

The New Texas Rule Against Perpetuities

North Texas Estate Planning Council
September 21, 2022



Kelly M. Perez, Executive Director
Wealth Advisor
J.P. Morgan Private Bank, Dallas

214.965.3072
kelly.m.perez@jpmorgan.com

Kelly M. Perez

Executive Director
Wealth Advisor



J.P. Morgan Private Bank
1900 N. Akard St., 5th Floor
Dallas, Texas 75201
jpmorgan.com/privatebank

PHONE
214.965.3072

EMAIL
kelly.m.perez@jpmorgan.com

Kelly M. Perez is an Executive Director and Wealth Advisor in the Dallas, Texas, office of J.P. Morgan Private Bank. Leveraging years of experience as a trusts and estates attorney in private practice, Kelly works closely with affluent individuals and multi-generational families to open up the breadth of opportunities derived from strategic wealth guidance and tax-driven estate planning.

Whether clients seek tax minimization, asset protection, advice on charitable giving or the comfort of simply having a plan in place, Kelly is skilled in recommending bespoke approaches to pursue these goals. Kelly blends her empathetic style, technical proficiency and J.P. Morgan's robust resources to provide a holistic approach to estate planning and wealth preservation. The strategies she employs are often complex, and she distills these concepts into relatable conversations that facilitate informed decision making and confidence in the process.

Kelly brings more than a decade of advanced planning experience to her role. Most recently, she was an Executive Director with UBS Global Wealth Management, and prior to that she practiced with several prestigious law firms. She is Board Certified in Estate Planning and Probate Law by the Texas Board of Legal Specialization and was named an American College of Trust and Estate Counsel Young Leader. Kelly is also Co Chair of the Tax Litigation and Controversy Committee for the RPTE Section of the American Bar Association and serves on the Dallas Bar Association's Probate, Trusts & Estates Committee.

Known among the professionals in this highly specific niche for her deep knowledge base, Kelly has been featured in *Trusts & Estates Magazine*, and frequently speaks in Texas and throughout the country on various estate planning topics.

Kelly is a graduate of Cornell University, where she serves as an Alumni Admissions Ambassador, and has a J.D. from the University of Pittsburgh School of Law. While in her hometown of Pittsburgh, Kelly interned for the Honorable Donetta W. Ambrose, Chief Judge of the District Court for the Western District of Pennsylvania.

Kelly and her husband, Travis, live in Flower Mound with their two children, Travis Jr. and Helen.

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Section 112.046 of the Texas Trust Code

Introduction

- Texas Constitution & Bill of Rights
 - “Perpetuities and monopolies are contrary to the genius of free government and shall never be allowed...”
 - No definition of “perpetuities”
- H.R. 654 signed into law by Governor Abbott on June 16, 2021
- Revised Section 112.036 of the Texas Trust Code effective September 1, 2021 and generally applies to non-charitable trusts created on or after this date
- 300 years fixed for non-charitable trusts
- 100 years fixed for “real property asset”

Previous TX Rule Against Perpetuities (RAP) Period

- Common law rule, see *Singer v. Singer*, 237 S.W.2d 600 (1951) and *Kettler v. Atkinson*, 383 S.W.2d 557 (1964)
- Codified in Section 112.036, codified and effective January 1, 1984

Sec. 112.036. RULE AGAINST PERPETUITIES. The rule against perpetuities applies to trusts other than charitable trusts. Accordingly, an interest is not good unless it must vest, if at all, not later than 21 years after some life in being at the time of the creation of the interest, plus a period of gestation. Any interest in a trust may, however, be reformed or construed to the extent and as provided by Section 5.043.

Previous TX RAP Period (Cont.)

- Every interest in the trust (in every possible situation) must vest prior to the applicable measuring term
- Vesting requires termination → Outright distribution
- Applicable measuring term
 - Exercise of a power of appoint in further trust
 - New trust's RAP period same as the original trust's RAP period
 - Unless (1) general power appointment (GPOA) exercised in favor of the powerholder's estate or beneficiary of new trust is granted a presently exercisable GPOA
 - Addition of new measuring lives through exercise of power of appointment

New TX RAP Period

Sec. 112.036. RULE AGAINST PERPETUITIES.

- (a) The rule against perpetuities applies to an interest in a trust other than a charitable trust.
- (b) For purposes of this section, the effective date of a trust is the date the trust becomes irrevocable.
- (c) An interest in a trust must vest, if at all:
 - (1) not later than 300 years after the effective date of the trust, if the effective date of the trust is on or after Sept. 1, 2021; or
 - (2) except as provided by Subsection (d), not later than 21 years after some life in being at the time of the creation of the interest, plus a period of gestation, if the effective date of the trust is before September 1, 2021.
- (d) An interest in a trust that has an effective date before September 1, 2021, may vest as described by Subsection (c)(1) if the trust instrument provides that an interest in the trust vests under the provisions of this section applicable to trusts on the date that the interest vests.
- (e) Any interest in a trust may be reformed or construed to the extent and as provided by Section 5.043.
- (f) Under this section, a settlor of a trust may not direct that a real property asset be retained or refuse that a real property asset may be sold for a period longer than 100 years.

New TX RAP Period (Cont.)

- Fixed 300 year vesting rule
- 100 year vesting rule for trust owned real property
 - Not applicable if trustee has the power to sell real property
 - What if held in an entity (though most trust agreements grant power to sell so not likely necessary)
- Section 112.036(d) – special language
- Trusts created between June 16, 2021 (when signed into law) and September 1, 2022 (effective date)
- Decanting cannot be used to modify RAP language in this case because Texas Trust Code 112.085(6) prohibits decanting to modify a perpetuities provision

Potential Issues

—Constitutionality

- Perpetuities against genius of a free government and shall never be allowed...
- 300 years is not exactly forever and there is not a definition of perpetuities to rely on
- Drafting to take this into account
 - Savings clause: if found to be unconstitutional then rely on previous RAP period and include measuring lives

—Modification

- Original terminating distributees
 - Virtual representation issues

Potential Issues (Cont.)

- Potential Federal gift tax consequences
 - If a trust beneficiary consents to modify, is there a taxable gift?
 - terminating distributee
 - change in “transferor” for GST purposes if gift
- Potential Federal GST tax issues
 - Modification of GST exempt trusts under Treasury Regulation Section 26.2601-1(b)(4)(i)(D) safe harbor
 - ... the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust...
 - Potential loss of GST exempt status (GST tax at 40% rate)

Planning considerations

Best Practices

- New perspective on client counseling: **active conversation** on duration
 - For example, which purpose is more important to the settlor:
 1. Providing the greatest benefit to children, grandchildren and great-grandchildren (individuals they will know), or
 2. Maximizing the term of the trust to provide generational wealth to unknown recipients come what may
 - Re-think the use of **age-terminating trusts** v. dynastic discretionary trusts
- Also consider:
 1. Trust funding and additional contributions, if any
 2. Trust asset composition and **future performance and value**
- Streamline** overall estate plan

Best Practices (cont.)

- Create a **flexible trust agreement** to withstand the test of time
 1. Robust trustee succession provisions
 - Consider the use of a “back-stop” corporate trustee
 2. Decanting
 - Ensure trust agreement is drafted in a manner to allow the trustee to decant under TX Property Code section 112.071
 - Full discretion will provide the most flexibility (as opposed to limited discretion)
 3. Include powers of appointment
 - Include non-general power of appointments to give future beneficiaries opportunity to re-assess the current family situation

Best Practices (cont.)

But...be aware of potential issues and concerns:

1. Settlor may not have an independent trustee that she “trusts” (see #3)
2. Corporate trustees and decanting (committee approval)
3. With decanting and giving a trustee “full discretion” a settlor may not feel comfortable giving a trustee power to distribute principal in absence of an ascertainable standard
4. Settlor may have a certain view regarding the **level of control**
5. Decanting and powers of appointment may cause **adverse transfer tax consequences**
 - e.g. estate inclusion, taxable gifts or loss of GST exempt status
 - Decanting on the Internal Revenue Service no-ruling list

Texas Dynasty Trust v. Delaware Dynasty Trust

Texas is now a **strong competitor** with Delaware perpetual trusts

—Duration

- 300 fixed term v. no time limit (so long as assets remain in the trust)
- What about interests in real property?

—Directed trusts

- TX statute modeled after DE

—Court system and precedent

- DE has rich history, including guidance on Directed Trusts, etc.
- TX is moving in the right direction but still not a lot of guidance on Directed Trusts, etc.
- 5th Circuit is very taxpayer friendly for estate & gift tax controversy

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Texas Dynasty Trust v. Delaware Dynasty Trust (cont.)

—Other specialty trusts

- DE – has upper hand with:
 1. Self-settled trusts - Asset protection trusts (APTs)
 2. Silent trusts/use of designated representative
 3. Incomplete non-grantor trusts (INGs) (not a huge concern for TX residents)
- TX – Self-settled trusts/APTs not permitted
 - Next best options in TX
 1. Spousal lifetime access trusts (SLATs)
 2. Beneficiary defective inheritor's trust (BDITs or I.R.C. section 678 Trusts)

Additional resources / disclaimers

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