

Trusts and the 100-Year Life

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As human lives grow longer, what will happen to the law that governs death? How will a person's property be divided at death, and will we see any changes in the way people make wills, trusts, and plans for the distribution of their estates after they pass away? In this chapter, I argue that the answers to these questions are surprising: As lives grow longer, the law of property distribution at death will become less important. People who expect to live into their second centuries will have less property to pass at death and will feel a greater need to hand it over to their descendants and beneficiaries before they die. The law of trusts and estates will remain a bedrock feature of the legal system, but it will look more and more like a backstop and less and less like a preferred mode for dividing up the bulk of accumulated estates.

11.1 BACKGROUND

The declining importance of the law of decedents' estates promised by the lengthening of human lives will intensify a trend that has already been growing for decades. As John Langbein explained in a seminal law review article in 1988, the law of estates has been diminishing in importance since at least the middle of the twentieth century, and possibly long before.¹ The causes are many. One is the transformation in the character of wealth. Whereas the estates of the old aristocracies prototypically consisted of land, today wealth tends to consist primarily of financial assets, such as securities, savings accounts, and insurance contracts. These forms of financial assets are much easier to transfer than land and, therefore, require less attention from lawyers and judges when they are transferred at death. Similarly, much of the wealth that passes from generation to generation in 2024 consists of investments in human capital that tend not even to register as forms of wealth

¹ John H. Langbein, *The Twentieth-Century Revolution in Family Wealth Transmission*, 86 MICH. L. REV. 722 (1988).

transfer at all. When a professional family devotes hundreds of thousands of dollars to the private education of its children, no intervention by a probate court is needed.

Still another cause of decline in the law of probate is the growth and now dominance of forms of wealth transfer that self-consciously avoid the law of probate. Life insurance proceeds, bank accounts, retirement accounts, and brokerage accounts can all be crafted to name beneficiaries to take assets in the event of an owner's death. When the day comes, the assets move solely by the actions of these financial institutions, with no need for a will or probate court. Even a family home can be owned jointly with a right of survivorship, so that a spouse's death automatically transfers their share to the spouse who survives, again with no need for probate.

Estate-planning practitioners have cut further into the domain of the probate courts by mastering the so-called "revocable trust." A revocable trust is a trust that its creator – known as a "settlor" – can take back at any time. A revocable trust can work as an excellent substitute for a will because, like a will, it does not become permanent until the settlor's death. The settlor can add and remove assets from it as the settlor pleases during their lifetime, making no final decisions until moments before they pass away. The revocable trust offers many advantages, one of which is to avoid probate. Since, at the time of a settlor's death, the property in a revocable trust formally belongs to the trustee rather than the settlor, the property is not part of the settlor's estate for purposes of probate. The dispositive terms of the trust need not be filed with a probate court, and lifetime transfers to the trustee generally cannot be challenged as part of probate proceedings.

The intentional attempt to avoid probate reflects the reality that probate is often expensive and time-consuming, especially for modest estates that have little need of the benefits probate ostensibly offers. If an estate of modest size can be divided up by a series of financial institutions that merely carry out the orders embedded in financial contracts, the estate can often avoid the costly intervention of lawyers, the potential for dispute, and the occasions for taxation and fee extraction that tend to follow entry into probate.

11.2 LESS WEALTH AT DEATH

The lengthening of human lives will intensify this downward trend in the importance of probate for two reasons. The first is that decedents will have less wealth to pass. For the same reasons that lengthening lives will strain systems of public retirement support, they will also strain private savings. As working years take up a smaller share of human lives, workers will have to spend more years living off of their savings. To support a period of extended retirement and prolonged illness, family homes will have to be liquidated, 401(k) accounts used up, and savings accounts eaten away. All of this will leave fewer assets to be transferred when a person passes away.

Some portion of the burden on private savings might be lightened by lengthening years of work. If people spend some of their extra years working and saving, the financial pressure of those extra years will not be as intense as if people spent all of their extra lifespans on the golf course. But there remains a real possibility that the extra years in income-earning labor will not be enough to compensate for the extra years in retirement and illness. If that happens, the size of probate estates and even nonprobate transfers will decline. A person will have to use their savings to support themselves rather than to provide for the next generation.

11.3 GREATER URGENCY OF LIFETIME TRANSFER

For the fortunate few who have a surplus of wealth even after their extended years of retirement, the lengthening of life will intensify the downward trend in death-time transfers for a second reason: People will feel a greater need to pass their wealth before they die. The trouble is that the age at which people conceive and bear children is not growing as quickly as the age at which people die. Many people can now expect to live past 100, but relatively few will bear children past forty. As a result, the gaps between generations, though growing, are not growing as quickly as human lives, so that as parents die at older and older ages, their children are receiving transfers of wealth at later and later stages in their lives. Think of the difference between Queen Elizabeth II of the United Kingdom, who ascended to the throne at age twenty-five after her father passed away at the age of fifty-six, and Elizabeth's son Charles, who remained a prince into his seventies as his mother continued to occupy the throne well into her nineties. Few families have thrones to pass on to their children. But what about homes, cars, and 401(k) accounts?

This postponement of wealth transfer presents a problem. Money is often most useful when a person is young. This is partly a result of the cycles of human lives and earnings. Income tends to grow over the first five or six decades of life, so that an educated person in their twenties will tend to earn less than they will in their forties or fifties. Help with a down payment for a house is thus more useful when the person is young and has a lifetime of mortgage payments and future earnings still ahead than when they are middle-aged and have a padded savings account and a mortgage that is already half paid off. A related concern about life cycles is that a person's propensity to consume tends to drop later in life. Extra money has little appeal for an infirm elderly person who no longer needs fashionable clothes, comfortable vacations, or extra square footage. A parent with extra resources to spare might therefore feel a greater urgency to subsidize children and grandchildren while they are still relatively young than older children who have established incomes.

Money also tends to be useful when a person is young because money has a time value. The foundation of finance is the conviction that money today is worth more than money tomorrow. All else equal, therefore, a child and his family will prefer to start consuming today than wait for another thirty years while the old family home

sits underutilized by parents. Like all rational people, Junior might prefer to spend money now than later. Even if we set aside the concerns about Junior's uneven income over the course of his life, we might still be concerned about the simple time value cost of forcing Junior and his offspring to wait to enjoy the fruits of grandparents' savings. Some of these concerns about time value might be mitigated by the possibility of investment growth. That is, Junior might be rewarded for his patience with compounding returns on the savings and a larger ultimate inheritance upon the death of his parents. But savings may not grow at a rate commensurate with the discount factors of younger generations, especially if the savings consist of assets that are costly to maintain or that might decline in value, such as homes and cars.

A final reason to hasten the transfer of wealth is that wealth sometimes requires active management or even active consumption. Think of a family business in which a founder must transfer control to their children. A son might take over the family restaurant, or a daughter might assume the corner suite of the family investment office. In an age when retirements were short and death came early, the transfer of control over a family business often coincided with death. Junior would take over the day Father was laid to rest. As retirements and lives lengthen, death-time succession will no longer suffice. Later generations have to be given control well before earlier generations pass on. We cannot expect an elderly founder to effectively manage a business into their eighties and nineties, and we cannot expect their children to wait for them to retire when they are in their fifties and sixties.

The need for active management often mixes with a need for active consumption. Though remaining in the family home may be satisfying and comforting to an elderly person who has spent most of their adult life there, the prolonged decades of occupancy may come at a significant financial cost if the home is large enough to be used by (and sold to) a family with children and if it decays through the neglect of maintenance and renovation that often accompanies aging.

The need to shift transfers from death to life will intensify a problem that estate planners have always known and have always struggled with, which is how to balance the need for income in retirement with the need for timely transfer to the next generation. Mother might recognize that it would be good to pass on assets to Junior sooner rather than later, but at eighty-five years old, Mother might not know how many of these assets she will need to support herself for the rest of her life. If she has a million dollars in savings, she might need all of it if she expects to live another twenty years, or she might need just half of it if she expects to be gone in just another ten years. If she knows that Junior and his children could use the money now, how is she supposed to predict how much to give now and how much to hold on to? This is an old problem, and it long predates the growth of the 100-year life. But the greater strain on personal finances and the larger bands of uncertainty introduced by longer lives and retirements will make this needle even harder to thread.

The risk of passing too much too early makes it clear that what we need is not simply to smooth the making of transfers during life but also to allow such transfers

to be made flexibly, so that gifts can be made and then taken back if the life and needs of the donor become unexpectedly long and great.

11.4 CHALLENGES

What, then, stands in the way of such a system? What do we need to do to make it possible for long-lived people to pass their property before they die even as they retain enough control to take some of it back to meet the needs of an unexpectedly long life?

Many of the obstacles involve taxation. The system of unified estate and gift taxation we now have in the United States is a major accomplishment, in that it tries to treat life- and death-time transfers as part of a single pool. The details are complicated, but the basic gist is that if I make a gift during my life, I have to file a gift tax return in the year I make it, but I will owe no tax until the total of my life- and death-time gifts together exceeds the value of my exemption from the estate tax. Any excess over the exemption gets taxed only at the time the threshold of exemption is crossed, whether that happens in life or death. This system largely avoids the need to pay taxes on transfers during lifetime for any but the very wealthiest families.

Some obstacles to lifetime transfers remain, however. One is the so-called step-up in income tax basis at death. If a donor takes a piece of property in life and then holds it as it appreciates in value, the income tax basis for the donor is usually the price at which the donor purchased the property minus any depreciation. Were the donor to sell the property during their lifetime, they would owe income tax on the appreciation. But if the donor waits until their death and then transfers the property by will, the basis of the donees will equal the value of the property at the time of the donor's death, appreciation and all. Were the donees to sell the property immediately after the donor's death, they would owe no income tax. Lifetime transfers do not receive the same favor. The donee of a lifetime gift receives the same basis as the donor.

The trouble, of course, is that this system creates profound incentives to hold property until death. If I bought a house in Palo Alto in 1975 and watched it skyrocket in value through 2024, it would be disastrous to sell or donate the house before I passed away. Instead, the tax incentive would be to hang on to the house for all 110 years of my long life and then leave it to my children in my will. A lifetime transfer would be an income tax disaster. A death-time transfer is the only rational strategy.

One can imagine strategies for accelerating the use of the property, but none is fully satisfying. I could rent the house out and make a gift of the income to my children every year. But the income might exceed the annual gift tax exemption. Additionally, I would owe income tax on the rental income, and my children would not have immediate access to the full value of all the capital accumulated in the house.

Another obstacle to flexible and accelerated transferring is the generation-skipping transfer tax. If a 110-year-old donor hesitates to make a gift to their child who is already eighty-five years old, then the donor could achieve greater value for the gift by handing the assets to a grandchild or even great-grandchild who can make better use of the money. If the goal is to support someone who has yet to attend college, a donor can simply select a beneficiary further down the family tree. The donor can wait until death and still see the assets go to a person who is young enough to genuinely need them.

The problem with this strategy is the generation-skipping transfer tax, or GST tax. The tax is designed to ensure that assets subject to the estate tax get taxed at every generation. Congress did not want a person to be able to pass their fortune to their great-grandchildren without making the fortune subject to estate taxation at the deaths of the person's children and grandchildren. To put it a bit crudely, the GST tax imposes the estate tax multiple times, based on the number of generations the donee sits below the donor on the family tree.

Private estate planners have developed strategies for handling the GST tax. One is the creation of a perpetual trust that is funded with assets up to the full amount of the estate tax exemption and then made perpetual so that it can benefit the donor's children, grandchildren, great-grandchildren, and other descendants later on. Since the transfer was made only once, the trust can continue to benefit the donor's descendants across many generations without encountering estate or gift tax.

The perpetual trust has its drawbacks, however, including the obvious governance problems that come with having something exist forever, not to mention the fact that it only works for the estate tax exemption amount, which, though relatively high right now, might easily come down in the future to levels that make life uncomfortable for a greater share of the public.

A further obstacle to lifetime giving is the tax benefits of retirement accounts. A person who contributes to a 401(k), IRA, or similar retirement account owes no income tax on the money contributed at the time of the contribution and continues to owe no income tax as the investments appreciate until the time the person makes a withdrawal. Such accounts can be leveraged to great effect, ensuring that assets appreciate over time without being periodically reduced by capital gains taxation. The effect can be compounded by continuing to hold the account until death and then handing it over to children and letting them continue to enjoy the same benefits until they are forced to make withdrawals of their own. The length of time a child can hold the account was diminished by the tax reforms of 2017, but the possibilities for savings by keeping assets inside the account after a donor's death remain substantial. The benefits available under these retirement accounts thus encourage death-time transfers, because there is no way to hand these assets to spouses or children during the donor's lifetime without undoing the tax benefits.

One might argue with respect to all of these tax issues that convenience and efficiency are not the only policies we must consider in taxation. We have to think

about the raising of revenue, redistribution, and so on. Retirement savings, for instance, are supposed to be used to fund retirement, not to accumulate dynastic wealth, and so one might not be troubled by the possibility that lengthening lifespans may complicate the accumulation of dynastic wealth. My point, however, is that whatever our other goals for taxation might be, the lengthening of life will put pressure on them to the extent people come to prefer life over death in the timing of wealth transfers. Tax policy has several goals, but one of them is to avoid distorting people's behavior. And to the extent tax law encourages a person to cling to property they do not need until they pass away at 110 just so their descendants can save money on taxes, it will be shaping people's actions in ways that are not socially optimal.

In addition to posing problems for taxation, a shift toward lifetime giving will raise other challenges for the system of wealth transfer as well. In particular, one wonders about the future of life insurance as a form of wealth transfer. By its nature, a term life insurance policy does not pay out until the insured person dies. So, what if the great length of a person's expected lifespan pushes the person to prefer a transfer before their death? Life insurance will not be a good option. People will continue to use life insurance as a protection against the prospect of an untimely death, but it will cease to be an attractive option for transferring wealth when death comes late.

11.5 CONCLUSION

One might think that as people live longer lives, the system of law that governs the transfer of their property at death would become more important. But the opposite is true. People will have fewer assets to transfer at death and a stronger desire to transfer them during life. People will want flexibility between life and death, and they will want the law to help them achieve it.