

U.S. Supreme Court Case Supports Constitutionality of Perpetuities Repeal

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Effective Aug. 19, 2007, the North Carolina General Assembly passed the Act Defining Perpetuities and Suspension of Power of Alienation for Trusts, repealing the rule against perpetuities based on vesting with respect to trusts created or administered in North Carolina. N.C.G.S. § 41-23(h). The repeal does not permit perpetual restraints upon alienation of trust property. The act specifically provides that a trust is void if it restrains alienation of trust property beyond the traditional period of lives then in being plus 21 years. N.C.G.S. § 41-23(a). A trust does not restrain alienation so long as the trustee has the power to sell trust property.

Article I, Section 34 of the North Carolina Constitution

Despite the statutory repeal of the rule against perpetuities, the use of North Carolina perpetual trusts has been chilled by Article I, Section 34 of the North Carolina Constitution, which states “[t]hat perpetuities and monopolies are contrary to the genius of a free state and shall not be allowed.”

On its face, Section 34 appears to be a bar to the legislative repeal of the rule against perpetuities. However, when read in its historical context, Section 34 only prohibits restraints upon alienation, not trusts which allow for indefinite postponement of vesting. When the predecessor to Section 34 was adopted in 1776, the term “perpetuity” only applied to restraints upon alienation, the most common of which was the fee tail. In the latter part of the 1800’s John Chipman Gray, who is recognized as the father of the common law rule against perpetuities, began writing about the perceived advantages of limiting a grantor’s power to postpone the vesting of interests held in trust. Subsequently, North Carolina, like many states, adopted a common law rule against perpetuities that prohibited the postponement of vesting beyond a life in being plus 21 years. In 1995, the North Carolina General Assembly adopted the Uniform Statutory Rule Against Perpetuities adding, among other things, a 90-year wait-and-see rule on vesting. N.C.G.S. § 41-15.

Brown Bros. Harriman

In *Brown Bros. Harriman Trust Co., N.A. v. Benson*, 688 S.E.2d 751 (N.C. Ct. App. 2010), appeal dismissed, review denied 364 N.C. 239, 698 S.E.2d 391 (2010), the Court of Appeals affirmed the decision of the North Carolina Business Court, holding that the repeal of the rule against perpetuities by N.C.G.S. § 41-23 does not violate Section 34 of the North Carolina Constitution. In *Brown Bros.* the Court of Appeals held that the dynasty trust at issue did not create a perpetuity in violation of the constitutional prohibition so long as the trustee of the trust had the power to sell trust property. The Court of Appeals examined the intent of the framers of the Constitution, citing two North Carolina Supreme Court cases in support of its decision.

The first case was the 1820 case of *Griffin v. Graham*, 8 N.C. (1 Hawks) 96 (1820). In *Griffin*,

the North Carolina Supreme Court held that a perpetual charitable trust was not a perpetuity because the trustee of the trust had the power to alienate trust property. The Supreme Court stated:

The meaning which the law annexes to this term, is that of an estate tail so settled that it cannot be undone or made void. As when, if all the parties who have interest, join, they cannot bar or pass the estate; but if by the concurrence of all having the estate tail, that the word is used in the Bill of Rights[.] ... [A] perpetuity which the Law would deem void, must be an estate so settled for private uses that by the very terms of its creating there is no potestas alienandi in the owner.

Griffin, 8 N.C. (1 Hawks) at 130-32.

Two years later, in *Yadkin Navigation Co. v. Benton*, 9 N.C. (2 Hawks) 10, 13 (1822), the North Carolina Supreme Court held that the term “perpetuity” as used in the “clause of the Declaration of Rights which condemns modern monopolies and perpetuities ... imports property locked up from the uses of the public, and which no person has power to alienate.”

As mentioned above, when Section 34 was promulgated John Chipman Gray’s common law rule against perpetuities based on vesting had not been developed. As a side note, it is interesting that Gray in his seminal 1888 treatise on the rule against perpetuities had this to say about Section 34 and similar provisions in other states’ constitutions: “These provisions seem to be simply pieces of declamation without juristic value, at least on any question of remoteness.” In other words, the father of the common law rule against perpetuities felt that Section 34 did not have any application to a rule against perpetuities based on vesting such as the common law rule against perpetuities.

In *Brown Bros.*, both the Court of Appeals and Business Court recognized the distinction between Section 34’s prohibition of restraint against alienation and the common law rule prohibiting indefinite postponement of vesting of beneficial interests in trusts. The decision of the Court of Appeals was based on two relevant North Carolina Supreme Court cases that clearly addressed what constitutes a perpetuity under Section 34.

Estate of Bosch

Despite the Court of Appeals’ decision in *Brown Bros.*, estate planners, their clients, and trustees still required certainty in the federal courts for federal tax purposes. Under *Commission v. Estate of Bosch*, 387 U.S. 456, (1967), the United States Supreme Court held that the Internal Revenue Service was not bound by a ruling of the Connecticut Probate Court regarding the allocation of estate tax between the marital and the non-marital shares of the estate. Instead, under the principles set forth in *Erie R. Co. v. Thompkins*, 304 U.S. 64 (1938), the court held

that where federal estate tax liability turned upon the character of a property interest held and transferred by a decedent under state law, only that law as announced by the highest court of the state was final and binding upon federal authorities. *Bosch*, 387 U.S. at 457. Similar to the contextual interpretation of Section 34, *Bosch* did more than enunciate a single rule. Instead, the court noted a broader set of rules: (a) lower state court decisions should be attributed some weight but are not controlling, where the highest court of the state has not addressed the issue, (b) “an intermediate appellate state court ... is a datum for ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise,” and (c) that federal courts shall apply state law in accordance with the decisions of a state’s highest court. *Id.* at 465 (emphasis in original).

Lack of Substantial Constitutional Question

North Carolina gives a litigant an appeal of right to its Supreme Court from any decision of its Court of Appeals that directly involves a substantial question arising under the Constitution of the United States or of this state. In *Brown Bros.* the defendants exercised this right and asked for a discretionary review. The appellees, in their responses to the appeal, asked the court to hear the appeal and affirm the Court of Appeals decision either through a discretionary review or because the case involved a substantial constitutional question under state law. However, on June 16, 2010, the North Carolina Supreme Court dismissed the substantial constitutional question appeal *ex mero motu*, and denied the appellant’s petition for discretionary review. *Brown Bros.*, 364 N.C. at 239, 698 S.E.2d at 391.

Nonetheless, the court’s dismissal of the appeal constitutes a decision on the merits affirming the Court of Appeals’ judgment. In *R.J. Reynolds Tobacco Co. v. Durham County, North Carolina*, 479 U.S. 130 (1986), imported tobacco intended for domestic manufacture and consumption was held by R.J. Reynolds Tobacco Company in custom-bonded warehouses located in Forsyth and Durham Counties. On its annual listing of taxable personal property, Reynolds claimed that this tobacco was immune from taxation by these counties, on federal constitutional grounds. The North Carolina Court of Appeals affirmed the decision of the Property Tax Commission that the imported tobacco was taxable by the counties, but as in *Brown Bros.*, the North Carolina Supreme Court dismissed the case for lack of a substantial constitutional question. Reynolds involved a federal constitutional question and *Brown Bros.* involved a state constitutional question. The United States Supreme Court noted that this dismissal “could be interpreted as a decision on the merits affirming the Court of Appeals’ judgment, or it could be viewed as a determination by that court it lacked jurisdiction over the appeal.” Reynolds, 479 U.S. at 138. In resolving this jurisdictional question, the court held that “in the absence of positive assurance to the contrary from the North Carolina Supreme Court, we consider that court’s dismissal of Reynolds’ appeal to be a decision on the merits.” *Id.* The court noted that this decision was consistent with its reasoning in a comparable situation arising from the Ohio and its view of its own summary dispositions. *Id.* at 139.

Conclusion

The North Carolina Supreme Court dismissed the plaintiff’s appeal in *Brown Bros.* because there was no substantial constitutional issue. Since there is no positive assurance that the dismissal of the *Brown Bros.*’ appeal was anything but a ruling on the merits, the dismissal of the plaintiff’s appeal in *Brown Bros.* should be considered a decision on the merits by the North Carolina Supreme Court that N.C.G.S. § 41-23 is constitutional. As a result, federal courts should be

bound by the North Carolina Supreme Court's decision that N.C.G.S. § 41-23 is constitutional.

One important take away from the litigation in North Carolina over the term perpetuity is to be careful when you think you know the meaning of a legal term. If a perpetual trust that meets the definition of a perpetuity under Gray's universally accepted common law rule against perpetuities is not a perpetuity under the North Carolina Constitution can we really be confident of the meaning of any legal term?

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