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Escaping the Malthusian Trap: Dynasty Trusts for Serious Dynasts

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Dynasty Trusts for Serious Dynasts

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The centuries-long history of Anglo-American property law can be told as a struggle between the dynastic impulse that seeks to tie up a family's property forever and the public policy of providing an opportunity for the talented and ambitious to acquire property (and eventually found their own dynasties). From the beginning, an estate in fee simple was inheritable – as indicated by the formula "to A and his heirs" – but when it also became alienable, the risk emerged that one unwise descendant could bring the dynasty to an abrupt end.[1] The effort to limit descent to the "heirs of the body" seemed to offer a solution, turning the fee simple into a series of life estates in successive descendants. But English judges defeated this attempt by construing

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[1] See 2 Frederick Pollock & Frederic William Maitland, *The History of English Law* 13 (2d ed. 1898) (Beginning early in the thirteenth century, "[t]he tenant in fee [simple] could alienate the land away from his heir. This having been decided, it became plain that the words 'and his heirs' did not give the heir any rights . . . .").

the resulting estate as a fee simple conditional, which could be alienated after the birth of issue.[2] The dynasts' response in 1285 was the statute De Donis Conditionalibus, requiring the judges to read the grant as written (that is, as creating a fee tail).[3]

In due course, royal judges permitted the entail to be "barred" (or broken) by an ingenious series of legal fictions, allowing the tenant in tail to convey a fee simple.[4] Undeterred, elite lawyers tried one expedient after another until eventually a compromise was reached between the dynastic impulse and public policy. The Rule Against Perpetuities – which would more accurately be called "the rule against remote vesting" – limited the reach of the dead hand to the next generation or two.[5] For centuries, this compromise held, until a renewed dynastic initiative, spurred by a change in federal tax law in 1986,[6] took advantage of dissatisfaction with the complexities and absurdities of the Rule Against Perpetuities and engineered its modification or outright repeal.[7] The dynasty trust, dis-

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[2] See Sheldon F. Kurtz, *Moynihan's Introduction to the Law of Real Property* § 5, p. 50 (5th ed. 2011).

[3] 13 Edw. I, c. 1 (1285).

[4] See Taltaram's Case, Y.B. 12 Edw. 4, Mich. 25 (1472). For a description of the common recovery, the usual means of barring the entail, see John V. Orth, *Does the Fee Tail Exist in North Carolina?*, 23 Wake Forest L. Rev. 767, 775-76 (1988). See also John V. Orth, *After the Revolution: "Reform" of the Law of Inheritance*, 10 Law & Hist. Rev. 33 (1992).

[5] The Rule Against Perpetuities, as we know it, can be traced to the Duke of Norfolk's Case, 3 Ch. Ca. 29, 22 Eng. Rep. 931 (Ch. 1682). It reached its classic formulation in the treatise on the subject by Professor John Chipman Gray, first published in 1886: "No interest is good unless it must vest, if at all, not later than 21 years after some life in being at the creation of the interest." John Chipman Gray, *The Rule Against Perpetuities* § 201, p. 191 (4th ed. 1942).

[6] The Tax Reform Act of 1986, Pub. L. No. 99-514, § 1431, provided a generous exemption from the generation-skipping-transfer tax, originally $1 million, but regularly increased. Estate planners quickly recognized the long-term tax advantages that would result from placing the exempted amount in a perpetual trust and distributing only the income it produced. See Jesse Dukeminier et al., *Wills, Trusts, and Estates* 909 (8th ed. 2009).

[7] Support for the common law Rule Against Perpetuities had been steadily eroded

tributing income "to my descendants alive from time to time forever" – "a sort of throwback to entail"[8] – is now a reality in many states.[9]

Modern concerns about the consequences of allowing dynasty trusts are eerily reminiscent of the concerns expressed over two centuries ago about the fee tail. When the North Carolina General Assembly abolished entailment in 1784, for example, it explained that "entails of estates tend only to raise the wealth and importance of particular families and individuals, giving them an unequal and undue influence in a republic, and prove in manifold instances the source of great contention and injustice."[10] If they function as planned, dynasty trusts will have the same effect, creating an hereditary class of wealthy individuals. But modern critics of dynasty trusts have consoled themselves with the thought that the costs of administration, inflation, rising expectations, and (above all) "an ever growing army of surviving descendants of the settlor and their dependents" will ultimately defeat the dynastic impulse.[11]

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by what Professor W. Barton Leach called "argumentative jargon" – memorable labels, such as "the unborn widow" and "the fertile octogenarian," intended to highlight the absurdity of some of the extreme applications of the Rule. See W. Barton Leach, *Perpetuities: The Nutshell Revisited*, 78 Harv. L. Rev. 973, 991 n. 78 (1965). See also John V. Orth, *Labels: Argumentative Jargon*, in John V. Orth, *Reappraisals in the Law of Property* 117 (2010).

[8] Adam Hirsch, *Inheritance: United States Law*, in 3 *Oxford International Encyclopedia of Legal History* 235, 239 (2009).

[9] For a list of states that had repealed the Rule Against Perpetuities as of 2009, see Dukeminier, *Wills, Trusts, and Estates* 909.

[10] Act of 1784, ch. 204, § 5. The first North Carolina Constitution, in a provision still in effect (and replicated in other state constitutions), decried perpetuities as "contrary to the genius of a free state." N.C. Const. of 1776, Decl. of Rts. § 22; N.C. Const. Art. I, § 34. See John V. Orth, *Allowing Perpetuities in North Carolina*, 31 Campbell L. Rev. 399 (2009). Notwithstanding the constitutional prohibition, the North Carolina Court of Appeals recently upheld the constitutionality of legislation allowing perpetual trusts. Brown Bros. Harriman Trust Co. v. Benson, 688 S.E.2d 752 (N.C. App. 2010).

[11] William J. Turnier & Jeffrey Harrison, *A Malthusian Analysis of the So-Called Dynas-*

The prediction that people can multiply faster than resources can grow is associated with a pessimistic eighteenth-century Englishman, the Rev. Thomas Malthus.[12] Summed up in the classic formula that population increases geometrically while agricultural production increases only arithmetically,[13] Malthusianism doomed humanity to periodic famines in order to bring people and their food supply into balance. As applied to the dynasty trust, the Malthusian trap would seem inevitably to frustrate the settlor's purpose, as the number of beneficiaries outpaces the growth in trust income, eventually reducing distributions to trivial amounts.[14] In fact, humanity has so far escaped the Malthusian effect by using improved methods of agriculture that increase yield and restrictive reproductive practices that limit population growth. Similarly, dynasty trusts may escape the Malthusian trap if pursued with sufficient skill and resolution.

Serious dynasts – or, to be more precise, their legal advisors – have long recognized the threat posed by excessive demands on dynastic property. No one who has read the classics of English literature (or watched the popular television series Downton Abbey[15]) can fail to recognize the traditional solution: primogeniture, limiting the estate to one taker in each generation, typically the first-born

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ty Trust, 28 Va. Tax Rev. 779, 784 (2009). See also Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. Rev. 1303, 1339 (2003) ("Multiplication of beneficiaries is not such a bad thing . . . . It tends to dilute the concentration of wealth . . . .").

[12] Thomas Malthus, *An Essay on the Principles of Population* (1st ed. 1798; reprinted 1970).

[13] Id. at 71 ("Population, when unchecked, increases in a geometrical ratio. Subsistence increases only in an arithmetical ratio.").

[14] For a sophisticated economic analysis, see generally Turnier & Harrison, *Malthusian Analysis*, 28 Va. Tax Rev. 779. For an extreme example of the effect of division of an inherited asset among all descendants in each generation, see Hodel v. Irving, 481 U.S. 704 (1987) (discussing the fractionation of Native American allotments over a century) ("The average tract has 196 owners and the average owner undivided interests in 14 tracts."). See generally Alberto B. Lopez, *A Revaluation of Cy Pres Redux*, 78 U. Cin. L. Rev. 1307, 1351 (2010) ("An anticommons develops when ownership becomes splintered into numerous shares . . . .").

[15] See *Money Lessons from "Downton Abbey,"* Wall St. J., March 2-3, 2013, p. B1, B10.

male.[16] The head of the family at any given time is responsible for conserving and, if possible, increasing the patrimony, while making provision for daughters and younger sons. No English aristocrat or landed gentleman would ever have thought of requiring the equal distribution of annual income among all his surviving descendants in each generation. True dynasts were focused on maintaining the status of the family in perpetuity, not on the perpetual well-being of each and every family member.

To maintain family status, income-producing assets must be preserved intact. When land was the primary source of income in the form of rent, that meant tying up title to real property. Now that wealth consists primarily of personal property and income takes the form of dividends and interest, the trust is as good a device as the fee tail for the purpose of asset preservation – better, actually, since a professional trustee is more likely to preserve capital than is an individual produced by the random draw of birth order. But merely preserving capital is not enough to satisfy the serious dynast. In order to maintain the family's influence and social standing, income must not be dissipated among too many takers, but concentrated in only a few representatives (or even in only one) in each generation.

Although equal treatment of all descendants in each generation has been the norm for the last century or two,[17] traditional dynasts were made of sterner stuff. The limitation of a life estate to the settlor's first-born child with successive life estates to that beneficiary's first-born child and so forth, generation after generation ("to A for life, then to B for life, then to C for life . . ."), was the time-tested

[16] Primogeniture was part of the common law of inheritance, but great English landowners typically used sophisticated estate planning in the form of strict settlements to limit the enjoyment of the estate to one taker in each generation. For a brief description of the strict settlement, see Orth, *Fee Tail*, 23 Wake Forest L. Rev. at 777.

[17] Within a few years of the Revolution, all American states had replaced primogeniture with partible inheritance. See Carol Shammas et al., *Inheritance in America: From Colonial Times to the Present* 32-33 (1987). Primogeniture survived in England until 1926 and in Scotland until 1964. See David M. Walker, *The Oxford Companion to Law* 988-89 (1980).

way to preserve both the wealth and prominence of a family forever. As with the aristocratic estate, an arrangement in favor of the first born does not exclude provision for other descendants. The incumbent, taking into account needs and available income (as well as the display of proper family pride), can provide support for siblings and their progeny.

In the days before significant income taxation, this could be accomplished by simply vesting the head of the family with all the income from the estate to distribute as he saw fit. Today the most obvious device would be to allocate the bulk of the income to the present incumbent, while giving him a special noncumulative and exclusive power of appointment over the remaining amount, exercisable in favor of other descendants of the settlor (and, perhaps, their spouses). An institutional trust protector (that is, a professional manager empowered to supervise the administration of the trust) could be used to prevent abuse, and provision could be made to deal with the risk of the donee's incompetence by age or disability. Of course, all beneficiaries should be protected from their own improvidence by spendthrift provisions.[18] In addition, the goals of preserving the corpus in perpetuity and maintaining the standard of living of the present head of the family must be expressly declared to be material purposes of the trust, in order to protect it from premature termination on the demand of a then-living beneficiary.[19]

A settlor who is reluctant to confer so much power on one representative in each generation may consider more imaginative devices. Distributions of the reserved income could be mandatory but limited to a finite number of the most nearly related descendants, preserving the affluence of at least certain members of each genera-

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[18] See Uniform Trust Code § 502 (2000) (defining a spendthrift clause as one that "restrains both voluntary and involuntary transfer of a beneficiary's interest").

[19] For the current, somewhat qualified, statement of the material purpose rule, see Restatement (Third) of Trusts § 65(2) (2003) (Beneficiaries cannot compel termination or modification of a trust after the settlor's death if it would be inconsistent with a material purpose, "except . . . with authorization of the court if it determines that the reason(s) for termination or modification outweigh the material purpose.").

tion. Minimum amounts (indexed for inflation) could be prescribed to guarantee that distributions would be sufficient to maintain the recipients at an appropriate level of economic and social standing. The Malthusian effect could be further countered by limiting the number of children of any one descendant who could receive a distribution, encouraging reproduction at or below the replacement rate. To address fears that the family standard-bearer might not continue to uphold the family honor (however defined), a self-renewing panel of trust protectors might be empowered periodically to review the representative's performance according to some ascertainable standard and allocate or re-allocate income accordingly.[20]

For the present, the dynastic impulse has prevailed over the demands of public policy. But history suggests that this victory, like all previous ones, is unlikely to be permanent. As ever, the gravest threat will come from changes in the law of property or redistributive taxation. If the past is any guide, the pendulum will eventually swing back in favor of restrictions. In the meantime, estate planners should be prepared to propose creative ways to reconcile the dynastic impulse with demography. Professor Austin Scott, the doyen of trust lawyers, long ago reminded us that "[t]he purposes for which we can create trusts are as unlimited as our imagination."[21] So, too, our imagination is the only limit on the terms of dynasty trusts tailored to maintain the dynast's family at the top level of income and status in perpetuity.

[20] I am indebted to James P. Spica, Esq. for the suggestion that incentive trust devices be added to the "serious" dynasty trust.

[21] 1 Austin Wakeman Scott, *The Law of Trusts* § 1, p. 4 (1939).