

## Perpetual Trust States— The Latest Rankings

A guide to picking the best jurisdiction for your client

If I had to rank the 23 perpetual trust jurisdictions, top honors would be awarded in this order: South Dakota is number one; Delaware is a close second; and both Alaska and New Hampshire are tied for third place.<sup>1</sup>

What does such ranking mean to the advisor on the street? Ultimately, not that much. What really matters to practitioners are the nuances of all the states' laws and how these might serve a particular client's needs—or run counter to those needs. That's why advisors must be able to distinguish among different trust laws. So armed, they can truly help clients.

Clearly, situs and the trust law imposed on a family make a difference, especially in the context of multigenerational trusts. Not only is there overwhelming economic value in avoiding transfer taxation for multiple generations (perhaps perpetually), but there also are great advantages to operating in a state whose trust laws permit practical and flexible administration of long-term trust relationships.

Momentum for reform of the perpetuities laws clearly has been established. But state laws differ substantially in their quality and character with respect to advantageous situs from a variety of perspectives.

By **Daniel G. Worthington**,  
president,  
Worthington  
Consulting Group,  
Salt Lake City

# Perpetual and Close-to-Perpetual Trust Jurisdictions

Although there are 23 of them, only 16 make the grade

Rank	Situs	Common Law Rule	Uniform Statutory Rule	Rule Against Alienation	State Income Tax	Limited Power of Appointment	Change of Situs	Directed Trust Statute	Trust Protector Statute	Self-Settled Trusts	Effective GST Limit
1	SD*	Abolished	No	Vesting w/Trustee	No	Unlimited	Perpetual	Yes	Yes	Yes	Perpetual
2	DE*	Abolished	No	Limited Vesting w/Trustee <sup>1</sup>	Tax only Residents	Unlimited	Perpetual	Yes	Yes	Yes	Perpetual
3	AK*	Abolished	No	Vesting w/Trustee	No	Likely USRAP	Limited	Yes	Yes	Yes	1000 yrs. or less
3	NH*	Abolished	No	Vesting w/Trustee	Residents <sup>2</sup>	Unlimited	Perpetual	Yes	Yes	No	Perpetual
5	ID*	Abolished	No	Power w/Trustee	Yes	Unlimited	Perpetual	No	Yes	No	Perpetual
5	MO*	Abolished	No	Vesting w/Trustee	Yes	Unlimited	Perpetual	No	No	Yes	Perpetual
5	WI*	Abolished	No	Vesting w/Trustee	Tax Only Residents	Unlimited	Perpetual	No	No	No	Perpetual
8	NJ*	Abolished	No	Vesting w/Trustee	Yes	Unlimited	Limited By Statute	No	No	No	Perpetual
9	NV	No	365 yrs.	365 yrs.	No	Likely USRAP	No	No	No	Yes	Likely USRAP
9	WY	Yes	1000 yrs.	Likely Common Law Rule	No	Likely Common Law Rule	No	No	Yes	No	Likely Common Law Rule
11	CO	No	1000 yrs.	1000 yrs.	Yes	Likely USRAP	No	Yes	No	Yes	Likely USRAP
11	FL	No	360 yrs.	360 yrs.	No	Likely USRAP	No	No	No	No	Likely USRAP
13	IL	Yes Opt Out	No	Vesting w/Trustee	Tax Only Residents	Likely Common Law Rule	No	Yes	No	No	Likely Common Law Rule
13	OH	Yes Opt Out	No	Likely Common Law Rule	Tax Only Residents <sup>3</sup>	Likely Common Law Rule	No	No	No	No	Likely Common Law Rule
13	RI	Abolished	No	None	Yes	Likely USRAP	No	No	No	Yes*	Likely USRAP
13	UT	No	1000 yrs.	1000 yrs.	Yes	Likely 90 yrs.	No	No	No	Yes	Likely USRAP

**Ranking methodology:** True perpetual trust treatment was given the most weight. Other weighted factors include whether a state had: (1) an income tax and whether it exempted nonresident trusts; (2) a power-of-appointment statute and how that may affect perpetual trust treatment; (3) trust law which allows for or inhibits change of situs without creating a constructive addition; (4) adopted a directed trust statute and/or a self-settled trust statute; and (5) an effective generation-skipping transfer tax exempt limit. The jurisdictions that did not make the rankings are: Arizona, District of Columbia, Maine, Maryland, Nebraska, Virginia and Washington.

\* Denotes true perpetual jurisdictions

<sup>1</sup> Delaware retains the 110 year real property rule.

<sup>2</sup> New Hampshire does not have an income tax, but does tax dividends and interest of residents

<sup>3</sup> However, Ohio has an accumulated earnings tax

—Source: Daniel G. Worthington

Since 1948, 23 states and the District of Columbia have abolished or modified their rules against perpetuities, in whole or in part, so that trusts created in these jurisdictions can last forever, or for extremely long periods of time.<sup>2</sup> Connecticut, Hawaii, Iowa, Kentucky, Nevada, New York and Texas have proposed modifying the rule, but have not yet done so.<sup>3</sup> Not all “perpetual regimes” offer a complete package of tax-saving opportunities. It is clear, for example, that states such as Arizona and Florida—which have chosen to merely modify their rule against perpetuities, rather than repeal it entirely—have not been effective for federal generation-skipping transfer (GST) tax purposes.<sup>4</sup> Commentators suggest that the most effective statutory accommodation of both state and federal law for GST purposes is the actual repeal of the common law rule against perpetuities or its modern corollary, the Uniform Statutory Rule Against Perpetuities (USRAP). This approach eliminates the timing element of the rule, meaning the element of the rule that deals with how long a trust may exist. More effective regimes have been adopted in states such as Alaska, Delaware, Idaho, Missouri, New Hampshire, New Jersey, Rhode Island, South Dakota and Wisconsin.

But that step alone is not enough to create a true perpetual jurisdiction. There also must be an alternative statutory method for vesting of trust interests, meaning that it must be possible that the interests in the trust may be vested in some way within the federal GST tax look-back period in order for the trust to continue to enjoy GST exempt status.<sup>5</sup> The method for meeting the vesting element or requirement is typically done by modifying the rule against alienation and suspen-

sion of powers. And this may be accomplished by providing through statute that a trustee with the power to alienate trust assets is equivalent to a “vesting.” This trustee power would include the power to sell or distribute trust assets, or to terminate the trust altogether. This approach has been taken only by Alaska, Delaware, Idaho, Missouri,

## Last year, the IRS seems to have fired a shot across the bow of perpetual regimes.

New Hampshire, New Jersey, South Dakota and Wisconsin.

Those jurisdictions that have chosen to merely extend the rule against perpetuities<sup>6</sup> for a term beyond the traditional rule or USRAP (such as Colorado, Florida, Nevada, Utah, Washington and Wyoming) or attempted to opt out of the rule in certain situations (Arizona, District of Columbia, Illinois, Maine, Maryland, Nebraska, Ohio and Virginia), face timing or vesting problems in their statutes and are ineffective for GST tax-exemption purposes beyond the common law or uniform statutory rule against perpetuities. You should ask two questions when ranking the jurisdictions for the effectiveness of their perpetual regimes (and choosing a situs for clients’ trust assets): First, do the laws of the state provide truly perpetual trust situs or something less? Second, what other trust and tax laws and practices distinguish one jurisdiction from another?

It’s also important to note how fluid trust law is. The Internal Revenue Service this past year expressed a new perspective

regarding powers of appointment, and that perspective may have an impact on state law.

### THE IRS

Last year, the IRS seems to have fired a shot across the bow of perpetual regimes. Internal Revenue Code Section 2041(a)(3) was established to prevent the use of powers of appointment to extend the term of a trust beyond the common law rule against perpetuities or the uniform statutory rule against perpetuities. Violation of this rule is sometimes referred to as the “Delaware Tax Trap.”<sup>7</sup>

Some perpetual jurisdictions have sought to get around the prohibition by merely extending the term of years to exercise powers to coincide with a lengthier rule against perpetuities.

Richard Nenko, vice president and trust counsel of Delaware’s Wilmington Trust, notes in his material for the 2006 Heckerling Institute on Estate Planning in Miami, “Relieving Your Situs Headache: Choosing and Rechoosing the Jurisdiction for a Trust,” that during an informal discussion he had with an IRS official, he learned that the IRS intends to ignore what it refers to as “phony (term of year) periods” for the purposes of the exercise of certain powers of appointment. Powers of appointment are normally limited by IRC Section 2041(a)(3). If this is the IRS’ new interpretation and the courts uphold it, there will be problems for states like Alaska, with its 1,000-year power-of-appointment statute, and others that have “term-of-years” rules against perpetuities like Florida (360 years), Nevada (365 years), Utah (1,000 years), Washington (150 years) and Wyoming (1,000 years).<sup>8</sup>

Neeno also wrote, “[T]he 360-year or 1,000-year periods adopted by Florida and Alaska, respectively, greatly exceed the IRS’ safe harbor periods (either the common-law or the USRAP period) in the constructive addition regulations for the exercise of limited powers of appointment.”<sup>9</sup> And he points out that the “Grandfathered Dynasty Trusts Treasury Regulations Section 26.2601-1(b)(1)(v)(B)(2) applies to any exercise of a power and not just to a power creating a second power. The regulation suggests, however, that if an ending period is essential to avoid the application of IRC [Section] 2041(a)(3), the IRS will require [this] ending period to be no longer than the traditional period or 90 years.”<sup>10</sup>

Only those jurisdictions that have the possibility of providing perpetual trusts provide maximum protection for clients eager to legally avoid transfer taxes. Tax traps for the unwary lay hidden within the complexity of the state jurisdictional rules and trust laws, as well as the federal laws and regulations that affect them. The half-way approaches taken by jurisdictions (such as Arizona, District of Columbia, Colorado, Florida, Illinois, Maine, Maryland, Nebraska, Nevada, Rhode Island, Utah, Virginia, Washington and Wyoming) to abolish or modify their rule against perpetuities may have a profound unwitting effect for clients seeking the maximum protection available under the state and federal law from both the federal estate and GST taxes.

### NOT ALL EQUAL

Clearly, jurisdictions differ significantly in their approach to the rule against perpetuities, as well as to related aspects of their state trust and tax laws.

A number of states have entered

the race to compete for trust business or at a minimum, not lose trust business to more reform-minded states. Nothing is more evident of this trend than the recent flurry of state legislative attempts to temper the local rule against perpetuities and provide greater flexibility.<sup>11</sup> For example, New Hampshire, a state that had already abrogated the rule against perpetuities and adopted an alternate vesting statute, recently improved its stature by adding

## Jurisdictions vary significantly in their approach to the rule against perpetuities.

directed trust and trust protector statutes. Nevada and Colorado, on the other hand, recently attempted to extend their existing rules against perpetuities to 365 years and 1,000 years respectively, rather than abrogating the rule altogether.

A growing number of state legislatures have been reluctant to abolish the rule altogether—because of longstanding policy concerns, constitutional barriers or political resistance. In those jurisdictions (Colorado, Florida, Nevada, Utah, Washington and Wyoming), it may be impossible to fully abrogate the rule. Thus, we see some jurisdictions (Arizona, District of Columbia, Illinois, Maine, Maryland, Nebraska, Ohio and Virginia) attempting to reach a compromise—to stay competitive, while preserving elements of traditional law. Several approaches, including the “term of years” and the “opt-out” approach, have taken the path of least resistance. But is this path effective? Not likely.

What is likely, is that in those

states that have “opt out” statutes, the effective GST limit is whatever the underlying statute calls for—whether it is the common law rule or statutory rule against perpetuities. In those jurisdictions with a term-of-years rule, the likely GST limit is the greater of the common law rule or the statutory rule. In those states that have abolished the rule but not their vesting statute (Rhode Island), the likely GST limit is the longer of the common law rule or the statutory rule.

### OTHER FACTORS

Moreover, other trust law factors affect whether one particular jurisdiction is more appropriate than another to help meet a client’s needs. Consider the following 10 factors, listed in no particular order:

- (1) income tax treatment of resident and nonresident grantors and beneficiaries;<sup>12</sup>
- (2) effectiveness of flexible trust planning and administration tools, including limited powers of appointment;<sup>13</sup>
- (3) ability to change situs without triggering a constructive addition problem;<sup>14</sup>
- (4) presence of an effective directed trust statute;<sup>15</sup>
- (5) statutory acknowledgment of the role of trust protector;<sup>16</sup>
- (6) treatment of other nonresident fiduciaries doing business with the trust (often clients want to use multiple trust advisors);<sup>17</sup>
- (7) situs rules under applicable law (including possible conflict-of-laws issues);<sup>18</sup>
- (8) asset protection considerations (nine perpetuities states have adopted versions of these statutes: Alaska, Colorado, Delaware, Ohio, Missouri, Nevada, Rhode Island, South Dakota and Utah);<sup>19</sup>
- (9) application of the federal and state transfer tax systems, especially with regard to property law defini-

tions, possible inadvertent constructive addition problems and other technical termination rules; and

(10) inheritance or death tax provisions, capital gains tax, documentary tax, premium tax, etc.

## ONLY THE BEGINNING

This is, of course, just a glimpse of the complex issues associated with understanding the qualities of the various perpetual trust jurisdictions. Much more needs to be done both in terms of the science and the art of intergenerational planning so that it can be done with great competence and confidence. ■

### Endnotes

- The methodology for ranking the trust jurisdictions addresses two related questions: (1) Does the jurisdiction permit truly perpetual trusts or something less? (2) Does a jurisdiction have other trust laws and practices that give it an edge? Truly perpetual trust treatment was given the most weight. Other factors: whether a state had an income tax and whether it exempted nonresident trusts; whether it had a power-of-appointment statute and how that may effect perpetual trust treatment; whether its trust law allowed for change of situs without creating a constructive addition; whether it adopted a directed trust statute; whether it adopted a self-settled trust statute; and finally, whether it had an effective generation-skipping transfer tax limit.
- Under the common law rule against perpetuities, an interest must vest, if at all, within the period of a life in being, plus 21 years (plus a reasonable period for gestation). The statutory rule against perpetuities typically provides the longer of the common law rule against perpetuities or 90 years.
- Jesse Dukeminier and James E. Krier, "The Rise of the Perpetual Trust," 50 UCLA L. Rev. 1303, at p. 1316. See Idaho Code Section 55-11 (Michie 2000); Wis. Stat. Section 700.16(5) (1999); S.D. Codified Laws Section. 43-5-8 (Michie 1997). See also Del. Code Ann. tit., 25 sec. 503(a) (Supp. 2000); 765 Ill. Comp. Stat. Ann. 305/4 (West 2001); Alaska Stat. Section 34.27.100 et. al.; N.J. Stat. Ann. Section 46:2F-9 (West Supp. 2002); Ohio Rev. Code Ann. Section 2131.08(B) (West Supp. 2003); Md. Code Ann. Est. & Trusts Section 11-102(C) (2001); Fla. Stat. Ann. Section 689.225 (West 2003); Ariz. Rev. Stat. Ann. (A) (1) Section 14-2901 (West Supp. 2002); Mo. Ann. Stat. Section 456.236 (West Supp. 2003); Neb. Rev. Stat. Sections 76-2001 (1996 and Supp. 2002); Colo. Rev. Stat. Sections 15-11-1102.5 (2006); Me. Rev. Stat. Ann. Tit. 33, Sections 101 (West 1964); R.I. Gen. Laws Section 34-11-38 (Supp. 2003); Va. Code Ann. Section 55-13-3(C) (Michie Supp. 2002); D.C. Code Sections 19-109 (10) (2002); Wash. Rev. Code Ann. Section 11.98.130 (West 2002); Wy. H.B. 77 (2003); N.H. Rev. Stat. Ann. Section 547:3-k and 564:24 (West, Westlaw through 2003 Sess.); Utah Code Ann. Sections 75-2-1201 (Lexis Supp. 2002); Nev. Rev. Stat. Section 111.1031 ((See Nev. Rev. Stat. Ann. Sections 111.103-1039 (Michie Supp. 2004)).
- Ibid.* See also Daniel G. Worthington, "Florida's Rule Against Perpetuities: A Tax Trap for the Unwary," *Trusts and Estates* (December 2000) at p. 12.
- The look-back period for generation-skipping transfer (GST) tax purposes is 90 years or the greater of the traditional rule, if it's possible that interests in trust may vest within that period, the rule is satisfied.
- See Worthington, *supra* at note 4, citing several classifications of perpetual trust laws as explained by Garret Moritz, "Dynasty Trusts and the Rule Against Perpetuities," 116 *Harvard L. Rev.* 2588, 2596 (2003).
- The so-called "Delaware tax trap" is one example of how the federal and state laws may interact to create unexpected results. It may be a concern for a trust created in a state in which the trust might last beyond the common law rule against perpetuities or the Uniform Statutory Rule Against Perpetuity (USRAP). Prior Delaware law provided the opportunity through the exercise of successively limited powers of appointments over successive generations, thus allowing for a perpetual trust without federal transfer taxes. Internal Revenue Code Section 2514(d) was enacted in 1951 to prevent this from happening. The current code section dealing with this issue is IRC Section 2041(a)(3).
- Richard Nenko, "Relieving Your Situs Headache: Choosing and Rechoosing the Jurisdiction for a Trust," 2006 *Heckerling Tax Institute*, at 3-1; 3-51. In any event, it's difficult to distinguish in any practical sense among Delaware with its indefinite period, Wisconsin with its 30-year period easily negated by a power of sale, and states such as Alaska (1,000-year period) or Florida (360-year period) with their definite periods of such inordinate length that they might as well be indefinite. Note that the 360-year or 1,000-year periods adopted by Florida and Alaska, respectively, greatly exceed the IRS' safe harbor periods (either the common law or the USRAP period) in the constructive addition regulations for the exercise of limited powers of appointment over grandfathered dynasty trusts. Treasury Regulations Section 26.2601-1(b)(1)(v)(B)(2) applies to any exercise of a power and not just to a power creating a second power. The regulation suggests, however, that if an ending period is essential to avoid the application of IRC Section 2041(a)(3), the IRS will require such ending period to be no longer than the traditional period or 90 years. No tax policy would be served by a different tax result under state laws with allegedly "phony" periods and states with an indefinite period. In informal discussions, IRS representatives confirmed this view with me.
- Ibid.*
- Ibid.*
- See Moritz, *supra* at note 11. In a 2003 Harvard law review note, Moritz outlined six categories or approaches that the (then 15) jurisdictions had undertaken to create perpetual trusts. See discussion in Worthington, *supra* at note 4.
- Only five perpetuities states have no income tax: Alaska (1,000 years), Florida (360 years), Nevada (365 years), South Dakota (perpetual), and Wyoming (1,000 years). Four states tax their residents but do not

tax nonresidents: Delaware (perpetual with 110-year real property rule), Illinois (opt-out, uncertain), Ohio (opt-out, uncertain) and Wisconsin (perpetual).

13. Only the bellwether states of Idaho, South Dakota and Wisconsin, and the later-adopting states of Delaware, Missouri, New Hampshire and New Jersey, have a clear advantage here. All are clearly perpetual. Alaska, although perpetual, has chosen to limit powers of appointment to 1,000 years. The power of appointment rules in the remaining jurisdictions may create problems with IRC Section 2041(a)(3) if powers are exercised beyond the default statute applicable in the state or in accordance with a “phony” term-of-years statute.
14. The problem presented by change of situs is related to the allocation of GST tax exemption either upon the funding of the trust or at the close of the estate tax inclusion period (ETIP). Once the GST tax has been allocated to a trust, any material change to the nature of the beneficial interest might trigger a constructive addition and thus erode the GST tax inclusion ratio. Each jurisdiction has somewhat different perpetuities rules except for Idaho, South Dakota and Wisconsin, and the states of Alaska (with exception of the power of appointment statute), Delaware, Missouri, New Hampshire and New Jersey. Although Rhode Island has no rule against perpetuities, it also has no vesting statute; thus, it is unclear whether Rhode Island is in the same class as the other states for change of situs purposes.
15. Only six states appear to have effective directed trust statutes. These facilitate the use of administrative trustees for situs purposes, and other fiduciaries, trust advisors, and the like for other purposes. Only Alaska, Colorado, Delaware, Illinois, New Hampshire and South Dakota have codified the directed trust.
16. A trust protector statute recognizes the authority of a trust protector, which provides greater flexibility for future generations as conditions change. Only Alaska, Delaware, Idaho, New Hampshire, South

Dakota and Wyoming appear to have effective trust protector statutes.

17. Multiple trust advisors who do not reside in the perpetuities jurisdiction of choice create contacts with other jurisdictions, with possible situs rule conflicts.
18. Generally, the approach taken by the perpetuities jurisdictions is that the trust must be administered in the state of choice for the trust to have its situs in the jurisdiction. These rules are established to define the quality and character of activities and minimum contacts required to establish situs in the state. Where the rules are too weak, the trust actually may fall within the situs rules of competing jurisdictions, each having a justifiable claim to the situs of the trust, creating a possible conflict-of-laws problem. This may create income tax, GST tax and other problems in the long term. Where the rules are too rigid, trust business is driven to more accommodating jurisdictions. Thus, there is a balancing of issues.
19. While all the qualifying jurisdictions provide an added level of asset protection, several states have adopted the “self-settled trust” statutory scheme for grantors and their families. Under these rules, the grantor can have his or her cake and eat it too: The trust is established so that the grantor or settlor can be a permissible beneficiary of the trust—if creditors cannot otherwise reach the trust assets to satisfy the legal obligations of the settlor. It is clearly established that a transfer to a trust in a qualified jurisdiction is complete for gift tax purposes; it is equally unclear whether a transfer to the trust is complete for estate tax purposes because of the non-qualified retained interest under IRC Section 2036. This leaves open the ETIP question for GST tax planning purposes, thus foiling the inclusion ratio of an unsuspecting grantor. Alaska Stat. Section 34.40.110; Colo. Rev. Stat. Section 38-10-111; Del Code Ann. Tit. 12, Section 3570-3576; Mo. Rev. Stat. Section 456.5-505; Nev. Rev. Stat. Section 166.010-166.170; R.I. Gen. Laws Section 18-19.2-1-18-

19.2-7; S.D. Codified Laws Sections 55-16-1-55-16-17; Utah Code Ann. Section 25-6-14; Oklahoma, a perpetual trust state, passed the Family Wealth Preservation Act on June 9, 2004, with the same effective date. The Missouri statute was passed on July 9, 2004 (however, the Missouri statute replaces a similar law). See Gideon Rothschild, “New Asset Protection Laws,” *Trusts & Estates’ Wealth Management Letter*, (Aug. 25, 2004).

## SPOTLIGHT



**Rich Color, Rich Price**—Gustav Klimt’s landscape, “Birch Forest” (1903), sold for about twice its estimated price at Christie’s “Impressionist and Modern Art Evening Sale” on Nov. 8, 2006, in New York City. It fetched an astonishing \$40.336 million.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.