

Duquesne University School of Law

From the Selected Works of Martha W. Jordan

Summer 2008

Requiem for Pennsylvania's Rule Against Perpetuities?

Martha W. Jordan, *Duquesne University School of Law*



Available at: https://works.bepress.com/martha_jordan/5/

DUQUESNE UNIVERSITY
SCHOOL OF LAW

LEGAL STUDIES RESEARCH PAPER SERIES



*Requiem for Pennsylvania's Rule Against
Perpetuities?*

Martha W. Jordan
Associate Professor of Law

Duquesne University School of Law Research Paper No. 2014-06

Originally published in 46 DUQUESNE LAW REVIEW (2008)

Requiem for Pennsylvania's Rule Against Perpetuities?

Martha W. Jordan*

I think the general consensus among the practitioners that practice in this area of law is that the rule against perpetuities is understood by few and can be explained by fewer yet.¹

I.	INTRODUCTION	555
II.	RISE AND FALL OF PENNSYLVANIA'S RULE AGAINST PERPETUITIES.....	557
	A. <i>History of Pennsylvania's Rule</i>	557
	B. <i>Explaining the Fall of the Rule</i>	561
III.	THE RULE AGAINST PERPETUITIES, THE GENERATION SKIPPING TRANSFER TAX, AND DYNASTY TRUSTS.....	563
IV.	POWERS OF APPOINTMENT: THE BANCO'S GHOST OF PENNSYLVANIA'S RULE AGAINST PERPETUITIES?	566
	A. <i>Powers of Appointment and the Rule Against Perpetuities</i>	566
	B. <i>The Intersection of Powers of Appointment, the Doctrine of Relation Back, and the Repeal of the Rule Against Perpetuities</i>	570
V.	THE DELAWARE TAX TRAP	577
VI.	CONCLUSION.....	580

I. INTRODUCTION

The Pennsylvania Uniform Trust Act, inter alia, repeals the rule against perpetuities, effective for interests created after December 31, 2006.² Given the current trend in the law, repeal was inevitable. Not, as indicated by the comment that precedes this

* Associate Professor of Law, Duquesne University School of Law; J.D., University of Arizona; LL.M., University of Denver. My thanks and deep appreciation to Sara Miller, Duquesne University College of Law Class of 2008, for her invaluable assistance.

1. Representative Craig A. Dally, H.R. Jour., 46-2006, Reg. Sess. 1746 (Pa. 2006).

2. S.B. 660, 190th Gen. Assem., Reg. Sess. (Pa. 2006) (codified at 20 PA. CONS. STAT. ANN. § 6107.1 (West. 2007)).

article, because the lawyers who encounter it regularly do not understand it,³ but because they understand it all too well. They want to use perpetual dynasty trusts to permanently avoid the generation skipping transfer tax.⁴ The rule against perpetuities, however, prohibits permanent avoidance of the generation skipping transfer tax and curtails deferral of the tax beyond the perpetuities period.⁵

Although critics have decried the proliferation of perpetual trusts and cautioned against the adverse effects of accumulating wealth in perpetual trusts,⁶ states continue to repeal the rule out of fear that inaction will result in the exodus of their trust business.⁷ Retention and attraction of trust business was clearly a motivating factor behind Pennsylvania's repeal.⁸

The purpose of this article is not to debate the wisdom of repealing the rule against perpetuities but to highlight two arcane problems created by the repeal. Both of these problems derive from the interaction of the doctrine of relation back with powers of appointments. The doctrine of relation back deems the exercise of a special or a testamentary general power of appointment as the completion of an act begun by the donor when the power was created.⁹ Consequently, the perpetuities period for contingent interests created by the exercise of a special or a testamentary general power of appointment begins when the donor creates the power, not when the donee exercises it.¹⁰

The first question addressed by this article is whether the doctrine of relation back makes the rule against perpetuities applicable to contingent interests resulting from the exercise of a special or a testamentary general power of appointment created prior to, but exercised after, the effective date of the repeal. This article concludes there is no definitive answer to this question and suggests that savvy practitioners circumvent the question whenever

3. In fact, the recommendation to repeal Pennsylvania's rule against perpetuities did not come from the Advisory Committee on Decedents' Estates Law. See *infra* note 43.

4. See Ira Mark Bloom, *The GST Tax Tail is Killing the Rule Against Perpetuities*, 87 TAX NOTES 569, 572 (2000); Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303 (2003).

5. See *infra* notes 64-81 and accompanying text.

6. See *infra* notes 55-63 and accompanying text.

7. Bloom, *supra* note 4 at 572.

8. See *infra* notes 53-54 and accompanying text.

9. *In re Boyd's Estate*, 49 A. 297 (Pa. 1901); *Estate of Lawrence*, 20 A. 521 (Pa. 1890); see also *In re Grubb's Estate*, 36 Pa. D. & C. 1 (1939). See also *infra* notes 101-103 and accompanying text.

10. *Estate of Lawrence*, 20 A. 521 (Pa. 1890). See also *Grubb's Estate*, 36 Pa. D. & C. 1.

possible by exercising the power to create the trust in a state that has repealed the rule retroactively, as well as prospectively.¹¹ This article also suggests that the Pennsylvania legislature revisit the reasons, if any, for making the repeal prospective and, either clarify whether the rule continues to apply to contingent interests created by the exercise of special or general testamentary powers created prior to the repeal or, absent compelling reasons to the contrary, make the repeal retroactive, at least with respect to testamentary general powers.¹²

The second question addressed by this article concerns the impact of the repeal on the estate and gift tax consequences to the donee of a special power of appointment. Generally speaking, the donee of a special power of appointment is not taxed on the value of the appointive property.¹³ An exception to the general rule, called the "Delaware tax trap," taxes the donee of a special power of appointment on the value of the appointive property if the donee exercises the power to create another power of appointment, unless the perpetuities period for determining the validity of any contingent interests created by the second power is determined by reference to the creation of the first power.¹⁴

Because Pennsylvania repealed the rule against perpetuities without substituting the prohibition on the power to suspend alienation, the exercise of a special power of appointment to create another power of appointment triggers the Delaware tax trap. After discussing various possible legislative solutions to this problem, this article recommends the adoption of a perpetuities period applicable to successive powers that begins at the creation of the first power as the most viable solution.¹⁵

II. RISE AND FALL OF PENNSYLVANIA'S RULE AGAINST PERPETUITIES

A. *History of Pennsylvania's Rule*

The rule against perpetuities has been law since the Duke of Norfolk's Case¹⁶ in the 17th Century. The most commonly accepted modern formulation of the common law rule remains the

11. See *infra* notes 111-146 and accompanying text.

12. See *infra* note 166 and accompanying text.

13. I.R.C. §§ 2041(a)(1),(2), 2514(a),(b) (2000).

14. *Id.* §§ 2041(a)(3), 2514(d).

15. See *infra* notes 147-164 and accompanying text.

16. 3 Ch. Cas. 1, 21 Eng. Rep. 665.

one given by John Chipman Gray: "No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest."¹⁷

The rule against perpetuities invalidates contingent future interests that are too remote.¹⁸ Remoteness has nothing to do with the likelihood that a contingent interest will or will not become possessory, but rather with how long the interest may remain contingent. To be valid, a contingent interest must vest, or fail to vest, within the perpetuities period.¹⁹ If an instrument creates multiple interests, all interests violating the rule against perpetuities are stricken from the conveyance;²⁰ however, as a general rule, all valid interests take effect.²¹

The rule's timely vesting requirement is mercilessly applied to class gifts, where an all-or-nothing rule holds sway.²² A class gift is void unless the interest of each class member vests, or fails to vest, in a timely manner, which means that a class gift stands only if the class closes and all conditions precedent are satisfied within the perpetuities period.²³ If one member's interest violates the rule, the entire class gift is stricken, and the interests of all class members, even those certain to vest in a timely fashion, are void.²⁴

The common law rule applies a prospective, what-might-happen test, to determine remoteness.²⁵ A contingent interest offends the common law rule if, at the time the interest is created, there is the slightest possibility that the interest might still be contingent after the close of the perpetuities period, the infamous life in being plus twenty-one years.²⁶ This test for remoteness takes into account all possible, and quite a few highly improbable, future sce-

17. 1 JOHN CHIPMAN GRAY, *THE RULE AGAINST PERPETUITIES* § 201 (4th ed. 2002). For a Pennsylvania recitation of this rule, see *Warren's Estate*, 182 A. 396 (Pa. 1936).

18. W. Barton Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 639 (1938).

19. Jesse Dukeminier, *A Modern Guide to Perpetuities*, 74 CAL. L. REV. 1867, 1895 (1986).

20. *Id.*

21. *Id.* The exception to this is the doctrine of infectious invalidity, which invalidates the entire conveyance if the court determines that the transferor would prefer total failure to partial implementation of her dispositive plan. *Id.*

22. *Id.*

23. *Id.* at 1895. A class gift is valid only if the class closes and all conditions precedent are resolved with respect to all members of the class within the perpetuities period. *Id.* at 1892. A class closes when all members of the class are ascertained. *Id.*

24. Dukeminier, *supra* note 19, at 1891.

25. *Id.* at 1869.

26. *Id.* A contingent interest guaranteed to vest or fail to vest within 21 years is valid even though there is no associated measuring life. *Id.*

narios.²⁷ The slightest possibility that vesting might be delayed until after the perpetuities period expires makes the interest void *ab initio*.²⁸ The common law rule demands certainty: a contingent interest is valid only if it is certain to vest or to be destroyed within the perpetuities period.²⁹

The common law rule against perpetuities has been the subject of much scholarly criticism.³⁰ Two of its most frequently excoriated features are the possibilities test, which frequently invalidates interests based on "a chain of events [that] will *almost* certainly *not* happen,"³¹ and the calculation of the perpetuities period, which necessitates identifying the life or lives in being that establish the perpetuities period for a particular interest.³²

In 1947, Pennsylvania became the first state to replace the common law rule with the wait-and-see rule against perpetuities ("wait-and-see").³³ Wait-and-see replaces the possibilities test with an actualities test, one that waits until the perpetuities period ends and then determines whether the contingent interests have, in fact, vested or been destroyed.³⁴ Only interests that remain contingent at the expiration of the perpetuities period are

27. Two of the more notorious possibilities are the "fertile octogenarian" and the "unborn widow." The "fertile octogenarian" refers to the law's "conclusive presumption of lifetime fertility." Lawrence W. Waggoner, *Perpetuity Reform*, 81 MICH. L. REV. 1718, 1729 (1983) (citing *Jee v. Audley*, 1 Cox 324, 29 Eng. Rep. 1186 (Ch. 1787)). For a Pennsylvania reference, see *Coggins Appeal*, 16 A. 579 (Pa. 1889). The "unborn widow" refers to the law's assumption that one may marry someone not yet born. Waggoner, *supra* at 1741. For a Pennsylvania reference, see *Disston's Estate*, 46 D. & C. 496 (Pa. 1942), *aff'd* 36 A.2d 457 (Pa. 1944). For further discussion of improbable scenarios, see Dukeminier, *supra* note 19, at 1876-80.

28. Dukeminier, *supra* note 19, at 1869. As a general rule, only the offending interest is invalidated; however, a court may use the doctrine of infectious invalidity to void the entire conveyance if the offending interest was essential to the donor's dispositive plan. *Id.* at 1896.

29. *Id.*

30. See, e.g., W. Barton Leach, *Perpetuities in Perspective: Ending the Rule's Reign of Terror*, 65 HARV. L. REV. 721 (1952).

31. See Waggoner, *supra* note 27, at 1726.

32. See Jesse Dukeminier, *Perpetuities: The Measuring Lives*, 85 COLUM. L. REV. 1648, 1710 (1985).

33. Act of Apr. 24, 1947, No. 39, § 4, 1947 Pa. Laws 100 (codified at 20 PA. STAT. ANN. §§ 301.4-301.5 (West 1950)). See Donald S. Cohan, *The Pennsylvania Wait-And-See Perpetuity Doctrine - New Kernels from Old Nutshells*, 28 TEMP. L.Q. 321 (1955). Wait-and-see was considered a quite controversial development in the evolution of the rule against perpetuities. See W. Barton Leach, *Perpetuities Legislation: Hail, Pennsylvania!*, 108 U. PA. L. REV. 1124 (1960); Lewis M. Simes, *Is the Rule Against Perpetuities Doomed? The "Wait and See" Doctrine*, 52 MICH. L. REV. 179 (1952). For a further discussion of the debate, see Dukeminier & Krier, *supra* note 4, at 1306-1307.

34. See Cohan, *supra* note 33, at 321.

invalidated.³⁵ Although Pennsylvania adopted wait-and-see, it retained the common law perpetuities period.³⁶

Both the common law rule and wait-and-see invalidate any contingent interest that does not vest or fail during the perpetuities period. Because the common law rule evaluates interests based on the mere possibility that vesting might be delayed beyond the permitted period, it invalidates many interests that will, in fact, vest within the requisite time period. Wait-and-see eliminates this problem by only invalidating contingent interests that actually vest too remotely. The difference in how the two approaches work is shown by the following example.

Grandfather dies survived by Son. Grandfather's will devises his property to Son for life, then to his grandchildren who reach age twenty-five. Under the common law, the class gift to the grandchildren is invalid due the possibility that Son might have a child who will not turn twenty-five until more than twenty-one years after Son's death.³⁷ Under wait-and-see, the class gift to the grandchildren is valid unless there is a grandchild who does in fact turn twenty-five more than twenty-one years after Son's death.

On July 7, 2006, the Pennsylvania legislature passed the Pennsylvania Uniform Trust Act, which, inter alia, repealed Pennsylvania's rule against perpetuities for interests created after December 31, 2006.³⁸ Pennsylvania's rule against perpetuities continues to apply to interests created before January 1, 2007.³⁹

35. 20 PA. CONS. STAT. ANN. § 6104(b) (West 2007).

36. *Id.* Immediately prior to its repeal, Pennsylvania's rule against perpetuities read as follows: "Upon the expiration of the period allowed by the common law rule against perpetuities as measured by actual rather than possible events, any interest not then vested and any interest in members of a class the membership of which is then subject to increase shall be void." *Id.* Pennsylvania also changed the rules applicable to incomplete dispositions of property. If, as a result of the application of the rule against perpetuities, there is an incomplete disposition of the property, Pennsylvania law, as a general rule, vests title in the holder of the last valid interest, rather than creating a reversion in favor of the grantor. *Id.* § 6105.

37. *See Appeal of Coggin*, 16 A. 579 (Pa. 1889).

38. S.B. 660, 190th Gen. Assem., Reg. Sess. (Pa. 2006); 20 PA. CONS. STAT. ANN. § 6107.1 (West 2007).

39. 20 PA. CONS. STAT. ANN. § 6107.1(a) (West 2007). The legislature simultaneously repealed the rule against excessive income accumulations by trusts, thereby removing all impediments to the concentration of wealth and power in a trust. *Id.*

B. Explaining the Fall of the Rule

The original *raison d'être* for the rule against perpetuities, fostering the alienation of land, has been largely superseded.⁴⁰ Modern scholars typically refer to the prevention of dead hand control when defending the rule's continued existence.⁴¹ Another modern justification is curtailing the use of trusts "to protect wealthy beneficiaries from bankruptcies and creditors, decrease the amount of risk capital available for economic development, and . . . tie up the family in disadvantageous and undesirable arrangements."⁴²

The rule against perpetuities is not being repealed because it lacks societal utility.⁴³ Nor is it being repealed because those lawyers who confront it most frequently are incapable of understanding it.⁴⁴ Professor Ira Mark Bloom, who has studied the repeal movement since it began in 1997,⁴⁵ has concluded that the real impetus behind the repeal movement is avoidance of the federal generation skipping transfer ("GST") tax.⁴⁶ According to Professor Bloom, "[t]he rule is being repealed so that wealthy individuals

40. Dukeminier, *supra* note 19, at 1868; Bloom, *supra* note 4, at 570. Now that trusts are the almost universal means of creating future interests, alienability is not a concern; the trustee, as holder of legal title, has the power to alienate the trust corpus. Bloom, *supra* note 4, at 570.

41. Dukeminier, *supra* note 32, at 1710. Professor Lewis Simes, for example, defended the rule's role in preventing dead hand control by saying the rule "strikes a fair balance" between the wishes of the living and the dead regarding the use and disposition of property while allowing the living, rather than the dead, to control the "wealth of the world." LEWIS M. SIMES, PUBLIC POLICY AND THE DEAD HAND 58-59 (1955).

42. Dukeminier, *supra* note 19, at 1869.

43. The Advisory Committee on Decedents' Estates recommended retaining Pennsylvania's rule against perpetuities but amending the perpetuities period to substitute a 150-year period for the common law period of a life in being plus 21 years. See The General Assembly of the Commonwealth of Pennsylvania Joint State Government Commission, THE PENNSYLVANIA UNIFORM TRUST ACT (Proposed Official Draft 2005) and AMENDMENTS TO THE PROBATE, ESTATES AND FIDUCIARIES CODE 138 (April 2005), <http://jsg.legis.state.pa.us/UTC%204%202005.pdf>.

44. The estate planning bar has mastered the rule against perpetuities to such an extent that it routinely develops ways, such as perpetuities savings clauses, to minimize the risk that the rule will interfere with a well-crafted estate plan. Estate planners who commit malpractice because of the rule against perpetuities are most likely to be those who engage in estate planning infrequently, not specialists. See Leach, *supra* note 33, at 1134. The removal of the rule can be viewed as creating a level playing field for testators who consult with a non-specialist. *Id.* On the other hand, one might argue that an unintended benefit of the rule is dissuading casual estate planners from engaging in a practice area in which they lack competence.

45. In 1997, the repeal movement began when Alaska unsuccessfully tried to repeal its rule against perpetuities. Ira Mark Bloom, *The Death of the "Death Tax": How Federal Transfer Taxes Affect the Development of Property Law*, 48 CLEV. ST. L. REV. 661, 673 (2000).

46. Bloom, *supra* note 4, at 569.

will be able to create perpetual dynasty trusts to exploit the GST tax system."⁴⁷

Prior to 1986, when the GST tax was enacted, there were three states that had repealed the rule against perpetuities.⁴⁸ Yet, perpetual trusts were virtually unheard of.⁴⁹ Once the perpetual dynasty trust movement began, states felt compelled to repeal the rule or suffer the migration of their residents' wealth to perpetual dynasty trusts domiciled in those states that had repealed the rule.⁵⁰ Banks and other professional fiduciaries added to the pressure by advertising their perpetual dynasty trust business outside their states' borders.⁵¹ Consequently, states repeal the rule in order to keep the perpetual dynasty trust business of their residents and in order to attract the perpetual dynasty trust business of residents of states retaining the rule.⁵²

Remarks made by Representative Stephen Maitland endorsing the Pennsylvania Uniform Trust Act support the validity of Professor Bloom's conclusions, at least as pertains to Pennsylvania's reasons for repealing the rule.⁵³ Representative Maitland said he could "attest that this is an excellent product that will help attract trust business to Pennsylvania. Trust funds are highly movable. They flow to States that have repealed the rule against perpetuities."⁵⁴

Professor Bloom, the leading critic of the repeal movement, has more than adequately stated the consequences of repeal.⁵⁵ The advantages include creation and retention of trust business and the elimination of complexity.⁵⁶ The primary disadvantage is the removal of the rule's prohibition on perpetual trusts.⁵⁷ The creation of perpetual trusts, particularly ones that evade the transfer

47. *Id.* See pages 569-70 for a discussion of the GST tax and perpetual dynasty trusts. See also Mary L. Fellows, *Why the Generation Skipping Transfer Tax Sparked Perpetual Trusts*, 27 *CARDOZO L. REV.* 2511 (2006).

48. Dukeminier & Krier, *supra* note 4, at 1315.

49. *Id.*

50. Bloom, *supra* note 4, at 572.

51. Dukeminier & Krier, *supra* note 4, at 1316.

52. *Id.*

53. H.R. Jour., 46-2006, Reg. Sess. (Pa. 2006). The repeal, however, is not limited to perpetual dynasty trusts. It encompasses all interests previously subject to the rule and authorizes the creation of perpetual trusts for any purpose.

54. *Id.* Representative Maitland also submitted to the record *A Model Law for the Repeal against [sic] Perpetuities* (Dec. 2005), a paper he had written in law school arguing for the repeal of the rule. *Id.* at 1746.

55. Bloom, *supra* note 4, at 574-76.

56. *Id.* at 571-72.

57. *Id.* at 574.

tax system, will eventually result in the greater concentration of wealth and its inevitable corollary, power, in the hands of dynastic families.⁵⁸ Furthermore, because these trusts bypass the transfer tax system, the federal Fiske will be depleted, forcing Congress to look for new ways to raise revenue.⁵⁹ This search is bound to result in new taxes, a reallocation of the tax burden and, possibly, even a total repeal of the GST exemption.⁶⁰ Furthermore, the existence of perpetual trusts will increase the power of the financial services industry.⁶¹ Banks and other corporate trustees who manage these trusts will determine how their wealth is employed.⁶² And, since professional trustees are notoriously risk adverse, a reduction in the available sources of risk capital is likely.⁶³

III. THE RULE AGAINST PERPETUITIES, THE GENERATION SKIPPING TRANSFER TAX, AND DYNASTY TRUSTS

The federal estate tax taxes gratuitous transfers other than those to a spouse or a charity.⁶⁴ As the transfer tax system is intended to reach only the wealthiest taxpayers, each person has an exemption.⁶⁵ For taxpayers dying in 2007 or 2008, the estate tax exemption is \$2 million; for taxpayers dying in 2009, \$3.5 million.⁶⁶

The estate tax achieves its intended purpose of taxing the transmission of wealth from one generation to the next quite well so long as property passes directly from one generation to the next; however, because the estate tax only reaches property included in a testator's estate, it is ill-equipped to tax temporal divisions of wealth. When a grantor transfers property to a trust benefiting multiple generations, the resulting "mere shifts in in-

58. *Id.* at 575. If the corpus of a perpetual dynasty trust originally funded with \$2 million grows at an average rate of five percent, compounded annually, after taking into account income tax, distributions, mismanagement, and market fluctuations, in 100 years the trust will hold over \$250 million. See Ira Mark Bloom, *Transfer Tax Avoidance: The Impact of Perpetuities Restrictions Before and After Generation-Skipping Taxation*, 45 ALB. L. REV. 260, 301 n.219 (1981).

59. Bloom, *supra* note 4, at 575.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. I.R.C. §§ 2055(e), 2056(a) (2000). The federal gift tax mirrors the estate tax and prevents circumvention of the estate tax by taxing *inter vivos* transfers that deplete a donor's gross estate. *Id.*

65. *Id.* §§ 2010, 2505. The exemption is called the unified credit or applicable credit amount. *Id.* § 2010.

66. *Id.* § 2010(c).

terests such as occur upon distributions from an existing trust to a beneficiary or upon the termination of a trust or a trust beneficiary's interest" escape the reaches of the estate tax.⁶⁷ Until 1986, when Congress enacted the GST tax, estate planners routinely used life estates to circumvent the estate tax.⁶⁸ Although the initial transfer to the life tenant and remainderman was subject to estate tax, when the life tenant died, the property would pass to the remainderman free from the imposition of estate tax.⁶⁹

The GST tax closes this loophole by taxing shifts in beneficial interests, such as those that occur when a life tenant dies and the next generation's remainder interest becomes the present interest or when a trust terminates and distributes its corpus to the remaindermen.⁷⁰ Furthermore, the GST tax reaches the property at the time of the shift, which means that any appreciation in the value subsequent to the testator's death is subject to tax.⁷¹

The GST tax is a punitive tax, designed to discourage significant generation skipping transfers by the wealthiest class of society,⁷² the class with sufficient wealth to limit a generation's inheritance to the income derived from property without adversely impacting its lifestyle. Like the estate tax, the GST tax grants every taxpayer an exemption. Currently, the GST exemption and the estate tax exemption are equal.⁷³ For decedents dying in 2007 and

67. RICHARD B. STEPHENS, ET AL., FEDERAL ESTATE & GIFT TAXATION § 1.04(1) (1991).

68. Dukeminier & Krier, *supra* note 4, at 1312.

69. *Id.*

70. I.R.C. §§ 2611(a)(1), (a)(2), 2612(a), (b) (2000). The GST tax reaches a shift in interest even if the trust continues, *id.* §§ 2611(a)(2), 2612(a)(1), or simply makes a distribution to a skip person. *Id.* § 2621(a). The GST also taxes direct transfers of property that skip the next succeeding generation. *Id.* § 2612(c).

71. *Id.* §§ 2621(a)(1), 2622(a)(1). The GST is equally applicable to trusts created by inter vivos transfer; however, for simplicity this article will assume that all trusts are created in the testator's will. Perpetual dynasty trusts created during 2007, 2008, or 2009 are most likely to be testamentary because, during those years, the GST exemption for testamentary transfers is greater than the GST exemption for inter vivos transfers.

72. The punitive nature of the GST tax is amply demonstrated by its tax rate. The GST tax rate is a flat rate equal to the maximum federal estate tax rate. I.R.C. § 2641(a)(1) (2000). Unlike the estate tax or the gift tax, there are no lower brackets. *See id.* § 2001(c). The applicable rate, however, may be lower because of the operation of the inclusion ratio. *Id.* §§ 2641(a)(2), 2642. *See infra* note 76.

73. For many years the GST tax targeted only the top strata of taxpayers subject to estate and gift tax. Until 2002, the amount of the exemption for the GST tax exceeded that for the estate and gift tax. Compare I.R.C. § 2010(c) (2000) prior to amendment by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(a), 115 Stat. 38 (2001), and I.R.C. § 2631(c) (2000) prior to amendment by The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(c), 115 Stat. 38, (2001).

2008, the GST exemption equals \$2 million, for those dying in 2009, \$3.5 million.⁷⁴

Testators are permitted to allocate their GST exemption among their generation skipping transfers.⁷⁵ As long as the amount of the exemption allocated to a transfer equals the amount of the transfer, the transfer completely escapes the GST tax.⁷⁶ More importantly, if the transfer is to a trust, as long as the amount transferred to the trust does not exceed the GST exemption allocated to the trust, the GST tax will never apply to the trust or to any shift in beneficial interest or distribution from the trust, regardless of how much the corpus of the trust appreciates.⁷⁷

Perpetual dynasty trusts exploit that aspect of the GST exemption that permanently shelters a trust from application of the GST tax, so long as sufficient GST exemption is allocated to the trust. The most efficient use of a taxpayer's GST exemption is to create a perpetual dynasty trust that will run as long as the law permits and then fund it with an amount equal to the taxpayer's GST exemption.⁷⁸

The ideal perpetual dynasty trust looks something like the following: income to my children for life, then income to my grandchildren for life, then income to my great-grandchildren for life, and so forth for as long as the testator has descendants living with a gift over to charity or some other designated beneficiary if all of the testator's descendants die.⁷⁹ Obviously, the rule against perpetuities foils this objective by limiting the number of life estates that can be tacked onto the sequence. Regardless of whether the common law rule or wait-and-see applies, the number of generations that can hold life interests in the trust is going to be lim-

74. I.R.C. §§ 2631(a), 2010(c) (2000). The GST exemption for inter vivos transfers during these years is \$1 million. *Id.* §§ 2631(c), 2010(c), 2505(a)(1) (2000).

75. *Id.* § 2631(a).

76. *Id.* §§ 2602, 2641(a), 2642(a)(1),(2). The GST tax is calculated by multiplying the value of the property transferred by the applicable rate, *id.* § 2602, which is defined as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the particular transfer. *Id.* § 2641(a). The inclusion ratio depends on the amount of a taxpayer's GST exemption allocated to a particular transfer. *Id.* § 2642(a)(2). If the GST exemption allocated to a transfer equals the value of the property transferred, the inclusion ratio is zero. I.R.C. § 2642(a)(1) (2000). If the GST exemption allocated to a transfer is less than the value of the property transferred, the inclusion ratio will equal the percentage of the value of the property transferred sheltered by the GST exemption. *Id.* Once established, the inclusion ratio remains fixed and applies to all future shifts in interest. *Id.*

77. *Id.* §§ 2602, 2641(a), 2642(a)(1),(2).

78. See Bloom, *supra* note 4, at 574.

79. *Id.*

ited.⁸⁰ Eliminating the rule's constraining force frees testators to create perpetual dynasty trusts that last as long as the testators' lineal lines.⁸¹

IV. POWERS OF APPOINTMENT: THE BANCO'S GHOST OF PENNSYLVANIA'S RULE AGAINST PERPETUITIES?

A. *Powers of Appointment and the Rule Against Perpetuities*

A power of appointment, whether general or special, presently exercisable or testamentary, gives the donee of the power authority to dispose of a property interest owned by another.⁸² A power is general, as opposed to special, if the power can be exercised in favor of the donee, the donee's creditors, the donee's estate, or the creditors of the donee's estate.⁸³ A power is presently exercisable if the donee may exercise it currently by deed,⁸⁴ and testamentary if the donee may only exercise it in her will.⁸⁵

The rule against perpetuities invalidates powers of appointment that can be exercised too remotely and assesses the validity of contingent interests created by the exercise of a valid power.⁸⁶ For purposes of applying the rule against perpetuities to either the creation or the exercise of a power of appointment, the law differentiates between presently exercisable general powers of appointment and special or testamentary general powers.⁸⁷ This distinction is predicated on the greater power granted to the donee of a presently exercisable power. Since all that stands between the donee of a presently exercisable power and outright ownership of the appointive property is "the stroke of a pen," the law treats the donee of a presently exercisable general power as the owner of the appointive property.⁸⁸ Donees of special powers and general testamentary powers cannot enjoy the property in their own right;

80. See *supra* notes 18-37 and accompanying text.

81. Bloom, *supra* note 4, at 574.

82. RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 11.1 (1986).

83. RESTATEMENT OF PROPERTY § 320(1)-(2) (1940); I.R.C. § 2041(b)(1) (2000). For the tax treatment of powers of appointment, see *infra* notes 145-148 and accompanying text.

84. RESTATEMENT OF PROPERTY § 321(2) (1940).

85. *Id.* § 321(1). A presently exercisable power may also be exercisable by will. Richard R. B. Powell, *Powers of Appointment*, 10 BROOK. L. REV. 233, 238 (1940).

86. Dukeminier, *supra* note 19, at 1901. See also Laurence M. Jones, *The Rule Against Perpetuities and Powers of Appointment: An Old Controversy Revived*, 54 IOWA L. REV. 456, 458 (1968).

87. Dukeminier, *supra* note 19, at 1901.

88. *Id.*

they can only fill in the blank on the donor's gift of the appointive property.⁸⁹

The creation of a power of appointment violates the rule against perpetuities if the power, a contingent interest subject to the rule, can be exercised too remotely.⁹⁰ The creation of a power of appointment satisfies the rule only if the donee must exercise the power within the perpetuities period.⁹¹ In the case of a general power, this requirement is satisfied so long as the power is certain to become presently exercisable within the perpetuities period.⁹² A power of appointment may be valid under the rule against perpetuities even though its terms permit the donee to make an invalid appointment.⁹³

When these rules are applied to powers subject to the wait-and-see rule against perpetuities, the results can be summarized as follows. A special power or a testamentary power of appointment is invalid unless it is exercised within the perpetuities period.⁹⁴ A general power, however, is valid, even though the donee fails to exercise it within the perpetuities period, as long as it become presently exercisable by the expiration of the perpetuities period.⁹⁵

The rule against perpetuities also invalidates remote contingent interests created by the exercise of a power of appointment.⁹⁶ When evaluating the validity of interests created by the exercise of a power of appointment, the law draws the same distinction between special or general testamentary powers and presently exercisable general powers.⁹⁷ The distinction determines when

89. *Id.*

90. *Id.* at 1902.

91. *Id.*

92. Dukeminier, *supra* note 19, at 1902.

93. *In re Warren's Estate*, 182 A. 396 (Pa. 1936).

94. Cohan, *supra* note 33, at 339. *See also* Jones, *supra* note 86, at 458.

95. Jones, *supra* note 86, at 458.

96. Dukeminier, *supra* note 19, at 1901-05; Jones, *supra* note 86, at 459-60.

97. Dukeminier, *supra* note 19, at 1901. As a general rule, if an appointment is invalid, the appointive property passes to the takers in default, if any. *Id.* at 1903. In the absence of takers in default the common law directed the appointive property back to the donor or the donor's estate. *Id.* Pennsylvania, however, has modified this rule by statute. *See* PA. CONS. STAT. ANN. § 6104 (West 2007). The doctrine of capture, however, may pull the appointive property into the donee's estate if the donee invalidly exercises a general power in such a manner as to indicate the donee's intent to assume control of the appointive property for all purposes, not merely for purposes of appointing it a third party. Dukeminier, *supra* note 19, at 1904. The most common method for a donee to capture the appointive property is to blend the appointive property with the property included in the donee's estate. *Id.* This is usually done by incorporating the exercise of the power into a clause that also disposes of the donee's own property. *Id.*

the perpetuities period begins—at the time the donee exercises the power or at the time that the donor created the power.⁹⁸

Settled law applies the doctrine of relation back to the exercise of a special⁹⁹ or a general testamentary power of appointment.¹⁰⁰ According to the doctrine, “the exercise of a power of appointment ‘relates back’ to the instrument creating the power.”¹⁰¹ The donee is viewed as the agent of the donor, completing a gift that was begun by the donor when the power was created;¹⁰² the person to whom the appointment is made takes his title as though the creation of the power and its exercise were effectuated by the same instrument.¹⁰³ The doctrine of relation back also controls when the perpetuities period begins with respect to interests created by the exercise of a special power¹⁰⁴ or a testamentary general power;¹⁰⁵ the perpetuities period begins when the donor creates the power, not when the donee exercises it.¹⁰⁶ As a result, any contingent interest created by the exercise of a special or a testamentary general power of appointment is valid only if it vests or fails during a life in being plus twenty-one years measured from the time the donor created the power of appointment.

98. Dukeminier, *supra* note 19, at 1901; Jones, *supra* note 86, at 459-60.

99. *In re Boyd's Estate*, 49 A. 297 (Pa. 1901). See also Jones, *supra* note 86, at 40.

100. Appeal of Mifflin, 15 A. 525, 527 (Pa. 1888). See also Dukeminier, *supra* note 19, at 1902-03; Jones, *supra* note 86, at 459-60.

101. *In re Estate of Frank E. Moore*, 283 A.2d 50, 53, 54 (Pa. 1971) (citing *Barton's Trust*, 35 A.2d 266 (Pa. 1944); *Huddy's Estate*, 84 A. 909 (Pa. 1912); *Commonwealth v. William's Executors*, 13 Pa. 29 (1850)).

102. *Boyd's Estate*, 49 A. 297; *In re Grubb's Estate*, 36 Pa. D. & C. 1 (1939); See also Jones, *supra* note 86, at 40.

103. *Estate of Frank E. Moore*, 445 Pa. 17 (citing *Barton's Trust*, 35 A.2d 266; *Huddy's Estate*, 236 Pa. 276, 84 A. 909 (1912); *William's Executors*, 13 Pa. 29; and RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 20.1 (1986). “The donee of a power of appointment is acting for the donor to complete a transfer made by the donor”). *Id.*

A similar philosophy is apparent in Pennsylvania's inheritance tax, which taxes the value of appointive property in the estate of the donor, rather than the donee, of the power. 72 PA. CONS. STAT. ANN. §§ 9111(k), 9116(f) (West 2000). For inheritance purposes, however, Pennsylvania does not distinguish between presently exercisable general powers and other powers. *Id.*

104. *Boyd's Estate*, 49 A. 297; *Mifflin*, 15 A. 525, 527 (Pa. 1888). See also Dukeminier, *supra* note 19, at 1902-03; Jones, *supra* note 86, at 40.

105. *Mifflin*, 15 A. at 527 (citing Gray, *supra* note 17, § 526(b)). Pennsylvania follows the majority rule regarding the application of relation back to the exercise of powers of appointment. Jones, *supra* note 86, at 463. But see Jones, *supra* note 86, at 461-469 for a discussion of whether testamentary general powers should be accorded the same treatment as presently exercisable general powers and exempted from the doctrine of relation back.

106. Although the perpetuities period begins when the donor creates the power, the second look doctrine provides that circumstances existing at the time the power is exercised are taken into account for purposes of determining the validity of any interests created by the exercise of the power. *In re Lewis' Estate*, 37 A.2d 482 (Pa. 1944); Dukeminier, *supra* note 19, at 1902-03.

With respect to interests created by the exercise of a presently exercisable general power of appointment, the perpetuities period commences at the time the donee exercises the power, rather than when the donor creates it.¹⁰⁷ This rule is consistent with the one that treats the donee of a presently exercisable general power as the owner of the appointive property.¹⁰⁸ The following example illustrates the impact of the doctrine of relation back on the calculation of the perpetuities period for an interest created by the exercise of a power of appointment.

Example: Testator died in 1990, leaving a will that included a power of appointment marital deduction trust giving Surviving Spouse a general power of appointment over the trust corpus. Assume Testator and Surviving Spouse had one child, Son. In 1995, Surviving Spouse remarried and gave birth to Daughter. In 2006, Surviving Spouse exercises the power of appointment to appoint the trust corpus to a trust with the following terms: income to my children for life, then remainder to my grandchildren per stirpes. If Surviving Spouse's power of appointment is a testamentary general power, the perpetuities period for measuring the validity of the grandchildren's remainder interest is measured from 1990, when Testator created the power of appointment. Consequently, only Son, not Daughter, can serve as a measuring life. If, however, Surviving Spouse's power of appointment is a presently exercisable general power of appointment, the perpetuities period begins in 2006, when Surviving Spouse exercises the power. Consequently, both Daughter and Son can serve as measuring lives. Under wait-and-see, if the power is a presently exercisable general power, the grandchildren's remainder interest is valid regardless of whether Son or Daughter dies last, but if the power is a testamentary general power, the grandchildren's remainder interest is valid only if it vests within twenty-one years of Son's death, which means that if Daughter outlives Son, the remainder interest may turn out to be invalid.

Pennsylvania has codified the rule for calculating the perpetuities period for contingent interests created by the exercise of a

107. *Mifflin*, 15 A. at 527.

108. *Id.* See also *Jones*, *supra* note 86, at 460.

presently exercisable general power of appointment,¹⁰⁹ but relies on the common law to determine the commencement of the perpetuities period for interests created by the exercise of a special or a testamentary general power of appointment.¹¹⁰

B. The Intersection of Powers of Appointment, the Doctrine of Relation Back, and the Repeal of the Rule Against Perpetuities

Powers of appointment play an important role in estate planning, particularly in drafting marital deduction trusts. In a power of appointment trust, for example, the surviving spouse must be given a general power of appointment, either testamentary or presently exercisable, over the corpus as a condition precedent to obtaining the marital deduction.¹¹¹ Typically, a power of appointment trust limits the surviving spouse to a testamentary general power if the testator wants to preserve the corpus of the trust¹¹² or hopes to exert some control over the ultimate recipients of the property.¹¹³ For example, a power of appointment trust might have the following terms: income to the surviving spouse for

109. 20 PA. CONS. STAT. ANN. § 6104(c) (West 2007). The Pennsylvania Uniform Trust Act limited application of this rule to interests created before January 1, 2007. *Id.* § 6107.1.

110. *Id.* § 6104(c) cmt. b (1947).

111. I.R.C. §§ 2056(b)(1), (b)(5) (2000). The surviving spouse's general power of appointment must be exercisable in favor of the surviving spouse or the surviving spouse's estate. *Id.* § 2056(b)(5). The marital deduction is denied if the surviving spouse is given a terminable interest. *Id.* § 2056(b)(1). A terminable interest exists if (i) the surviving spouse's interest in the property is terminable; (ii) the decedent also transfers, or has transferred, an interest in the property to someone other than the surviving spouse; and (iii) after the death of the surviving spouse, such other person may come into possession or enjoyment of the property as a result of the interest received from the decedent. *Id.* The terminable interest rule basically insures that a marital deduction gift will be included in the surviving spouse's estate. With a power of appointment trust, the surviving spouse's general power of appointment ensures inclusion of the trust corpus in the surviving spouse's estate. *Id.* § 2041(a)(2).

112. Geoffrey P. Pickett, *Powers of Appointment as an Estate Planning Tool*, 26 N.Y.U. INST. ON FED. TAX'N 1435, 1449 (1968).

113. Prior to enactment of the QTIP trust in 1981 testators who wanted to control the ultimate disposition of their property had to choose between a power of appointment trust with a testamentary general power or foregoing the marital deduction. A testamentary general power was viewed as offering the testator some control on the theory that the surviving spouse was less likely to exercise the power of appointment if it was testamentary. Albert Mannheimer, *Relative Merits of Two Kinds of Trusts that Qualify for the Marital Deduction*, 11 N.Y.U. INST. ON FED. TAX'N 673, 684 (1953). It was hardly a foolproof solution, since the surviving spouse could exercise the general power of appointment to appoint the property away from the takers in default. *Id.* A testator who was really adamant about control could throw obstacles in the way to make it harder for the surviving spouse to exercise the power, such as prohibiting a blanket exercise of the power and requiring, instead, a specific reference to the power. *Id.* Once the QTIP trust was introduced, testators could keep total control over the disposition of their estate without sacrificing the marital deduction. See I.R.C. § 2056(b)(7)(B) (2000).

life; testamentary general power of appointment to the surviving spouse; and a gift over in default of appointment to the testator's children, per stirpes.

A QTIP trust is another example of a marital deduction trust that frequently grants the surviving spouse a power of appointment.¹¹⁴ Although a power of appointment is unnecessary to qualify a QTIP trust for the marital deduction,¹¹⁵ QTIPs frequently grant the surviving spouse a special testamentary power of appointment in favor of the remaindermen, typically the testator's issue, to provide flexibility;¹¹⁶ the surviving spouse can determine whether events subsequent to the testator's death should affect the division of the trust corpus among the remaindermen.¹¹⁷ A QTIP trust, for example, might include the following terms: income to the surviving spouse for life; a special testamentary power to the surviving spouse in favor of the testator's issue; and a gift over in default of appointment to the testator's children per stirpes.

The above examples are by no means an exhaustive list of the powers of appointment created prior to the repeal of the rule against perpetuities that a practitioner may encounter post-repeal. They do illustrate, as explained below, two of the most likely situations in which a practitioner will be tempted to exercise a special or a testamentary general power to create a perpetual dynasty trust, raising the question of whether the interaction of the doctrine of relation back with the effective date for the repeal subjects the perpetual dynasty trust to the rule against perpetuities.

Current estate tax law encourages the creation of a perpetual dynasty trust by allowing the permanent removal of the trust corpus from the transfer tax system. The amount that can be sheltered varies depending on the year of the testator's death. The

114. I.R.C. § 2056(b)(7) (2000).

115. *Id.* § 2056(b)(7)(B). The trust must satisfy the requirements for qualified terminable interest property, which essentially require that all income be paid to the surviving spouse for life and that during the surviving spouse's life none of the trust corpus can be distributed to anyone other than the surviving spouse. *Id.* § 2056(b)(7)(B)(II). The decedent's estate must make a QTIP election to claim the marital deduction with respect to property transferred to the trust. *Id.* § 2056(b)(7). A power of appointment is unnecessary since the QTIP election causes the property to be included in the surviving spouse's estate. *Id.* § 2044(b)(1)(A). Consequently, testators who want total control over the ultimate distribution of their estates choose QTIP trusts over power of appointment trusts.

116. KATHRYN G. HENKEL, *ESTATE PLANNING AND WEALTH PRESERVATION* ¶ 4.02(2)(g) (1998).

117. *Id.*

maximum amount is \$2 million for testators who die in 2007 or 2008,¹¹⁸ \$3.5 million for those who die in 2009.¹¹⁹ And, as long as the money remains in the perpetual dynasty trust, any appreciation is also exempt from transfer tax.¹²⁰ Consequently, it is probably malpractice *per se* not to suggest a perpetual dynasty trust to any client who can afford to fund one.

Many surviving spouses who should take advantage of a perpetual dynasty trust have insufficient personal assets to fund the trust; they derive their wealth, and their potential estate tax liability, from a marital deduction trust. Consequently, their only chance of funding a perpetual dynasty trust is to appoint property from the marital deduction trust. This strategy works from a GST tax perspective. Because the corpus of a marital deduction trust is included in the surviving spouse's gross estate for estate tax purposes, the surviving spouse is considered the transferor of the entire corpus of the trust for GST tax purposes.¹²¹ Therefore, a surviving spouse who has a power of appointment over the corpus of the marital deduction trust can exercise that power to fund a perpetual dynasty trust, regardless of whether the power is general or special, presently exercisable or testamentary, and then allocate her GST exemption to the trust to permanently shield the corpus from estate, gift, or GST tax.¹²²

Appointing assets from the marital deduction trust to fund the surviving spouse's perpetual dynasty trust is an obvious solution in a situation where the surviving spouse's separate property is insufficient. But, if the surviving spouse holds a special or a testamentary general power of appointment created prior to January 1, 2007, the effective date for the repeal of Pennsylvania's rule against perpetuities, the question arises whether the doctrine of relation back determines when the interests are created, as well as the starting date for the perpetuities period by which the validity of such interests will be judged. Simply put, are contingent

118. I.R.C. §§ 2631(c), 2010(c) (2000).

119. *Id.*

120. See *supra* notes 72-81 and accompanying text.

121. I.R.C. § 2652(a)(1) (2000). As a general rule, the donee of a special power is not considered the transferor of the appointive property for purposes of the GST tax because the value of the appointive property is not included in the donee's gross estate. *Id.* When a surviving spouse holds a special power over the corpus of a QTIP trust, the value of the appointive property, the trust corpus, is included in the surviving spouse's estate as a result of the QTIP election, without regard to the nature of the surviving spouse's power of appointment. *Id.* § 2044.

122. *Id.* This assumes in the case of a special power that the perpetual dynasty trust is a permissible appointee. *Id.* § 2652 (a)(1).

interests created by the exercise of a special or a testamentary general power of appointment created when the donee exercises the power or when the donor creates the power? The theory underlying the doctrine of relation back indicates that the interests are created when the donor creates the power.¹²³ Further support for the theory that the interests are created at the time the donor creates the power, rather than when the donee exercises it, can be found in the inheritance tax rules. Pennsylvania's inheritance tax taxes the value of appointive property in the estate of the donor of a power of appointment, not in the estate of the donee.¹²⁴ If the interests are created when the donor created the power, any interests created by the exercise of the power, including any contingent interests in a perpetual dynasty trust created by the exercise or to which the property is appointed, will be subject to the rule against perpetuities. To the extent that a perpetual dynasty trust is subject to the rule against perpetuities, the trust's purpose, the permanent removal of the corpus from the estate tax base, will be thwarted when the rule terminates the trust at the end of the perpetuities period.

The question of how the doctrine of relation back interacts with the effective date of a statute has risen before on slightly different facts. *In re Estate of Frank E. Moore*¹²⁵ considered whether a charitable gift created by the exercise of a testamentary general power qualified for an exemption to the inheritance tax applicable to charitable transfers when the power of appointment was created prior to, but exercised after, the effective date for the exemption.¹²⁶ Since the exemption applied to all "transfers" made after the effective date, the court had to determine whether the transfer to the charity occurred when the power was created or when it was exercised.¹²⁷

The trial court held that the transfer occurred at the time the power was created and, therefore, did not qualify for the exemption.¹²⁸ The first time the supreme court heard the case, an evenly divided court affirmed.¹²⁹ The doctrine of relation back, a doctrine "firmly embedded in Pennsylvania law,"¹³⁰ was the primary justi-

123. See *supra* notes 99-106 and accompanying text.

124. 72 PA. CONS. STAT. ANN. §§ 9111(k), 9116(f) (West 2000). See *supra* note 103.

125. 283 A.2d 50 (Pa. 1971).

126. *Moore*, 283 A.2d at 51.

127. *Id.*

128. *Id.* at 52.

129. *Id.* at 54.

130. *Id.* at 55.

fication cited by those justices who voted to affirm.¹³¹ When the case was reheard, a similarly divided court reversed itself and held, four to two, that the transfer occurred after the effective date of the exemption.¹³²

On rehearing, the majority was persuaded by the fact that the charities, the eventual appointees, had no interest in the appointive property until the power was exercised, an act that occurred after the effective date of the exemption.¹³³ The majority concluded that there could be no transfer to the charities prior to the time when they had some sort of legal or equitable interest in the property.¹³⁴ The majority also concluded that its reading comported with the purpose of the exemption and advanced Pennsylvania's long-standing policy of encouraging donations to charity.¹³⁵

The majority in *Moore* did not definitively hold that the doctrine of relation back would never be applied to determine if an appointment was made after the effective date of a statutory change,¹³⁶ although it did refer to the doctrine dismissively as "a historical fiction."¹³⁷ Instead, the majority declined to use the doctrine "to reach a result opposite to that clearly suggested by both the text and underlying policy of the exemption statute."¹³⁸ Consequently, the doctrine of relation back remains settled law.

While one can argue that the holding in *Moore* mandates a similar conclusion regarding the interaction of powers of appointment with the effective date of the repeal of the rule against perpetuities, *Moore* is distinguishable. The issue in *Moore* was when the "transfer" to the appointees occurred;¹³⁹ the issue with respect to the repeal of the rule against perpetuities is when the contingent

131. *Moore*, 283 A.2d at 50.

132. *Id.* Only six members of the court heard either argument. The first time the appeal was heard, Justices Cohen, Eagan, and O'Brien voted to affirm and Justices Roberts, Bell, and Jones dissented. *Id.* at 54. In the interim between the first argument and the rehearing, Justice Cohen died; he was replaced by Justice Barbieri. None of the justices who heard both arguments changed their vote. The reason for the change in outcome was the substitution of Justice Barbieri for Justice Cohen. *Id.*

133. *Id.* at 52. See also *Bourne Estate*, 69 Pa. D. & C.2d 591 (1974) (extending the holding of *Moore* to charitable appointments made pursuant to a special power of appointment created prior to the effective date of the exemption from inheritance tax for charitable transfers).

134. *Moore*, 283 A.2d at 52.

135. *Id.* at 52-53.

136. *Id.* at 53-54.

137. *Id.* at 54.

138. *Id.* The majority also concluded that there was a material difference between a change in the tax rate and the creation of an exemption from tax. *Id.* at 53.

139. *Moore*, 283 A.2d at 52.

interest given to the appointees is *created*.¹⁴⁰ It may seem like nitpicking to parse the issue this finely, but it is just this sort of hairsplitting that has tripped up many a lawyer in the past.

The difference between when property is *transferred* and when it is *created* is sufficient to prevent *Moore* from definitively answering the question. One can argue that the justification offered by the *Moore* court for its conclusion that the transfer occurred after the effective date of the amendment, that there was no transfer to the charities prior to the time when they had some sort of legal or equitable interest in the property,¹⁴¹ supports the argument that the charities' interests were created at the time the power was exercised. An equally plausible interpretation is that the court is simply saying the interests, created at the time the donor created the power of appointment, were not transferred to the appointees until they had some legal or beneficial interest in the property.

Even if accepted as the controlling authority, *Moore* offers, at best, ambivalent support for the proposition that the interests are created when the power is exercised. *Moore* stands for the proposition that the doctrine of relation back is relevant to the question of whether contingent interests are created before the effective date of the a statute only if application of the doctrine is not repugnant to the policies underlying the statute.¹⁴² One policy underlying the repeal of the rule against perpetuities is the encouragement of perpetual trusts; however, the legislature explicitly limited the repeal only to interests created after the effective date. Either the doctrine of relation back controls, which means the interests are created before the effective date and do not qualify for the repeal, or it does not, which means the interests are created after the effective date and qualify for the repeal. And, unlike the situation in *Moore*, there is no long-standing policy of encouraging perpetual trusts to counter balance the legislature's clear intent that perpetual trusts can only be created, and funded with interests created, after the effective date of the repeal.

Putting *Moore* aside, indirect support for the argument that the repeal does not apply to interests created by the exercise of powers created before the effective date of the repeal can be found in the settled expectations of donors and donees. As long as the doctrine of relation back and the rule against perpetuities are in effect, the

140. 20 PA. CONS. STAT. ANN. § 6107.1 (West 2007).

141. *Moore*, 283 A.2d at 52.

142. *Id.*

exercise of a special power of appointment is a nontaxable event to the donee.¹⁴³ Consequently, it is reasonable to assume that many special powers created prior to the effective date of the repeal authorize the creation of successive powers. Making the repeal retroactive prevents the exercise of those powers in the manner contemplated by the donor without adverse tax consequences to the donee.¹⁴⁴ In the case of special powers, making the repeal retroactive creates a trap for the unwary donee or, to be more precise, the unwary lawyer advising the donee.

To summarize, the question of whether the rule against perpetuities applies to contingent interests created by the exercise of a special or general testamentary power created prior to, but exercised after, the effective date for the repeal of Pennsylvania's rule against perpetuities remains open. *Moore* provides an argument that such interests are not subject to the rule against perpetuities, but can one afford to dismiss the question, the doctrine of relation back, and the rule against perpetuities, when exercising a special or general testamentary power created prior January 1, 2007? For estate planners, the answer is no for some very pragmatic reasons.

First, as explained above, current law encourages the exercise of powers of appointment created prior to the repeal of the rule to create interests that vest beyond the time period permitted by the rule against perpetuities. So, many estate planners will eventually face a situation that raises the question.

Second, the consequences of gambling, and losing, are catastrophic. Regardless of the ultimate resolution of the question, the prudent estate planner will not risk the possibility that a perpetual dynasty trust will be terminated by the rule against perpetuities and the trust corpus returned to the transfer tax system. Particularly since, under wait-and-see, the question will probably not be raised until sometime in the distant future when the value of the perpetual dynasty trust may have multiplied exponentially. Wait-and-see increases the potential value of the trust at the time that the issue is raised and, if the prognostications of Professor Bloom and others are correct, the chances that there may be a change in attitude towards the repeal of the rule at the time the issue is raised. If the repeal results in the predicted concentration

143. See *infra* notes 152-157 and accompanying text.

144. See *infra* notes 156-158 and accompanying text. Some states have explicitly limited the repeal of the rule to special powers created after the effective date of repeal to avoid this problem. See *e.g.*, MO. ANN. STAT. § 456.025-3(1) (West 2007); NEB. REV. STAT. ANN. § 76-2005(9) (LexisNexis 2007).

of wealth in perpetual trusts, there may be a backlash; a reform-minded court may seize on any excuse to reduce the amount of wealth controlled by perpetual trusts.¹⁴⁵

Third, current law offers an easy way to circumvent the entire problem, so why gamble? The prudent estate planner will avoid the potential problem entirely, especially since the problem can be circumvented without foregoing funding of the perpetual dynasty trust. The easy solution is to appoint the property to a perpetual dynasty trust domiciled in a state that has repealed the rule against perpetuities with respect to all interests and not just with respect to interests created after a certain date;¹⁴⁶ however, if the power is a special power of appointment, practitioners should mind the Delaware tax trap, discussed below.

V. THE DELAWARE TAX TRAP

The other possible problem created by the repeal of Pennsylvania's rule against perpetuities concerns the estate and gift tax treatment of property subject to a special power of appointment. The problem arises because of a recondite provision in the estate and gift tax, enacted to prevent circumvention of the transfer tax system by the use of successive special powers of appointment.

Special powers of appointment are frequently included in trusts to create flexibility.¹⁴⁷ For example, the donee of a special power may be given the authority to sprinkle income or to modify trust terms.¹⁴⁸ Because a corporate trustee is unlikely to sacrifice its trustee's fees by voluntarily terminating a trust and because judicial termination is both doubtful and costly, special powers may be used to give one or more of the trust beneficiaries the authority to terminate the trust.¹⁴⁹ In some perpetual trusts, successive special powers are used as the device that transfers enjoyment of the trust corpus from one generation to the next.¹⁵⁰ For example, each successive income beneficiary may be given a special power of ap-

145. One possible impetus for a future backlash may be that the corpus of a perpetual dynasty trust is also removed from Pennsylvania's inheritance tax base. 72 PA. CONS. STAT. ANN. §§ 9107, 9113 (West 2000).

146. For example, the rule against perpetuities has no effect in New Jersey. N.J. STAT. ANN. § 46:2F-9 (West 2007). Ohio explicitly extends its repeal to any general power exercised after the effective date of its repeal. OHIO REV. CODE ANN. § 2131.09(B)(3)(c) (West 2007).

147. Dukeminier & Krier, *supra* note 4, at 1332.

148. *Id.*

149. *Id.* at 1332-33.

150. *Id.* at 1318.

pointment authorizing the beneficiary to appoint the portion of the trust corpus generating that beneficiary's share of trust income in further trust for the benefit of the beneficiary's spouse and descendants.¹⁵¹

The estate and gift tax system distinguishes between general and special powers when determining the tax consequences to the donee of the power.¹⁵² The donee of a general power of appointment must include the value of the appointive property in her gross estate, regardless of whether the power is exercised or not.¹⁵³ Similarly, the donee of a general power is treated as making a taxable gift if the donee exercises the power during life.¹⁵⁴ The donee of a special power of appointment, on the other hand, is not, as a general rule, taxed on the value of the appointive property, even though the donee exercises the power.¹⁵⁵ An exception to the general rule, called the "Delaware tax trap," taxes the donee of a special power on the value of the appointive property if the donee

exercises [the] power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.¹⁵⁶

This exception earned its nickname because it was enacted in response to Delaware's statutory overrule of the doctrine of relation back with respect to the exercise of special powers.¹⁵⁷ Basically, it provides that any donee of a special power who exercises that power to create another power is taxed on the value of the appointive property unless the perpetuities period for the newly created power begins concurrently with the perpetuities period for

151. *Id.*

152. I.R.C. §§ 2041(a)(1),(2), 2514(a),(b) (2000). The Tax Code defines a general power as one which can be exercised in favor of the donee, the donee's estate, the donee's creditors, or the creditors of the donee's estate. *Id.* § 2041(b)(1).

153. *Id.* § 2041(a)(2). This rule is limited to general powers created after October 21, 1942. *Id.* Powers created before that date must be exercised for the value of the appointive property to be included in the donee's gross estate. *Id.* § 2041(a)(1).

154. *Id.* § 2514(a),(b).

155. *Id.*

156. *Id.* §§ 2041(a)(3).

157. Dukeminier & Krier, *supra* note 4, at 1332-33 (citing DEL. CODE ANN. tit. 25, § 501 (1989)). Delaware has subsequently repealed this statute. *Id.*

the original power. In other words, the second power cannot extend the period that the appointive property is subject to contingent interests.

State legislatures need to be cognizant of the Delaware tax trap when repealing the rule against perpetuities. Simply repealing the rule against perpetuities eliminates the perpetuities period, making it impossible to exercise one special power to create another without springing the Delaware tax trap.¹⁵⁸ Consequently, a state should not repeal its rule against perpetuities without simultaneously legislating a way for donees of special powers to circumvent the Delaware tax trap. Failure to do so, essentially, prevents the use of successive special powers of appointment.

Commentators have suggested various ways for a state to circumvent the Delaware tax trap when repealing the rule against perpetuities. One solution is to substitute a rule against suspending the power of alienation but permit that rule to be waived so long as the trustee has the power of sale.¹⁵⁹ Under this solution, the power of alienation is never actually suspended and successive special powers can be created indefinitely without adverse tax consequences.¹⁶⁰ Another solution is to create a perpetuities period for interests created by the exercise of a special power of appointment.¹⁶¹

Unfortunately, the Pennsylvania legislature repealed Pennsylvania's rule against perpetuities without substituting a rule prohibiting the suspension of the power of alienation or taking any other actions to circumvent the Delaware tax trap.¹⁶² Consequently, if the donee of a special power created after December 31, 2006 exercises that power to create another power, the donee will be subject to estate or gift tax on the value of the appointive property.¹⁶³ In addition, the exercise of a special power created prior to January 1, 2007 to create another power will include the value of the appointive property in the donee's gross estate unless the doctrine of relation back subjects the new power to the rule against perpetuities.¹⁶⁴

158. Dukeminier & Krier, *supra* note 4, at 1333-34.

159. *Id.* at 1333.

160. *Id.*

161. *Id.*

162. *Id.*

163. I.R.C. §§ 2041(a)(3), 2514(d) (2000). See also Dukeminier & Krier, *supra* note 4, at 1333.

164. See *supra* notes 111-146 and accompanying text.

The Advisory Committee on Decedents' Estates Law has suggested the adoption of the following amendment as a solution to this problem:

If a power of appointment is exercised to create a new power of appointment, any interest created by the exercise of the new power of appointment is invalid if it does not vest within 360 years of the creation of the original power of appointment, unless the exercise of the new power of appointment expressly states that this provision shall not apply to the interests created by the exercise.¹⁶⁵

The language proposed by the Advisory Committee does not explicitly address the creation of more than one successive power. Instead, the proposed language appears to rely on the doctrine of relation back to write the third, fourth, or any succeeding power back into the original power. This could cause a problem if, for example, a perpetual trust that uses successive powers to transfer beneficial enjoyment of the property from one generation to the next. It could also cause problems if a court negates the doctrine of relation back as a historical fiction. The language of the proposed amendment should be altered to provide that in the event of multiple successive powers, the 360-year period begins at the creation of the first power.

VI. CONCLUSION

The rule against perpetuities continues to serve several important purposes and only time will tell whether repeal was beneficial or merely the first step toward another problem. As things stand, however, Pennsylvania's rule against perpetuities is repealed for interests created after December 31, 2006. Although the rule has been repealed, practitioners cannot disregard it as an anachronism. Not only might they confront it in documents drafted prior to the repeal, but, as discussed in this article, the rule, or at least the consequences of its repeal, may impact documents drafted after the repeal.

The legislature, on the other hand, needs to revisit the repeal. It should reconsider the effective date of the repeal and the rea-

165. REPORT OF THE ADVISORY COMMITTEE ON DECEDENTS' ESTATES LAWS, PROPOSED AMENDMENTS TO TITLE 20 OF THE PENNSYLVANIA CONSOLIDATED STATUTES: THE PROBATE, ESTATES AND FIDUCIARIES CODE, (Oct. 2007), available at <http://jsg.legis.state.pa.us/DEL%20Report%202007.pdf>.

sons, if any, for making the repeal prospective.¹⁶⁶ If there are no substantial policy reasons for making the repeal prospective, the legislature should consider making it retroactive for all interests other than successive special powers of appointment. If the legislature means for the repeal to be prospective, then it should clarify whether, regardless of the continuing viability of the doctrine of relation back, the rule against perpetuities continues to apply to interests created by the exercise of special or testamentary general powers created prior to, but exercised after, the effective date of the repeal. If the legislature determines that the repeal should be prospective for reasons unrelated to powers of appointment, it might consider making the repeal applicable to all interests created by general powers, whether testamentary or presently exercisable, but it should not extend the repeal to powers of appointment created by the exercise of a special power unless it solves the problem of the Delaware tax trap. Lastly, and most importantly, the legislature needs to amend the current statute so that the exercise of a special power of appointment to create another power does not fall within the Delaware tax trap. The simplest solution to that problem is to create a lengthy perpetuities period, such as the 320-year period suggested by the Advisory Committee, that begins running at the exercise of the first special power and applies to interests created by all successive powers.

166. Wait-and-see was originally made prospective, 20 PA. STAT. ANN. §§ 301.4-.5 (West 1950), and only made retroactive in 1978, 20 PA. STAT. ANN. § 6104(d) (West 1978). In the interim, the Pennsylvania courts denied relief to trusts created prior to the adoption of wait-and-see. See e.g., *In re Newlin Estate*, 80 A.2d 819 (Pa. 1951); *In re Lovering's Estate*, 96 A.2d 104 (Pa. 1951); *Estate of Davis*, 297 A.2d 451 (Pa. 1972). This disparate treatment can be avoided with respect to the repeal of the rule if the Pennsylvania legislature acts quickly to remedy the flaws in this statute.