

Why Not Repeal the Rule Against Perpetuities?

by Thomas L. Stover

The common law Rule Against Perpetuities ("the RAP" or "the Rule") was developed as a response to feudal lords restricting the disposition of tenants' real property, and was designed to prevent the exclusion of property from the channels of commercial development for extended periods of time. However, currently, the Rule is vague, confusing, burdened by exceptions, and bears little relation to the modern trust and estate practice or the contemporary business or commercial world.¹ Courts have even refused to apply the RAP where the presence of remotely vesting contingent interests served public policies that outweighed the policies promoted by the Rule.²

Applicability of the RAP

Colorado adopted its statutory RAP ("CSRAP") in 1991,³ which superseded the common law Rule. Because Colorado's Rule was "uniform" legislation, it is referred to in this article as "USRAP." A list of exceptions to USRAP is codified at CRS § 15-11-1105 (2000). Because of these exceptions, the RAP is inapplicable to many types of transactions, making it even more irrelevant. For example, because "nondonative transfers" are excluded from the statutory rule, one commentator has theorized that the RAP is effectively dead in Colorado for most commercial transactions.⁴

Even when the RAP does apply, USRAP takes a "wait-and-see" approach, whereby the interest is invalid only if it does not actually vest or terminate within ninety years after its creation.⁵ By postponing the invalidating of an interest for ninety years, the Rule had already been greatly eviscerated prior to the recent amendments in Colorado. In 2001, the RAP was eroded even further. USRAP was amended in the 2001 legislative session by the addition of a new exception to invalid nonvested property interests.⁶ This amendment effectively repeals the RAP for most donative transfers in Colorado. Thus, trusts created for gifting and estate planning purposes for Colorado residents may postpone vesting indefinitely, as long as the trustee has the discretion to distribute all or part of the income or principal of the trust to a person who is living when the trust is created.⁷

Arguments Against Repeal

Notwithstanding the fact that the RAP has largely withered away, opponents of complete repeal remain. They offer two general objections:

- 1) *Repeal is bad for the economy.* It removes property from the rough and tumble efficiencies of the free marketplace, depositing it for perpetuity in the hands of overly conservative corporate trust officers; and
- 2) *Repeal is bad for society.* First, it allows for perpetual "dead-hand" control by the long deceased at the expense of the living—who clearly have a better opportunity to observe present conditions and

circumstances. Second, it is bad for the beneficiaries who are rendered spoiled, shiftless, and dependent. Third, large concentrations of wealth are dangerous.

The first objection fails to account for modern economic and statutory realities, as well as the changing nature of trusts as economic entities. The second may have some merit, but there is not enough empirical evidence to take it beyond speculation. Most private practitioners harbor none of the nostalgia for the RAP apparently still present in legal academia. Its demise will hardly be noticed. As a practical matter, it would change most trust and estate practices very little. Few clients wish to place all of their property in a trust that will never vest in any descendent. Most clients just want to skip the generations they have seen go astray, holding out optimistic hope for the unborn and the very young and still innocent.

Part of the first objection seems to center on the misperception that the repeal of the RAP is a repeal of the rules against unreasonable restraints on alienation. The RAP invalidates interests that vest too remotely, while the rule against restraints on alienation relates to unreasonable restraints on rights of alienation of a property owner.⁸ A limitation on a trustee from ever divesting the trust of an asset would probably not be enforceable, either under the unreasonable restraint on alienation rules, the trustee's obligation to invest as a "prudent investor,"⁹ or under evolving trust law.

The Uniform Prudent Investor Act, with its emphasis on a diversified portfolio and "total return," requires the fiduciary to review the portfolio regularly so as to maintain the required balance of assets.¹⁰ "A trustee's investment and management decisions respecting individual assets must be evaluated, not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust."¹¹ It would be a rare asset that would appropriately be held in a trust portfolio forever.

The Uniform Trust Code is a comprehensive codification of trust law promulgated to the states by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in its summer 2000 meeting. It includes a number of provisions allowing for modification of trusts in the event of changed circumstances, making it even more unlikely that assets could be trapped in trusts in perpetuity. In fact, the comments to § 411 ("Modification or Termination Because of Unanticipated Circumstances or Inability to Administer Trust Effectively") state the following:

Owners may deal without restraint with their own property but not when impressed with a trust for the benefit of others. . . . Thus, attempts to impose unreasonable restrictions on the use of trust property, such as a provision severely impairing the use of real property, will fail.

As for the concern about conservative investing by trust officers, conservatism can be beneficial for the economy. One of the classic conservative trust investments is a corporate bond. Far from removing wealth from the marketplace, bond purchases are loans to the world's most successful capitalists. The purchase of equities also is a positive engagement with the market system. Trustees, to raise capital for more "conservative" bond, cash, and equity investments, usually sell risky assets. Thus, riskier assets (stock in fledgling start-up companies or uncertain real estate ventures) are put back into the hands of entrepreneurs.

The societal argument against repeal has three themes. First, dead-hand control is thought to lead to the unproductive use of property and the inefficient allocation of trust resources by overly conservative trustees. This concern was addressed above. Second, perpetual trusts, it is believed, will foster a dependent and slothful cohort of beneficiaries who would be much better served if they could just get their hands on the assets. Because trustees should be investing assets with the same (if not greater) regard to financial efficiency than do individuals, it is the moral fiber of the beneficiaries that we are apparently worried about. Empirical data on this point are scarce. Even assuming that permanent beneficiary status leads to poor spending and saving habits, an argument has been made that profligate spending by heirs and beneficiaries is good for the economy in that it fosters consumerism, a good thing in an earnings-driven economy.¹²

The third prong of the societal argument is similar to arguments made against repeal of the estate tax; that is, that large concentrations of wealth are a bad thing.¹³ This proposition, while often stated, is hardly provable. Never in the history of mankind has society seen the concentrations of wealth currently present in modern America. Never has society been so materially satisfied.¹⁴ Whether our moral and spiritual well-being is in jeopardy is a question for the philosophers, not necessarily the trust and estate bar.

Finally, unless the federal estate tax is eventually repealed, there most certainly will be a congressional response creating some type of federal RAP that will "vest" property for estate tax purposes every ninety years or so. However, repealing the RAP as it relates to discretionary trusts will eliminate confusion and expand estate-planning opportunities available in Colorado. Perpetual trusts can be used to protect family wealth for multiple generations from transfer taxes, creditors, and spendthrifts, while preserving control by the senior family members who usually created the wealth. Perpetual trusts provide a unique opportunity to avoid, or at least defer, estate and generation-skipping transfer taxes. South Dakota repealed its statutory and common law RAP in 1983, without significant negative effect. Alaska, Illinois, Wisconsin, Delaware, Idaho, and other states also have repealed their RAPs, either in their entirety or as they relate to interests in trusts.¹⁵

Conclusion

Why not repeal the RAP? It is an anachronism in the modern trust and estate practice. Ancient concerns with vesting of property interests and dead-hand control have been largely negated by current economic realities and uniform laws relating to every facet of trust creation, modification, administration, and accounting. Repeal of the RAP would allow more flexibility in estate planning, including additional opportunities to avoid transfer taxes.

NOTES

1. See *Lucas v. Hamm*, 56 Cal.2d 583, 364 P.2d 685 (1961).
2. *Cambridge Co. v. East Slope Inv. Corp.*, 700 P.2d 537, 540 (Colo. 1985) (refusing to invalidate preemptive rights that would have been voided under a technical application of the RAP).
3. CRS §§ 15-11-1101 *et seq.*
4. Hendrix, "Death of the Rule Against Perpetuities in Commercial Transactions," 21 *The Colorado Lawyer* 475 (March 1992).
5. CRS § 15-11-1102(1)(b).
6. This amendment was patterned after the original Alaska statute, Alaska Stat., § 34.27.050(a)(3).
7. This would seem a simple requirement. Apparently, however, a nondiscretionary simple trust would still be subject to the Rule.
8. *Atchison v. City of Englewood*, 463 P.2d 297 (Colo. 1969).
9. The current standard required under Colorado's Uniform Prudent Investor Act, CRS Art. 1.1, Part 15.
10. CRS § 15-1.1-102(c)(5).
11. CRS § 15-1.1-102(b).

12. Davenport, Professor of Law, Rutgers University: "The Morality, Amoral, and Immorality of Taxation," *Tax Analysts, Tax Practice* (April 20, 1998), letter to the editor.

13. Gates, Sr., "Burden of Wealth—The Estate Tax: What's at Stake," *The Washington Post* (Feb. 18, 2001).

14. Dobris, "The Death of the Rule Against Perpetuities, or the RAP Has No Friends—An Essay," 35 *Real Prop. Prob. & Tr.J.* 602 (Fall 2000).

15. See "Background and Current Status of the RAP," *supra*, notes 1 and 3.