Chapter Twenty-One

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Unexpected Consequences of a Perpetual Trust

During the last dozen years, many attorneys and financial planners in the United States have recommended that their clients create perpetual trusts. These vehicles are frequently referred to as dynasty trusts. While there are a number of individual and family reasons that might impel an individual to create such a trust, in large measure the motivating factor has been to avoid the federal generation-skipping tax on the assets of trusts for later family generations.[1]

This method of tax avoidance has created a cottage industry in perpetual trusts. This industry has now reached sufficient scale that a number of states interested in competing for this business have eliminated their rules against perpetuities to permit the creation of perpetual trusts within their boundaries. (In doing so, they joined a number of states that had never adopted this rule.) These new statutes are overturning some three-hundred-plus years of statutes and common-law precedents in England and America that were founded on the principle that trusts for individuals, as opposed to charities, should not be permitted to last indefinitely.

It is my observation that this emphasis on tax saving as the motive for the creation of perpetual trusts, and the resulting changes in statutory and precedentual law to meet this motive, have frequently obscured critical thinking by planners and trust founders on how the lives of the beneficiaries living within such trusts will be affected and of how society as a whole may view the existence of such trusts. I would like to illuminate these issues here so that planners and founders may consider them in determining how the perpetual trusts they are intending to create will be of the greatest benefit to the individuals for whom the trusts are created.

The trust as we know it evolved in England and on the European continent, particularly in France, out of the Roman idea of "use." This is the legal concept that provides that a person may have the use of a thing for a period of time without also having the underlying ownership of that thing. This idea took root in the English and French common laws as the trust, and by the time of the Crusades it was well established in land titles. At that time the law made no distinction regarding the terms of trusts, thus permitting trusts to last indefinitely or, if you will, perpetually. Rather quickly, the nobility of England and France saw that by placing their lands in perpetual trusts they could, theoretically, perpetuate their class position indefinitely. Therefore, much of England and France's land found its way into perpetual trusts.[2]

Unfortunately for the economics of the countries where this system developed, there were two unintended consequences. First, the land in trust often could not be alienated even if the noble family needed money or in some cases had disappeared. Second, such lands were often poorly administered, because they had no owner who cared about their improvement, since he or she would never own them outright. Many life tenants sought to receive the maximum annual return possible without regard to such a policy's long-term effect on the land's productivity.

The result of these unintended consequences was that a portion of England's and France's wealth was seen by its rising commercial classes to be wasted. Equally, those who had money and entrepreneurial creativity were frustrated that they could not buy and improve this land, thus exacerbating the perceived negative effect of the perpetual trust on the economy. In addition, the suspension of vesting of property as a result of perpetual trusts often led to certain members or even whole generations of noble families becoming trust-funders and falling into the same lassitude or remittance addiction that we often see today in some of the third- and fourth-generation members of the great families of nineteenth-century Industrial America. Often then, as now, this lassitude resulted from the fact that no member of that noble family ever owned or would own the capital locked up in the trust from which he or she received monthly stipends, nor would any family member ever be required to learn to manage these assets. In fact, work in commerce of any kind was seen as beneath the dignity of such personages.

The result of these perpetual trusts in England was that, by the end of the seventeenth century, the perpetual trust came to be seen by lawyers, merchants, and economists as a substantial drag on commerce (since so much land could not be purchased or sold) and as an abuse of the original idea of trust: that a period of suspension of ownership while another used something could be beneficial to commerce. The result of these concerns was the adoption in England, in the late 1600s, of the Rule Against Perpetuities. At the time this rule was adopted, first by case law and then by statute, lawyers, judges, economists, and parliamentarians saw it as a great reform.[3]

The history of the perpetual trust in France is also instructive. Historically, France had a well-understood perpetual trust provision. Until its revolution in 1789, France made no such reform as the English made with their Rule Against Perpetuities. In France the absence of such a reform and the resulting restriction on the growth of France's economy, caused by the inability to purchase and sell land, slowed France's development. The perceived abuse of the economy, through the use of the perpetual trust by the nobility, was seen by Napoleon and the jurists who advised him to be so serious that in 1805, in the Code Napoléon, he eliminated the trust altogether in France. Today a number of French lawyers are attempting to reintroduce the trust through a legal entity called the *fiducie,* because they feel the lack of this vehicle has held back their clients' ability to properly plan their estates. None of the advocates of the *fiducie,* interestingly, are suggesting such an entity be perpetual.

So what can we learn from the history of the perpetual trusts? We can say that at least at one time in the evolution of the law of trusts, such trusts were perceived by society to have had a significant negative impact on the marketplace and to have perpetuated a non-productive class of people. As to the first of society's objections to the perpetual trust, there is no doubt about such trusts' historically negative impact on land sales and acquisitions. As to the second, the histories of France and Russia have not been kind to a class of people whom society perceives as never needing to earn their own living, and particularly unkind to those who enjoy such a status just because an ancestor, whom they often never even knew, created a perpetual trust for his or her descendants.

There is a third drawback to the perpetual character of dynasty trusts, a disadvantage less widely perceived in the society at large but pertinent to our modern economic environment, where wealth is represented far more in movable assets than in immovable property. The trustees of nearly every trust are constrained by the state laws that govern trusts to make no investment that is not prudent. In the commercial arena, however, creativity is defined as entrepreneurship and is all about taking risks. Creativity and the risks it entails are not included within these state-law definitions of prudence, and rightly so, since it is someone else's assets that the trustee is administering. This reality proves unfortunate over time for trust beneficiaries. Why? Because over time, the prudent trustee cannot take the risks that an entrepreneur using his or her own resources can take, and so, over time, the return achieved by the trustee in competition with all other investors will be less. This logic, carried out over the multiple generations assumed by a perpetual trust, suggests strongly that, assuming the market is neutral, a trust's assets will fail to grow at the same rate as the market as a whole, and suggests that such trusts will eventually find themselves in the same negative position commercially as those that owned but could not trade in land.

When I address the supposedly new idea of a perpetual trust, I am reminded of the admonition by George Santayana that "those who cannot remember the past are condemned to repeat it." I wonder how many of the multitude of financial planners who promote dynasty trusts as a product and rush them off the shelf to solve a tax problem have studied the history of the first chapters in the life of the perpetual trust. I wonder how many of them understand that many previous societies have found the creation of a perpetual leisure class unacceptable, and that the longer assets remain prudently invested within a trust, the greater the likelihood that those assets will underperform the market as a whole. It is my purpose in this chapter to raise these questions so that we as planners can meet the wise man's admonition about remembering the past and form a thoughtful view about perpetual trusts. By doing so we can best advise our clients on the possible outcomes of the plans they are creating. I also feel obliged to observe that the United States Congress in 2001 passed the Economic Growth and Tax Relief Reconciliation, which will eliminate the federal generation-skipping tax. I wonder whether greater familiarity with the history of the perpetual trust, and with the issues I am about to discuss of beneficiaries' lives within such trusts, might have caused many founders to pause and think before creating a perpetual legal vehicle, especially had they not been driven to solve a tax problem that may very well not exist for the trust's lifetime.

Let us look, then, at three issues that would not normally be first thoughts in the minds of tax planners but are often the first thoughts of caring professionals concerned about the long-term effects of their actions on the lives of their clients, on the families of which they are a part, and on the systems within which they live and operate. Let us consider the law of unintended or unexpected consequences; the interest of society in the outcomes of the individual decisions of its members, and society's ability to influence these decisions; and the second law of thermodynamics, the law of entropy.

The Law of Unexpected Consequences

Modern physics informs us that there are often unintended or unexpected consequences of acts the universe performs. Increasingly, modern economists, social scientists, and psychologists are seeing this same reality and applying these principles in their fields. The ancient Greeks understood this idea long before its modern disciples and expressed it when they were preparing young men and women to enter the service professions, by admonishing them to do no harm. The ancient Greeks recognized that rushing to do good before understanding the whole system and all the issues relating to the problem to be solved often led to doing more harm than good.

I would synthesize modern thinkers and the Greeks by suggesting that because there are often unintended or unexpected consequences of what we do, and because some of what we do may do harm, we should start any planning project with the rule "First, be sure to do no harm." This rule is particularly applicable to the creation of a perpetual trust. Why? Because the planner is mortal, and the trust he or she is creating is theoretically immortal. In such a case, many questions regarding the natures and experiences of the descendants of the trust's founder, and the environment in which they and the trust will exist, will not only not be known or discernable by the founder, they will also not be known or discernable by the planner. The planner, in assisting the founder in creating such a trust, must recognize that he or she will be significantly affecting the lives of each of the trustee's beneficiaries, as each beneficiary in turn integrates the trust's existence into his or her own. It can be a humbling experience for trust planners and trust founders to imagine what life might be like for these beneficiaries even just two or three generations removed from those alive today, much less the seventh, eighth, and ninth, generations thereafter. Perhaps the admonition of the Iroquois elders to one another as they began important tribal work—"It should be our hope that the care and thoughtfulness we bring to our decision making today will be remembered and honored by our descendants seven generations from today"—would be helpful to planners and founders of perpetual trusts as they begin their work. Rightly, the creation of a perpetual trust, affecting so many generations of a family, ought to be done and entered into with great humility and plenty of patience. The thought "hasten slowly" comes again to mind.

I strongly suggest that every planner carefully consider all the possible impacts the trust may have on the lives of its beneficiaries, particularly its unintended consequences, and bring those thoughts to the attention of the trust's potential founder. By so alerting the trust's founder, the planner will be trying to eliminate to the greatest extent possible the negative impact the trust might have on these beneficiaries, and to meet an adviser's highest responsibility to the founder and the beneficiaries to do no harm. Strangely, I often observe that in the rush to get the tax work done and the papers out, the trust's impact on the lives of its beneficiaries is never discussed. This failure to take the time to consider these issues may be, from the founder's standpoint, given his or her intention to benefit the beneficiaries by enhancing their lives, the greatest unintended mistake. Why? Because it may lead to the creation of a trust that diminishes the lives of its beneficiaries. Should such a result occur, the founder would have been deprived by the trust's planner of the advice he or she most needed in attempting to accomplish his or her enhancement goals.

We as planners owe a duty to our clients to bring to them all the issues that may impact their decisions so that they may make the most informed decisions. It is my hope that when one of our clients is thinking of creating a perpetual trust, such issues as its possible negative impact on its beneficiaries by (1) causing them to become remittance addicted, or worse, victims of the state of mind we know as entitlement, and (2) depriving them of a chance to dream and the freedom to bring their dreams to life will be the issues we choose to discuss most deeply with the founder. Why? Because in these issues lies the greatest risk of unintended negative consequences to the lives of the beneficiaries and to the enhancement goals of the trust's founder.

Society and the Perpetual Trust

Turning to the second of my questions, society's interest in the decisions its individual members make: as I explained previously, English, French, and Russian societies at earlier periods of history found the perpetual trust and the perpetual-leisure or nonworking class it created unacceptable. In America, anxiety about the existence of such a class led to the adoption, first by inheritance of the English common law and later by individual state statutes, of rules against perpetuities. These statutes expressed society's view that the perpetual suspension of the ownership of property was an unacceptable hindrance to the economy and to the movement of wealth within society as a whole. These rules may also express a concern about a perpetually landed class that did not need to work.

My aim here is simply to point out to planners that in France and arguably Russia, enmity toward a landed class helped lead to revolution. I believe it is our duty as planners to advise our clients of these histories so that they may consider all points of view before acting to create an entity that certain societies have seen as unacceptable. I believe it is also important to consider that no society known to history has ever accepted within its midst a perpetually leisured or nonworking class.

As a historian and amateur sociologist, I cringe when I see masterful statistical analyses created by trust planners projecting the enormous buildups of wealth within these perpetual trust entities, all designed to encourage potential trust founders to get on with buying such a product from the planner. I wonder whether the planner is appealing to the founder's ego by suggesting the creation of such a monument to the founder, all the while disguising this fact by suggesting how happy the beneficiaries will be.[4] History shows that society has never permitted such monuments to last very long. Remember Ozymandias? I suggest that society, like biology, seeks creation and change in order to meet new circumstances and to allow new forms of community to arise. As Heraclitus said, everything is in flux. I suggest that society dislikes the profound order found in monuments. Given this history, I suggest that society's concerns have to be taken into account in characterizing to founders the long-term likelihood that their planners' projections of monumental financial results will turn out to be true. I also caution readers who are now just beginning to imagine life without federal estate taxation and federal generation-skipping taxation to consider how likely it is that American society will bring both of these taxes back if it perceives that they are needed as a way to avoid a perpetual-leisure or nonworking class. Coming again to the law of unintended consequences, are we, as planners, recreating the environment within American society for the re-enactment of the federal estate tax and generation-skipping tax sometime in the future by promulgating perpetual trusts?

The Law of Entropy

Finally, we have the third issue: the second law of thermodynamics, or the law of entropy. This law of physics reminds us that everything that is material will over time be frictioned away by entropy. While it may be heartening to trust founders to think they are perpetually endowing the enhancement of the lives of their descendants, I strongly suggest that they be disabused of such an idea. Planners who play to the hubris of their clients by suggesting that a perpetual trust is a monument that will endure forever are pandering to their clients' worst instincts. Bringing the law of entropy into the conversation brings both planner and founder back to humility and to the awareness that in their work together on a legal entity that will impact others lives—and particularly a perpetual trust, with its intended extended period of life—they must be sure *they will do no harm before they try to do good.*

Summing up this section, I cannot urge too strongly that planners discuss with potential founders of perpetual trusts the following three important realities:

1) There will be unintended consequences of this perpetual trust. Have we considered as many possible outcomes of the creation of this trust as we can imagine, with our greatest focus being on those that may decrease, rather than increase, the pursuits of individual happiness of the beneficiaries of the trust? Have we used the seventh-generation wisdom of the Iroquois? Have we hastened slowly? Have we asked what harm will we do before we try to do good?

2) Society will have a view about (and an impact on) this perpetual trust. Have we considered what society's view and impact might be? Have we considered not only that society is averse to what we may first perceive as our goal of having a trust last perpetually but also that society may have a valid point of view that might cause us to modify our plan? Have we at least considered the idea that society as a system will in some way constrain our goals of having a trust last perpetually?

3) The law of entropy is alive and well and informs us that nothing material lasts forever. Have we brought this law of physics into our consciousness as we plan, and have we imagined how it will impact the life and operation of the perpetual trust?

The emphasis of the three areas set out above appears to be on external forces that will affect a perpetual trust. I argue, however, that the most significant risk to the success of a perpetual trust is internal. It is the risk that because of a lack of internal governance of the relationship between the beneficiaries and the trustees, the trust will not enhance the lives of its beneficiaries but rather will diminish them. One is reminded of Walt Kelly's comic character Pogo, who went searching for the enemy and found it was us. In other words, a trust's planners, founders, and beneficiaries are the most likely cause of the trust's failure to prove enhancing to its beneficiaries. In my practice, it is common to meet beneficiaries who tell me that a trust has been a net negative in their lives.

Planners who are seeking genuinely to guide their clients will always offer them an enlightened and educated view of the possible outcome of trusts. The sharing of such views is particularly important in the case of perpetual trusts. Why? Because the laws of demographic probability imply a geometric increase in the possible beneficiaries of such trusts in each later family generation. Thus, through the normal birth rates expected within families, such trusts are more likely to spawn unproductive or remittance-addicted persons than are fixed-term trusts. The potential founders of perpetual trusts are entitled to be made aware of this potential.

Another reality of trusts of all kinds is that many beneficiaries do not feel worthy of such a gift and find the trust a hindrance to their development, to their sense of freedom to make their own life choices, and to their sense of self-worth. While to the average person without a trust these may seem like strange thoughts, they are in fact one of the realities of trust life. Many beneficiaries feel that the trust saps them of creativity and the excitement of making something of their own. They sincerely wonder who they might be if the trust did not exist—would they be happier, and would they hold their own unique abilities and gifts in higher esteem? In addition they feel beholden to someone they often will never meet, and scarcely even feel related to, yet whose history they are expected to appreciate, admire, and emulate. In fact they may be embarrassed by that history while being locked into it by the trust.

Yet another reality of trust life is nonmentoring trustees. Many trusts fail their founders' hopes that they will enhance the lives of their beneficiaries because the trustees of such trusts themselves go into entropy. Often trustees fail to change with the times and bring outdated thinking to new problems. Worse, some trustees begin to see themselves as the real owners of the trust's property, acting as if they are the founder's alter ego rather than the beneficiary's representative, and begin to believe they know better than the beneficiaries how the beneficiaries should live their lives. They arrogate to themselves the role of parents and, in the extreme, become autocrats, when properly their role is to serve the growth and development of the beneficiaries as human beings and as intellectual creatures. Too often, and especially in the later years of a long-lived trust, when the founder is long dead and successor trustees never knew him or her, the trustees begin to identify themselves and their stations in life by the trust's assets and start doing and acting accordingly, forgetting that they are the servants of the beneficiaries and of future generations of beneficiaries to come.

Thoughtful planners who suggest the formation of perpetual trusts and the founders who create them will realize that there is a heightened possibility of failed trust governance when the relationship between the beneficiaries and the trustee will last for an extended period of time. All trust governance is at risk of failure from the beneficiary's becoming remittance-addicted and the trustee's falling into entropy and self-dealing. Unfortunately, with a perpetual trust these risks are heightened, since there is simply more time for the law of entropy to work its will through the beneficiaries' and trustees' negative experiences of the trust and of their relationships with each other.

Happily, today enlightened advisers have an armamentarium of planning antidotes to protect beneficiaries and trustees against failed trust governance. Part Three of this book touched on many of them. One in particular is worth recalling here. As I discussed in chapters 10, 11, and 19, mentor-trustees working to create excellent relationships with their beneficiaries, and beneficiaries working to become excellent beneficiaries in managing their relationships with their trustees, have real possibilities of success. It is in the good management of these relationships that the trust's purpose has a reasonable prospect of being fulfilled. As the trustees and beneficiaries begin this process of self-government, what are some of the outcomes they might consider so that the trust, whether perpetual or fixed term, will provide the greatest enhancement to its beneficiaries' lives? I suggest that both parties begin by recognizing that for each beneficiary, the following three goals—(1) becoming fully self-aware and achieving personal freedom so as to be able to live an independent life, (2) achieving the fulfillment of his or her life's dreams through knowing and fulfilling his or her life's calling, and (3) being able to take full responsibility for his or her actions—are goals of high value and purpose. I worry that in a perpetual trust the beneficiaries may say, Why should I bother with becoming an excellent beneficiary and with trust governance, and do all the labor of making this relationship work, if neither I, nor my children, nor my future descendants will ever own the assets? Why should I learn to be a good steward? Why should I work, or be an apprentice, or find my calling, when I can do nothing?!

Who will help the beneficiary understand that these questions must be well answered if he or she is to achieve a full share of independence and self-worth? Let's hope that founders, alerted to these questions and realities by their planners, will both provide language within their trusts that raise these questions for their beneficiaries and select trustees prepared to help the beneficiaries find life-enhancing individual answers.

All trusts have the capacity to help beneficiaries become self-aware and independent, seek a calling, and be able to take full responsibility for their actions—or to empower them to do nothing and become dependent, with all the sadness such entropic lives engender. I am particularly concerned about perpetual trusts, however, because their history suggests they may have a greater risk of leading to dependence than fixed-term trusts. Whether my concerns will be borne out will be known only many decades from now, when the second and third generations of beneficiaries of such trusts take their places. It is my hope that this discussion and the questions it poses will offer today's trust planners and trust founders food for thought about the consequences their decisions may have on the lives of future beneficiaries. Perhaps the thought and time they invest in considering these questions will lead to their trusts' enhancing rather than diminishing those beneficiaries' lives. Should such a result be achieved by some perpetual trusts, it is likely that these trusts' founders will have taken Santayana's admonition about the past to heart.

Thoughtful giving begins with carefully considering whether a gift will do harm and then—after weighing its possibly harmful affects—whether it will do good.

Chapter Notes

1. This reflection originally appeared in somewhat different form in *The Chase Journal* (Volume 5, Issue 3, 2001).

2. The perpetual trust was also widely used by the Roman Catholic Church to hold its land, until in certain parts of England and France the Church became the largest landowner. As Europe's business environment modernized in the fifteenth and sixteenth centuries this fact caused much dissatisfaction with the Church's secular, rather than spiritual, role. The resulting stultification of commerce—land being its principal medium—was seen by the Tudors in England as highly prejudicial to England's development. As a result many people in the mercantile classes warmly welcomed as a necessary reform Henry VIII's decision as part of his Reformation to sequester and redistribute church property, because they saw its potential to accelerate the development of England's economy.

3. An excellent synopsis of the English legal history of this subject can be found in *Wills, Trusts and Estates,* Sixth Edition, by Jesse Dukeminier and Stanley M. Johenson (New York: Aspen Publishers, Inc., 1999).

4. I also wonder whether these planners have studied Aristotle's view of how difficult the journey is for Western man to be happy and how much of that journey is about knowing oneself, finding useful work in calling and living out one's own dream, and how little is about inheritance of other dreams as reflected by such monuments? Confucius, Socrates, the Buddha, Gandhi, and many twentieth-century figures like Jung, Maslow, and Erik Erikson also have much to say about this journey, and each in his own way comes to much the same conclusion about what enhances people's lives and what diminishes them.