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Dynasty Trusts: Another View

-by Neil E. Harl*

An article published in a recent issue of an agricultural publication about “dynasty trusts” merits a response. While such trusts may offer some attractive short-term features, the probable long-term consequences are sobering. Indeed, from both a policy perspective and from the standpoint of the best long-term interests of generations to come, it has been the conclusion of this author that setting up such a trust would likely produce enormously disadvantageous results if widely used. Indeed, it is difficult to conceive of a plan that would be more disadvantageous to future generations.

Here are the arguments supporting that conclusion.

The Rule Against Perpetuities

The concept of “dynasty trusts” that can last forever is dependent upon repeal of the Rule Against Perpetuities which has been a part of the common law heritage for more than three centuries. The Rule, as it is commonly known, had its origins in the Duke of Norfolk’s case in the late 17th Century.¹ The case involved disagreements among the heirs of the Duke of Norfolk over the propriety of leaving property in successive life estates. The court believed that it was wrong to tie up property beyond the lives of persons living at the time the property was conveyed, although the exact period for which such transfers should be permitted was not determined until roughly 150 years later.²

As followed at common law (and the statutory versions that followed the common law) in the United States, the Rule established a limit on holding property in trust or otherwise precluding property from vesting, measured by a class of lives in being plus 21 years.³ That usually has permitted the life of a trust to last for 100 years, but usually not more than about 120 years. About half of the states adopted the Uniform Statutory Rule Against Perpetuities (USRAP) under which an interest in property was valid if it would necessarily vest or fail within lives in being plus 21 years (basically the common law rule) or the property actually vested within 90 years of creation.⁴

However, commencing about 30 years ago, a trend developed of repealing the Rule and about half the states have done so.⁵

Number of beneficiaries

The problems associated with so-called “dynasty” trusts are principally long-term in nature and involve significant policy issues. First, the trusts are irrevocable – they generally cannot be revoked or amended. Most think in terms of a couple of generations. But let’s fast forward to the year 2511, 500 years from now. These trusts are set up *to last forever*. Not

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Happy Holidays to You and Yours!

just 500 years or 1,000 years but *forever*. What started out in 2011 as a couple with two children would, with normal fertility levels, have increased to 3.4 million beneficiaries in 500 years.⁶ After only 150 years, the trust would be expected to have around 2500 beneficiaries.⁷ The beneficiaries would by then be likely to view their interest in the trust much as the way the Social Security Trust Fund is viewed today – very distant and with virtually no influence over the trust or its investments. It would fundamentally alter the way individuals and family view property – as some distant and largely unresponsive fund. Getting agreement to amend the trust would be almost impossible.

Beneficiaries still farming?

Although certainly not limited to owning farmland, for those owning farmland the view of many who have set up such trusts is that successors within the family will continue to farm the land (or at least to own the land as landlords). Is that a realistic assumption? We don't know what technology lies ahead but just in the past 80 years the number of farmers has dwindled sharply. It seems a safe bet that the future will see more of the same. There is no assurance in 500 years that any of the successors within the family would have the remotest interest in farming.

Would the land in question even be used for farming in 500 years? Or would it be covered over with concrete and blacktop as a city? Or a huge regional airport? Would the family successors who might be interested in farming be working in the shadow of a skyscraper?

Past generations have been able to assess their interests and abilities and strike out in areas hardly dreamed of by their parents, taking their share of the family wealth with them and under their control.

What about access to assets?

Just ponder for a moment what the chances of acquiring land (or other assets) today would be if the wealthy in 1011 had frozen all of the land in trust? It has been an article of faith in this country that if one works hard, saves their money, some day they can acquire property. That would be substantially curbed if dynasty trusts were to become widespread.

Who would be in control of the land?

Most dynasty trusts are set up with a bank or trust company as trustee. That might involve trust administration in places like Cedar Rapids or Peoria or even Indianapolis. But the way banking is changing and consolidating, the trust might end up being administered in Beijing or Singapore or some other distant place.

It would place enormous economic power in the hands of the corporate trustees with little accountability. There is no secret why banks and trust companies have been the big advocates for dynasty trusts. That whistling sound overhead is money and other assets on the way to South Dakota, Alaska and the other states that have repealed the Rule. Moreover, the fees charged are largely unregulated.

Reduced economic growth

It is well known that corporate trustees tend to be cautious and conservative, not wanting to be "surcharged" for mistakes in judgment in handling a trust. With the trust assets largely shielded from market forces, widespread ownership of assets in such trusts would almost certainly reduce the rate of economic growth in the country. It is an article of economic faith that economic growth is

maximized if resources are fully subject to the forces and pressures of the market and are routed to where the economic return is the greatest.

The Administration's Position

The current Administration (principally originating in the Department of the Treasury) in February of 2011 published the "green book"⁸ which outlined a proposal to limit the duration of perpetual or "dynastic" trusts to a maximum of 90 years at which time the exemption of generation skipping would expire. Technically, the generation skipping tax exclusion allocated to the trust would terminate on the 90th anniversary of the creation of the trust.⁹ That seems to be sufficiently long to accommodate the usual objectives of trustors other than to create a perpetual trust.

The key question

Do we want to place our economic system in jeopardy with such a short-sighted move as to see a substantial share of the country's wealth tied up in trust forever? Individuals emigrating to this country a century or two ago did so in large measure because of the promise of economic opportunity. The risks to our system of property rights and access to assets is too precious to sacrifice at the altar of rescuing banks and trust companies from the competition emanating from the 20 or so states that have been foolish enough to repeal the Rule Against Perpetuities. That rule was formulated in the 17th Century to prevent land from being tied up forever.

As legal philosophers have opined, "let's not let the dead hand of the past control the present." The author of that quote, Professor Lewis Simes, an esteemed legal philosopher, stated, in articulating two reasons for limits on how long property should be able to be tied up in trust (or otherwise), "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 they enjoy during life. . . . But, in my opinion, a second and even more important reason for the [Rule Against Perpetuities] is this. It is socially desirable that the wealth of the world be controlled by living members and not by the dead."¹⁰

ENDNOTES

¹ 3 Ch. Cas. 1, 22 Eng. Rep. 931 (Ch. 1682). That case concerned Henry, the 22nd Earl of Arundel, later the Duke of Norfolk.

² *Cadell v. Palmer*, 1 Cl. & Fin. 372, 6 Eng. Rep. 936 (H.L. 1832-1833).

³ E.g., Iowa Code § 558.68 (2011).

⁴ E.g., Minn. Stat. § 501A.01.

⁵ E.g., Alaska Stat. § 34.27.50, 34.27.051.

⁶ See Joint Editorial Board for the Uniform Probate Code, Legal Information Institute, Cornell University, Ithaca, New York.

⁷ *Id.*

⁸ General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals, Department of the Treasury, February 2011. The report is available at <http://www.treas.gov/offices/tax-policy/library/greenbk12.pdf>.

⁹ *Id.*

¹⁰ Simes, Public Policy and the Dead Hand 58-59 (1955).