

ISSN 1936-5349 (print)  
ISSN 1936-5357 (online)

# HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

PERPETUITIES, TAXES, AND ASSET  
PROTECTION: AN EMPIRICAL  
ASSESSMENT OF THE JURISDICTIONAL  
COMPETITION FOR TRUST FUNDS

Robert M. Sitkoff  
and  
Max M. Schanzenbach

Discussion Paper No. 609

05/2008

Harvard Law School  
Cambridge, MA 02138

This paper can be downloaded without charge from:

The Harvard John M. Olin Discussion Paper Series:  
[http://www.law.harvard.edu/programs/olin\\_center/](http://www.law.harvard.edu/programs/olin_center/)

The Social Science Research Network Electronic Paper Collection:  
[http://papers.ssrn.com/abstract\\_id=1095421](http://papers.ssrn.com/abstract_id=1095421)

This paper is also a discussion paper of the  
John M. Olin Center's Program on Corporate Governance

## Chapter 14

# Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds\*

ROBERT H. SITKOFF\*\*

MAX M. SCHANZENBACH\*\*\*

### Synopsis

#### ¶ 1400 Introduction

- ¶ 1400.1 First Empirical Study
- ¶ 1400.2 Prior Literature
- ¶ 1400.3 Difficulties in Empirical Study
- ¶ 1400.4 Broad Implications

#### ¶ 1401 Trust Laws Studied

#### ¶ 1402 The Rule Against Perpetuities

- ¶ 1402.1 Reform of the RAP
- ¶ 1402.2 The Race to Abolish the RAP
- ¶ 1402.3 Defining Abolition
- ¶ 1402.4 The Standard Story: The GST Tax
- ¶ 1402.5 An Alternative Story: Perpetual Control

#### ¶ 1403 Self-Settled Asset Protection Trusts

---

\* This chapter is based on Robert H. Sitkoff & Max M. Schanzenbach, "Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes," 115 *Yale Law Journal* 356 (2005), and Max M. Schanzenbach & Robert H. Sitkoff, "Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust," 27 *Cardozo Law Review* 2465 (2006). Readers are encouraged to consult those sources for more fulsome analysis and citations.

\*\* **Professor Robert H. Sitkoff:** Robert H. Sitkoff is the John L. Gray Professor of Law at Harvard Law School (rsitkoff@law.harvard.edu).

\*\*\* **Professor Max M. Schanzenbach:** Max M. Schanzenbach is Professor of Law at Northwestern University School of Law and is currently the Bruce W. Nichols Visiting Professor of Law at Harvard Law School (Spring 2008) (m-schanzenbach@law.northwestern.edu).

Professors Sitkoff and Schanzenbach are currently working on a series of empirical studies of trust law reforms that will form the core of a book that is under contract with Yale University Press.

<b>¶ 1400</b>	<b>2008 INSTITUTE ON ESTATE PLANNING</b>	<b>14-2</b>
	¶ 1403.1	Validation of APTs
	¶ 1403.2	Political Dynamic
	¶ 1403.3	Value of APTs
¶ 1404	Fiduciary Income Taxes	
	¶ 1404.1	Taxation of Trust Income
	¶ 1404.2	Perpetual Trusts and Fiduciary Income Taxes
	¶ 1404.3	Coding State Tax Rules
¶ 1405	Other Margins of Competition	
	¶ 1405.1	Directed Trustee Statutes
	¶ 1405.2	Trust Investment Laws
¶ 1406	Description of the Data	
¶ 1407	Graphical Analysis I: Since the GST Tax	
	¶ 1407.1	Delaware, New York, and South Dakota
	¶ 1407.2	Delaware and Comparison States
	¶ 1407.3	South Dakota and Comparison States
	¶ 1407.4	Illinois and Comparison States
	¶ 1407.5	Delaware, Illinois, New York, and South Dakota
¶ 1408	Graphical Analysis II: Prior to the GST Tax	
	¶ 1408.1	Idaho, Wisconsin, and Comparison States
	¶ 1408.2	South Dakota and Comparison States
	¶ 1408.3	South Dakota, Wisconsin, and Idaho
¶ 1409	Summary of Graphical Analysis	
¶ 1410	Econometric/Regression Analysis	
¶ 1411	Summary of Econometric Results	
	¶ 1411.1	The Rule Against Perpetuities
	¶ 1411.2	Fiduciary Income Taxes
	¶ 1411.3	Perpetuities and Fiduciary Income Taxes Together
	¶ 1411.4	Conclusions for Perpetuities and Taxes
	¶ 1411.5	Caveats for Perpetuities and Taxes
	¶ 1411.6	Self-Settled Asset Protection Trusts
¶ 1412	Conclusions	
	¶ 1412.1	Jurisdictional Competition
	¶ 1412.2	Situs and Choice of Law
	¶ 1413.3	The RAP is Dead
¶ 1414	Appendix: Dating of Trust Law Changes During the Period Under Study	
¶ 1400	Introduction	

By summer 2007, twenty-two states had validated perpetual trusts by abolishing the Rule Against Perpetuities<sup>1</sup> as applied to interests in trust. The driving force behind the repeal of the Rule was not a careful reconsideration of the common law policy against perpetuities, but rather a 1986 reform to the federal tax code. Under the 1986 Code (as

<sup>1</sup> We will also refer to the Rule Against Perpetuities as “the Rule” or “the RAP.”

## 14-3 JURISDICTIONAL COMPETITION FOR TRUST FUNDS ¶ 1400.2

amended through 2007), a transferor can pass \$1 million during life, or \$2 million at death, free from federal wealth transfer taxes. By passing this \$1 million or \$2 million in trust, a transferor can ensure that successive generations benefit from the trust fund, free from federal wealth transfer taxes, for as long as state perpetuities law will allow the trust to endure. In a state that has abolished the Rule, successive generations can benefit from the trust fund, free from subsequent federal wealth transfer taxation, forever.

### ¶ 1400.1 First Empirical Study

This chapter summarizes the results of the first academic, empirical study of the jurisdictional competition for trust funds. Based on state-level panel data assembled from annual reports to federal banking authorities by institutional trustees, we find that the interstate competition for trust funds is both real and intense. Our analysis indicates that, on average, through 2003 a state's abolition of the Rule Against Perpetuities increased its reported trust assets by about \$6 billion and its average trust account size by roughly \$200,000.

To put these figures in perspective, in 2003 the average state had roughly \$19 billion in reported trust assets and an average account size of about \$1 million. In the timeframe of our data, seventeen states abolished the Rule, *implying that through 2003 roughly \$100 billion—10% of total reported trust assets—moved as a result of the Rule's abolition.*<sup>2</sup> In addition, our findings highlight the importance of state fiduciary income taxes. Abolishing states only experienced an increase in trust business if the state also did not levy an income tax on trust funds attracted from out of state.

In sum, our findings provide strong evidence of a national market for trust funds that is responsive to the interplay between state trust law and state and federal tax law.

### ¶ 1400.2 Prior Literature

Prior to our study, the evidence of jurisdictional competition in trust law has been entirely anecdotal. Lawyers and bankers in New York and other states that have not abolished the Rule regularly complain about the loss of billions of dollars in trust business to South Dakota, Delaware, and other trust-friendly jurisdictions.<sup>3</sup> Anecdotes of competition have even been reported by popular media outlets such as the *Wall*

---

<sup>2</sup> The \$100 billion figure is only a point estimate. For discussion of this estimate and its confidence interval, see Sitkoff & Schanzenbach, *Jurisdictional Competition*, supra note \*, at 404 n.125.

<sup>3</sup> See, e.g., Charles F. Gibbs & Colleen F. Carew, *Trusts Leaving New York, Situs in Cyberspace: Time for Legislation?*, N.Y.L.J., Dec. 20, 2002, at 3 (“Our New York state trust banker friends have been proclaiming for some years now a substantial loss of trust business to Delaware, South Dakota, and other more-hospitable venues.”); Charles F. Gibbs & Marilyn Ordovery, *An Open Letter to Assemblywoman Ann Carrozza*, N.Y.L.J., Feb. 5, 2001, at 3 (arguing that “to remain competitive with the other states,” New York must repeal the RAP); Thomas Scheffey, *Is Immortality Just Around the Corner? “Dead Hand” Trust Law Relaxes Its Grip*, Conn. L. Trib., Mar. 4, 2002, at 10 (noting that the Connecticut legislature was considering a revision of the Rule “in an effort to keep legal and banking work for ultra-rich clients from migrating to states with friendlier trust laws”).

**¶ 1400.3****2008 INSTITUTE ON ESTATE PLANNING****14-4**

*Street Journal, New York Times, and Forbes Magazine.*<sup>4</sup>

In spite of the anecdotal evidence, before our study there were at least two reasons to doubt the magnitude of the jurisdictional competition for trust funds. First, no state collects a filing or other fee on the creation of a private trust under its law, and several of the leading jurisdictions that have abolished the Rule do not levy an income tax on trust funds attracted from out of state.<sup>5</sup> Hence, in these states there is no direct state revenue payoff from attracting trust funds.

Second, the main tax benefits of a trust not subject to the Rule Against Perpetuities accrue not to the donor, but to beneficiaries whose interest in the trust will not vest within twenty-one years of the death of a life in being at the time the trust became irrevocable. Hence, as compared with an ordinary in-state trust, the added benefits of settling an out-of-state perpetual trust flow to beneficiaries who are remote descendants unknown to the donor.<sup>6</sup>

**¶ 1400.3 Difficulties in Empirical Study**

The absence of empirical study of the jurisdictional competition for trust funds represents a gaping hole in the literature. This lacuna stems from the difficulties that inhere in such a project.

Because inter vivos trusts are private arrangements for which there are no public filings, it is commonly assumed that trust data is unavailable. Jesse Dukeminier and James Krier, authors of a widely used casebook on property law, believe that “[i]t is difficult to get hard data on the popularity of perpetual trusts among consumers.”<sup>7</sup> Eric Rakowski has written that “[t]here is no way to count [perpetual trusts] with certainty.”<sup>8</sup> The English Law Commission, which in the 1990s was tasked with making recommendations on perpetuities reform in England, “considered the possi-

---

<sup>4</sup> See Carole Gould, *Shifting Rules Add Luster to Trusts*, N.Y. Times, Oct. 29, 2000, § 3, at 11; Rachel Emma Silverman, *Building Your Own Destiny: States Toss Out Restrictions on Creating Perpetual Trusts; Downside—Fees Lost Forever, Too*, Wall St. J., Sept. 15, 2004, at D1; John Turrettini, *Providing for the Year 3000*, Forbes, June 11, 2001, at 220. In February 2005, the Wall Street Journal published an article summarizing our research as reported in an early draft. Rachel Emma Silverman, *Looser Trust Laws Lure \$100 Billion*, Wall St. J., Feb. 16, 2005, at D1.

<sup>5</sup> More precisely, these states do not levy a tax on income in a trust consisting of stocks, bonds, and other financial assets if the trust was settled by a nonresident for the benefit of nonresidents, even if an in-state bank or trust company serves as trustee and the trust provides that it is to be governed by the law of that state.

<sup>6</sup> For example, suppose that the donor’s grandchild is living at the time the trust becomes irrevocable. That grandchild is a measuring life validating a remainder in that grandchild’s unborn children, who would be the transferor’s great-grandchildren. In such a scenario, assuming the trust is for that particular grandchild’s branch of the family only, the first generation for which abolition of the Rule would make a difference is that of the donor’s great-great-grandchildren, who share only a 6.25% genetic overlap with the donor. We thank Lawrence Waggoner for suggesting the genetic calculation.

<sup>7</sup> Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. Rev. 1303, 1315 (2003).

<sup>8</sup> Eric Rakowski, *The Future Reach of the Disembodied Will*, 4 Pol. Phil. & Econ. 91, 124 n.8 (2005).

## 14-5 JURISDICTIONAL COMPETITION FOR TRUST FUNDS ¶ 1400.4

bility of commissioning a full study of the economic implications of abolishing the rule,” but declined to do so “because it proved impossible to obtain sufficient data.”<sup>9</sup>

Further, the domestic perpetual trust phenomenon exists at the intersection of several varied and complex bodies of law, including the Rule Against Perpetuities, federal wealth transfer taxes, and state fiduciary income taxes. Designing an empirical study of the perpetual trust phenomenon thus requires sensitivity to each of those fields.

Finally, to avoid omitting other potentially relevant variables, empirical study of the perpetual trust phenomenon requires accounting for other possible margins of jurisdictional competition for trust funds. Perhaps the most significant is the rise of the self-settled asset protection trust. Contrary to traditional law, in a jurisdiction that has validated self-settled asset protection trusts, the settlor can shield assets from his or her creditors by placing those assets in a trust for his or her own benefit.

### ¶ 1400.4 Broad Implications

We find strong evidence that transferors have been escaping the Rule’s application at an increasingly rapid pace since the mid-1990s. Although neither the federal wealth transfer taxes nor the interstate competition for trust funds relates to the policies underpinning the Rule, together they have mortally wounded the Rule by reducing it to a mere transaction cost. Accordingly, to the extent that the Rule’s anti-dead-hand policy continues to have contemporary relevance, it is necessary to look elsewhere to implement that policy—for example, to the law of trust modification and termination.

Our results are also relevant to the ongoing policy debate in Congress and elsewhere over the future of federal wealth transfer taxation.<sup>10</sup> A principal tax policy underlying the 1986 code, the relevant features of which remain in effect today, is to prevent the “enjoyment of property followed by its movement down the generations without being subjected to estate or gift tax.”<sup>11</sup> If Congress wants to put this policy into practice, it will need to close the loophole opened by the states that have abolished the Rule Against Perpetuities. Successful implementation of federal tax policy necessarily requires attention to its interaction with state property law.

On a theoretical level, our findings are relevant to the ongoing scholarly debate over the nature of jurisdictional competition. Even if attracting business does not directly increase the state’s tax revenue, local interest groups nonetheless may benefit from, and hence lobby for, laws that will attract business to the state. Thus, the critical question for social welfare is whether local interest group preferences will be aligned with good or bad social policy.

---

<sup>9</sup> English Law Comm’n, Report No. 251, *The Rules Against Perpetuities and Excessive Accumulations* 20 (1998), available at <http://www.lawcom.gov.uk/docs/lc251.pdf>.

<sup>10</sup> See, e.g., Staff of J. Comm. on Taxation, 109th Cong., *Options To Improve Tax Compliance and Reform Tax Expenditures* 392–424 (Comm. Print 2005), available at <http://www.house.gov/jct/s-2-05.pdf>.

<sup>11</sup> Jeffrey N. Pennell, *Wealth Transfer Planning and Drafting* ch. 18, at 27 (2005).

**¶ 1401****2008 INSTITUTE ON ESTATE PLANNING****14-6****¶ 1401 Trust Laws Studied**

We examine the effect of abolishing the Rule Against Perpetuities on a state's trust business. To do so, we must also account for other state trust and tax laws that might influence a donor's choice of jurisdiction. Accordingly, we begin by reviewing: (1) the Rule Against Perpetuities; (2) the controversial authorization of self-settled asset protection trusts; and (3) the state income taxation of trust funds attracted from out of state.

**¶ 1402 The Rule Against Perpetuities**

The Rule Against Perpetuities prohibits remote vesting of property interests. The classic formulation is that of John Chipman Gray: "No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest."<sup>12</sup> The period of the Rule reflects a common law policy that a transferor should be allowed to tie up property only for so long as the life of anyone possibly known to the transferor plus the period of the next generation's minority (hence lives in being plus twenty-one years).

The Rule is said to have two purposes: (1) to keep property marketable, and (2) to limit "dead-hand" control. Preventing indefinite fracturing of property ownership implements the first purpose. The Rule ensures that land periodically will be reconstituted into fee simple because all contingent future interests in the property must vest or fail within the perpetuities period.

The dead-hand rationale for the Rule is best understood as a response to the disagreeable consequences that can arise from unanticipated circumstances. The Rule implements this anti-dead hand policy by curbing future interests that, after some period of time and change in circumstances, tie up the property in potentially disadvantageous arrangements. Forever is a long time.

Measured against its purposes, the Rule is both underinclusive and overinclusive. The Rule is underinclusive because it only applies to contingent interests, but vested interests that will not become possessory for a long time can also compromise the Rule's underlying policy objectives. It is overinclusive because if the trustee is given the power to sell the trust property and reinvest the proceeds, as is typical, there is no concern with marketability.<sup>13</sup> Nonetheless, the prevailing academic view is that the Rule "does, by and large, effectively prevent tying up property for an inordinate length of time."<sup>14</sup>

**¶ 1402.1 Reform of the RAP**

Under the orthodox what-might-happen possibilities test, even extremely remote

---

<sup>12</sup> John Chipman Gray, *The Rule Against Perpetuities* § 201, at 191 (4th ed. 1942).

<sup>13</sup> Today, because almost all life estates and future interests are created in trust rather than as legal interests, the Rule's primary application is to interests in trusts funded with stocks, bonds, and other liquid financial assets.

<sup>14</sup> Jesse Dukeminier, Stanley M. Johanson, James Lindgren, & Robert H. Sitkoff, *Wills, Trusts, and Estates* 675 (7th ed. 2005).

## 14-7 JURISDICTIONAL COMPETITION FOR TRUST FUNDS ¶ 1402.1

possibilities can render a contingent future interest invalid. As a result, the law books are replete with improbable and bizarre occurrences such as childbearing octogenarians and toddlers, unborn widows, inexhaustible gravel pits, wars that never end, slothful executors, and explosive birthday presents.<sup>15</sup>

Eventually, dissatisfaction with the Rule's exasperating complexities, absurd assumptions, and booby traps led to reform to stay what Barton Leach famously called "the slaughter of the innocents" in the Rule's "reign of terror."<sup>16</sup> Some states enacted statutory fixes for specific fantasy scenarios, in particular the unborn widow and the fertile octogenarian. Other states authorized the courts to reform instruments that otherwise would have been void ab initio. Still other states adopted the so-called wait-and-see principle whereby courts wait to see if, in light of actual instead of possible events, the interest will in fact vest or fail within the allowable period.

The culmination of the twentieth-century perpetuities reform movement was the Uniform Statutory Rule Against Perpetuities (USRAP) of 1986. USRAP, some form of which is now in force in about half the states, provides for a wait-and-see period of ninety years and authorizes reformation of instruments that would otherwise violate the Rule.<sup>17</sup>

A related response to the Rule's dangers was the development of the perpetuities saving clause. Such a clause ensures that an overlooked violation of the Rule will not render the trust invalid. The use of a saving clause is standard good drafting practice.<sup>18</sup>

In sum, the unifying theme of the perpetuities reform movement through 1995—except in Idaho, South Dakota, and Wisconsin, which for reasons that are not entirely clear abolished their Rules by 1957, 1983, and 1969 respectively<sup>19</sup>—was continuing respect for the long-standing policy against remote vesting. Even in its reformed versions and buffered by saving clauses, the Rule required contingent interests to vest or fail within a specified period. For this reason, for most of the

---

<sup>15</sup> See, e.g., *id.*, at 678–86.

<sup>16</sup> W. Barton Leach, *Perpetuities in Perspective: Ending the Rule's Reign of Terror*, 65 *Harv. L. Rev.* 721 (1952); W. Barton Leach, *Perpetuities: Staying the Slaughter of the Innocents*, 68 *L.Q. Rev.* 35 (1952).

<sup>17</sup> Both wait-and-see in general and USRAP in particular sparked heated debate in the law reviews that Susan French aptly dubbed the "Perpetuities Wars." Susan F. French, *Perpetuities: Three Essays in Honor of My Father*, 65 *Wash. L. Rev.* 323, 332–34 (1990); see also Sitkoff & Schanzenbach, *Jurisdictional Competition*, *supra* note \*, at 366–69 (recounting the perpetuities wars and collecting citations).

<sup>18</sup> Hence, contrary to a pernicious leading case, see *Lucas v. Hamm*, 364 P.2d 685 (Cal. 1961), it is almost certainly malpractice to draft an instrument that violates the Rule and lacks a saving clause. See *Wright v. Williams*, 121 Cal. Rptr. 194, 199 n.2 (Ct. App. 1975); Joseph William Singer, *Introduction to Property* § 7.7.4, at 333 (2d ed. 2005).

<sup>19</sup> Wisconsin may have abolished its Rule even earlier (indeed, Wisconsin may never have had the Rule). See W. Barton Leach, *Perpetuities: The Nutshell Revisited*, 78 *Harv. L. Rev.* 973, 974–75 (1965). We need not resolve the status of the Rule in Wisconsin prior to 1969, however, because our data does not begin until that year.



**¶ 1402.2****2008 INSTITUTE ON ESTATE PLANNING****14-8**

twentieth century the Rule limited the duration of trusts.<sup>20</sup>

**¶ 1402.2 The Race to Abolish the RAP**

Unlike prior reform efforts, which preserved the Rule's core prohibition against remote vesting, beginning in the mid-1990s a movement arose to repeal the Rule as applied to interests in trust. This movement appears to have originated in Delaware, which abolished its Rule in 1995.<sup>21</sup> The official synopsis of the Delaware legislation states its purpose plainly:

Several states, including Idaho, Wisconsin and South Dakota, have abolished altogether their rules against perpetuities, which has given those jurisdictions a competitive advantage over Delaware in attracting assets held in trusts created for estate planning purposes. . . .

The multi-million dollar capital commitments to these irrevocable trusts, and the ensuing compound growth over decades, will result in the formation of a substantial capital base in the innovative jurisdictions that have abolished the rule against perpetuities. Several financial institutions have now organized or acquired trust companies, particularly in South Dakota, at least in part to take advantage of their favorable trust law.

Delaware's repeal of the rule against perpetuities for personal property held in trust will demonstrate Delaware's continued vigilance in maintaining its role as a leading jurisdiction for the formation of capital and the conduct of trust business.<sup>22</sup>

In response, Alaska, Arizona, Illinois, Maine, Maryland, New Jersey, Ohio, and Rhode Island authorized perpetual trusts by year-end 2000. By late 2007, Colorado, Florida (360 years), Missouri, Nebraska, Nevada (360 years), New Hampshire, North Carolina, Pennsylvania, Utah (1,000 years), Virginia, and Wyoming (1,000 years) had followed suit. The legislative history and contemporaneous media coverage of these repeals indicate that their purpose was to compete for so-called dynasty trust funds, meaning perpetual transfer-tax-exempt trusts.

Figure 1 illustrates the extent of the Rule's abolition at year-end 2007.

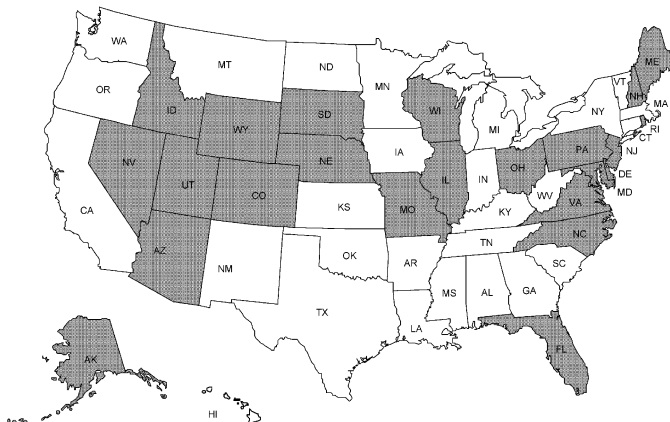
---

<sup>20</sup> Because the Rule prohibits vesting outside of the applicable perpetuities period, the identity of all persons with a claim to the underlying trust property will be ascertained within that period. Once all the beneficiaries are ascertained, they can terminate the trust when the perpetuities period ends. See Restatement (Second) of Property, Donative Transfers § 2.1 (1983). If the beneficiaries do not terminate the trust, the trust corpus will be distributed to the principal beneficiaries when the preceding life estates expire.

<sup>21</sup> See Act of July 7, 1995, 70 Del. Laws 428 (1995).

<sup>22</sup> H.R. 245, 138th Gen. Assemb. (Del. 1995) (bill synopsis).

Figure 1: Perpetual Trust States (2007)



### ¶ 1402.3 Defining Abolition

We must acknowledge some doctrinal nuances that we gloss over when we speak of the Rule's abolition. Some states have abolished the Rule entirely. Some states have abolished it as applied to interests in trust if the trustee has the power to sell the trust assets and then reinvest the proceeds (in the technical jargon, as applied to trusts that do not suspend the power of alienation). Some states have abolished the Rule as applied to interests in personal property. Some have established such lengthy perpetuities periods (360 or even 1,000 years) that in those states the Rule is barely recognizable. In still others, the Rule, which had always been construed as a mandatory rule to curtail the dead hand,<sup>23</sup> has been changed to a default rule that applies unless the settlor provides otherwise.

The distinctions between the foregoing approaches have been carefully parsed elsewhere.<sup>24</sup> For the purpose of our empirical analysis, all that matters is whether the

<sup>23</sup> Gray expressed this view in stronger language:

The Rule against Perpetuities is not a rule of construction, but a peremptory command of law. It is not, like a rule of construction, a test, more or less artificial, to determine intention. Its object is to defeat intention. Therefore every provision in a will or settlement is to be construed as if the Rule did not exist, and then to the provision so construed the Rule is to be remorselessly applied.

Gray, *supra* note 12, § 629.

<sup>24</sup> See Note, *Dynasty Trusts and the Rule Against Perpetuities*, 116 *Harv. L. Rev.* 2588, 2590–95 (2003). Readers familiar with the more arcane features of property law might wonder about the rule against accumulations of income. In Delaware, Illinois, and South Dakota, which are among the leading perpetual trust states, the legislatures have dealt with this question expressly. See *Del. Code Ann.*, tit. 25, § 506 (Supp. 2004); 765 *Ill. Comp. Stat.* 315/1 (2001); 1998 *S.D. Sess. Laws*, ch. 282, § 27. In states without legislative action, the law is less clear. But the common law accumulations period is the same as the perpetuities period. Thus, if the perpetuities period with respect to a particular trust is extended by repeal of the Rule, then the permissible accumulations period should be likewise extended. See Robert H. Sitkoff, *The Lurking Rule Against Accumulations of Income*, 100 *Nw. U. L. Rev.* 501 (2006).

**¶ 1402.4****2008 INSTITUTE ON ESTATE PLANNING****14-10**

state's perpetuities law permits what is in effect a perpetual trust. If the answer is yes, we count the state as having abolished the Rule. Our coding is detailed in the Appendix.

**¶ 1402.4 The Standard Story: The GST Tax**

The dominant view among both scholars and policymakers is that the enactment of the generation skipping transfer (GST) tax in 1986 sparked the movement to abolish the Rule. Mass media outlets such as the *Wall Street Journal*, the *New York Times*, and *Forbes* magazine tell a similar story.<sup>25</sup>

Prior to 1986, the estate tax could be avoided via successive life interests, for example, by leaving property to one's child for life, then to one's grandchild. Because a life tenancy terminates at death and the estate tax is levied only on the decedent's transferable interests, in the foregoing example there would be no tax when, on the death of the transferor's child, the transferor's grandchild's interest became possessory.

The 1986 GST tax closed the successive-life-estates loophole by levying a tax equal to the highest rate of the estate tax on any generation-skipping transfer.<sup>26</sup> In rough terms, a transfer to a grandchild, great-grandchild, or any other person who is two or more generations below the transferor is a generation-skipping transfer.<sup>27</sup>

However, under the 1986 code (as amended) a transferor can pass \$1 million during life, or \$2 million at death, free from federal wealth transfer taxes, including the GST tax.<sup>28</sup> By funding a trust with the amount of the transferor's exemption, successive generations can benefit from the trust fund and any appreciation therein, free from federal wealth transfer taxes, for as long as state perpetuities law will allow the trust to endure.

Crucially, Congress put no limit on the duration of a transfer-tax-exempt trust, leaving that question to state perpetuities law.<sup>29</sup> Enactment of the GST tax therefore gave state perpetuities law renewed salience among estate planners. The longer a transfer-tax-exempt trust could be extended, the more generations could benefit from the trust fund free from transfer taxes. In a state that has abolished the Rule, successive generations can benefit from the trust fund, free from subsequent federal wealth transfer taxation, forever.

On this view, the movement to abolish the Rule is perhaps more precisely described

---

<sup>25</sup> See sources cited in *supra* note 4.

<sup>26</sup> The maximum rates are as follows: 49% in 2003; 48% in 2004; 47% in 2005; 46% in 2006; and 45% in 2007-09. I.R.C. §§ 2641, 2001.

<sup>27</sup> See I.R.C. § 2651 (defining generational assignments); *id.* § 2613 (defining skip and non-skip persons); *id.* § 2611 (defining generation-skipping transfer); *id.* § 2612 (defining taxable events).

<sup>28</sup> The exemption schedule is as follows: through 2003, \$1,000,000; in 2004 and 2005, \$1,500,000; in 2006 through 2008, \$2,000,000; and in 2009, \$3,500,000. I.R.C. §§ 2631(c), 2010(c).

<sup>29</sup> "When Congress originally enacted a tax on generation-skipping transfers, it noted that '[m]ost States have a rule against perpetuities which limits the duration of a trust.'" JCT Report, *supra* note 10, at 394.

## 14-11 JURISDICTIONAL COMPETITION FOR TRUST FUNDS ¶ 1402.5

as a race between the states to allow donors to exploit a loophole in the federal transfer taxes.

### ¶ 1402.5 An Alternative Story: Perpetual Control

In spite of the intuitive appeal of the foregoing tax-avoidance story, there are good reasons to suppose that perpetual trusts had (and continue to have) appeal independent of the influence of the GST tax.

First, the legislative record of South Dakota's 1983 repeal, although scanty, implies that the purpose of repeal was to attract trust business to the state<sup>30</sup>—and South Dakota's repeal occurred three years prior to the enactment of the GST tax. Hence it appears that, prior to the GST tax, lawyers and bankers in South Dakota concluded that offering perpetual trusts would attract trust business to the state.

Second, in a recent study of donor preferences, Joshua Tate examined the online promotion of perpetual trusts. Tate concluded that “while tax concerns are very important,” perpetual trust settlors also “want to make sure that their money is put to good use” and is protected “from beneficiaries’ bad judgment or misfortune.”<sup>31</sup>

Finally, history is replete with efforts by one generation to control subsequent generations’ disposition of the family patrimony.<sup>32</sup> On this view, the perpetual trust might be reckoned the modern counterpart to the fee tail and strict settlement.

---

<sup>30</sup> South Dakota's Legislative Research Council (LRC) maintains the legislative history for bills introduced prior to 1997. See How to Compile Legislative History Using the Legislative Research Council Website, <http://legis.state.sd.us/general/leghist.htm> (last visited April 21, 2008). In response to a request by the law library of Northwestern University for copies of the records pertaining to South Dakota's repeal of the RAP, the LRC sent the following: (1) a one-page chronology of the steps leading up to the bill's passage copied from the 1983 House Bills Index; (2) the bill's language; and (3) the voting records of the House and Senate Judiciary Committees copied from the House and Senate Journals. None of these materials contains a reference to the reason for repealing the RAP. However, a voting record sheet of the House Judiciary Committee indicates that Tom Shelby, a Vice President at the Sioux Falls branch of the First Bank of South Dakota, and Dick Bogue, an attorney from Canton, testified in favor of repeal on February 23, 1983. Hearing Before the H. Judiciary Comm., 58th Leg. (S.D. Feb. 2, 1983) (statements of Tom Shelby and Dick Bogue).

<sup>31</sup> See Joshua C. Tate, Perpetual Trusts and the Settlor's Intent, 53 U. Kan. L. Rev. 595, 620–25 (2005). Tate explained:

While most settlors certainly want to pass tax savings down to their descendants, that is not the only apparent goal: settlors also wish to protect their wealth from being wasted and to encourage their descendants to be productive members of society. Moreover, although it may be true that most settlors do not care about their unborn descendants, some of them might, and those who do probably want their spendthrift provisions and restrictions on the use of funds to continue indefinitely.

Id. at 620.

<sup>32</sup> Perhaps the most notorious is that of Peter Thellusson, who died in 1797. See Leach, Terror, supra note 16, at 726 (stating that the “family-dynasty mentality flourished in the eighteenth century and reached a fine fruition in the will of Peter Thellusson”). Thellusson's will provided that the bulk of his considerable estate, plus all the income it would earn during the lives of the nine male descendants who survived him, should be accumulated for the ultimate benefit of his oldest male descendant at the end of that period. See Patrick Polden, Peter Thellusson's Will of 1797 and Its Consequences on Chancery Law (2002); Sitkoff, supra note 24.

## ¶ 1403

## 2008 INSTITUTE ON ESTATE PLANNING

14-12

## ¶ 1403 Self-Settled Asset Protection Trusts

A longstanding principle of trust law holds that the settlor cannot shield assets from his or her creditors by placing them in a trust for his or her own benefit. Even if the trust is discretionary, spendthrift, or both, the settlor's creditors can reach the maximum amount that the trustee can pay the settlor or apply for the settlor's benefit.<sup>33</sup> Thus:

Suppose *O*, a surgeon, transfers property to *X* in trust to pay so much of the income and principal to *O* as *X* determines in *X*'s sole and absolute discretion. Five years later, *O* botches a routine surgery, causing grievous injury to the patient, *A*. *A* may enforce an award of damages against the entire corpus of the trust, because *X* could, in *X*'s discretion, pay the entire corpus to *O*. This result obtains even if the trust instrument provides that *O*'s interest may not be reached by *O*'s creditors (a spendthrift clause). Nor does it matter that *O*'s right to the trust assets is subject to *X*'s discretion.

In the latter part of the twentieth century, however, several offshore and domestic jurisdictions enacted statutes that reverse the traditional rule, thereby giving rise to the self-settled asset protection trust (APT). If such a statute were applicable in the foregoing example, then *A* would have no recourse against the trust assets even if *O* admitted to botching *A*'s surgery and put up no defense in the malpractice suit.

## ¶ 1403.1 Validation of APTs

The story of the recognition of APTs begins in the sunny Caribbean, South Pacific, and other exotic offshore locales. In the 1980s, a host of such jurisdictions—including the Bahamas, Barbados, Belize, Bermuda, Cayman Islands, Cook Islands, Cyprus, Gibraltar, Grenada, Liechtenstein, Mauritius, Nevis, Samoa, St. Lucia, and Turks and Caicos—amended their trust laws to allow the creation of a self-settled trust against which the settlor's creditors have no recourse.<sup>34</sup> Although it has been conjectured that the value of offshore APTs exceeds \$1 trillion,<sup>35</sup> no reliable estimate exists.

The APT migrated onshore in 1997 in the form of an innovative Alaska statute. This statute was drafted by a prominent New York trust lawyer, his brother (who is now the

---

<sup>33</sup> See Restatement (Second) of Trusts § 156 (1959). These rules are carried forward in Restatement (Third) of Trusts §§ 58(2), 60 cmt. f (2003); and Unif. Tr. Code § 505 (2000).

<sup>34</sup> See Denis Kleinfeld, Choosing an Offshore Jurisdiction, in *Asset Protection Strategies: Planning with Domestic and Offshore Entities* 73 (Alexander A. Bove, Jr. ed., 2002); Elena Marty-Nelson, Offshore Asset Protection Trusts: Having Your Cake and Eating It Too, 47 *Rutgers L. Rev.* 11, 62 (1994). The Cook Islands' International Trusts Act of 1984, which is representative, validates self-settled spendthrift trusts, provided that the beneficiary is not a resident of the Cook Islands. International Trusts Act 1984 (No. 14) §§ 2, 5(1) (Cook Islands), reprinted as amended in 2 *International Trust Laws*, at D8-3, D8-3, D8-6 (1999). As Sterk has observed, this qualification is "a sure sign that the purpose of the statute was to attract foreign capital." Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 *Cornell L. Rev.* 1035, 1048 (2000).

<sup>35</sup> See Walter H. Diamond, Foreword to 1 *International Trust Laws and Analysis* (Walter H. Diamond et al. eds., 2004); see also Sterk, supra note 34, at 1036 (stating that "conservative estimates exceed one trillion dollars").

## 14-13

## JURISDICTIONAL COMPETITION FOR TRUST FUNDS

## ¶ 1403.1

head of the Alaska Trust Company), and an Alaska lawyer. The three had the idea while on a fishing trip in Alaska.<sup>36</sup> Under the Alaska statute, the settlor's creditors have no recourse against the settlor's interest in a self-settled discretionary trust provided that the initial transfer was not fraudulent.<sup>37</sup> To ensure a local payoff, Alaska statutory law provides for both jurisdiction in the Alaska courts and the applicability of Alaska law if an Alaska resident or banking institution is designated as trustee and some of the trust assets are deposited with an Alaska institution.<sup>38</sup>

In 1997 Delaware likewise validated APTs.<sup>39</sup> The official synopsis of the Delaware bill states that it "is similar to legislation recently enacted in Alaska. It is intended to maintain Delaware's role as the most favored domestic jurisdiction for the establishment of trusts."<sup>40</sup> Since then, Nevada (1999), Rhode Island (1999), Oklahoma (2004), Utah (2004), probably Missouri (2005), South Dakota (2005), Tennessee (2007), and Wyoming (2007) have also passed statutes that authorize some form of APT.

---

<sup>36</sup> See Douglas J. Blattmachr & Jonathan G. Blattmachr, A New Direction in Estate Planning: North to Alaska, *Tr. & Est.*, Sept. 1997, at 48; James L. Dam, New Trusts Will Offer Estate Tax Breaks, Protection from Creditors, *Law. Wkly.*, Apr. 21, 1997, at 1 (including a photograph of one of the fish caught); Brigid McMenamin, Flimsy Shelters, *Forbes*, Sept. 8, 1997, at 94; Alaska Trust Co., The Genesis of the Alaska Trust Company, the Alaska Trust Act, and Other Unique Trust Legislation, <http://www.alaskatrust.com/www/thegen.html>. Representative Al Vezey sponsored the legislation. See Hearing on H.B. 101 Before the H. Comm. on Labor & Commerce, 20th Leg. (Alaska 1997) (statement of Rep. Vezey); Rose Ragsdale, Opposing Parties Join Forces To Attract Family Trust Industry to Alaska, *Alaska J. Com.*, Apr. 14, 1997, at 6. On passage of the Act the local media and Alaska lawyers and bankers predicted a substantial inflow of trust business. See Katharine Fraser, With New Law, Alaska Aiming To Be Trust Capital, *Am. Banker*, Apr. 21, 1997, at 1; Carrie Lehman, Legislation Changes Alaska Tax, Trust Laws, Attracts New Investors to State, *Alaska J. Com.*, Aug. 18, 1997, at 6; Deanna Thomas, Trust Bill Could Mean Boon, *Alaska Star*, Mar. 20, 1997, at 1.

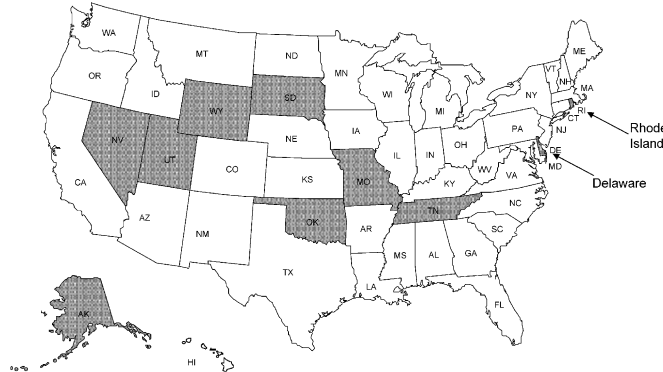
<sup>37</sup> Alaska Stat. § 34.40.110 (2004).

<sup>38</sup> *Id.* § 13.36.035. Another provision authorizes the transfer of existing trusts to Alaska. *Id.* § 13.36.043.

<sup>39</sup> Del. Code Ann. tit. 12, §§ 3570-3576 (2001). The Delaware statute carves out an exception for support claims by children and former spouses and for claims arising from death, personal injury, or property damage that occurred before the trust was settled. *Id.* § 3573.

<sup>40</sup> H.R. 356, 139th Gen. Assemb., 71 Del. Laws 159 (1997); see Douglas J. Blattmachr & Richard W. Hompesch II, Alaska vs. Delaware: Heavyweight Competition in New Trust Laws, *Prob. & Prop.*, Jan./Feb. 1998, at 32; Todd Spangler, Delaware Again 1st in Trusts, *Anchorage Daily News*, July 29, 1997, at F1.

Figure 2: Self-Settled Asset Protection Trust States (2007)



### ¶ 1403.2 Political Dynamic

The political dynamic driving the validation of APTs is similar to that which drives the movement to abolish the Rule Against Perpetuities. Local bankers and lawyers, who stand to benefit from an influx of trust assets, are the principal supporters of APTs. However, the motivation for use of a perpetual trust is different from the motivation for the use of an APT. The desire to provide a transfer-tax-exempt trust for future generations motivates use of the former. The desire to limit personal liability exposure motivates use of the latter.

For example, there is anecdotal evidence that, in the face of rising premiums, some doctors have opted to drop their malpractice insurance in favor of moving their assets into an APT (this is the motivation for the hypothetical in ¶ 1403 above).<sup>41</sup> Indeed, the validation of APTs is sometimes defended on the ground that tort liability is “out of control.”<sup>42</sup> On this account, APTs “might be reckoned as the revenge of the trust lawyers against the tort lawyers.”<sup>43</sup>

### ¶ 1403.3 Value of APTs

It remains to be seen whether the courts of states that adhere to the traditional rule will respect domestic APTs.<sup>44</sup> In spite of this uncertainty, however, validation of APTs

<sup>41</sup> See Rachel Emma Silverman, *Litigation Boom Spurs Efforts To Shield Assets*, Wall St. J., Oct. 14, 2003, at D1; Rachel Emma Silverman, *So Sue Me: Doctors Without Insurance*, Wall St. J., Jan. 28, 2004, at D1.

<sup>42</sup> Roundtable Discussion, 32 Vand. J. Transnat’l L. 779, 792–93 (1999) (statement of Eric Henzy).

<sup>43</sup> Dukeminier et al., *supra* note 14, at 558.

<sup>44</sup> Although there are not yet any definitive appellate decisions involving domestic APTs, there is a cautionary scholarly literature that explores bankruptcy law, fraudulent conveyance law, choice-of-law rules, federal constitutional considerations (such as the Full Faith and Credit Clause), and other doctrinal bases for refusing enforcement. This literature also takes on the normative policy question. See, e.g., Karen E. Boxx, *Gray’s Ghost—A Conversation About the Onshore Trust*, 85 Iowa L. Rev. 1195 (2000); John K. Eason, *Developing the Asset Protection Dynamic: A Legacy of Federal Concern*, 31 Hofstra L. Rev. 23 (2002); Randall J. Gingiss, *Putting a Stop to “Asset Protection” Trusts*, 51 Baylor L. Rev. 987

## 14-15 JURISDICTIONAL COMPETITION FOR TRUST FUNDS ¶ 1404.1

is a potentially important distinguishing feature of state law in the jurisdictional competition for trust funds. To the extent that an APT gives the settlor additional leverage in settlement negotiations with creditors, the APT has value, although just how much is uncertain.<sup>45</sup> Thus, as with the abrogation of the Rule Against Perpetuities, validation of APTs has the potential to attract trust funds. We code for APTs as indicated in the appendix.

### ¶ 1404 Fiduciary Income Taxes

Suppose *O*, a prospective settlor who resides in state *A*, wants the law of state *B* to govern the administration and validity of her trust. In such circumstances, *O* will often be advised not only to designate in the trust instrument that the law of state *B* is to govern, but also to name a bank or trust company located in state *B* as trustee. In doing so, a relevant concern to the settlor is whether as a result state *B* will levy a tax on the trust's income. Such a tax is called a fiduciary income tax (FIT) because the fiduciary is responsible for filing the return and paying the tax.

#### ¶ 1404.1 Taxation of Trust Income

To ascertain whether differences in state FIT regimes affect the location of trust funds, we must first attend to the federal taxation of trust income, under which trusts are treated as conduit or passthrough entities.<sup>46</sup> Income distributed to a beneficiary in the year it is received is taxable to the beneficiary, not to the trust; income that is not so distributed is taxable to the trust, not the beneficiary. Hence, from the perspective of minimizing federal income taxes, trust income should be distributed or accumulated depending on the relative applicable tax rates. In the primary period under study, the rates applicable to individuals were significantly lower than those applicable to trusts.<sup>47</sup> The Internal Revenue Code thus creates an incentive for trust income to be distributed to the beneficiary in the year it is received.<sup>48</sup>

---

(1999); Henry J. Lischer, Jr., *Domestic Asset Protection Trusts: Pallbearers to Liability?*, 35 *Real Prop. Prob. & Tr. J.* 479 (2000); Sterk, *supra* note 34. For a contrary academic view, see Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 *Hastings L.J.* 287 (2002). Offshore APTs have met judicial hostility, see, e.g., *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002); *FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999), though some view these cases as cautionary tales on how not to draft an offshore trust. See Alexander A. Bove, Jr., *Drafting Offshore Trusts, Tr. & Est.*, July 2004, at 44, 45–46.

<sup>45</sup> Eric Henzy, who represented the plaintiff in *In re Brooks*, 217 B.R. 98 (Bankr. D. Conn. 1998), explained: "In *Brooks* we got a judgment essentially voiding this offshore trust. We then settled for approximately fifty cents on the dollar, because the enforcement problems were so significant." Roundtable Discussion, *supra* note 42, at 786 (statement of Eric Henzy).

<sup>46</sup> See Jeffrey G. Sherman, *All You Really Need To Know About Subchapter J You Learned from This Article*, 63 *Mo. L. Rev.* 1, 12 (1998).

<sup>47</sup> See *id.*, at 5, 37–38; [1987] 1 *Stand. Fed. Tax Rep. (CCH)* ¶ 421.05, at 10,052. The current rates are stated in I.R.C. § 1(a)-(d) for individuals and I.R.C. § 1(e) for estates and trusts.

<sup>48</sup> Even if the trustee has discretion not to make distributions, the trustee's duty of prudence requires reasonable efforts to minimize taxes. See Mark L. Ascher, *The Fiduciary Duty To Minimize Taxes*, 20 *Real Prop. Prob. & Tr. J.* 663 (1985).



**¶ 1404.2****2008 INSTITUTE ON ESTATE PLANNING****14-16**

States that levy a FIT tend to follow a similar conduit model.<sup>49</sup> As a result, for many trusts state FITs are avoided in the course of avoiding federal income taxes. We therefore hypothesize that, by itself, whether a state levies a FIT on trust funds attracted from out of state will have at best an attenuated observable effect on trust fund location.

To be clear, we do not claim that state FITs do not affect trust situs choices. For example, settlors of trusts that are likely to realize significant capital gains may be tax sensitive in spite of the distribution deduction. Rather we posit that the existence of the distribution deduction removes consideration of state FITs for enough trusts that the effect of a state's FIT rules, by themselves, will not be observable from the data we examine in the studies summarized in this chapter.<sup>50</sup>

**¶ 1404.2 Perpetual Trusts and Fiduciary Income Taxes**

Unlike an ordinary trust, a transfer-tax-exempt perpetual trust has a different duration and purpose that might warrant accumulation of income notwithstanding the federal income tax penalty. For similar reasons, the balance of risk and return for a long-term trust will in general favor heavier investment in equities and hence more frequent realization of capital gains. Income accumulated in a transfer-tax-exempt trust is exempt from subsequent wealth transfer taxation, but such income loses its exempt status upon distribution to a beneficiary. The federal income tax penalty is not trivial, but it is less than the almost 50 percent top rate of the federal transfer taxes. Hence, for a transfer-tax-exempt perpetual trust, it may be a sensible long-term strategy to incur a present income tax liability to avoid a bigger future transfer tax bill. Further, unless some income is retained, the trust will lose value because of inflation, a significant consideration if the trust's purpose is to provide for future generations.

Although a settlor cannot avoid the federal income tax by switching states, she can avoid piling on state income taxes by choosing a state that does not tax income in trusts attracted from out of state. Accordingly, we predict that the effect of the abolition of the Rule will be magnified in states that do not tax income in trust funds attracted from out of state. Once the settlor has committed to incurring the costs of settling an out-of-state trust, the marginal cost of choosing a state that will not levy a FIT on the trust's income is close to zero but the benefits are potentially significant.

**¶ 1404.3 Coding State Tax Rules**

Each state has a "unique matrix of statutory rules" setting forth what contacts with the state will trigger FIT liability.<sup>51</sup> Based on our examination of the FIT statutes of

---

<sup>49</sup> Max Gutierrez, Jr. & Frederick R. Keydel, Am. Coll. of Trusts & Estates Counsel, Study 6: State Taxation on Income of Trusts with Multi-State Contacts 12 (2001); Bradley E.S. Fogel, What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts, 32 U. Rich. L. Rev. 165, 173-74 (1998).

<sup>50</sup> Among other things, the data we examine in the studies summarized here collapses simple, complex, and grantor trusts. We intend to reexamine the effect of state FITs on trust fund situs in future work using more refined data compiled from trust income tax returns.

<sup>51</sup> Jeffrey A. Schoenblum, 2004 Multistate Guide to Estate Planning 11-1 (2004) (updated yearly).

## 14-17 JURISDICTIONAL COMPETITION FOR TRUST FUNDS ¶ 1405.2

all fifty states from 1985 through 2004, we have coded each state as YES or NO for each year, pursuant to the following standards: Relevant FITs are those that would be levied on income in a trust (1) consisting entirely of financial assets (in the jargon, intangible personal property) that is (2) settled by a nonresident (3) for the benefit of a nonresident. Moreover, such taxes are relevant only if they would be triggered even if the trust's only contact with the state is (a) an in-state trustee, (b) in-state administration, or (c) in-state situs.

We have used these standards because they characterize the paradigmatic trust fund attracted from out of state, and our estimation strategy measures relative increases in the states' reported trust assets. Settling an out-of-state trust with an out-of-state trustee is the primary method of avoiding state FITs other than changing the settlor's or the beneficiary's state of residence. For the rest of this chapter, when we speak of state taxation of income in trusts attracted from out of state, we refer to the six conditions stated in the prior paragraph. In the absence of clarifying regulations or case law, we resolved statutory ambiguity in favor of YES.

Our FIT coding, which is consistent with the methodology of Jeffrey Schoenblum's annual *Multistate Guide to Estate Planning*,<sup>52</sup> is summarized in the appendix. There is variation across states and some variation across time, which allows us to test the importance of FITs on their own as well as their interactive effect with abolition of the Rule Against Perpetuities.

### ¶ 1405 Other Margins of Competition

#### ¶ 1405.1 Directed Trustee Statutes

In future work using more refined data and a more suitable timeframe, we will investigate the effect, if any, of statutes that immunize trustees from liability for following the direction of a third party.<sup>53</sup>

#### ¶ 1405.2 Trust Investment Laws

In a study forthcoming in the peer-reviewed *Journal of Law and Economics*, we show that adoption of the new prudent investor rule was associated with a statistically and economically significant shift in trust portfolio allocation away from government bonds and toward corporate securities.<sup>54</sup> Further, subsequent to the timeframe of our data, state laws on principal and income became increasingly differentiated with the proliferation of unitrust conversion and/or equitable adjustment statutes.<sup>55</sup> In future

<sup>52</sup> See *id.* at 11-2 to -17 tbl.11.01.

<sup>53</sup> See, e.g., Richard W. Nenko, *Directed Trusts: Can Directed Trustees Limit Their Liability?*, 21 *Prob. & Prop.* 45 (Nov./Dec. 2007); Dennis I. Belcher, *My Fault — The Devil Made Me Do It! Responsibilities and Duties of a Delegating or Directed Trustee*, in Tina Portando, ed., 41 *Heckerling Institute ch. 13* (2007).

<sup>54</sup> See Max M. Schanzenbach & Robert H. Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?*, 50 *J.L. & Econ.* \_\_\_\_ (forthcoming 2007), available online at <http://ssrn.com/abstract=868761>.

<sup>55</sup> See Sitkoff & Schanzenbach, *Jurisdictional Competition*, *supra* note \*, at 378–79 n. 71.

**¶ 1406****2008 INSTITUTE ON ESTATE PLANNING****14-18**

work using more refined data and a later timeframe, we will investigate the effect, if any, of these rules on trust administration.

**¶ 1406 Description of the Data<sup>56</sup>**

The trust data (state-level panel data) come from annual reports collected by the four federal agencies charged with banking regulation: (1) the Federal Deposit Insurance Corporation (FDIC); (2) the Federal Reserve System; (3) the Office of Thrift Supervision (which superseded the Federal Home Loan Bank Board); and (4) the Office of the Comptroller of the Currency.

All banks and other financial institutions that are regulated by these agencies must file annual reports detailing their trust holdings, including total assets and number of accounts.<sup>57</sup> Based on this data, from 1968 until 2001 the Federal Financial Institutions Research Council published annual reports of trust holdings by regulated entities, summarizing the results by state.<sup>58</sup> Since 2001, the FDIC has been publishing these reports (now available online) organized by individual institution and by state.<sup>59</sup>

The trust holdings of regulated entities are reported in categories entitled “Employee Benefit,” “Personal Trusts,” and “Estates.” We examine only “Personal Trusts,” a category that includes both private and charitable trusts (both testamentary and inter vivos), but that excludes commercial trusts and employee benefit plans. Prior to 1985, federal authorities only collected information on actively managed personal trusts (meaning trusts for which the regulated entity had discretionary investment authority), and neither savings-and-loan institutions nor savings banks with trust powers were required to report.

**¶ 1407 Graphical Analysis I: Since the GST Tax**

We begin our analysis of the data by comparing trends in reported trust assets in leading abolition states to each other, their neighboring states, and national averages. Because differences in population and local economies make graphical comparisons of total assets across states almost meaningless, in our comparisons we use trust assets per person or average account size. Dividing total assets by state population or number of trusts reduces the influence of population and highlights the success of small states such as Delaware and South Dakota, which have small populations but significant trust assets and many high-value trusts. Average account size is of interest for two additional reasons. First, average account size is less sensitive than total assets to the potential biasing effect of bank mergers and consolidations. Second, because the

---

<sup>56</sup> For a more fulsome discussion of the data and its limitations, see *id.*, at 387–90, 434–35.

<sup>57</sup> Federal statutes make these filings mandatory. 12 U.S.C. § 1817 (2000) (FDIC); *id.* §§ 248(a), 1844(a) (Federal Reserve System); *id.* § 1464 (Office of Thrift Supervision); *id.* §§ 161, 1817 (Office of Comptroller of the Currency).

<sup>58</sup> See, e.g., Fed. Fin. Insts. Examination Council, *Trust Assets of Financial Institutions-1987* (1987).

<sup>59</sup> An interactive website allows one to obtain new data, state by state. See FDIC: Statistics on Depository Institutions, <http://www2.fdic.gov/sdi/main.asp>. Older reports, from 1996 through 2000, may also be obtained. See FFIEC: Trust Institutions Information, <http://www2.fdic.gov/structur/trust/index.asp>.

## 14-19

## JURISDICTIONAL COMPETITION FOR TRUST FUNDS

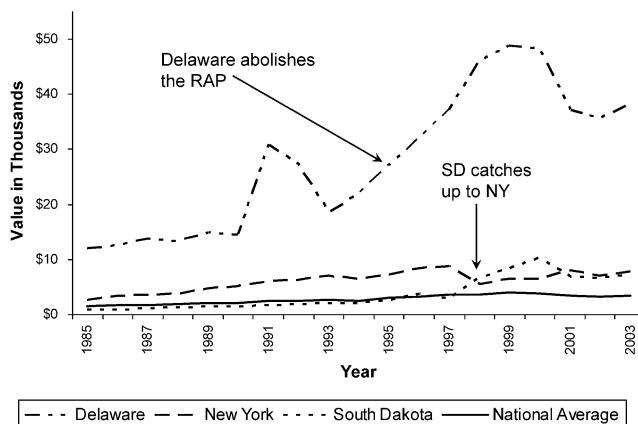
## ¶ 1407.2

current exemption from the GST tax is \$2 million and for much of the period under study was \$1 million, an upswing in average account size above those figures implies an influx of trust assets that are not transfer-tax exempt.

## ¶ 1407.1 Delaware, New York, and South Dakota

Figure 3 presents trust assets per person during the period 1985 through 2003 in the important abolition states of Delaware and South Dakota in comparison with New York, a leading banking state, and with the national average. Delaware abolished the RAP in 1995, and South Dakota abolished the RAP in 1983. As can be seen, South Dakota started out with trust assets per person just below the national average at the beginning of the period studied. By the mid-1990s, however, South Dakota's assets per person exceeded the national average and equaled or exceeded that of New York. Having long been a trust-friendly jurisdiction, Delaware's trust assets per person began at a very high level (with an unexplained blip in 1991 and 1992, prior to abolition<sup>60</sup>), then experienced a strong upward trend in the mid-1990s, roughly coinciding with Delaware's abolition of the RAP.

Figure 3: Reported Trust Assets per Person in Delaware, New York, and South Dakota



## ¶ 1407.2 Delaware and Comparison States

In Figure 4 we compare average account size in Delaware with that of Maryland, Pennsylvania, and New York. Delaware and New York started out with similar average account sizes, but Delaware rapidly outpaced New York in the mid-1990s, roughly coincident with the abolition of the RAP in Delaware. Neither Pennsylvania nor Maryland was in the same league as Delaware. Even after the precipitous drop in

<sup>60</sup> We have no good explanation for the 1991-1992 blip. Given Delaware's otherwise smooth upward trend, we could interpolate the data for 1991 and 1992. However, this unexplained increase in trust assets occurred prior to Delaware's abolition of the RAP. As such, if included in our regression analysis, it would tend to bias our estimate of the effect of abolishing the Rule downward, working against a positive finding. For this reason, we have chosen the more conservative approach of accepting the data as reported by the FDIC.

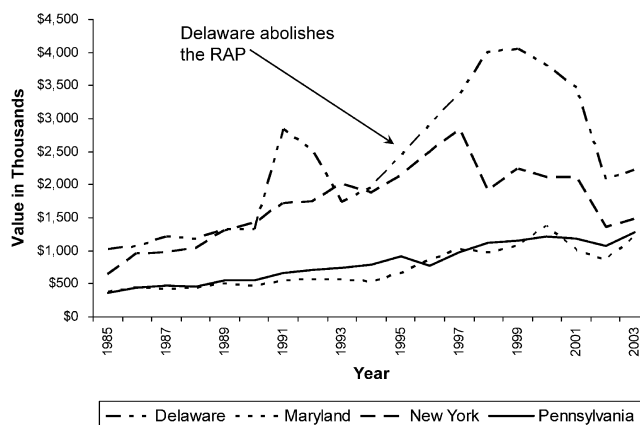
## ¶ 1407.3

## 2008 INSTITUTE ON ESTATE PLANNING

14-20

average account size in Delaware following the stock market decline of the early 2000s, Delaware's average trust account size in 2003 was about double that in Pennsylvania and Maryland. Although Maryland abolished the Rule in 1998, since 1988 it has levied a fiduciary income tax on trust funds attracted from out of state. We posit that aversion to this tax explains Maryland's inability to compete with Delaware. Our formal econometric analysis supports this hypothesis.

Figure 4: Average Account Size in Delaware and Comparison States



## ¶ 1407.3 South Dakota and Comparison States

South Dakota, which we examine in Figure 5, presents a clearer picture. In the mid-1980s, South Dakota's average account size was slightly larger than North Dakota's and Iowa's. The gap between these states then began to grow after 1987, with the implementation of the GST tax, and increased notably in the mid-1990s. This latter increase coincided with the abolition of the RAP in Delaware and the subsequent nationwide movement to abolish the RAP. In addition, at about the same time the Governor of South Dakota formed a task force to study the South Dakota trust laws and to recommend reforms to allow South Dakota to continue its position as "a highly desirable jurisdiction in which to locate trusts."<sup>61</sup>

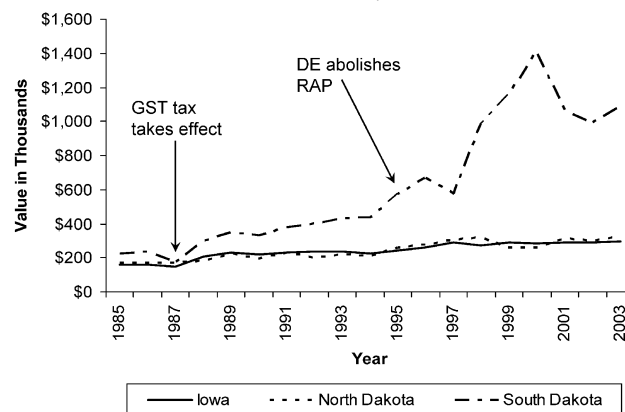
<sup>61</sup> Michael J. Myers & Rollyn H. Samp, South Dakota Trust Amendments and Economic Development: The Tort of "Negligent Trust Situs" at Its Incipient Stage?, 44 S.D. L. Rev. 662, 664 (1999) (quoting State of South Dakota, Office of the Governor, Exec. Order No. 97-10 (Aug. 11, 1997)).

14-21

## JURISDICTIONAL COMPETITION FOR TRUST FUNDS

¶ 1407.4

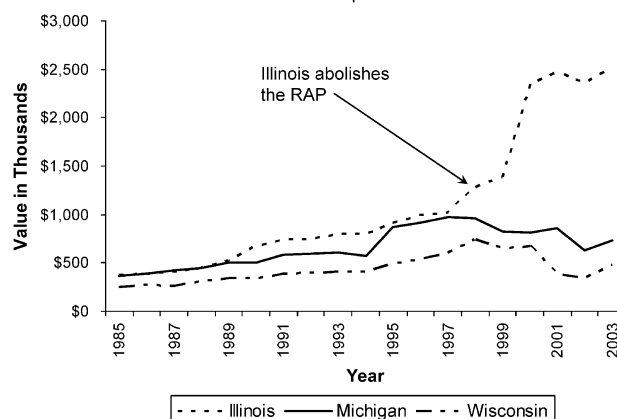
Figure 5: Average Account Size in South Dakota and Comparison States



## ¶ 1407.4 Illinois and Comparison States

Illinois, which we examine in Figure 6, abolished the RAP in 1998. Average account size in Illinois increased by roughly 70% two years later, from \$1.4 million to nearly \$2.5 million. This increased average account size remained stable even in the face of the stock market decline of the early 2000s (which implies a continued influx of large trusts).

Figure 6: Average Account Size in Illinois and Comparison States



Interestingly, Wisconsin, which abolished the RAP long before the introduction of the GST tax, appears to have been unable to compete with Illinois. As in the case of Delaware and Maryland, we posit that the disparity between Illinois and Wisconsin is a result of their different FIT rules. During the period under study, Illinois did not tax income in trust funds attracted from out of state, but for most years Wisconsin did. Our formal econometric analysis supports this hypothesis.

**¶ 1407.5****2008 INSTITUTE ON ESTATE PLANNING****14-22**

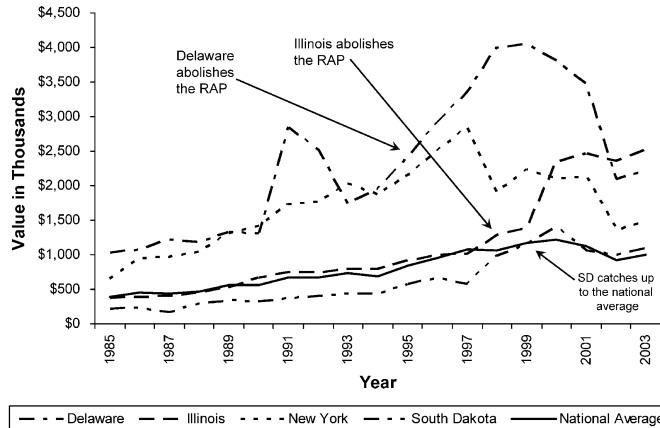
Another interesting implication of Figure 6 is that after Illinois abolished the RAP its trust institutions experienced an influx of large trusts that were probably not wholly transfer-tax exempt. The exemption from the GST and estate taxes is currently \$2 million and for most of the period under study was \$1 million. Yet after Illinois abolished the RAP, its average account size rose quickly from less than \$1.5 million to about \$2.5 million. The implication is that a fair number of the new accounts were worth more than \$2.5 million. To the extent that the initial funding of a trust exceeds the exemption amount, the excess is subject to federal wealth transfer taxation. In a similar vein, observe that Delaware, like Illinois, experienced a rapid increase in its average account size, which at the time Delaware abolished the RAP already exceeded the exemption amount (see Figure 4 above and Figure 7 below).

We conjecture 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. Under typical fee schedules, larger accounts pay a smaller percentage in fees relative to smaller accounts, and professional fiduciaries are willing to negotiate even lower fees for (and to give more personal service to) larger accounts. It appears, therefore, that the availability of perpetual transfer-tax-exempt trusts provides an opening to attract all of the donor's trust business.

**¶ 1407.5 Delaware, Illinois, New York, and South Dakota**

In Figure 7, we compare average account sizes in Delaware, Illinois, New York, South Dakota, and the national average. Many of the trends remarked upon above are again discernible. The trend in average trust account size in Delaware roughly tracked that of New York until Delaware abolished the RAP in 1995, whereupon Delaware outpaced New York in all subsequent years. Average account size in South Dakota, which had abolished the RAP prior to the enactment of the GST tax, trailed the national average until the mid-1990s. By 1998, when Illinois abolished the RAP, South Dakota caught up to the national average. Average account size in Illinois, which prior to 1998 more or less tracked the national average, broke away and substantially outpaced the national average from that point forward, catching up with New York in 2000 and Delaware in 2002.

Figure 7: Average Account Size in Delaware, Illinois, New York, and South Dakota



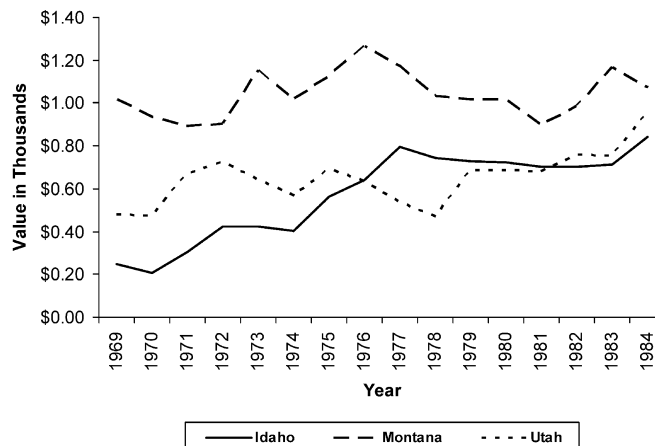
¶ 1408 Graphical Analysis II: Prior to the GST Tax

To assess whether abolishing the RAP had an effect on a state’s trust business prior to 1985, we begin with simple graphical comparisons between Idaho, Wisconsin, South Dakota and their neighboring states. To adjust for inflation, all of the graphs plot values in constant dollars as of 2000. We also normalize trust assets to account for differences in population and local economies across states by examining trust assets per person and average account size.

¶ 1408.1 Idaho, Wisconsin, and Comparison States

In Figures 8 and 9 we compare Idaho and Wisconsin respectively to some of their neighbors between 1969 and 1984.

Figure 8: Trust Assets per Person in Idaho and Comparison States (1969-1984)

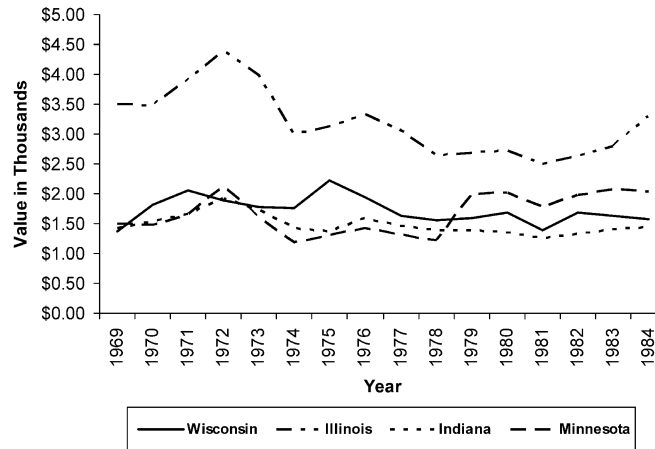




¶ 1408.2

2008 INSTITUTE ON ESTATE PLANNING

Figure 9: Trust Assets per Person in Wisconsin and Comparison States (1969-1984)

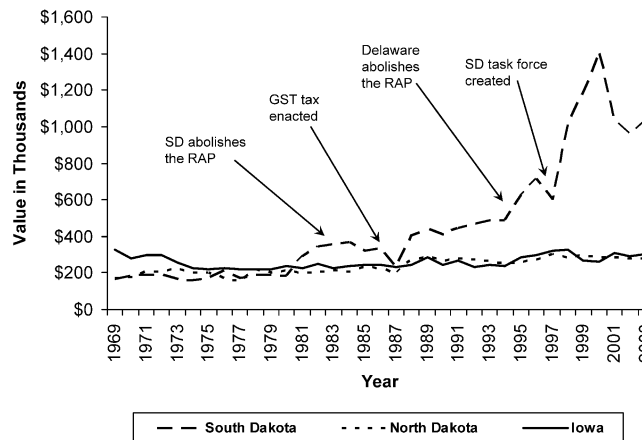


It does not appear that either Wisconsin or Idaho outperformed its neighbors over the sample period, which implies that Wisconsin’s and Idaho’s prior abolition of the Rule did not give them an advantage in the jurisdictional competition for trust funds.

¶ 1408.2 South Dakota and Comparison States

In Figure 10 we turn to South Dakota, which abolished the RAP in 1983.

Figure 10: Average Account Size in South Dakota and Comparison States (1969-2003)



Prior to the early 1980s, average account sizes in South Dakota, Iowa, and North Dakota were quite similar, with Iowa faring a bit better over the 1970s. South Dakota overtook both Iowa and North Dakota beginning in 1980, three years before South Dakota abolished the RAP in 1983. There was no obvious increase in South Dakota’s average account size immediately after 1983. There was also no immediate rise in assets after the 1986 enactment of the GST, but rather a gradual trend upward that accelerated in the mid-1990s, around the same time that Delaware abolished the RAP

## 14-25

## JURISDICTIONAL COMPETITION FOR TRUST FUNDS

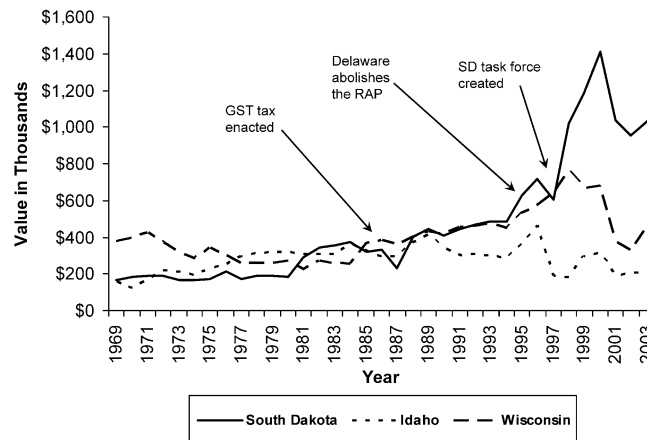
## ¶ 1409

(1995) and that the governor of South Dakota formed a task force to assess South Dakota's competitiveness for trust business (1997). By contrast, average account size in Iowa and North Dakota remained virtually unchanged throughout the sample period.<sup>62</sup>

## ¶ 1408.3 South Dakota, Wisconsin, and Idaho

Figure 11 compares South Dakota to Wisconsin and Idaho for the entire timeframe of the data so as to allow for a pre- and post-GST tax comparison. Wisconsin and South Dakota clearly overtook Idaho by the early 1990s. Further, South Dakota outpaced Wisconsin in the late 1990s, after Delaware's repeal of its RAP and the formation of the governor's task force. (Average trust account size in all three states appears to be sensitive to the stock market decline beginning in 2001.)

Figure 11: Average Account Size in South Dakota, Wisconsin, and Idaho (1969-2003)



We posit that South Dakota broke away from Idaho and Wisconsin in the mid-1990s because South Dakota does not levy an income tax on trust funds attracted from out of state but Idaho does and Wisconsin did until it repealed the tax in 1999. Although it is too soon to assess whether Wisconsin's 1999 repeal of its tax on trust funds attracted from out of state made it competitive with the other abolishing states, Figure 5 suggests that Wisconsin may have stopped losing ground to South Dakota after 1999.

## ¶ 1409 Summary of Graphical Analysis

The foregoing graphs support the hypothesis that, since the enactment of the GST tax, those states that abolished the RAP and did not tax income in trusts attracted from out of state experienced a significant inflow of large trust funds upon abolishing the RAP. The foregoing graphs also support the hypothesis that abolishing the RAP prior to the enactment of the GST tax had little effect on a state's trust business. Our regression analysis supports these interpretations of the graphs. Before turning to the

<sup>62</sup> The changes in data collection methods discussed in ¶ 1406 and introduced in 1985 do not appear to have had much of an effect for these states.

**¶ 1410****2008 INSTITUTE ON ESTATE PLANNING****14-26**

regression analysis, however, we wish to make three further observations about Figures 10 and 11, which show that South Dakota experienced an increase in trust business after the GST tax, but not (visually) a substantial increase until the mid to late 1990s, after Delaware abolished its Rule.

First, we suspect that the delay may reflect the time necessary for the bar to digest the change in the tax law and to sell clients on the advantages of perpetual transfer-tax-exempt trusts. The GST tax and the Rule Against Perpetuities are complex, and the interaction of the two was not immediately obvious.

Second, we suspect that Delaware's repeal of its RAP may have validated the use of transfer-tax-exempt perpetual trusts. Delaware is the leading state in corporate law and law firms elsewhere pay attention to developments in Delaware law. Further, at around the same time, an increasing number of states began recognizing estate planners' malpractice liability to intended beneficiaries.<sup>63</sup> Because many clients instruct that their estate plan should be designed to minimize all possible taxes, together these factors may have helped overcome lawyers' resistance to settling trusts out of state. In a related vein, the increased salience of the Rule after the GST tax may have overcome lawyers' lack of awareness that perpetual trusts were even possible.

Third, because existing trusts in non-abolition states are drafted to comply with the Rule, and because moving a trust often requires judicial approval, the perpetual trust phenomenon may well be driven by new trusts rather than the movement of existing trusts.

**¶ 1410 Econometric/Regression Analysis**

Readers interested in our formal econometric analysis and methodology are encouraged to examine Robert H. Sitkoff & Max M. Schanzenbach, "Jurisdictional Competition for Trusts Funds: An Empirical Analysis of Perpetuities and Taxes," 115 *Yale Law Journal* 356, 399-409, 422-29 (2005), which presents our formal econometric analysis of the data since the enactment of the GST tax; and Max M. Schanzenbach & Robert H. Sitkoff, "Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust," 27 *Cardozo Law Review* 2465, 2492-94, 2498-09 (2006), which presents our regression analysis of the data prior to the enactment of the GST tax.

In the next section we summarize the key results of our formal analysis.

**¶ 1411 Summary of Econometric Results****¶ 1411.1 The Rule Against Perpetuities**

We find that abolition of the Rule Against Perpetuities had no impact on a state's reported trust assets prior to enactment of the GST tax. After the GST tax, however, abolition of the Rule increased a state's reported assets by as much as 20% relative to states that retained the Rule. This finding is replicated for average account size, which

---

<sup>63</sup> Indeed, two South Dakota lawyers suggested in 1999 the possibility of a tort of "negligent trust situs." See Myers & Samp, *supra* note 61. In 1979 Jesse Dukeminier presciently predicted that expanding malpractice liability would prompt lawyers to lobby for reform of technical rules. See Jesse Dukeminier, *Cleansing the Stables of Property: A River Found at Last*, 65 *Iowa L. Rev.* 151 (1979).

**14-27****JURISDICTIONAL COMPETITION FOR TRUST FUNDS****¶ 1411.4**

likewise increased by as much as 20% relative to states that retained the Rule. In dollars, after a state abolished the Rule, its reported trust assets increased by roughly \$6 billion relative to those that retained the Rule. Average account size increased by roughly \$200,000. These results reflect data through 2003 only. Further, the results were not sensitive to the inclusion or exclusion of Delaware and Alaska, which tells us that the phenomenon extends beyond just the first-moving states.

The results of more sophisticated regression analyses, which we report in our 2005 study cited in ¶1410, indicate that the effect of abolishing the Rule increases and then decreases over time. We interpret these results as follows: Early abolition states attracted trust business, but as more states abolished the Rule, competition increased while the number of potential settlors living in states that did not allow perpetual trusts decreased. On this interpretation, more recently abolishing states may have simply retained indigenous trust business instead of attracting out-of-state business.

**¶ 1411.2 Fiduciary Income Taxes**

We found that, by itself, whether a state levied an income tax on trust funds attracted from out of state had no observable effect on the state's reported trust assets. This finding is consistent with the incentives created by the federal income tax. For many trusts the process of avoiding the federal income tax likewise avoids state income taxes.

**¶ 1411.3 Perpetuities and Fiduciary Income Taxes Together**

Perpetual trusts have a different duration and purpose from ordinary trusts that might warrant accumulating trust income and more frequent realization of capital gains. Although doing so unavoidably triggers federal income tax liability, state income tax liability can be avoided by locating the trust in a state that does not levy a FIT on trust funds attracted from out of state.

We tested the interactive effect of a state's income tax and perpetuities laws. These tests indicate that 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. States that abolished the Rule but taxed such trusts experienced no observable increase in reported trust assets.

These findings are intuitive. Once a settlor has committed to incurring the costs of establishing an out-of-state perpetual trust, there is no additional cost to choosing a state that also does not tax trusts attracted from out of state, but the benefits of doing so are potentially great.

**¶ 1411.4 Conclusions for Perpetuities and Taxes**

We conclude that the effect of abolishing the Rule is substantial. *Our findings imply that, through 2003, roughly \$100 billion in trust funds have poured into the states that have validated perpetual trusts.*<sup>64</sup>

---

<sup>64</sup> The \$100 billion figure is only a point estimate. For discussion of this estimate and its confidence interval, see Sitkoff & Schanzenbach, *Jurisdictional Competition*, supra note \*, at n.125.

**¶ 1411.5****2008 INSTITUTE ON ESTATE PLANNING****14-28****¶ 1411.5 Caveats for Perpetuities and Taxes**

First, we cannot estimate the tax revenue lost owing to the use of perpetual transfer-tax-exempt trusts. Such an estimate would require complex actuarial discounting based on individual account data, but we have only state-level data. The most we can say is that not all the trust dollars that have poured into the abolishing states are transfer-tax exempt. After abolishing the Rule, average account size in Illinois and Delaware both increased and exceeded the transfer-tax exemption.

Second, we cannot discern the extent to which any given state's increase in reported trust assets stemmed from an inflow of newly created trusts versus the poaching of already existing trusts. Likewise, to the extent that our findings represent the movement of already existing trusts, we cannot identify from which states those trusts moved.

Third, because our sample data are limited to federally reporting trustees (and so do not include the entire trust fund population), our estimates likely understate the amount of trust assets that has moved as a result of the abolition of the Rule.

**¶ 1411.6 Self-Settled Asset Protection Trusts**

Our results with respect to APTs are inconclusive, likely because of data limitations. APTs were validated only recently and only in a few states in the timeframe of our study (recall our data extend only through 2003). It is possible that APTs are important, but our data are not sufficiently refined to detect their effect. We will revisit the issue in future work employing more refined data and a longer sample time frame during which more states validated APTs.

**¶ 1412 Conclusions****¶ 1412.1 Jurisdictional Competition**

Using well-accepted econometric techniques, we find that, on average, from the enactment of the GST tax through 2003 a state's abolition of the Rule increased its trust assets by \$6 billion (a 20% increase on average) and increased its average trust account size by \$200,000. These estimates imply that roughly \$100 billion in trust funds have moved to take advantage of the abolition of the Rule. By contrast, we find that, prior to the GST tax, a state's abolition of the Rule did not increase the state's trust business. Further, only those states that both abolished the Rule Against Perpetuities and did not levy an income tax on trust funds attracted from out of state experienced an increase in reported trust assets after the GST tax. Our analysis of the effect of APTs was inconclusive.

**¶ 1412.2 Situs and Choice of Law**

Our analysis demonstrates that choice of law and trust situs are important considerations in trust practice. Trust funds flow to states with more favorable laws and lower taxes. States that do not provide such benefits will lose trust business.

**¶ 1413.3 The RAP is Dead**

Even if some states retain the Rule Against Perpetuities, the Rule will apply, in effect, only to real property within those states. When it matters, people move their

## 14-29

## JURISDICTIONAL COMPETITION FOR TRUST FUNDS

## ¶ 1414

financial assets to escape the Rule's reach. As such, the federal wealth transfer taxes have mortally wounded the once-mighty Rule by reducing it to a mere transaction cost. Trust duration has become an issue of federal tax law.

¶ 1414 Appendix: Dating of Trust Law Changes During the Period Under Study<sup>65</sup>

State	RAP Abolished <sup>66</sup>	Self-Settled Asset Protection Trust	Fiduciary Income Tax <sup>67</sup>
Alabama	—	—	YES
Alaska	1997 <sup>68</sup>	1997	NO
Arizona	1998	—	YES
Arkansas	—	—	NO
California	—	—	YES
Colorado	2001	— <sup>69</sup>	YES
Connecticut	—	—	NO
Delaware	1995 <sup>70</sup>	1997	NO

<sup>65</sup> This table is exhaustive through the end of the period under study (that is, through year-end 2003). For the sake of completeness, however, the table also notes major perpetuities and asset protection legislation enacted since then.

<sup>66</sup> Unless noted otherwise, we define abolition to include any reform that would allow a settlor to create a perpetual trust of intangible personal property. Accordingly, our definition of abolition includes: (1) outright repeal of the Rule Against Perpetuities with respect to an interest in a trust funded with intangible personal property; (2) reconfiguration of the Rule with respect to such trusts as a default that applies unless the settlor provides otherwise in the trust instrument; and (3) an exemption from the Rule for interests in a trust funded with intangible personal property over which the trustee has the power to sell (i.e., a trust that does not suspend the power of alienation).

<sup>67</sup> A YES in this column indicates that the state might levy a fiduciary income tax on the basis of an in-state trustee, in-state trust administration, or an in-state situs, even if the trust was settled by a nonresident for the benefit of nonresident beneficiaries and the trust consists entirely of intangible personal property. A NO indicates that state law clearly excludes such a trust from income taxation. We resolved ambiguity in favor of YES.

<sup>68</sup> In 2000 Alaska established a 1,000-year limitation on the duration of powers of appointment, enacted new language that more clearly abolished the Rule Against Perpetuities, and repealed its enactment of USRAP.

<sup>69</sup> Some commentators have read an older statute in Colorado as authorizing APTs as to future creditors, see Colo. Rev. Stat. Ann. § 38-10-111, but in dicta the Colorado Supreme Court has rejected that interpretation. *In re Cohen*, 8 P.3d 429, 432–34 (Colo. 1999).

<sup>70</sup> In 1986 Delaware reconfigured the Rule as applied to interests in trust into a 110-year limitation on trust duration. Act of July 3, 1986, ch. 422, 65 Del. Laws 831. Prior to 1986, Delaware had enacted legislation providing that a new perpetuities period would begin on the exercise of a power of appointment, which remains good law in Delaware today. See Act of Apr. 6, 1933, ch. 198, 38 Del. Laws 678 (codified at Del. Code Ann. tit. 25, § 501 (1989)). Hence Delaware made possible a perpetual trust long before 1995. However, Congress effectively foreclosed this option with I.R.C. § 2041(a)(3) (2000), which makes the extension of the perpetuities period under section 501 a taxable event for all trusts

State	RAP Abolished <sup>66</sup>	Self-Settled Asset Protection Trust	Fiduciary Income Tax <sup>67</sup>
Florida	2001 <sup>71</sup>	—	YES, <sup>72</sup> NO beginning 2001
Georgia	—	—	NO
Hawaii	—	—	NO
Idaho	1957	—	YES
Illinois	1998	—	NO
Indiana	—	—	YES
Iowa	—	—	YES
Kansas	—	—	YES
Kentucky	—	—	YES
Louisiana	—	—	YES
Maine	1999	—	YES
Maryland	1998	—	NO, YES beginning 1988
Massachusetts	—	—	YES
Michigan	—	—	NO
Minnesota	—	—	NO
Mississippi	—	—	YES
Missouri	2001	2005 <sup>73</sup>	NO
Montana	—	—	YES
Nebraska	2002	—	NO
Nevada	2005 <sup>74</sup>	1999	NO
New Hampshire	2004	—	NO

created in or after 1942. See Dukeminier, et al., *supra* note 14, at 694–95 (7th ed. 2005); 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).

<sup>71</sup> In 2001 Florida amended its enactment of USRAP to provide for a 360-year perpetuities period for interests in trust. Because 360 years is significantly longer than is possible through the use of a saving clause, we count Florida as having abolished the Rule.

<sup>72</sup> Although Florida does not have a fiduciary income tax, it does have an intangible personal property tax, and before 2001 trustees of Florida situs trusts were required to pay this tax.

<sup>73</sup> In 1986 Missouri amended its statutory rules on spendthrift trusts in a manner that could be read to authorize APTs, see *Mo. Ann. Stat.* § 456.080 (repealed 2004), but there is some contrary case law and the literature tends not to regard Missouri as an APT jurisdiction. See *Markmueller v. Case*, 51 F.3d 775 (8th Cir. 1995); John K. Eason, *Retirement Security Through Asset Protection: The Evolution of Wealth, Privilege, and Policy*, 61 *Wash. & Lee L. Rev.* 159, 174 n.54 (2004). In 2004 Missouri adopted a nonuniform version of Uniform Trust Code § 505 that took effect on January 1, 2005, see *Mo. Ann. Stat.* §§ 456.5 to 505.3, and its drafters intended specifically to authorize APTs. See James G. Blase, *The Missouri Asset Protection Trust*, *J. Mo. B.*, Mar.-Apr. 2005, at 72. Whether the new Missouri statute in fact authorizes APTs does not bear on our empirical analysis because the new statute took effect after the timeframe of our data.

<sup>74</sup> In 2005 Nevada modified its enactment of USRAP to provide for a perpetuities period of 365 years.

## 14-31

## JURISDICTIONAL COMPETITION FOR TRUST FUNDS

## ¶ 1414

State	RAP Abolished <sup>66</sup>	Self-Settled Asset Protection Trust	Fiduciary Income Tax <sup>67</sup>
New Jersey	1999	—	NO
New Mexico	—	—	YES
New York	—	—	NO
North Carolina	2007	—	NO
North Dakota	—	—	YES
Ohio	1999	—	NO, YES beginning 2003
Oklahoma	—	2004 <sup>75</sup>	NO, YES beginning 1994
Oregon	—	—	YES
Pennsylvania	2007	—	NO
Rhode Island	1999	1999	NO
South Carolina	—	—	YES
South Dakota	1983	2005	NO
Tennessee	—	2007	NO
Texas	—	—	NO
Utah	2004 <sup>76</sup>	2004	YES, NO beginning 2004 <sup>77</sup>
Vermont	—	—	NO
Virginia	2000	—	YES
Washington	— <sup>78</sup>	—	NO
West Virginia	—	—	NO
Wisconsin	1969 <sup>79</sup>	—	YES, NO after 1999

Because 365 years is significantly longer than is possible through the use of a saving clause, we count Nevada as having abolished the Rule.

<sup>75</sup> Oklahoma's statute limits settlors to a single asset protection trust and caps the permissible initial funding at \$1 million. We need not resolve whether to code Oklahoma differently from the other APT states, however, because the Oklahoma statute was enacted after the period of our study.

<sup>76</sup> Utah's statute appears to establish a 1,000-year perpetuities period effective December 31, 2003. Given the length of this period, we treat Utah as having abolished the Rule.

<sup>77</sup> Only trusts that "first became" Utah trusts "on or after January 1, 2004" qualify for exemption from the income tax.

<sup>78</sup> Washington extended its perpetuities period to 150 years effective January 1, 2002. Because 150 years is not significantly longer than is possible through the use of a saving clause, we do not count Washington as having abolished the Rule.

<sup>79</sup> Wisconsin may have abolished its Rule even earlier (indeed, Wisconsin may never have had the Rule). See Lawrence M. Friedman, *The Dynastic Trust*, 73 *Yale L.J.* 547, 550 (1964); Leach, *supra* note



## ¶ 1414

## 2008 INSTITUTE ON ESTATE PLANNING

14-32

State	RAP Abolished <sup>66</sup>	Self-Settled Asset Protection Trust	Fiduciary Income Tax <sup>67</sup>
Wyoming	2003 <sup>80</sup>	2007	NO

19, at 974–75. We need not resolve the status of the Rule in Wisconsin prior to 1969, however, because our data do not begin until that year.

<sup>80</sup> Wyoming conditions the nonapplicability of the Rule on a provision in the trust instrument providing for the termination of the trust not later than 1,000 years after its creation. Given the length of this period, we treat Wyoming as having abolished the Rule.