TRUSTS

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TRUSTS

I. INTRODUCTION

A. TRUST DEFINED

A trust is a fiduciary relationship in which a trustee holds legal title to specific property under a fiduciary duty to manage, invest, safeguard, and administer the trust assets and income for the benefit of designated beneficiaries, who hold equitable title.

B. TYPES OF TRUSTS

Trusts are classified according to the method of their creation: (i) ***express trusts***, which arise from the expressed intention of the owner of property to create the relationship with respect to the property; (ii) ***resulting trusts***, which arise from the presumed intention of the owner of property; and (iii) ***constructive trusts***, which do not depend on intention but rather constitute a useful equitable remedy in cases involving wrongful conduct and unjust enrichment.

C. CATEGORIES OF EXPRESS TRUSTS

Express trusts fall into two categories: private trusts and charitable trusts. These two categories of trusts are distinguished primarily by the identity of their beneficiaries. A ***private trust*** is created for the benefit of certain ascertainable persons; thus, a trust "to T in trust for my husband, and at his death to my children," is a private trust. A ***charitable trust***, on the other hand, is created for the benefit of an indefinite class of persons or the public in general; thus, a trust providing scholarship funds for needy students at a named university is considered a charitable trust.

D. UNIFORM TRUST CODE

Much of trust law is founded on the common law, best represented in the Restatement of Trusts and the basis for this outline. In 2000, the Uniform Law Commission promulgated the first national codification of trust law. The Uniform Trust Code ("UTC"), enacted in more than half the states, draws on the common law and existing state law, and for some issues incorporates trust law reform. Although for purposes of the bar exam you will need to be familiar with the common law of trusts, references to the UTC will be made throughout this outline to highlight some of these reforms.

II. EXPRESS PRIVATE TRUSTS

A. CHARACTERISTICS OF AN EXPRESS TRUST

A trust is a fiduciary relationship with respect to property in which one person, the ***trustee***, holds the legal title to the trust property, the ***res***, subject to enforceable equitable rights in another, the ***beneficiary*** (cestui que trust). It is basically a device whereby one or more persons manage the property for the benefit of others. The trust must have a valid ***trust purpose***. The trustee ordinarily has legal title to the property and the beneficiaries have equitable title. The testator or grantor who creates an express trust is the trustor or ***settlor***, who must have had the ***intent*** to create the trust. Consideration is not required for the creation of a trust; in fact, trusts are usually created gratuitously.

1. Intention to Create a Trust

a. Manifested by Words, Writing, or Conduct

The settlor's manifestation of intention to create a trust is essential to the existence of an express trust. Except as limited by requirements of the Statute of Wills or Statute of Frauds (applicable to real property), this intention may be manifested by written or spoken words or by conduct, and it need not be manifested in any particular form of language. An oral trust of personal property is valid in almost all jurisdictions.

1) Delivery of Deed May Manifest Intent

Although some external expression of trust intent is required, the failure of the settlor to communicate his intention to the beneficiaries or other persons does not prevent the creation of a trust. Delivery ***to the trustee*** of the deed creating the trust is sufficient.

a) Problem Where Settlor Is Also Trustee

However, where the settlor is also the trustee and does not notify anyone of the trust, the trust may fail for lack of intent to create a trust. When the beneficiaries are not notified, evidence that the settlor-trustee segregated the property and kept separate account books for it is relevant in establishing that a trust was intended.

b. Must Be Manifested While Settlor Owns Property

The intention to create a trust must have been manifested by the settlor at a time when he owned the trust property and prior to its conveyance to another.

1) Must Manifest Intent Prior to Conveyance

One cannot convey property outright and later execute a trust instrument declaring that the transfer was actually one in trust. The conduct of the transferor and the transferee subsequent to the conveyance, however, may be important as evidence of the intention that existed at the time of the conveyance.

2) Must Intend Trust to Take Effect Immediately

The settlor must have intended the trust to take effect immediately and not at some future time (e.g., a promise by A to create a trust when he collects a debt from B does ***not*** create a trust now).

a) Future Interest May Be Trust Res

However, a presently declared trust can have as the trust res a future interest in property (e.g., A can convey "to B for life and then to C as trustee for D"; C has present duties to protect D's equitable future interest).

b) Effect of Promise to Create Trust

If the settlor promises gratuitously to create a trust in the future, a trust arises in the future only if, at that time, the settlor manifests anew his intention to create the trust. Often this promise will be to hold property in trust when the property is acquired. On the other hand, if the promise is ***supported by consideration***, the trust can arise in the future, when the property is acquired, without any further manifestation of intent.

c. **Precatory Expressions**

Usually a settlor clearly directs the trustee to carry out the intended terms of the trust, but difficulties arise when the transferor merely expresses a hope, wish, or suggestion that the property be used for a certain purpose. A direction such as "to B with the hope that B will use the property to provide for the support of C" is precatory language. Most courts today infer from such language that ***no trust*** was intended, but only that the transferor wished his desires to be known so that the transferee could comply with them if willing to do so. This inference may be overcome if:

1) The directions are ***definite and precise***, not vague;

2) The directions are addressed by a decedent to his ***executor*** or ***administrator***, or to one who otherwise occupies the position of a fiduciary under the will;

3) Failure to impose a trust results in an ***"unnatural" disposition*** by a testator (e.g., a close relative takes no interest under the will); or

4) Extrinsic evidence shows that the transferor had been supporting the alleged beneficiary ***prior to executing the instrument***, and the "beneficiary" would not have sufficient means of support absent a finding that a trust was created (e.g., A gives property to B with what appears to be precatory directions to use the property for C's benefit, but evidence shows that A had always supported C, suggesting that A intended to impose enforceable trust obligations on B).

2. **Trustee**

Although a trustee is essential to the operation of a trust, once a trust is established it will not fail merely because of the trustee's death, incapacity, resignation, or removal. Thus, where a will names X as trustee, the trust does not fail merely because X has predeceased the testator. A successor trustee will be appointed in order to carry out the testator's intention, except in the unusual case where it clearly appears that the trust is to continue only as long as the originally designated trustee continues to serve.

a. **Absence of Trustee—Testamentary vs. Inter Vivos Trusts**

The refusal of a named trustee to accept an appointment or his failure to qualify, or even the complete failure to name a trustee in a will, does not defeat a ***testamentary trust*** (a trust created by a will). On the other hand, because of the necessity of a present and effective transfer in order to create a ***trust by deed*** (*see* B.1.a., *infra*), the absence of a trustee may result in an attempted ***inter vivos*** trust (a trust created during settlor's lifetime) failing for want of delivery. Such a trust fails because there has been no transfer—not because there was no trustee, for equity would supply the trustee had there been a valid delivery of the deed creating the trust.

Example: O hands $10,000 to X, telling X to invest the $10,000 and pay the income to A for life, remainder to B. X remains silent, but takes the $10,000. The law may presume X's acceptance of the trust from his acceptance of the trust property, although inaction might also be a disclaimer. The particular circumstances and inferences therefrom must be examined. If X accepts delivery of the trust property but refuses to act as trustee, a trust may still have been created if that was O's intent. In

such a case, the court will appoint a substitute trustee, thereby preventing the failure of the trust.

b. Trustee Must Have Duties

An "active trust" exists when the trustee has duties. A "passive trust," one where the trustee has no duties at all, will fail and the beneficiaries will take legal title immediately. However, in many jurisdictions the duty to convey title to the beneficiaries is enough to make the trust "active." If the duties are not spelled out in the trust instrument, the court will imply the trustee's duties if there is (i) an intention to create a trust, (ii) a res, and (iii) an identified beneficiary.

Example: T bequeaths "$600 to X, as trustee for X's child, A; the trust to terminate when A reaches age 18." Nothing is said about the trustee's duties. Therefore, the court will imply that the income is to be accumulated and the accumulated income and principal invested and paid to A at age 18, and the trust will not fail.

c. Qualifications of Trustee

1) Capacity to Acquire or Hold Title for One's Own Benefit

In the absence of a statute, anyone who has capacity to acquire or hold title to property for his own benefit has capacity to take property as a trustee. Unincorporated associations can be trustees only where they can hold title to property for their own benefit. If a partnership cannot hold title to property, a purported transfer to the partnership in trust may be deemed to be a transfer to the partners individually as trustees.

2) Administrative Capacity

Although a party may have capacity to take and hold property as a trustee, he may not have the capacity to administer it. For example, minors or insane persons may take title to property, but because their contracts or acts are usually voidable, they are generally held to lack capacity to administer the trust. Such a trustee will be removed by the court and replaced with a qualified trustee.

3) Statutory Limitations on Right to Serve as Trustee

Statutes sometimes limit the right of some persons or corporations to serve as trustees. This is particularly common in the case of testamentary trusts. Foreign corporations are often denied the right to conduct trust business in states other than their state of incorporation.

Example: T dies a resident of California. Her will bequeaths $10,000 to the Chicago Northern Bank, an Illinois corporation, in trust for B. By statute, the Chicago bank cannot serve as trustee of a testamentary trust in California, so the court will appoint another trustee.

d. Removal of Trustee

A court has the power to remove a trustee or to refuse judicial confirmation of the appointment of a trustee in a will. (Denial of confirmation will be ordered when the named trustee is incompetent or declines to serve.)

1) **Grounds for Removal of Trustee**
Basically, a court may remove a trustee if his continuation in office would be detrimental to the trust (taking into consideration both the settlor's intent and the interests of the beneficiaries). There are numerous grounds upon which a trustee may be removed, including the following:

a) Commission of a serious ***breach of trust***;

b) Legal or practical ***incapacity*** to administer the trust;

c) ***Unfitness*** for the position (e.g., habitual drunkenness, commission of a crime involving dishonesty, permanent or long-continued absence from the state, or extreme old age or other practical inability);

d) ***Refusal to post bond or to account***;

e) The existence of a ***significant conflict of interest***;

f) The ***trustee's insolvency*** if the court feels that this situation jeopardizes the welfare of the trust; and

g) ***Extreme friction or hostility*** between the trustee and the beneficiaries, where such hostility is likely to interfere with the proper administration of the trust. However, the mere existence of friction that does not interfere with proper administration is not a ground for removal.

2) **Effect of Settlor's Knowledge of Grounds Prior to Appointment**
Circumstances that might constitute grounds for removal, such as the existence of conflicting interests, need not be acted upon by a court where such circumstances were known to the settlor at the time she created the trust. The existence and knowledge of grounds at the time the trust was created, however, are ***not conclusive***, and in extreme cases a court may nevertheless proceed to remove the trustee. The terms of the trust are significant, of course, in this regard.

3) **Beneficiaries Cannot Compel Removal Without Grounds**
Absent grounds for removal, the beneficiaries cannot compel the removal of a trustee, ***unless this power is granted*** to them by the trust instrument. The power to remove a trustee without grounds ***may also be reserved by the settlor***.

e. **Disclaimer or Resignation by Trustee**
A trustee who has not accepted the trust—either expressly, by implication, or by contracting in advance to do so—can disclaim and refuse appointment arbitrarily. However, he cannot accept a trust in part and disclaim it in part. Also, after having accepted the trust, the trustee cannot thereafter disclaim; the problem then becomes one of resignation (*see* below).

1) **Relation Back of Acceptance**
The trustee's acceptance of a testamentary trust "relates back" to the settlor's death, because the trust is treated as having been in existence from that date.

Thus, it is possible for the trustee, by accepting, to become liable (in his fiduciary capacity) on tort claims arising prior to the time he accepted.

Example: T devises an apartment house to X, in trust for B. P is injured by a defective stairway the day after T's death. X accepts his duties as trustee the following day. By accepting, X becomes liable to P on the tort claim (although as discussed at VI.E.5.b., *infra,* X is entitled to be reimbursed from the trust estate because he was not personally at fault).

2) Resignation

Once a trustee has accepted appointment, he cannot resign without permission of the appropriate court, unless (i) authorized to do so by the terms of the trust, or (ii) consent is given by all of the beneficiaries, all of whom have capacity to give this consent. The acceptance of a trustee's resignation is within the discretion of the court.

f. Merger of Title Where Sole Trustee Is Also Sole Beneficiary

Where the sole trustee, who holds legal title, and the sole beneficiary, who holds equitable title, are one and the same person, there is a merger of the legal and equitable titles. This defeats and terminates the trust, creating a fee simple absolute in the trustee-beneficiary. If the trustee does not hold precisely the same interests, both legal and equitable, there is no merger and the trust continues. The existence of either multiple trustees or multiple beneficiaries will normally preclude merger.

3. Trust Property

a. No Res—No Trust

Where there is no trust property, the trust fails because the trustee has no property to manage.

b. Property May Be of Any Type

The property may be real or personal, tangible or intangible, legal or equitable, and it may be either a present interest or a future interest, whether vested or contingent.

Example: T devises Blackacre to A for life, then to such of A's children as survive him. B, A's child, transfers his contingent interest to X in trust for the benefit of B's wife. This is a valid trust.

c. Trust Property Must Be an Existing Interest in Existing Property

An interest that has not yet come into ***legal existence*** cannot be held in trust (e.g., a son's hope of inheriting his father's property). If there is no trust res when the trust instrument is executed, the trust will not come into effect when the res comes into existence unless the settlor at that time manifests anew an intention to create a trust.

1) Future Earnings Can Be Trust Res

Future earnings from an ***existing contract*** or employment can be the res of a trust, but it is doubtful whether earnings from a contract or employment not yet in existence could be the res.

2) Doctrine of Potential Possession—Future Crops, Unborn Animals

Under the mortgage doctrine of potential possession (which may not be applied to trusts), a person has a present interest in a thing to be produced if he has the means of producing the thing. Thus, future crops or unborn animals might constitute a res if the settlor owns the land or the mother animal.

d. Property that Settlor Has Power to Convey Can Be Subject of Trust

The trust res must be existing property that the settlor has the power to convey. The res ***need not be tangible*** property, but the settlor must have an assignable interest. Thus, a promissory note, a contract, a patent or royalty interest, and a future interest can be the subject matter of a trust.

e. Trust Res Must Be Segregated from Other Property

The requirement that the trust property be identifiable and segregated means that the property is described with such certainty that it can be ascertained from existing facts. A person cannot declare himself trustee of "the bulk of my estate," because the description is too indefinite. But a conveyance of "all of my real property except Blackacre" is effective because by inventorying all of the settlor's real property on the date of the conveyance and excluding Blackacre, the identity of the trust estate can be established.

1) Res May Include Fractional or Undivided Interests

A trust res may be, or may include, fractional or undivided interests in specific property, and it may include patents, copyrights, choses in action, and an almost limitless variety of other types of property. Because of the possibility of holding undivided interests in trust, it is probable (although the law is not settled and courts are divided) that the requirement of identification and segregation is satisfied where one declares himself trustee or otherwise purports to create a trust of a particular quantum or portion of fungible goods, such as "half the grain in my storehouse" or "$10,000 of the cash in my safe deposit box" (which contains more than that amount at the time).

f. Debtor Cannot Hold Own Debt in Trust

A person cannot be a trustee of his own debt to another. Thus, if A owes money to B, A's declaration (even with B's consent or B's direction to A) that A shall hold the amount owed in trust for B's children would not make A the trustee for B's children. *Rationale:* A, as trustee, cannot sue A, as debtor, to collect the debt. However, A can declare himself trustee of his ***particular property*** from which the debt is to be paid. Thus, A could declare himself trustee of his bank account for the purpose of paying B. Note also that A's debt can be held in trust by another person. Because A's debt to B is an asset of B, B can transfer the debt to C to hold in trust for B's children.

g. Unenforceable Gratuitous Promise Cannot Be Trust Res

An unenforceable gratuitous promise cannot be the subject of a trust.

Example: A promises to pay B $5,000 and declares that he holds this amount in trust for B. Unless A actually sets aside $5,000, which becomes the trust res, there is no trust res.

4. Beneficiaries

Generally, a trust cannot exist without someone to enforce it. Thus, a beneficiary is ***necessary to the validity*** of every trust except charitable trusts (which can be enforced by the state attorney general although the beneficiaries are indefinite) and so-called honorary trusts (e.g., trusts for animals or to maintain graves). A private trust requires that there be ***definite beneficiaries*** (or at least that the beneficiaries will be ascertainable within the period when all interests must vest under the Rule Against Perpetuities).

a. Capacity

Any person, natural or artificial, capable of taking and holding title to property can be a beneficiary of a private trust. An unincorporated association, which has no capacity to take title, cannot be a trustee, and it is doubtful that it can be the beneficiary of a trust because it is not a legally recognized person.

Example: T bequeaths $100,000 to X in trust for the benefit of the Socialist Labor Party, an unincorporated noncharitable association. The association cannot take equitable title because it is not a legally recognized person, and therefore cannot be the beneficiary of a trust.

b. Incidental and Indirect Beneficiaries

Not every person who stands to benefit from the operation of a trust is to be regarded as a "beneficiary." If the trust operates only incidentally to benefit a person, that person is not a beneficiary and cannot enforce rights thereunder.

Example: If A conveys "to T in trust to pay the creditors of A," even assuming that this is a trust rather than a mere agency (there is a split of authority), it would probably be considered a trust for the benefit of A and not one enforceable by his creditors (except perhaps as third-party beneficiaries under a contract). It would seem that A could terminate the trust because he is its sole beneficiary.

1) Named Attorney Not Deemed Beneficiary

Where a trust requires the trustee to employ a named attorney for the trust, the attorney is not deemed a beneficiary and has no right to enforce a provision for his appointment. The trustee can refuse to employ the attorney, and in fact should do so, when he feels that the best interests of the trust will not be served by the appointment. However, the right to have the named person appointed as the attorney is a term of the trust presumably intended for the benefit of the beneficiaries, and the failure to make the appointment would be actionable by the beneficiaries (rather than by the attorney) if it resulted in a loss to the trust.

c. Notice to and Acceptance by Beneficiary

Notice to the beneficiary that a trust is being created for his benefit is not essential to the validity of the trust. (The failure to give such notice may, however, serve as evidence contesting an alleged present intention to create a trust.) However, the beneficiary must accept his rights under the trust. A ***trust cannot be forced*** on the beneficiary without his acceptance.

1) Acceptance May Be Express or Implied

Acceptance may be express or implied, even by silence or inaction, and the

acceptance of a beneficial interest is ***normally presumed***. The acceptance, whether express or implied, relates back to the date the trust was created.

d. Disclaimer

No one can be compelled to accept an interest in a trust against her will. A beneficiary may disclaim an interest by filing a written instrument with the trustee (or, if a trust created by will is involved, with the probate court). If a valid disclaimer is made, the trust is read as though the disclaimant was deceased as of the relevant date.

1) Time for Making Disclaimer

Statutes in about one-third of the states follow the Uniform Probate Code ("UPC") in not specifying a time limit for making a disclaimer. [UPC §2-1101] However, most state disclaimer statutes require that a disclaimer be made within nine months of the interest's creation, and that is the relevant period for federal gift tax purposes. [I.R.C. §2518] A disclaimer that is not made within the nine-month period is treated as an assignment and may have gift tax consequences. In the discussion below, the nine-month period is assumed to be the relevant time period for making a disclaimer.

a) Testamentary Trust

If a trust is created by will, disclaimer of a beneficiary's interest is governed by Wills law, which in most states requires a written disclaimer to be filed within nine months after the testator's death. (*See* Wills outline.)

b) Revocable Trust

A beneficiary named in a revocable trust must file a written disclaimer within nine months after the trust becomes irrevocable. This will be at the settlor's death, unless the settlor amends the trust to make it irrevocable during his lifetime.

c) Irrevocable Trust

An interest in an irrevocable trust must be disclaimed within nine months after the trust is established.

d) Future Interests

Several state statutes provide that the disclaimer of a future interest is timely if made within nine months after the future interest becomes a possessory estate (e.g., on the death of the life tenant). However, to be effective for gift tax purposes, disclaimer of all interests, including future interests, must be made within nine months after the trust is established.

e) Disclaimer by Beneficiary Under Age 21

For federal gift tax purposes and under many state statutes, the above time limits do not apply to a beneficiary who is under age 21. A disclaimer is timely if made within nine months after the beneficiary attains age 21. [I.R.C. §2518]

2) Estoppel

A beneficiary may be estopped from making a disclaimer if she has exercised any dominion or control over the interest or accepted any benefits under the trust.

3) Disclaimant's Creditors

Under most state disclaimer statutes, a disclaimer relates back to the date of the transfer for ***all*** purposes. In these states, a disclaimer by an insolvent beneficiary can be used to defeat creditors' claims. [*See* UPC §2-1106] However, a disclaimer will not defeat a federal tax lien. [Drye v. United States, 528 U.S. 49 (1999)]

e. Anti-Lapse Statutes

The anti-lapse statutes in most states apply only to wills and come into play only if a will beneficiary within a certain degree of relationship predeceases the testator. (*See* Wills outline.) However, several states have followed the UPC in applying their anti-lapse statute to future interests created in trusts—even to future interests expressly made contingent on survival—unless the trust makes an alternate gift in case of a beneficiary's nonsurvival. [UPC §2-707]

Examples: 1) Settlor creates a trust: "Income to my wife, Wanda, for life, and on Wanda's death, principal to such of my children as survive her." At the time the trust is established, Settlor has three children: Adam, Betty, and Carl. Five years later, Carl dies survived by two children (Gary and Grace). Then Wanda dies; she is survived by Adam, Betty, Gary, and Grace. In most states, the trust principal is distributed to Adam and Betty, as Settlor's surviving children. Under the UPC's anti-lapse statute, however, Carl's descendants take by representation the share Carl would have taken had he survived, and thus take one-sixth each.

2) Same facts, except that the trust provides: ". . . and on Wanda's death, principal to my children, but if any child dies during Wanda's lifetime, his or her share shall be distributed to the Salvation Army." Because the trust provides an alternate taker in the event of a beneficiary's nonsurvival, if Carl dies during Wanda's lifetime, one-third shares will be distributed to Adam, Betty, and the Salvation Army.

f. Divorce

Nearly all states have statutes under which a final decree of divorce or annulment revokes all beneficial gifts and fiduciary appointments in favor of a former spouse (and, under several statutes, relatives of the former spouse who are not relatives of the testator). (*See* Wills outline.) The UPC and several non-UPC states have extended the "divorce revokes" rule to all revocable dispositions, including revocable trusts and the designation of a former spouse as agent under a durable power of attorney. The governing instrument is read as though the former spouse and his relatives are deceased. [UPC §2-804]

g. Definiteness of Beneficiaries Under Private Trust

To have a private trust, there must be definite beneficiaries. Otherwise, there would be no one to enforce the trust, and the trustee could appropriate the trust property for himself, which is not what the settlor intended.

1) Unascertained Beneficiaries

Beneficiaries need not be identified at the time a trust is created, but they must be ***susceptible*** of identification by the time their interests are to come into enjoyment.

a) **Unborn Beneficiaries**
An unborn beneficiary may be described in the instrument, and the trust will be valid even as to his interest. Thus, if A conveys to T in trust for B for life, remainder to B's children, the beneficiaries are "definite" even though B had no children at the time of the trust conveyance. It is sufficient that B's children would be susceptible of identification at the time their interests were to come into enjoyment (i.e., on B's death).

2) **Class Gifts**
A private trust may exist for the benefit of members of a class, provided the class is one that is sufficiently definite. In fact, as long as the class is a ***reasonably definite*** one, it is permissible that the members of the class are to be selected by the trustee in his discretion, or that the property is to be held for such members of the class as the trustee finds meet certain requirements. If the class is too broad, however, the trust may be unenforceable; instead the instrument could be construed as an outright gift to the trustee or as a power of appointment.

h. **Resulting Trust Remedy Where Express Trust Invalid**
If a trust fails for lack of a beneficiary, a resulting trust in favor of the settlor or his successors is presumed.

Example: Settlor transfers assets by written deed, will, or declaration of trust to Bank as trustee under an instrument that provides: "The trustee shall distribute the trust's income and principal to the persons who were kindest to me during my last sickness." The trust fails for lack of identifiable beneficiaries. Bank holds upon a resulting trust for Settlor (or his successors). (*See* VIII.B.2., concerning resulting trusts.)

i. **Charitable Trusts Need Not Have Definite Beneficiaries**
The requirement of definite beneficiaries does not apply to charitable trusts, where the charitable purpose may be quite broad and the beneficiaries left for the determination of the trustee (e.g., "scholarships for needy students"). (*See* III.A., *infra*, on charitable trusts.)

5. **Trust Purposes**
Trusts may be created for any purpose that is not deemed contrary to public policy. An intended trust or a provision in the terms of a trust is ***invalid if***:

(i) It is ***illegal***;

(ii) Its performance involves the commission of a ***criminal or tortious act*** by the trustee; or

(iii) Its enforcement would be ***contrary to public policy***, even though not involving criminal or tortious conduct by the trustee.

a. **Definition of Acts Contrary to Public Policy**
Public policy is violated if the purpose of a trust is to: induce others to engage in criminal or tortious acts; encourage immorality; or induce a person to neglect parental, familial, or civic duties.

Example: T bequeaths a sum in trust "for A for life if he divorces B, remainder to A's children; otherwise, to C." This is probably an ***invalid*** trust purpose because it encourages divorce, which is generally against the public policy favoring marriage.

Compare: T bequeaths a sum in trust to pay for the care of minor black children whose fathers or mothers have been imprisoned as a result of conviction of a crime of a political nature. This was upheld as a ***valid*** trust, and not a trust to induce a breach of the criminal law. [*In re* Estate of Robbins, 371 P.2d 573 (Cal. 1962)]

b. Effect of Invalidity of Condition

Where a condition is attached to an interest and the condition is held to violate public policy, the consequences of the condition's invalidity depend upon a number of circumstances.

1) Provision by Settlor Controls

If the settlor provides what is to happen in the event a condition is held invalid, that will control.

2) Interest Relieved of Illegal Condition Subsequent

If the settlor has made no alternative provision, and the condition is determined to be a condition subsequent to the interest to which it pertains, the condition is invalidated, but the trust remains valid and the interest is relieved of the condition. Thus, if a person's right to certain benefits would be divested upon a condition subsequent that is invalid, the benefits would continue absolutely and free of the condition.

3) Invalid Condition Precedent Stricken

If the invalid condition is a condition precedent to a certain interest, upon striking out that condition the court may:

(i) Hold that the ***interest fails*** altogether, regardless of whether the condition occurs; ***or***

(ii) Hold that the ***interest is valid***, regardless of what happens in regard to the condition.

The general intent of the settlor will control. Holding the interest valid is the preferred view, unless there is evidence that the settlor's probable intention is to void the beneficiary's interest altogether if the condition is unenforceable.

c. Rule Against Perpetuities

Violations of the Rule Against Perpetuities can arise in creating interests in trust. Pursuant to the common law Rule, a nonvested property interest (e.g., the interest of a beneficiary under a trust) is invalid unless it is certain to vest or fail no later than 21 years after the death of a person who is alive when it is created. However, most states have adopted a wait-and-see approach or an alternative 90-year vesting period that would save the interest. (*See* Multistate Real Property outline.)

B. CREATION OF EXPRESS TRUSTS

A trust is generally created in one of three ways:

(i) An ***inter vivos trust*** (sometimes called a "living trust") may be created by a ***declaration of trust*** by a property ***owner***, stating that he holds the property as trustee in trust;

(ii) An ***inter vivos trust*** may also be created by ***transfer*** of property by the settlor during his lifetime; and

(iii) A ***testamentary trust*** is created by ***will***.

Trusts can also be created by the exercise of a power of appointment or by a promise enforceable under contract law.

1. Inter Vivos Trusts

a. Present Declaration or Present Transfer of Trust Required

1) Declaration of Trust

A person can create a trust by declaring himself trustee for another (e.g., A declares that he holds 100 shares of GM stock in trust for B). Where there is a declaration of trust, no delivery is required because the settlor is the trustee. When the trustee is another person, the property must be delivered to the trustee in order to transfer it in trust.

2) Transfer of Property

A trust can be created by the transfer of property to another as trustee. The ***trustee takes legal title*** upon delivery of a deed or other document of title, or upon actual delivery of manually transferable property.

3) Delivery Required

Delivery means an act that places ***the trust property out of the settlor's control*** (unless the settlor is to serve as trustee). A settlor may also deliver to a third person with instructions to that person to deliver to the trustee. As indicated previously, failure to name a trustee or a promise to name one in the future may indicate a lack of present intention and may prevent a delivery of the trust res.

4) Must Manifest Intent When Trust Res Exists

If a trust is not established because there is no trust res, and the subject matter of the trust later comes into the settlor's hands, a trust arises at the subsequent time if, and only if, the settlor manifests an intention ***then*** to create a trust.

Example: A tells B that she is leaving him $10,000 by will. Before A dies, B declares a trust of this legacy. The trust is invalid because there is no res. However, if after A dies, B in some way manifests an intention to hold the $10,000 in trust, the trust arises at that time.

b. Formal Requirements—Statute of Frauds

1) Writing Required for Trusts of Land

Most states ***do not require a writing*** for a trust of ***personal property***. If, however,

the subject matter of an inter vivos trust is ***land***, a ***written instrument*** is commonly required under the Statute of Frauds to make the trust effective. The writing must be signed by the person entitled to impress the trust upon the property. Note that, in certain circumstances, an otherwise invalid oral trust of land may be enforced by way of a constructive trust (an equitable remedy). (*See* VIII.C.5., *infra*.)

2) Parol Evidence Rule

In most jurisdictions, evidence outside the written agreement is permitted for the purpose of showing the true intent of the parties only where the writing is ***ambiguous on its face***. A few states, however, will allow the parol evidence even if the writing is unambiguous, holding that the necessary ambiguity may be created by the extrinsic evidence itself.

2. Testamentary Trusts

a. Formalities

To create a trust by will, the intention to create a trust and the other essentials of the trust (identification of the beneficiaries, the trust property, and the trust purposes) must be ascertainable in one of the ways permissible under the applicable Statute of Wills. This means that the trust intent and the ***essential terms*** of the trust must be ***ascertained*** from one of the following:

1) The ***terms of the will*** itself.

2) An existing writing properly ***incorporated by reference*** into the will (where incorporation by reference is recognized).

Example: In a will executed on July 31, T bequeaths a sum to First National Bank in trust for the purposes set forth in a trust instrument executed by T on June 30 of that same year. No trust came into being on June 30 because no res was put in the trust. T then dies. The June 30 trust instrument is incorporated by reference, and a testamentary trust by reference to that instrument is established.

If T had amended the trust on September 14, the amendment could not have been incorporated by reference because it was ***not in existence*** when the will was executed. Even so, by statute in most states the amendment is given effect under the Uniform Testamentary Additions to Trusts Act or its equivalent.

3) The exercise of a ***power of appointment*** created by the will.

Example: T bequeaths a sum in trust for the benefit of "such persons as A shall appoint by deed or will." The trustee holds on a resulting trust for T's estate until A exercises his power of appointment, and then he holds in trust for the beneficiaries appointed by A.

b. "Secret" and "Semi-Secret" Trusts

1) Absolute Gift But Trust Intended ("Secret Trust")—Constructive Trust May Be Imposed

In the case of a secret trust, the will makes a gift, absolute on its face, to a named

beneficiary. However, in reality, the gift was made in reliance upon the beneficiary's promise to hold the gift property in trust for another. To prevent the unjust enrichment of the named beneficiary (secret trustee), courts will allow the intended trust beneficiary to present ***extrinsic evidence*** of the agreement. If the agreement can be proved by ***clear and convincing*** evidence, a constructive trust will be imposed on the named beneficiary. The ***Statute of Frauds*** is not a bar because the suit is not to compel enforcement of the trust, but rather to impose a constructive trust to prevent unjust enrichment. The ***Statute of Wills*** is not a bar because the constructive trust does not operate on the will itself, but rather on the property, once it comes into the hands of the named beneficiary.

Example: T left 14 colleges $1.6 million. Concerned about a statutory restriction on gifts to charities, T executed a codicil giving the residue of his estate to R. The will gave no indication of a trust, or that R was not to have beneficial ownership. On T's death, the gift to the colleges failed and passed to R through the residuary clause. Evidence was offered that R had promised to hold the residuary in trust for the colleges. *Held:* To prevent unjust enrichment, a constructive trust was imposed upon clear and convincing evidence that R agreed to hold the gift in trust. [Trustees of Amherst College v. Ritch, 45 N.E. 876 (N.Y. 1897)]

a) Promise Enforceable Whether Made Before or After Will's Execution

Unlike the rule applicable to lifetime conveyances (*see infra*), in the case of wills, relief is given whether the agreement to hold in trust is made before or after the will is executed. In either situation there is ***induced reliance***—if the promise is made after the will's execution, the testator is induced not to change her will. Also, it does not matter whether the person intended to perform the agreement at the time he made his promise. All that matters is that the testator executed her will in reliance on the promise.

b) Compare—Attempted Modification of Gift Outside Will

If a testator executes a will making an absolute devise, then writes a note (opened after the testator's death) telling the legatee that she wants the legatee to hold the property in trust for certain enumerated purposes, the Statute of Wills prevents enforcement of the trust. No constructive trust is raised because there is no induced reliance and no unconscionable conduct on the part of the legatee. He cannot be compelled to execute the trust because no trust was created by the will.

2) Gift "In Trust" Without Beneficiary ("Semi-Secret Trust")—Resulting Trust Implied

In the case of a semi-secret trust, the will makes a gift to a person in trust, but ***does not name the beneficiary***. The testator may have communicated the terms to the "trustee." The majority of courts have taken the position that the trust is unenforceable because of the Statute of Wills. The will does not identify the intended beneficiary, and it would violate the policy of the wills statute to permit identification by parol testimony. The gift fails for want of identification of the beneficiary. The named trustee holds the property on a resulting trust for the testator's heirs.

3) Different Result in "Secret Trust" and "Semi-Secret Trust" Cases Explained
Why is it that in the secret trust cases (will purports to make absolute disposition) the trust can be proved, but in the semi-secret trust cases it cannot? The answer lies in who the litigants are in the two cases. In the secret trust case, the issue is between the legatee and the beneficiaries of the alleged oral promise; to prohibit proof of the legatee's promise would lead to unjust enrichment. But in the semi-secret situation, the one thing that is clear is that the legatee himself was not intended to take beneficial enjoyment; the disposition to him was "in trust." Thus, the dispute is between the intended but unidentified beneficiaries and the heirs; the "induced reliance-unjust enrichment" element is not present.

III. CHARITABLE AND HONORARY TRUSTS

A. DISTINCTIVE RULES APPLY TO CHARITABLE TRUSTS

Charitable trusts, because of their substantial benefit to society, are granted some special exemptions from the rules that apply to private trusts. In general, charitable trusts are liberally construed. The rules governing charitable trusts differ from those applicable to private express trusts in three important particulars.

1. Must Have Indefinite Beneficiaries

To be sustained as a charitable trust, the trust, if not for a specified charitable agency, must be in favor of a reasonably large class of indefinite beneficiaries and cannot be for the benefit of identifiable individuals. By contrast, a private trust must be for definite and ascertainable beneficiaries.

2. Cy Pres Doctrine Applicable

Where it is impossible to give the settlor's intention effect (e.g., the designated charity goes out of existence), the court may redirect the trust to a purpose "as near as possible" to the charitable endeavor initially designated by the settlor.

3. May Be Perpetual

A charitable trust may last forever; it is not subject to the Rule Against Perpetuities. By contrast, all interests in a private trust must "vest" within the period of the Rule Against Perpetuities.

B. TRUST MUST BE FOR CHARITABLE PURPOSES

The purpose of a charitable trust must be one that is considered to ***benefit the public***. Charitable purposes include the relief of poverty; the advancement of knowledge, education, or religion; the promotion of health; and the accomplishment of governmental purposes (e.g., parks, museums, playgrounds). A purpose that limits the benefits of the trust to a particular class of the public (e.g., Chicago orphans) may be charitable, but the class may not be so narrowly defined that it designates only a few individuals upon whom the settlor wishes to confer private benefits. A trust for the dissemination of ideas may be charitable even though the ultimate purpose may be to accomplish a change in present law (e.g., a trust to promote the abolition of discrimination against women, tariffs, or capital punishment).

Examples: 1) A trust for disseminating the views of a ***particular political movement*** qualifies as educational and hence charitable because awareness of political action is

deemed to be beneficial to the public. However, a trust for the benefit of a ***political party*** is not charitable. A fine line is drawn here. For example, a trust for the Socialist Labor Party is not charitable, but a trust to advance the doctrines of socialism is charitable.

2) A trust is charitable if its purpose ***benefits the community***, even though some persons not needing charitable assistance will benefit. For example, if the trust is for widows of police officers slain on duty, it is irrelevant that wealthy widows will be entitled to share because the public as a whole is benefited by such protection for police officers' wives. However, a trust for widows of the presidents of the Elks would not be a charitable trust unless limited to needy widows, as the public as a whole is not benefited by such a trust.

3) A trust is also charitable even though ***matching funds*** are required (e.g., $1 to the Red Cross for every $1 it raises from other sources).

Compare: 1) Where the beneficiary is a ***profit-making entity*** and the profits are not applied to charity, the trust is not charitable (e.g., if the beneficiary is a private school that pays out profits in dividends to investors, it is irrelevant that the gift also promotes education).

2) Where the beneficiary is ***not predominantly devoted to charitable objects***, the trust is not charitable. Thus, where a gift was to a fraternal order (e.g., the Knights of Columbus), it did not qualify as charitable because, even though the group was involved in charitable endeavors, it was primarily devoted to advancing social and fraternal relations among its members (noncharitable objective).

1. General Terms Acceptable

The charitable purpose may be expressed in very general terms. Thus, a direction to a trustee to apply funds for such "charitable" or "humanitarian" causes as he selects is sufficient. Where the trust was for "benevolent" or "worthy" causes, the English cases and some older cases held the trust void on the theory that "benevolent" meant proceeding from a good motive and did not limit the objects to charitable ones. Many courts now interpret the words "charitable" and "benevolent" to be synonymous, so that a trust for "benevolent purposes" will be limited to charitable objectives and be upheld. Note, however, that if benevolence is not construed to mean charitable, the trust will fail.

Example: A trust to provide gifts of money each Christmas to children in the John Kerr School has been held void because it was not limited to charitable causes; had it been for ***needy*** children it would have been valid. [Shenandoah Valley National Bank v. Taylor, 63 S.E.2d 786 (Va. 1951)]

2. Effect of Gift Controlling Factor

It is the ***effect*** of the gift to the public or a portion thereof, ***not the motive*** of the settlor, that controls. Thus, if S establishes a trust to build public tennis courts on land adjacent to his home, it is irrelevant that his motive was so he could use them. Likewise, it is irrelevant that a school, park, scholarship, etc., created through a trust is required to be named after the donor (e.g., John Jones Memorial Park).

3. Mixed Trust

Where the beneficiaries of a single trust are both charitable and noncharitable, the trust is a "mixed trust," and the special ***rules for charitable trusts do not apply***. However, two separate trusts will be found if there is some indication as to (i) how much of the corpus the settlor intended to be applied towards charitable purposes, or (ii) how long the settlor intended the corpus to be applied towards charitable purposes.

Example: T bequeaths $100,000 to trustees to distribute the income "to such educational institutions and worthy individuals as the trustees should select." This is a mixed trust and is not exempt from the Rule Against Perpetuities as charitable trusts are (*see* E., *infra*). It is void because the trustees' discretionary power to distribute income to worthy individuals can be exercised beyond the period of the rule. (*See* Wills outline on Rule Against Perpetuities applied to powers of appointment.)

4. Charitable Trust Implied When Charitable Purpose Clear

A gift "for the needy" implies that a trustee should be appointed to carry out the purpose. A gift "to the Red Cross" implies that the organization takes the property as trustee to apply it to the charitable purposes of the Red Cross. If the charitable organization is an unincorporated association unable to take title, a trustee will be appointed to administer the funds for the benefit of the organization. Of course, the trustee itself need not be a charitable organization (e.g., "to Bank of America as trustee for indigent widows").

C. INDEFINITE BENEFICIARIES

Beneficiaries of a charitable trust must be indefinite. For example, a trust to assist needy migrant farm workers meets this test, because the permissible recipients are an ***unnamed and changing class***. But if particular individual farm workers were the designated beneficiaries, even if they were very needy, the trust would not qualify as "charitable" because of the absence of an indefinite or changing group of beneficiaries. Note that the indefinite class can be quite small.

Examples: 1) A trust to assist needy children of persons convicted for participating in political demonstrations qualifies as charitable. The entire community benefits when any needy group receives necessary sustenance, education, etc.

2) Trusts to aid victims of a certain disaster (e.g., a fire or a hurricane) are charitable even though, in a sense, the beneficiaries are a fixed group.

D. ENFORCING CHARITABLE TRUSTS

1. Settlor and Potential Beneficiaries Have No Standing to Sue Charitable Trustee

Because the purpose of a charitable trust is to benefit the community, the courts consider the community at large the beneficiary of a charitable trust rather than the particular individuals who happen to receive benefits from it. The settlor of a charitable trust is deemed to have no greater interest in the performance of a charitable trust than any other member of the community, and therefore may not maintain an action for its enforcement. Nor may any potential recipients of the charitable trust maintain such an action. *Note:* Under the UTC, the settlor and qualified beneficiaries (i.e., current beneficiaries and first-line remaindermen) ***have standing*** to bring suit to enforce a charitable trust. [UTC §§110(b), 405(c)]

Example: S creates a trust to provide scholarships for Spanish-speaking residents of Chicago. S has no standing to bring suit against the trustee concerning

administration of the trust, nor does Juanita Hernandez, who lives in Chicago and claims that she has been discriminated against in not receiving a scholarship from the trust.

2. Charitable Trusts Enforceable by State Attorney General

In many states, the duty to enforce charitable trusts is placed upon the state's attorney general. Thus, in the above example, the settlor or Juanita Hernandez would have to persuade the attorney general to look into the matter.

E. RULE AGAINST PERPETUITIES

Charitable trusts may be perpetual. The Rule Against Perpetuities does not apply to charitable trusts. Also, under the "charity-to-charity" exception to the Rule, the Rule Against Perpetuities does not apply to transfers where a limitation is used to shift the beneficial interest from one charity to another on the happening of a remote condition. Note carefully, however, that the Rule ***will apply to a limitation shifting the interest*** from a private use to a charitable use or from a charitable use to a private use.

Examples: 1) "To the Cook County YMCA for so long as the premises are used for YMCA purposes, and if the premises shall ever cease to be so used, then to the Cook County United Fund." The gift is valid under the charity-to-charity exception.

2) "To the Cook County YMCA, its successors, and assigns; provided, however, that if the premises ever cease to be used for YMCA purposes, then over to Joan Smith, her heirs, successors, and assigns." The gift over violates the Rule; the invalid interest is stricken, and the Cook County YMCA has a fee simple absolute.

3) "To Joan Smith, her heirs, successors, and assigns for so long as the land is used for residential purposes; and if the land ever ceases to be used for residential purposes, then over to the Cook County YMCA." The gift over violates the Rule; Joan Smith has a fee simple determinable and the grantor has a possibility of reverter.

F. CY PRES

Because a trust for charitable purposes may be perpetual, it often happens that the specific charitable purpose indicated by the settlor is accomplished or becomes impracticable. In such a case, where the settlor had a general charitable intent, the court will direct that the trust property be applied to another charitable purpose as close as possible to the original one, rather than permit the trust to fail and become a resulting trust (*see* VIII.B.2.c., *infra*).

1. Rationale

The idea underlying cy pres (translated, it means "as near as possible") is this: The settlor had a general charitable intent as reflected by the trust (such as the curing of disease, the dissemination of knowledge, or the promulgation of a particular religious faith). To carry out her general charitable objective, she selected this particular agency as trustee or as the beneficiary. But her general charitable intent should not be frustrated because this secondary intent (that the named trustee or beneficiary be the agency for carrying out these objectives) can no longer be accomplished. Instead, the court will select another trustee or beneficiary whose work will most closely approximate the general objectives sought by the settlor.

2. Finding of General Charitable Intent Required

Where the specified charitable use is no longer possible or practical, the court must decide whether the settlor intended the trust to fail or would have wished the property devoted to a similar use. Of course, where the settlor has provided for such a contingency, her direction controls. The fact that a gift is given "on condition" that it be used for a specific charitable purpose has not precluded a finding of general charitable intent. Where a specific intent alone is found, the trust fails and passes as a resulting trust to the settlor's successors in title. The fact that a resulting trust would be impractical because through the passage of time those entitled are numerous and would take small shares often influences a court to find a general charitable intent.

a. Uniform Trust Code—General Charitable Intent Presumed in All Cases

The Uniform Trust Code modifies the cy pres doctrine by raising a presumption that the settlor had a general charitable intent. This means that in every case in which a particular charitable use becomes impossible or impracticable, the court will modify the trust terms by diverting the trust property to another charitable purpose—unless the settlor has specified what was to be done if this problem were to arise. [UTC §413]

3. Selecting a Purpose "As Near As Possible"

In formulating an alternative use for the trust property, the court must determine the settlor's primary purpose, although her other purposes should be taken into account.

Example: Where funds were given to a church to build a memorial hospital for tuberculosis patients, in formulating an alternative use it must be decided which of the settlor's purposes she considered most important: the church as recipient, the memorial nature of the building, or the medical nature of the gift.

4. Compare—Equitable Deviation

Even if the court refuses to apply cy pres—because the purpose of the trust can still be carried out—it can, by exercising its equitable power, authorize equitable deviation from an ***administrative term*** of the trust.

Example: Assume a trust is created for the benefit of students in Greenville City High School. The city high school district is subsequently consolidated with the county high school district. Equitable deviation may be applied, extending benefits to students in all high schools in the county.

5. Cy Pres Also Applies to Outright Gift to a Charitable Organization

The cy pres doctrine can apply to an outright gift to a charitable organization. Thus, if a will makes a disposition to a charitable organization and the organization no longer exists at the testator's death, a court could apply the cy pres doctrine to award the disposition to another similar organization.

G. HONORARY TRUSTS

An "honorary" trust is a trust that is ***not for charitable purposes*** and has ***no private beneficiaries***. Examples are trusts for maintenance of a cemetery plot and trusts for pets. These are called "honorary" trusts because there is no beneficiary who can enforce the trust by bringing an action against the trustee; the trustee is on her honor to carry out the trust. Even though not enforceable, honorary trusts are upheld in the sense that if the named trustee is ***willing*** to carry out the terms of the trust, she will be permitted to do so. If, however, she fails or refuses to do so, a resulting

trust will be imposed for the settlor or the testator's estate. *Note:* Under the UTC, honorary trusts ***are enforceable*** up to 21 years by someone named in the trust instrument or appointed by the court. A trust for the care of an animal alive during the settlor's lifetime is ***valid***; it terminates when the animal dies. [UTC §§408, 409]

1. Void If It May Continue Beyond Perpetuities Period

Many courts hold that an honorary trust is void if it may continue beyond lives in being plus 21 years. This creates a problem for most honorary trusts. Because the "measuring lives" that can be used for Rule Against Perpetuities purposes must be human lives (cannot use poodles, turtles, or elephants), absent special drafting to avoid the problem, a trust for the care of the settlor's dog may be held invalid. Under the "what might happen" remote possibilities test of the Rule Against Perpetuities, the dog ***might*** outlive anyone now alive by more than 21 years. Because the named trustee cannot be compelled to carry out the terms of the trust, she is treated as having a power of appointment, which might be exercisable beyond the period of the Rule Against Perpetuities.

2. Constructional Outs Taken to Avoid Perpetuities Problem

To uphold an honorary trust, some courts have taken these constructional "outs" to save the gift:

a. Trust Was Personal to Named Trustee

In a bequest of $5,000 "to my sister Sue, to be used by her to take care of my dear Bowser for the rest of his days," the court might hold that the trust was personal to Sue, such that Sue and only Sue could serve as trustee; when Sue dies, the trust will terminate. Because the likelihood is that Sue will outlive Bowser, the trust purposes can be accomplished, and Sue can be used as the "measuring life" for purposes of the Rule Against Perpetuities.

b. Fund Will Be Exhausted Within Period of Perpetuities

The court might stretch to find that the $5,000 bequeathed to Sue will likely be exhausted (by expenditures for dog food and veterinary bills) within the period of perpetuities; therefore, the trust will not last beyond the life in being plus 21 years.

IV. TRANSFER OF THE BENEFICIARY'S INTEREST

A. ALIENABILITY IN GENERAL

1. Voluntary Alienation

In the absence of some provision in a statute or trust instrument to the contrary (e.g., restriction on alienation of contingent interest), the equitable interest of a trust beneficiary is freely alienable to the extent the beneficiary can transfer other property. The transferee takes the interest subject to all conditions and limitations that would have applied but for the assignment.

2. Involuntary Alienation

Except as otherwise provided by statute or as validly restricted by the terms of the trust instrument, the interest of an insolvent trust beneficiary can generally be reached in

appropriate proceedings (such as a creditor's bill in equity) to satisfy the claims of his creditors. However, unless the debtor is the sole beneficiary and can presently demand conveyance of the trust property, the creditor reaches only the interest of the beneficiary and ***not the trust property itself***. The basic remedy of the creditor is to sell the beneficial interest and have the proceeds applied to his claim, with the buyer at the sale acquiring the exact interest the debtor held as beneficiary. Because of the sacrifice element involved, a court of equity may refuse to order sale of an income interest and will instead require the trustee to pay the beneficiary's income to the creditor until the debt is satisfied if the creditor will be paid by this method within a reasonable time.

B. RESTRAINTS ON ALIENATION—SPENDTHRIFT TRUSTS

A spendthrift trust is one in which, by statute or more often by virtue of the terms of the trust, the beneficiary is ***unable voluntarily or involuntarily to transfer his interest*** in the trust. In other words, he cannot sell or give away his right to future income or capital, and his creditors are unable to collect or attach such rights. This type of trust is usually created to provide a fund for the maintenance of the beneficiary that will be secure against his own improvidence.

1. Rights of Creditors

What are the rights of the creditors of an income beneficiary of a spendthrift trust? Creditors cannot reach the beneficiary's interest in the sense of selling it as a means of realizing upon and anticipating his future rights. However, the restraint on alienation does not apply to the income ***after it has been paid out*** to the beneficiary. Thus, the property in the beneficiary's hands after distribution is no longer protected by the spendthrift clause and is subject to the claims of his creditors. (However, the creditors have to catch the beneficiary before he spends it!)

2. Restraint on Involuntary Alienation Only—Invalid

A restraint that prohibits creditors from reaching a beneficiary's interest, but does not prohibit the beneficiary from voluntarily alienating his interest, ***violates public policy***. If the beneficiary could give his interest away, but his creditors could not reach it, it would violate the basic rule that creditors can reach any interest the debtor can alienate. (Nonetheless, in a few cases the restraint on involuntary alienation alone has been upheld.)

3. Attempted Assignment in Violation of Spendthrift Provision

Assume that A, the income beneficiary of a spendthrift trust, has purported to assign his interests to B. An assignee in such a case cannot compel a trustee to pay. Thus, B cannot compel the trustee to pay the income to him, and the trustee may not do so over A's objection. The purported assignment does, however, operate as an ***authorization*** to the trustee to pay income to B, and as long as the authorization has not been repudiated by A, the trustee may, without liability, make payments to B. Such an authorization generally does not violate the spendthrift restraint, because the trustee could pay A, who could turn it over to B. But the authorization may be repudiated by A at any time.

4. Exception—Settlor as Beneficiary

An important exception to the validity of spendthrift restraints is that the settlor cannot protect his own retained interests from his creditors by the inclusion of a spendthrift provision.

Example: If S transfers to T in trust to pay income to S for life, remainder to B, and the trust includes a spendthrift clause, S's creditors can reach S's right to the

income just as if the spendthrift clause had not been included. *Rationale:* If this were not true, debtors could easily avoid their creditors and retain income from their property.

a. Test for Determining Whether Beneficiary Is Also Settlor

Sometimes it is not clear whether the beneficiary is also the settlor. ***If a person furnishes the consideration for the creation of a trust, he is the settlor***, even though the trust is created by another person.

Example: If in consideration of the conveyance of Blackacre from A to B, B transfers Whiteacre to T in trust for A for life, remainder to A's children, ***A*** is the settlor of the trust. A's life estate can be reached by his creditors and can be assigned by him, even though the trust contains a spendthrift clause.

5. Exceptions for Special Classes of Creditors

Even where spendthrift restrictions are valid, in a number of states the beneficiary's interest is subject to certain types of claims such as the claims of ***dependents***, the ***government***, and ***persons supplying necessities*** (e.g., a divorced wife can usually reach the husband's interest to satisfy a claim for alimony; and the federal government can reach the interest to pay taxes owing). In a few states, ***tort creditors*** can reach the trust assets on the theory that they, unlike contract creditors, have no means of protecting themselves against the beneficiary's actions.

C. DISCRETIONARY TRUSTS

In a discretionary trust, the trustee is given discretion whether to apply or withhold payments of income or principal (or both) to a beneficiary. This discretion relates to more than just the time and manner of payment; it actually limits the extent of the beneficiary's rights to the amounts the trustee decides to give him, with the rest going over to others eventually.

1. Creditors' Rights

a. Before Trustee Exercises Discretion—Interest Cannot Be Reached

Before the trustee exercises his discretion to make payments to the beneficiary, the beneficiary's interest is not assignable and cannot be reached by his creditors. The theory is that, because the beneficiary has no right to payment that he can enforce against the trustee, there is nothing for the creditors to reach—i.e., the creditors' rights cannot rise above those of the beneficiary. Creditors are usually allowed to attach the beneficiary's interest but may not compel the trustee to make a distribution.

b. After Trustee Exercises Discretion—Payments Made to Creditors

If the trustee exercises his discretion and elects to make payments to the beneficiary, the trustee must make those payments not to the beneficiary but directly to his creditors or assignees if the trustee has notice of an assignment or attachment by the creditors, ***unless the beneficiary's interest is protected by a spendthrift restriction***.

Example: T bequeaths a sum in trust to pay the income and principal to B in the trustee's uncontrolled discretion. B's creditors cannot require the trustee to pay the income or principal to them. However, by giving notice to the trustee, they can prevent the trustee from paying B until their claims are

satisfied. Of course, if there is a spendthrift clause, they cannot reach B's interest in any way and the trustee can pay B if he chooses to do so.

c. **Creditors May Reach Discretionary Interest Created for Settlor**
The few cases on point seem to establish the principle that where a discretionary interest is created for the settlor himself, his creditors can reach the retained interest.

2. **Beneficiary's Rights**
The beneficiary cannot interfere with the exercise of the trustee's discretion unless the trustee ***abuses his power***. What constitutes abuse depends upon the extent of discretion conferred upon the trustee. If the trust is a "support trust," there is more room for a court's interference because the trust has a specific purpose; but even if the trustee's discretion is uncontrolled, the court will interfere if the trustee acts in bad faith or dishonestly.

D. SUPPORT TRUSTS

A support trust is one where the trustee is required to pay or apply only so much of the income or principal (or both) as is necessary for the support of the beneficiary.

1. **All Income for Support**
A trust to "pay all of the income to A for his support" is not a support trust. When the whole of the income is to be paid to A for his support, the words "for his support" merely state the motive for the transfer. The beneficiary is not limited to amounts necessary for his support.

2. **Not Assignable**
Even without a spendthrift clause, the character of a beneficiary's interest in a support trust is such that no one but the beneficiary can enjoy it; his interest is not assignable by definition. His creditors cannot reach it; that would defeat the purpose of the trust.

3. **Effect of Other Resources Available to Beneficiary**
Whether the beneficiary of a support trust who has other income or resources that can be used for his support is entitled to support out of the trust fund without taking into account such other resources is a question of the ***settlor's intention***. The cases are fairly evenly divided, some inferring that the beneficiary should receive his support from the trust regardless of other resources, and others inferring the opposite.
Example: T bequeaths a fund in trust to pay such income to B as is necessary to support B. It requires $25,000 a year to support B. B has $5,000 of income from other sources. The cases are split as to whether B gets $25,000 from the trust or only $20,000.

V. MODIFICATION AND TERMINATION OF TRUSTS

A. TERMINATION OF TRUST BY ITS OWN TERMS

A trust terminates when the duration of the trust as specified by the settlor has expired, or if the instrument specifies no termination time, when the settlor's purposes have been accomplished. Thereafter, the trustee must wind up the affairs of the trust with reasonable promptness, retaining only such powers as are necessary to preserve the property and to distribute it to the beneficiaries.

B. POWER OF SETTLOR TO REVOKE OR MODIFY

1. Must Reserve Right to Revoke or Modify

In many states, without an ***express*** reservation by the settlor of a right to revoke or modify the trust, he has no such powers. *Note:* Under the UTC and by statute in several non-UTC states, a trust is ***presumed revocable*** unless the trust instrument expressly provides that it is irrevocable. [UTC §602(a); Cal. Prob. Code §15400]

2. Power to Revoke Includes Power to Amend

Where the power to revoke exists, it includes the power to amend. If the method of revocation is specified in the trust instrument, it must be followed. If no method is specified, any instrument showing the settlor's intent will suffice. However, an inter vivos trust usually cannot be revoked by will, unless the trust expressly so provides.

C. MODIFICATION OR TERMINATION BY AGREEMENT OF BENEFICIARIES

Most jurisdictions permit modification or termination ***only if***:

(i) ***All beneficiaries consent***; ***and***

(ii) The modification or termination ***will not impair a material purpose*** of the trust.

1. Consent of All Beneficiaries

Consent is required of all beneficiaries—existing and ***potential*** beneficiaries (including unborn or unascertained beneficiaries) of all present and future interests, no matter how uncertain or contingent. Thus, even a remote, contingent interest in an unborn beneficiary can preclude termination. Note, however, that the UTC and a few states permit the appointment of a representative or guardian ad litem to represent the interests of minor, unborn, or unascertained beneficiaries.

Examples: 1) A testamentary trust provides: "The trustee shall distribute trust income to my husband, Harold, for life. On Harold's death, the trustee shall distribute the trust principal in equal shares to my children, but if any child predeceases Harold, that share shall be distributed to the child's then-living descendants." The testator is survived by Harold and by three children, none of whom has any children. Harold and the children want to terminate the trust, by distributing the actuarial value of Harold's life income interest to Harold and dividing the remaining property among the children. The trust cannot be terminated. The trust creates a contingent future interest in the unborn descendants of the three children, because a child might have a child and then die during Harold's lifetime. The consent of all beneficiaries cannot be obtained.

2) T's will creates an irrevocable trust with the trustee directed to distribute all income to T's spouse, Wanda, for life with remainder at her death to Bob and Mary, T's two adult children. Wanda, Bob, and Mary all wish to terminate the trust. In most states, the only beneficiaries of this trust are Wanda, Bob, and Mary; so the requirement that all beneficiaries consent would be met. However, the result would be different under the UPC, which applies the anti-lapse statute (*see* Wills outline) in this situation. If either Bob or Mary

were to die before Wanda, under the anti-lapse statute his or her descendants would be entitled to his or her share of the remainder. Thus, the as-yet-unborn descendants of Bob and Mary have an interest in the trust. Unless their interests could be represented by a court-appointed representative or guardian, the requirement that all beneficiaries consent cannot be met in a state that applies the anti-lapse statute to trusts.

2. Determining Material Purpose

The settlor's purpose in creating a trust is not always clear from the trust language. The following examples explore the problem of determining what constitutes a material purpose of the settlor:

a. Distribute Principal at Designated Age

Where a testator creates a trust to pay the income to A ***until he is 30 years old*** and then to distribute the remainder to him, A is the sole beneficiary. (Note, however, had the remainder provision been to A if he is living at a stated age, and if not, then to A's issue, A would ***not*** be the sole beneficiary.) In this case, should A be allowed to terminate the trust before he reaches age 30? Here, a court would probably say no. The primary purpose of the trust in this situation likely is to keep the principal of the property out of A's hands until he reaches the designated age.

b. Preserve Property for Remainderman

If a testator left property for life to A, remainder to B, and thereafter B died leaving his remainder interest to A, A could probably terminate the trust because it was not anticipated by the settlor at the outset that A would end up with all of the interests in the property. The purpose of the trust was probably ***to preserve the property for B***. To allow A to terminate now will not obstruct a purpose of the original trust.

c. Provide for Successive Enjoyment by Life Tenant and Remainderman

The most frequent type of case follows: A has a life interest and B has the remainder, and A and B join together to compel a termination of the trust. How does one determine what purpose the testator had in mind in creating the trust, unless clearly indicated on the face of the instrument?

Of course, the whole of the instrument and its surrounding circumstances may be considered. The general inference seems to be that a trust such as this one was set up merely for the purpose of providing for successive enjoyment by A and B; therefore, they can terminate the trust if they both agree. If there is no spendthrift provision, A can convey his life estate to B, resulting in B having the equitable fee and being able to terminate the trust. If the parties can terminate the trust by two pieces of paper (A transfers to B; B demands termination), why not let them do it with one piece (A and B demand termination)?

d. Protect Beneficiary from Own Poor Management or Judgment

However, if the settlor established a trust to protect a beneficiary from his own mismanagement or mistakes of judgment, the beneficiary would not be allowed to terminate. In the preceding example, if it is found that the settlor established the trust for A for life because he had no confidence in A's management of the property, a court should refuse termination.

e. Spendthrift Provision

In nearly all states, a spendthrift provision precludes early termination of a trust even if all beneficiaries consent to the termination. The courts have concluded that a material purpose of the trust was to protect the beneficiaries from creditors' claims, and an early termination would defeat that purpose. An early version of the UTC stated that the existence of a spendthrift clause was presumed ***not*** to constitute a material purpose of the trust. [UTC §411(c)] However, this provision received a chilly reception in the state legislatures, and the UTC was revised to make its presumption regarding spendthrift clauses optional. Several UTC states have enacted statutes explicitly stating that the existence of a spendthrift provision ***is*** assumed to constitute a material purpose.

3. Liability of Trustee

If ***all beneficiaries consent*** and if the trustee is willing to comply with their request for termination, a termination of the trust and a distribution of the corpus in the agreed fashion among the beneficiaries will almost certainly leave the trustee without any liability. This is so even though the termination of the trust violates an essential purpose of the settlor. The reason for this is that there is ***no one to hold the trustee liable*** for his act, all beneficiaries being estopped to bring an action against him because of their consent. (However, there is slight authority to the effect that the trustee may remain liable to the beneficiaries in such a case if a spendthrift trust were involved.)

4. Role of Settlor in Terminating Inter Vivos Trust

a. Settlor's Objections May Not Preclude Termination

If the beneficiaries have a right to terminate under the above rules, the settlor's objections will not preclude their terminating the trust. Of course, the settlor's objections might be considered relevant in determining what the purposes of the trust are and whether the termination defeats those purposes.

b. Joinder of Settlor Waives Material Purpose

If under the above rules, all beneficiaries request the termination and termination is precluded only by a material purpose of the settlor, the courts generally agree that the joinder of the settlor in the request for termination will have the effect of waiving that purpose and permitting the beneficiaries to compel termination.

D. JUDICIAL POWER TO TERMINATE OR MODIFY TRUST

1. Early Termination

A court may terminate a trust prior to the time fixed in the trust instrument where: (i) the trust purposes are ***accomplished early***; or (ii) the trust purposes become ***illegal or impossible*** to carry out. Trusts are not to continue where such continuation will be pointless.

2. Doctrine of Changed Circumstances (Equitable Deviation)

A court may authorize or direct a trustee to deviate from the ***administrative*** terms of a trust (including permitting acts that are not authorized or are even expressly forbidden by trust provisions) if: (i) compliance with the terms of the trust would defeat or substantially impair the accomplishment of the trust purposes; and (ii) the settlor did not know or anticipate the new circumstances.

Example: T devised his *World* newspaper stock in trust for his family and directed the trustee not to sell it. The stock has declined in value over many years and the prospects for recovery are slim. A court should approve the trustee's application to sell the stock. [*In re* Estate of Pulitzer, 139 Misc. 575 (N.Y. 1931)]

a. Doctrine Cannot Change Beneficial Rights of Beneficiaries

In most states, the doctrine of changed circumstances cannot be used to change the beneficial rights of beneficiaries. For example, a court cannot permit invasion of principal for the income beneficiary where this has not been provided for expressly or by implication in the terms of the trust instrument—even though the life beneficiary may be in serious need of additional benefits and even though it appears from the circumstances that the settlor would have wished to permit invasion of principal had he anticipated the needs which subsequently arose. To avoid this result, many states have enacted statutes that allow invasion of the principal if it furthers the primary purpose of the trust.

b. Uniform Trust Code

Under the UTC, a court may modify an administrative ***or dispositive*** provision of a trust or terminate a trust if, because of circumstances not anticipated by the settlor, the modification or termination will ***further the purposes of the trust***. [UTC §412]

Example: Testator's trust provided for income to Wife for life, and on Wife's death principal to Daughter. Daughter, severely disabled due to an accident that occurred after Testator's death, resides in a state hospital. After Wife's death, the trustee petitions for creation of a Special Needs trust, pointing out that otherwise most of the trust property will be taken by the state to pay for Daughter's medical expenses. In most states, the modification would not be permitted because only administrative provisions can be modified by a court. [Trust of Stuchell, 801 P.2d 852 (Or. 1990)] Under the UTC, the court could approve creation of a Special Needs trust because the modification would further the purposes of the trust by preserving the trust fund for Daughter's benefit. [*See In re* Riddell, 157 P.3d 888 (Wash. 2007)]

VI. TRUST ADMINISTRATION

A. POWERS OF THE TRUSTEE

1. Sources of Trustee's Power

The trustee can properly exercise only such powers as are expressly or impliedly conferred upon her. These include:

(i) Powers expressly conferred upon her by the ***terms of the trust***;

(ii) Powers conferred upon her by the ***terms of a statute*** or by ***court decree***; and

(iii) Those powers that are "***necessary or appropriate to carry out the purposes of the trust*** and are not forbidden by the terms of the trust" [Rest. 2d §186]. *Note:* The UTC confers

broad powers on the trustee, including all powers that an unmarried individual has over her own property. [UTC §815]

2. Joint Powers

Where there are two or more trustees, the traditional position taken by the courts is that all trust powers had to be exercised by ***unanimous*** agreement. However, both the UTC and the Uniform Trustees' Powers Act ("UTPA") provide that any power vested in three or more trustees may be exercised by a ***majority*** of them. Nearly half the states now apply this rule. Of course, under either rule, if there are only two trustees, they must act unanimously. Note that any action taken in contravention of the jurisdiction's rule is voidable. [UTC §703(a); UTPA §6(a)]

3. Personal Powers

Trustees' powers generally attach to the office of trustee and are not personal to the occupants originally named to that office; i.e., powers usually pass to successor trustees. However, powers may be personal to a particular trustee and therefore may not pass to a successor trustee. This may be implied from the terms of the instrument and the surrounding circumstances, but courts are generally reluctant to imply such a result. The mere fact that a power is discretionary is not a sufficient basis to treat it as one personal to the particular trustee named in the instrument. Courts will consider the purposes of the trust, the nature of the power, possible special qualifications that the originally appointed trustee may have, and any other factors that appear relevant.

4. Imperative and Discretionary Powers

a. Imperative Powers

A power is "imperative" (sometimes called a "mandatory" power) where the trust terms require the performance of a particular act—e.g., trustee is absolutely required to "sell all my real estate and hold the proceeds in trust for my grandchildren until they reach age 30." If a trustee fails or refuses to perform under an imperative power, a court will, upon petition, order the trustee to exercise the power as required by the trust instrument (provided that exercising the power would not violate the law or be against public policy).

b. Discretionary Powers

Most powers are discretionary in the sense that the trustee may or may not perform a particular act, as she determines in her judgment to be most appropriate. Exercise of a discretionary power is subject to judicial review to prevent abuse of the trustee's discretion. To the extent that the exercise of such a power involves a ***business judgment*** rather than a question of law or of interpretation, a court will generally refuse to interfere.

1) Effect of Giving Trustee Absolute Discretion

Where the terms of the trust provide that the trustee shall have "sole" or "uncontrolled" discretion, the trustee's power is still not wholly immune from review.

Example: T bequeaths a large fund in trust for the comfortable support of specified relatives and, on their deaths, to charity. T's will provides that the trustee has "sole discretion to determine what amounts are payable and shall not be accountable to anyone." One of the beneficiaries is living in poverty and the trustee gives her $100 a month and accumulates the balance of the trust income. When she asks

for more income, the trustee cuts her off completely. The beneficiary can sue and receive more income by court order. The clause purporting to relieve the trustee of the legal duty to account is void, insofar as it attempts to deprive a court of jurisdiction, if a beneficiary can show that the trustee is not acting in good faith, or, in some jurisdictions, that the trustee is acting unreasonably.

2) Limitation—Trustee Must Exercise Some Judgment

A court will also intervene where a trustee has completely ***failed to exercise judgment*** with regard to a discretionary power.

5. Implied Powers

The following powers may be impliedly conferred upon the trustee at common law, but are ***expressly conferred*** by the UTC. [*See* UTC §816]

a. Power of Sale

Where the trust terms neither confer nor withhold the power to sell trust property, a power of sale is generally quite readily inferred by the courts. In deciding whether to infer a power of sale, courts consider the language of the instrument, the character of the property, the purposes of the trust, and whether the property is to be transferred to the remaindermen on termination of the trust. A power of sale may be more readily inferred in cases involving personal property than in cases involving real property.

1) Directive Not to Sell

Note that the settlor can direct the trustee not to sell certain property transferred into the trust. This directive is valid, and the trustee cannot sell the property without a court order permitting the sale on the grounds that circumstances have changed so much that not selling would put the trust corpus in jeopardy (*see* V.D.2., *supra*).

b. Power to Incur Expenses

1) Necessary and Ordinary Expenses

It is generally implied that a trustee can incur expenses that are appropriate to carry out the trust purposes. She can incur such expenses as are necessary and ordinary in the management of the trust property and in keeping the property in repair, and she can employ agents and advisors where this is prudent or where she cannot reasonably be expected to personally perform certain duties.

2) Improvements on Trust Property

Courts are less willing to infer the power to make improvements on trust property, but generally improvements can be made. Improvements involve some element of investment discretion, and one might consider in relation to the propriety of a particular improvement whether it will have the effect of concentrating investment in a particular type of property so as to be a violation of the trustee's duty to diversify investments (*see* C.2.b.5), *infra*).

c. Power to Lease

Normally, a trustee has an implied power to lease trust property on such terms and for such periods as are reasonable under the circumstances.

d. No Implied Power to Borrow Money

Under ordinary circumstances, the trustee has no implied power to borrow money on the credit of the trust estate; nor has she power to mortgage or otherwise encumber the trust property. However, in the well-drafted trust instrument, the trustee is usually given the express power to borrow and mortgage.

B. DUTIES OF THE TRUSTEE

Under a revocable trust, a trustee's duties are owed exclusively to the settlor. For an irrevocable trust, a trustee owes duties to all of the trust beneficiaries.

1. Standard of Care Required of Trustee

In administering the trust, the trustee must exercise that degree of care, skill, and caution that would be exercised by a ***reasonably prudent person*** in managing her own property. ***Care*** relates to her diligence and to the efforts she makes. ***Skill*** relates to the trustee's capabilities. ***Caution*** is the element of conservatism in administering the trust.

2. Duty of Loyalty—No Self-Dealing

Absent court approval or contrary trust provision, a trustee cannot enter into any transaction in which she is dealing with the trust in her individual capacity. A trustee cannot "wear two hats," and in the same transaction represent both her personal interest and the interests of the trust estate. The concern addressed by the self-dealing rules is not that the trustee might act improperly or take advantage of the situation. Rather, the concern is that the trustee's personal interest might affect her judgment as to whether, e.g., the price is a fair one, or whether the asset should be sold at all. The possible effect on the trustee's judgment as to the wisdom of the action is what makes the self-dealing transaction improper. A trustee owes a ***duty of undivided loyalty*** to the trust and its beneficiaries, and that loyalty might be tainted by her personal interest. No fraud or bad faith need be shown by the beneficiaries, and no excuse can be offered by the trustee to justify the transaction. The self-dealing rules apply to all fiduciaries, including guardians and personal representatives of decedents' estates.

a. Specific Self-Dealing Rules

1) Cannot Buy or Sell Trust Assets

A trustee may not purchase any property owned by the trust even if she pays full value, and may not sell assets to the trust even if the price is a fair one.

Example: The trust's assets include 2,000 shares of Google common stock. Determining that there is a need to diversify the trust's investments, the trustee purchases 1,000 shares of Google stock from the trust, paying the market value as determined by the NASDAQ quotes on the day of the purchase. This is improper self-dealing. If the Google stock later goes up in value, the trust beneficiaries can demand that the trustee return the Google stock to the trust and take back her purchase price without interest. (If the Google stock later goes down in value, the beneficiaries would ratify the transaction and waive the breach of trust, in effect telling the trustee, "thanks for getting rid of that lousy investment.")

2) Cannot Sell Assets from One Trust to Another Trust

A trustee of one trust may not sell property to another trust of which it is also

trustee. The concern of this rule is not self-dealing, but the possibility of favoring one trust at the expense of another.

Example: Trust A holds 3,000 shares of Acme common stock. Deciding to diversify the trust's investments, the trustee sells 1,000 shares of the stock to Trust B, of which she is also trustee. Even though the sale price is a fair one, this is a breach of trust—and note that the trustee is in an impossible position. If the Acme stock rises in value, the beneficiaries of Trust A can sue for the lost profits. If the stock declines in value, the beneficiaries of Trust B can sue for the resulting loss.

3) Cannot Borrow Trust Funds or Make Loans to Trust

A trustee may not borrow trust funds, no matter how fair the interest rate and how well-secured the loan. A trustee may not loan her personal funds to the trust, and any interest paid on such a loan must be returned to the trust.

4) Cannot Use Trust Assets to Secure Personal Loan

A trustee may not use trust assets to secure a personal loan, and the lender does not obtain a valid security interest if she knew or had reason to know that the assets belonged to a trust.

5) Cannot Personally Gain Through Position as Trustee

A trustee cannot gain any personal advantage from her position (other than compensation for serving as trustee). The trustee is accountable for any profit arising out of administration of the trust, even if the profit did not result from a breach of trust.

6) Corporate Trustee Cannot Invest in Its Own Stock

A corporate trustee cannot invest in its own stock as a trust investment. But it can ***retain*** its own stock if such stock was a part of the original trust res when the trust was established, provided that retention of the stock meets the prudent investor standard.

7) Self-Employment Can Constitute Form of Prohibited Dealing

Generally, self-employment is a form of prohibited self-dealing. However, extraordinary services to the trust on the part of the trustee may entitle the trustee to additional compensation. This problem may arise if the trustee renders ***legal services*** to the trust that are outside the normal scope of her duties and for which additional compensation is fair and appropriate.

b. Indirect Self-Dealing—Transactions with Relatives, Business Associates

The above self-dealing rules apply to sales or loans to a trustee's relative or business associate, and to a corporation of which the trustee is a director, officer, or principal shareholder.

c. Duty to Account

The duty to keep and render accounts, and to furnish information to the beneficiary or his agent at the beneficiary's request, is one way of insuring that the trustee is meeting her obligation of loyalty.

d. **Good Faith Irrelevant**
Good faith on the trustee's part or benefit to the trust is irrelevant. (For example, a trustee, acting in complete good faith and to help the trust, loans money to the trust and takes a second mortgage on trust property. When the first mortgage is foreclosed, it turns out that the trustee has made a profit. That profit must be turned over to the trust.) The policy reason for this harsh rule is that personal interest on the part of the trustee opens the door to biased judgments and thus to decisions that may not be in the beneficiary's best interests.

e. **Duty Extends Equally to All Beneficiaries**
The duty of loyalty extends equally to all beneficiaries, unless the trust instrument specifies otherwise. Dealing impartially with the beneficiaries is more difficult when the beneficiaries are entitled to successive benefits; e.g., A receives income for life, B receives the trust corpus at A's death. The trustee has a duty to A to see that the trust property produces income. She violates her duty to A if the property is not income-producing. On the other hand, to carry out her duty to B, the trustee must insure that the trust property will not depreciate in value.

f. **Beneficiary's Rights in Case of Prohibited Transaction**
If a prohibited transaction takes place, the beneficiary may: (i) ***set aside*** the transaction; (ii) ***recover the profit*** made by the trustee, reduced by losses arising out of the same transaction (*see* E.1.b., *infra*); or (iii) ***ratify*** the transaction (which would occur when the transaction has turned out to be advantageous to the trust). Thus, the trustee bears the risk of subsequent loss, and is also required to turn over any profit where the dealings with the trust were advantageous to her.

g. **Restrictions on Self-Dealing Can Be Waived by Settlor**
The settlor of a trust can waive the rules prohibiting self-dealing by expressly conferring upon the trustee the power to act in a dual capacity. If the self-dealing rules are waived by the settlor, the trustee will not be held liable for her conduct unless she has acted dishonestly or in bad faith, or has abused her discretion.

3. **Duty to Separate and Earmark Trust Property—No Commingling**
Trust assets must be kept physically separate from the trustee's personal assets and from the assets of other trusts. (Statutory exceptions in most states permit a corporate fiduciary to hold property of trusts of which it is a trustee in a common trust fund.) In addition, trust property must be titled in the trustee, as trustee for a specific trust. For example, money deposited in a bank account must be deposited in the name of "T as trustee," and not in the name of T personally. If the trustee commingles trust assets with her own, she faces several "heads I win, tails you lose" presumptions:

a. **Property Lost or Destroyed**
If the trustee commingles trust property with her own and some of the property is thereafter lost or destroyed (e.g., casualty loss, or failure of a bank), the presumption is that the property lost was the trustee's own, and that the property still on hand belongs to the trust.

b. **Assets that Rise or Decline in Value**
If a portion of the commingled assets increased in value, it is presumed that those

belonging to the trust increased in value; if a portion declined in value, it is presumed that those belonging to the trustee, individually, declined in value.

4. Duty to Perform Personally (Prohibition on Delegation of Trust Duties)

A trustee cannot delegate the entire administration of a trust. A trustee also may not delegate discretionary functions, such as the decision to make discretionary distributions. On the other hand, she may delegate acts that would be unreasonable to require her to perform personally (e.g., mailing letters). There is no clear-cut standard for judging when delegation is proper. Should you have a question that raises an issue of improper delegation, discuss the facts in light of what a reasonably prudent person would do, the degree of discretion delegated, and whether someone with special skill is needed to do the act.

Example: Testator's will creates a trust naming longtime family friend, Friend, as trustee, and stating: "The trustee may from time to time distribute the trust income and principal to such one or more of my children and grandchildren as the trustee deems appropriate, taking into account any special needs they may have." The trust is to terminate on the death of Testator's last surviving child. Not being familiar with trusts or what it means to be a trustee, Friend wants to know whether he can delegate the authority to make discretionary distributions to the trust department of Reliable Bank, which has had no connections with Testator's family in the past. *Answer*: This trust duty cannot be delegated. Testator presumably selected Friend as trustee purposely to make the appropriate decisions regarding the discretionary distributions that should be made. Delegation of this duty would be a breach of trust.

a. Exception—Investment and Management Decisions

Under the traditional rule, investment decisions could not be delegated. Under the Uniform Prudent Investor Act ("UPIA"), however, a trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. [UPIA §9] (For an in-depth discussion of delegating investment and management decisions, *see* C.2.c., *infra*.)

b. Following Advice of Others

The trustee can seek the advice of attorneys and others on matters that she may not delegate. However, the trustee must make the decisions. If she appears to take advice without exercising her independent judgment, she may be held liable on the theory that she improperly delegated her duties.

c. Remedy

If a trustee improperly limits or surrenders her control over trust property, she becomes a ***guarantor*** of the fund. Her motives or the fact that the loss was not directly caused by the abdication of control will not be considered by the court. The trustee is held liable for the ***amount of the actual loss*** to the trust.

5. Duty to Defend Trust from Attack

Except when the trustee's examination reveals that an attack against the trust is well founded, she has a duty to defend the trust.

6. Duty to Preserve Trust Property and Make It Productive

There is a basic duty to preserve and protect the trust corpus. From this basic duty, there normally will be implied the duty to make the trust property productive, which includes the duty to invest. The duty to preserve and protect the corpus requires that the trustee exercise reasonable care to do the following (and if she has held herself out as having special skills or has been selected on account of such special skills, she will be held to exercise such skills):

a. Collect all claims due the trust.

b. ***Lease land or manage it*** so that it is productive; or sell it if it is not productive (but this does not apply if the trust instrument requires the trustee to convey that land to a beneficiary).

c. ***Record recordable documents*** to protect title; keep securities and funds in safe places; ***pay taxes*** on trust assets to prevent liens thereon; and ***secure insurance*** on trust properties. It is proper for the trustee to obtain insurance on trust property—including liability insurance—even though such insurance protects her individually as well as the trust estate.

d. ***Invest trust funds*** within a reasonable period of time following receipt thereof (and continuously review such investments and sell and reinvest when required). If the trustee fails to invest trust monies, she is chargeable with the amount of income that would normally accrue from appropriate investments.

C. INVESTMENTS

The majority of states have enacted a version of the UPIA, which regulates the investment responsibilities of the trustee. A few states continue to use a statutory "legal list" approach, which establishes approved types of investments for a trust.

1. Uniform Act or Legal List Are Default Rules

No matter which approach to investments a state uses, the trust terms can expand or limit a trustee's powers, including investment powers. Thus, the UPIA or legal list provisions apply ***only if there is no contrary provision in the trust instrument***.

a. Grant of Discretionary Powers

If the trust instrument provides for investments to be made "in the discretion of the trustee," it is a question of interpretation whether the trustee's investment power is enlarged beyond the powers prescribed by the UPIA or legal list.

1) UPIA Jurisdiction

In a UPIA jurisdiction, the trustee's authority to make investments "in her discretion" usually permits only those investments that satisfy the prudent investor standard.

2) Legal List Jurisdiction

In a "legal list" jurisdiction, such language is likely to free the trustee from the list and probably permits investment in a manner similar to that under the UPIA.

3) **Language Strictly Construed**
There is a tendency to strictly construe language that purports to enlarge the trustee's investment powers.

2. Uniform Prudent Investor Act

a. Standard of Care
Under the UPIA, a trustee must invest and manage trust assets as a prudent investor would, taking into account the purposes, terms, distribution requirements, and other circumstances of the trust. To satisfy this objective standard of prudence, the trustee must exercise ***reasonable care, skill, and caution***. [UPIA §2(a)]

1) **Fiduciaries with Special Skills Held to Higher Standard**
A trustee with special skills or expertise, or who has represented herself as having such knowledge, has a duty to use those skills or expertise. [UPIA §2(f)]

2) **Loyalty and Impartiality**
A trustee must act exclusively for the beneficiary when investing and managing trust assets, or she is acting imprudently. [UPIA §5] If there is more than one beneficiary, she must act impartially in investing and managing the trust assets, taking into account the beneficiaries' differing interests. [UPIA §6]

b. Prudence Evaluated as to Overall Investment Strategy
The UPIA is based on the modern portfolio theory of investing. Thus, each investment decision must be evaluated, not in isolation, but in the context of the ***entire trust portfolio*** (corpus) and as part of an ***overall investment strategy*** that has risk and return objectives reasonably suited to the particular trust. [UPIA §2(b)] Under this approach, an investment that might be imprudent standing alone because it is too risky can become prudent if undertaken in relation to other, more conservative trust investments.

1) **Investment Performance Measured by "Overall Return"**
Under the UPIA, investment returns are measured by the "overall return" concept rather than the production of ordinary income. Historically, trustees invested with the goal of generating income for the trust (e.g., dividends, interest, rental income). In today's investment world, assets that generate a steady income stream (e.g., corporate bonds) may decline in real value due to inflation. In contrast, many investments (e.g., publicly traded common stock, stock in a closely held corporation) generate little or no dividend income, yet produce substantial profits in the form of capital gains. A prudent investor seeks overall return, not merely income. The prudent investor rule recognizes that the most effective way to provide for current income beneficiaries, as well as the trust remaindermen, may be to generate gains through capital appreciation.

2) **Risk/Return Curve**
Modern investment practices reflect sensitivity to the so-called risk/return curve. Returns correlate strongly with risk, but tolerance for risk varies greatly with the purposes of the trust and the relevant circumstances of the beneficiaries. For example, a trust whose main purpose is to provide support for an elderly retiree

of modest means will have a lower risk tolerance than a generation-skipping trust designed to build wealth for the settlor's grandchildren. The UPIA requires the trustee to ***tailor an investment strategy*** that incorporates risk and return objectives ***suited to the particular trust***. [UPIA §2(b)]

3) Any Type of Investment Permitted

The UPIA permits a trustee to invest in ***any kind of property or any type of investment*** "consistent with the standards of this Act"; therefore, no particular type of investment is inherently imprudent. [UPIA §2(e)] The overriding concern is the risk/return objective of the investment, rather than the classification of investments as prudent or imprudent. Depending on the objectives of the trust and the circumstances of the beneficiaries, it may be prudent for a trustee to invest in recently developed investment vehicles such as derivatives, asset-based securities, options, and commodity futures contracts.

4) Factors Considered in Making Investment Decisions

The following circumstances are relevant and must be considered by the trustee in making investment decisions:

(i) General economic conditions;

(ii) The possible effect of ***inflation or deflation***;

(iii) The expected ***tax consequences*** of investment decisions or strategies;

(iv) The role that each investment plays within the ***overall trust portfolio***;

(v) The expected ***total return*** from income and the appreciation of capital;

(vi) ***Other resources*** of the beneficiaries;

(vii) Needs for liquidity, regularity of income, and preservation or appreciation of capital; and

(viii) An asset's ***special relationship*** or value to the purposes of the trust or to one or more of the beneficiaries.

[UPIA §2(c)]

a) Retention and Disposition of Assets

Within a reasonable time after accepting the trusteeship or receiving trust assets, the trustee must review the trust assets and make and implement decisions concerning their retention and disposition, taking into account the factors listed above. [UPIA §4]

b) Duty to Investigate

A trustee is also required to make a reasonable effort to verify information likely to affect the investment and management of the trust's assets (e.g., review audit reports). [UPIA §2(d)]

5) **Diversification of Investments**
A trustee must diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversification. [UPIA §3] In this regard, while a trust is revocable, the trustee owes duties only to the trust settlor. Accordingly, the settlor's direction that the trustee not diversify trust investments would constitute a "special circumstance" that would relieve the trustee of its duty to diversify trust investments.

6) **Reviewing Compliance with Act**
Compliance with the UPIA is determined in light of the facts and circumstances existing ***at the time of the trustee's decision or action*** and not by hindsight. [UPIA §8] A trustee who acts in substantial compliance with the Act is not liable to the beneficiaries even if the trust estate declines in value or produces less income than anticipated.

c. **Delegation of Investment and Management Functions Permitted**
A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. This provision recognizes that the trustee (especially an individual trustee) may have limited investment expertise, and that even an experienced investor may have limited expertise in sophisticated investment vehicles. The trustee must exercise ***reasonable care, skill, and caution*** in:

(i) ***Selecting*** an agent;

(ii) ***Establishing the scope and terms*** of the delegation, consistent with the purposes of the trust; and

(iii) ***Periodically reviewing*** the agent's actions to monitor the agent's performance and compliance with the terms of the delegation.

[UPIA §9(a)]

1) **Agent's Duty**
The agent has the duty to exercise reasonable care in complying with the terms of the delegation. [UPIA §9(b)]

2) **Trustee's Liability**
If the trustee exercises reasonable care, skill, and caution in selecting, delegating, and reviewing the agent's actions, she is not liable for the decisions or actions of the agent to whom the function was delegated. [UPIA §9(c)]

3. **Statutory Legal Lists**
A state's statutory legal list sets forth approved investments for trust assets. The list usually includes government bonds, first mortgages, and other conservative investments.

a. **Permissive vs. Mandatory Lists**
If the list is deemed to be "permissive," the trustee can invest in securities outside the

list but incurs a heavier burden of proving the propriety of each investment when she does so. If the list is "mandatory," the trustee probably commits a breach of trust any time she invests in properties outside the list, although the cases are not altogether consistent in this regard.

b. List May Not Be Followed Blindly

Under either type of statutory list, the trustee cannot blindly follow the list. The fact that a type of investment is permissible does not necessarily mean that the investment is proper. In selecting among permissible investments, the trustee must exercise reasonable care, skill, and caution. All circumstances must be taken into account, including such things as preserving purchasing power in the face of possible inflation, minimizing risks to capital, and the need to obtain a fair return on the investment. The propriety of particular investments is discussed below.

1) Unsecured Loans and Second Mortgages

Except for bank deposits bearing interest, an unsecured loan of trust funds is normally an improper investment. Most states regard an investment in a second mortgage as a breach of trust in the absence of extreme or compelling circumstances.

2) Corporate Stocks

Most statutory lists exclude common and preferred stocks.

3) Land

The courts are divided on whether investment in land is permissible. Acquisition of land or other property for the purpose of resale at a profit is speculation and therefore a breach of trust.

Example: Trustee buys 1,000 acres of unimproved desert land. This is an improper investment. Not only is it speculative, but it produces no income and the trustee has the duty of making the trust property ***productive***. Otherwise, the life tenant would lose his income by investments in unproductive property.

4) Mortgage Participations

Mortgage participations, under which large sums are advanced by several trusts administered by the same trustee as loans to property owners in exchange for mortgages, are increasingly upheld as proper investments—mainly because they permit a greater diversification than would be possible if a single trust fund had to make the loan by itself.

5) Investment in Mutual Funds

Historically, a trustee could not invest in mutual funds because doing so was regarded as an improper delegation of the investment duty. However, a mutual fund is a ***permissible investment*** under the UPIA, and statutes in several states ***expressly authorize*** investment in mutual funds because this produces ***diversification*** of investments in smaller trust estates.

6) Testator's Business

Where a testator is engaged in business at the time of his death and leaves all of

his property to his executor in trust, the executor cannot properly continue the business unless authorized by the testator. She must dispose of the business and make proper trust investments, and if she fails to do so within a reasonable time, she is liable for any losses that result.

D. SUMMARY—THE FIDUCIARY OBLIGATION

The standards imposed on the trustee are harsh. The policies behind such stringent standards and remedies for their violation are: (i) deterrence of wrongful conduct, and (ii) easing the burden of proving a breach of duty, should that become necessary. Do not overlook mentioning policy reasons in your answer. Watch for a bar exam question regarding ***self-dealing, diversification, improper investment***, and ***offsetting*** gain from one breach against loss from another. You should ask the following questions:

1. Was the act one that the trustee was ***authorized*** to perform under the terms of the trust and applicable law? If not, there is a breach of trust regardless of the good faith, skill, and diligence with which the trustee performed the act.

2. If the act was proper for the trustee to perform, did the trustee perform in a manner that ***satisfies the standard of conduct*** required of her? Did she act prudently, diligently, and in good faith, exercising the appropriate amount of care, skill, and caution of a reasonably prudent person under the circumstances?

E. LIABILITIES OF TRUSTEE

1. Enforcement by Beneficiaries

The beneficiaries may seek to have the trustee surcharged (i.e., pay damages suffered by the trust) or removed from office if the trustee breaches her duties. The settlor may sue if he is also a beneficiary, but third parties may not seek to enforce the trust.

a. Prior to Breach

A court of equity will compel the trustee to perform her duties or will enjoin her from committing the breach.

b. After Breach

The trustee is liable to the trust estate for losses resulting from the breach and for any profit that clearly would have accrued to the trust but for the breach, as well as any profit made by the trustee as a result of her breach. The trustee will also be liable for interest on her liability from the time of the breach.

c. Defenses

Equity may not enforce the trust if the beneficiaries expressly or impliedly ***consented*** to or ***joined in the breach*** of trust. The beneficiary must sue within a reasonable time after the breach or he will be barred from enforcing the trust by the doctrine of ***laches***. Note that the mere failure to object when the trustee commits a breach of trust does not constitute consent.

d. Virtual Representation

In any action in which trust beneficiaries are parties, a minor, incapacitated, or unborn

beneficiary who is not otherwise represented may be represented (and bound by any decision) by another beneficiary having a substantially identical interest with respect to the particular question or dispute, but only to the extent that there is no conflict of interest between the beneficiary and the person being represented. [*See, e.g.*, UTC §304]

Example: A trust provides for the payment of income to Alice for life, "and on Alice's death the trustee shall distribute the trust principal to my brother Ben if he is then living, but if Ben is not then living to Ben's then-living descendants." An order in any litigation concerning the trust in which Ben is named as a party is binding on Ben's descendants, as their contingent remainder interest is identical to Ben's interest.

2. More than One Breach of Trust—Losses Cannot Be Offset

Where a trustee is liable for losses resulting from one breach of trust, she cannot reduce the amount of this liability by offsetting it against a gain resulting from another breach of trust.

Example: Trustee is required by the trust instrument to invest in bonds. She invests one-half the corpus ($50,000) in Green Co. stock and one-half ($50,000) in Purple Co. stock. Purple Co. stock becomes worthless, but Green Co. stock doubles in value; so there is no net loss. Even so, the trustee has been dealing with ***different*** portions of the trust property. The gain in Green Co. stock ***cannot be offset*** against the loss in Purple Co. stock. Therefore, Trustee is personally liable for the $50,000 loss in Purple Co. stock.

3. Trustee's Liability for the Acts of Others

a. Agents

A trustee is ***not liable*** to the beneficiaries for the acts of her agents ***unless*** the trustee:

1) Directs, permits, or acquiesces in the act of the agent, or conceals the act, or negligently fails to compel the agent to redress the wrong;

2) Fails to exercise reasonable supervision over the agent;

3) Permits the agent to perform duties that the trustee was not entitled to delegate; or

4) Fails to use reasonable care in the selection or retention of her agents.

b. Co-Trustees

A trustee is ***not liable*** to the beneficiaries for a breach of trust committed by a co-trustee ***unless*** the trustee:

1) Improperly delegated her authority to the co-trustee (one trustee cannot delegate to a co-trustee power to manage the property);

2) Participated, approved, or acquiesced in the breach by her co-trustee, or negligently disregarded her own duties of administration so as to facilitate the breach by her co-trustee; or

3) Concealed the breach or failed to take proper steps to compel redress of it by the co-trustee.

c. Predecessor Trustees

A trustee is ***not liable*** to the beneficiaries for breaches of trust committed by a predecessor trustee ***unless*** she:

1) Knew or should have known of the breach and failed to take proper steps to prevent further breach or to compel redress of a prior breach; or

2) Negligently failed to determine the amount of property that should have been turned over to her, or otherwise neglected to obtain delivery of the full trust property from the predecessor.

d. Successor Trustees

A successor trustee can maintain the same actions as could be maintained by the original trustee. She can sue third persons for damaging trust property before she became trustee, and she can sue predecessor trustees to redress a breach of trust.

4. Effect of Exculpatory Clauses

An exculpatory clause is one that attempts to relieve the trustee of liability for breach of duty in the administration of the trust or lowers the standard of conduct required of her. Generally, courts tend to frown upon these clauses and will construe them narrowly. An exculpatory clause designed to absolve the trustee of ***all liability*** will be held ***void*** as against public policy. Limited exculpatory clauses are valid except insofar as they: (i) attempt to relieve the trustee from liability for ***bad faith, intentional breach of trust, or recklessness***; or (ii) appear in the trust instrument because of the trustee's ***abuse of a confidential relationship*** with the settlor. [Rest. 2d §222]

Example: The trust agreement authorizes Trustee to continue the settlor's business, and provides that Trustee shall not be personally liable for negligence. A large hole develops in the front steps of the business. Trustee is aware of this and does not remedy it within a reasonable period. Z falls in the hole and is injured. Trustee is liable because his conduct was reckless, not simply negligent.

5. Trustee's Liability to Third Parties

a. Contract Liability

Unless the contrary is explicitly provided in the contract, the trustee is personally liable to third parties on contracts entered into with them in the course of the trust administration.

1) Indemnification Rights

As long as the trustee acted properly in making the contract (i.e., the contract was within her powers, and she acted with reasonable prudence and care), she is entitled to ***indemnification***—either by paying the creditor directly from the trust property or by paying the claim herself and obtaining reimbursement from the trust estate.

2) Reimbursement for Legal Fees

The trustee is also entitled to reimbursement for legal fees incurred in defending

suits brought against her by third parties, unless the suit arises out of a breach of duty or from some fault of the trustee.

b. Tort Liability

The trustee is personally liable to third parties for torts to the same extent as would be an ***ordinary owner***. She is liable for torts committed by herself or her agents.

1) Indemnification

The trustee is entitled to indemnification from the trust if she is not personally at fault and if the tort liability is a risk that is a normal incident of the type of activity in which the trustee was properly engaged.

Example: T holds in trust an apartment house as a proper investment. T does not take out liability insurance, which is a breach of duty. A is injured when a painter negligently leaves a ladder in the hall. T is liable to A in tort. T is not entitled to indemnification from the trust because, although T was not personally at fault, the loss results from T's breach of duty in not insuring.

2) Creditors

If the trustee is entitled to indemnification, tort creditors can reach the trust assets to satisfy their claims.

F. LIABILITY OF THIRD PARTIES TO THE TRUST

1. Property Improperly Transferred to Party Who Is Not Bona Fide Purchaser

The trustee's transactions with third parties that constitute a breach of trust can be set aside by a beneficiary or successor trustee, provided it does not result in taking property from a bona fide purchaser. The third party can be compelled to return the trust property improperly transferred to him or to restore the proceeds or product of that property, if it can be traced into his hands.

2. Transfer to Bona Fide Purchaser Cuts Off Beneficiaries' Interests

A third party who acquires the legal title to trust property ***for value and without notice of the trust*** takes the property free of the equitable interests of the beneficiaries.

a. Third Party Deemed to Have Notice If Knows Facts Requiring Inquiry

The third party will be deemed to have notice of the existence of the trust if he knows of facts requiring an inquiry that, if pursued, would have disclosed the existence of the trust. If the third party knows that the property is held in trust (e.g., the existence of the trust appears on the face of a document representing the property), courts have generally held that he has a duty to inquire into the trustee's authority; therefore, he will be charged with such information as a reasonable inquiry would produce. Some cases and many statutes relieve persons dealing with trustees of the duty to inquire into the propriety of the trustee's actions.

b. Innocent Donee Is Not Liable for Damages

An innocent donee of trust property must restore the property to the trust but cannot be held liable for damages. If the donee has exchanged the trust property for other

property, he can either restore the value of the property when received or its substitute, whichever value is lower.

3. Participation in Breach of Trust

Clearly, a third party who ***knowingly*** participates in a breach of trust by the trustee is liable for the resulting loss to the trust estate. One who ***innocently participates*** in a breach of trust is generally not liable to the beneficiaries, except to the extent he is obligated to return property transferred to him when not protected as a bona fide purchaser.

4. Direct Suit by Beneficiary

Generally, the beneficiaries of a trust ***cannot*** bring an action in law or in equity against a third party who damages the trust property or is liable to the trustee on a contract. The trustee is the proper person to sue the third party. However, the beneficiaries can sue the trustee for breach of trust. The ***exceptions*** to the general prohibition on a direct suit by the beneficiaries are:

a. Trustee Participates in Breach

If the trustee participates with the third party in a breach, the beneficiaries can sue the third party directly. *Rationale:* The third party has directly wronged the beneficiaries by inducing the trustee to commit a breach of trust.

b. Trustee Fails to Sue

If the trustee fails to sue a third party liable in tort or contract, the beneficiaries can bring a suit in equity to compel her to perform her duty. To prevent multiplicity of actions, the third party can be joined in this suit.

c. Trustee Abandons Office

If the trustee has abandoned her office or has left the jurisdiction and a successor trustee has not been appointed, the beneficiaries can sue the third party in equity without joining the trustee.

G. ALLOCATION OF RECEIPTS AND EXPENSES BETWEEN INCOME AND PRINCIPAL ACCOUNTS

Assets received by the trustee must be allocated to either principal or income. For example, suppose a trust is created for A for life, remainder to B. A is to receive the income for life; at A's death, B is to receive possession of the principal. The trustee will usually credit the assets received to principal, and credit all income earned to income. However, certain receipts are of a mixed nature (both income and principal), depending upon how they are viewed, and certain expenses are made to protect both income and principal. Thus, allocation problems occur.

1. Uniform Principal and Income Act

As previously noted, the majority of states have enacted the UPIA to enable a trustee to make prudent investment decisions without having to realize a particular portion of the portfolio's total return in the form of traditional trust accounting income. To implement adoption of this new investment regime, the majority of states have also enacted the Uniform Principal and Income Act ("UPAIA"). The Act, which applies to all trusts and estates ***unless the governing instrument provides otherwise*** [UPAIA §103(a)], gives the trustee or personal representative an ***adjustment power*** to reallocate investment portfolio return

[UPAIA §104]. This adjustment power authorizes the trustee to characterize items such as capital gains, stock dividends, etc., as income if the trustee deems it appropriate or necessary to carry out the trust purposes, e.g., where the income component of a portfolio's total return is too small (or too large) because of the investment decisions made by the trustee.

a. Duty of Fairness to All Beneficiaries

The trustee is under a ***duty to administer the trust impartially*** "based on what is fair and reasonable to all of the beneficiaries," except to the extent that the trust or the will manifests an intent that one or more of the beneficiaries is to be favored over the others. [UPAIA §103(b)]

b. Adjustment Power

If the trust describes the amount that may be distributed to a beneficiary as "income," the starting point is that the trustee must follow traditional trust accounting rules by distributing interest and dividend income, etc., to the beneficiary. If the resulting distribution effectuates the settlor's intent and the purposes of the trust, then nothing further needs to be done. If, however, the trustee determines that by distributing only the trust's "income" she is unable to comply with the requirement that all beneficiaries be treated fairly, the trustee may adjust between principal and income to the extent the trustee considers necessary. [UPAIA §104]

Example: If a trustee decides that the investment portfolio should be composed primarily of financial assets whose total return will result primarily from capital appreciation rather than dividends and interest, the trustee can satisfy its duty of fairness to the beneficiaries by allocating capital gains to the income account. On the other hand, if the trustee decides that the risk and return objectives for the trust are best achieved by a portfolio whose total return includes interest and dividend income that will provide the income beneficiary with an appropriate level of beneficial enjoyment, the trustee can decide that it is unnecessary to exercise the power to adjust.

c. Factors to Be Considered

In deciding whether and to what extent to exercise the adjustment power, the trustee is to consider the following factors:

(i) The nature, purpose, and expected duration of the trust;

(ii) The ***intent*** of the settlor;

(iii) The identity and circumstances of the ***beneficiaries***;

(iv) The needs for liquidity, regularity of income, and preservation and appreciation of capital;

(v) The nature of the trust's ***assets***;

(vi) The ***net amount allocated to income*** under the other sections of this Act and the increase or decrease in the ***value of the principal assets***;

(vii) Whether and to what extent the trust gives or denies the trustee the power to ***invade principal or accumulate income***;

(viii) The actual and anticipated effect of ***economic conditions*** on principal and income and effects of ***inflation and deflation***; and

(ix) The anticipated tax consequences of an adjustment.

[UPAIA §104(b)]

d. Adjustment Not Permitted If Result Would Be Adverse Tax Consequences

The trustee may not make an adjustment if the trustee is a beneficiary of the trust, as this would give the beneficiary a general power of appointment for estate tax purposes, and the trust assets would be taxed in the beneficiary's estate. Also, an adjustment cannot be made if the adjustment power would disqualify the trust for a federal estate tax marital or charitable deduction or cause the trust's income to be taxed to the trustee under the Internal Revenue Code's "grantor trust" rules. [UPAIA §104(c)]

2. Allocation of Receipts

The Act sets out detailed rules as to how certain receipts and expenses are to be allocated between the income and principal accounts (subject to the trustee's adjustment power). In general, the allocation rules follow traditional accounting rules. Net rental income is income, as is interest on a bond or a certificate of deposit. [UPAIA §405] The proceeds of sale of a trust asset (including any capital gains or profit resulting from the sale) are principal, as are eminent domain awards for the governmental taking of property. [UPAIA §404]

a. Receipts from Entity

Money received from an entity such as a corporation, partnership, or real estate investment trust (e.g., cash dividends, partnership cash distributions) is characterized as income unless the money is characterized as a capital gain for federal income tax purposes, or is received in partial or total liquidation of the entity. ***All property other than money*** received from an entity (e.g., stock dividends, stock splits) is characterized as principal. [UPAIA §401]

b. Insurance Policies and Other Contracts

Proceeds from a life insurance policy or other contract in which the trust or trustee is named beneficiary are allocated to principal. If a contract insures the trustee against a type of loss (e.g., loss of profits from a business), the proceeds are allocated to income. [UPAIA §407]

1) Dividends from Insurance Policy

Dividends on an insurance policy are allocated to the account from which the premiums are paid. [UPAIA §407(a)]

c. Deferred Compensation—Ten Percent Default Rule

For periodic receipts from a deferred compensation plan (e.g., pension or profit-sharing plan or individual retirement account), the receipt is income to the extent that the payment is characterized by the payor as income, and the balance is principal. If no

part of the payment is characterized as income or as a dividend, 10% of the payment is characterized as income and the balance is principal. [UPAIA §409]

d. Liquidating Assets Such as Patents, Copyrights—Ten Percent Rule

A "liquidating asset" is an asset whose value will diminish over time because the asset is expected to produce receipts over a limited period. Proceeds from such liquidating assets (e.g., patents, copyrights, book royalties) are allocated 10% to income and 90% to principal. [UPAIA §410]

e. Mineral Interests—Ten Percent Rule

For most oil, gas, mineral lease, and water right payments, receipts are allocated 10% to income and 90% to principal. [UPAIA §411]

f. Unproductive Property

Under the former law, if a particular trust asset produced little or no income, on the asset's sale, the income beneficiary was entitled to a portion of the sale proceeds under the principle of "delayed income." The objective was to compensate the beneficiary for the income the asset would have earned had it been invested more productively. Consistent with the UPIA, which looks to total return from the overall portfolio rather than the income from particular assets, the unproductive property rule was repealed except for certain trusts that are intended to qualify for the estate tax marital deduction. [UPAIA §413]

3. Allocation of Expenses

a. Expenses Charged to Income

The following expenses are charged against income: one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee; one-half of all expenses for accountings, judicial proceedings, and other matters affecting both income and remainder interests; the entire cost of ordinary expenses (including interest, ordinary repairs, and regularly recurring taxes assessed against principal); and insurance premiums covering the loss of a principal asset. [UPAIA §501]

b. Expenses Charged to Principal

The following expenses are charged against principal: the remaining one-half of the compensation of the trustee and any person providing investment advisory or custodial services to the trustee; the remaining one-half of all expenses for accountings, judicial proceedings, and other matters affecting both income and remainder interests; payments on the principal of a trust debt; expenses of a proceeding that concerns primarily an interest in principal; estate taxes; and disbursements related to environmental matters. [UPAIA §502]

VII. WILL SUBSTITUTES

A. IN GENERAL

If a settlor desires to transfer, at the moment of her death, property interests to a trustee and

beneficiaries (or merely to a beneficiary), she must do so by a duly executed will. However, it is possible for a settlor to make an ***inter vivos transfer*** by which economic benefits pass at her death without the formalities of a will. The principal vehicles by which this is done are ***revocable inter vivos trusts, life insurance designations***, and ***bank arrangements***.

B. REVOCABLE INTER VIVOS TRUSTS

A revocable inter vivos trust avoids the costs and delays of probate and has a number of advantages over a will. The reason why the revocable trust is not a will, and does not have to comply with the Statute of Wills, is that an ***interest passes*** to the beneficiary ***during the settlor's life***; it merely becomes ***possessory*** on the settlor's death. The interest can be revoked or divested during the settlor's life, but it passes subject to revocation.

1. Determining Whether an Interest Passes

Whether "an interest passes" during the settlor's life is really a conclusion derived from applying the ritual and evidentiary policies of the Statute of Wills. Where a written instrument is delivered to an independent third-party trustee, there is little doubt that these policies are satisfied. Still, certain problems remain with the revocable trust when the court is not satisfied that the policies are met.

a. Where Trustee Given Usual Powers

If a settlor transfers property to another in a revocable inter vivos trust, and the trustee has normal trustee powers, the trust is valid everywhere.

Example: S transfers to T a sum in trust to pay the income to S for life, then on S's death to pay the principal as S directs by will, and if S fails to direct, to pay the principal to C. S retains the right to revoke the trust. This is a valid trust.

b. Where Administrative Powers Retained

If a settlor transfers property in writing to another in a revocable inter vivos trust, but the ***settlor retains administrative and investment control over the trustee***, it can be argued that the arrangement is no more than an agency that ceases at the settlor-principal's death. However, almost all modern cases ***sustain*** a revocable trust of this kind.
Rationale: The ritual and evidentiary policies of the Statute of Wills are satisfied by the writing and delivery, even though the trustee is not independent.

c. Declaration of Trust

If a settlor declares herself the trustee of a revocable inter vivos trust, the trust might fail on the theory that the settlor is still the owner and no interest has passed to a beneficiary. Inasmuch as any act by the settlor-trustee could be deemed a revocation of the trust, it is hard to see how any beneficiary would ever have any enforceable right against the settlor-trustee. Nonetheless, such a trust has been upheld in modern cases where the settlor notified third parties or ***took some action that made clear her intention to create a trust***.

Example: S declares herself trustee of shares of stock in Bay View Corporation. The income is payable to S; the trust is revocable at any time, but if it remains unrevoked at S's death, the stock is payable to B. S ***notifies the corporation*** that she is holding the stock under a declaration of trust. The trust is valid.

If S merely wrote out a declaration of trust, which she kept in her desk drawer, and did not change the name on the corporation's books or notify anyone, probably no trust would be created.

Comment: The courts want to be sure that S ***intended*** to make a ***binding*** transfer, even though revocable. The ***witnessing*** of a declaration of trust may give that assurance.

2. Advantages of Revocable Trust

A revocable inter vivos trust is widely used in estate planning and has the following advantages:

a. Management of Assets

Harold has retired, and he and his wife, Wanda, do a lot of traveling in their motor home. This makes management and supervision of Harold's investments rather inconvenient, so Harold transfers his investment assets to Central National Bank as trustee of a revocable trust, to pay the income to Harold for life, then to Wanda for her life, then to distribute the principal to their descendants per stirpes. This arrangement provides for effective management of Harold's assets by a bank with investment expertise and provides the other benefits described below.

b. Planning for Incapacity—Avoidance of Guardianship

Suppose that Harold, in the above example, has a stroke and is incapacitated. If Harold had not established the revocable trust (and if Harold had not given Wanda or some other family member a "durable" power of attorney), it would be necessary to have Harold adjudicated an incompetent and a guardian appointed to manage his assets. But because Harold transferred legal title in his investment assets to the bank as trustee, the trust continues to operate for Harold's benefit without the necessity of a guardianship administration.

c. Avoidance of Probate

Suppose Harold dies, survived by Wanda and their children. Because legal title to Harold's investment assets is held by the bank as trustee, the assets are not subject to probate administration. The assets continue to be held for the benefit of Wanda (and the children) without the expenses and delays of a probate administration.

d. Secrecy

A will is a public record, but an inter vivos trust is not recorded anywhere. Secrecy as to assets and beneficiaries is thus available.

e. Choice of Law

The settlor can select as trustee a person living in another state and provide that the law of that other state shall govern the trust. Local restrictions on testation can thereby be avoided—e.g., by choosing a state that permits spendthrift trusts, or permits a spouse's statutory forced share to be avoided by a revocable trust.

f. Defeat Spouse's Forced Share?

In all non-community property states except Georgia, a surviving spouse is given the right to elect a forced share (in most states, one-third or one-half) of the decedent's

estate at death. In ***some*** states, a person can undercut the elective share entitlement by placing her assets in a revocable trust and thereby removing the assets from her probate estate. Under the Uniform Probate Code and in most states, however, lifetime transfers by the decedent are subject to the elective share if the grantor-spouse retained the power to ***revoke, or to invade, consume, or dispose of the principal***. (*See* Wills outline.)

3. "Pour-Over" Gift from Will to Revocable Trust

Suppose that S has created a revocable trust that will continue after her death for the benefit of her nephews and nieces. By her will, S wants to bequeath her residuary estate in trust for the same nephews and nieces. One approach might be for S's will to create a testamentary trust. However, this would result in two trusts for the same beneficiaries, two sets of trustee's fees, and added complications. Instead, S's will might provide: "I bequeath my residuary estate to the First National Bank, trustee under an instrument of trust executed by me on May 11, 2010, to be added to and administered in accordance with the trust terms, including any amendments thereto." Such a gift to an inter vivos trust (called a ***pour-over*** gift in practice) is valid under the Uniform Testamentary Additions to Trusts Act ("UTATA"), which has been adopted by most states. The statute thus permits the integrated disposition of testamentary assets with a trust created during the settlor's lifetime. [UTATA §1]

a. Trust May Be Established Before, After, or Concurrently with the Will

Traditionally, a pour-over gift from a will to an inter vivos trust was invalid if the trust was established after execution of the will. However, the prevailing view now is that a will may devise property to a trustee of a trust established ***or to be established*** during the testator's lifetime. [*See* UTATA §1(a); UPC §2-511]

b. Trust May Be Amendable and Revocable

A pour-over gift by will is valid even though the inter vivos trust is amendable and revocable. The gift is to the trust as it exists at the testator's death, including amendments to the trust made after the will was executed.

c. Gift Is Valid Even Though Trust Unfunded During Settlor's Lifetime

The statute authorizes pour-over gifts to a trust that is not funded with any assets during the settlor's lifetime and whose sole purpose is to receive such a testamentary gift. The statute eliminates any basis for challenging the gift on the ground that no valid trust was created during the settlor's lifetime because the trust had no res. Such a devise is valid even though the only res of the trust is the possibility of receiving a devise under a will. Another statute authorizes the payment of life insurance proceeds, employee death benefits, and similar benefits to an unfunded trust whose sole purpose is to receive such benefits on the settlor's death.

C. LIFE INSURANCE TRUSTS

Life insurance trusts are usually one of the following kinds:

1. Contingent Beneficiary Trust

W, owner and insured under a life insurance policy, designates the policy beneficiary as her husband, H; and if H does not survive W, to B to hold in trust for W's children. This is a ***valid inter vivos trust***, which becomes effective immediately. The contingent right to the proceeds in W's children is a sufficient res. B has ***active duties*** in that he waits to see if H

dies before W and, if he does, collects the proceeds on W's death. This is not a testamentary trust, even though B receives the proceeds, if at all, only on W's death, because the trust came into being during W's life.

2. Assignment of Policies

A, owner and insured under a life insurance policy, assigns the policy to B to hold in trust for A's children. The trust can be funded (i.e., other funds are transferred to B from which B pays the premiums), or unfunded (i.e., the only trust res is the policy and A continues to pay the premiums). In either event, it is valid as an ***inter vivos transfer***.

3. Payable to Testamentary Trustee

A, owner and insured under a life insurance policy, designates as beneficiary "the trustee ***named in my will***." In A's will, she names her brother B as trustee of her property for the benefit of her children. Some courts have held that this is a testamentary designation that does not comply with the Statute of Wills and, thus, fails. Others (e.g., California) have held that if A has a will executed ***prior*** to the change in beneficiary designation, an inter vivos trust arises as soon as the beneficiary designation is made because A so intends. However, if the beneficiary designation is "the trustee ***to be named in my future will***," no inter vivos trust would arise at the time of the change of beneficiary, and the attempted designation would fail as a testamentary act. In many states (e.g., California), statutes have been passed ***permitting*** trustees "to be named in a will" to be designated as insurance beneficiaries without rendering the transaction testamentary.

D. TOTTEN TRUST BANK ACCOUNTS

"Totten trust" is the name given to a bank account in the depositor's name "as trustee" for a named beneficiary (e.g., "A, trustee for B"). Under such a bank account, A, the depositor, retains the passbook and continues to make deposits and withdrawals during her lifetime. B has no beneficial interest in the account during A's lifetime, but succeeds to whatever is on deposit at A's death. It is called a Totten trust because it was first recognized in *In re Totten,* 71 N.E. 748 (N.Y. 1904).

1. Trustee-Depositor Has Full Rights During Lifetime

A Totten trust is not really a trust because there is no separation of legal and equitable title. The depositor remains the owner of all funds on deposit during her lifetime and can withdraw them at any time.

2. Revocation by Other Lifetime Act

While Totten trusts are revoked by withdrawals, they can also be revoked by any lifetime act that manifests an intent to revoke.

Example: A delivered to her attorney a document expressly revoking "all of my 'in-trust-for' accounts." This is a valid revocation, even though the revoking instrument was not delivered to the various banks. Thus, the funds passed under A's will rather than to the designated Totten trust beneficiaries. The fact that A did not comply with the method for changing beneficiaries set out in the bank signature card was irrelevant; that agreement was solely for the protection of the bank and did not limit A's right to revoke.

3. Revocation by Will

If A leaves a will that says, "I bequeath all funds on deposit in my 'in-trust-for' savings

accounts to my friend C," this is a valid disposition. C, and not the beneficiaries named in A's Totten trusts, is entitled to the funds on deposit.

a. Compare—Joint Bank Accounts

By contrast, a joint bank account with survivorship provisions ***cannot*** be bequeathed by a will.

Example: A deposits funds in a savings account, the signature card for which (signed by A and B) provides that A and B hold "as joint tenants with right of survivorship." A leaves a will that purports to bequeath all of her interest in the bank account to C. The gift to C is ineffective because on A's death the fund passed by right of survivorship to B.

4. Gift upon Delivery of Passbook

Most states hold that if depositor A delivers the passbook to beneficiary B, this constitutes a valid gift to B of the amount on deposit.

5. Subject to Creditors' Claims

Because the depositor has complete control over the deposit during his lifetime, he is treated as the owner insofar as his creditors are concerned. His creditors can reach the deposit while he is living, and can reach it as part of his estate on death.

6. Terminates If Beneficiary Predeceases Depositor

If beneficiary B predeceases depositor A, the trust automatically terminates. The funds on deposit belong to A absolutely and do not pass to B's estate. (The beneficiary must survive the depositor-trustee in order to succeed to the amount on deposit under a Totten trust account.)

E. UNIFORM TRANSFERS TO MINORS ACT

To provide a convenient procedure for making gifts to minors who have no legal capacity to manage or sell property, every state has enacted some version of the Uniform Transfers to Minors Act ("UTMA"), under which property may be transferred to a person (including the donor) as custodian for the benefit of a minor. The transfer may be made to a custodian by an executor, trustee, or guardian under a governing instrument (e.g., will, power of appointment, or deed, for a minor beneficiary). The transfer is in the form, "To [name of custodian] as custodian for [name of minor] under the [name of state] Uniform Transfers to Minors Act." [UTMA §9] Under the UTMA, custodianship terminates when the donee attains age 21. [UTMA §20]

1. Custodian's Powers and Duties

A custodianship is not a trust. The custodian does not hold legal title to the custodial property; legal title is in the minor, subject to the custodian's statutory power. The custodian has statutory powers: (i) to collect, hold, manage, invest, and reinvest the custodial property; (ii) to pay to or on the minor's behalf so much or all of the custodial property as the custodian deems advisable for the minor's use and benefit; and (iii) to the extent not expended, to pay over the property when the minor attains age 21 (or to the minor's estate should she die before age 21). A custodian is a fiduciary and is subject to the standard of care of a prudent person dealing with property of another. [UTMA §§12, 14, 20]

2. Qualifies for Annual Gift Tax Exclusion

A custodial gift made pursuant to the UTMA qualifies for the annual federal gift tax exclusion.

F. GIFT CAUSA MORTIS (GIFT IN VIEW OF IMPENDING DEATH)

A gift causa mortis (also called a gift in view of impending death) is a gift of ***personal property*** made in contemplation of immediately approaching death.

1. Delivery and Acceptance

Gifts causa mortis are subject to the same delivery and acceptance requirements as inter vivos gifts.

a. Actual Physical Delivery

If the donor physically vests the donee with possession of the subject matter of the gift, the delivery requirement is satisfied. To show that delivery has been accomplished in this manner, there must be a showing that the donee has ***received dominion and control*** over the subject matter of the gift.

Example: A husband places certain securities in an envelope. The envelope bears the following inscription: "The enclosed are for my wife, Mary." The envelope is then placed with its contents into the husband's safe deposit box. There would be no valid gift. The delivery requirement is not satisfied because the husband has not physically transferred the securities to his wife and has retained dominion and control over his own safe deposit box.

b. Constructive Delivery

When an item, because of its size or location, would be impossible or impracticable to manually deliver, substitute delivery may be sufficient. In such cases, the delivery requirement will be satisfied if the donor surrenders as much control over the subject matter of the gift as he presently possesses. Generally, this means surrendering the means to obtain possession and control.

Example: If A declares that he gives an antique desk and all its contents to B and hands B the only key to the desk, the delivery requirement is likely to have been satisfied because A has given B control over the desk.

c. Symbolic Delivery

Symbolic delivery occurs when the donor hands over some object, other than the item given, that is symbolic of the item. Symbolic delivery is most commonly effectuated by delivering a written instrument that evidences ownership. In a significant number of states, a gift causa mortis cannot be accomplished by symbolic delivery. The courts reason that if a written instrument is used to pass property at death, it should comply with the Statute of Wills.

2. Anticipation of Death

The donor of this type of gift must be suffering from a condition that realistically confronted her with a fear of death. The mere abstract fear of death from a future cause (e.g., fear of flying, fear of death in war, etc.) is not sufficient.

3. Revocation

a. By Affirmative Act

A gift causa mortis is a revocable transaction. The donor reserves the right, as a

condition subsequent, to revest ownership in herself by any affirmative act manifesting such intention.

b. **Recovery—Gift Revoked by Operation of Law**
If a donor recovers from the condition that put her in fear of impending death, the gift is revoked by operation of law. As long as the donor has failed to recover, the gift is not revoked. One who attempts a gift causa mortis in contemplation of death will have made a valid gift as long as she fails to recover—even if the precise cause of death is different.

c. **Donor Survives Donee—Gift Revoked by Operation of Law**
The gift is revoked by operation of law if the donee fails to survive the donor.

4. **Creditor Claims**
A gift causa mortis is subject to the claims of creditors of the donor's estate.

VIII. TRUSTS ARISING AS A MATTER OF LAW—RESULTING AND CONSTRUCTIVE TRUSTS

A. IN GENERAL

Resulting and constructive trusts do not arise by a settlor's express declaration of trust. They are ***implied*** by law or ***imposed*** by the courts. Resulting trusts involve a ***reversionary interest*** when the equitable interest in property is not completely disposed of and are based on the presumed intent of the settlor. The doctrine of constructive trusts was developed by equity courts as a means of granting relief where, by a series of events, one person has obtained legal title to property (real or personal) that, the conscience of equity feels, rightfully belongs to another, the purpose being to prevent ***unjust enrichment*** by the person who has obtained title. Because resulting and constructive trusts are implied by the courts, the Statute of Frauds is inapplicable; no writing is necessary even where real property is involved.

B. RESULTING TRUSTS—WHEN WILL THEY BE IMPLIED?

Resulting trusts are generally of three types: (i) ***purchase money resulting trusts***, (ii) resulting trusts arising on ***failure of an express trust***, and (iii) resulting trusts arising from an incomplete disposition of trust assets (i.e., *excess corpus*). In resulting trusts, the person who is declared by equity to be the beneficiary of the resulting trust is the one responsible for supplying the trust property (corpus). He has either directly conveyed the property to the person held to be the trustee, or he has supplied the consideration for a transaction through which the other person, the "trustee," acquired title to the property. Thus, the person who holds title did not give consideration. From this fact, equity presumes that he was not intended to have the benefits of ownership and that he should be a trustee for the person who did furnish the consideration or conveyed title to him.

1. **Purchase Money Resulting Trusts**
In the typical situation, there is a sale of property—real or personal—in which Y obtains legal title from the seller (e.g., a deed names him as grantee; stock certificates list him as owner). But Y, who takes title, did not supply the consideration; another person, X, paid the consideration. Unless X and Y are close relatives (*see* e., *infra*), it is unlikely that X intended

a gift. X probably intended to retain some benefit; thus, the courts imply that Y is trustee and X is beneficiary of a resulting trust. ("Resulting" in that it results from X having furnished the consideration.) This resulting trust is dry or passive in that Y, the title holder and trustee, has no management duties. His ***sole duty*** is to convey his title to X, the beneficiary. The court's decree that there is a resulting trust will likely order him to do so.

a. Form of Consideration Immaterial

The consideration given by X, the beneficiary, is usually money; but it need not be. The resulting trust will arise if the seller asks for consideration in the form of services and X supplies them, or if X gives consideration by canceling a debt owed to him by the seller. The trust will be implied whether X pays the consideration directly to the seller or deposits it with Y, who in turn passes it to the seller and takes title. *But note:* A resulting trust arises only from consideration ***given for actual purchase of the property***. This excludes money furnished by X to pay off a mortgage, to pay taxes on the land, or to build improvements on it.

b. Time When Consideration Furnished

For a resulting trust to arise, the beneficiary, X, must supply the consideration ***at or before*** the time Y takes title (e.g., in the case of real property, at the time of delivery of the deed to Y). It is also sufficient if X obligates himself, prior to or at the time Y takes title, to pay the consideration (e.g., X gives the seller a promissory note). Payments made by X ***after*** Y has taken title will not give rise to a resulting trust unless X has bound himself to make such payments.

c. Burden of Proof on One Claiming as Beneficiary

The burden is on X, the party claiming to be the beneficiary of a resulting trust, to prove by ***clear and convincing evidence*** that he supplied the consideration. He is entitled to bolster his claim by extrinsic evidence (i.e., evidence outside the contract of sale of the property and the deed or other document of title given to Y) that Y had agreed to hold the property solely for his benefit. Of course, if there is an actual trust agreement between X and Y, and if any applicable Statute of Frauds provision is satisfied, the trust would be an express trust, not a resulting trust.

d. Rebuttable Presumption of Resulting Trust

Once X proves that he supplied the consideration, a resulting trust is presumed. However, Y, the title holder and alleged trustee, may rebut the presumption by submitting evidence that no trust was intended and that, to the contrary, the money used as consideration for the purchase was either: (i) a ***gift*** from X to Y; (ii) a ***loan*** from X to Y; or (iii) ***payment*** by X of a ***debt owing*** to Y.

1) Presumption Rebutted by Proof of Loan

If X loans the money to Y to buy the property, there is no resulting trust because the money belonged to Y (who had obligated himself to repay the loan) when the consideration was paid. On the other hand, if X lends money to Y to purchase property and title is taken in the name of X, the lender, there is a resulting trust in favor of Y as beneficiary because he supplied the consideration (funds he had borrowed) and yet did not receive title.

2) Recitals as to Who Paid Consideration Not Conclusive
A recital in the contract of sale, deed, or other document of title that X (or Y) paid the consideration is not conclusive. Extrinsic evidence will be received to establish not only how much the consideration for a transfer was, but also who paid it.

3) Effect of Agreement Between Parties as to Nature of Interest
The alleged trustee, Y, may ***partially*** rebut the presumption of a trust by showing, e.g., that X and Y had agreed that X (who paid the consideration) would have only a life estate or some other interest less than a full fee simple absolute in resulting trust.

e. Major Exception—No Trust Presumption Where Parties Closely Related
If X (the person supplying the consideration) is a close relative of Y (the one taking title), ***a gift*** from X to Y of the funds used for consideration, rather than a resulting trust, is presumed. The close family relationship between X and Y precludes any presumption of a trust.

1) Relationships Where Gift Is Presumed
A gift, not a trust, is presumed from the following relationships:

a) ***Parent*** supplies consideration, title taken in ***child's*** name.

b) ***Grandparent*** supplies consideration, title taken in ***grandchild's*** name.

c) ***Spouse*** supplies consideration, title taken in ***other spouse's*** name.

2) Relationships Where Trust Is Presumed
The normal presumption of a trust applies where the person furnishing consideration is the ***uncle, aunt, brother, sister, child, or grandchild*** of the person receiving title.

f. Second Exception—Unlawful Purpose
Equity will usually decline to imply a trust where the arrangement under which title is taken in Y's name is for an unlawful purpose, such as:

(i) X, who supplied the consideration, is trying to keep property from his creditors.

(ii) X is trying to avoid a tax liability.

(iii) Y is eligible for financing (e.g., he is a veteran) that X cannot get.

This exception is often justified on the ground that X cannot invoke the equitable resulting trust doctrine because he has "unclean hands." Under modern decisions, however, illegality of purpose may not always bar relief by way of resulting trust, especially where the gravity of the illegal scheme is slight compared to the unjust enrichment that will occur if Y is permitted to keep the property for which he did not pay.

g. Third Exception—Transferee Obtained Title Wrongfully
For there to be a resulting trust, the placing of title in Y's name must be with the

consent of X, the one furnishing consideration. Where Y has taken title without such consent, there is usually fraud or other wrongdoing sufficient to raise a ***constructive trust*** in favor of X (*see* C.2., *infra*).

h. Pro Rata Resulting Trusts

Where X pays only ***part*** of the purchase price, the resulting trust in his favor will be only for a pro rata portion of the title. Thus, if the total price is $8,000 and X paid $2,000 of it, the resulting trust doctrine makes X the equitable owner of an undivided one-fourth interest. He is a co-tenant with the title holder, Y (or perhaps with some other resulting trust beneficiary who paid all or part of the remaining $6,000).

2. Resulting Trusts Arising on Failure of Express Trust

Typically, S, the settlor, creates an express trust and conveys legal title to T, the trustee. A problem arises when the beneficiary of the trust cannot be located or is dead, or the trust is unenforceable or void for some other reason (e.g., it violated the Rule Against Perpetuities), and the settlor, S, in creating the trust, did not provide what should be done with the property in this event. Equity implies the answer: The express trust ends and a resulting trust arises in which S is the beneficiary. This resulting trust is dry or passive—T's duty as trustee of the resulting trust is simply to convey title back to S. If S is dead, his estate is the beneficiary. The property will go to his heirs or to those who took under his will.

a. Rationale

The theory of this type of resulting trust is that S must have intended the property to revert to him or his successors if the trust could not be carried out. T was intended only to manage the property and not to have full beneficial ownership. Because the trust has failed, T's duties have ended and he should not be entitled to retain title to the trust property.

b. No Resulting Trust Where Consideration Paid to Settlor

There is no resulting trust in favor of S where he received consideration for his conveyance of the property to the trustee. If someone other than T paid the consideration, a trust may result in favor of that person. If T paid it, T keeps title.

c. On Failure of Charitable Trust

Where the express trust is charitable and the designated beneficiary ceases to exist (e.g., the XYZ Home for the Blind closes down operation), a resulting trust in favor of the settlor is implied ***where no general charitable intent*** by S appears (so that the cy pres doctrine is inapplicable).

d. Limitation—Illegal Purpose

If the express trust that fails was established by S for an illegal purpose (e.g., to defraud S's creditors), equity may refuse to imply a resulting trust, allowing T to keep title plus the beneficial interest. Modern cases indicate that equity will imply a resulting trust despite the illegal scheme if the gravity of S's wrongdoing is slight compared to the unjust enrichment T would obtain if he were permitted to keep the trust property.

3. Resulting Trust Implied from Excess Corpus

A resulting trust in favor of the settlor also arises when the trust purpose is fully satisfied and

some trust property remains (e.g., trust was to construct a lodge building and the project is completed with funds left over). There could be a resulting trust of part of the corpus even where the trust is not completely terminated, if it is clear that the trust property is in excess of the amount needed to carry out the trust purpose.

C. CONSTRUCTIVE TRUSTS—WHEN WILL THEY BE IMPLIED?

A constructive trust is not really a trust at all. Rather, "constructive trust" is the name given to a ***flexible equitable remedy*** imposed by a court to prevent an unjust enrichment of one person at the expense of another as the result of ***wrongful conduct***, such as fraud, undue influence, or breach of a fiduciary duty. The constructive trustee's ***only*** duty is to convey the property to the person who would have owned it but for the wrongful conduct. This permits the wronged party to receive the very property of which he was deprived. This remedy is especially important where property has increased in value since it was wrongfully acquired.

Proof of the facts necessary to establish a constructive trust must be by ***clear and convincing evidence***.

1. Constructive Trust Arising from Theft or Conversion

If Y steals or converts property from X, ***title remains in X***, so there is no need to imply a trust to restore title to the owner, X. But if Y uses the proceeds of his theft to buy other property, he takes title to it. X can trace to this new property and have a constructive trust imposed upon it to prevent Y from profiting from his wrong. X is the beneficiary of the constructive trust; Y is the trustee. Y's sole duty is to convey the property to X, for once a constructive trust is declared by a court to exist, it is a dry trust and the trustee has no active management duties.

2. Constructive Trust Arising from Fraud, Duress, Etc.

Where Y, by fraudulent misrepresentation or concealment (*see* Multistate Torts outline), ***causes X to convey title to property to him***, X is entitled to a decree that Y holds the property in constructive trust for X's benefit. Moreover, if Y, after defrauding X out of property, sells or exchanges it for other items, the items would be the subject of a constructive trust under the tracing doctrine.

a. Property Conveyed to Third Party Who Is Not a Bona Fide Purchaser

If Y acquired title from X by fraud and conveyed title to a third party, Z, who is not a bona fide purchaser (e.g., he did not pay value or he knew that Y had acquired title by fraud), the constructive trust could be imposed against Z, requiring him as "trustee" to convey title back to the victim, X.

Accordingly, where the third party, Z, has given value to Y to acquire X's property and has acquired it with notice of fraud, the victim, X, will have a choice of two possible constructive trusts to pursue (i.e., X can have Z declared constructive trustee of the original property or have Y declared constructive trustee of the proceeds from the sale to Z).

b. Circumstances Giving Rise to Constructive Trust

As in the case of fraud, a constructive trust will be declared against a party who obtains title to property by ***duress, undue influence, or mistake of fact***. (Under modern

decisions, even a unilateral mistake of material fact by the owner of property, causing him to convey it, is a sufficient basis for implying a constructive trust.)

c. Where Will Is Concealed or Fraudulent

Where Y conceals X's true will and takes property under a prior will or by intestacy, he holds the property as constructive trustee for the aggrieved devisees and legatees. Where a party takes title to property under a forged or fraudulent will, he is a constructive trustee for decedent's aggrieved heirs or devisees, even if he was innocent of wrongdoing.

d. Interference with Contract Relations

The constructive trust remedy is also available against a party who obtains title to property by committing the tort of interference with contract relations.

3. Constructive Trust Arising from Breach of Fiduciary Duty

a. Fiduciary Relationship Defined

One who stands in a fiduciary relationship to another person owes that person a duty to deal fairly with his property. Examples of the fiduciary relationship are attorney to client, guardian to ward, director to his corporation, trustee to trust beneficiary, executor to estate, etc. The fiduciary's duty prohibits him from taking title to property belonging to the beneficiary (at least not without making full disclosure as to its value, etc.), and from seizing for himself an opportunity to acquire property that comes to him in his capacity as fiduciary. (*See, e.g.*, the Corporations outline on the duty of a director not to "usurp a corporate opportunity.")

b. Breach of Fiduciary Duty

If the fiduciary violates this duty, he will be required to hold the property he thereby acquires in constructive trust in favor of the person to whom he owes the duty. Under the same principle, if an attorney advising a client on his will permits the client to leave property to the attorney without the attorney's making full disclosure of all he knows concerning its value, the attorney will, on the client's death, hold title to the property in constructive trust for the estate of the client.

4. Constructive Trust Arising from Homicide

If one person kills another and is convicted of murder or manslaughter, he holds any property he acquires from the victim by will or intestacy as constructive trustee in favor of whomever would have taken the property (e.g., a more distant relative of the victim) had the killer predeceased the victim. (*See* Wills outline.)

a. Where Victim and Killer Held Property in Joint Tenancy

Where the victim held property in joint tenancy with the killer, the latter obtains full legal title to the property. However, he holds at least one-half interest therein as constructive trustee for the estate of the victim. In some states, he holds the whole fee in constructive trust for the victim's estate, less his own life estate in one-half.

5. Constructive Trust Arising from Breach of Promise

a. General Rule—No Constructive Trust

Generally, a person's mere breach of a promise is not a sufficient basis for implying a constructive trust. Thus, where A conveys real property to B on B's oral promise either to hold it as trustee for C or to convey it to C, and B later repudiates his promise, there is no constructive trust. (If the rule were otherwise, the purpose of the Statute of Frauds would be frustrated.) However, A may be able to get a constructive trust imposed in his favor. (A growing number of cases and the Restatement (Third) of Trusts say he can.) A can then convey the property directly to C. The theory is that to permit B to keep the property would result in unjust enrichment, which thwarts the purpose of the Statute of Frauds.

1) Consideration for Promise Irrelevant

The general principle that a mere breach of promise will not raise a constructive trust uniformly applies even where there was consideration for the promise. A may recover damages and, in some circumstances, obtain specific performance, but a constructive trust will not be imposed.

b. Exceptions to General Rule

1) Breach of Fraudulent Promise—Fraud in the Inception

If A conveys land to B on his oral promise to hold it for, or convey it to, C, and if ***at the time he made the promise B did not intend to keep it***, there is almost certainly fraud (misrepresentation) and a constructive trust will be imposed against B in favor of C (or perhaps in favor of A, who will then be able to convey directly to C).

2) Breach of Promise by One in Confidential Relationship

Where the grantee who orally promises to hold the property in trust is in a confidential relationship with the grantor (e.g., family relation, attorney-client, business partners), the breach of the grantee's promise is constructively fraudulent and the agreement to hold in trust may be shown for the purpose of imposing a constructive trust for the benefit of the intended beneficiaries. The grantee's promise must be proved by clear and convincing evidence.

This is the big loophole in the Statute of Frauds. Such a confidential relationship exists not only where there is a fiduciary relationship such as attorney-client, but also where the transferor, because of family relationships or otherwise, is accustomed to being guided by the judgment of the transferee. Very seldom will a person give a deed of land to another on an oral trust where a confidential relationship does not exist.

3) Breach of Promise Concerning a Will or Inheritance

Broken promises to a decedent concerning devolution of his property on death are a major exception to the general rule that a mere breach of promise is an insufficient basis for imposing a constructive trust. This exception appears to stem from the fact that when the promise is broken, the promisee is dead, unable to personally seek enforcement, and thus particularly in need of assistance from equity.

Examples: 1) H wills all of his property to W in reliance on her oral promise to leave it to H's children at her death. H dies; W takes the property,

but on her death wills it to X. X holds title as constructive trustee for H's children. (*See* Wills outline on will contracts.)

2) A writes his will leaving his property to B (or forgoes changing a prior will in favor of B) in reliance on B's promise to hold the property for C or to convey it to C. A dies; B takes title and does not carry out his promise. The majority rule holds that B is a constructive trustee for C. The same rule applies where A forgoes writing any will and dies intestate in reliance on a promise by his intestate heir, B, to hold for or convey to C. (*See* discussion of secret and semi-secret trusts, II.B.2.b., *supra*.)

In both examples 1) and 2), the required promise of the constructive trustee can be implied, as where the testator asks him if he will dispose of the inheritance or bequest in a certain manner and he remains silent under the circumstances, suggesting acquiescence.

3) X renders services to Y in reliance on Y's promise to leave property to X, and Y does not do so. Some courts will find the heir or devisee of Y who has taken title on Y's death to be a constructive trustee for X, particularly ***where X's services are difficult to value*** so that an action for quasi-contract against Y's estate is not an adequate remedy; ***or where X would suffer unconscionable injury*** because he has been induced to make a detrimental ***change of position*** in reliance on the oral agreement. Other jurisdictions hold that the Statute of Wills or the Statute of Frauds bars the constructive trust remedy in this context.

4) Promise Causing Debtor to Forgo Bidding at Foreclosure Sale

Some jurisdictions will impose a constructive trust on the promisor where his promise to buy and convey land to the debtor causes the debtor to forgo bidding at the foreclosure sale.

Example: A's land is to be sold in a foreclosure sale. B promises to buy the land for A's benefit; in reliance, A does not bid at the sale. B buys the land but breaks his promise to hold for A or convey to A. A number of jurisdictions will hold B a constructive trustee for A, on condition that A repay B's expenses, particularly where B's actual damages are hard to value. Other jurisdictions hold that the Statute of Frauds bars the constructive trust remedy under such facts.

c. Standard of Proof—Clear and Convincing Evidence

The party seeking to have a constructive trust imposed must prove the facts he relies on (e.g., fraud, breach of confidence, theft) by clear and convincing evidence (i.e., more than a mere preponderance).

D. OBLIGATIONS OF TRUSTEE OF CONSTRUCTIVE OR RESULTING TRUST

1. Duty to Convey Title

From the time the court declares a constructive or resulting trust to exist, ***the sole duty of the***

trustee is to convey legal title to the beneficiary. If he does not do so, he is responsible for the profits the beneficiary would have earned. This problem is usually avoided by the court decreeing title to be in the beneficiary at the time it finds an implied trust to have arisen.

2. Other Trustee Duties and Liabilities—Constructive Trusts

When a court declares a constructive trust to exist, such a trust is retroactive to the later of: (i) the date the trustee took title; or (ii) the time of the fraud, breach of promise, or other wrongful conduct on which the trust is based.

a. All Profits Taken from Property

From that date, the trustee is accountable to the beneficiary for all profits he has taken from the property and, if he has used it himself, its fair rental value.

b. Profits on Transactions in Breach of Fiduciary Duty

Also, from that date, the trustee owes a fiduciary duty to the beneficiary to deal fairly with the property and to make full disclosure, and he will be accountable for profits made on transactions where he breached this duty.

c. Liability for Damage to Property

During this period of time and prior to conveying title to the beneficiary, the trustee will be held liable for damages to the property that he willfully or negligently causes.

d. No Duty to Invest

The trustee has no duty to invest the trust property.

3. Other Trustee Duties and Liabilities—Resulting Trusts

The rules above are also applicable to trustees of resulting trusts from the date on which they arise:

a. In the case of a resulting trust on failure of an express trust, from the date the express trust becomes void, or from the date it becomes inoperable for lack of a beneficiary;

b. In the case of excess corpus, from the date the trust purpose is completed; and

c. In the case of a purchase money resulting trust, from the date the trustee takes title to the property.

4. Tracing Assets

The doctrine of tracing trust assets is fully applicable to dealings by the trustee of a constructive or resulting trust with trust property and the profits from trust property.

E. APPLICATION OF EQUITABLE PRINCIPLES

Actions in which a party seeks a declaration imposing a resulting or constructive trust were historically actions in equity. Thus, most equitable principles are applicable.

1. Party Claiming as Beneficiary Must Not Have "Unclean Hands"

The party claiming to be the beneficiary of such a trust may be denied relief if he has "unclean hands" (i.e., his conduct regarding the matter at issue has been unlawful or inequitable, e.g., if he has made misrepresentations to other parties).

2. Party Claiming as Beneficiary Must Be Willing to "Do Equity"

The party claiming to be the beneficiary of such a trust and seeking relief in equity must himself "do equity." For example, if the alleged trustee has in good faith paid taxes on the property, paid for sewer lines and the like, or constructed improvements on the land, the beneficiary must agree to make reasonable reimbursement to the trustee.

3. Exception—Adequate Remedy at Law Does Not Preclude Relief

While most equitable principles apply to actions seeking to impose a resulting or constructive trust, there is one important exception: These remedies are generally available even though the one claiming to be the beneficiary has an adequate remedy at law (e.g., a suit for damages). In answering a question on constructive or resulting trusts, you should expressly state that an adequate remedy at law ordinarily does not preclude such type of equitable relief. However, as noted above, an adequate remedy in damages at law may preclude a constructive trust in two particular instances: (i) breach of oral promise to make a will; and (ii) breach of oral promise to hold property purchased at a foreclosure sale for the benefit of the promisee.

APPROACH TO EXAMS

TRUSTS

IN A NUTSHELL: A trust is a fiduciary relationship with respect to property in which one person (the ***trustee***) holds the legal title to the trust property (the ***res***) subject to enforceable equitable rights in another (the ***beneficiary***). It is a device whereby one or more persons manage the property for the benefit of others. The trust must have a valid ***trust purpose***. The trustee ordinarily has legal title to the property, and the beneficiaries have equitable title. The testator or grantor who creates an express trust is the ***settlor***, who must have had the ***intent*** to create the trust. Consideration is not required for the creation of a trust; in fact, trusts are usually created gratuitously.

I. REQUIREMENTS OF AN EXPRESS PRIVATE TRUST

A. Settlor with Capacity and Present Intent to Create a Trust

1. Must intend trust to take effect immediately
2. Must express intent by words or conduct while settlor owns the property
3. Precatory expressions (hope, wish, suggestion) result in inference that no trust was intended, but inference may be overcome by other evidence

B. Trustee

1. Failure to name trustee (or failure of trustee to accept or qualify) does not defeat a testamentary trust; court will appoint trustee
2. Inter vivos trust will fail without trustee because there can be no valid delivery and transfer of trust property (*see* below)
3. Trustee must have duties
4. Settlor may declare himself trustee

C. Trust Property (Res)

1. Property may be of any type, including future interests
2. Must be property that settlor has the power to convey
3. Must be described with certainty

D. Beneficiaries

1. Must be capable of taking and holding title to property
2. Must be definite (susceptible of identification when their interests come into enjoyment); *e.g.*, "friends" is insufficient
3. Notice not required but beneficiary must accept; acceptance is presumed

E. Valid Trust Purpose

1. Trust or provision must not be:
    a. Illegal;
    b. Impossible to achieve;
    c. Contrary to public policy (*e.g.*, induce crimes, torts, divorce, child neglect, etc.); or
    d. Intended to defraud settlor's creditors based on illegal consideration
2. Effect of invalid condition subsequent—condition stricken, but trust is valid
3. Effect of invalid condition precedent—condition stricken, but court decides whether interest is valid or fails

F. Formalities

1. Inter vivos trust—created during settlor's life
   a. Declaration of trust by property owner that he holds in trust, or
   b. Transfer of property by the settlor to the trustee
   c. No writing required unless trust of land
2. Testamentary trust—created by settlor's will
   a. Essential terms must be ascertained from will, incorporated document, facts of independent significance, or exercise of power of appointment
   b. Secret trust (absolute gift but trust intended)—constructive trust imposed
   c. Semi-secret trust (gift in trust without beneficiary)—resulting trust for testator's heirs

II. CHARITABLE AND HONORARY TRUSTS

A. Charitable Trusts

1. Purpose must benefit the public (*e.g.*, poverty relief, education, health)
2. Must have indefinite beneficiaries
3. May be perpetual—Rule Against Perpetuities ("RAP") does not apply
   a. RAP ***does not*** apply to limitations that shift beneficial interest from one charity to another (charity-to-charity exception)
   b. RAP ***does*** apply to a limitation shifting the interest from private use to charitable or from a charitable use to a private use
4. Enforceable by attorney general, not settlor or beneficiaries
5. Cy pres—if settlor's intended purpose is impracticable, unlawful, or wasteful, court substitutes new charitable purpose
   a. Must find settlor had general charitable intent, not just interested in the named charity
   b. Court will select another purpose as near as possible
   c. UTC—settlor's general charitable intent is presumed and application of cy pres is mandatory

B. Honorary Trusts

1. Not for charitable purpose, but no private beneficiaries who can enforce trust (*e.g.*, trusts for pets, graves)
2. Not enforceable, but trustee may choose to carry it out
   a. Under UTC, enforceable for 21 years
3. If trustee does not carry it out, a resulting trust imposed for settlor's estate

III. TRANSFER OF BENEFICIARY'S INTEREST AND CREDITOR'S RIGHTS

A. Beneficiary's Equitable Interest Is Alienable

Beneficiary may voluntarily transfer interest in trust, and his creditors may levy on his interest

B. Spendthrift Trusts

1. Spendthrift trust provides that beneficiary may not voluntarily or involuntarily transfer his interest (*i.e.*, cannot sell or give away interest, and creditors cannot reach it)
2. Not valid if settlor is also a beneficiary

3. Dependents, government, those supplying necessities may be able to reach the protected interest

C. Discretionary Trusts—Trustee Has Discretion to Pay or Withhold Income or Principal

1. Before trustee makes discretionary payment, interest cannot be reached by creditors
2. After trustee elects to make payments, must pay creditors directly if he has notice—unless there is a spendthrift restriction

D. Support Trust Cannot Be Assigned or Reached Even Without Spendthrift Clause

IV. MODIFICATION AND TERMINATION OF TRUST

A. By Settlor

1. Must reserve right to revoke or modify
   a. UTC: Trusts presumed revocable
2. Power to revoke includes power to modify

B. By Beneficiaries

1. May terminate or modify if:
   a. All beneficiaries consent (watch for remote unborn beneficiaries), ***and***
   b. It will not interfere with a material purpose (*Claflin*)
      1) Examples of purposes precluding termination—distribution at specific age, preserving property for remainderman, protecting beneficiary from own poor judgment
2. Joinder of settlor waives material purpose
3. Spendthrift trust cannot be terminated without settlor's consent

C. By Court

1. May terminate if trust purposes accomplished or become illegal or impossible
2. May modify if changed circumstances make compliance incompatible with trust purpose

V. TRUST ADMINISTRATION

A. Powers of Trustee

1. Power to sell and lease unless limited by trust instrument
2. Power to incur expenses—necessary and ordinary management expenses allowed; power to improve property usually not inferred
3. Power to borrow money must be granted in trust instrument

B. Duties of Trustee

1. Care—standard is that of reasonably prudent person managing own property
2. Loyalty—no self-dealing
   a. Cannot buy assets from or sell assets to the trust
   b. Cannot borrow from trust or loan to trust
   c. Cannot personally gain through position

d. Corporate trustee cannot buy (but may retain) own stock
e. If duty breached, beneficiary may:
1) Set aside transaction,
2) Recover profit; or
3) Ratify the transaction
f. Settlor can waive self-dealing restrictions

3. Duty to separate trust property—no commingling with own property or other trusts' property
a. Commingled property lost or destroyed presumed to be trustee's
b. If portion of commingled assets increases in value, presumed to be trust assets
c. If portion of commingled assets declines in value, presumed to be trustee's

4. Duty to perform personally—cannot delegate administration of trust

5. Duty to preserve property and make it productive
a. Investments must be prudent; trustee must use reasonable care, skill, and caution
1) Trustees with special skills held to higher standard
2) Trustee must diversify investments
3) Investment decisions may be delegated if a prudent trustee would do so
b. Prudence evaluated in terms of overall strategy

C. Trustee's Liability

1. Liable to beneficiaries for breach of trust (surcharge action)
2. Losses from one breach may not be offset against gains from another
3. Defenses—laches or express or implied consent to the breach by beneficiaries
4. Exculpatory clauses relieving trustee of all liability or liability for bad faith, intentional breach, or recklessness are void
5. Trustee liable to third parties for contracts and torts, but usually entitled to indemnification

D. Allocation of Receipts and Expenses—Uniform Principal and Income Act ("UPAIA")

1. Trustee must administer trust impartially; must be fair to all beneficiaries

2. Interest and dividend income to income beneficiary
a. If such distribution does not effectuate trust purpose and is unfair, trustee may adjust between principal and income

3. Receipts
a. Income—rental income, interest on bond or CD, money received from entity, liquidating assets and mineral rights—10% rule
b. Principal—proceeds of sale of asset, eminent domain awards, capital gains, property other than money received from entity, insurance proceeds where trust is beneficiary, liquidating assets and mineral rights—90%

4. Expenses
a. Income—one-half trustee and consultant compensation; one-half accounting and legal expenses; ordinary expenses (interest payments on debt, ordinary repairs, taxes, insurance premiums)

b. Principal—one-half trustee and consultant compensation; one-half accounting and legal expenses; principal payments on debt; environmental costs

VI. WILL SUBSTITUTES

A. Revocable Trusts

1. Interest passes during life but becomes possessory at death
2. Pour-over from will to revocable trust
    a. Trust may be established before, after, or concurrently with will
    b. Trust may be amendable and revocable
    c. Gift is valid even if trust unfunded during the settlor's lifetime

B. Life Insurance Trusts

1. Contingent beneficiary trust allowed (*e.g.*, "proceeds to A, but if A does not survive, to B in trust for my children")
2. Assignment of policy trust allowed (assign policy to party to hold in trust)

C. Totten Trust Bank Accounts

1. Trustee-depositor has full rights during lifetime
2. Revoked by withdrawals, any other lifetime act indicating intent to revoke, or by will
3. Subject to depositor's creditors' claims
4. Automatically terminates if beneficiary predeceases depositor

VII. RESULTING AND CONSTRUCTIVE TRUSTS

A. Resulting Trusts

1. Purchase money resulting trusts—person taking title did not supply consideration; sole duty is to convey title to one furnishing consideration
    a. No resulting trust presumption if parties closely related
2. Failure of express trust—resulting trust arises with settlor as beneficiary
3. Excess corpus—if trust property remains after purpose fulfilled, resulting trust for settlor arises

B. Constructive Trusts—Equitable Remedy to Prevent Unjust Enrichment

1. Theft or conversion
2. Fraud, duress, undue influence, mistake, or interference with contract relations
3. Breach of fiduciary duty (*e.g.*, attorney/client, director/corporation, trustee/beneficiary)
4. Breach of fraudulent promise, promise by one in confidential relationship, promise concerning will or inheritance, promise to forgo foreclosure bid

ESSAY EXAM QUESTIONS

INTRODUCTORY NOTE

The essay questions that follow have been selected to provide you with an opportunity to experience how the substantive law you have been reviewing may be tested in the hypothetical essay examination question context. These sample essay questions are a valuable self-diagnostic tool designed to enable you to enhance your issue-spotting ability and practice your exam writing skills.

It is suggested that you approach each question as though under actual examination conditions. The time allowed for each question is 30 minutes. You should spend 10 minutes spotting issues, underlining key facts and phrases, jotting notes in the margins, and outlining your answer. If you organize your thoughts well, 20 minutes will be more than adequate for writing them down. Should you prefer to forgo the actual writing involved on these questions, be sure to give yourself no more time for issue-spotting than you would on the actual examination.

The BARBRI technique for writing a well-organized essay answer is to (i) spot the issues in a question and then (ii) analyze and discuss each issue using the "CIRAC" method:

C — State your ***conclusion*** first. (In other words, you must think through your answer ***before*** you start writing.)
I — State the ***issue*** involved.
R — Give the ***rule(s)*** of law involved.
A — ***Apply*** the rule(s) of law to the facts.
C — Finally, restate your ***conclusion***.

After completing (or outlining) your own analysis of each question, compare it with the BARBRI model answer provided herein. A passing answer does ***not*** have to match the model one, but it should cover most of the issues presented and the law discussed and should ***apply the law to the facts*** of the question. Use of the CIRAC method results in the best answer you can write.

EXAM QUESTION NO. 1

Otis loaned Amy $10,000 and Ben $20,000, and took their promissory notes as evidence of the loans.

Three months later, before leaving for an extended trip to Europe, Otis did the following:

- Mailed a letter to Amy with the promissory notes of Amy and Ben enclosed. In the letter Otis stated that he wanted Amy to hold the two debts ($10,000 and $20,000) in trust for Chloe.
- Executed and delivered to Don an unattested instrument purporting to transfer to Don in trust for Chloe such Ford Motor stock as Otis should own at the time of his death. (Otis then owned 500 shares of Ford Motor stock.)
- Validly executed a will that contained these provisions:

    1. I bequeath $30,000 to Xavier hoping that he will let Yolanda have a good part of it.
    2. I bequeath all of my AT&T stock to Don upon trust for such purposes as I have communicated to him.
    3. I give the rest of my property to Rachel.

Prior to the execution of the will, Otis told Don that he wanted him to hold the AT&T stock that he would receive under Otis's will in trust for Chloe.

Otis was killed in an auto accident while in Europe and left no wife or descendants surviving. At Otis's death who is entitled to (1) Amy's debt of $10,000, (2) Ben's $20,000 debt, (3) Otis's 500 Ford Motor shares, (4) Otis's 300 AT&T shares, and (5) the $30,000 bequest contained in the first item in Otis's will? Explain.

EXAM QUESTION NO. 2

In consideration of the payment of $50,000 by Andrew to Beth, Beth transferred Whiteacre to Carl in trust to pay the income from the land to Andrew for his life and then to convey the land to Diane. The trust instrument provided that the interests of Andrew and Diane should not be transferable by them or subject to the claims of their creditors, and expressly authorized Carl to withhold the income.

Subsequently, Beth transferred 500 shares of Google stock to Carl in trust to pay the income to Emily until Emily should reach age 30, and then to transfer the shares to Emily.

The following year, Beth died and by will bequeathed $100,000 to First Bank in trust to pay the income to Frank for life, and then to distribute the corpus to Frank's children.

Answer the following questions:

(1) May a creditor of Andrew, who sold Andrew a yacht, reach the income from Whiteacre while it is still in Carl's hands?

(2) May a creditor of Diane, who sold Diane a luxury automobile, reach Diane's trust interest in Whiteacre while Andrew is alive?

(3) Emily, age 26, asks Carl to terminate the trust of the Google stock and transfer the 500 shares to her. Carl refuses.

(a) May Emily compel Carl to transfer the stock?

(b) If Carl decides to transfer the stock to Emily, may Carl incur liability by so doing?

(4) Frank and his three children, all over 21 and mentally competent, request First Bank to terminate the trust and transfer the $100,000 to them. First Bank refuses. May Frank and his children compel termination of the trust?

EXAM QUESTION NO. 3

By her will, Tara put one-third of her net probate estate into a private, noncharitable trust. Tara's will named Xander, Yvonne, and Zeke (all of whom survived Tara) as trustees. On administration of Tara's estate, Xander, Yvonne, and Zeke received the subject matter of the trust and undertook their duties as trustees. Read the following three ***separate, alternative*** assumptions of fact, and respond to the questions.

(1) Assets of the trust include a commercial building. Tara's will directed the trustees to sell the building and invest the proceeds of sale in corporate bonds. Xander and Yvonne wish to sell the building and invest in negotiable bonds issued by Innovative, Inc., a commercial corporation. Zeke believes the proposed investment to be imprudent and refuses to consent to the sale and investment. Can Xander and Yvonne without fear of future liability proceed with the proposed sale and investment on the basis of majority vote?

(2) Assets of the trust at Tara's death include a parcel of unimproved land. Should the trustees retain the land as an investment?

(3) Assets of the trust at Tara's death include items that are properly disposed of by holding a public sale. Xander, one of the trustees, wishes to purchase some artwork at the sale, and tells Yvonne and Zeke that he intends to bid at the sale. What should Yvonne and Zeke do?

Discuss fully.

EXAM QUESTION NO. 4

Hal's will, duly admitted to probate, creates a $750,000 testamentary trust for the benefit of Hal's widow, Wendy. The will provides that all the income of the trust is to be paid to Wendy during her life; thereafter, the principal is to be paid over to Hal's granddaughter, Grace.

Tom has just accepted appointment as trustee of the trust and seeks your advice with respect to the following:

The trust assets include a $500,000 commercial building rented out to tenants. To maintain the property, it is essential that current repairs be made promptly, and it is desirable that certain permanent improvements (e.g., replacement of wood floors with concrete) be undertaken if tenants are to be kept. Tom asks you as his attorney (1) whether costs of current repairs and taxes are chargeable against current receipts; (2) whether it is permissible to make permanent improvements, and if costs of permanent improvements are chargeable against principal; (3) whether Tom may mortgage the building to raise money for making improvements; and (4) whether Tom is personally liable on the contracts he makes as trustee. Advise Tom on the law with respect to these matters. Explain.

ANSWERS TO ESSAY EXAM QUESTIONS

ANSWER TO EXAM QUESTION NO. 1

(1) & (2) **Amy's and Ben's Debts**

The debts of Amy and Ben are held in a valid trust for Chloe. Elements of a valid trust are: a trustee, a beneficiary, trust property, an intention to create a trust, and a valid trust purpose. Here, Chloe is the beneficiary, the debts evidenced by promissory notes are the trust property, the letter to Amy clearly indicates an intent to create a trust, and nothing in the facts indicates a trust purpose that is illegal or against public policy. The issues are whether the debts are the proper subject matter of a trust and whether Amy can serve as trustee.

The debts are a proper trust res. A trust res may be property of any type—real or personal, tangible or intangible, legal or equitable. Thus, a debt, which is intangible property, is a proper res. Amy cannot, however, be the trustee of the trust that contains her own debt as the trust res. A person cannot be the trustee of her own debt to another. Amy, as trustee, cannot sue herself, as debtor, to collect the debt. Because Amy could not carry out all of the duties of a trustee, she cannot qualify. This fact probably will not cause the trust to fail, however. A basic rule of trust law is that no trust fails for lack of a trustee. The court will appoint someone to serve as trustee, provided all of the other elements and requirements are present. The reason is that the settlor's primary intention was to create a trust to carry out the specified objectives (here to provide something for Chloe); the naming of the specific trustee was incidental to this primary purpose. The mere fact that the named trustee cannot serve is no reason to defeat the settlor's primary intention, so the court will appoint someone else to carry out the trust. There is no reason to believe that Otis intended the trustee powers to be personal to Amy; so there is no impediment to the court's naming a substitute trustee.

There is an argument that the trust of Amy's debt will fail, and thus pass by the residuary clause of Otis's will to Rachel. If, because of Amy's disqualification, Amy is considered absent or dead, the trust, being an inter vivos trust, will fail for lack of a valid delivery. This argument likely will not succeed given the fact that Otis clearly intended title to the property to pass and that it be held in trust for Chloe. The settlor's intent is the crux of the delivery requirement. It seems unlikely that an equity court will conclude that the trust fails because of a technicality; i.e., that Otis did not know that Amy was disqualified from acting as trustee of her own debt.

Thus, the trust will most likely be held valid with respect to both debts, and a new trustee will be named, at least with respect to Amy's debt.

(3) **500 Ford Motor Shares**

The Ford Motor stock passes to Rachel under the residuary clause of Otis's will. The issue is whether the unattested instrument delivered to Don created a valid trust for Chloe's benefit.

Here, the requisite intent to create a present trust was lacking, and there was no valid delivery of assets so as to create a valid inter vivos trust. Clearly, because Otis stated that he wished the trust to contain all of the Ford stock owned at his death, he intended to create a testamentary trust. A testamentary trust is created by will and must, therefore, comply with the formalities dictated by the Statute of Wills. Because the instrument delivered to Don is unattested, it does not comply with the Statute of Wills and will not qualify as a testamentary trust. Because the trust fails, the stock falls into the residue of Otis's estate and will pass to Rachel.

(4) **300 AT&T Shares**

Under the traditional majority view, the AT&T stock will pass to Rachel, the residuary legatee. (Under the minority view, the AT&T stock would pass to Chloe, the intended beneficiary.) The issue is whether the bequest and prior oral instructions to Don created a valid trust for Chloe's benefit.

This is a semi-secret trust because the trust is clear from the terms of the will, but no beneficiary is named. When this happens and the testator dies, as here, while relying on an oral promise by the intended trustee to hold the property in trust, the property is distributed as follows: The designated trustee, Don, will not take the gift because on the face of the will it is clear he is given no beneficial interest. Most courts follow the rule that a resulting trust is implied for the benefit of the settlor or his estate (here, the residuary legatee). This way it is not necessary to breach the Statute of Wills by hearing extrinsic evidence of the testator's intent. Thus, the stock will be held by Don on a resulting trust for Rachel.

(5) **$30,000 Bequest**

The $30,000 will pass to Xavier as the absolute owner. Yolanda has no enforceable interest in the $30,000. The issue is whether the phrase "hoping that he will let Yolanda have a good part of it," creates a trust in favor of Yolanda.

Whether precatory words, such as "hope," create a trust or merely reveal what the transferor would like to have done with the property without requiring the transferee to do it, is a question to be determined from the facts. However, most courts infer from such language that no trust was intended, and that the transferor merely wished his desires to be known. This inference may be overcome by: (i) definite and precise directions, (ii) directions addressed to a fiduciary, (iii) the fact that a failure to impose a trust will result in an unnatural disposition, or (iv) the fact that the transferor had been supporting the "beneficiary." Nothing in the facts given indicates the presence of any of these factors that would overcome the inference that no trust was intended. In fact, the directions given are exceptionally vague. Therefore, the court will most likely find that there is no trust, and Xavier takes the $30,000 free and clear.

ANSWER TO EXAM QUESTION NO. 2

(1) **Andrew's Creditor**

Andrew's creditor can reach the income from Whiteacre while it is still in Carl's hands. The issue is whether a beneficiary who furnished the consideration for the creation of a spendthrift trust can protect his interest in the trust from his creditors.

A spendthrift trust is one in which a valid restraint on alienation is imposed, expressly or impliedly, by the terms of the trust, providing that the beneficiary cannot transfer his interest voluntarily and that his creditors cannot reach it for the satisfaction of their claims. Thus, the beneficiary cannot sell or give away his right to future income, and his creditors cannot reach these rights. However, the settlor of a trust cannot protect his own interests from his creditors by the inclusion of a spendthrift provision. If a person furnishes the consideration for the creation of a trust, he is the settlor, even though the trust is created by another person.

Here, the trust instrument provides that the interests of Andrew and Diane cannot be transferred by them or subject to the claims of their creditors. Thus, this is a spendthrift trust. The facts state that Andrew gave Beth $50,000 in consideration for the creation of this trust. Therefore, Andrew is the settlor of this trust. As settlor, Andrew cannot use an otherwise valid spendthrift provision to protect his own interest. Thus, the spendthrift provision is invalid as it pertains to Andrew, and Andrew's creditor can reach the income of the trust.

(2) **Diane's Creditor**

Diane's creditor probably cannot reach Diane's interest in the trust while Andrew is alive. The issue is whether a creditor can reach the remainder interest in a spendthrift trust.

The trust in this case states that the income from Whiteacre goes to Andrew for his life, and then Whiteacre passes to Diane. Therefore, Diane has an equitable remainder interest. Because the majority

of courts uphold the validity of a spendthrift restriction on an equitable remainder, Diane's creditor probably will not be able to reach Diane's interest in the trust while Andrew is alive.

(3) **Termination of Trust by Emily**

(a) **Material Purpose:** Emily may not compel Carl to transfer the Google stock to her. The issue is whether Emily, as the sole beneficiary, has the power to terminate the trust.

The majority view permits termination of a trust by a beneficiary only if: (i) all beneficiaries are in existence and consent, and (ii) the termination will not interfere with a material purpose of the settlor. Because Emily is the only beneficiary and she wishes to terminate the trust, clearly the first requirement is satisfied. The next step is to determine Beth's purpose in establishing the trust. When a settlor creates a trust to pay the income to an individual until that individual reaches a designated age and then to distribute the principal to that same person, the court will not allow termination by the sole beneficiary. The reason is that the primary purpose of the trust in this situation must be to keep the principal of the property out of the beneficiary's hands until she reaches the designated age. Because Emily is not to receive the principal of this trust until she reaches age 30, the court will assume that keeping the stock out of Emily's hands until that time was a material purpose of Beth. Thus, Emily will not be able to compel Carl to distribute the stock.

Note that the answer would change if Beth were to join Emily in asking that the trust be terminated. If all beneficiaries request the termination of the trust and termination would be precluded only by a material purpose of the settlor, the courts generally agree that the joinder of the settlor in the request for termination will waive the purpose and permit the beneficiaries to compel termination. Obviously, Beth's death prevents this from happening here.

(b) **Carl's Liability:** Carl would not be liable if he transfers the stock to Emily. The issue is whether the trustee is liable for the early termination of the trust.

If all beneficiaries consent and the trustee is willing to comply with their request for termination, a termination of the trust and a distribution of the corpus in the agreed fashion among the beneficiaries will leave the trustee without any liability. This is so even though the termination of the trust would violate an essential purpose of the settlor. Because Emily, the only beneficiary of the trust, wishes to terminate the trust, Carl, the trustee, will not incur liability by so terminating. There is no one to hold the trustee liable for his act, since Emily is estopped from bringing an action because of her consent.

(4) **Termination of Trust by Frank and His Three Children**

Absent the consent of a court-appointed representative, Frank and his now living children cannot compel the termination of the trust. The issue is whether a trust can be terminated without the consent of a possible or unborn beneficiary.

As discussed above, ***all*** beneficiaries must consent to the termination of the trust. The facts state that the trust will pay income to Frank for life, corpus to Frank's children. Because Frank is still alive, he can have more children. Thus, the possibility of an unborn beneficiary precludes the consent of ***all*** beneficiaries. Because ***all*** potential beneficiaries cannot consent to the trust's termination, Frank and his now living children cannot compel the termination of the trust. However, under the UTC, a representative can be appointed to represent the interests of minor, unborn, or unascertained beneficiaries. Therefore, if the court were to appoint a representative, it would be possible to obtain the consent of all beneficiaries.

ANSWER TO EXAM QUESTION NO. 3

(1) **Commercial Building**

Whether Xander and Yvonne may without fear of future liability proceed with the proposed sale and

investment on the basis of majority vote depends on the law followed by the jurisdiction regarding the exercise of joint powers.

In many states, investment decisions by co-trustees must be ***unanimous*** unless there is evidence of an intent to the contrary by the settlor. In other states and under the Uniform Trust Code ("UTC"), however, trust powers may be exercised by a ***majority*** of trustees. However, even in states that require unanimity, if a co-trustee's continued presence is hindering the purposes of the trust, the other trustees may be able to obtain a court order removing the co-trustee and appointing a substitute trustee.

Here Tara, as settlor, expressly directed the trustees to sell the commercial building and invest the sale proceeds in corporate bonds. That is exactly what Xander and Yvonne propose to do. Unless Zeke's objection is to these particular bonds, Xander and Yvonne are on firm ground in arguing that Zeke is hindering the purpose of the trust and therefore should be removed.

(2) **Unimproved Land**

The trustees probably should not retain the parcel of unimproved land as an investment. The issue is whether retaining unimproved land as a trust asset is prudent.

Trustees of a trust are under a duty to maximize the profitability of trust assets. Most states follow some form of the "prudent investor" rule, whereby a trustee must exercise that degree of skill, judgment, and care that persons of prudence would, by considering the purpose, terms, distribution requirements, and other circumstances of the trust.

The trustees have a duty to use reasonable care and skill to provide a reasonable rate of return from each and every trust asset. If land is involved, the trustees are under a duty to lease or manage the property so as to produce income. If the land cannot be made productive (and the trust instrument does not require its retention), the trustees' duty to the income beneficiaries obligates them to sell within a reasonable time and invest the proceeds more prudently.

Here, unless the trust requires the trustees to retain the unimproved land or it is not too speculative to anticipate the unimproved land producing income (e.g., through the lease of mineral interests), retaining the land would be a breach of their duty to make the trust property productive.

(3) **Artwork**

Yvonne and Zeke must take the appropriate steps to avoid liability for Xander's self-dealing. The issue is trustees' liability to the beneficiaries for a breach of trust committed by a co-trustee.

A trustee has a duty of loyalty, which requires the trustee to administer the trust property according to the interest of the beneficiaries alone. This duty prohibits the trustee from placing himself in a position in which a conflict of interest might arise. Thus, a trustee cannot purchase trust property. A prohibited transaction is not made permissible because it takes place at a public sale. Here, if trustee Xander bids on artwork at the public sale, he breaches his fiduciary obligation to the trust beneficiaries not to engage in self-dealing.

Yvonne and Zeke should try to dissuade Xander from buying the artwork. If that fails, they should refuse to join in any transfer to Xander if Xander is successful in bidding at the sale. A transfer by less than all of the trustees (or in some jurisdictions, less than a majority) is voidable. They could also notify the beneficiaries and the court of Xander's actions. Xander's purchase of trust assets is a breach of trust and, thus, grounds for removal.

If Xander purchases the artwork, the beneficiaries may (i) set aside the transaction, (ii) recover the profit made by Xander, or (iii) affirm the transaction. Yvonne and Zeke are not liable for Xander's breach of trust unless they participate, approve, or acquiesce in the breach; negligently disregard their own duties of administration so as to facilitate the breach; or conceal the breach or fail to seek proper redress by Xander.

ANSWER TO EXAM QUESTION NO. 4

A trustee is under a fiduciary duty in the management of trust assets to insure the security and fairness of its administration. The trustee must use the same degree of judgment, skill, and care as would a "prudent investor" in the management of the trust assets. Unless otherwise stated in the trust instrument, a trustee must not only preserve the trust assets but also use the trust property in a productive manner. The trustee is responsible for protecting the interest of both the life income beneficiary and the principal beneficiary. Thus, in this case, the trustee, Tom, has a duty to provide income to Wendy and to protect the trust res for Grace.

(1) **Current Repairs and Taxes**

The expense of making the current repairs and paying the taxes is chargeable to the income interest of the trust. At issue is the allocation of ordinary expenses between the income and principal accounts.

Under the Uniform Principal and Income Act ("UPAIA"), when the trustee incurs "ordinary expenses" in the administration of the res, they are chargeable to the income interest. These expenses include ordinary repairs and maintenance, taxes assessed upon the principal, insurance premiums, and the like. While the holder of a life estate is never required to make repairs upon the property of the estate, the same does not hold true for a trustee of a life estate.

Here, the trustee is directed by the trust instrument to provide income to Wendy, a direction that can be followed only if the building is productive, i.e., if the tenants pay rent. If the repairs to the building are not made and the building becomes uninhabitable, then the purpose of the trust is frustrated. The same holds true for the current assessed taxes on the premises during Wendy's life estate. Thus, in order to maintain the purpose of the income trust, ordinary repairs must be made and property taxes must be paid; they are thus chargeable to the income interests. In addition, the rents collected from the tenants in the building are deemed income payable to Wendy under the trust.

(2) **Permanent Improvements**

The costs of making the permanent improvements to the res are chargeable to the principal. At issue is the allocation of extraordinary expenses between the income and principal accounts.

Under the UPAIA, when extraordinary expenses or repairs are incurred for the purpose of making a capital improvement to the trust property, such costs are chargeable against principal.

In this case, Tom wishes to make improvements to the building that will preserve and possibly increase the value of the property. This is consistent with the duty of the trustee and the intention of the settlor. Accordingly, Tom may make the permanent improvements to the trust property and charge the expense to principal, but if the improvements are likely to depreciate, they are amortized out of income over the expected life of the improvement so that the principal account is paid back. Additionally, Grace is entitled to the full purchase price upon the sale of the property.

(3) **Mortgage**

With court approval, Tom may mortgage the building to raise money for making improvements. At issue are a trustee's implied powers.

Unless expressly provided by the trust terms, a trustee generally has no power to mortgage trust property. (If the jurisdiction has adopted the UTC, however, the trustee has the express power to encumber trust assets.) There may be situations where the purposes and circumstances of the trust may make it appropriate to imply the power to mortgage. In these cases, a court may authorize the trustee to mortgage if necessary to preserve the trust estate and it is consistent with the settlor's probable intent. Therefore, the court will probably authorize Tom to mortgage the property if it is necessary to preserve the building and the money for the improvements cannot be obtained in any other way.

(4) **Tom's Liability**

Tom is personally liable on the contracts he makes as trustee. At issue is a trustee's liability to third parties.

The trustee, as holder of the legal title in the trust property, is personally liable on contracts entered into on behalf of the trust. When the trustee acts in good faith and within the scope of his duties, he is entitled to indemnification from the trust. Thus, Tom is personally liable on all contracts entered into on behalf of the trust because he is the legal owner of the property; however, he may be entitled to indemnification from the trust estate.