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Estate Planning | Wills & Trusts

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Estate to Be Distributed 92 Years After Death

The estate of a man who died in 1919 is finally being distributed to his heirs in 2011, and chances are that it is only being distributed now because it can no longer remain in Trust under a rarely invoked law.

The Rule Against Perpetuities is a complex common law provision that most clients never hear about and most lawyers learn and forget during law school. The Rule provides that a Trust must terminate no later than 21 years after the death of the last identifiable beneficiary living at the time of the execution of the Trust. Since most Trusts terminate much earlier, the Rule rarely applies. However, once in a while, we see the Rule applied to a real life Trust. The case of Wellington R. Burt, a lumber and iron tycoon who resided in Michigan until his death in 1919, will likely be used in law schools as an example of the Rule for decades to come.

Prior to his death, Burt executed a handwritten Will which essentially froze his estate until 21 years after the death of his last living grandchild, allowing for only small, unequal annual allowances for his children and similar allowances for some of his employees, including his secretary, cook, housekeeper, coachman and chauffeur. The reason for the unusual provision requiring a final distribution at this time was clearly the Rule Against Perpetuities.

Burt's last living grandchild died in 1989, which meant that under the Rule, his estate must be distributed by 2010. The judge in the case advised Burt's twelve living heirs to reach a settlement amongst themselves regarding how the estate, estimated over $100 million, will be divided—otherwise the court would have to determine the distribution. The lawyers representing the heirs met in April and reached an agreement that would give larger sums to closer descendants and smaller sums to more distant descendants. Burt's living descendants who will now inherit his estate consist of three great-grandchildren, seven great-great

grandchildren and two great-great-great grandchildren ranging in age from 19 to 94 and distributions ranging from $2.6 million to $16 million.

It is unclear whether Burt's motive for the delayed distribution was to avoid property tax assessments or transfer taxes on his real estate or to circumvent his children due to a family dispute. Regardless of the reason behind his decision, his estate will now be distributed to twelve of his descendants that he never met.

Had Burt been living today, he would have had the option of avoiding the Rule altogether and leaving his assets in Trust forever.[1] Many states, including Michigan, have either repealed the Rule or provided an opportunity to opt out of it. Under current Illinois law, a Trust may opt out of the Rule Against Perpetuities by stating in the terms of the Trust that the Rule shall not apply, resulting in a "Qualified Perpetual Trust." This opt-out provision allows Illinois taxpayers to utilize a tool called a Dynasty Trust—a trust which is intended to last for generations, paying out only income or limited principal in certain circumstances (see the "Definition of the Month" below).

While a Trust created today may avoid the limitation, it is possible that the Rule Against Perpetuities or another law limiting the life of a Trust may apply in the future. Therefore, an opt-out provision must be drafted carefully to provide for unpredictable legislative changes that may arise.

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[1]Additionally, if Burt had passed away under current tax laws, the estate's assets would be subject to Generation Skipping Transfer Tax, which was not enacted until 1976, since the assets are passing to descendants beyond his children.

Gifts of Tuition and Medical Care

The Gift Tax was first enacted in 1924 to prevent individuals from making deathbed gifts in order to avoid the Estate Tax. Today, there is $13,000 annual exemption from the Gift Tax which allows any individual to give any other individual up to $13,000 per year without incurring any tax. Such gifts can be made to an unlimited number of individuals.

In addition to the annual exemption, there are two categories of gifts which are exempt from Gift Tax.

First, gifts of tuition are excluded from Gift Tax. However, in order to qualify, such gifts must be made directly to the educational institution. In other words, reimbursements to the beneficiary or his or her parent for tuition that was already paid will not qualify for the exclusion. Additionally, only tuition expenses

qualify for the exclusion—expenses for books, supplies, room, board or other related expenses do not qualify.

Second, gifts of medical and dental expenses are excluded from Gift Tax. Again, such gifts must be made directly to the institution or facility providing the medical services.

There is no limit on gifts of tuition or medical expenses. Use of these exclusions can be a valuable tool in reducing an individual's taxable estate. However, it is important to understand these exclusions before they arise due to the strict requirements for making such gifts.

Definition of the Month: *Dynasty Trust*

A Dynasty Trust is a long-term, perpetual trust created specifically to provide for the grantor's descendants for several generations to come, if not indefinitely.

Properly structured and executed, a Dynasty Trust can remove the grantor's assets from his or her estate and also keep the assets out of the beneficiaries' estate until distributed. This allows the assets to pass tax-free from one generation to another until they are needed for the purposes set forth by the grantor.

As discussed above, a Dynasty Trust may opt-out of the Rule Against Perpetuities if state law allows such an opt-out, which Illinois does. Many states have repealed the Rule Against Perpetuities altogether. If the state has not repealed the Rule and does not allow an opt-out, then the Dynasty Trust must terminate 21 years after the death of the last identifiable beneficiary who was alive when the trust was written.

Manish C. Bhatia is an Illinois attorney focusing his practice in the area of Estate Planning. Manish has focused his education and practice on Tax Planning, Estate Planning and Business Succession Planning since the first year of law school. He has also added Asset Protection, Elder Law and Nonprofit Organizations/Charitable Giving to his fields of practice. Manish is also a member of the Chicago Bar Association, the Asian American Bar Association of Chicago and the Indian American Bar Association.

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