# NOTES

# THE GOOD, THE BAD, AND THE UGLY: THE POLITICAL ECONOMY AND UNINTENDED CONSEQUENCES OF PERPETUAL TRUSTS

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TABLE OF CONTENTS



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## I. INTRODUCTION

President Obama's 2012 and 2013 budget proposals contained similar provisions to tax perpetual trusts ninety years after their creation at the maximum Generation-Skipping Tax rate of 55 percent—a move consistent with arguments by law professors and the American Law Institute.[1] These proposals went little noticed except by investment publications, which advised individuals to create perpetual trusts before they could be taxed.[2] Despite the support of the legal academy, the president's proposal stands little chance of success. Nor should it come as a surprise that a tax proposal with little chance of success was proposed at the beginning of an election cycle—instead, as this Note explains, it should be expected.

Perpetual trusts, facilitated by the 1986 enactment of the Generation-Skipping Tax Exemption ("GST Exemption") and the subsequent repeal of

1. STAFF OF JOINT COMM. ON TAXATION, 112TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2012 BUDGET PROPOSAL 522 (2011) [hereinafter 2012 BUDGET PROPOSAL]; JOINT COMM. ON TAXATION, 112TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2013 BUDGET PROPOSAL 275–78 (2012) [hereinafter 2013 BUDGET PROPOSAL].

2. *See, e.g.*, Lauren Foster, *Dynasty Trusts Make the Money Last Forever*, BARRON'S (March 5, 2011), http://online.barrons.com/article/SB50001424052970204232804576166572535811978.html (advising the wealthy to establish perpetual trusts before the budget proposal is passed).

the rule against perpetuities ("RAP") in most states, allow individuals to place money into trusts where it grows free of intergenerational transfer taxes forever.[3] Prior to the 1986 tax reform, individuals could use successive life estates in trust to transfer money to their grandchildren without triggering the estate tax.[4] To close this loophole, Congress enacted the Generation-Skipping Tax ("GST") in 1986 to tax transfers to individuals more than one generation removed, and the GST Exemption to soften the taxpayer burden.[5] Congress assumed RAP, which limited trust duration to a life in being at the time the trust was created plus twenty-one years, would remain in effect in the states to temporally limit trusts.[6] As a result, Congress also assumed that the GST Exemption would be only a limited tax deferral and not a permanent tax-avoidance mechanism.[7] However, states have repealed RAP at an accelerating rate to attract the trust industry to their states. Since 1986, large sums of money have flowed to perpetual trusts. One frequently cited study estimated that approximately one hundred billion dollars was under management in perpetual trusts as of 2003.[8] One 2010 commentary suggests this may drastically understate the value of perpetual trusts.[9]

Prior articles have analyzed perpetual trusts within the property and trust context of RAP,[10] or within the framework of a jurisdictional competition for trust assets.[11] The literature has not considered the underlying political economy of perpetual trusts or the incentives they create beyond their tax-avoidance motivations. Since perpetual trusts arose out of changes in both property and tax law, this Note takes a different approach. After providing an overview of perpetual trusts in Part II, Part III will develop a political-economic framework to explain the development of perpetual trusts. Although one might presume that the tax advantages of

3. Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303, 1313 (2003).

4. *Id.* at 1312.

5. *Id.* at 1312–13.

6. 2012 BUDGET PROPOSAL, *supra* note 1, at 526.

7. *Id.*

8. Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 359 (2005).

9. RAY D. MADOFF, IMMORTALITY AND THE LAW: THE RISING POWER OF THE AMERICAN DEAD 76–84 (2010) (describing dynasty trusts and the evolving treatment of them).

10. *See, e.g.*, Note, *Dynasty Trusts and the Rule Against Perpetuities*, 116 HARV. L. REV. 2588, 2605 (2003) (arguing that perpetual trusts are good because they create enhanced property rights as compared to RAP).

11. A third variant is an objective analysis of the jurisdictional competition for trust assets. *See generally* Sitkoff & Schanzenbach, *supra* note 8 (analyzing the jurisdiction competition for perpetual trusts).

perpetual trusts resulted from interest-group lobbying, a different dynamic has been at work. In contrast to the traditional view of special-interest politics, which argues that preexisting groups lobby for favorable legislation (the Mancur Olson model),[12] an alternative view posits that legislators often create rights that serve as a touchstone for group formation and can then extract rents in the form of political contributions and votes (the reverse Mancur Olson model).[13] Under the reverse Mancur Olson model, groups often provide rents to maintain their status quo rights.[14] The politics surrounding both the GST Exemption and state-level repeal of RAP reflect the reverse Mancur Olson model—legislators created rights around which interest groups formed. Now that a perpetual-trust industry exists, there is an opportunity for Congress to extract rents through the threat to tax. That the president's budget proposals came during an election cycle, when the need for donations is most acute, reflects the rent-extraction paradigm of the reverse Mancur Olson model and suggests the president's proposal is unlikely to ever pass.

As explained in Part IV, the difficulty in limiting perpetual trusts is, ironically, a good thing since the individual-level problems of perpetual trusts are outweighed by the societal benefit they provide. Perpetual trusts pose significant problems on an individual level that demand an immediate solution—they will present a collective-action problem for beneficiaries, may fall short of the dynastic wealth promised by their proponents, and may benefit the trustee more than the beneficiaries. However, despite being justified on revenue, redistributive, and equality grounds,[15] the current tax system distorts economic decisionmaking in favor of lifetime consumption by taxing intergenerational wealth transfers.[16] Since intergenerational transfer is the primary motivation in savings and capital accumulation, the estate tax reduces overall wealth and the wealth available for

12. MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 10–11 (1965); Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371, 373–85, 395 (1983).

13. Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159, 1164 (2006). This reverses the standard form of rent extraction. As opposed to groups using rents to create political rights, politicians can threaten existing rights to extract rents from groups. *Id.* at 1172.

14. *Id.* at 1173.

15. Joseph Bankman & David A. Weisbach, *The Superiority of an Ideal Consumption Tax over an Ideal Income Tax*, 58 STAN. L. REV. 1413, 1420 (2006).

16. Michael J. Boskin, *An Economists' Perspective on Estate Taxation*, *in* DEATH, TAXES AND FAMILY PROPERTY: ESSAYS AND AMERICAN ASSEMBLY REPORT 56, 60–63 (Edward C. Halbach, Jr. ed., 1977). Intergenerational transfer taxes include the estate tax, the generation-skipping tax, and the gift tax. *See infra* notes 25–29 and accompanying text.

redistribution.[17] By shielding wealth from the estate tax, perpetual trusts incentivize savings and facilitate capital accumulation, while also ensuring assets are efficiently allocated, thus generating a societal benefit. Given the dual efficiency and fairness goals of the tax system and the dubious philosophical basis for the estate tax,[18] perpetual trusts mitigate the inefficiencies of the estate tax and could result in increased overall wealth and greater equality.

Finally, as argued in Part V, the current income tax system is not up to the task of resolving the individual-level problem while maintaining the societal benefit within a political context prone to rent extraction. Instead of attempting to resolve the problems of perpetual trusts within the current income tax structure, Congress should turn to a fundamental rethinking of the tax system as a progressive consumption tax. Under a progressive consumption tax, individuals are taxed on their total income but deduct savings and investments, incentivizing savings when compared to the current income tax which taxes savings twice—when money is earned and on the yield to capital.[19] Since a progressive consumption tax could come without an estate tax component, there would be little need to create a perpetual trust, as the same benefits would be immediately available. Moreover, as compared to the solutions generally posed, implementing a progressive consumption tax could avoid the rent-extraction dynamic of the reverse Mancur Olson model, as there would be no interest group from which to extract rents. Thus, a progressive consumption tax would resolve the individual-level problem of perpetual trusts and maintain the same societal benefit, while also offering immediate efficiency gains over the current tax system.

## II. TRUSTS THAT LAST FOREVER

Advertised as a means of creating dynastic family wealth,[20] perpetual trusts leverage the dual developments of the GST Exemption and state repeal of RAP to create trusts that grow free of the estate tax forever.[21] Indeed, avoiding the GST and minimizing taxes appears to be the primary

17. Laurence J. Kotlikoff, *Introduction* to WHAT DETERMINES SAVINGS? 1, 27 (1989).

18. *See infra* Parts IV.C–V.A.

19. Michael J. Graetz, *Implementing a Progressive Consumption Tax*, 92 HARV. L. REV. 1575, 1580, 1629 (1979).

20. *See, e.g.*, *The Delaware Advantage: Top Ten Reasons to Have Your Wealth Managed in Delaware*, WILMINGTON TRUST (2008), http://www.wilmingtontrust.com/repositories/wtc_sitecontent/PDF/lib-WP-top10.pdf (advertising perpetual trusts as creating dynastic wealth).

21. Verner F. Chaffin, *Georgia's Proposed Dynasty Trust: Giving the Dead Too Much Control*, 35 GA. L. REV. 1, 16 (2000) (identifying tax-free growth as a negative repercussion of perpetual trusts).

motivation in creating a perpetual trust.[22] Existing work on perpetual trusts takes a different tact, however, identifying the control of future generations as one of the foremost purposes of creating a perpetual trust,[23] with only a few articles pointing to tax minimization as the motivating force in perpetual-trust formation.[24] The argument in this Note differs from the existing literature in that it is less concerned with dead-hand control of property. Not only do perpetual trusts employ assets efficiently, but they also provide economic incentives that ameliorate the negative externalities of the estate tax—an argument not addressed in the existing literature.

### A. A BRIEF OVERVIEW OF INTERGENERATIONAL TRANSFER TAXES AND RAP

The present tax code imposes transfer taxes on wealth at least once each generation in three forms. Taxes are imposed on gifts, estate tax transfers on death, and a generation-skipping tax on bequests made to individuals more than one generation removed from the transferor.[25] The GST was first added to the Internal Revenue Code in 1976 and an exemption was first introduced in 1986, intended to lighten the taxpayer burden.[26] Under the GST Exemption, transferors are entitled to exempt a specified amount from the GST, passing the exempted amount tax free to their grandchildren.[27] In 2009, the GST was set at forty-five percent, and went to zero in 2010. However, the GST will be reinstituted in 2013 at a maximum rate of forty percent.[28] The introduction of the GST Exemption

22. Based on an analysis of seventeen perpetual trust websites and advertising material conducted by the author, the first advantage advertised is not that perpetual trusts allow wealth to grow dynastically, but instead that they are tax exempt or located in states with no state tax. Only three of the websites surveyed list passing wealth to the next generation as one of the top two reasons to create a perpetual trust. *See* Wojciech Kopczuk & Joseph P. Lupton, *To Leave or Not to Leave: The Distribution of Bequest Motives*, 74 REV. ECON. STUD. 207, 210 (2007) (arguing that altruism is unlikely to motivate bequests); Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust*, 27 CARDOZO L. REV. 2465, 2469–70 (2006) (finding that perpetual trusts are formed to avoid tax). *But see* Joshua C. Tate, *Perpetual Trusts and the Settlor's Intent*, 53 U. KAN. L. REV. 595, 617–20 (2005) (arguing that settlors create perpetual trusts for reasons other than tax avoidance). *See also* Donald R. Thompson II, *A Banker's Perspective on the Repeal of the RAP in Colorado*, 30 COLO. LAW., July 2001, at 61, 61–62 (stating that few clients attempted to control future generations).

23. *See, e.g.*, Chaffin, *supra* note 21, at 22 (arguing that dead-hand control is the primary purpose of perpetual trusts); Tate, *supra* note 22, at 617 (same).

24. *See, e.g.*, Note, *Dynasty Trusts and the Rule Against Perpetuities*, *supra* note 10, at 2589 (arguing that tax avoidance is the primary purpose to create a perpetual trust).

25. 2012 BUDGET PROPOSAL, *supra* note 1, at 520.

26. Dukeminier & Krier, *supra* note 3, at 1313; MADOFF, *supra* note 9, at 80.

27. 2012 BUDGET PROPOSAL, *supra* note 1, at 520–21.

28. The generation-skipping tax is imposed at the maximum estate tax rate. I.R.C. §§ 2641(a)(1),

created a new method of tax avoidance, whereby individuals could use the exemption amount to create trusts for generation-skipping beneficiaries. However, this was limited until the mid-1990s by RAP, which placed a sharp temporal limit on trust duration.[29]

RAP is derived from the Duke of Norfolk's Case, and was originally concerned with limiting dead-hand control of land through transfers at death to ensure land was used efficiently.[30] At the time, RAP made perfect sense since wealth was measured by land holdings.[31] RAP permitted control of land for a life in being at the time of trust formation plus twenty-one years, and placed assets in the free flow of commerce so they could flow to the highest and best, most efficient use and user, one of the central goals of property law.[32] The fear motivating RAP was that resources would be allocated inefficiently without consent, and resource use would be determined by contingencies allowing a long-deceased ancestor to control the property of the living.[33]

Over time, though, the basis of the rule began to change.[34] The prevalent view is that RAP was a way to balance the desire to pass wealth to one's descendants with keeping property marketable, limiting dead-hand control, and preventing wealth concentration.[35] Although only a secondary concern in the majority of literature on perpetual trusts and RAP, a more nuanced view—consistent with its historical development—is that RAP was intended to place assets into efficient use at a time that wealth was tied up primarily in land.[36] Significantly, the literature seems to accept controlling assets after death, objecting only to the temporal duration.

For reasons that will be developed in Part III, RAP is under fire and

(b) (2006). As modified by the recent American Taxpayer Relief Act of 2012, the maximum estate tax rate will be set at forty percent in 2013. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 101(c), 126 Stat. 2313, 2317–18 (2013) (to be codified at scattered section of I.R.C.).

29. 2012 BUDGET PROPOSAL, *supra* note 1, at 524.

30. Stewart E. Sterk, *Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P.*, 24 CARDOZO L. REV. 2097, 2097 n.1, 2110 (2003) (arguing that RAP dealt with alienability in land).

31. *See id.* at 2110 ("[L]and—far more than capital or labor—represented money and power.").

32. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 11 (5th ed. 1998) ("When resources are being used where their value is highest, or equivalently when no reallocation would increase their value, we may say that they are being employed efficiently.").

33. *Id.* at 560.

34. MADOFF, *supra* note 9, at 77–78.

35. Chaffin, *supra* note 21, at 5; Schanzenbach & Sitkoff, *supra* note 22, at 2471.

36. *Compare* Chaffin, *supra* note 21, at 5 (citing efficient resource use as a third justification of RAP), *with* Note, *Dynasty Trusts and the Rule Against Perpetuities*, *supra* note 10, at 2588 (identifying efficient use as the primary justification for RAP).

has been rapidly repealed by states since 1995. The interaction of the GST Exemption and RAP repeal allows settlors to allocate their GST Exemption to perpetual trusts, which can now last forever in most states.

### B. CHARACTERISTICS OF PERPETUAL TRUSTS

Perpetual trusts are created by allocating a settlor's GST Exemption to money or property placed into trust.[37] If allocated correctly, the assets in the trust grow free of intergenerational transfer taxes forever.[38] Once the assets are in the trust, they can be freely disposed of by the trustee to increase the total value of the assets in trust over time.[39] The trust settlor determines the method of distributions to beneficiaries in the initial trust documents. Distributions are generally structured to be discretionary, allowing payments to be distributed as gifts that also go tax free.[40]

Although the GST Exemption is statutorily limited, aggressive estate planning can magnify the initial allocation to the trust.[41] For example, the GST Exemption allocation can be used to purchase a life insurance policy of up to ten million dollars on the death of the trust settlor, which, due to the interactions of the Internal Revenue Code, goes untaxed and appreciates tax free in the trust.[42] Other asset allocations can also be employed, such as note sales in limited partnerships, using the trust as start-up capital for businesses, and purchasing minority interests in existing businesses.[43] State-law developments now also allow the creation of family trust companies, which create a perpetual trust that is managed by a member of the family serving as the corporate trustee.[44]

The potential growth of perpetual trusts depends on the investment strategy of the trust settlor and risk undertaken by the trustee. However, perpetual trusts are likely to be invested in a portfolio with a relatively stable rate of return that maintains the corpus in a liquid form to facilitate

37. ANN HART WERNZ, TAMARA L. PETERSON & SCOTT A. WINGET, WELLS FARGO FAMILY WEALTH, GENERATION-SKIPPING AND DYNASTY TRUSTS: SELECTED ISSUES IN PLANNING, DRAFTING AND ADMINISTRATION 2 (2008) (on file with author).

38. *Id.*

39. *See infra* Part IV.B.2.

40. MADOFF, *supra* note 9, at 84.

41. *See id.* at 76–85 (arguing that the value of perpetual trusts is significantly understated).

42. *Id.* at 82–83.

43. *Id.* at 83–84.

44. For a discussion of the use of family trust companies as an estate planning tool in perpetual trusts, see Iris J. Goodwin, *How the Rich Stay Rich: Using a Family Trust Company to Secure a Family Fortune*, 40 SETON HALL L. REV. 467, 467–70 (2010) (arguing family trust companies are the "masterstroke" to exploit the elimination of RAP).

distributions to beneficiaries.[45] Once fiduciary fees, tax on trust transactions, and interim distributions are accounted for, a perpetual trust is likely to be worth between $19,312,500 and $113,830,200 at the end of seventy years.[46]

At the same time the trust is growing free of intergenerational transfer taxes, families will also grow exponentially.[47] Assuming average birth, fertility, and death rates, a family will grow to approximately thirty-two members after seventy-five years, and to 1024 members at the end of two hundred years.[48] This is well within the permitted trust duration of nearly all the states that have repealed RAP.[49] Each generation also bears a declining genetic relationship both to each other and to the initial trust settlor.

TABLE 1. Descendants Through the Twentieth Generation[50]

| *Generation* | *Number of Years After Settlor's Death* | *Descendants Per Generation* | *Genetic Relationship to Settlor* |
|---|---|---|---|
| 5th | 75 | 32 | 3.125% |
| 10th | 200 | 1,024 | 0.0976562% |
| 15th | 325 | 32,768 | 0.0030517% |
| 20th | 450 | 1,048,576 | 0.0000953% |

All the while, trustees earn fees at a rate between 0.5 and 1 percent of assets under management each year.[51] A study of the assets under management in perpetual trusts estimated that at least one hundred billion dollars had been placed in perpetual trusts as of 2003.[52] At the time, this

45. *See* William J. Turnier & Jeffery L. Harrison, *A Malthusian Analysis of the So-Called Dynasty Trust*, 28 VA. TAX REV. 779, 789 (2009).

46. The wide range of the expected value of a perpetual trust reflects the variance of the rate of return, distributions, and the costs associated with managing the trust. *See id.* at 814–16.

47. Lawrence W. Waggoner, *From Here to Eternity: The Folly of Perpetual Trusts* 6–11 (Univ. of Mich. Law Sch. Pub. Law & Legal Theory Research Paper Series, Working Paper No. 259, 2012), *available at* http://ssrn.com/abstract=1975117.

48. *Id.* at 10.

49. *See infra* Table 2.

50. Waggoner, *supra* note 47, at 9–11.

51. Edward J. McCaffery, *The Dirty Little Secret of (Estate) Tax Reform*, 65 STAN. L. REV. ONLINE 21, 26 (2012); Scott Martin, *Trust Firm Launches "Why Pay More for Trust Services" Marketing Campaign*, THE TRUST ADVISOR (Sept. 10, 2011), http://thetrustadvisor.com/news/directedtrust2#more-4331 (describing Alaska's use of flat fees).

52. Sitkoff & Schanzenbach, *supra* note 8, at 359. Since trusts are private arrangements with no

represented approximately 10 percent of all assets under trust management.[53] Given the tools available to aggressive estate planners discussed above, these figures likely drastically understate the aggregate assets in perpetual trusts in 2012.[54] As dynasty trusts become more widely utilized, the value of assets under management is likely to grow exponentially and free of tax.

### C. CRITICISM OF PERPETUAL TRUSTS AND THE USUAL SOLUTIONS

Criticism of perpetual trusts in the existing literature can be broadly grouped into five categories. Perpetual trusts facilitate dead-hand control,[55] consolidate wealth and aristocracy,[56] result in a loss of tax revenue,[57] divide trust assets among a multiplicity of beneficiaries,[58] and violate RAP.[59] In contrast, the literature supporting perpetual trusts focuses on the estate planning and tax-avoidance benefits,[60] the ability to transmit "property plus" to beneficiaries,[61] and the ability of existing structures to limit intergenerational transfers of dynastic wealth.[62]

The solutions normally posed to mitigate the problems of perpetual

public filings, state-level data is often cited as a proxy for money flowing to perpetual trusts. This also better reflects the impact of RAP repeal as an element of the jurisdictional competition for trust assets.

53. *Id.*

54. *See* MADOFF, *supra* note 9, at 76–85 (arguing that 2005 statistics understate perpetual-trust assets due to various investment schemes that can go tax free in perpetuity); Waggoner, *supra* note 47, at 4–5 (arguing that perpetual trusts have grown in size since earlier studies).

55. MADOFF, *supra* note 9, at 76–77; Chaffin, *supra* note 21, at 3; Tate, *supra* note 22, at 596.

56. John V. Orth, *Allowing Perpetuities in North Carolina*, 31 CAMPBELL L. REV. 399, 410 (2009); Gregory S. Alexander, *Cornell Law Professor Expresses Support for Durational Limit on GSTT Exemption*, TAX NOTES TODAY, Aug. 4, 2010, *available at* 2010 TNT 149-23 (LEXIS).

57. Lawrence W. Waggoner, *Message to Congress: Halt the Tax Exemption for Perpetual Trusts*, 109 MICH. L. REV. FIRST IMPRESSIONS 23, 24 (2010), http://www.michiganlawreview.org/assets/fi/109/waggoner.pdf.

58. *Id.* at 25–26.

59. *See id.* (describing the long-ranging effects of perpetual trusts); MADOFF, *supra* note 9, at 76–78; Chaffin, *supra* note 21, at 22 (describing how perpetual trusts work against the interests underlying RAP); Orth, *supra* note 56, at 409 (same); Tate, *supra* note 22, at 597–98 (explaining proposed modifications to perpetual trusts more consistent with RAP).

60. Michelle M. Arruda & William F. J. Ardinger, *The Policy and Provisions of the Trust Modernization and Competitiveness Act of 2006*, 47 N.H.B.J., Fall 2006, at *6, *8 (2006), *available at* http://www.nhbar.org/publications/display-journal-issue.asp?id=337; Stephen E. Greer, *The Alaska Dynasty Trust*, 18 ALASKA L. REV. 253, 254 (2001); Richard A. Oshins & Steven J. Oshins, *Protecting & Preserving Wealth into the Next Millennium*, TR. & EST., Sept. 1998, at 52; Note, *Dynasty Trusts and the Rule Against Perpetuities*, *supra* note 10, at 2588; Steven J. Oshins & Judith K. Ruud, *Dynasty Trusts in Nevada: Countdown to 12/01/02*, 9 NEV. LAW., Oct. 2001, at *18.

61. Note, *Dynasty Trusts and the Rule Against Perpetuities*, *supra* note 10, at 2605–06.

62. Keith L. Butler, Comment, *Long Live the Dead Hand: A Case for Repeal of the Rule Against Perpetuities in Washington*, 75 WASH. L. REV. 1237, 1250–53 (2000).

trusts generally follow two lines. The first is to reintroduce RAP, or some form thereof, at the state level.[63] The second is to modify the GST Exemption to limit the tax-free treatment of perpetual trusts, taxing them at the maximum GST rate at a set period in time.[64] Others argue that existing tax structures and the likelihood of a federal solution will mitigate the negative effects of perpetual trusts.[65] However, for the reasons identified in Part III, this fails to account for the lobbying power of money, which favors some form of perpetual trust and continuation of the GST Exemption, and legislators who benefit from this lobbying.[66]

The primary deficiency of prior studies of perpetual trusts is the way they conceptualize the problem. First, the existing solutions are framed within the status quo—the existing political and tax regime—without critically considering the underlying political economy of perpetual trusts. Even though some articles have considered the jurisdictional competition for trusts among the states, these arguments have not been framed within the reverse Mancur Olson model developed in Part III. When viewed through the lens of the reverse Mancur Olson model, the feasibility of a federal tax or state RAP solution seems doubtful at best.

Further, prior articles have analyzed perpetual trusts without considering the positive and negative economic externalities they create, and have focused largely on the near-term problem of eliminating RAP without dividing the problem temporally to focus on long-term issues.[67] Once the issue is divided temporally, one can see that perpetual trusts present an individual-level problem in failing to achieve the settlor's intent, but also bring a societal benefit that should be encouraged within the existing tax system. Given the collective-action problems that could arise for perpetual trust beneficiaries, the individual-level problem requires an immediate solution.

63. *See* Chaffin, *supra* note 21, at 26 (arguing for the use of the USRAP); Tate, *supra* note 22, at 624–25 (arguing that RAP better solves the potential problems of perpetual trusts).

64. *See* 2012 BUDGET PROPOSAL, *supra* note 1, at 523–26 (describing the budget proposal to tax perpetual trusts ninety years after their creation); Lawrence W. Waggoner, *Congress Should Impose a Two-Generation Limit on the GST Exemption: Here's Why* 1 (Univ. of Mich. Law Sch. Pub. Law & Legal Theory Research Paper Series, Working Paper No. 205, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1640742 (advocating a tax on perpetual trusts two generations after formation).

65. Chaffin, *supra* note 21, at 24–25.

66. McCaffery, *supra* note 51, at 26.

67. *Cf.* Sterk, *supra* note 30, at 2098 (arguing that the inefficiencies of perpetual trusts are too distant and uncertain to oppose repealing RAP).

## III. THE POLITICAL ECONOMY OF PERPETUAL TRUSTS

### A. THE MANCUR OLSON VIEW OF LEGISLATIVE POLITICS

Originally developed by Mancur Olson in his classic 1965 book on collective action, the common view of legislative politics, particularly in tax legislation, is one of small interest groups pushing for special benefits from lawmakers.[68] In this view, groups organize voluntarily and independently of political actors, preceding the political right for which they later lobby.[69] Groups tend to form around specific industries, ameliorating the competing and disorganized interests of the general business community.[70] Politically successful groups are small relative to the groups that are taxed to subsidize them, and tend to be homogenous, mitigating collective-action and free-rider problems.[71] After forming for a separate purpose, interest groups are armed with the authority and capacity to coerce members, which is necessary to begin lobbying.[72]

Politicians enter the picture late in the game as an object of group action.[73] Interest groups use their money and votes to lobby and to set the legislative agenda.[74] Politicians are passive, reacting to the groups that have already formed and being driven more by a reelection motive than by money.[75] Competition between groups determines the distribution of taxes, subsidies, and favors, in a positive sum game of political rent creation.[76] This comes at a steep cost to the general population, which funds the tax benefits groups obtain.[77]

Although this view creates a compelling narrative, it fails to explain the lack of money in legislative politics, the proactive role of legislators, and the reason a special interest is threatened absent a competing group. Empirically, there is far less money in congressional politics than the traditional Mancur Olson model would predict.[78] The correlation between

68. Becker, *supra* note 12, at 372.

69. OLSON, *supra* note 12, at 7, 132–33.

70. *Id.* at 45.

71. Becker, *supra* note 12, at 385–92.

72. OLSON, *supra* note 12, at 133–35.

73. McCaffery & Cohen, *supra* note 13, at 1163–65.

74. *See* Becker, *supra* note 12, at 395 (arguing interest groups use money to set the terms of legislative debate); McCaffery & Cohen, *supra* note 13, at 1163–65 (same).

75. Jonathan R. Macey, *Public Choice: The Theory of the Firm and the Theory of Market Exchange*, 74 CORNELL L. REV. 43, 46, 51 (1988); McCaffery & Cohen, *supra* note 13, at 1163–64.

76. Becker, *supra* note 12, at 372–73; Macey, *supra* note 75, at 46.

77. OLSON, *supra* note 12, at 144–45.

78. *See* Stephen Ansolabehere, John M. de Figueiredo & James M. Snyder, Jr., *Why Is There So*

money and votes is similarly weak, but an important correlation exists between money and legislative involvement, suggesting there is a different dynamic at work.[79] The reactive role assigned to politicians also ignores the proactive role politicians often play in the legislative process.[80] Finally, a special-interest group right would not be expected to come under threat without an equally powerful competing group on the other side.[81]

This does not mean that money, interest groups, and political contributions are not important. In fact, quite the opposite is true. Money mobilizes legislators who are already predisposed to support legislation, and sets the legislative agenda, serving as a precondition to affecting legislative outcomes.[82] Thus, the Mancur Olson model may be accurate as far as it goes, but fails to account for broader legislative behavior and voting patterns.[83]

### B. THE REVERSE MANCUR OLSON MODEL

An alternative view to the Mancur Olson model—the reverse Mancur Olson model—posits that interest groups sometimes form in reaction to rights created by legislators.[84] Under this view, legislators create interest groups either intentionally or unintentionally, and can then rationally use legislative threats to extract money and votes.[85] Legislators thus resolve the collective-action problem by creating the occasion for special-interest groups to form in the first place.[86]

As opposed to entering the game late in a reactive mode, legislators actively create groups as part of an "arms race" to raise money, to fuel ambition for higher office, and to aid their political parties.[87] In this view, the Mancur Olson model misunderstands the good at issue by focusing on special favors provided by legislators in response to incentives from

*Little Money in U.S. Politics?*, 17 J. ECON. PERSP. 105, 110–11 (2003) (arguing that a public-choice model would predict far higher levels of money flowing to Congress); Richard L. Hall & Frank W. Wayman, *Buying Time: Moneyed Interests and the Mobilization of Bias in Congressional Committees*, 84 AM. POL. SCI. REV. 797, 813–15 (1990) (same).

79. Hall & Wayman, *supra* note 78, at 813–15.

80. Ansolabehere, de Figueiredo & Snyder, Jr., *supra* note 78, at 109–10.

81. *See* Becker, *supra* note 12, at 394–96 (describing the competition between interest groups).

82. Hall & Wayman, *supra* note 78, at 814.

83. *See* McCaffery & Cohen, *supra* note 13, at 1161 (arguing that the Mancur Olson model fails to empirically explain the full extent of legislative behavior).

84. *Id.* at 1164.

85. *Id.* at 1173.

86. *Id.* at 1175.

87. *Id.* at 1170; McCaffery, *supra* note 51 at 22.

special-interest groups.[88] Politicians instead create rights around which industry groups coalesce, and can then use legislative threats to extract rents.[89] Payments are often made to legislators not to gain favor, but to avoid disfavor.[90] The history of the estate tax, in which Congress has repeatedly come up just short of repeal, provides just one example of the rent-extraction model.[91]

In using threats to create rents, politicians are successful only to the degree those threats are credible.[92] They work, however, with a built-in advantage—the greater the threatened loss, the less a group is able to call the legislature's bluff. Since legislative threats are constitutionally protected, private parties are never completely safe in their political rights and are often subject to future threats.[93] However, the threatened action must be plausible. Otherwise, there is no incentive to lobby and no opportunity to extract rents—the result would be a foregone conclusion.[94] This dynamic is frequently observed in tax legislation:[95]

> The taxing power creates a prototype for rent extraction. Congress has the constitutional power to tax. This ability to tax necessarily entails the ability *not* to tax, that is, to propose taxation but then not levy the tax threatened. Proposing onerous legislation and then—for a price—agreeing not to push or even withdrawing the legislation is a paradigm for rent extraction. . . . Rent-extracting games are observed routinely as part of tax legislation proposals: private individuals pay, not for affirmative special favors, but to avoid disfavor.[96]

The typical rent-extraction game has several characteristics. There is

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88. FRED S. MCCHESNEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION 2 (1997). *See* McCaffery & Cohen, *supra* note 13, at 1164–65 (arguing that Congress often creates groups and then extracts rents, as evidenced by the estate tax).

89. McCaffery & Cohen, *supra* note 13, at 1173.

90. *Id.* at 1172 ("In a rent-extraction/extortion game, potential victims pay politicians not to have losses imposed on them.").

91. *See id.* at 1164–65 (arguing that the estate tax provides a paradigm for the rent-extraction model); McCaffery, *supra* note 51 at 22–23 (describing the dynamics of rent extraction as related to the estate tax).

92. MCCHESNEY, *supra* note 88, at 38.

93. *Id.* at 86–87; McCaffery & Cohen, *supra* note 13, at 1174.

94. *See* McCaffery & Cohen, *supra* note 13, at 1177–78 (arguing that there must be plausible action on both sides of the issue for groups to lobby).

95. MCCHESNEY, *supra* note 88, at 86–87; McCaffery & Cohen, *supra* note 13, at 1161, 1164–65. *See also* Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913, 934 (1987) (noting politicians' use the specter of tax to extract rent); Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 6–8 (1990) (arguing public-interest theory and public-choice theory fail to explain tax reform in the 1980s).

96. McCaffery & Cohen, *supra* note 13, at 1174 (footnotes omitted).

an issue of enormous importance to a small group, which has a low salience for most voters, avoiding public attention and scrutiny. There are generally interest groups and plausible actions to be taken on both sides, allowing legislators to benefit no matter which outcome they choose. Finally, to ensure legislators can extract maximum rents, the issue must be "plausibly long-lived"[97] and "at least valuable enough to be worth paying for."[98]

### 1. Interest Group Formation Through the GST Exemption

At the federal level, the history of the estate tax and GST Exemption presents a case of Congress inadvertently creating a right around which industry groups later formed. The first move facilitating perpetual trusts was the 1986 addition of the GST Exemption to the Internal Revenue Code, allowing a limited amount of money to pass tax free to a transferor's grandchildren. Although Congress did not intend to create an industry for perpetual trusts, its good-faith efforts to close a tax loophole facilitated the development of the perpetual-trust industry from which rents can now be extracted.

Originally implemented in 1916, the estate tax was intended to raise revenue, not to prevent the accumulation of wealth.[99] At the time, Congress called the estate tax the "largest untapped field of revenue in this country."[100] Despite a tax designed for the uniform taxation of estates and the intergenerational transfer of wealth, individuals employed successive life estates in trusts to avoid transferring the corpus and triggering the estate tax.[101] Life tenants received an interest in the trust until their death, at which time the tenancy passed to their descendants. This structure was never subject to the estate tax, and could exist tax free until either the governing documents or RAP terminated the trust.[102]

As part of the 1986 tax reform, Congress closed this loophole by imposing a tax on transfers, either in trust or otherwise, to a person at least

97. *Id.* at 1178.

97. McCaffery, *supra* note 51, at 23.

98. Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223, 230 (1956).

99. *Id.* Conspicuously absent in 1916 was any discernible effort to eliminate extreme concentrations of wealth or to disincentivize interngenerational wealth transfers. In fact, prior efforts to impose an intergenerational transfer tax were rebuffed in both 1909 and 1913. Prior estate taxes, imposed in 1797 and 1862, were enacted in times of recession and later repealed when the economy improved. *Id.* at 225–30.

100. Dukeminier & Krier, *supra* note 3, at 1312.

101. *Id.*

one generation removed.[103] A generation-skipping transfer was defined to mean (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.[104] By applying the GST to direct skips and taxable distributions—which include successive life estates in trust—Congress foreclosed the use of successive life estates to avoid the estate tax.[105] At the same time, Congress enacted the GST Exemption, allowing an exempt portion of the estate to pass free of tax to a generation-skipping person.[106] The exemption was initially set at $1 million, increased to $3.5 million in 2009 and then increased again to $5.12 million indexed for inflation in 2010.[107] The inflation adjusted exemption is set at $5.25 million in 2013.[108] The exemption allows estate planners to allocate $5.12 million per settlor in 2012 to a trust free of the GST.[109] Since the exemption is portable between spouses, a married couple could allocate up to $10.24 million to a perpetual trust.[110] At the time of enactment, it was assumed that RAP's continued application in the states would limit the duration of trusts, ensuring they would be taxed subject to intergenerational transfer taxes.[111]

Contrary to the expectations of the Mancur Olson model, the GST Exemption was enacted not through lobbying by existing interest groups, but by individuals. In fact, an organized lobby against the estate tax did not develop in earnest until the 1990s.[112] The GST Exemption resulted from the individual lobbying efforts of the Gallo family of California to avoid paying more than $100 million in estate taxes under the 1986 tax revisions.[113] The Gallos donated more than $325,000 to ensure the exemption was included in the 1986 tax reform bill.[114] Although it is tempting to view the initial GST Exemption as a rent-extraction game, it is

102. I.R.C. § 2601 (2006); Dukeminier & Krier, *supra* note 3, at 1312.

103. I.R.C. § 2611.

105. Dukeminier & Krier, *supra* note 3, at 1312.

106. *Id.* at 1313.

107. 2012 BUDGET PROPOSAL, *supra* note 1, at 521; Rev. Proc. 11-52, 2011-45 I.R.B. 701, 707.

108. STAFF OF JOINT COMM. ON TAXATION, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 112TH CONGRESS 106 (2013).

109. Rev. Proc. 11-52, 2011-45 I.R.B. 701, 707.

110. McCaffery, *supra* note 51, at 24.

111. 2012 BUDGET PROPOSAL, *supra* note 1, at 526.

112. *See* MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 242–46 (2005) (describing the development of the antiestate tax lobby in the mid-1990s).

113. MCCHESNEY, *supra* note 88, at 64–65.

114. *Id.* Former senator and presidential candidate Bob Dole, then a member of the Senate Finance Committee, received $49,000 in donations from the Gallo family. GRAETZ & SHAPIRO, *supra* note 112, at 18.

unlikely that Congress intended it as such.[115] From 1985 to 1986, while the tax reform bill was being developed, members of the House Ways and Means Committee and the Senate Finance Committee received 23.5 percent of all donations to Congress, suggesting the GST Exemption was just one of many lobbying issues.[116]

Further, although there was no national industry for perpetual trusts prior to 1986, one has developed in a big way. At the time of the 1986 tax reform, perpetual trusts were not feasible because of RAP's continued application in the states. With the repeal of RAP, many of the nation's largest banks—including Citibank, Wells Fargo, Merrill Lynch, Charles Schwab, PNC, and Bank of America's US Trust subsidiary—now provide perpetual trust services in twenty-eight states and the District of Columbia.[117]

2. RAP Elimination and Industry Formation in the States

At the same time that Congress enacted the GST Exemption, states began to rethink RAP, in many cases eliminating or significantly restricting its reach.[118] As of 2010, twenty-eight states and the District of Columbia have eliminated or severely restricted RAP.[119] The dynamics surrounding RAP repeal in the states display the same characteristics of the reverse Mancur Olson model, as repeal has generally preceded the development of in-state trust industries.[120] The primary purpose of repealing RAP is to create an in-state trust industry and to attract jobs and trust assets to the

115. MADOFF, *supra* note 9, at 79; Mary Louise Fellows, *Why the Generation-Skipping Transfer Tax Sparked Perpetual Trusts*, 27 CARDOZO L. REV. 2511, 2520 (2006); Mary Louise Fellows & Gregory S. Alexander, *Forty Years of Codification of Estates and Trusts Law: Lessons for the Next Generation*, 40 GA. L. REV. 1049, 1081–82 (2006); Schanzenbach & Sitkoff, *supra* note 22, at 2477–78.

116. MCCHESNEY, *supra* note 88, at 47; Doernberg & McChesney, *supra* note 95, at 937.

117. *The Delaware Advantage*, CHARLES SCHWAB BANK, http://content.schwab.com/sac/ats/advantage.html (last visited Apr. 11, 2013); *Delaware Trusts*, PNC, https://www.pnc.com/webapp/unsec/ProductsAndService.do?siteArea=/pnccorp/PNC/Home/Personal/Investments+and+Wealth+Management/Wealth+Management+and+Advice/Asset+Protection/Delaware+Trusts (last visited Apr. 11, 2013); *Estate Planning: Using Trusts to Lower Taxes*, MERRILL LYNCH, http://www.wealthmanagement.ml.com/wm/pages/ArticleViewer.aspx?TITLE=Using-Trusts-to-Lower-Taxes&referrer=estate-planning (last visited Apr. 28, 2013); Ian Prior, *Long Live the Dynasty Trust!*, U.S. TRUST: CAPITAL ACUMEN ONLINE (2011), http://www.ustrust.com/publish/ust/capitalacumen/summer2011/features/long-live-dynasty-trust.html; *Trust Services*, CITI PRIVATE BANK, https://www.privatebank.citibank.com/our_services/individuals_families/wealth_advisory/trust.htm (last visited Apr. 1, 2013).

118. Dukeminier & Krier, *supra* note 3, at 1313–16 (describing the variants of state RAP repeal).

119. *See* Ira Mark Bloom, *The GST Tax Tail Is Killing the Rule Against Perpetuities*, 87 TAX NOTES 569, 570 (2000) (arguing that states are engaged in a race to the bottom to attract trust assets by repealing RAP).

120. *See infra* notes 122–43 and accompanying text.

states.[121]

Consistent with the reverse Mancur Olson model, states that had no sizeable trust industry prior to repealing RAP have done so at an accelerating rate. At the time of the 1986 tax reform, only two states, South Dakota and Wisconsin, had repealed RAP. Beginning in 1995 with Delaware, states began the repeal process with nine states eliminating RAP by 2000, and an additional eighteen states since 2000. These states can be broken into two broad categories: states that allow for perpetual duration and states that allow intermediate trust durations of 150 to one thousand years.[122]

121. *See, e.g.*, Sterk, *supra* note 30, at 2103 (arguing that states are engaged in jurisdictional competition to attract trusts).

122. Commentators differ on how to categorize states that have repealed RAP, identifying between six and eight categories, based on trust duration and other state law characteristics. *Compare* Dukeminier & Krier, *supra* note 3, at 1313–14 (identifying eight categories), *with* Note, *Dynasty Trusts and the Rule Against Perpetuities*, *supra* note 10, at 2590–95 (identifying six categories). For the purposes of this analysis, we are interested in the duration, so the specific categories are of less relevance.

TABLE 2. States That Have Repealed RAP and Permissible Trust Duration

| *State* | *Year of Repeal* | *Permissible Duration* |
|---|---|---|
| Wisconsin | 1969 | Perpetual |
| South Dakota | 1983 | Perpetual |
| Arizona | 1995 | 500 years |
| Delaware | 1995 | Perpetual |
| Illinois | 1997 | Perpetual |
| Maryland | 1998 | Perpetual |
| Ohio | 1998 | Perpetual |
| Maine | 1999 | Perpetual |
| New Jersey | 1999 | Perpetual |
| Rhode Island | 1999 | Perpetual |
| Florida | 2000 | 360 years |
| Virginia | 2000 | Perpetual |
| Alaska | 2001 | 1000 years |
| Colorado | 2001 | 1000 years |
| District of Columbia | 2001 | Perpetual |
| Washington | 2001 | 150 years |
| Nebraska | 2002 | Perpetual |
| Utah | 2003 | 1000 years |
| Wyoming | 2003 | 1000 years |
| Missouri | 2004 | Perpetual |
| New Hampshire | 2004 | Perpetual |
| Nevada | 2005 | 365 years |
| North Carolina | 2007 | Perpetual |
| Tennessee | 2007 | 360 years |
| Idaho | 2008 | Perpetual |
| Michigan | 2008 | 360 years |
| Hawaii | 2010 | Perpetual |
| Kentucky | 2010 | Perpetual |
| Pennsylvania | 2010 | Perpetual |

*Sources*: ALASKA STAT. § 34.27.051 (2012); ARIZ. REV. STAT. ANN. § 14-2904 (2012); COL. REV. STAT. ANN. § 15-11-1102.5 (2012); 25 DEL. CODE ANN. tit. 25, § 503 (2009); D.C. CODE § 19-904 (Supp. 2012); FLA. STAT. ANN. § 689.225 (West Supp. 2013); HAW. REV. STAT. ANN. § 525-4 (LexisNexis Supp. 2011); S.B. 2842, 2010 Leg., Reg. Sess. (Hi. 2010); IDAHO CODE ANN. § 55-111 (2012); S.B. 1334, 2008 Leg., 2nd Sess. (Id. 2008); 765 ILL. COMP. STAT. ANN. § 305/4 (West 2001); KY. REV. STAT. ANN. § 381.224 (LexisNexis Supp. 2012); ME. REV. STAT. ANN. tit. 33, § 101-A (Supp. 2012); Chris Stevenson, *Maine's Dynasty Trust Statute: The Product of an Informed Judgment?*, 23 MAINE B.J. 224, 224 (2008); MD. CODE ANN., EST. & TRUSTS § 11-102 (LexisNexis 2011); H.D. 495, 1998 Leg., Reg. Sess. (Md. 1998); MICH. COMP. LAWS SERV. §§ 554.75, 554.93 (Lexis 2012); MO. ANN. STAT. § 456.025 (West 2007); NEB. REV. STAT. § 76-2005 (2009); NEV. REV. STAT. ANN. § 111.1037 (Lexis 2010); N.H. REV. STAT. ANN. § 564:24 (2007); N.J. STAT. ANN. § 46:2F-9 (West 2003); N.C. GEN. STAT. § 41-23 (2011); OHIO REV. CODE ANN. § 2131.09 (West 2005); 20 PA. CONS. STAT. ANN. § 6107.1 (West Supp. 2012); R.I. GEN. LAWS § 34-11-38 (2011); S.D. CODIFIED LAWS § 43-5-8 (2004); TENN. CODE ANN. § 66-1-202 (Supp. 2012); UTAH CODE ANN. § 75-2-1203 (LexisNexis Supp. 2012); VA. CODE ANN. § 55-12.4 (2012); WASH. REV. CODE ANN. § 11.98.130 (West 2006); WIS. STAT. ANN. § 700.16 (2001); WYO. STAT. ANN. § 34-1-139 (2011).

Repeal of RAP has generally preceded the development of an in-state trust industry,[123] and thus groups that might lobby for the right to create perpetual trusts. The experience of two states—Alaska and Nevada—proves particularly instructive.[124] Jonathan Blattmachr, then a high-powered New York attorney specializing in sophisticated trust and estate planning, drafted Alaska's statute permitting perpetual trusts.[125] Blattmachr intended to use the Alaska law to funnel wealthy clients to the Alaska Trust Company, owned by his brother.[126] Prior to repealing RAP, Alaska had no domestic nondepository trust companies,[127] compared to the two that now exist.[128] Similarly, Nevada's repeal of RAP was authored by Steven Oshins, a Nevada trust and estate lawyer. In testimony before the state assembly, Oshins reported moving between $5 and $10 billion in perpetual-trust assets to South Dakota for both in-state and out-of-state clients. Oshins advocated permitting perpetual trusts in Nevada to keep trust assets in state, create jobs, and to develop a Nevada trust industry.[129] Nevada now has twenty-six nondepository trust companies.[130]

Other states have experienced a similar growth in the trust industry after repealing RAP. South Dakota had zero domestic nondepository trust companies prior to amending RAP in 1997, and now has sixty-six.[131]

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123. *See generally* Sterk, *supra* note 30, at 2103 (arguing that states are engaged in jurisdictional competition for trusts to attract jobs and economic benefits).

124. There are indications that Michigan's trust law changes were also driven by the trust industry and written by a trust lawyer. *See* Karen L. Kayes, *Building a Dynasty: Michigan Law Now Allows Perpetual Trusts*, WARNER, NORCROSS & JUDD, LLP (Nov. 26, 2008), http://www.wnj.com/Publications/Building-A-Dynasty-Michigan-Law-Now-Allows-Pe (stating that Greenleaf Trust "spearheaded" changes in Michigan trust law). However, the legislative record on Michigan's trust law change is less developed.

125. DAVID CAY JOHNSTON, PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH—AND CHEAT EVERYBODY ELSE 5 (2003).

126. *Id.*

127. Since the FDIC stopped reporting statistics on personal trusts in 2004, data is generally not available on the size of individual trusts or those held by banks. MAX SCHANZENBACH, EVALUATING THE IMPACT OF TRUST BUSINESS ON DELAWARE'S ECONOMY 7 (May 25, 2011), http://www.epcdelaware.org/Delaware-DE/Library/Trust%20Business%20Report-5-25-11b.pdf. Nondepository trust companies are state law entities that are permitted to establish trusts in various states and are one proxy by which to measure the development of an in-state trust industry. *Id.* at 12.

128. DIV. OF BANKING AND SEC., 2011 ALASKA DIRECTORY OF BANKS AND FINANCIAL INSTITUTIONS 43 (2011), *available at* http://commerce.state.ak.us/bsc/pub/Directory_May_2011.pdf.

129. MINUTES OF THE MEETING OF THE ASSEMBLY COMM. ON JUDICIARY, 2005 Leg., 73d Sess., at 16–17 (Nev. 2005) (statement of Steve Oshins, author of Nevada's trust law).

130. Scott Martin, *South Dakota Sets Record for New Trust Companies*, THE TRUST ADVISOR (May 15, 2010), http://thetrustadvisor.com/news/sd-record.

131. S.D. DEP'T OF LABOR AND REGULATION, LISTING OF TRUST COMPANIES LICENSED TO DO BUSINESS IN SOUTH DAKOTA (Apr. 5, 2013), *available at* http://dlr.sd.gov/banking/trusts/documents/state_chartered_trust_companies.pdf.

Delaware, another favored state for perpetual trusts, grew to thirty-four trust companies after repealing RAP in 1995.[132] While other states have not exhibited the same explosive industry formation, they exhibit the same characteristic of a nonexistent trust industry prior to repeal with the emergence of a small industry afterwards.[133]

The primary motivation in the movement by states to repeal RAP is the competition for trust assets.[134] Of the states repealing RAP, authorities from fourteen have specifically stated the purpose is to attract out-of-state trust assets or to keep trusts in the state and prevent capital flight.[135] For

132. SCHANZENBACH, *supra* note 127, at 12.

133. *See, e.g.*, WASH. STATE DEP'T OF FIN. INSTS., 2009 ANNUAL REPORT 21 (2009), *available at* http://dfi.wa.gov/about/pdf/2009-annual-report.pdf (listing seven trust companies in Washington).

134. Bloom, *supra* note 119, at 572; Dukeminier & Krier, *supra* note 3, at 1315; Sitkoff & Schanzenbach, *supra* note 8, at 359; Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035, 1037 (2000); Sterk, *supra* note 30, at 2103; Note, *Dynasty Trusts and the Rule Against Perpetuities*, *supra* note 10, at 2590–91.

135. Fourteen of the states repealing RAP have included language to this effect in the prefatory clause of the bill limiting RAP, official legislative reports, or the governor's enacting statement. *See* S.B. 2842, 25th Leg. (Haw. 2010) ("The intent of this Act is to offer incentives to high net-worth individuals throughout the United States and throughout the world to transfer a portion of their liquid net worth into this State . . . . This Act is designed to increase the assets under management by Hawaii's private financial sector, increase state tax revenues, and position the State as a world-class financial management jurisdiction."); RICHARD SMREKER, H. COMM. ON CIVIL AND ADMIN. LAW, 91ST H., SUMMARY OF THE COMMITTEE VERSION OF THE BILL (HB 241) (Mo. 2004), *available at* http://house.mo.gov/content.aspx?info=/bills01/bilsum01/commit01/SHB241C.HTM ("[M]issouri trusts companies and attorneys have been losing trust business to those other states."); H. Comm. on Real Prop. & Probate, Analysis 3 (HB 599) (Fla. 2000), *available at* http://archive.flsenate.gov/data/session/2000/House/bills/analysis/pdf/HB0599.RPP.pdf ("[S]tates such as Florida that have not repealed or modified their Rule Against Perpetuities have experienced a flight of capital to those states that have repealed their [RAPs]."); Staff of Ariz. State Senate, Fact Sheet for S.B. 1112 (Ariz. 1998), *available at* http://azleg.state.az.us/legtext/43leg/2r/summary/s.1112.ced.htm ("The concern is that people who would like to set up these types of trusts will go to these other states . . . ."); ILL. 90TH GENERAL ASSEMBLY, H. OF REPRESENTATIVES, TRANSCRIPTION DEBATE, May 22, 1997, at 103–04 (Ill. 1997) (Statement of Rep. Wood) (arguing to "allow the State of Illinois to continue to do trust business" and noting that "trust companies, fiduciary companies, and others are losing some business"); OHIO LEGISLATIVE SERVICE COMM., 122ND CONG., FINAL BILL ANALYSIS, H.B. 701 (Ohio 1997), *available at* http://lsc.state.oh.us/coderev/fnla122.nsf/All%20Bills%20and%20Resolutions/D59B68F91C025E0E852566F6004B4874 (noting the purpose of repeal is to permit dynasty trusts and explaining requirements that the trust be executed or administered in Ohio); MINUTES OF THE MEETING OF THE ASSEMBLY COMMITTEE ON JUDICIARY, *supra* note 129, at 16–17 (statement of Steve Oshins, author of Nevada's trust law) (describing how his law firm moved assets outside of Nevada, and noting that the bill "increases the assets at the banks and financial institutions in Nevada, [and] it stops them from leaving Nevada"); OFFICE OF THE LEGIS. FISCAL ANALYST, UTAH FISCAL NOTE: HB0299S1—TRUST LAW AMENDMENTS (Utah 2003) (noting that if the bill creates new trust business, there would be an increase in revenue); Christine Todd Whitman, Recommendations for Reconsideration for A.B. 2804, *available at* http://www.njleg.state.nj.us/9899/Bills/a3000/2804_v1.pdf (last visited Apr. 14, 2013) (noting that the "effect of this repeal is to allow banks and trust companies to offer 'dynasty' trusts or 'wealth building' trusts to their customers"); Exec. Order No. 97-17, State of S.D., Office of the Governor (directing South Dakota's review of its trust laws to ensure it can "continue its position as a

example, New Hampshire's governor stated the purpose of RAP repeal was "to establish New Hampshire as the best and most attractive legal environment in the nation for trusts and trust services."[136] Similar statements are evident in either the legislative history or enacting statements of virtually all the states repealing RAP. This move was also supported in some states by the state banking and bar associations.[137] Of note, the only state that eliminated RAP primarily to simplify an arcane area of the law was the state of Washington.[138]

Empirically, RAP repeal has attracted perpetual trusts and, at least in Delaware, has resulted in a disproportionate increase in trust assets under management and fiduciary fees.[139] From 1986 through 2003, more than $100 billion was moved into perpetual trusts with the average state gaining $6 billion in total trust assets compared to states where RAP was still in effect.[140] The size of the average trust rose by more than $200,000 after repeal—a 25 percent increase.[141] Delaware, in particular, has disproportionately benefited from repealing RAP. A conservative estimate places the non-Delaware trust business in Delaware at approximately $600 million to $1.1 billion, generating annual fiduciary fees of at least $300 million.[142] "Delaware has ten to twenty times the trust assets and fiduciary fees that would be predicted for a state of Delaware's size and income."[143] This suggests that state-level repeal is reaping enormous dividends, both in

highly desirable jurisdiction in which to locate trusts and trust companies"); Arruda & Ardinger, *supra* note 60, at *6 ("[T]he purpose of the TMCA is 'to establish New Hampshire as the best and most attractive legal environment in the nation for trusts and trust services.'") (citations omitted); Chris Stevenson, *Maine's Dynasty Trust Statute: The Product of an Informed Judgment?*, 23 MAINE B.J. 224, 225 (2008) (quoting Maine's governor arguing that Maine repealed RAP to "open the door to the simple miracle of compound interest" and to achieve "increased business for Maine financial planners and fiduciaries which generates more income tax revenue").

136. Arruda & Ardinger, *supra* note 60, at *6.

137. *See* MINUTES OF THE MEETING OF THE ASSEMBLY COMMITTEE ON JUDICIARY, *supra* note 129, at 4–5 (reporting testimony by the Nevada Bankers Association); SMREKER, *supra* note 135 (noting the support of the Missouri Bankers Association); H. Comm. on Real Prop. & Probate, *supra* note 135 (noting that other states repealed their RAP "at the urging of their bar associations and banking groups"); Stevenson, *supra* note 135, at 224 (arguing Maine's repeal was driven by the Maine Bankers Association).

138. *See* H. BILL REP., S.B. 5054, 55TH LEGIS. (Wash. 2001), *available at* http://apps.leg.wa.gov/documents/billdocs/2001-02/Pdf/Bill%20Reports/House/5054.HBR.pdf; S. FINAL BILL REP., S.B. 5054, 55TH LEGIS. (Wash. 2001), *available at* http://apps.leg.wa.gov/documents/billdocs/2001-02/Pdf/Bill%20Reports/Senate/5054.FBR.pdf.

139. SCHANZENBACH, *supra* note 127, at 1; Schanzenbach & Sitkoff, *supra* note 22, at 2477–78; Sitkoff & Schanzenbach, *supra* note 8, at 356.

140. Sitkoff & Schanzenbach, *supra* note 8, at 356.

141. Schanzenbach & Sitkoff, *supra* note 22, at 2467.

142. SCHANZENBACH, *supra* note 127, at 1.

143. *Id.*

monetary terms and in creating an in-state industry that was preceded by a right to create perpetual trusts.

### C. THE PRESIDENT'S BUDGET PROPOSALS: A RENT EXTRACTION GAME?

Thus, it should come as no surprise that the GST Exemption was threatened—it provides an opportunity to extract rent from groups that organized around a right Congress inadvertently created.[144] Although the history of the GST Exemption does not suggest it was passed with a rent-extraction motive, the development of the perpetual trust industry suggests that legislative threats can now be strung along as part of a rent-extraction game. The value, both politically and economically, derives from the threat to eliminate the GST Exemption; however, it is plausible that the right could be limited. Thus, the president's budget proposal will probably not pass.

The president's 2012 budget proposed taxing perpetual trusts ninety years after their creation at the maximum GST rate, currently 40 percent.[145] Perhaps pandering to those who have benefited from the existing regime, the proposal is not retroactive and does not apply to existing trusts.[146] Under the Mancur Olson model, this is a relatively inexplicable move as there is no comparable political group competing for a tax advantage. The issue comes into sharper focus, though, when viewed from the perspective of the reverse Mancur Olson model.

Beyond fitting with the president's broader political narrative of ensuring that the wealthy do not avoid taxes,[147] the proposal threatens the existing rights of both the wealthy and the fiduciary trust industry.[148] Tax-based threats to existing rights are a hallmark of congressional rent extraction.[149] From the legislative perspective, this is a rational move since those parties represent enormous wealth and are a prime source of financial contributions. The parties threatened by the proposal donated significant sums of money to political action committees during the 2011–2012

144. McCaffery, *supra* note 51, at 21–22.

145. 2012 BUDGET PROPOSAL, *supra* note 1, at 525. *See also supra* note 28 and accompanying text.

146. 2012 BUDGET PROPOSAL, *supra* note 1, at 525.

147. *See* Barack Obama, U.S. President, Remarks by the President in State of the Union Address (Jan. 25, 2012), *available at* http://www.whitehouse.gov/photos-and-video/video/2012/01/25/2012-state-union-address-enhanced-version#transcript (arguing for changes in the tax code so the wealthiest Americans pay their "fair share").

148. McCaffery, *supra* note 51, at 26.

149. McCaffery & Cohen, *supra* note 13, at 1174.

election cycle.[150] Although much of the money donated was likely devoted to a number of issues, the sheer amount of donations provides a frame of reference for the rent-extraction possibilities.[151]

In contrast, the group favoring regulation is much less powerful and more diffuse, and includes the American Law Institute and law professors.[152] This group favors a two-generation limitation on the GST.[153] Compared with the threatened groups, they have little to provide in the form of money or votes.

Given the low salience of the issue to the general public and the credibility of the threat to tax, this is a perfect situation for Congress to extract rents. As opposed to seeking real change, the threat of change better meets the underlying political and personal objectives of politicians, since those affected will likely pay to maintain the status quo.[154] However, plausible action can be taken to limit perpetual trusts given their tax-avoidance characteristics and the president's theme of taxing the wealthy. Also, the trust industry's interest in protecting perpetual trusts is consistent with the objectives of Congress, which should seek industry expansion so more rents can be extracted in the future. That this proposal was made at the beginning of an election cycle, when the need for political donations is most acute, further reflects the salience of the reverse Mancur Olson model.

## IV. THE INDIVIDUAL PROBLEM AND SOCIETAL BENEFIT OF PERPETUAL TRUSTS

The great irony is that the difficulty in limiting perpetual trusts is a

150. *Interest Groups*, OPENSECRETS.ORG, http://www.opensecrets.org/industries/index.php (last visited Apr. 16, 2013). The financial services, insurance, and real estate industries made $656,923,622 in political donations in 2011–2012, and law firms and lobbyists donated an additional $247,543,360. *Id.*

151. For a general discussion of the groups and interests at play, see McCaffery, *supra* note 51, at 26.

152. *See, e.g.*, Alexander, *supra* note 56; John H. Langbein, *Law Professor Supports Two-Generation Limit on GSTT Exemption*, TAX NOTES TODAY, Aug. 11, 2010, *available at* 2010 TNT 154-18 (LEXIS); Lawrence W. Waggoner, *Professor Argues for Two-Generation Limit on GSTT Exemption*, TAX NOTES TODAY, Aug. 11, 2010, *available at* 2010 TNT 154-17 (LEXIS); Waggoner, *supra* note 47, at 14; Lawrence W. Waggoner, *The American Law Institute Proposes a New Approach to Perpetuities: Limiting the Dead Hand to Two Younger Generations* 3–4 (Univ. of Mich. Law Sch. Pub. Law & Legal Theory Working Paper Series, Working Paper No. 200, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1614936.

153. *Compare* Waggoner, *supra* note 57, at 23 (arguing for a repeal of the GST Exemption), *with* Waggoner, *supra* note 152, at 1 (arguing for a two-generation limitation on perpetual trusts and the GST).

154. McCaffery, *supra* note 51, at 26.

good thing from a societal perspective. As opposed to arguing that perpetual trusts are either good or bad as is done in the current literature, this Note takes a more nuanced approach to the issue. Although perpetual trusts pose an individual-level problem for the families who create them, they incentivize savings and investment, mitigating the negative incentives of the estate tax and creating a societal benefit. At least within the current tax system, the creation of perpetual trusts should be encouraged.

### A. THE INDIVIDUAL-LEVEL PROBLEM OF PERPETUAL TRUSTS

Perpetual trusts meet the settlor's immediate goal of avoiding the estate tax. However, they lock up the value of assets in the trust, limit the value to later beneficiaries, pose a significant collective-action problem in terminating or winding up the trust, and create a principal-agent problem. Although this is detrimental to the individual, it is a positive from a societal perspective. The process of wealth dispersion breaks up dynastic wealth even when it is in a trust, and the maintenance of assets in the trust prevents waste and keeps property marketable.

The primary advantage to a perpetual trust on an individual level comes in the tax savings to the settlor's estate, which avoids both the estate tax and the GST. Avoiding intergenerational transfer tax is the primary objective of most perpetual-trust settlors—a motive reflected in trust-company websites, which advertise tax savings as the principal benefit of perpetual trusts.[155] While this is positive for the individual, it results in some revenue loss to the government. However, the significance of the revenue loss is unclear, given that gift and estate taxes have generated only .88 to 2.37 percent of federal revenue per year since 1950 and, once indirect revenue and behavioral effects are controlled for, true estate tax revenues may be neutral or even negative.[156] Moreover, the estate tax has never been particularly effective at breaking up concentrated wealth.[157]

#### 1. Perpetual Trusts May Not Create or Perpetuate Dynastic Wealth

Despite meeting the settlor's near-term tax-avoidance objective, perpetual trusts may fail to create or perpetuate dynastic wealth because of fees on internal trust transactions, which limits their utility to future

155. *See supra* note 22 and accompanying text.

156. B. Douglas Bernheim, *Does the Estate Tax Raise Revenue?*, 1 TAX POL'Y & ECON. 113, 135 (1987).

157. *See* Boskin, *supra* note 16, at 63–64 (arguing that the estate tax has no real effect on decreasing inequality in society).

generations. One analysis of perpetual trusts suggests that the ability to create or perpetuate dynastic wealth, one of the frequently cited benefits of perpetual trusts, is overstated due to the costs of internal trust transactions (see table 3).[158] Inflation, tax on trust transactions, and management fees all erode trust returns and distributions.[159] Even assuming there are only twenty-five beneficiaries over a seventy year period at 9.25 percent interest, estimates of distributions provide only $19,100 to each beneficiary per year.[160] While these distributions are significant, an annual income stream of $19,100 is hardly dynastic wealth.

TABLE 3. Distribution Per Beneficiary by Retention Period and Number of Beneficiaries

| *Retention Period* | *25* | *30* | *35* | *50* | *Corpus Total* |
|---|---|---|---|---|---|
| 50 | 11,700 | 9,800 | 8,400 | 5,900 | 11,855,100 |
| 60 | 15,000 | 12,500 | 10,700 | 7,500 | 15,131,200 |
| 70 | 19,100 | 15,900 | 13,600 | 9,500 | 19,312,500 |

*Note*: Assuming a 9.25 percent return on the trust. Distribution is in real income and assumes a constant number of beneficiaries. An increase in beneficiaries would decrease the distribution amount. Turnier & Harrison, *supra* note 45, at 814.

Furthermore, dynastic wealth is ameliorated naturally by the effects of wealth dispersion. Although intergenerational transfers increase wealth in the second generation, when viewed holistically across generations, there is an overall decrease in wealth concentration.[161] Family wealth tends to disperse in three generations, as less successful children gradually consume the wealth left by prior generations.[162] This occurs not because inherited wealth makes future generations lazy, but for two separate reasons. First, wealth is divided between multiple beneficiaries, limiting the amount inherited by a single individual.[163] Second, descendants are likely to be less successful than their ultra-successful ancestor and revert to the median

158. Turnier & Harrison, *supra* note 45, at 782–85.

159. *Id.*

160. *Id.* at 814–16. A higher rate of return would result in greater distributions, but would also lock up more money in the trust corpus, which could grow to as much as $113,830,200 in fifty years. *Id*.

161. LOUIS KAPLOW, THE THEORY OF TAXATION AND PUBLIC ECONOMICS 267–68 (2008).

162. Gary S. Becker & Nigel Tomes, *Human Capital and the Rise and Fall of Families*, 4 J. LAB. ECON. (SPECIAL ISSUE) S1, S32 (1986).

163. *Id.* at S32.

income, consuming inherited wealth during their lifetime.[164] Economists are divided on the correlation of wealth between children and their parents, with some finding a strong correlation and others weak.[165] The wealth dispersion phenomenon will likely be even more pronounced in perpetual trusts, given the exponential generational expansion identified above supported by a single trust.[166]

### 2. A Collective-Action Problem for Perpetual-Trust Beneficiaries

Even beyond their debatable value in creating dynastic wealth, perpetual trusts pose a collective-action problem for beneficiaries as families grow in size, particularly if they need to invade the corpus more than seventy-five years after the trust is created. State trust codes generally provide two methods for modification or termination—judicial, if it is consistent with the intent of the settlor,[167] and nonjudicial modification by the unanimous consent of beneficiaries.[168] While this may provide a feasible means to modify or terminate a trust in the first or second generation, the issue becomes more acute in later generations.[169] A collective-action problem is presented in obtaining unanimous consent from beneficiaries who have increased exponentially over generations and have little relationship to one another.[170] In seventy-five years, thirty-two people could presumably coordinate and come to some consensus on trust termination or alteration. However, at the two-hundred-year mark—well within the perpetuities period permitted in most states—the beneficiaries will have grown to approximately 1024.[171] During that period, the beneficiaries will almost certainly have moved to different states, if not different countries, and will have little incentive to benefit a distant family

164. *Id.* at S2.

165. *Compare* Gary Solon, *Intergenerational Income Mobility in the United States*, 82 AM. ECON. REV. 393, 394 (1992) (describing correlations of less than .2 between sons' earnings and parents' income), *with* David J. Zimmerman, *Regression Toward Mediocrity in Economic Stature*, 82 AM. ECON. REV. 409, 427 (1992) (finding a correlation of .4 or higher between the lifetime earnings of fathers and sons).

166. *See* Adam J. Hirsch & William K.S. Wang, *A Qualitative Theory of the Dead Hand*, 68 IND. L.J. 1, 53 (1992) (noting that a family could "grow so large relative to the [trust] corpus that the trust becomes worthless").

167. *See, e.g.*, WIS. STAT. ANN. § 701.13 (West 2011) (permitting judicial modification of a trust if it is consistent with the intent of the trust settlor).

168. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 65 (2003) (requiring unanimous consent of beneficiaries for nonjudicial modification).

169. Dukeminier & Krier, *supra* note 3, at 1328–31; Sterk, *supra* note 30, at 2118.

170. *See supra* Table 1.

171. *See supra* Table 1.

member with whom they have only a slight relationship.[172]

There is some suggestion that the market may be adapting to this issue, but it appears to be uneven at best. One estate planning guide prepared by Wells Fargo advises those considering perpetual trusts to include a discretionary termination clause, allowing the trustee to terminate the trust if specified contingencies arise.[173] The guide further advises that the "clause should be drafted as broadly as possible" to account for changing circumstances.[174] Materials from other sophisticated estate planners, however, include no advice on including termination or windup provisions.[175] Furthermore, it is impossible as a practical matter to assess the degree to which these tools are used or the extent to which they have been used in the past. Thus, while there are preliminary indications that the trust industry is taking some account of the problems posed by termination, windup, and the multiplicity of beneficiaries, the market has yet to fully resolve the issue. Given the collective-action problem created by perpetual trusts in combination with the potential for relatively modest trust distributions, beneficiaries may come to view their perpetual trust as an inconsequential "nuisance trust," ignore it, and leave it to benefit primarily the trustee.[176]

### 3. The Principal-Agent Problem: Will Perpetual Trusts Benefit Trustees More Than Beneficiaries?

The most significant aspect of the individual-level problem is the principal-agent problem, as the trust may come to benefit the trustee more over time than the beneficiaries.[177] An agency problem could arise as trustees are paid based on the value of assets under management, and thus have an interest in maintaining the corpus of the trust, whereas

172. Waggoner, *supra* note 47, at 6–8.

173. Wernz, *supra* note 37, at 13.

174. *Id.*

175. *See, e.g.*, RICHARD W. NENNO, PLANNING WITH PERPETUAL DYNASTY TRUSTS (2004), *available at* http://meetings.abanet.org/webupload/commupload/RP582000/newsletterpubs/nenno1.pdf (failing to address the issue of termination or windup in perpetual-trust planning); THOMAS R. PULSIFER & TODD A. FLUBACHER, DYNASTY TRUSTS MAY BE EVEN MORE POWERFUL IF TRANSFER TAX LAWS CHANGE (2007), *available at* http://65.36.194.206/mnat/PDFs/DynastyTrusts.pdf (same); CAROL H. GONNELLA & M. JASON MAJORS, DYNASTY TRUSTS: ESTATE PLANNING FOR SUCCESSIVE GENERATIONS (2008) (same).

176. Hirsch & Wang, *supra* note 166, at 53.

177. *See* Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 636–38 (2004) (describing the economics and cost of agency). Agency costs arise any time there is an informational asymmetry between owners and managers. Although the theory of agency cost has not typically been applied to trusts, it arguably provides as much insight into trust management as it does to corporate management. *Id.* at 633–34.

beneficiaries have an interest in distributions. Trustees who manage perpetual trusts earn between 0.5 and 1 percent of assets under management in annual fiduciary fees.[178] Given the potential that the combination of a modest income stream and collective-action problems could lead beneficiaries to ignore their perpetual trust, the fiduciary could conceivably earn more from the trust than any of the beneficiaries. Since many perpetual trusts are structured to provide discretionary distributions, this poses a significant moral-hazard problem—trustees have an incentive to keep assets in the trust to maximize their income while beneficiaries would prefer distributions.[179]

Even if beneficiaries can resolve the collective-action problem necessary to modify or terminate the trust, the trustee will likely oppose them successfully. The Claflin Doctrine, which governs trust termination, provides that a trust can only be modified or prematurely terminated with the consent of the settlor, or if it does not offend a "material purpose" of the trust.[180] Trustees faced with the prospect of losing their income would have little difficulty pointing to the tax-avoidance purpose of a perpetual trust to avoid termination, as it would be subject to the GST at the then-prevailing rate. A court would likely look favorably on this argument, given the tax-avoidance purpose of the trust and the tendency to deny termination under the Claflin Doctrine.[181]

Particularly in perpetual trusts, this aligns the trustee's interests with the interests of the state. The state has a broad interest in preventing waste and the inefficient use of assets.[182] This is accomplished through trusts because trustees have a fiduciary duty to invest freely alienable assets to maximize the value of the trust, and they have no right to waste.[183] In contrast, individuals have no duty to use assets efficiently and are free to waste.[184] Accordingly, the state's interests are aligned with those of the trustee.

178. McCaffery, *supra* note 51, at 26.

179. Sterk, *supra* note 30, at 2111–12.

180. Sitkoff, *supra* note 177, at 658–59.

181. *Id.* Even as trust law has slowly liberalized, the trend has been towards effectuating the settlor's intent. *Id.* at 660–62.

182. *See* POSNER, *supra* note 32, at 11 (arguing that property is used efficiently in the free flow of commerce).

183. Hirsch & Wang, *supra* note 166, at 52–53.

184. *See* Edward J. McCaffery, *Must We Have the Right to Waste?*, *in* NEW ESSAYS IN THE LEGAL AND POLITICAL THEORY OF PROPERTY 76, 76–77 (Stephen R. Munzer ed., 2001) (arguing that Anglo-American law provides an unfettered right to waste property owned in fee simple absolute).

## B. THE NET SOCIETAL BENEFIT OF PERPETUAL TRUSTS

Despite the individual-level problems posed by perpetual trusts, they create a net societal benefit by incentivizing savings and capital accumulation, and efficiently employing assets. Although the efficient use of assets has been identified as a benefit of perpetual trusts in prior articles,[185] those articles have not analyzed the incentives of perpetual trusts within the broader context of the estate tax and GST. While perpetual trusts may result in greater wealth concentration, that wealth is locked up in the trust corpus, limiting its effect on politics and democracy. The savings and bequest incentives of perpetual trusts also mitigate the negative externalities of the estate tax, suggesting that on a societal level, we should encourage perpetual trusts as a mechanism to incentivize savings and investment.

### 1. Incentivizing Savings and Capital Accumulation

One of the principal drawbacks to the estate tax regime is that it incentivizes lifetime consumption to avoid tax.[186] This has the net effect of substantially reducing bequests and capital accumulation, limiting the capital available for investment and redistribution. Perpetual trusts counter this problem by leveraging the bequest motive, the desire to pass wealth intergenerationally, which is both the most significant motive in overall savings and the primary source of capital accumulation.

Economists commonly identify four primary motivations for savings: "life cycle saving for retirement, saving for intergenerational transfers, precautionary saving resulting from life span uncertainty, and precautionary saving resulting from uncertain health expenditures."[187] Although some economists believe that adding bequests does not significantly alter savings patterns,[188] the majority view is that it plays a central role in savings.[189] "[A] wide variety of evidence suggests that

185. *See, e.g.*, Sterk, *supra* note 30, at 2110 (arguing that the issue of dead-hand control is not applicable to trusts).

186. *See infra* Part IV.C.

187. Kotlikoff, *supra* note 17, at 39.

188. William Lord & Peter Rangazas, *Savings and Wealth in Models with Altruistic Bequests*, 81 AM. ECON. REV. 289, 293 (1991).

189. Laurence J. Kotlikoff, *Intergenerational Transfers and Savings*, *in* WHAT DETERMINES SAVINGS?, *supra* note 17, at 68, 69; Laurence J. Kotlikoff & Lawrence H. Summers, *The Role of Intergenerational Transfers in Aggregate Capital Accumulation*, 89 J. POL. ECON. 706 (1981), *reprinted in* WHAT DETERMINES SAVINGS?, *supra* note 17, at 43; Edward J. McCaffery, *Tax Policy Under a Hybrid Income-Consumption Tax*, 70 TEX. L. REV. 1145, 1209–13 (1992). An alternative view posits either that intergenerational wealth transfer is the result of a hump in lifecycle savings, or an

intergenerational transfers play a major role, if not a predominant role in U.S. wealth accumulation."[190] Studies on the intergenerational transfer of wealth estimate that 15 to 70 percent of the U.S. capital stock is passed intergenerationally, with an average estimate of 50 percent.[191] Absent intergenerational transfers, "the US capital stock would be substantially smaller."[192]

Perpetual trusts incentivize savings, playing off the bequest motive by allowing savings to pass tax free to the next generation. Since intergenerational transfer taxes substantially decrease bequests, undermining the primary savings motivation and capital accumulation, perpetual trusts mitigate the negative externalities of the estate tax.[193] With an ability to shield wealth from the estate tax, there is less incentive to engage in lifetime consumption to avoid taxes.[194] Viewed from the opposite perspective, a decrease in bequests motivated by taxation is unlikely to increase equality, as lifetime consumption will increase.[195]

Although derided as tools of inequality in the existing literature, perpetual trusts are likely to increase overall societal wealth and provide for stronger redistribution.[196] An increase in savings enhances future economic growth potential by making more money available for investment, lowering interest rates, and increasing productivity and aggregate gains.[197] Since more money is saved and invested, the total capital stock increases.[198] With more capital, labor is more productive and brings a higher rate of return,

important but quantitatively modest percentage of savings. Franco Modigliani, *The Role of Intergenerational Transfers and Life Cycle Saving in the Accumulation of Wealth*, 2 J. ECON. PERSP. 15, 19, 23 (1988).

190. Kotlikoff, *supra* note 17, at 27.

191. Barbara H. Fried, *Who Gets Utility from Bequests? The Distributive and Welfare Implications for a Consumption Tax*, 51 STAN. L. REV. 641, 642 (1999). The variance in estimates is the result of differing measuring methodologies utilized by economists. *Id.* at 642 n.1.

192. Kotlikoff & Summers, *supra* note 189, at 43.

193. Boskin, *supra* note 16, at 63.

194. *Id.* at 62.

195. *Id.* at 63.

196. *See* Fried, *supra* note 191, at 643 (arguing that overall welfare will increase through greater savings and the resultant increase in the capital stock); Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 306–07 (1994) (arguing that increasing the capital stock may increase equality under a consumption tax).

197. McCaffery, *supra* note 189, at 1166; Charles Steindel, *How Worrisome Is a Negative Saving Rate?*, CURRENT ISSUES IN ECON. & FIN., May 2007, at 4, *available at* http://www.newyorkfed.org/research/current_issues/ci13-4.pdf.

198. MARSHALL B. REINSDORF, SAVING, WEALTH, INVESTMENT, AND THE CURRENT-ACCOUNT DEFICIT (2004), *available at* www.bea.gov/scb/pdf/2005/04April/PersonalSavingBox.pdf (identifying the downward trend in personal savings as a factor in declining net national savings).

which, over time, reduces inequality as wealth is redistributed.[199] By decreasing savings, the estate tax reduces the return on labor and capital, which may have the perverse effect of declining efficiency and increasing inequality.[200] As opposed to concentrating wealth and increasing inequality, perpetual trusts may therefore have the opposite effect of decreasing inequality by increasing the rate of return on labor and capital.

2. Perpetual Trusts Encourage Efficient Use of Property

Perpetual trusts also achieve a central goal of property law by placing assets into the free flow of commerce so they can be used efficiently. "When resources are being used where their value is highest, or equivalently when no reallocation would increase their value, we may say that they are being employed efficiently."[201] RAP and a limitation on trust duration served an important purpose when value and wealth were tied up in land.[202] In a modern financial system, in which we are concerned more about the value of the underlying assets and not the assets themselves, RAP is simply no longer needed.[203] Instead, perpetual trusts provide a more efficient means to allocate wealth.

Although some recent criticisms have focused on perpetual trusts as extending dead-hand control like never before, the issue of dead-hand control can be subdivided into two subordinate arguments.[204] The first argument, previously addressed by RAP, is that a scheming ancestor could control the actions of future descendants by placing restrictions on the use of property and conditions on its receipt. The second argument is that perpetual trusts take assets out of efficient economic use and tie them to a long-dead ancestor, raising questions of intergenerational equity.

Ironically, few commentators have focused on the first argument, perhaps because we are always bound by the past through genetics: "The

199. Boskin, *supra* note 16, at 64; McCaffery, *supra* note 189, at 1166. *See also* Ethan S. Harris & Charles Steindel, *The Decline in U.S. Saving and Its Implications for Economic Growth*, FED. RES. BANK OF N.Y. Q. REV., Winter 1991, at 15, *available at* www.ny.frb.org/research/quarterly_review/1990v15/v15n34article1.pdf (noting that declining savings challenges future growth potential and slows technological innovation); Steindel, *supra* note 197, at 4 (savings plays a "major role" in the accumulation of capital and thus helps to determine future economic growth).

200. Boskin, *supra* note 16, at 62–64.

201. POSNER, *supra* note 32, at 11.

202. Sterk, *supra* note 30, at 2110.

203. *See* McCaffery, *supra* note 184, at 89 ("The chief repository of property value has moved since the eighteenth century from real to intangible property, paradigmatically money.").

204. *See* MADOFF, *supra* note 9, at 76–85 (arguing that perpetual trusts extend dead-hand control like never before).

inheritance of a large amount of money may seem to confer an unfair advantage, but why more unfair than inheriting brains and energy?"[205] However, it may also result from the recognition that trusts are generally not intended to control future generations.[206] Although earlier studies on bequest motivations were premised on the assumption that testators sought to influence beneficiary behavior,[207] a more recent study noted that there is little evidence to support the desire to condition the behavior of future beneficiaries, and that intergenerational transfers are used primarily to minimize tax liability.[208] This suggests that the first argument against perpetual trusts on the basis of extending dead-hand control addresses a problem that cannot be resolved, and simultaneously may not exist.

The latter argument against dead-hand control is twofold: ancestors can restrict both use and investment decisions.[209] This concern is motivated by an understanding of property that is rooted in land—if land is locked up for generations, later generations have less freedom to alienate and no land to restrict.[210] This misses a critical transition, since the repository of value is now defined by money, not by land as it was at the time RAP was created.[211] Perpetual trusts resolve this concern as they permit neither use nor investment restrictions.[212] All states that permit perpetual trusts require that trustees have the power to alienate trust assets, as well as a fiduciary duty under state trust laws to invest assets efficiently for the benefit of the trustees.[213] Fiduciary duties also usually include a requirement to diversify assets,[214] ensuring that trust assets remain marketable and eliminating inefficiencies.[215] Although perpetual trusts were previously subject to criticism on the basis that trustees invested with suboptimal risk,[216] the

205. POSNER, *supra* note 32, at 553.

206. For the account of one trust officer, see Thompson II, *supra* note 22, at 61–62 (stating that few clients want to control future generations).

207. *See, e.g.*, B. Douglas Bernheim, Andrei Shleifer & Lawrence H. Summers, *The Strategic Bequest Motive*, 93 J. POL. ECON. 1045, 1046 (1985) (taking as a premise that "testators use bequests to influence the behavior of potential beneficiaries").

208. Kopczuk & Lupton, *supra* note 22, at 210, 231.

209. Hirsch & Wang, *supra* note 166, at 4.

210. Sterk, *supra* note 30, at 2110.

211. McCaffery, *supra* note 184, at 89; Sterk, *supra* note 30, at 2110.

212. Hirsch & Wang, *supra* note 166, at 19–20.

213. *See, e.g.*, ME. REV. STAT. ANN. tit. 18-B, § 816 (2012) (requiring perpetual-trust assets to be alienable).

214. *See, e.g.*, WIS. STAT. ANN. § 881.01 (West 2002) (requiring trustees to diversify investments).

215. *See* Sterk, *supra* note 30, at 2110 (noting that since trust property is marketable, there is no issue with dead-hand control).

216. *See* Chaffin, *supra* note 21, at 23–24 (arguing that fiduciary duties resulted in suboptimal risk allocation).

liberalization of state trust laws now allow trustees to balance risk based on the entire portfolio.[217] Perpetual trusts therefore ensure a more economically efficient allocation of assets, which beneficiaries would have no similar obligation to alienate or use efficiently.[218]

Finally, and little noticed by most commentaries on perpetual trusts, perpetual trusts professionalize management by increasing specialization and avoiding waste. First, they place assets into the hands of corporate fiduciaries. Since no individual will live long enough to manage a perpetual trust, the favored trustee is generally a corporate trustee either at a large bank offering trust services, or at a specialized trust company in the states permitting perpetual trusts.[219] Trustees, unlike individual property owners, have no right to waste. Second, the creation and use of family trust companies to manage perpetual trust assets encourages the development of professional investment skills in wealthy families.[220] This creates a new generational cadre of investment professionals who can help to efficiently manage assets, as opposed to consuming them or allowing them to go to waste.

### C. THE FAILURE OF THE ESTATE TAX

Despite the imposition of the estate tax at a high marginal rate, it has never been effective in raising revenue or breaking up concentrated wealth, even though it may have been effective in breaking up extreme wealth concentration.[221] This issue is brought into focus by three related sets of data: the revenue raised by the estate tax, the relatively consistent concentration of American wealth throughout the twentieth century, and similar concentrations of wealth in countries that have no estate tax. Not only does this data call into question the efficacy of the estate tax generally, but it also criticizes perpetual trusts on the basis that they facilitate wealth concentration.

The estate tax has done a poor job of achieving its initial purpose of generating federal revenue. In 2008, the Gift and Estate Tax generated

217. Goodwin, *supra* note 44, at 500–10. *See, e.g.*, WIS. STAT. ANN. § 881.01 (requiring trustees to manage assets as prudent investors, evaluating transactions in light of the broader portfolio and not individual assets). Trustees were previously limited to evaluating risk based on individual stocks under the Prudent Man Rule; however, the introduction of the Prudent Investor Rule in state fiduciary duty statutes now allows trustees to evaluate risk based on the entire portfolio. Goodwin, *supra* note 44, at 499–504.

218. *See* McCaffery, *supra* note 184, at 77.

219. Sitkoff & Schanzenbach, *supra* note 8, at 434.

220. Goodwin, *supra* note 44, at 510–15.

221. Boskin, *supra* note 16, at 64–65.

approximately $29 billion in federal revenue, but then decreased to $23 billion in 2009 and $19 billion in 2010.[222] The Congressional Budget Office projects that receipts from the Gift and Estate Tax will generate $11 billion in 2012 and $14 billion in 2013.[223] While these figures are large in absolute terms, they account for less than 1 percent of total federal revenues.[224] Further, the estate tax might even lose revenue by incentivizing lifetime consumption and lifetime giving free of tax.[225] Thus, despite the high marginal rate on estate taxation, the estate tax has been "a very minor player indeed."[226]

Furthermore, the estate tax has had little effect historically on wealth concentration in the United States.[227] Throughout the 1900s, wealth concentration in the United States remained relatively constant and similar to wealth concentration in other Western countries.[228] Changes in wealth concentration tended to mirror changes in the overall economy, and bore no significant correlation to the estate tax rate.[229] It is important to note that throughout this period, the same tax avoidance achieved through perpetual trusts was accomplished through the use of successive life estates, suggesting that similar percentages of wealth were subject to estate taxation.[230] Significantly, one 2009 study found that eliminating the estate tax would have no measurable impact on either inequality or wealth concentration.[231] By subjecting the GST Exemption amount to the estate

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222. OFFICE OF MGMT. & BUDGET, HISTORICAL TABLES: BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2012, at 46 tbl.2.5 (2012), *available at* http://www.gpo.gov/fdsys/pkg/BUDGET-2012-TAB/pdf/BUDGET-2012-TAB.pdf.

223. CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2012 TO 2022, at 85 (2012), *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/01-31-2012_Outlook.pdf.

224. *Id.*

225. Bernheim, *supra* note 156, at 135.

226. Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 269 (1983).

227. However, estimates of wealth concentration do show an increase in incomes attributable to wages as opposed to past wealth. EMMANUEL SAEZ, STRIKING IT RICHER: THE EVOLUTION OF TOP INCOMES IN THE UNITED STATES (UPDATED WITH 2011 ESTIMATES) 4 (2013), *available at* http://elsa.berkeley.edu/~saez/saez-UStopincomes-2011.pdf. Although Saez believes cuts to the estate tax could permit greater wealth concentration, the Joint Committee on Taxation notes that the impact of the estate tax on savings and bequests is an open theoretical and empirical question. *Id.* at 5; 2013 BUDGET PROPOSAL, *supra* note 1, at 247–48. Moreover, one could argue that the estate tax is driving wealth concentration through aggressive tax planning like perpetual trusts. Edward J. McCaffery, *Distracted from Distraction by Distraction: Reimagining Estate Tax Reform* 12 (Univ. of S. Cal. Law Sch. Law & Econ. Working Paper Series, Working Paper No. 160, 2013).

228. McCaffery, *supra* note 196, at 323–24.

229. *See* Edward N. Wolff, *Changing Inequality of Wealth*, 82 AM. ECON. REV. 552, 553 (1992) (concluding that wealth concentration varied due to factors other than the estate tax).

230. *See supra* notes 99–111 and accompanying text.

231. Marco Cagetti & Mariacristina De Nardi, *Estate Taxation, Entrepreneurship, and Wealth*, 99

tax, therefore, only an incremental gain could be made in breaking up concentrated wealth.[232]

Even more striking is the relative similarity between wealth concentration in the United States and countries that have no intergenerational transfer tax. Countries that have historically taxed intergenerational transfers as inheritance taxes and countries with no intergenerational transfer tax—Canada and Australia, for example—have similar concentrations of wealth to the United States.[233] This suggests concerns over perpetual trusts and wealth concentration are overstated. Given the factors identified in the prior section related to reversion to the mean wealth and division of assets between multiple beneficiaries, wealth dispersion could serve a stronger moderating force in mitigating wealth concentration than estate taxation.[234]

Finally, as discussed above, estate taxation creates significant inefficiencies by distorting economic decisionmaking. Most importantly, it distorts decisions on savings and investment, favoring lifetime gifts and consumption.[235] An individual has three potential uses of wealth: consumption, gifts, and bequests.[236] The imposition of an estate tax in any form dramatically increases the cost of bequests—which incentivizes lifetime consumption and limits savings and capital accumulation—and introduces a substantial inefficiency as bequests are suboptimal.[237] The United States has traditionally taxed intergenerational wealth at the termination of an estate, but given the inefficiencies of the estate tax, one must question whether this is because it is effective or simply because it has always been done this way.

## V. TOWARD A PROGRESSIVE CONSUMPTION TAX

Given the discussion in Parts III and IV of this Note, it should be evident that solutions to the individual-level problem of perpetual trusts will be difficult if not impossible within the current political framework. The political economy of perpetual trusts and the reverse Mancur Olson understanding of legislative politics suggest perpetual trusts are here to

AM. ECON. REV. 85, 106 (2009).

232. McCaffery, *supra* note 196, at 324, 329–30, 329 n.174. "It may not be better for society to have one thousand millionaires . . . than a single billionaire." *Id.* at 324.

233. *Id.* at 323–24, 327–28.

234. Boskin, *supra* note 16, at 63.

235. *Id.* at 61–63; Cagetti & De Nardi, *supra* note 231, at 86.

236. Bequests, here, include savings and investments.

237. Boskin, *supra* note 16, at 60–63.

stay. Moreover, that may not be a bad thing since they employ property efficiently, incentivize savings and capital formation, and mitigate the inefficiencies of the estate tax. Thus, within the current tax system, perpetual trusts should be encouraged.

The difficulty is that steps to resolve the individual-level problem risk creating a reverse Mancur Olson rent-extraction game, as demonstrated by the president's budget proposal. Given the inefficiencies of the estate tax discussed in Part IV, Congress should instead turn to a more fundamental rethinking of how and why we tax, and fashion a tax system that meets objectives of efficiency, redistribution, and fairness. A progressive consumption tax with no estate tax component provides a feasible and efficient means to realize these objectives. A progressive consumption tax would remove the incentive to create perpetual trusts, ameliorating the individual-level problem and maintaining the societal benefit. Further, since the transition to a progressive consumption tax would affect all taxpayers, it would be less susceptible to a reverse Mancur Olson rent-extraction dynamic.

### A. WHY WE TAX

The current income tax system has generally been justified on three bases: it is efficient in raising revenue, it is more redistributive than alternative tax systems, and it breaks up concentrated wealth.[238] The current system focuses on liquidity and the left side of the famed Haig-Simons definition of income—income equals consumption plus savings. Largely ignored under the current income- or hybrid-based tax system is the right side of the Haig-Simons equation, consumption and savings. This simple equation suggests there are two opportunities to tax: first, when money is earned (income), and second, when money is spent (consumption). Many of the problems of both the estate tax and the income tax more broadly can be resolved by reference to the right side of the income equation. Simply by subtracting savings from both sides of the equation, consumption comes to equal income minus savings. This basic statement provides the basis for a progressive consumption tax.[239]

Given the problems noted in Part IV pertaining to the inefficacy of the estate tax, it is worth pausing for a moment to consider the philosophical justification for taxing wealth. For that, we turn to John Rawls. Rawls identifies three purposes for tax in a just society: "The purpose of these

238. Bankman & Weisbach, *supra* note 15, at 1420.
239. McCaffery, *supra* note 196, at 285 n.5.

levies and regulations is not to raise revenue . . . but gradually and continually to correct the distribution of wealth and to prevent concentrations of power . . . and fair equality of opportunity."[240] Of interest to this analysis, Rawls argues that inheritance should be taxed to ensure equality of opportunity and fairness. Recognizing the inherent challenges that intergenerational transfer taxes pose to efficiency, however, Rawls states, "inheritance is permissible provided that the resulting inequalities are to the advantage of the least fortunate and compatible with liberty and fair equality of opportunity."[241] This tension suggests that the estate tax rests on a dubious philosophical basis, and could be eliminated without raising concerns of fairness and equality.

Another tenet of tax law is that it should be neutral, meaning that individuals should make the same economic decisions under the tax that they would make in a hypothetical nontax world.[242] However, as discussed in Part IV, the estate tax creates significant distortions in savings and capital accumulation. Given the distortionary effects of taxing intergenerational wealth transfers and the societal benefit of perpetual trusts, one could just as easily imagine an alternative system of taxation that meets the same objectives. "Leaving aside many complications, it is worth noting that a proportional expenditure [consumption] tax may be part of the best tax scheme . . . ."[243]

### B. THE BASICS OF A PROGRESSIVE CONSUMPTION TAX

Unlike the current income-based tax system, a progressive consumption tax taxes wealth when it is spent, not when it is earned. In doing so, a progressive consumption tax incentivizes savings and capital accumulation, providing greater opportunities for redistribution.[244] Familiar elements of a consumption tax are already incorporated into the present tax code through the tax treatment of pensions, IRAs, and life insurance policies, resulting in what one commentator has called a "hybrid" tax system.[245]

In its simplest form, a cash-flow consumption tax, a progressive

240. JOHN RAWLS, A THEORY OF JUSTICE 245 (Revised ed., Oxford Univ. Press 1999) (1971).

241. *Id.*

242. McCaffery, *supra* note 189, at 1157.

243. RAWLS, *supra* note 240, at 246.

244. McCaffery, *supra* note 189, at 1161–66. *But see* Douglas Holtz-Eakin, *The Uneasy Empirical Case for Abolishing the Estate Tax*, 51 TAX L. REV. 495, 495 (1996) ("[V]ery little can be said with confidence regarding the distributional consequences of the estate and gift tax.").

245. McCaffery, *supra* note 189, at 1154.

consumption tax would not appear or operate all that differently from the current income tax structure.[246] Individuals would be taxed based on their total income, much as they are today, but would deduct savings and investments.[247] Other deductions could be treated in much the same way they are today, and would face the same challenges.[248] Progressivity could be achieved through the imposition of steeply progressive rates based on overall consumption, thus better reflecting a taxpayer's ability to pay.[249]

What then of wealthy individuals who make most of their money as capital income under the current income tax structure? Under a progressive consumption tax, this distinction is irrelevant. "A consumption tax ignores the labels put on earnings because the tax is not imposed directly on earnings."[250] Instead, the tax is imposed uniformly when the money is spent. The recharacterization of capital income as ordinary income comes without any disincentive to savings or investment because of their immediate deductibility.

"It has been known for a considerable time that an income tax distorts two choices, by discouraging both work and saving, while a consumption tax distorts only one, by discouraging work."[251] Beyond just the dynamics of the estate tax, the current system effectively taxes savings twice. Wealth is taxed when it is earned and, for wealth that is not immediately consumed, a second time by the imposition of a tax on the yield to capital.[252] By taxing returns on savings and investments, savings is penalized and lifetime consumption is favored.[253] In contrast, a progressive consumption tax does not distort the economic decision to consume or save.[254] Since bequest savings are most distorted within the current structure and yet most critical to the broader savings motive, a progressive

246. *See* Graetz, *supra* note 19, at 1580 (arguing that a progressive consumption tax could be approximated by reference to income and savings).

247. *Id.*

248. *Id.* at 1584.

249. *See* Bankman & Weisbach, *supra* note 15, at 1419 (arguing that a consumption tax can be made progressive by imposing graduated marginal rates, thereby imposing a high rate of tax on future consumption); Daniel N. Shaviro, *Replacing the Income Tax with a Progressive Consumption Tax*, 103 TAX NOTES 91, 92–93 (2004) (arguing a consumption tax could be just as progressive as the current income tax).

250. Bankman & Weisbach, *supra* note 15, at 1437.

251. Daniel Shaviro, *Beyond the Pro-Consumption Tax Consensus*, 60 STAN. L. REV. 745, 783 (2007).

252. Edward J. McCaffery & James R. Hines, Jr., *The Last Best Hope for Progressivity in Tax*, 83 S. CAL. L. REV. 1031, 1042 (2010).

253. Bankman & Weisbach, *supra* note 15, at 1423.

254. Joseph Bankman & David Weisbach, *Reply—Consumption Taxation Is Still Superior to Income Taxation*, 60 STAN. L. REV. 789, 800 (2007).

consumption tax offers instantaneous efficiency and social advantages.[255] With increased savings, there is also a stronger redistributive effect.[256]

Finally, a progressive consumption tax, particularly as it pertains to this analysis, should come without an estate tax or intergenerational wealth transfer component. Under a progressive consumption tax, income from a trust would be treated differently than today. It would be deducted if it is reinvested, but taxed at normal rates if it is consumed.[257] This reinforces the value of a progressive consumption tax in incentivizing savings, and avoids undercutting the other incentives created for savings and investment.

### C. RESOLVING THE CHALLENGES OF PERPETUAL TRUSTS

As applied to the problem of perpetual trusts, one can immediately see several distinct advantages to a progressive consumption tax. It removes the incentive for perpetual trusts, as they are no longer necessary to transfer wealth intergenerationally in order to avoid taxes. This solves the individual-level problem while institutionalizing the societal benefit by incentivizing savings and investment. By taxing consumption and allowing for a savings and investment deduction, it preserves the benefit of capital accrual.[258] Transitioning to a progressive consumption tax might also avoid rent-extraction behavior because the group affected—all taxpayers—is simply too large, offering a significant advantage over prior proposals because it is politically feasible within the reverse Mancur Olson understanding of legislative politics.[259]

A progressive consumption tax would remove the need to create perpetual trusts as it favors savings and the intergenerational transfer of wealth.[260] Since savings is primarily motivated by the bequest motive and is highly tax elastic, coupling a progressive consumption tax with an elimination of the estate tax and GST would increase savings.[261] Further,

255. *See* Bankman & Weisbach, *supra* note 15, at 1424–25 (describing the impact of a nonuniform tax on spending and saving behavior).

256. *Id.* at 1426–28.

257. Graetz, *supra* note 19, at 1624.

258. *See id.* at 1628–34 (arguing that a consumption tax brings a positive net benefit and automatically incentivizes savings).

259. Given the incentive effect for savings and removal of an oppressive estate tax or GST on intergenerational wealth transfers, the groups that can currently be expected to protect their interest in the GST Exemption would not be threatened.

260. Graetz, *supra* note 19, at 1627–29.

261. *See* McCaffery, *supra* note 189, at 1208–10 (favoring the elimination of intergenerational wealth transfer taxes in combination with the adoption of a progressive consumption tax). As argued

property would be used more efficiently since it would be allowed to flow to its most productive users—those who are willing to pay the most for it.[262] By creating an incentive to bequest wealth and only taxing it once, a more efficient incentive structure is created.[263]

Disbursements from perpetual trusts also would not be allowed to go tax free under a progressive consumption tax. Like any other source of income, beneficiaries would include disbursements in their receipts and deduct any amount reinvested.[264] Thus, the tax-avoidance motivation for creating a perpetual trust would be removed, without lessening the incentive for savings that perpetual trusts provide. This suggests that over time, perpetual trusts would decline in favor. While the individual-level problem would still be present, settlors and beneficiaries would be incentivized to terminate existing trusts and transfer the corpus to more traditional investments before intractable collective-action problems arise, thereby reducing transactions costs.

Moreover, a progressive consumption-tax-based solution to the perpetual trust problem could avoid many of the challenges of the reverse Mancur Olson model. All taxpayers would be impacted by the transition, removing the first condition for a rent-extraction game—a small cohesive group from which Congress could extract rents.[265] The solutions proposed in prior articles on perpetual trusts might create opportunities for rent-extraction, suggesting they would not succeed. Ironically, efforts to move to a progressive consumption tax might reflect the traditional Mancur Olson problem. There is a collective-action problem posed by a large, diffuse group of beneficiaries (all taxpayers) banding together to achieve relatively small per capita benefits. Since there is no cohesive group to

earlier, the elimination of taxes on intergenerational wealth transfers might not have any effect on wealth concentration—a fact supported by the existence of similar levels of wealth concentration in countries with no tax on intergenerational wealth transfer. It would also incentivize savings, thereby reaping greater economic rewards and a greater potential for wealth redistribution. *See supra* Part IV.B–C.

262. Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 10–11 (1995) (arguing that the most efficient use of assets is in the free flow of commerce).

263. *See* Graetz, *supra* note 19, at 1623–25 (arguing that a progressive consumption tax only taxes intergenerational transfers once); McCaffery, *supra* note 189, at 1184–85 (arguing in favor of taxing inherited wealth only once).

264. Graetz, *supra* note 19, at 1627. Although Graetz advocated a generation-skipping tax to impose tax at least once per generation, subsequent research has questioned the efficacy of intergenerational wealth transfer taxation. *Compare id.* at 1628 (arguing rules taxing GST are necessary to impose tax at least once per generation), *with* McCaffery, *supra* note 196, at 345–55, 337 n.198 (arguing for consumption without estate tax).

265. *See supra* Part III.B.

advocate for this shift, those threatened by the president's proposal to curb perpetual trusts might take the lead as their objectives could be better realized under a progressive consumption tax.[266] Given that a progressive consumption tax will resolve the individual-level problem, institutionalize the societal benefit, and offer additional efficiency advantages, Congress should seize this opportunity.

### D. AN INTERMEDIATE SOLUTION

Although a progressive consumption tax is subject to criticism on the basis that it has been sought, but never realized, since at least the 1970s, intermediate solutions to the individual-level perpetual trust problem might not fare any better. As demonstrated in Parts III and IV above, the reverse Mancur Olson model suggests there are strong factors militating against an intermediate solution. However, a plausible solution to the individual-level problem could conceivably be fashioned.

One intermediate solution is to create a federal consumer protection act for perpetual trusts. This could presumably be accomplished under either the contracts clause or the interstate commerce clause, given that many if not most perpetual trusts involve assets from settlors in other states and large sums of money.[267] Such an act would almost certainly require windup and termination provisions for the trusts, and would need to be retroactive. Although this would leave open the issue of taxation, it would go a long way towards resolving the individual-level problem.

Even with this relatively modest solution, there are significant challenges. First, there is little money involved that could be used to place it on the legislative agenda. Under the reverse Mancur Olson model, institutional trustees might even oppose such a move since, over the long term, the trust might benefit fiduciaries more than beneficiaries.[268] Second, members of the academy who may view it as violating existing trust doctrine could also oppose such a solution. Finally, given the lack of attention to perpetual trusts in the mainstream media and political consciousness, it is doubtful that perpetual trusts would rise to a level of social concern where they would demand a prophylactic solution.[269]

266. The robust lobby against the estate tax could also be persuaded to adopt this issue. For a discussion of political dynamics surrounding the estate tax, see GRAETZ & SHAPIRO, *supra* note 112, at 242–46 (discussing estate tax repeal efforts) and McCaffery, *supra* note 51, at 24 (discussing efforts to eliminate the estate tax).

267. *See supra* Part III.

268. *See supra* Part IV.A.3.

269. *See supra* note 2 and accompanying text.

## VI. CONCLUSION

Perpetual trusts are likely here to stay so long as the current tax structure is perpetuated, based on the money involved and Congress' tendency towards rent extraction in the tax arena. And this might not be a bad thing, as perpetual trusts encourage savings, place assets into the free flow of commerce so they can be used efficiently, and help mitigate the negative externalities of the estate tax. The problem thus reduces to a question of how best to manage the externalities of perpetual trusts—the individual-level problem of failing to achieve dynastic wealth, the collective-action problem for beneficiaries, and the related principal-agent problem. A progressive consumption tax resolves these concerns by disincentivizing the creation of perpetual trusts, while maintaining the savings and efficiency incentives that perpetual trusts provide, perhaps better meeting the objectives of perpetual trust settlors. Moreover, it avoids the reverse Mancur Olson rent-extraction dynamic, and provides a politically palatable alternative to the current tax system.