trusts and direct skips, the 1986 GST tax revisions encouraged tax planners to search out new tax avoidance techniques.³²

30. See, e.g., S.D. CODIFIED LAWS §§ 43-5-1, 43-5-4, 43-5-5 (2012); cf. DEL. CODE ANN. tit. 25, §§ 503, 504 (2012); Spica, *supra* note 28 (arguing that the Delaware provision fails to achieve its intended purpose).

31. See, e.g., COLO. REV. STAT. § 15-11-1102.5(1), (3) (2013); MICH. COMP. LAWS § 554.93 (2012).

32. See Cooper, *supra* note 16, at 169 (predicting increased interest in tax avoidance as original GST tax closed popular loopholes for the very rich); 1984 Hearings, *supra* note 21, at 30, 46 (statement of Harry L. Gutman) ("The frequency of 'grandchildren exclusion' trusts in post-1976 wills indicate[s] that individuals will create trusts to take advantage of 'benefits,' even though prior to the enactment of [the GST tax] they did not take advantage of unlimited generation-skipping opportunities."); *id.* at 337, 338 (statement of Raymond H. Young, Chairman) ("People who otherwise would have the good sense not to enter into any such arrangement will have their judgment and decisions colored by what will seem to be an opportunity created for them to take advantage of."); *id.* at 313-14 (statement of Howard M. McCue III) (arguing that imposing GST tax on direct skips would encourage "long-term discretionary trusts for grandchildren, great-grandchildren, and more remote descendants").

IV. MARKETING PERPETUAL TRUSTS

Perpetual trusts undeniably offer opportunities for avoiding transfer taxes, but this is not their sole attraction. Along with tax benefits, the promotional literature for perpetual trusts touts their ability to conserve and manage accumulated wealth for future generations and protect beneficiaries against improvidence and misfortune (including claims of creditors and former spouses).³³ While the same features are also found in trusts of more limited duration, the prospect of projecting the settlor's control indefinitely into the future intensifies the allure of perpetual trusts. Indeed, the promotional literature is replete with thinly veiled appeals to settlors' vanity and dynastic aspirations.³⁴ Of course the psychic benefits of perpetual trusts cannot be empirically verified, and even the tax and financial advantages should not be overstated. The potential tax benefits are limited initially by the size of the GST exemption and ultimately by the trustee's ability to conserve the trust property and increase its value.³⁵ Despite the rosy scenario of exponential appreciation suggested by projections of tax-free compounding over a century or more,³⁶ the actual value of a perpetual trust is likely to be eroded over time by administrative costs, income taxes, and demands for distributions of income and corpus from an ever-proliferating group of beneficiaries.³⁷ Furthermore, Dukeminier and Krier identify what they call a "problem of duration": the longer a trust lasts, the greater the

33. See Tate, *supra* note 6, at 613–17. Moreover, competition for trust business has led several states (including some but not all of those that allow perpetual trusts) to authorize self-settled spendthrift trusts. See Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 383–84 (noting the similar "political dynamic" behind abolition of the rule against perpetuities and the validation of self-settled spendthrift trusts, and observing that the former is driven by the desire "to provide a transfer-tax-exempt trust for future generations" while the latter is driven by the desire to limit "the settlor's personal liability exposure"); Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035 (2000) [hereinafter Sterk, *Race to the Bottom*].

34. See Tate, *supra* note 6, at 617–20. In a similar vein, a foundation catering to investors who contemplate long-term cryogenic preservation reportedly promises that "you'll be able to buy youth and perfect health for centuries" and projects that a \$10,000 investment will grow to more than \$8 million in 100 years. See MADOFF, *supra* note 4, at 55 (quoting promotional brochure).

35. The GST exemption was set at \$1 million in 1986 and indexed for inflation beginning in 1999. The base amount remained capped at \$1 million during the initial rush to repeal the rule against perpetuities from 1995 to 2003, and subsequent increases brought the exemption up to \$5 million in 2010. A perpetual trust is subject to GST tax to the extent contributions exceed the amount of GST exemption allocated to the trust. See I.R.C. §§ 2602, 2631, 2641, 2642.

36. See, e.g., RICHARD W. NENNO, DELAWARE DYNASTY TRUSTS, TOTAL-RETURN UNITRUSTS, AND ASSET-PROTECTION TRUSTS 31, 222 (2008) (noting that a \$1 million tax-exempt dynasty trust compounded at 10% for 100 years would grow to more than \$13 billion); Bloom, *supra* note 12, at 301 n.219 (noting that \$1 million invested at 6% for 300 years would grow to approximately \$50 trillion).

37. For a hardheaded analysis of dynasty trusts and their limitations, see William J. Turnier & Jeffrey L. Harrison, *A Malthusian Analysis of the So-Called Dynasty Trust*, 28 VA. TAX REV. 779, 781 (2009) (concluding that "promoters [of dynasty trusts] promise more than such trusts are able to deliver").

likelihood that strict adherence to its original terms may become wasteful and counterproductive.³⁸ Even in states that retain some version of the rule against perpetuities, there is a trend to allow courts greater latitude to modify the terms of a trust or terminate the trust at the request of the beneficiaries or the trustee.³⁹ In the case of a perpetual trust, the problem is likely to become even more acute and the need for mechanisms to respond to changed circumstances correspondingly more pressing. Careful drafting can provide a degree of flexibility, but the courts will almost certainly be called on sooner or later to balance the competing goals of enforcing the settlor's directions, protecting the beneficiaries' interests, and ensuring efficient administration by the trustee.⁴⁰

By all accounts, the states that rushed to abolish the rule against perpetuities did not do so in response to any groundswell of popular sentiment. The vast majority of people will never incur estate or GST tax liability, nor will they have \$1 million in spare funds to lock up in a perpetual tax-exempt trust. Instead, the demand for legislation authorizing perpetual trusts came from lawyers and bankers who saw an opportunity to attract new trust business or siphon off existing business from other states. This competition for trust business was not intended to raise revenue for the participating states, which for the most part imposed no income tax on trusts with nonresident settlors and beneficiaries,⁴¹ nor was it likely to improve the efficiency of local trust law.⁴² The immediate beneficiaries of perpetuities

38. Dukeminier & Krier, *supra* note 4, at 1327–39.

39. See UNIF. TRUST CODE §§ 411, 412, 414–416 (2011) (providing for modification, termination, combination, and division of noncharitable trusts). These provisions are mandatory; they cannot be overridden by the terms of the trust. See *id.* § 105(b)(4); see also RESTATEMENT (THIRD) OF TRUSTS § 65 (2003).

40. See Dukeminier & Krier, *supra* note 4, at 1339–42 (proposing measures to limit dead hand control over perpetual trusts); Tate, *supra* note 6, at 620–25 (criticizing proposals as defeating settlor's intent). Although it has been suggested that the problem of dead hand control can be “resolved” by drafting a perpetual trust “so that each generation is given a special power to appoint the remainder to the next generation outright or in further trust,” Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 413, such a power must be carefully drafted to avoid unintended estate tax exposure. See *supra* notes 35–40 and accompanying text.

41. See Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 410 (“only those states that did not tax income in trusts attracted from out of state experienced an inflow of trust assets after abolishing the Rule”); Sterk, *Race to the Bottom*, *supra* note 33, at 1060 (“Jurisdictions seeking to become trust havens . . . appear content to draw business to local financial institutions and lawyers, even without direct benefit to the public fisc.”).

42. See Sterk, *Jurisdictional Competition*, *supra* note 3, at 2113 (“even when agency costs are high, settlor might create a [perpetual tax-exempt] trust to effect a transfer from the government (and presumably, other taxpayers) to the settlor and her beneficiaries—even though the transfer generates no social gain to offset the high agency costs”). See generally Sterk, *Race to the Bottom*, *supra* note 33, at 1055–74 (discussing jurisdictional competition for trust business in the context of asset

repeal appear to be the bankers and lawyers who lobbied hard for enabling legislation and invested heavily in marketing their services to prospective clients.⁴³ The promotional literature is remarkable less for its meager informational content than for its tone of arrant puffery, which suggests that it is aimed at an affluent but not very sophisticated audience.⁴⁴ Consistent with the goal of drawing in new clients, the literature casts perpetual trusts in a soft and rosy light, vaguely promising financial security, perpetual control, and lavish tax benefits without mentioning any potential drawbacks.⁴⁵ It is impossible to know whether perpetual trusts will ultimately perform as promised. At this point, all that can be said with confidence is that the bankers and lawyers who promote perpetual trusts have profited handsomely from the rush to repeal the rule against perpetuities; the benefits to settlors remain speculative; and the costs of recovering foregone tax revenues and modifying stale trusts are being shifted to future taxpayers and beneficiaries.⁴⁶

V. UNINTENDED CONSEQUENCES

In amending the GST tax in 1986, Congress almost certainly did not appreciate the full implications of the \$1 million exemption, which was intended primarily to make the tax simpler and easier to administer. Professional organizations representing bankers, lawyers and other interest groups, which had been largely sidelined in 1976,⁴⁷ unanimously condemned the original version of the GST tax and insisted that a generous exemption

protection trusts).

43. See Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 417 (“The story of jurisdictional competition in trust law is a story of successful lobbying by local banks and trust lawyers, the principal beneficiaries of attracting new trust business to the state.”); Sterk, *Jurisdictional Competition*, *supra* note 3, at 2117 (“[T]he beneficiaries of perpetual trusts are concentrated and politically powerful banks and trust companies.”).

44. Cf. Tate, *supra* note 6, at 612 (noting that advertisements were intended to “introduce the concept of a dynasty trust to wealthy individuals who either are unaware that such a tool exists or do not understand its purpose; the goal is to attract more business by bringing in new clients or informing existing clients about the potential benefits of a dynasty trust”).

45. See *id.* at 611–20.

46. See Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 420 (estimating that states that abolished the rule against perpetuities attracted \$100 billion in trust funds); Sterk, *Jurisdictional Competition*, *supra* note 3, at 2118 (“If a state legislature abolishes the Rule, the legislature may be authorizing new inefficiencies—but those inefficiencies will not be felt by anyone in the state for at least half a century!”).

47. On the legislative process leading up to the 1976 legislation, see Stanley S. Surrey, *Reflections on the Tax Reform Act of 1976*, 25 CLEV. ST. L. REV. 303, 320 (1976) (describing reforms, including the GST tax, as “the price that could be paid for the increased estate tax exemption” demanded by farm groups, despite opposition from the American Bankers Association); *id.* at 325 (describing input from bar groups as “pious urging of caution and really no action lest the statute become too complex”).

was essential to make the revised version acceptable.⁴⁸ Although a few experts noted the inherent tax avoidance incentive of the proposed \$1 million exemption, little attention seems to have been paid to the prospect that the exemption might be used to shelter trusts from GST tax *in perpetuity*.⁴⁹ Instead, Congress seems to have taken the rule against perpetuities for granted as part of the backdrop of local law which defines property rights and interests subject to federal taxation.⁵⁰ In the event, the assumption that the rule would remain in force as an indirect constraint on the use of generation-skipping trusts proved to be a serious flaw in the design of the GST tax. At this point, it may be possible to staunch the revenue loss by denying the GST exemption prospectively for newly-created perpetual trusts,⁵¹ but it seems unlikely that the damage to the rule against perpetuities at the state level can be repaired any time soon.⁵²

48. See 1984 Hearings, *supra* note 21, at 267 (American Bankers Association); *id.* at 278 (American Bar Association, Section of Taxation); *id.* at 282 (American Bar Association, Section of Real Property, Probate and Trust Law); *id.* at 293 (American College of Probate Counsel); *id.* at 303 (American Institute of Certified Public Accountants). The professional organizations were also unanimous in their condemnation of the original version of the GST tax, which had proved “unduly complicated” and ultimately unworkable. STAFF OF J. COMM. ON TAX’N, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 1263 (1986). By any standard, the 1986 legislation provided a bonanza for wealthy taxpayers. In addition to the \$1 million exemption for post-effective-date transfers and a special \$2 million per-grandchild exemption for direct skips occurring before 1990 (the “Gallo amendment”), the legislation retroactively repealed the original version of the GST tax and sheltered pre-effective-date irrevocable trusts from the amended version. See Tax Reform Act of 1986, Pub. L. 99-514, § 1433, 100 Stat. 2085, 2731-32 (1986).

49. See 1984 Hearings, *supra* note 21, at 30, 46 (statement of Harry L. Gutman); *id.* at 337, 338 (statement of Raymond H. Young).

50. See 1976 BLUEBOOK, *supra* note 20, at 564 (“Most States have a rule against perpetuities which limits the duration of a trust.”); see also *Morgan v. Commissioner*, 309 U.S. 78, 80 (1940) (“State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.”).

51. See STAFF OF J. COMM. ON TAX’N, OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 392–95 (2005) (noting that proposed denial of GST exemption “does not prevent an individual from creating a trust in a State that has repealed the rule against perpetuities” but “does . . . eliminate a Federal transfer tax advantage for creating a trust in [such] a State”); U.S. DEP’T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2013 REVENUE PROPOSALS 81–82 (2012) (proposing 90-year limit on GST exemption). The question remains open whether GST exemption should be curtailed for trusts already in existence. Compare Lawrence W. Waggoner, *Effectively Curbing the GST Exemption for Perpetual Trusts*, 135 TAX NOTES 1267 (2012) (proposing denial of GST exemption for all trusts, including those already in existence, that are not required to terminate within specified perpetuities period), with Dennis I. Belcher et al., *Federal Tax Rules Should Not Be Used to Limit Trust Duration*, 136 TAX NOTES 832 (2012) (objecting to “unprecedented retroactive federal tax penalty” and proposing that any prospective limitation on exemption not take effect before the end of the perpetuities period).

52. For a slightly more sanguine perspective, see Joel C. Dobris, *Undoing Repeal of the Rule Against Perpetuities: Federal and State Tools for Breaking Dynasty Trusts*, 27 CARDOZO L. REV.

At least two further factors should be considered in accounting for the precipitous decline of the rule against perpetuities. One contributing factor is the Uniform Statutory Rule Against Perpetuities,⁵³ which was promulgated by the Uniform Law Commission in 1986—coincidentally, the same year that Congress amended the GST tax. The statutory rule introduced a 90-year wait-and-see rule as an alternative to the common law rule and authorized judicial reformation of interests that failed to vest within the 90-year period.⁵⁴ At its high water mark, the uniform statute was adopted by more than half the states, but several of those states subsequently joined the rush to abolish the rule. Although the Uniform Law Commission undoubtedly hoped to reinvigorate the rule by making it simpler and more effective, the uniform statute contained the seeds of its own destruction. By promulgating a fixed 90-year wait-and-see period, the drafters of the uniform statute implicitly endorsed the creation of 90-year trusts, which Jesse Dukeminier predicted would cause the rule to fall into disuse and eventually lead to its formal abolition.⁵⁵ Moreover, several states that adopted the uniform statute have extended the wait-and-see period well beyond 90 years.⁵⁶ As Stewart Sterk asked, “if ninety years is unobjectionable, why not 150, or 200?”⁵⁷ In hindsight, there is reason to think that, contrary to the drafters’ intentions, the uniform statute played a supporting role in bringing down the rule against perpetuities.

The second factor concerns the timing of the statutes abolishing the rule. When Congress amended the GST tax in 1986, several states already allowed perpetual trusts and the incentive for tax avoidance created by the \$1 million exemption was clear for all to see.⁵⁸ Yet no state responded by

2537 (2006) (comparing trust termination to “tattoo removal”).

53. UNIF. STATUTORY RULE AGAINST PERPETUITIES, 8B U.L.A. 223 (2001 & 2012 Supp.).

54. *See id.* §§ 1–3.

55. *See* Jesse Dukeminier, *The Uniform Statutory Rule Against Perpetuities: Ninety Years in Limbo*, 34 UCLA L. REV. 1023, 1025–27 (1987); Jesse Dukeminier, *A Modern Guide to Perpetuities*, 74 CAL. L. REV. 1867, 1884 (1986) (describing the uniform statute as “revolutionary” and predicting that, if adopted, it “probably will bring about the demise of the Rule Against Perpetuities”).

56. *See, e.g.*, ARIZ. REV. STAT. ANN. § 14-2901 (2012) (500 years); COLO. REV. STAT. § 15-11-1102.5 (2012) (1000 years); FLA. STAT. 689.225 (2012) (360 years); UTAH CODE ANN. § 75-2-1203 (2012) (1000 years).

57. Sterk, *Jurisdictional Competition*, *supra* note 3, at 2104; *see also* Dukeminier & Krier, *supra* note 4, at 1310 (“USRAP makes a mere number the salient thing, the topic of debates, the target of reforms, the subject of marginal alterations—extensions by a few years, by a few decades, by a couple of centuries or so.”); Fellows, *supra* note 4, at 2519.

58. In congressional testimony, one expert warned that the proposed \$1 million GST exemption would give rise to “a substantial increase in the establishment of generation skipping trusts” because “bank trust departments, financial planners, lawyers and others will be aggressively marketing and advising establishment of million dollar generation skipping trusts, forever exempt from the tax no matter how long or for how many generations the trusts continue.” 1984 Hearings, *supra* note 21, at 335, 338 (statement of Raymond H. Young). Another expert predicted that the \$1 million exemption

repealing the rule until Delaware did so in 1995, followed by Alaska two years later.⁵⁹ Why did it take so long? One possible explanation is that the bankers and lawyers were slow on the uptake,⁶⁰ but it seems likely that the economic expansion and stock market boom of the late 1990s also played an important role in stoking demand for perpetual trusts.⁶¹ After all, the statutes abolishing the rule were enacted at the behest of lawyers and bankers who presumably calculated that the time was ripe for a mass marketing campaign to promote perpetual trusts. The promotional literature appears to have been aimed primarily at clients with up to \$1 million of disposable wealth and little prior experience with trust investments or sophisticated tax planning.⁶² Such a marketing strategy, with its rhetorical appeal to unlimited private capital accumulation, settlor autonomy, and dynastic pretensions, makes far more sense in times of general prosperity and rising expectations than during an economic slump.⁶³

In sum, it seems indisputable that the 1986 GST tax amendments played a significant role in hastening the demise of the rule against perpetuities. Without the tax loophole opened by the GST exemption for perpetual tax-exempt trusts, the competition among states to attract trust business by

would create a “significant psychological push to use trusts to take advantage of any available exemption” and a “great temptation to undervalue assets passing to generation-skipping trusts in order to keep them within the exemption,” leading to “serious avoidance problems.” *Id.* at 30, 37, 46 (statement of Harry L. Gutman).

59. See 70 Del. Laws ch. 164, §§ 1–3 (1995) (abolishing rule for personal property held in trust); 20 Alaska Sess. Laws ch. 6, § 6 (1997). The preamble to the Delaware statute indicates that it was prompted by a desire to compete for trust business with “innovative jurisdictions” such as South Dakota that had “abolished the rule against perpetuities.” See Jesse Dukeminier, *Dynasty Trusts: Sheltering Descendants From Transfer Taxes*, 23 EST. PLAN. 417, 422–23 (1996) (quoting preamble).

60. See Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 2492 (speculating that due to the complexity of the GST tax and the rule against perpetuities the interaction was “not immediately obvious” and that it would take time “to digest the change in the law and to sell the new product to clients”).

61. During the same period, the mass marketing of other estate planning techniques coincided with widespread changes in state law concerning asset protection trusts, family limited partnerships, and limited liability companies.

62. Undoubtedly the target audience also included high-end clients, though presumably these would already have access to sophisticated estate planning advice and would be less likely to respond to the marketing pitch. Cf. Sitkoff & Schanzenbach, *Empirical Analysis*, *supra* note 4, at 396–97 (noting that average account size in Illinois and Delaware exceeded the GST exemption and conjecturing that “the inflow of very large accounts reflects the administrative efficiencies of locating all of one’s trust assets in a single account with one institutional trustee”).

63. See Joel C. Dobris, *The Death of the Rule Against Perpetuities, or the RAP Has No Friends—An Essay*, 35 REAL PROP. PROB. & TR. J. 601 (2000) (discussing changing attitudes toward wealth, inequality and perpetual trusts).

abolishing the rule would not have unfolded as it did. At the same time, the tax-driven account does not provide a completely satisfactory explanation of the rule's decline. Bankers and lawyers who promote perpetual trusts pitch them to potential clients as multipurpose vehicles that offer an array of benefits including tax reduction, fiduciary management, financial security for successive generations, and protection from creditors, along with the added psychic satisfaction of dynastic continuity. That some of these benefits may be overstated or even illusory does not make them any less marketable than other speculative elements of value. Perpetual trusts, like other upscale goods and services, are sold at retail to well-heeled consumers through appeals to vanity, anxiety, and ambition, as well as tangible financial returns.

VI. CONCLUSION

If the demand for perpetual trusts is driven by competition for trust business, then it seems fair to say that the rule against perpetuities is a collateral casualty of that competition. Responsibility for the death of the rule lies at least as much with the bankers and lawyers who promote perpetual trusts as with the GST exemption that they have so assiduously exploited. It is also possible, however, that the rule would have run its course in any event and that its demise was merely hastened by the 1986 GST tax amendments. For the time being, one can only speculate about the long-term consequences of abandoning the rule, both for local property law and for the federal transfer tax system. But the process, once set in motion, appears to be irreversible. Perpetual trusts, for better or for worse, will be with us for a very long time.