

MEMORANDUM

TO: Secretary of State Trust Laws Study Group

FROM: Dynasty Trust/Virtual Representation Sub-Committee

DATE: August 21, 2009

RE: Status Report Concerning Examination of Rule Against Perpetuities and Virtual Representation

Introduction - This Sub-Committee is charged with examining the potential reform of the Rule Against Perpetuities and the introduction of Virtual Representation into State Law. The Sub-Committee is charged with providing a recommendation to the Secretary of State Trust Laws Study Group. The Secretary of State Trust Laws Study Group will, in turn, make recommendations for proposed legislation to be introduced in the 2010 Legislative Session.

Rule Against Perpetuities - The Sub-Committee has studied and discussed statutes adopted by various states to reform the Rule Against Perpetuities based on research provided by the Secretary of State Division of Policy and Research. The Sub-Committee has also reviewed the research findings of Prof. Robert H. Sitkoff, Visiting Professor of Law, New York University, and Associate Professor of Law, Northwestern University, and Prof. Max M. Schanzenbach, Assistant Professor of Law, Northwestern University.

At present, the consensus of the Sub-Committee is to recommend reformation of the Rule Against Perpetuities in Mississippi. Specifically, the Sub-Committee is discussing the following two approaches:

(1) Leave the existing Rule Against Perpetuities as the default provision. Add a provision that allows an attorney to chose a modified Rule Against Perpetuities affirmatively stated in the trust. Under this approach, the attorney could insert a provision in the trust that would provide a restriction on alienation of trust property for a period of 150 years. For consistency, the Rule would apply to both personal and real property. To preserve flexibility, the attorney would also have to provide in the trust either (a) a power allowing the trustee to make a sale of personal or real property, in their discretion, despite the specific restraint on alienation or (b) a right granted to one or more beneficiaries or third parties to terminate the trust. This approach would be coupled with a repeal of the fiduciary income tax.

(2) Leave the existing Rule Against Perpetuities as the default provision. Add a provision that allows an attorney to chose a modified Rule Against Perpetuities affirmatively stated in the trust. Under this approach, the 150 years is a default rule and the attorney could draft a provision to extend the 150 year default rule for an additional period of time. The Sub-Committee discussed the possible extensions of time to be 300 years, 500 years or 1,000 years. For consistency, the Rule would apply

to both personal and real property. To preserve flexibility, the attorney would also have to provide in the trust either (a) a power allowing the trustee to make a sale of personal or real property, in their discretion, despite the specific restraint on alienation or (b) a right granted to one or more beneficiaries or third parties to terminate the trust. This approach would also be coupled with a repeal of the fiduciary income tax.

Attached to this Memorandum is an excerpt from a *Yale Law Journal* Article “Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities in Taxes,” by Professors Robert A. Sitkoff and Max M. Schanzenbach. The attached graph is provided by the authors to support the hypothesis that the experience of those states that abolish the Rule Against Perpetuities and did not tax income in trusts attracted from out-of-state a significant inflow of large trust funds upon abolishing the Rule.

The Sub-Committee formulated additional questions which the Secretary of State Division of Policy and Research has presented to Prof. Sitkoff as follows:

A. His opinion concerning the advantages and disadvantages of the two approaches listed above.

B. His comments with respect to states (such as Delaware) that have completely abolished the Rule Against Perpetuities for assets in trust.

C. Since the studies performed by Prof. Sitkoff have shown a significant

increase in the average size of trust accounts in Delaware and South Dakota, after reform of the Rule Against Perpetuities, the Sub-Committee inquired of Prof. Sitkoff if there was any significant difference in the approach taken as long as the statute allows dynasty trusts.

D. If there is any reason to think that raising the time period from 150 years to 300 years, or from 150 years to 1,000 years, would have any effect on the total trust assets for average account size;

E. If, other than Delaware, Illinois and South Dakota, he can identify any other states which have benefitted greatly from appealing or reforming the Rule Against Perpetuities;

F. If his studies reveal any evidence of trust assets or average trust account size decreasing in jurisdictions that have modified or repealed the Rule Against Perpetuities and abolished fiduciary income taxation; and

G. If he has seen any definitive evidence that validating asset protection trusts will increase the amount of trust assets or average trust account size in states recognizing asset protection trusts.

Prof. Sitkoff has advised the Secretary of State Division of Policy and Research that he wishes to confer with his colleague, Prof. Schanzenbach and will respond to the questions posed by the Sub-Committee thereafter.

Virtual Representation - The Sub-Committee was provided by the Secretary of State Division of Policy and Research a research paper discussing various approaches to Virtual Representation. The research paper notes that Mississippi has not adopted a statute allowing for Virtual Representation. The current law in Mississippi is defined by *Miss. Code Ann.* (1972), as amended, §9-5-89, which allows the Chancery Court to appoint a guardian *ad litem* to represent a minor or “defendant of unsound mind,” if the Court deems it necessary for the protection of the interests of the minor or “defendant of unsound mind.” The Secretary of State Division of Policy and Research also provided the Sub-Committee with case law from the Fifth Circuit Court of Appeals providing that Virtual Representation “demands the existence of an expressed or implied legal relationship in which parties in the first suit are accountable to non-parties who file subsequent suits raising identical issues.” The Fifth Circuit has defined a number of situations in which the Doctrine may arise, including “estate beneficiaries bound by administrators, presidents and sole stockholders by their companies, parent corporations by their subsidiaries and a trust beneficiary by the trustee.”

The Uniform Probate Code (“UPC”) provides for Virtual Representation with a specific requirement that the representation be adequate. The UPC Virtual Representation applies to “formal proceedings involving trusts or estates of decedents,

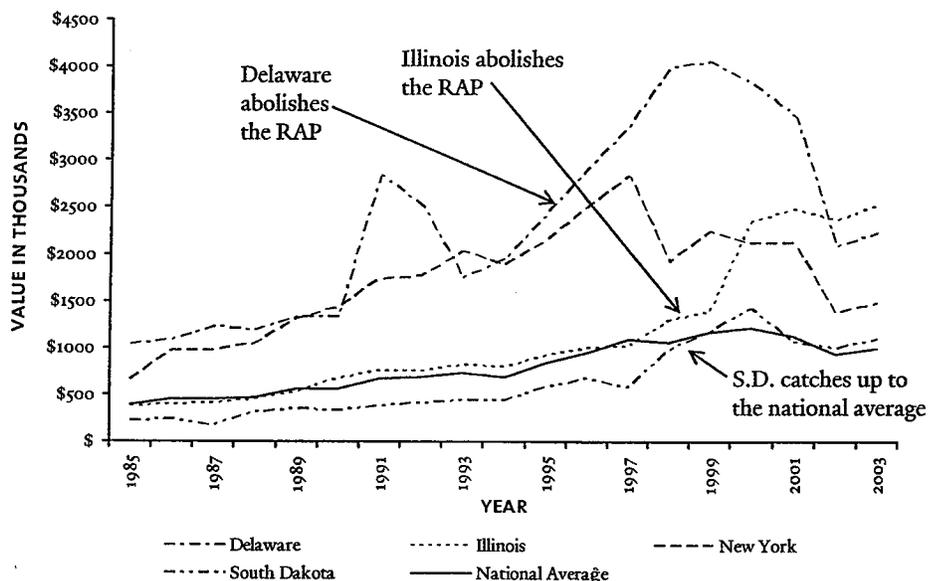
minors, protected persons, or incapacitated persons, and in judicially supervised settlements.” The UPC approach does not apply to non-judicial proceedings. The UPC approach has been adopted by a total of 19 states.

The research paper discusses Section 304 of the Uniform Trust Code (“UTC”) which provides Virtual Representation for a “minor, incapacitated or unborn individual or person whose identity or location is unknown and not reasonably ascertainable.” Under the UTC these individuals are represented by a party having a “substantially identical interest with respect to the particular question or dispute.” Neighboring states that have adopted the UTC approach include Alabama, Arkansas, Florida, North Carolina, South Carolina and Tennessee. In all, 23 states have adopted the UTC Virtual Representation provision. The UTC approach does not differentiate between judicial and non-judicial proceedings.

The Sub-Committee is discussing the potential recommendation of the UTC approach to Virtual Representation. The consensus of the Sub-Committee is that the adoption of the Virtual Representation statute would in no way limit the discretion of the Chancery Court to appoint a guardian *at litem* if the Court deems it necessary to protect a particular party’s interest. In addition, the Sub-Committee is still discussing whether Virtual Representation by remaindermen should also apply to contingent remaindermen.

Figure 8.

AVERAGE ACCOUNT SIZE IN DELAWARE, ILLINOIS, NEW YORK, AND SOUTH DAKOTA



In our view, the foregoing graphs support the hypothesis that those states that abolished the RAP and did not tax income in trusts attracted from out of state experienced a significant inflow of large trust funds upon abolishing the Rule. This hypothesis is borne out in the econometric analysis below.

These data also suggest that the abolition of the Rule Against Perpetuities prior to the introduction of the GST tax had no observable effect on a state's trust assets. Recall that Idaho (1957), Wisconsin (1969),¹¹⁷ and South Dakota (1983) abolished the RAP prior to the 1986 enactment of the GST tax, and that throughout this period South Dakota did not have a FIT. Yet in 1985 and 1986, the two years prior to the GST tax that are included in our sample timeframe,

117. Wisconsin may have abolished its Rule even earlier (indeed, Wisconsin may never have had the Rule). See Lawrence M. Friedman, *The Dynastic Trust*, 73 YALE L.J. 547, 550 (1964); W. Barton Leach, *Perpetuities: The Nutshell Revisited*, 78 HARV. L. REV. 973, 974-75 (1965). We need not resolve the status of the Rule in Wisconsin prior to 1985, however, because our data do not begin until that year.