

THE GST TAX TAIL IS KILLING THE RULE AGAINST PERPETUITIES

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I. Introduction

The Rule Against Perpetuities is under siege in the United States. In the past three years, eight states have repealed the rule, and many other states are seriously considering its repeal. /1/ What is sparking the perpetuities repeal movement? Is it the recognition that this ancient property rule no longer serves any social policy? No. /2/ The rule is being repealed so that wealthy individuals will be able to create perpetual dynasty trusts to exploit the generation- skipping transfer (GST) tax system. /3/

The federal GST tax system provides an inflation-adjusted exemption of \$ 1 million. /4/ For the year 2000, the GST exemption amount is \$ 1,030,000 per transferor. /5/ A unique feature of the GST exemption is that it must be allocated no later than when the transferor's estate tax return is due to be filed, /6/ even though trust distributions may be delayed for a substantial period of time after the transferor's death.

Consider a prototypical GST tax exempt (GST-exempt) trust: A grandparent dies in 2000. A testamentary trust of \$ 1,030,000 is created under the grandparent's will. The terms of the trust provide income to the grandparent's child for life, principal to the grandparent's grandchild. /7/ Assuming the grandparent did not use up any of her GST exemption during lifetime, the grandparent's GST exemption of \$ 1,030,000 could be allocated to the testamentary trust. /8/

Assume that the income beneficiary dies in 2030 and that the trust principal is then worth \$ 15 million. Because the trust was made GST exempt on the grandparent's death, no GST tax will be payable on the \$ 15 million trust distribution to the grandchild in 2030. /9/ In effect, \$ 15 million will have escaped any transfer taxation at the child's generation level.

Although the skipping of transfer taxation on \$ 15 million at one generation is not unimpressive, the \$ 15 million will not escape transfer taxation at the grandchild's generation level. Moreover, since any income generated by the

trust must be paid to the grandparent's child, the after-tax amount of income not consumed by the child will be subject to either gift or estate taxation at the child's generation level.

Estate planners understand that much better use can be made of the GST exemption under other GST trust arrangements. /10/ Ideally, the trust principal should not be mandatorily distributed but should be held in the trust as long as possible. Further, trust income should not be mandatorily distributed but should be accumulated and thereby held in trust for as long as possible.

The ideal GST exempt trust would last potentially forever, that is, a perpetual trust for the trust creator's family: a perpetual dynastic trust. The trust principal, enhanced by accumulations of trust income, would remain in trust. Any discretionary distributions of trust income or principal would be free from GST taxation, although the unconsumed distribution would be subject to transfer taxation at the beneficiary's level.

The impediments to perpetual dynastic trusts in most states have been state law property rules, in particular, the Rule Against Perpetuities. As of this writing, perpetual trusts may be created in 11 states. /11/ The perpetuities repeal movement is quite understandable. Unless a state repeals its rule, its wealthy residents will create GST exempt trusts in those states that have repealed the Rule Against Perpetuities.

Part II of this article will show that states, in the blind race to facilitate the exploitation of the GST exemption by perpetual dynastic trusts, have overlooked the non-tax societal reasons for some rule against perpetuities. Parts III and IV of the article evaluate the positive and negative consequences of the perpetuities repeal movement. My sad conclusion is that the GST tax tail is killing a vitally important societal rule that limits unacceptable control by the dead hand.

II. Contemporary Reasons for the Rule

The Rule Against Perpetuities was developed by the English common law to foster the alienation of land, that is, the transfer of full ownership in land in fee simple absolute. /12/ If land was conveyed so that one person had a present estate in the land -- typically a life estate -- and one or more persons had a future estate in the land, fee simple ownership could be transferred only if all persons conveyed their estate in the land to a third person. If one or more future estates in land were made contingent on some future event -- for example, on an unborn person being born -- the present alienation of the land would be prevented until that future contingency was resolved.

In application, the Rule Against Perpetuities was designed to invalidate those

remote nonvested interests in land that would have the effect of indirectly restraining the alienation of land for too long a period. /13/ If, however, land was held in trust, the alienation of the land would not be restrained provided the trustee had the power to alienate the land. Thus, the original purpose for the rule did not and does not apply to land (or any other property) held in trust provided the trustee has the power to sell the trust property.

Is there any modern justification for the Rule Against Perpetuities for property held in trust when the trustee has the power to sell the trust property? The late Professor Lewis Simes, one of the seminal perpetuities scholars and thinkers of the past century, undertook to answer this question. /14/

Simes's thoughts are compelling and timeless. He concluded that there were two modern bases "for the social policy of the Rule, the force of which can scarcely be denied." /15/

First, the Rule Against Perpetuities strikes a fair balance between the desires of members of the present generation, and similar desires of succeeding generations, to do what they wish with the property which they enjoy. . . . In a sense this is a policy of alienability, but it is not alienability for productivity. It is alienability to enable people to do what they please at death with the property which they enjoy in life. As Kohler says in his treatise on the Philosophy of Law [12 Modern Philosophy 205 (1914)]: 'The far-reaching hand of a testator who would enforce his will in distant future generations destroys the liberty of other individuals, and presumes to make rules for distant times.'

But, in my opinion, a second and even more important reason for the Rule is this. It is socially desirable that the wealth of the world be controlled by its living members and not by the dead. I know of no better statement of that doctrine than the language of Thomas Jefferson, contained in a letter to James Madison, when he said: "The earth belongs always to the living generation. They may manage it then, and what proceeds from it, as they please during their usufruct." /16/

With the late Professor A. James Casner as reporter, The Restatement (Second) of Property (Donative Transfers), expresses the contemporary societal concern over dead hand control:

[I]t is fair to conclude that the social interest in preserving property from excessive interference . . . rests partly upon the necessities of maintaining a going society

controlled primarily by its living members, partly upon the social desirability of facilitating the utilization of wealth, and partly on the social desirability of keeping property responsive to the current exigencies of its current beneficial owners. /17/

Two of the leading contemporary perpetuities scholars, Professor Jesse Dukeminier and Professor Lawrence W. Waggoner, also reinforce the need for the Rule Against Perpetuities to curb dead hand control:

[I]n reforming the Rule, reformers should keep clearly in view the primary purpose of the Rule: curtailing the dead hand. /18/

Professor Dukeminier and I agree on most of the important points concerning perpetuity law and perpetuity reform. We agree that the Rule Against Perpetuities still serves a socially useful function of limiting dead hand control, and should not be abolished. /19/

Technically, the common law Rule Against Perpetuities only indirectly restricts the duration of trusts. However, there is a common law doctrine that relies on the rule to limit the duration of trusts. Section 2.1 of The Restatement (Second) of Property (Donative Transfers) sets forth the rule on undue trust duration:

A trust created in a donative transfer, which has not terminated within the period of the rule against perpetuities as applied to such trust, shall continue until the trust terminates in accordance with its terms, except that a trust, other than a charitable trust, may be terminated at any time after the period of the rule against perpetuities expires by a written agreement of all of the beneficiaries of the trust delivered to the trustee, which agreement informs the trustee that the trust is terminated and gives the trustee directions as to the distribution of the trust property. /20/

The Restatement's rationale amply justifies the need for some rule to curb excessive dead hand control over trust duration:

When all the beneficiaries of a trust are ascertained and sui juris, they, acting together, can force a termination of the trust, unless thereby a material purpose of the trust will be defeated. . . . The rule of this section places a limit on the period of time that the creator of a trust is allowed to force the effectuation of the material purpose of the trust, when the

continued accomplishment of such purpose is against the wishes and desires of the current beneficial owners of the trust property. Some limit is desirable in order to prevent the possible undesirable social consequences of the views of persons long removed from the current scene influencing unduly the wishes and desires of those living in the present. /21/

III. Positive Consequences of Repeal

A. Creating Trust Business

Before the Spring of 1997, only three states had repealed their rules against perpetuities as applied to property held in trust. /22/ During the past three years, eight more states have repealed their Rule Against Perpetuities as applied to property held in trust. /23/ Several other states are actively considering repealing their rules as applied to private trusts. /24/

Sources on state legislative history are quite limited and not readily available through legal databases. However, my research /25/ compels me to conclude that, during the past three years, states have repealed the rule as applied to trusts for two major reasons: to allow their residents to create GST exempt dynastic perpetual trusts in their home states so that trust and legal business will not leave the state, and to attract new GST exempt trust business from other states. /26/ Soon after the enactment of the Alaska Trust Act in 1997, /27/ Delaware, the preeminent haven for out-of-state business, followed suit. /28/

Consider the recent experience of New Jersey, which repealed its Rule Against Perpetuities in 1999 under Section 13 of "The Trust Modernization Act of 1999." /29/ Sponsored by the New Jersey Bankers Association, /30/ the legislative history explains the bill as follows:

The bill repeals the Uniform Statutory Rule Against Perpetuities, . . . and supersedes the common law with respect to the rule against perpetuities. Under the bill, a trust can endure forever as long as the trust documents allow the trustee to sell an absolute ownership interest in the trust assets within a specified period, generally 21 years after the death of an individual or individuals alive at the time the trust is created. The effect of this repeal and supersession is to permit banks and trust companies to offer 'dynasty trusts' to their customers, such as those that are being offered by banks and trust companies located in other states. /31/

The bill was unanimously passed by the New Jersey Assembly 76-0, and by the Senate 40-0. On July 8, 1999, the governor signed the bill into law. The

conclusion is that New Jersey now sanctions perpetual trusts provided the trustee has the power to sell the trust property. In effect, neither the Rule Against Perpetuities, nor the related rule that might have limited trust duration, applies to qualified perpetual trusts in New Jersey. /32/

Not unexpectedly, banks and others have applauded the blessings that New Jersey has bestowed on perpetual trusts. Consider the announcement of the New Jersey Bankers Association: "The new law repeals New Jersey's statutory and common law Rule Against Perpetuities . . . and thus permits banks and trust companies to offer 'dynasty' or 'wealth building' trusts." /33/

The following is an excerpt from an article entitled "Remember the Rule Against Perpetuities? Well, Forget it! New Jersey Undoes Centuries of Jurisprudence with a Pen Stroke":

Some state bankers and financial advisers say the new law will allow New Jersey banks and trust companies to compete more easily with other states for wealthy clients.

'This will bring New Jersey into basic parity with Delaware as a favorable situs for trusts,' says Bill Knox, a financial planner and investment adviser with Bugen, Stuart, Korn and Cordaro in Chatham. 'After many centuries of stumbling around, in New Jersey we've finally arrived at the right rule.' /34/

Surely, New Jersey lawyers will also benefit from trust business staying in New Jersey as well as from trust business coming from other states, primarily New York. In addition, lawyers will benefit if New Jersey residents who created trusts in dynasty trust states repatriate them to New Jersey. /35/

B. Eliminating Complexity: Revenge of the Law Student?

As every former law school student can attest, the complexities of the Rule Against Perpetuities were a learning nightmare. /36/ In fact, the original common law Rule Against Perpetuities has been justifiably attacked as being too harsh and too complex. /37/ Indeed the wait-and-see movement developed in response to the perceived problems with the common law rule. /38/ The latest formulation of the wait-and-see rule is the Uniform Statutory Rule Against Perpetuities (USRAP), which has a 90-year wait-and-see period. /39/ It has been enacted in more than half of the states. /40/

Since most nonvested interests will likely vest or fail to vest within 90 years of trust creation, USRAP should eliminate complexity for the current generations. If, however, the uncertainty is not resolved during the 90-year period, a court may then need to exercise its cy pres power to reform the

trust. Fortunately, no living professional or jurist will have to deal with the problems of trust invalidity 90 years down the road.

The conclusion on complexity is inescapable: the repeal of the common law Rule Against Perpetuities, or the wait-and-see formulation of the Rule, eliminates complexity as applied to trust creation. A New Jersey estate planner applauded New Jersey's prospective repeal of USRAP: "Who needs all this stuff? . . . Isn't good estate planning complex enough without something like this?" /41/

IV. Considering the Consequences?

In their haste to jump on the repeal bandwagon, no repealing state appears to have seriously considered the negative consequences of sanctioning GST exempt perpetual trusts. /42/ Unfortunately, there will be serious negative consequences under the trust creator's infinite dead hand control.

Consider the prototypical GST exempt dynastic trust in those states that have repealed the Rule Against Perpetuities and have no rule that limits trust duration if the trustee can sell the trust property: An individual is counseled to create a lifetime trust that uses the available GST exemption amount -- \$ 1,030,000 in 2000. /43/ To maximize the GST exemption, the trust will be designed to last as long as there are descendants of the trust creator, with a gift over to the settlor's heirs, but if none, a charitable gift over whenever the settlor's lineal line runs out. /44/ The terms of the trust give the trustee the absolute discretion to distribute income or trust principal to the settlor's descendants. Any undistributed income shall be accumulated and added to the trust. On the advice of counsel, the settlor appoints a corporate trustee as immediate or successor trustee.

Consider some of the negative consequences of infinite dead hand control under such carefully-crafted GST exempt perpetual dynasty trusts.

A. Trust Duration in Perpetuity

Absent prior termination, a perpetual trust is just that - - a trust that can last forever, in perpetuity. In an effort to quantify perpetuity, we might look to the world of astrophysics where it is reliably predicted that human life on earth could last for somewhat more than 1 billion years. /45/

It is no answer that a perpetual trust may be terminated before the transferor's lineal line runs out. Unless the corporate trustee exercises its discretion to terminate the trust, trust termination cannot be compelled absent some emergency. /46/

B. Administrative Nightmare

Quite understandably, the National Conference of Commissioners on Uniform State Laws (NCCUSL) is distressed by the perpetuities repeal movement. Indeed, if fully successful, the movement would be the undoing of USRAP. /47/

In October of 1999, NCCUSL issued a press release entitled: "Uniform Statutory Rule Against Perpetuities Is Law in 26 States: Move of a Few States to Abolish the Rule In Order to Facilitate Perpetual (Dynasty) Trusts is Ill-Advised." /48/ Consider the potential trust administrative nightmare with dynastic trusts that is warned of by Professor Lawrence W. Waggoner, Director of Research of the Joint Editorial Board for the Uniform Probate Code in the NCCUSL press release:

Over time, the administration of such trusts is likely to become unwieldy and very costly.

Government statistics indicate that the average married couple has 2.1 children. Under this assumption, the average settlor will have more than 100 descendants (who are beneficiaries of the trust) 150 years after the trust is created, around 2,500 beneficiaries 250 years after the trust is created, and 45,000 beneficiaries 350 years after the trust is created. Five hundred years after the trust is created, the number of living beneficiaries could rise to an astounding 3.4 million. /49/

And, Professor Waggoner's statistics are only for relatively short-term periods possible under perpetual dynastic trusts. /50/ Imagine the administrative problems with a dynasty trust for "only" a 1,000 years. How many beneficiaries might a perpetual trust have in 10,000 years? 100,000 years? 1 million years? 5 million years? 1 billion years? (About 100 million years before human life is predicted to be extinguished.)

C. Trustee Power

A well-drafted GST exempt perpetual trust will have escape hatches so that the trust can be prematurely terminated. On one approach, the transferor would confer discretionary distributive powers on the corporate trustee. /51/ In effect, the corporate trustee would be invested with the extraordinary power to control the wealth and well-being of the trust beneficiaries. Although the trustee's discretion is subject to court supervision, a court will not upend trustee decisions lightly. /52/ Future generations of trust beneficiaries should not be surprised if a corporate trustee resisted exhortations by them for trust distributions.

Recall Professor Simes's point: "It is socially desirable that the wealth of the

world be controlled by its living members and not by the dead." /53/ I doubt that Professor Simes had in mind control over wealth by society's corporate trustees.

D. Size of Trust Principal

The ideal GST exempt trust would amass as much wealth as possible, thereby preventing its depletion by federal transfer taxation. /54/ Consider the wealth that might already be amassed or might be amassed in a perpetual trust based on the exponential explosion of the recent stock market. /55/

Who knows what lies ahead in the future? But consider the value of \$ 1 million with an after-tax return of 6 percent for the following (relatively short) periods: /56/

Value	after	100	years:	\$	369	million
Value	after	200	years:	\$	136.43	billion
Value	after	300	years:	\$	50.395	trillion

Perpetual trusts can (and will) facilitate enormous wealth and power for dynastic families. In the process, we leave to future generations some serious issues about the nature of our country's democracy. /57/

E. Termination of GST Exemption

The recent repeal of perpetuities laws is designed to encourage the creation of GST-exempt perpetual dynastic trusts in the repealing state. /58/ Yet, there is no real guarantee that the federal government will allow perpetual exemption from GST taxation. /59/ Will the repealing states then reinstate some rule against perpetuities if the GST-exemption is limited, for example, to 90 or 100 years? If the GST-exemption is limited, might GST exempt perpetual trusts be terminable on the basis that their purposes have been accomplished? /60/ If not, will there be problems with non-GST- exempt perpetual trusts?

F. Non-GST-Exempt Perpetual Trusts

Although states are in a mad dash to repeal the Rule Against Perpetuities so that \$ 1 million+ GST exempt perpetual dynastic trusts can be created, no state that has repealed the rule restricts perpetual trusts to those created for GST tax purposes. Even if non- GST-exempt perpetual trusts were subject to GST taxes, the after-tax amount in these trusts could be staggering. Consider a dot -- com multimillionaire who creates a perpetual dynastic trust exceeding \$ 50 million, or exceeding \$ 100 million, or even more.

In the final analysis, the negative consequences under GST exempt perpetual trusts could be greatly exacerbated under non-GST exempt perpetual trusts.

G. Increase in Aggregate Power in Banks & Trust Cost.

In my view, one of the most serious societal consequences of perpetual trusts will be the increase in aggregate power in the hands of banks and trust companies that serve as corporate trustees of multiple perpetual trusts. Already that power is significant and growing. From 1990 through 1998, the value of equities held in bank personal trusts and estates grew from \$ 190 billion to \$ 538 billion. /61/ Consider also that the largest of the banks and trust companies have traditionally held a sizeable percentage of the common stock held by all banks and trust companies. /62/

V. Conclusion

Having decried the perpetuities repeal movement, I wish I had a politically simple solution. At this point, my politically incorrect suggestion is that the repealing states should rescind their measures. /63/ If these states took such action, then the real issue could be addressed: How long should society allow the dead hand to control the duration of trusts?

In fact, I sympathize with states that are losing trust business to GST-exempt state havens. The need by such states to respond by repealing their rules against perpetuities is very real and understandable. The tax tail seems destined to kill the rule. /64/ Will the states next need to repeal their fiduciary income tax systems so that residents will not flee to state tax havens to create perpetual trusts? /65/

Where does the law of the least common denominator stop? Will the states next need to offer asset protection trusts to compete with Alaska and Delaware? /66/ If Alaska or some other state finds more attractive ways to entice trust business, will all the states need to follow suit? /67/

Will the property and tax laws of each state cease to be based on principles and the societal good? I sincerely hope not.

FOOTNOTES

/1/ See notes 23-24 infra and accompanying text.

/2/ See notes 12-21 infra and accompanying text.

/3/ See notes 22-35 infra and accompanying text.

/4/ See section 2631.

/5/ See section 3.18 of Rev. Proc. 99-42, 1999-46 I.R.B. 568, Doc 1999-35283 (15 original pages), 1999 TNT 213-8.

/6/ See section 2632. Technically, the GST exemption is accounted for under the GST tax system by the inclusion ratio mechanism of section 2642. The inclusion ratio is generally defined under section 2642(a)(1) as one minus the applicable fraction determined for the transferred property. In turn, the applicable fraction for a GST trust will have as its numerator the GST exemption allocated to the transfer; the denominator will generally be the estate value of the property transferred in trust if the inclusion ratio is established at the transferor's death. See sections 2642(a)(2) and 2642(b)(2).

/7/ Estate taxes are made payable from a source other than the trust. Otherwise estate taxes could be apportioned against the trust, thereby reducing the amount that can pass GST tax free by virtue of the full GST exemption amount.

/8/ The inclusion ratio for the trust would then be established at zero, that is, one minus the applicable fraction amount of one. The applicable fraction would be one because the numerator would be \$ 1,030,000, the available GST exemption amount, as would the denominator, that is, the estate tax value of the testamentary trust, or \$ 1,030,000.

/9/ On the child's death, a GST event occurs, that is, a taxable termination under section 2612(a) in the taxable amount of \$ 15 million. See section 2622. However, there is no GST tax imposed under section 2602 because the tax on the \$ 15 million is determined by multiplying it by the applicable rate, which is zero. Section 2641 defines the applicable rate as the product of highest marginal estate tax rate times the inclusion ratio. Recall that the inclusion ratio, established at the grandparent's death, was zero.

In effect, if a zero inclusion ratio is established for a transfer in trust pursuant to which a GST may later occur, no GST tax will be payable on the GST transfer whenever it occurs and however large the taxable amount is at the time of the actual GST transfer. For example, if the value of the trust at the child's death in 2030 was \$ 95 million, no GST tax would be imposed because the applicable rate would still be zero.

/10/ The GST exemption should be leveraged to optimize avoidance of GST taxation. Ideal candidates for a GST exempt trust would include a minority interest in a family limited partnership or LLC which is expected to appreciate in value and a second-to-die life insurance policy. For the charitably minded, charitable lead trust are very attractive vehicles for

leveraging the GST exemption. See generally Georgiana J. Slade, "Remembering the Grandchildren -- Leverage, Discount and Freeze Perpetually: Intervivos Generation-Skipping Transfer Tax Planning," 34 Univ. of Miami (Philip E. Heckerling) Inst. on Est. Plng. Ch. 4 (2000). A recent leveraging favorite involves the sale of a remainder interest in a GRAT to a dynasty trust. See David A. Handler and Steven J. Oshins, "GRAT Remainder Sale to a Dynasty Trust," Tr. and Est., Dec. 1999, at 20.

/11/ See note 22-23 *infra* and accompanying text.

/12/ See The Restatement (Second) of Property (Donative Transfers), part I (1983).

/13/ See *id.*

/14/ Lewis M. Simes, Public Policy and the Dead Hand 56-63 (1955).

/15/ *Id.* at 58.

/16/ *Id.* at 58-59.

/17/ The Restatement (Second) of Property (Donative Transfers), part I (1983).

/18/ Jesse Dukeminier, "Perpetuities: The Measuring Lives," 85 Colum. L. Rev. 1648, 1710 (1985).

/19/ Lawrence W. Waggoner, "Perpetuities: A Perspective on Wait- and- See," 85 Colum. L. Rev. 1714, 1714 (1985).

/20/ The Restatement (Second) of Property (Donative Transfers), section 2.1 (1983). See generally Ira Mark **Bloom**, "Transfer Tax Avoidance: The Impact of Perpetuities Restrictions Before and After Generation-Skipping Taxation," 45 Alb. L. Rev. 260, 271-76 (1981) (discussing trust duration rules).

/21/ *Id.* Comment a. (emphasis added).

/22/ Idaho, South Dakota and Wisconsin. Idaho effectively repealed any dead hand control rules over personal property in 1957. Idaho Code section 55-111. See **Bloom**, *supra* note 20, at 275-76 (1981) (discussing perpetuities repeal in Idaho).

In 1969, Wisconsin repealed the common law Rule Against Perpetuities but maintained a rule against the undue suspension of the power of alienation in both real and personal property. See Wis. Stat. Ann. section 700.16. South Dakota followed suit in 1983. See S.D. Codified Laws section 43-5-8

(repealing the rule); S.D. Codified Laws section 43-5-4 (no undue suspension of the power of alienation if the trustee has the power to sell the trust property).

Section 700.16 of Wisc. Stat. Ann. provides in applicable part as follows:

(1)(a) A future interest or trust is void if it suspends the power of alienation for longer than the permissible period. The permissible period is a life or lives in being plus a period of 30 years.

...

(2) The power of alienation is suspended when there are no persons in being who, alone or in combination with others, can convey an absolute fee in possession of land, or full ownership of personalty.

(3) There is no suspension of the power of alienation by a trust or by equitable interests under a trust if the trustee has power to sell, either expressed or implied, or if there is an unlimited power to terminate in one or more persons in being.

(4) ...

(5) The common-law rule against perpetuities is not in force in this state.

If the trustee has the power to sell the trust principal the exception to Wisc. Stat. Ann. section 700.16(3) applies, and the Wisconsin trust may last in perpetuity. See **Bloom**, supra, at 275. The same result is obtained under the comparable South Dakota statutes. See S.D. Codified Laws section 43-5-4.

/23/ See Alaska Stat. section 34.27.050(3); Del. Code Ann. tit. 25, section 503(a); 765 Ill. Comp. State. Ann. section 305/4; Me. Rev. Stat. Ann. Tit. 33, section 101-A; Md. Code. Ann. section 11- 102(e); N.J. Stat. Ann. sections 46:2F9-2F11; Ohio Rev. Code Ann. section 2131.09(B); R.I. Gen. Laws section 34-11-38.

In the Spring of 1997, Alaska was the first state to enact repeal legislation, but it appears not to have effectively repealed its rule against perpetuities in all instances. See *infra* note 27. The other states, however, appear to have been effective in crafting general repeal legislation, although differences exist on varying issues, such as whether the trust instrument must specifically provide that the Rule Against Perpetuities does not apply. Compare 765 Ill. Comp. State. Ann. section 305/3 (requiring a specific

provision in the trust document that the rule does not apply), with N.J. Stat. Ann. section 46:2F11 (omitting the requirement of a specific provision in the trust document that the rule does not apply). See generally Richard B. Covey, "Rule Against Perpetuities Changes and Perpetual (Dynasty) Trusts: Problems and Opportunities," *Prac. Drafting* 5871-80 (Jan. 2000) (discussing issues raised by the repealing legislation of the various states).

/24/ See H.B. 599, 102nd Leg. Sess (Passed in Florida. House on March 15, 2000); H.B. 566, S.B. 2060, 78th Leg., 2d. Sess. (Iowa 2000); S.B. 5957 Assembly Joint Resolution No. 4, 70th Leg. (Nev. 1999) (seeking to eliminate a constitutional prohibition on perpetuities); S.B. 5957, 222nd. Leg. Sess. (N.Y. 1999); Tenn. Perpetual Trust Act, H.B. 912, S.B. 565, 101st Leg. (1999); S.B. 502, H.B. 789, 2000 Sess. (Va. 2000).

/25/ I wish to gratefully acknowledge the invaluable research assistance of Bob Emery, Reference Librarian, Albany Law School, and Deborah Kearns, my student research assistant.

/26/ Alaska began this recent flurry of perpetuities repeal in 1997 for the express purpose of attracting trust business to Alaska. The testimony of Representative Vezey, the sponsor of the perpetuities repeal legislation, revealed that perpetuities repeal was the result of his efforts to look at what could be done to stimulate economic development in the state of Alaska and to look at why it is that Alaska couldn't be more of a financial center for the economy of Alaska, America and the whole world. . . . [H]e looked to see if there was an opportunity to change [Alaska's] laws that would encourage financial markets to headquarter in Alaska. With the help of a number of individuals who were also looking for a home for this type of an entity, they came up with some changes that could be made in Alaska to [Alaska's] trust laws that would make Alaska an attractive place to administer large trusts.

Hearings on H.B. 101 Before the Subcomm. on Labor and Commerce, 20th Leg. (Ala. 1997) (statement of Representative Vezey).

Designed to prevent the loss of business to offshore trusts that serve as asset protection havens, the 1997 Alaska legislation also upended the rule that permitted a settlor's creditors to reach trust assets if the trustee could make discretionary distribution to the settlor. Consider the summary of Representative Vezey's testimony:

[T]here is a huge market for trusts -- very large assets where people are looking for ways of preserving these assets for future generations and more than just one or two generations . .

[C]urrently this market is largely going to foreign countries such as Asia, Carribean, Cayman Islands and Cook Islands. Those

countries have strong trust laws. . . . [T]he Cayman Islands has major banks as they are administering funds, including the trusts.

Id.

The principal beneficiaries of the Alaska legislation were predicted to be: "attorneys, bankers, certified public accountants and money managers." Id. Indeed, Jonathan Blattmachr, a well-known New York estate planning attorney, was instrumental in drafting the Alaska legislation. See *id.*; see generally Douglas J. Blattmachr and Jonathan J. Blattmachr, "A New Direction in Estate Planning: North to Alaska," *Tr. and Est.*, Sept. 1997, at 48. Jonathan Blattmachr is also a member of the Alaska bar; his brother is the president of a trust company in Alaska.

/27/ The 1997 Alaska legislation failed to repeal the Rule Against Perpetuities in all circumstances so new pending legislation is necessary to effectively repeal the Rule. See S.B. 162, 21st Leg. (Alaska 2000). The House Judiciary Minutes of May 10, 1999, indicate that

[t]he problem with the Alaska Trust Act is that it does not allow a person to create a perpetual charitable lead trust . . . Since the passage of the Alaska Trust Act, many persons have contacted trust companies and attorneys in Alaska and have expressed a desire to create perpetual charitable lead trusts. This new legislation would completely repeal the rule against perpetuities and would permit the creating of perpetual charitable lead trusts.

Hearing on H.B. 219 Before the House Judiciary Standing Comm., 21st Leg. (Ala. 2000) (statement of Cory Winchell).

/28/ See Del. Code Ann. tit. 25, section 503(a); Katharine Fraser, "Delaware Matches Alaska Law Attractive to Personal Trusts," *Am. Banker*, July 24, 1997, at 9.

/29/ Section 13 provides: "No interest created in real or personal property shall be void by reason of any rule against perpetuities, whether the common law rule or otherwise. The common law rule against perpetuities shall not be in force in this State." Trust Modernization Act of 1999, July 8, 1999, ch. 159, 1999 N.J. Laws 159 (codified at N.J. Stat. Ann. section 46:2F-9).

/30/ See Rachel Wolcott, "New Jersey Poised to Allow Dynasty Trusts," *Institutional Inv. Inc.*, May 17, 1999, at 1 ("The bill, sponsored by the New Jersey Bankers Association, was drawn up so that New Jersey trust

institutions could avoid losing potential dynasty trust business and other types of trust business to Delaware, South Dakota and Alaska.").

/31/ A. 2804, 208th Leg. (N.J. 1999).

/32/ The New Jersey legislation was patterned after the Wisconsin legislation set forth in note 1. See "Trust Modernization Act Signed by Governor," 77 N.J. Banker's Ass'n Bulletin (July 14, 1999) (indicating New Jersey used Wisconsin as a model).

Section 14 of the Trust Modernization Act provides in applicable part as follows:

a. (1) A future interest in or trust is void if it suspends the power of alienation for longer than the permissible period. The power of alienation is the power to convey to another an absolute fee in possession of land, or full ownership of personalty. The permissible period is within 21 years after the death of an individual or individuals then alive.

...

b. The power of alienation is suspended when there are no persons then alive who, alone or in combination with others, can convey an absolute fee in possession of land, or full ownership of personalty.

c. There is no suspension of the power of alienation by a trust or by equitable interests under a trust if the trustee has power to sell, either express or implied, or if there is an unlimited power to terminate in one or more persons then alive.

Trust Modernization Act of 1999, July 8, 1999, ch. 159, 1999 N.J. Laws 159 (codified at N.J. Stat. Ann. section 46:2F10).

/33/ "Trust Modernization Act Signed by Governor," note 31 supra.

/34/ Wendy Davis, "Remember the Rule Against Perpetuities? Well, Forget it! New Jersey Undoes Centuries of Jurisprudence with a Pen Stroke," 157 N.J.L.J. 217 (1999).

/35/ Section 15(2) of the act states:

a future property interest or a power of appointment created before the effective date of this act pursuant to the laws of any other state that does not have the rule against perpetuities

in force and to which, after the effective date of this act, the laws of this State are made applicable by transfer of the situs of a trust to New Jersey, by a change in the law governing a trust instrument to New Jersey law, or otherwise. For purposes of this section only, a future property interest or a power of appointment is created when the power is irrevocably exercised or when a revocable exercise becomes irrevocable.

Trust Modernization Act of 1999, July 8, 1999, ch. 159, 1999 N.J. Laws 159 (codified at N.J. Stat. Ann. section 46:2F11).

/36/ During the 1997 Illinois debates on the repeal of the rule, Representative Durkin asked:

[r]epresentative, give me one more chance and educate me. What the heck is the rule against perpetuities? I went to law school, I took Bar-bri . . . [Bar-bri] said something about the rule against perpetuities states that all interests must vest, if at all, within 21 -- years in lives of being. What the heck does that mean?

Hearings on H.B. 1619 Before the House of Representatives, 90th Leg. (May 22, 1977).

/37/ See, e.g., W. Barton Leach, "Perpetuities in a Nutshell," 51 Harv. L. Rev. 638, 643-46 (1938).

/38/ See W. Barton Leach, "Perpetuities in Perspective: Ending the Rule's Reign of Terror," 65 Harv. L. Rev. 721 (1952). Other states kept the common law Rule but made refinements to alleviate the perceived problems. See, e.g., N.Y. Estates, Powers & Trusts Law, sections 9-1.1 to 9.1-3. See generally Ira Mark **Bloom**, "Perpetuities Refinement: There Is an Alternative," 62 Wash. L. Rev. 23 (1986).

/39/ USRAP is contained in sections 2-901 to 2-906 of the Uniform Probate Code.

/40/ See note 48 infra and accompanying text.

/41/ Davis, note 34 supra.

/42/ To its credit, the Florida legislature is taking into account the undesirable impact of infinite dead hand upon future trust beneficiaries. On March 15, 2000, the Florida House passed legislation that would permit trusts to last for 1,0000 years -- in the scheme of things a lot less than the

length of perpetual trusts. However, after 90 years, trust modification or termination could be ordered by the court, or consented to by the trust beneficiaries in certain circumstances. See H.B. 599, 102nd leg. Sess. (Fla. 2000).

/43/ Since the GST exemption amount will be annually adjusted upward for inflation, annual additions of property to the trust in the amount of the increased GST exemption amount can facilitate additional avoidance of GST taxation.

/44/ You might recognize this formulation as having ingredients similar to the fee tail, which was effectively abolished in the 15th century.

/45/ See I-Juliana Sackmann, et al., "Our Sun. III. Present and Future," *The Astrophysical J.* 457 (Nov. 1993), also available at http://adsbit.harvard.edu/cgi-bin/nph-article_query?1993ApJ...418..457S (visited Mar. 28, 2000).

/46/ See *The Restatement (Second) of Trusts*, section 335 (1959).

/47/ As examples, Alaska and New Jersey already have repealed USRAP prospectively. See Alaska Stat. Ann. section 34.27.070 and N.J. Rev. Stat. section 46:2F-11(a)(1).

/48/ The press release is set forth in <http://www.nccusl.org/pressrel/usrap799.htm> (visited March 28, 2000).

/49/ See *id.*

/50/ Professor Waggoner suggested to me that a way to think about distant future time was to think about time in the distant past. Think about how different our society was only 50 years ago, 100 years ago, during the middle ages, at the death of Mohammed, Christ, Moses. . . .

/51/ The discretionary trust powers could be without standards or with standards, for example, distributions necessary for the health, education, maintenance and support of trust beneficiaries.

Other types of escape hatches could give trust beneficiaries considerable control over their destinies. For example, a concerned transferor might wish to give trust beneficiaries control over trust termination by way of ceding them special powers of appointment. The trust creator's dead hand control would also be minimized if the empowerment of trust beneficiaries were empowered to remove and replace the corporate trustee.

/52/ See *The Restatement (Third) of Trusts*, section 50 (Tentative Draft No.

2, 1999). Powers subject to an ascertainable standard would be subject to greater court supervision, but courts will still be reluctant to interfere with corporate trustee's decisions, including the decision not to be made trust distributions. See *id.*

/53/ Simes, note 14 *supra*, at 59.

/54/ Although federal income taxation may be unavoidable, it may be minimized under the prudent investor standard whereby the trustee can invest for total return so that the vast bulk of income will be in form of capital gains. State fiduciary income taxation may be totally avoided in a few states. See note 65 *infra*.

/55/ The New York Times recently listed individual stocks that had meteoric rises during the 1990s. See Kenneth N. Gilpin, "10 Stocks for 2010: Buy-and-Hold Picks From Top Investors," NY Times, Feb. 20, 2000, at BU1. For example, Microsoft had a total return of 9,562 percent, but that pales in comparison with Cisco Systems, which had a rise of 69,000 percent during the 1990s! See *id.* at BU5.

/56/ See **Bloom**, note 20 *supra*, at 301 n.219.

/57/ Professors Simes and Leach thought that the problem of wealth concentration should be handled by taxation, not by a rule against perpetuities. See Simes, note 14 *supra*, at 56-57. Assuming one agrees with this viewpoint, I doubt that they contemplated the \$ 1 million+ exemption from transfer taxation. For reasons unpersuasive to me, Simes also did not take seriously the impact of inherited wealth for society. See *id.* at 57-58. However, consider the cogent observation of the late Professor Richard Powell: "That which the wealthy can do with their wealth shapes the lives of even our most unwealthy citizens." Richard R. Powell, *The Law of Future Interests in California* 3 (1980).

/58/ See note 26 *supra* and accompanying text.

/59/ In 1997 Treasury made an abortive effort to limit the effectiveness of the GST exemption. See Mitchell M. Gans, "Federal Transfer Taxation and the Role of State Law: Does the Marital Deduction Strike the Proper Balance?," 48 Emory L. J. 871, 878-79 (1999) (discussing promulgation and deletion of regulation).

/60/ The Restatement (Second) of Trusts provides that a trust will be terminated if the trust purposes become impossible to accomplish. See The Restatement (Second) of Trusts section 335 (1959).

/61/ U.S. Department of Commerce, Statistical Abstract of the United States

532 (119th ed. 1999).

/62/ See William L. Carey and Melvin Aron Eisenberg, *Cases and Materials on Corporations* 245 (1995). See generally Library of Congress, Congressional Research Service, *The Exercise of Voting Rights by Large Institutional Investors: A Survey* (1977).

/63/ I would suggest that the repeal of perpetuities repeal legislation have retroactive application. Although vested rights may be constitutionally protected, most interests in perpetual trusts will likely be nonvested. See generally Leonard Levin, "Section 6104(d) of the Pennsylvania Rule Against Perpetuities: The Validity and Effect of the Retroactive Application of Property and Probate Law Reform," 25 *Vill. L. Rev.* 213 (1980).

/64/ Perhaps it is not too late for states considering repeal to build in termination provisions like Florida. See note 42 *supra*. Better yet, trust beneficiaries could be required to be given special powers of appointments that were exercisable after a reasonable period into the trust's existence. Repeal could also be limited to only trusts that qualify for the GST exemption.

/65/ For example, Alaska and South Dakota do not impose an income tax on trusts. Delaware effectively exempts trusts created for non-resident beneficiaries from income taxation. See Del. Code Ann. tit. 30, section 1138. However, some states, including New Jersey and New York, impose a fiduciary income tax if the trust was created by their state residents. See N.J. Stat Ann. section 54A:1-2(o) and N.Y. Tax Law section 605(b)(3)(c). See also Chase Manhattan Bank v. Gavin, 249 Conn. 172, 733 A.2d 782, cert. denied 120 S.Ct. 401 (1999) (upholding constitutionality of Connecticut's fiduciary income tax on trusts created by residents).

/66/ See generally John K. Easton, "Home from the Islands: Domestic Asset Protection Trust Alternatives Impact Traditional Estate and Gift Tax Planning Considerations," 52 *Fla. L. Rev.* 41, 43 n.4 (2000) (noting that Nevada passed asset protection trust legislation in 1999 and that legislation is pending in Texas; further noting that Missouri and Colorado have sanctioned self-settled trusts since 1983 and 1861, respectively).

/67/ Alaska's latest gimmick allows non-resident married couples to treat property held in Alaska trusts as community property to obtain a step-up in basis under section 1014(b)(6). See Jonathan G. Blattmachr, Howard M. Zaritsky, and Mark L. Ascher, "Tax Planning with Consensual Community Property," 33 *Real Prop, Prob. & Trust J.* 615 (1999). The Service has not yet ruled whether it will allow section 1014(b)(6) to apply under Alaska's consensual community property system.