INTRODUCTION

Estate planning attorneys throughout the United States long have fretted about the poorly understood aspect of the federal tax laws known as the Delaware tax trap ("the Trap"), which is codified in §2041(a)(3) and §2514(d). Although practitioners have had a vague notion that triggering the Trap might be beneficial in certain situations, they have been scared to death that a client’s exercise of a power of appointment might inadvertently subject a trust to federal estate or gift tax. Would a malpractice action be far behind? As a result, the goal has been to avoid triggering the Trap at all cost.

Times change.

It is true that planners still must avoid stumbling into the Trap for many trusts. For example, it would be disastrous for a client to spring the Trap in a trust that is not subject to federal generation-skipping transfer tax (GST tax) because it was irrevocable on September 25, 1985 (Grandfathered Trust) or that is exempt from GST tax as the result of allocation of GST exemption (Exempt Trust) if the client already has enough assets to exhaust his or her federal estate or gift tax. Would a malpractice action be far behind? As a result, the goal has been to avoid triggering the Trap at all cost.

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would pass free of tax for one or more additional generations.

Similarly, given that the federal estate tax exemption and the GST exemption are equal at $5.43 million, that the federal estate tax rate and the GST tax rate are equal at 40%, and that a stepped-up income tax basis is available under §1014 for assets owned at death and under §2654(a)(2) for assets subject to a taxable termination, the decision to spring or not to spring the Trap for a trust that is neither grandfathered nor exempt for GST tax purposes (Nonexempt Trust) often will be tax neutral. But, it would be disadvantageous to trigger the Trap if doing so would subject trust assets to a state death tax.4

Nevertheless, following enactment of the American Taxpayer Relief Act of 2012,5 clients sometimes might benefit by forgoing continued immunity from GST tax in order to obtain a stepped-up income tax basis. Thus, a client might want to spring the Trap for a Grandfathered Trust or an Exempt Trust to obtain a stepped-up income tax basis under §1014 to the extent the client has available federal estate tax exemption. Unused GST exemption might then be allocated to those trust assets.

Although commentators have developed ways to trigger the Trap by exercising nongeneral powers of appointment to confer presently exercisable general powers of appointment, they recognize that there is a crucial risk with this technique, i.e., the donee of the presently exercisable general power might exercise it and take the money.6 Instead, I will focus on the original approach, viz., the successive exercise of nongeneral powers of appointment.

Accordingly, I will use the following definitions:

- **First Power** — a nongeneral lifetime or testamentary power of appointment granted by a Will or an inter vivos trust instrument.
- **Second Power** — a second or further nongeneral lifetime or testamentary power of appointment conferred by a First Power.

This article will:
- Review the Trap’s history
- Describe how to spring and not to spring the Trap
- Discuss when to spring and not to spring the Trap
- Summarize how the Trap works under current Delaware law
- Note how the Trap works under the laws of some other states
- Identify related issues.

**HISTORY**

**The Delaware Statute**

Under Delaware statutory law, the exercise of a power of appointment usually begins a new perpetuities period.7 The predecessor to this provision, which was enacted in 1933, provided:8

> Every estate or interest in property, real or personal, created through the exercise, by will, deed or other instrument, of a power of appointment, irrespective of whether such power is limited or unlimited as to appointees, irrespective of the manner in which such power was created or may be exercised, and irrespective of whether such power was created before or after the passage of this Act, shall for the purpose of any rule of law against perpetuities, remoteness in vesting, restraint upon the power of alienation or accumulations now in effect or hereafter enacted be deemed to have been created at the time of the exercise and not at the time of the creation of such power of appointment; and no such estate or interest shall be void on account of any such rule unless such estate or interest would have been void had it been created at the date of the exercise of such power of appointment otherwise than through the exercise of a power of appointment. (Emphasis added.)

The above provision offered the possibility, through the exercise of nongeneral powers of appointment in successive generations, of having a perpetual trust without the imposition of federal transfer tax.

*Illustration:* Fred died in 1934. In his Will, he created a trust for his daughter Alice for her life, giving her a First Power. At Alice’s death in 1959, the trust

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8 38 Del. Laws 198, §1 (1933).
was not subject to federal estate tax because she held only a nongeneral power of appointment. By her Will, she exercised her First Power to create a trust for her son George, giving him a Second Power. Under the Delaware statute, the determination of whether Delaware’s traditional rule against perpetuities was violated was measured from the date of Alice’s death not from the date of Fred’s death. Under this regime, assets could remain in trust perpetually and no federal estate tax would be due other than at Fred’s death.

Congress’s Response

To prevent this from happening, the predecessor to §2041(a)(3) was enacted in 1951. Under it, a trust is subject to federal estate tax at the death of the donee of a First Power who:

- Exercises a 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. (Emphasis added.)

The legislative history makes clear that the Delaware statute was Congress’s target:

In at least one state [i.e., Delaware] a succession of powers of appointment, general or limited may be created and exercised over an indefinite period without violating the rule against perpetuities. In the absence of some special provision in the statute, property could be handed down from generation to generation without ever being subject to estate tax.

The Treasury Regulations

The determination as to whether the donee springs the Trap is based on:

- The instrument that created the First Power
- The instrument that exercises the First Power to create a Second Power
- Applicable local law.

Consequently, even if state law provides that the exercise of a First Power to create a Second Power starts a new perpetuities period and even if the instrument granting the First Power does not limit its exercise, the donee may avoid invoking §2041(a)(3) by including appropriate limitations in the instrument exercising the First Power to create the Second Power. To avoid triggering the Trap, instruments exercising First Powers over Grandfathered Trusts in Delaware typically include language such as the following:

I further direct that any power of appointment conferred upon any person under the provisions of this instrument may not be exercised in any manner which would vest an interest in trust beyond the expiration of twenty-one (21) years after the death of the last survivor of my spouse and my issue living on [date original trust became irrevocable]. If any such power is so exercised, I direct that it be declared void ab initio.

The regulations illustrate the application of the Trap as follows:

If . . . the decedent appoints the income from the entire [$100,000] fund to a beneficiary for life with power in the beneficiary to appoint the remainder by will, the entire $100,000 will be includable in the decedent’s gross estate under section 2041(a)(3) if the exercise of the Second Power can validly postpone the vesting of any estate or interest in the property or can suspend the absolute ownership or power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

Case Law

The only reported case that considered §2041(a)(3) is Estate of Murphy v. Commissioner, in which the Tax Court held that the exercise of a First Power to create a Second Power did not spring the Trap because, under applicable Wisconsin law, the exercise of a nongeneral power of appointment did not commence a new perpetuities period. The IRS acquiesced in the result. The Action on Decision explained that:

Section 2041(a)(3) refers to the creation of a power which under state law can be validly exercised so as to postpone vesting or suspend ownership “for a period ascertainable

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9 The corresponding federal gift-tax provision is §2514(d).
10 §2041(a)(3). See Reg. §20.2041-3(e)(1).
12 Reg. §20.2041-3(e)(1)(ii).
13 Reg. §20.2041-3(e)(2) (Citation omitted.)
14 71 T.C. 671 (1979).
without regard to the date of the creation of the First Power.” Since the Wisconsin rule measures the period from the creation of the first nongeneral power, the statute by its very words cannot apply. This conclusion is supported by Treas. Reg. §20.2041-3(e)(1)(ii).

While an argument can be made that Congress intended to tax all creations of successive powers where vesting or ownership/power of alienation are affected, without regard to state law, such an argument ignores the very language of the Code and regulation. The regulation itself indicates that postponing of vesting and suspension of ownership/alienation power are mutually exclusive conditions of includability which are governed by the particular applicable state law. Finally, under Wisconsin law, ownership has not been suspended because the trustee was given the power to sell trust assets. The regulation, as it is written, appears to say that because local law is phrased in terms of the suspension of ownership/power of alienation, and if there is no such suspension under that local law, then section 2041(a)(3) cannot apply.

**HOW TO SPRING AND NOT TO SPRING THE TRAP**

**Introduction**

As noted above, §2041(a)(3) provides for estate taxation if a trust beneficiary:

> [E]xercises a 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.

Hence, for a trust to be includable in the gross estate of the donee of a First Power created after October 21, 1942, the donee must:

- Exercise the First Power
- Exercise the First Power to create a Second Power
- Exercise the First Power to create a Second Power that, under applicable local law, can be validly exercised to do one of the following for a period ascertainable without regard to the date of the creation of the First Power:
  - Postpone the vesting of any estate or interest in such property; or
  - Suspend the absolute ownership or power of alienation of such property.

Conversely, the donee of a First Power will not fall into the Trap if the donee:

- Does not exercise the First Power
- Exercises the First Power but does not create a Second Power
- Exercises the First Power to create a Second Power that is tied to the date of creation of the First Power.

**Beginning of Measuring Period**

From the foregoing, it is apparent that the key to whether the exercise of a First Power to create a Second Power springs the Trap is whether the duration of trusts created by the Second Power will be based on the date of creation of the First Power or on the date of its exercise. If tied to the date of creation, the Trap should not be sprung; if tied to the date of exercise, the Trap should be sprung. I summarize where some states stand on this issue below.

**End of Measuring Period**

Some commentators suggest that the Trap makes it impossible for donees to exercise First Powers to create Second Powers over trusts created in states, such as Delaware, that allow perpetual trusts without adverse tax consequences. This concern was articulated in a 2009 article in the following way:

> To avoid the Trap, it is necessary to specify a period during which vesting may be postponed, or absolute ownership or the power of alienation suspended, that begins on the date of the Second Power’s exercise and ends on a date that cannot be ascertained without regard to the date of creation of the First Power. Such a period must be finite. (emphasis added).

As a result, several states set a maximum period (ranging from 360 years to 1,000 years) for the duration of trusts created by the exercise of nongeneral powers of appointment.

Several comments are in order:

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18 See below for some examples.
The fixed-period requirement appears nowhere in the authorities summarized above. This isn’t surprising because perpetual trusts were not generally available when the authorities were developed, but the fact remains that a fixed period is not required by the tax laws or regulations. The primary authority cited by the author of the above article is an earlier article, which also cites meager sources.19

The argument assumes that §2041(a)(3) requires the existence of a “fixed period” to avoid its application. In fact, by its terms, §2041(a)(3) only applies to a Second Power that can be exercised to suspend vesting for one type of period — a “period ascertainable without regard to the date of the creation of the first power.” If the Second Power can be exercised to suspend vesting indefinitely and if this is not a “period,” the section literally does not apply.

Even if avoidance of §2041(a)(3) does require a “period” to demonstrate such period was ascertainable with regard to the date of the creation of the first power, Delaware, and other perpetual trust states, do have such a period — an indefinite one. The notion that a period may be indefinite is consistent with dictionary meanings of the word. For example, the Oxford English Dictionary20 defines “period” as both “an indefinite portion of time” and as “any specified period or division of time.”

It is difficult to distinguish, in any practical sense, among states that permit perpetual trusts and states with 1,000-year periods or states with 360-year periods with their definite periods of such inordinate length that they might as well be indefinite. Note that the foregoing fixed periods greatly exceed the IRS’s “safe harbor” period (the common-law rule against perpetuities, 90 years, or the shorter of such periods) in the regulations for the exercise of nongeneral powers of appointment over Grandfathered Trusts,21 which apply to any exercise of a power and not just to an exercise of a First Power that creates a Second Power.22 The regulations suggest that if an ending period is essential to avoid the application of §2041(a)(3), the IRS will require such ending period to be no longer than the traditional period or 90 years. In informal discussions in 2003, IRS representatives confirmed this view with me. At that time, the IRS declined to issue a revenue ruling or private letter ruling on the Trap.

Given that the determination of whether the Trap is triggered is based, in part, on the instrument exercising the First Power,23 such instruments should place a maximum fixed period on trusts created by the exercise of Second Powers if the drafting attorney shares this concern.

WHEN TO SPRING AND NOT TO SPRING THE TRAP

Grandfathered Trust

The Trap is of particular concern for a donee who is exercising a First Power over a Grandfathered Trust because, if the power is exercised inadvertently, he or she might subject an otherwise tax-free trust to estate or gift tax. For example, if the donee exercises a nongeneral power of appointment over a $5 million Grandfathered Trust so as to spring the Trap, his or her estate would owe $2 million of federal estate tax ($5 million times 40%) that should not have been due. Nonetheless, the Trap rarely will be of concern for Grandfathered Trusts for at least two reasons.

First, just three states (Idaho, South Dakota, and Wisconsin) allowed perpetual trusts before September 26, 1985. Therefore, most Grandfathered Trusts expressly require all trusts (including those established through the exercise of powers of appointment) to terminate at the end of the common-law period.

Second, the GST tax regulations allow a donee exercising a nongeneral power of appointment over a Grandfathered Trust (whether or not he or she creates a Second Power) to extend the trust until the expiration of the common law rule against perpetuities, the passage of 90 years, or the end of the shorter of those periods.24 If a donee complies with these regulations, he or she probably has no Trap concern.

On several occasions, the IRS ruled that exercises of First Powers over Grandfathered Trusts to create Second Powers would not cause the trusts to lose their tax-favored status.25 Nonetheless, as noted above, a client might intentionally trigger the Trap in a Grandfathered Trust to the extent that he or she has unused federal estate tax and GST tax exemption.

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23 Reg. §20.2041-3(e)(1).
25 See PLR 201029011, PLR 200535009, PLR 200243048, PLR 200206045, PLR 200124006, PLR 199912021, PLR 9351016.
Exempt Trust

The Trap can pose a significant problem for Exempt Trusts. Thus, if the donee of a nongeneral power of appointment over a $5 million Exempt Trust exercises the power in a way that springs the Trap, the estate again would owe $2 million of federal estate tax that should have been avoided. Currently, over half the states authorize perpetual or very long trusts, and many Exempt Trusts take advantage of these statutes. Exempt Trusts typically also confer First Powers that enable donees to modify trust terms over time to adapt to changing circumstances. Assessing the potential impact of the Trap is crucial to this planning.

As discussed above, the donee of a First Power over an Exempt Trust should not create federal gift or estate tax liability if he or she does not exercise the First Power to create a Second Power or includes appropriate limiting language in the Will or instrument by which the power is exercised.

In a 2002 private letter ruling, the IRS concluded that a donee’s exercise of a First Power to create a Second Power did not cause an Exempt Trust to lose its zero inclusion ratio because all resulting trusts had to terminate within the common-law perpetuities period determined from the date of creation of the original trust.

Placing a fixed limitation on the duration of trusts created by the exercise of First Powers over Exempt Trusts puts a state that is trying to attract trust business at a serious competitive disadvantage. The problem is that once an Exempt Trust is established in one of those states, it cannot be moved to a state with a longer perpetuities period without adverse transfer-tax consequences, which will discourage wealthy families who want to preserve flexibility from creating the trust there in the first place. This is particularly true for states that set relatively short fixed periods.

Theoretically, the Trap might be triggered in a state that still follows the common-law rule against perpetuities.

Illustration: Parent creates a trust for the lifetime benefit of Child, remainder to Grandchild, and grants Child the power to appoint trust property either outright or in further trust to Grandchild. As part of this power, Child can grant Grandchild a nongeneral power of appointment. The trust is subject to the laws of a jurisdiction under which Grandchild’s exercise of a nongeneral power of appointment starts a new perpetuities period running. If Child exercises the First Power by creating a trust for Grandchild and granting Grandchild a Second Power, the property of Grandchild’s trust will be includible in Child’s estate under §2041(a)(3) because Child has exercised the First Power by creating a Second Power that may be exercised so as to suspend absolute ownership of trust property without reference to the date of the trust created by Parent.

Therefore, the Trap must be considered by a donee exercising a First Power in almost every state. Given the prevalence of the issue, attorneys drafting new trusts or instruments exercising powers of appointment should include language to alert donees and their attorneys to the concern.

As mentioned above, though, it might be desirable to trigger the Trap over an Exempt Trust if a client has unused exemptions.

Nonexempt Trust

The Trap provides an interesting planning option for a Nonexempt Trust given the substantial increase in the federal estate tax exemption ($5.43 million in 2015). An individual’s total tax liability sometimes might be lower if trust assets are subject to estate tax and sometimes might be lower if they are subject to GST tax. Various mechanisms have been suggested to minimize a trust beneficiary’s total transfer tax liability, but they usually depend upon the inclusion of a formula in the original trust instrument or the exercise of discretion by a trustee who might possess less than complete information.

The Trap might provide the ideal mechanism because it gives the donee the ability to choose between estate tax and GST tax in light of circumstances as they are at the time of the choice. Thus, if the donee’s tax liability will be lower if the trust is subject to estate tax (which might be the case if the estate is below $5.43 million and if a stepped-up income tax basis is desirable), he or she may exercise a First Power to trigger the Trap. Conversely, if the donee’s tax liability will be lower if a trust is subject to the GST tax (which might be the case if he or she lived in a state that has a death tax), he or she may refrain from exercising a First Power or exercise it in a way that does not spring the Trap.

26 PLR 200219034.
CURRENT DELAWARE LAW

Rule Against Perpetuities

The common law rule against perpetuities has been abolished in Delaware. The basic rule is as follows: 30

No interest created in real property held in trust shall be void by reason of the common-law rule against perpetuities or any common-law rule limiting the duration of noncharitable purpose trusts, and no interest created in personal property held in trust shall be void by reason of any rule, whether the common-law rule against perpetuities, any common-law rule limiting the duration of noncharitable purpose trusts, or otherwise.

Trust interests in personal property may be perpetual, but trust interests in real property must be distributed "at the expiration of 110 years from the later of the date on which a parcel of real property or an interest in real property is added to or purchased by a trust or the date the trust became irrevocable." 31

The 110-year limitation may be circumvented by contributing a parcel of real property to an entity because, "real property does not include any intangible personal property such as an interest in a corporation, limited liability company, partnership, statutory trust, business trust or other entity, regardless of whether such entity is the owner of real property or any interest therein." 32

Powers of Appointment

Delaware law generally measures violations of the rule against perpetuities from the date of exercise — rather than from the date of creation — of powers of appointment. The basic rule is: 33

Every estate or interest in property, real or personal, created through the exercise, by will, deed or other instrument, of a power of appointment, irrespective of:

(1) Whether such power is nongeneral or general as to appointees;
(2) The manner in which such power was created or may be exercised;
(3) Whether such power was created before or after the passage of this section,

shall, for the purpose of any rule of law against perpetuities, remoteness in vesting, restraint upon the power of alienation or accumulations now in effect or hereafter enacted be deemed to have been created at the time of the exercise and not at the time of the creation of such power of appointment. No such estate or interest shall be void on account of any such rule unless the estate or interest would have been void had it been created at the date of the exercise of such power of appointment otherwise than through the exercise of a power of appointment.

Regarding the above rule, another section provides: 34

[T]rusts created by the exercise of a power of appointment, whether nongeneral or general, and whether by will, deed or other instrument, shall be deemed to have become irrevocable by the trustor or testator on the date on which such exercise became irrevocable.

The law is mindful of not falling into the Trap through the exercise of First Powers over Grandfathered Trusts and Exempt Trusts in most situations. Accordingly, the general rule is reversed for these trusts as follows: 35

Notwithstanding any other provision of this chapter, and except as otherwise provided in subsection (b) of this section, in the case of a power of appointment over property held in trust (the "first power"), if the trust is not subject to, or has an inclusion ratio of zero for purposes of, the tax on generation-skipping transfers imposed pursuant to Chapter 13 of the Internal Revenue Code or any successor provision thereto and the first power may not be exercised in favor of the donee, the donee’s creditors, the donee’s estate or the creditors of the donee’s estate, then every estate or interest in property, real or personal, created through the exercise, by will, deed or other instrument, of the first power, irrespective of:

(1) The manner in which the first power was created or may be exercised, or
(2) Whether the first power was created before or after the passage of this section,

32 Del. Code Ann. tit. 25, §503(c). The subsection addresses what happens if such an entity ceases to exist.
shall, for the purpose of any rule of law against perpetuities, remoteness in vesting, restraint upon the power of alienation or accumulations now in effect or hereafter enacted, be deemed to have been created at the time of the creation of, and not at the time of the exercise of, the first power. For purposes of applying the foregoing rule, if any part of an estate or interest in property created through the exercise of the first power includes another power of appointment (the “second power”), then the second power of appointment and any estate or interest in property (including additional powers of appointment) created through the exercise of the second power shall be deemed to have been created at the time of the creation of the first power. (citation omitted).

Elsewhere, it is provided:36

Notwithstanding the foregoing, in the case of a power of appointment described in §504 of this title as a “first power,” and subject to §504(a), trusts created by the exercise of the power of appointment, whether by will, deed or other instrument, shall be deemed to have become irrevocable by the trustor or testator on the date on which the first power was created.

But, the law recognizes that it might be desirable to spring the Trap over Grandfathered Trusts and Exempt Trusts:37

Subsection (a) of this section shall not apply to the exercise of a first power or second power over property held in a trust that is not subject to, or has an inclusion ratio of zero for purposes of, the tax on generation-skipping transfers imposed pursuant to Chapter 13 of the Internal Revenue Code or any successor provision thereto if the instrument of exercise of any such power makes express reference to subsection (a) of this section and expressly states that subsection (a) of this section shall not apply to the exercise of the power or makes express reference to §501 of this title and expressly states that §501 of this title shall apply to the exercise of the power.

STATUSES OF THE TRAP IN SOME OTHER STATES

Leading Trust States

Introduction

A January 2014 article identifies the best trust states as follows:38

In our view, the four top-tier jurisdictions for 2014 (listed by the year they adopted their perpetuities legislation) remain South Dakota, Delaware, Alaska and Nevada. We rank New Hampshire in fifth place.

As described above, the donee of a First Power over a Delaware trust can exercise the power to spring the Trap and get a stepped-up income-tax basis. This option does not appear to be available in Alaska, Nevada, New Hampshire, or South Dakota.

Alaska

A testator or trustor may create a perpetual Alaska trust,39 but trusts created via the exercise of nongeneral powers of appointment are limited to 1,000 years.40 The donee of a First Power over an Alaska Trust cannot spring the Trap because the duration of trusts created by First Powers and Second Powers relates back to the creation of the First Power under the following provision:41

If a nongeneral power of appointment is exercised to create a new or successive nongeneral power of appointment . . . , all property interests subject to the exercise of that new or successive nongeneral . . . power of appointment are invalid unless, within 1,000 years from the time of creation of the original instrument or conveyance creating the original nongeneral power of appointment that is exercised to create a new or successive nongeneral . . . power of appointment, the property interests that are subject to the new or successive nongeneral . . . power of appointment either vest or terminate.

Nevada

A Nevada statute42 allows trusts created by Wills, inter vivos trust instruments, and exercises of nongeneral powers of appointment to last for 365 years, but

37 Del. Code Ann. tit. 25, §504(b). The law addresses the manner in which powers of appointment may be exercised. See Del. Code Ann. tit. 25, §505.
39 Alaska Stat. §34.27.075.
40 Alaska Stat. §34.27.051(a).
41 Alaska Stat. §34.27.051(c).
42 Nev. Rev. Stat. §111.1031(1)(b), §111.1031(3)(b).
the statute probably is unconstitutional because §4 of Article 15 of the Nevada Constitution provides that, “No perpetuities shall be allowed except for eleemosynary purposes,” and because, in 2002, Nevada voters disapproved a ballot initiative to repeal this prohibition. In this regard, a late 2014 article observes:

[W]e conclude that legislation authorizing perpetual or long-enduring dynasty trusts is constitutionally suspect in a state with a constitutional prohibition of perpetuities . . . .

A Nevada practitioner contends that a 1941 decision of the Supreme Court of Nevada — Sarrazin v. First Nat’l Bank of Nevada — and a 2015 decision of the same court — Bullion Monarch Mining, Inc. v. Barrick Gold Strike Mines, Inc. — mean that the constitutional limitation no longer is relevant.

The Sarrazin case was decided long before Nevada adopted a 365-year period for trust interests. Its entire description of the law of perpetuities in Nevada is as follows:

Section 4 of article XV of the constitution of Nevada reads: “No perpetuities shall be allowed except for eleemosynary purposes.” There is no Nevada statute defining the rule against perpetuities. The common-law rule is usually stated thus: “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.” Other than the constitutional provision above quoted, there have not been called to our attention any other provisions, either constitutional or statutory, invalidating interests which vest too remotely, or forbidding restraints on alienation. (citations omitted; emphasis added).

The above emphasized sentence is dictum at best because the court concluded that all interests in the trust in question would vest within the common law rule against perpetuities period.

The Bullion Monarch Mining case involved the applicability of Nevada’s rule against perpetuities to “commercial mining agreements for the payment of area-of-interest royalties.” Not surprisingly, the court held that it did not. In the course of the opinion, the court discussed a 1974 case — Rupert v. Stienne — as endorsing statutes that depart from the common law. Nevertheless, Rupert, which dealt with the “old common-law rule of interspousal immunity,” did not involve a common law rule that had been codified in Nevada’s constitution.

A decision of the Supreme Court of Nevada validating 365-year trusts might be helpful. It has been suggested that the court would uphold the statute in the interest of supporting Nevada’s business development efforts. That would be a regrettable basis for such a decision if the law is to the contrary.

The best way to resolve the uncertainty would be for the voters to repeal the constitutional prohibition.

In any event, the following statute prevents the donee of a First Power over a Nevada trust from triggering the Trap:

For purposes of NRS 111.103 to 111.1039, inclusive, a nonvested property interest or a power of appointment arising from a transfer of property to a previously funded trust or other existing property arrangement is created when the nonvested property interest or power of appointment in the original contribution was created.

New Hampshire

In New Hampshire, a trust may be perpetual if the governing instrument expressly exempts it from the application of the rule against perpetuities and if the trustee or another person has the power to sell, mortgage, or lease trust property for any period beyond the period that would be required for an interest in the trust to vest in order to be valid under the rule against perpetuities. Given that New Hampshire has no statute regarding the beginning date for measuring the validity of the exercise of a power of appointment or when a First Power becomes irrevocable, the Trap cannot be sprung in New Hampshire because, under the common law, the duration of trusts created by

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47 Sarrazin, 111 P.2d at 51.
48 111 P.2d at 53.
49 Bullion Monarch Mining, 345 P.3d at 1041.
50 345 P.3d at 1044.
52 Bullion Monarch Mining, 345 P.3d at 1042.
powers of appointment dates back to the creation of the original trust.\textsuperscript{55}

**South Dakota**

South Dakota permits trusts created by Wills, inter vivos trust instruments, and exercises of powers of appointment to be perpetual.\textsuperscript{56} Nevertheless, the donee of a First Power over a South Dakota trust cannot spring the Trap as a result of the following statute:\textsuperscript{57}

If a future interest or trust is created by exercise of a power of appointment, the permissible period is computed from the time the power . . . is created if the power is not a general power.

**States Where Trap Cannot Be Sprung**

**Introduction**

As just discussed, it appears that the Trap cannot be sprung in Alaska, Nevada, New Hampshire, or South Dakota. Below are other states where the technique also is not available.

**Connecticut**

Connecticut follows the Uniform Statutory Rule Against Perpetuities (USRAP). Thus, a trust created by a Will or inter vivos trust instrument\textsuperscript{58} or by the exercise of a power of appointment\textsuperscript{59} must vest at the expiration of the common-law rule against perpetuities or at the expiration of 90 years after creation. The Trap cannot be triggered because the date of creation relates back to the creation of the original trust under the following statute:\textsuperscript{60}

For purposes of sections 45a-490 to 45a-496, inclusive, a . . . power of appointment arising from a transfer of property to a previously funded trust or other existing property arrangement is created when the . . . power of appointment in the original contribution was created.

**New Jersey**

In New Jersey, trusts created by Wills, inter vivos trust instruments, and exercises of powers of appointment may be perpetual\textsuperscript{61} but the donee of a First Power over a New Jersey trust cannot spring the Trap by reason of the following statute:\textsuperscript{62}

If a future property interest or trust is created by exercise of a power of appointment, the permissible period is computed from the time the power is exercised if the power is a general power exercisable in favor of the donee, the donee’s estate, the donee’s creditors or the creditors of the donee’s estate, whether or not it is exercisable in favor of others, and even if the general power is exercisable only by will; in the case of other powers the permissible period is computed from the time the power is created . . . .

**New York**

Trusts created by Wills, inter vivos trust instruments, and exercises of powers of appointment in New York are subject to the common law rule against perpetuities.\textsuperscript{63} A donee exercising a First Power over a New York trust cannot trigger the Trap pursuant to the following statute:\textsuperscript{64}

Where an estate is created by an instrument exercising a power of appointment, the permissible period of the rule against perpetuities begins:

(1) In the case of an instrument exercising a general power which is presently exercisable, on the effective date of the instrument of exercise.

(2) In all other cases, at the time of the creation of the power.

**Another State Where Trap Can Be Sprung (Pennsylvania)**

In Pennsylvania, trusts created by Wills, inter vivos trust instruments, and exercises of powers of appointment may be perpetual.\textsuperscript{65} A donee exercising a First Power over a Pennsylvania trust may trigger the Trap under the following statute:\textsuperscript{66}

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

\textsuperscript{55} 850 T.M., *Generation-Skipping Transfer Tax*.
\textsuperscript{56} S.D. Codified Laws §43-5-8.
\textsuperscript{57} S.D. Codified Laws §43-5-5.
\textsuperscript{58} Conn. Gen. Stat. §45a-491(a).
\textsuperscript{59} Conn. Gen. Stat. §45a-491(c).
\textsuperscript{60} Conn. Gen. Stat. §45a-492(c).
\textsuperscript{63} N.Y. Est. Powers & Trusts Law §9-1.1
\textsuperscript{64} N.Y. Est. Powers & Trusts Law §10-8.1(a).
expressly states that this provision shall not apply to the interests created by the exercise.

**RELATED ISSUES**

**Fiduciary Powers**

The regulations under §2041 define “power of appointment” expansively. Consequently, attorneys advising trustees regarding trust modifications, exercises of decanting powers, and changes of trust situs (as well as donees exercising First Powers) must be mindful of §2041(a)(3) and §2514(d). Nevertheless, the provision’s legislative history indicates that they do not apply to powers exercised by trustees:

The existing statute contains a provision which was intended to cover this situation, but it is too broadly worded. Under it, for example, the exercise of an otherwise exempt power might be taxed if it were exercised by giving a trustee discretionary power to invade principal.

**Creditor Rights**

The practitioner should be aware of any creditor issues relating to the exercise of First Powers. Under Delaware law, for example, the exercise of a nongeneral power of appointment does not cause trust assets to be subject to creditor claims. The exercise of a general power — lifetime or testamentary — only subjects trust assets to the claim of a creditor in favor of whom the power is exercised.

**Tax Payment**

The planner should pay close attention to how federal estate tax will be paid if a donee triggers the Trap and how GST tax will be paid if a donee does not spring the Trap over a Nonexempt Trust. Charging all taxes to the residue of the probate estate will be ill-advised in almost every case. If the donee of a First Power triggers the Trap and thereby generates federal estate tax, §2207 is available. It provides:

*Unless the decedent directs otherwise in his will*, if any part of the gross estate on which the tax has been paid consists of the value of property included in the gross estate under section 2041, the executor shall be entitled to recover from the person receiving such property by reason of the exercise, nonexercise, or release of a power of appointment such portion of the total tax paid as the value of such property bears to the taxable estate. If there is more than one such person, the executor shall be entitled to recover from such persons in the same ratio. In the case of such property received by the surviving spouse of the decedent for which a deduction is allowed under section 2056 (relating to marital deduction), this section shall not apply to such property except as to the value thereof reduced by an amount equal to the excess of the aggregate amount of the marital deductions allowed under section 2056 over the amount of proceeds of insurance upon the life of the decedent receivable by the surviving spouse for which proceeds a marital deduction is allowed under such section. (Emphasis added.)

Similarly, if a taxable termination occurs in a Nonexempt Trust, §2603(b) is available. It provides:

*Source of tax. Unless otherwise directed pursuant to the governing instrument by specific reference to the tax imposed by this chapter [§2601 et seq.], the tax imposed by this chapter [§2601 et seq.] on a generation-skipping transfer shall be charged to the property constituting such transfer. (Emphasis added.)*

The tax clause in the client’s Will should be coordinated with the above tax-recovery provisions.

**Incapacity of Testator/Trustor**

In many ways, the Trap is an ideal way to minimize the payment of federal taxes because it puts the decision as to whether to subject assets to federal estate tax or to GST tax in the hands of the person who is best able to make that determination. That might involve reviewing the situation periodically and signing appropriate estate planning documents, which grows difficult if the donee of a First Power becomes incompetent. With that in mind, donees of First Powers might want to include provisions in durable powers of attorney authorizing attorneys-in-fact to amend exercises of powers of appointment (which might be as minimal as specifying whether the duration of trusts will be measured from the creation rather than from the exercise of powers or vice versa) or might want to...

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67 Reg. §20.2041-1(b)(1).
68 See PLR 200744020 (exercise of decanting power over grandfathered trust did not fall within §2041(a)(3)).
72 §2207.
73 §2603(b) (emphasis added).
include language in instruments of appointment authorizing court-appointed guardians to make appropriate decisions. It also might be prudent to include language in new trusts authorizing trustees to make appropriate distributions.

**CONCLUSION**

Flexibility is essential in the estate planning world. For decades, estate planning attorneys did their utmost to prevent trusts from being classified as grantor trusts for federal income tax purposes. Now, grantor trusts are the norm. Similarly, planners, who long have abhorred the Trap, now should add it to their planning palette. I hope that this article has alerted planners to the Trap’s perils and possibilities.74

74 In a future article, I hope to explore the circumstances, if any, in which the Trap option can be made available through the exercise of a merger or a decanting power, a nonjudicial settlement agreement, a change of situs, or a court proceeding.