[Note: Numbers in brackets refer to the printed pages of Understanding Trusts and Estates by Roger W. Andersen where the topic is discussed.]

LexisNexis Capsule Summary
Trusts and Estates

Chapter 1
LAWYERS, ESTATES, AND TRUSTS

§ 1 Serving the Living [1-2]

Trusts and Estates is the study of ways to help living people solve family problems. Recognizing that lawyer conduct affects the living, some courts have broken down traditional defenses and held lawyers responsible to will beneficiaries who were not their clients.

A. Traditional Defenses

1. Privity

Traditionally, will beneficiaries who lost their share because of the lawyer's negligence were out of luck. Because the lawyer had rendered service to the now-dead client — rather than to the will beneficiaries — the beneficiaries had no "privity" with the lawyer and could not recover.

2. Statute of Limitations

Traditional rules said the statute of limitations for any negligence began to run when the will was drafted, often many years before the error was discovered after the client died. The delay barred many claims.

B. A Trend

Starting with *Lucas v. Hamm*, 364 P.2d 685 (Cal. 1961), courts have been abolishing the privity defense and reading the statute of limitations as beginning to run at the testator's death. The trend is not universal. See, e.g., *Miller v. Mooney,* 725 N.E.2d 545 (Mass. 2000) (rejecting tort liability, but leaving open the question of third party beneficiary liability).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

§ 2 An Overview of Intergenerational Wealth Transfer [2-11]

A. Probate

1. The Process

Probate systems collect the assets of decedents, satisfy creditors, resolve conflicts among beneficiaries, and distribute what is left to the appropriate persons or institutions.

a. Subject to Probate.

Property that the decedent held alone or as a tenant in common is subject to the system. Joint tenancy (or tenancy by the entirety) property, life insurance proceeds on the decedent's life, and property in lifetime trusts are all outside of probate. Depending upon local rules, the decedent's half of community property may or may not pass through probate.

b. Personal Representative

When a person dies and a decision is made to probate his estate, someone—usually a family member—will petition a court in the decedent's state of domicile to appoint a "personal representative" to handle the work. Executors (if there is a will) and administrators (if there is no will) are the most common types of personal representatives.

c. Small Estates

Many states allow small estates to pass without court administration, or with minimal court involvement. See, UPC §§ 3-1201 to 3-1204.

d. Supervised Estates

Though local practice will vary, administration of a court-supervised estate generally looks like this:

Upon appointment of the personal representative, the court issues appropriately titled "letters" to evidence the individual's authority. The personal representative then contacts banks, stock transfer agents, and the like, to collect the decedent's assets. An inventory is filed and creditors are notified. If known or reasonably ascertainable creditors are given actual notice, their claims may be cut off if the creditors don't file promptly. See *Tulsa Professional Collection Services, Inc. v. Pope,* 485 U.S. 478 (1988).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Next, estate administration enters a holding period. Appraisals are made; tax forms are filed; sometimes property is sold to pay creditors or because no one wants it. There may be a will contest or litigation about the will's meaning. When all questions are resolved, the personal representative closes the estate by distributing the remaining property to those entitled to it.

2. Is Probate Necessary?

Probate is not always necessary. All, or virtually all, of the property may pass free of probate. There may be no creditors, or they may have been found and paid. Everyone may agree on who's to get the property.

B. Lifetime Transfers

1. Trusts

Harvard Professor Austin W. Scott said, "[t]he purposes for which trusts can be created are as unlimited as the imagination of lawyers." 1 Austin W. Scott & William F. Fratcher, The Law of Trusts 4 (4th ed. 1987-1991).

a. Basic Requirements:

- Intention
- Property
- Trustee
- Beneficiary

b. Living v. Testamentary

A trust created during the life of the settlor is called a "living" (or "lifetime" or "inter vivos") trust. A trust is created by will is called a "testamentary" trust. Questions involving living trusts can be resolved in courts of general jurisdiction, but there is no ongoing judicial supervision. Testamentary trusts are typically subject to the continuing jurisdiction and supervision of the probate court.

2. Other Lifetime Transfers

Surviving joint tenants own the entire property when one joint tenant dies. Because the survivor no longer shares ownership with the one who has died, the decedent effectively has transferred wealth at death without the need of probate Funds paid by a third party (like a life insurance company) at the death of someone are often treated as contract rights of the beneficiary, rather than property of the one who died. "Payable-on-death" and "transfer-on-death" bank and brokerage accounts reach the same result.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C. The Uniform Codes and the Restatements

The Uniform Probate Code (UPC) and the Uniform Trust Code (UTC) offer statutory language and commentary to state legislatures considering reform (and indirectly influence court decisions). The Restatements of Property and of Trusts provide guidance to courts (and indirectly influence legislatures).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 2
INTESTACY

§ 3 Overview [13-14]

Intestate statutes identify who takes a decedent's probate property:

- if there is no valid will (total intestacy) or
- to the extent that the will does not dispose of all of the property (partial intestacy).

Often these statutes also serve as models for other laws that mandate shares for disinherited spouses or forgotten children. Intestate schemes also provide document drafters with a large variety of choices to present to their clients who want wills or trusts.

§ 4 Spouses [15-18]

A. Who Is a Spouse?

Whether an individual can inherit as a "spouse" is usually a question of each state's domestic relations law. Most states require a valid marriage between people of different genders. Someone who has cohabited under a good faith, but mistaken, belief that he or she was married may be able to claim an intestate share as a putative spouse. *See* Restatement (Third) of Property § 2.2 comment. e. Vermont recognizes parties to a civil union as spouses. See 15 Vt. Stat. Ann. § 1204(b).

B. The Spouse's Share

The size of a surviving spouse's share varies, depending upon both state law and who else survives. If the decedent left no children, the spouse might get everything, or might share with the decedent's parents. If the decedent left children, the spouse will often share with them, taking half if there is one child, and one-third if there is more than one child. Some states give the spouse a lump-sum amount and then divide the balance between the spouse and the children. In other states, the spouse gets everything, and the children have to rely upon their surviving parent to serve as a conduit, leaving them anything that is left over at her death.

1. The Conduit Theory

The conduit theory may work well in the traditional situation of spouses who marry, raise children, and die without having divorced or remarried. When the surviving spouse is not the parent of some or all of the decedent's children, however, the survivor may be less likely to favor those children and, thus, be less reliable as a conduit.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

The UPC distinguishes between single-marriage and multiple-marriage situations. If the surviving children are all children of the decedent and surviving spouse, the surviving spouse gets everything. UPC § 2-102(1)(ii). If the surviving spouse is the parent of the decedent's children, but also has other children, the survivor takes $150,000, plus one-half of the balance. UPC § 2-102(3). If the decedent left children who are not children of the surviving spouse, the survivor takes only $100,000, plus one-half of the balance. UPC § 2-102(4).

§ 5 Other Family Members [18-30]

A. Qualifying to Take

1. Nonmarital Children

At common law, nonmarital children could not inherit from anyone. Now they can always inherit from their mothers. Jurisdictions define differently the situations in which nonmarital children can inherit from their fathers (and vice versa).

The Equal Protection clause of the 14th Amendment protects nonmarital children to some extent. *Trimble v. Gordon*, 430 U.S. 762 (1977), invalidated an Illinois statute that allowed nonmarital children to inherit from their fathers only if their parents eventually married and the fathers acknowledged the children. In *Lalli v. Lalli*, 439 U.S. 259 (1978), the Supreme Court upheld a New York statute that allowed a nonmarital child to inherit from her father only if the man had been found to be the father in a paternity action brought both within two years of the child's birth and while the man was alive. These sorts of requirements seem harder to justify in an age of DNA analysis.

2. Adopted Children

a. Identifying the Question

Questions can arise about whether the adopted person (the adoptee) can inherit **from** the adoptee's genetic parent or **through** the adoptee's genetic parent (for example, from a grandparent). Similarly, there may be questions about whether the adoptee can inherit **from** the adoptee's adoptive parent or **through** the adoptee's adoptive parent. The same sorts of questions can arise in the other direction, if the adoptee dies first (for example, whether the adoptee's genetic grandparent can inherit from the adoptee).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

b. In General

At least in situations not involving adoption by stepparents, many states remove the adoptee from the families of the genetic parents and place her in a new family, that of the adoptive parents. Some place the child in both families for all inheritance purposes. Some allow the child to inherit from both her genetic and her adopted families, but cut off the genetic parents from inheriting from the child.

c. Step-parent Adoptions

Many states have established rules governing inheritance in the special situation of a stepparent adoption. There is no widespread agreement, however, on what those rules should be. Pre-1990 UPC § 2-109 simply said that "adoption of a child by the spouse of a natural parent has no effect on the relationship between the child and either natural parent." The section has since been revised to distinguish between custodial and noncustodial genetic parents. In the context of a stepparent adoption, the full parent-child relationship is maintained with the custodial genetic parent, but the relationship with the noncustodial genetic parent's family runs only to the benefit of the child.

3. Half-bloods

Two people are in a half-blood relationship when they have one common ancestor. A few states discriminate against half-blood, as opposed to whole-blood, surviving relatives, but the distinction is dying out.

4. Degree of Relationship

To determine who among a decedent's surviving relatives will inherit, you must consult the local statute. Usually you will be well served by treating the decedent's spouse as a special case and then applying the "look down, look up, look down, look up" (more formally, the "parentelic") principle. When looking for heirs, first look down for descendants, following each child's line down, stopping when you find a survivor. If there are no descendants, look up to the parents. If none, look down again, to sisters and brothers and, if necessary, nieces and nephews. If none, go up to the grandparents (on both sides). Then it's down again, this time to aunts, uncles, and cousins. A large number of states follow this approach this far.

The UPC cuts off relatives more distant than descendants of the decedent's grandparents. UPC § 2-103.

When survivors get more remote than grandparents and their descendants, many states designate the "next of kin" to take the estate. The typical way of

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

determining who is "next" is to count the number of people in the family tree connecting the decedent to the survivor. The closest one "wins."

A. Allocating Shares

1. The Problem

Two basic notions work both independently and together in various schemes for allocating intestate estates among the heirs. One, called a "per capita" approach, counts people. The other goes by either of two names, "per stirpes" or "by right of representation," and views the family vertically, "by the stocks."

For a chart setting out the hypothetical Jones family and series of examples of the schemes described below, see pages 27-30 of the text.

2. *Per Capita*

Under a *per capita* approach, we simply give an equal share to each survivor identified.

3. Representation: Strict *Per Stirpes*

The "strict *per stirpes*" approach divides at the first generation of descendants. *Lombardi v. Blois*, 40 Cal. Rptr. 899 (Cal. App. 1964). Those who prefer this system view the family tree in vertical terms. As a result, however, persons closer to the decedent may get smaller shares than those more distant. Moreover, people in the same generation may get widely differing shares; their shares depend on how prolific their parents or grandparents were.

4. Representation: *Per Capita* with Representation

As a partial response to such uneven results, pre-1990 UPC § 2-106 and some states adopted a compromise interpretation of "representation." The estate is divided into shares at the first generation leaving survivors. Older, "empty" generations are skipped. While sometimes called division by "representation," this technique often is called "per capita with representation." It is "per capita" at the first level that has survivors, and "with representation" after that.

5. Representation: *Per Capita* at Each Generation

A few states and revised UPC § 2-106 emphasize equal treatment of each generation. Called "per capita at each generation," this approach views the family horizontally. To use it, divide the estate in a series of steps. First, find

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

the first generation with survivors and add the number of survivors plus the number of those who died leaving descendants who survive. Give each survivor in the older generation a share based on the total. Next, move down a generation and divide the remainder of the estate according to the same principle. How many survivors are there in this generation, and how many in this generation have died leaving descendants? Keep repeating the process until you run out of takers. This scheme treats equally those who are equally distant from the decedent.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 3
WILLS

§ 6 Overview [31-32]

As you work through this section consider each topic from different angles: a litigator looking back upon existing documents; a planner designing an approach able to withstand future challenges while retaining the flexibility to adapt to unforeseeable change; a public-policy maker sensitive to directions the law may take as it continues to develop.

§ 7 Creation [32-63]

A. The Mental Element

1. Intention

As a threshold matter, for a will to be valid, the testator must have had a "testamentary intention" at the time the will was executed. Testamentary intention is commonly an issue when wills are homemade. See, e.g., *In re Estate of Kuralt*, 15 P.3d 931 (Mont. 2000) (Language in letter: "I'll have the lawyer visit the hospital to be sure you inherit the rest of the place in MT. if it comes to that" was intended as an amendment to a will.).

2. Capacity

The capacity element in wills law stems directly from statutory requirements that testators be "of sound mind." See, e.g., UPC § 2-501. Capacity can be lacking in either of two senses.

a. Mental Deficiency

Mental deficiency concerns the general capacity *to make a will*. Thus, a testator who has a guardian because he cannot handle his own affairs may still be able to make a will. See *Gilmer v. Brown*, 44 S.E.2d 16 (Va. 1947). Though courts use a variety of formulations, they tend to require a testator to:

(1) Know the nature and extent of his or her property,
(2) Know which persons would be expected to take the property,
(3) Understand the basics of the plan for disposing of the property,
(4) Understand how the above elements interrelate.

If a testator suffers from mental deficiency at the time the will was executed, the whole will is invalid.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

b. Insane Delusion

An insane delusion is a false belief adhered to against reason. Challenges on insane delusion grounds often involve beliefs about family members. See, e.g., *In re Honigman's Will*, 168 N.E.2d 676 (N.Y. 1960) (testator thought his wife had been unfaithful). If that false belief affects provisions of the will, those provisions are invalid.

3. Undue Influence

A will (or will provision) that is the product of undue influence is invalid. Although courts have struggled to articulate a test for undue influence, they typically focus upon some mix of the following factors:

- the testator's condition
- the opportunity of the influencer to exercise control
- some activity on the part of the influencer
- the effect on the mind of the testator
- the level of secrecy
- whether the influencer was in a confidential relationship with the testator
- whether the testator received independent advice
- whether the influencer received an undue benefit

See generally 1 Page on Wills §§ 15.1-15.13.

Like insane delusion, an undue influence challenge often leaves most of the will alone, invalidating only the tainted provisions. If the influence extends to the whole will, or if the offending gift is so central to the estate plan that the plan collapses without it, the whole will fails. See, e.g., *In re Estate of Marsh*, 342 N.W.2d 373 (Neb. 1984).

4. Fraud

Fraud might be either in the *inducement*, which involves fooling the testator into making or changing will provisions, or in the *execution*, which involves getting the testator to sign the wrong document. The elements have been stated as follows: "A will is invalid if the testator has been willfully deceived by the beneficiary as to the character or contents of the instrument, or as to extrinsic facts which are material to the disposition and in fact caused it." Atkinson on Wills § 56. Often the fight is about whether the facts are "material."

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

5. Planning Considerations

a. Structural Elements

The estate plan might include any combination of a number of features designed to discourage bringing, or limit the chances of succeeding at, a will contest.

i. No-Contest Clauses

A no-contest clause denies benefits to someone who contests a will, but the clause can work only if it is accompanied by a gift to the potential contestants. Otherwise, they have nothing to lose by bringing the contest. In most capacity and undue influence cases, if the contest is successful, the no-contest clause will have no effect. It will fail with the will or the other challenged clauses.

When contests fail, courts are divided on whether no-contest clauses are a good idea. See generally Martin D. Begleiter, *Anti-Contest Clauses: When You Care Enough to Send the Final Threat,* 26 Ariz. St. L.J. 629 (1994). Many jurisdictions refuse to apply no-contest clauses if there was "probable cause" to bring the contest. In addition, courts often construe such clauses narrowly.

ii. Explanations

When a testator wants to leave out some family members or reduce their shares, one option is for the testator to explain in the will the reasons for the different treatment. If the testator is equalizing treatment among various takers, as when one child's gift is reduced to take into account a lifetime gift, this technique may work well. When favoritism of one side of the family is prompted by ill will toward the other side, displaying the family laundry in public may fuel a contest.

iii. Living Probate

A few jurisdictions allow wills to be admitted to probate before the death of the testator. Though the details vary, the basic idea is to allow a testator to give notice to interested parties of an intent to probate the will. If there are no objections, or if proponents overcome them, the court admits the will to probate. That will, unless it is later revoked, controls distribution of the estate.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

iv. Living Trusts and Other Gifts

Another way to get property to a favored beneficiary without risking a will contest is to make lifetime gifts, including creating a trust. Later, a will contest would be irrelevant because the property would not be in the estate.

v. Family Law Options

In some situations, testators may be able to protect their estate plans by getting married or by adopting an intended beneficiary.

b. Conduct

Working with one eye viewing the elements of mental capacity and undue influence, lawyers can preserve evidence that their clients were acting competently on their own at the time they executed the wills. If the testator is disinheriting someone for reasons that he would rather keep private, the lawyer could ask the testator to **write out an explanation** to keep on file for later use. A **videotape** of the testator explaining the will could be powerful evidence of competency and actual intention. Because witnesses in these situations are more likely to be called to appear in court, clients should **choose witnesses with care**. Also, right after the will execution ceremony, lawyers could **ask the witnesses to dictate their recollections** of the event. These statements could then be used in later litigation to refresh recollections.

B. Execution

A testator must meet particular formal, statutorily-mandated requirements to create a valid will. For citations to wills statutes around the country, see Restatement (Third) of Prop. § 3.1, Statutory Note.

1. The Policies

Commentators have identified four principal functions of Statutes of Wills:

- preserving evidence
- channeling testators to use similar forms, features, and procedures
- requiring a level of formal ceremony
- preventing others from overreaching.

Traditionally, courts have strictly construed Statute of Wills requirements. The following comment is typical: “[T]he testator’s intent to execute a valid will is not by itself sufficient to give validity to an instrument

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

not executed in accordance with the statutory requirements." *In re Estate of Weber*, 387 P.2d 165, 169 (Kan. 1963).

2. A Typical "Statute of Wills"

a. In Writing

With minor exceptions, wills must be written. They may be handwritten, typed, or printed from a word processor. Nevada now allows electronic wills. 2001 Nev. Stat. ch. 458.

Some states allow oral wills ("nuncupative wills"). Sometimes called "Soldiers' and Sailors' Wills" because they apply only to last-illness gifts (and sometimes are only available to armed services personnel), they may be limited to giving personal property only, or to giving amounts under a stated value.

b. Signed [At the End?]

The requirement that the testator sign the will has two aspects. First, there must be some sort of mark on the will. While a formal, complete signature is common, a label of relationship, initials, or even an "X" is acceptable. Second, the signature must have been intended as an operative, validating act. See *In re Estate of McKellar,* 380 So. 2d 1273 (Miss. 1980).

The title to this section includes "at the end?" in brackets because that requirement is included in a few states. Sometimes there are disputes about where the "end" is.

c. By the Testator or Another

Virtually all states allow someone else to sign on behalf of the testator. Usually the proxy must sign in the testator's presence, at his direction.

d. Attested in the Testator's <u>Presence</u>

Unless the state allows so-called "holographic" wills (see § 7, B, 3), wills must be witnessed. Virtually all states require two witnesses. Commonly, the witnesses must themselves sign "in the presence of" the testator. Sometimes they must also sign in the presence of each other. Courts have struggled with what "presence" means. They have generally followed either a "line-of-sight" test or, more commonly, a "conscious presence" approach. Compare *In re Demaris' Estate,* 110 P.2d. 571 (Or. 1941) with *Stevens v. Casdorph*, 508 S.E.2d 610 (W. Va. 1998).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

UPC § 2-502 eliminated the presence requirement, except for proxy signatures (where conscious presence is required). Witnesses must still "witness" something the testator did: the signing itself, an acknowledgment of the signature, or an acknowledgment of the will. Their own signatures, however, need not be affixed in the testator's presence. Moreover, the signatures need only be placed on the will within a "reasonable time" after the witnessing took place, even if that is after the testator's death.

e. By Competent Witnesses

Witnesses must be competent in terms of mental ability at the time of the will's execution. Many states also say part of being competent is being "disinterested," in the sense of not taking any gifts under the will. Strictly applied, the rule would invalidate most wills signed by interested witnesses. Rather than letting the will fail, however, states that follow this rule usually save the will through "purging statutes," which eliminate the gain to the interested witness. If the witness would have had a share under an earlier will or the intestate statute, the new gift usually is reduced to the size of the earlier share. See *Estate of Parsons*, 63 Cal. Rptr. 70 (Cal. App. 1980).

UPC § 2-505(b) has abolished the rule: "The signing of a will by an interested witness does not invalidate the will or any provision of it."

f. Some Other Rules

Some jurisdictions require witnesses to sign in each other's presence. Some require publication, which generally means the testator identifies the document as his will. Some require the testator to request the witnesses to sign.

g. Attestation Clauses and Self-Proving Affidavits

Neither attestation clauses nor self-proving affidavits are required as part of a valid will, but they are commonly included. Attestation clauses typically appear after the testator's signature, but above the witnesses' signatures. They are phrased from the witnesses' point of view, attesting that the elements of the local statute have been followed. In most states, they set up a rebuttable presumption that the facts stated in the clause are correct.

UPC § 2-504 has popularized self-proving affidavits. The big differences between self-proving affidavits and traditional attestation clauses are: (1) the testator also signs the self-proving affidavit, and (2) the affidavit is notarized. Under the UPC, self-proving affidavits raise a

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

conclusive presumption that the statute's signature requirements have been met.

3. Holographs

Many states allow informal wills called "holographs." These wills should be viewed as qualifying for recognition under an alternative set of rules.

Most importantly, holographs need not be witnessed. In return for eliminating the need for witnesses, states require additional elements, mostly aimed at assuring the genuineness of the document. UPC § 2-502(b) sets these bare-bones requirements: the signature and "material portions" must be in the testator's handwriting. More traditional statutes require the document to be "entirely" in the testator's handwriting and may require a date or some of the elements applicable to attested wills.

Because of their minimal requirements, holographic wills can crop up in unlikely places. See *In re Kuralt*, 15 P.3d 931 (Mont. 2000) (part of a letter). Once courts validate these writings, however, they carry the same weight as a document executed with all the trimmings in a law office.

4. Mistake in Execution

a. Traditional Law

Orrell v. Cochran, 695 S.W.2d 552 (Tex. 1985), illustrates how courts traditionally have interpreted the elements in their statutes. A witness signed the will where the testator should have, and the testator only signed in a self-proved affidavit following the will. Because the testator did not sign the will itself, it was denied probate.

b. Substantial Compliance

One solution for those frustrated with the tradition of strict interpretation of will statutes' requirements is to validate a will if there has been "substantial compliance" with the statutory elements. See *In re Will of Ranney*, 589 A.2d 1339 (N.J. 1991); Restatement (Second) of Prop. § 31.1 comment g.

c. Excusing Harmless Error

UPC § 2-503 provides: "Although a document or writing added upon a document was not executed in compliance with Section 2-502 [which gives the basic elements], the document or writing is treated as if it had been executed in compliance with that section if the proponent . . .

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

establishes by clear and convincing evidence that the decedent intended the document or writing to constitute (i) the decedent's will . . . ."

The reform is variously called a rule of excusing "harmless error," "excused noncompliance," and a "dispensing power."

d. Working with the Doctrines

Note carefully that while substantial compliance focuses on being close, harmless error ignores the traditional statutory elements and focuses directly on whether the testator intended the document to be effective.

Here is a series of questions to ask in will-execution situations:

- Does the document strictly comply with the elements for an attested will?
- If not, does your jurisdiction recognize holographic wills?
- If so, would the document work as a holograph?
- If not (or if holographs are not recognized), do the facts show "substantial compliance" with the statutory elements?
- If not, should the will be allowed under a harmless error approach?

5. The Execution Ceremony

Anyone familiar with courts' traditionally picky approach to will execution and the ease with which mistakes can happen should approach a will execution ceremony with great care.

§ 8 Components [63-66]

This section centers around the question: What items constitute the will?

A. Integration

The doctrine of integration addresses the question in the physical sense: which pieces of paper were meant to be in the will when it was executed? Integration is seldom a problem because usually all of the will's pages are found stapled together, with the signatures at the end. Occasionally, however, someone will offer a loose pile of papers as a will. See *In re Beale's Estate*, 113 N.W.2d 380 (Wis. 1962).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

B. Incorporation by Reference

Incorporation by reference is a way to give testamentary effect to a document not present at the execution ceremony. In most states, the following elements must be met for a document to be incorporated by reference:

- the document being incorporated must exist at the time of the execution ceremony
- the will must indicate an intention to incorporate
- the will must refer to the document sufficiently to allow its identification, and
- the will must say that the document is in existence.

Because the last element has proved troublesome in practice, UPC § 2-510 requires only the first three. See also Restatement (Third) of Prop. § 3.6.

Litigation often arises because someone has tried to use the doctrine to include material added *after* the will's execution. See *Simon v. Grayson*, 102 P.2d 1081 (Cal. 1940).

1. Tangible Personal Property

UPC § 2-513 allows wills to refer to a separate, signed writing that identifies who should get particular items of tangible personal property. The writing can be changed after the will has been executed.

§ 9 Revocation [66-77]

By a variety of methods, wills can be revoked completely or in part.

A. By a Writing

1. Formal Requirements

A will can be revoked by a later writing that itself meets the elements for creating a will. See text pages 32-63. Courts traditionally have taken the same strict approach toward revocation requirements as they have toward will executions, with the same intention-defeating results. See *In re McGill's Will*, 128 N.E. 194 (N.Y. 1920).

2. Express Revocation

The most common, and surest, way to revoke a will is by executing a later document that expressly revokes the will. Documents intended to revoke a will in part are called "codicils."

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

3. Inconsistency

If a later will is inconsistent with a prior will, but lacks a clause expressly revoking the prior one, complicated problems can arise. The second will might impliedly revoke the first to the extent of the inconsistency. If the inconsistency is too great, however, the second may totally revoke the first. Courts have struggled with where to draw the line. See, e.g., *Gilbert v. Gilbert*, 652 S.W.2d 663 (Ky. Ct. App. 1983).

To avoid litigation in these situations, UPC §§ 2-507(b)-(d) establish some presumptions. The key is whether the later will made a complete disposition of the estate. If so, it is presumed to have revoked the prior will completely. If not, it is presumed to have been intended as a supplement to the prior will. In either case, the presumption can be overcome by clear and convincing evidence.

B. By Physical Act

1. Specific Acts

Testators can also revoke wills by physically altering the document with the intent to revoke it. Typically, statutory lists include words like "tearing," "burning," "canceling," and "obliterating." A common source of litigation has been whether particular physical acts were enough to revoke the will in question. Words like "burning" or "tearing" refer to acts done to the paper; words like canceling" or "obliterating" refer to the language on the page. Traditionally, the act must actually interfere with the words. See *Thompson v. Royall,* 175 S.E. 748 (Va. 1934). UPC § 2-507(a)(2) allows revocation by burning, tearing or canceling, even if the act does not touch the words on the will.

2. Presence

The acts must be done by the testator, or in the testator's presence at his direction. Resolving whether the testator is in the "presence" of those doing the act involves the same issues as whether witnesses are in the testator's "presence" at a will's execution. See text pages 48-50.

3. Presumed Revocation and Lost Wills

If a will cannot be found, but was last in the testator's hands, it will be presumed revoked. (If a will has not been revoked, but nonetheless cannot be located, its validity and terms can be proved by other evidence. See, e.g., Ohio Rev. Code Ann. § 2107.26.)

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

4. Partial Revocation

Many (but not all) states allow partial revocation by physical act. Often the question is whether the physical act was intended to revoke the whole will, or only a particular section.

A different sort of partial revocation problem arises if there are both a will and a codicil, but only one document is touched. Imagining the will as a base, with the codicil resting on top, helps the general rules make sense. If the intention is to revoke both documents, destroying the will is usually sufficient. If the intention is unclear, however, the codicil may remain valid if it can sensibly stand alone, but it will fail if it needs the will's support. Conversely, tearing up a codicil normally leaves the supporting will in place.

C. By Operation of Law

Wills may also be revoked (totally or partially) "by operation of law." In particular, many states have statutes that revoke all or part of a will if a testator divorces, but does not amend the will to take into account the change.

D. Revival

"Revival," identifies the issues surrounding this circumstance: A testator executes Will I, and then sometime later executes Will II, which revokes Will I. Changing his mind again, the testator revokes Will II. The question is whether Will I is good again.

Virtually all states have statutes on the question. See Restatement (Third) of Property § 4.2, Statutory Note. There are three basic approaches:

- Because wills speak only at the testator's death, Will I was never really revoked by Will II, so Will I still stands as the testator's "last will."
- Because Will I was revoked by Will II, the only way to get back Will I is to re-execute it.
- If the testator intends to revive Will I at the time of revoking Will II, that intention will prevail. Otherwise, Will I stays revoked.

The third option is the most common, but identifying a testator's intention can be difficult. See *In re Estate of Boysen*, 309 N.W.2d 45 (Minn. 1981).

UPC § 2-509 distinguishes between complete and partial revocations, and revocations by physical act and those by written instrument:

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

- If Will II totally revoked Will I and is itself later revoked by physical act, Will I is revived only "if it is evident from the circumstances of the revocation of the subsequent will or from the testator's contemporary or subsequent declarations" that the testator intended Will I to be effective.
- If Will II only partially revoked Will I, the previously revoked parts of Will I are revived, "unless it is evident . . . that the testator did not intend" the revival.
- If a third will is involved (revoking all or part of Will II), Will I is revived "to the extent it appears from the terms of the later will that the testator intended" the revival.

E. Dependent Relative Revocation (Ineffective Revocation)

1. A Remedy for Mistakes

"Dependent relative revocation," known to generations of law students as "DRR" is fundamentally a doctrine for undoing mistaken revocations. It carries an odd title because courts—traditionally reluctant to correct mistakes involving wills—engage in a fiction. When they decide to ignore a mistaken revocation, they traditionally pretend that the revocation itself was really dependent on some condition. When (because of the mistake) the condition is not met, the courts may then presume that the mistaken revocation never really happened in the first place. Because there has been no revocation, the will in question stands.

2. An Example

Suppose Hans Schmidt wanted to redo his will. At the execution ceremony for the new will, Hans somehow managed not to sign it. Wrongly believing the new will to be effective, he tore up the old one. When the mistake is discovered after Hans' death, a court unable to probate the new will (because there is no signature) might well use DRR to ignore the revocation of the old will. In theory, Hans' revocation of the old will was dependent upon the new will being effective; since the new will fails, the old will was never revoked when Hans tore it up.

3. A Consolation Prize

The doctrine does not give Hans what he really wanted, and thought he had: the new will. Rather, he gets a consolation prize: the old will he thought he had revoked. Most courts look at the circumstances, compare the various wills and the intestate statute, and then choose what they believe the testator would have done had the testator known what hindsight has revealed.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

4. A Warning

Students sometimes see DRR cropping up everywhere. As a device for keeping DRR under control, treat every revocation separately and ask, "Did this happen by mistake?" If not, ignore DRR.

F. The Ethics of Safeguarding Wills

Clients can lose wills, mangle them, "correct" them, use them for scratch paper. In response, many lawyers have kept the will for the client. That way it will be protected from harm and easily available when needed. Not so coincidentally, later updating and, most lucratively, the ultimate probating, are likely to be handled by the law office where the will has been stored. Because of the conflict of interest, some have criticized this approach. See *State v. Gulbankian*, 196 N.W.2d 733 (Wis. 1972).

§ 10 Contracts Regarding Wills [77-80]

Contracts to make – or not make – or to revoke – or not revoke – wills do not change wills law. Wills can still be made or revoked, despite the promises. But the contracts do affect how property is ultimately distributed. A common remedy will be to create a constructive trust in favor of the promisee and enforce it against estate assets. As a practical matter, the promisee takes the property as a creditor, before will beneficiaries or intestate heirs.

To discourage litigation about whether there was such a contract, UPC § 2-514 requires contracts concerning succession to be in writing or, at the very least, to be referred to in a will and then proved by extrinsic evidence.

Questions about whether there has been an agreement not to revoke a will generally arise between spouses who have children from prior marriages and who execute wills with reciprocal terms. See, e.g., *Junot v. Estate of Gilliam,* 759 S.W.2d 654 (Tenn. 1988). Even if valid, these contracts are notorious litigation-breeders. In virtually all blended-family situations, a trust will better protect the interests of all the survivors.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 4
PRIVATE EXPRESS TRUSTS

§ 11 An Overview [81-83]

This chapter supplements the introduction appearing on pages 8-9 of the text.

A. Living v. Testamentary Trusts

To establish a living trust, the settlor can either give the property to someone else (or an institution, like a bank) to hold as trustee or declare herself to be the trustee. Testamentary trusts are created by a will, which simply gives estate assets to someone to be held in trust according to directions.

In general, living trusts are more complicated to set up, but are more flexible once they are in operation. Testamentary trusts are easier to establish, but generally subject to more restrictions when funded.

B. Reasons for Creating Trusts

Common reasons for creating trusts include:

- Providing asset management for disabled persons or minors
- Avoiding probate (if a living trust)
- Saving estate taxes

§ 12 Creation [83-98]

An important reason that trusts are so wonderfully flexible is that the law requires so little to create a trust. The key concept is creation of a fiduciary relationship by separating ownership into two parts: "legal title" in a trustee with management duties, and "equitable title" in a beneficiary who can enforce those duties.

A. Intent

Usually the intention to create a trust is quite clear: a multi-page document is labeled "Trust Agreement," or a will section is titled "Family Trust." However, trusts can arise easily without such formalities. See *Jimenez v. Lee,* 547 P.2d 126 (Or. 1976) (father held to be trustee of savings bond his mother purchased for his daughter's education).

1. Mandatory v. Precatory Language

Poorly drafted documents may not make clear whether the settlor intended to impose duties on a particular beneficiary, or only expressed a desire that

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

the beneficiary behave in a certain way. The result will depend upon whether a court finds the language regarding the children to be "mandatory" (a trust) or "precatory" (no obligation). Cases like these tend to be resolved very much on their own facts. See, e.g., *In re Estate of Martin*, 300 N.Y.S.2d 751 (N.Y. App. Div. 1969) ("request" was mandatory); *Brannon v. Morgan*, 106 S.W.2d 841 (Tex. Civ. App. 1937) ("request" was precatory). The lesson: be specific. If a trust is intended, say so. If not, use language like "I hope, but I impose no obligation."

B. Trust Property

To have a trust, there must be trust property. After all, there must be something for a trustee to protect. In many cases, there is really no question about trust property.

In some situations the items claimed to be held in trust can be very insubstantial, like future profits or the beneficial interest in a life insurance policy. Then the question becomes whether the item can be defined as "property" for the purpose of sustaining a trust. In answering that question, some courts are quite rigid, while others are very flexible. Compare *Brainard v. Commissioner*, 91 F.2d 880 (7th Cir. 1937), with *Speelman v. Pascal,* 178 N.E.2d 723 (N.Y. 1961).

A. Beneficiary

1. Separation of Title

Doctrinally, beneficiaries are required in order to achieve the separation of legal and equitable title which characterizes the trust relationship. A trustee must owe duties to someone else. See *Morsman v. Commissioner*, 90 F.2d 18 (8th Cir. 1937).

2. Identifiability

Even if the separation of title question is not present, beneficiaries of a private trust must be identifiable. The trustee must be able to tell who should get the property, and a court should have a standard by which to judge whether the trustee distributes trust benefits to the right persons.

This rule does not apply to charitable trusts, which are characterized by the lack of particular, identified beneficiaries. See text pages 112-116.

3. Chosen by the Trustee?

When the settlor names someone, usually the trustee or executor, to choose among the members of an indefinite group (like "friends"), courts

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

traditionally have said no trust can arise. See *Clark v. Campbell*, 133 A. 166 (N.H. 1926). Restatement (Second) of Property § 12.1 comment e, seeks to reform the rule. It says that rather than failing, a provision like that in *Clark* "should be construed to give the [trustees] a power of appointment exercisable within a reasonable period of time . . . ." See also Restatement (Second) of Trusts § 122; Restatement (Third) of Trusts § 46(2). Uniform Trust Code § 402(c) is direct: "A power in a trustee to select a beneficiary from an indefinite class is valid."

4. Honorary Trusts

Recognizing that funds to care for a pet or an inanimate object—like a grave site—serve a social purpose, courts usually allow them under a theory of "honorary trusts." The "trustee" who is given the money has the choice of honoring the trust or of returning the money to the estate. Uniform Trust Code sections 408(b) & 409 allow a settlor (or a court) to appoint someone to enforce the trust.

D. Trustee

If a trust is intended, but no trustee is named, or if a sitting trustee dies or resigns, a court will appoint a trustee rather than let the trust fail.

1. Choosing Trustees or Trust Advisors

Settlors should choose trustees with great care. They must handle both the financial and the personal sides of administration. Settlors sometimes appoint co-trustees, one a corporation and the other an individual. The corporate trustee, usually a bank, provides investment expertise, and the individual provides the personal touch. A co-trustee arrangement can be unwieldy, however, because all trustees traditionally must join in acting on the trust's behalf.

To avoid that problem, clients may want to name a single trustee and also identify a trusted friend or relative to serve as a "trust advisor." The trust document could require the trustee to consult with, or get the approval of, or follow the directions of, the advisor before distributing the trust's funds.

E. The Problem of Revocability

A testamentary trust, as part of a will, is revocable under wills law. Living trusts will be recognized even though the settlor reserves a power to revoke. In most states, the power to revoke a living trust must be reserved expressly in the document. In contrast, UTC § 602(a) puts the burden on those who want *irrevocable* trusts to say so.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

The validity of revocable living trusts was open question because these trusts can look a lot like wills, but usually do not meet the local Statute of Wills requirements. Consider a settlor who creates a trust giving a remainder to his wife, but retaining a life estate (to secure present enjoyment of the property) and a power to revoke (in case he changes his mind). The form is different, but the substance is close to the situation of a testator who retains ownership and executes a will leaving everything to his wife. The parallel is even closer if the settlor declares himself to be the trustee. Nonetheless, virtually all courts will sustain such a trust when created in reliable circumstances. See *Farkas v. Williams*, 125 N.E.2d 600 (Ill. 1955).

1. Ignoring Trust Form

The law is coming to recognize that a trust might be recognized for one purpose, but not for another. For example, *State Street Bank & Trust Co. v. Reiser*, 389 N.E.2d 768 (Mass. App. 1979), allowed creditors of an estate to reach the assets of a valid living trust, even though the trust assets would otherwise pass outside the probate system. See also *Sullivan v. Burkin*, 460 N.E.2d 572 (Mass. 1984).

F. Formalities (and Constructive and Resulting Trusts)

1. A Writing

Oral living trusts *for land* typically run afoul the Statute of Frauds' writing requirement. Oral testamentary trusts conflict with the Statute of Wills.

2. Constructive Trusts

Not allowing an oral trust may enrich a grantee unjustly. Suppose Javier delivers a deed of Blackacre, absolute on its face, to Maria, but Maria orally promises to hold the land in trust for Javier for life and then transfer it to Frank. If Maria refuses to turn over the land to Frank, we have a conflict between the policy of limiting oral evidence (and thereby the danger of false claims) and the policy of preventing people from unjustly enriching themselves. To avoid unfair results, courts sometimes will apply a " constructive trust" against a donee like Maria to prevent the donee from holding in her own behalf.

The constructive trust theory does not impose management duties on the "trustee." Rather, constructive trust is a remedy. The constructive trust theory is a device for preventing unjust enrichment by moving legal title from a person who has title but should not, to someone who should. The remedy is appropriate in a wide variety of situations.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

3. Resulting Trusts

Unjust enrichment can also arise when there is a semi-secret trust. These occur when will shows a trust intention on its face, but the details are oral. To prevent the "trustee" from becoming unjustly enriched by keeping the property, a court may impose a "resulting trust" under which the trustee holds the property for the benefit of the estate. *Olliffe v. Wells*, 130 Mass. 221 (1881). This is just one example of a resulting trust theory applying to an express trust that fails.

§ 13 The Size of a Beneficiary's Interest [98-107]

A. Discretionary and Support Trusts

1. Discretionary Trusts

Trusts that authorize the trustee to pay the beneficiaries "such amount of income or principal as the trustee in its absolute discretion shall deem advisable" are commonly called "discretionary trusts." Sometimes the discretion applies only to income or only to principal.

2. Support Trusts

Trusts that attempt to control the trustee's discretion by limiting distributions to those "necessary for the comfortable support of the beneficiary" are commonly called "support trusts."

3. Hybrids

Sometimes a settlor will create a hybrid, a "discretionary support trust," by giving the trustee "uncontrolled discretion" to pay funds "for support." To clarify these categories, Restatement (Third) of Trusts § 50 and Uniform Trust Code § 504 treat support trusts as a type of discretionary trust.

4. Why Trustees Are Often Conservative

Trustees can often be more stingy than their settlor would have wanted. See, e.g., *Old Colony Trust Co. v. Rodd,* 254 N.E.2d 886 (Mass. 1970). Trustees tend to be conservative because the law presents them with different risks. If they are too generous, they risk a court later ordering the trustee to repay to the trust the money which should not have been distributed. On the other hand, if they are too stingy, they are likely only to suffer a slap on the wrist and an order to be more generous in the future. The selection of the trustee or trust advisor is probably the most important factor for achieving the balance between the flexibility and control

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

appropriate for any particular client. Words of guidance in a document can also help. For some suggestions, see text pages 100-101.

B. Alienability

Two principles underlie much of the law surrounding the transfer of a trust beneficiary's interest. First, unless a statute or the trust document provides otherwise, a trust beneficiary can transfer his or her interest to someone else. Second, creditors' rights typically follow alienability: the creditor usually can get what the beneficiary can transfer. For a good illustration of how various trust devices affect creditors' claims see *Shelley v. Shelley*, 354 P.2d 282 (Or. 1960).

1. Voluntary Transfers

Just as you can give an old armchair to a friend or sell it at a garage sale, so can a trust beneficiary give away or sell a life estate or a remainder interest in trust. Sometimes, with an eye to protecting beneficiaries against against their own foolishness, a settlor may want to restrict a beneficiary's power to make such transfers. A discretionary or a support trust can achieve that result. So can a spendthrift trust (discussed below).

Discretionary, support, and spendthrift trusts are often viewed primarily as devices for avoiding creditors. However, such devices can also affect the ability of both trustees and beneficiaries to adjust to changing situations.

2. Involuntary Transfers: Creditors' Claims

Unless a document or statute provides otherwise, creditors can satisfy their claims by reaching a trust beneficiary's interest. The procedure varies among the states, but familiar creditors' devices like attachment, garnishment and execution tend to be available. See UTC § 501.

a. Spendthrift Clauses

Spendthrift clauses both prohibit a beneficiary from transferring his trust interest and protect that interest from creditors' claims. The clauses do not mean the creditor can never get paid, but they do put the creditor at a distinct disadvantage. Rather than obtaining their debtor's beneficial interest in a spendthrift trust, or forcing the trustee to pay them directly, creditors must wait until the trustee pays the beneficiary and then try to catch the money there.

Commentators have long debated the merits of spendthrift clauses, but they have been approved overwhelmingly (but not universally) by courts and legislatures.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

1. **Exceptions**

In some situations, spendthrift clauses have not been effective. The most common rule is that one cannot create a spendthrift trust for oneself (a "self-settled" trust). But some states are abandoning that limitation. See Alaska Stat. § 34.40.110. Many states eliminate the spendthrift shield when a claim comes from some of the following classes of creditors: alimony, spousal support, providers of "necessary" services, state claims, federal claims, and (in a few cases) some kinds of tort claims. See Restatement (Third) of Trusts § 59; UTC § 503.

b. Special Needs Trusts

Many jurisdictions authorize individuals to create "special needs trusts" on behalf of disabled persons. These trusts allow supplemental support without endangering the beneficiaries' rights to government benefits. The rules vary considerably from state to state. See generally Joseph A. Rosenberg, *Supplemental Needs Trust for People With Disabilities: The Development of a Private Trust in the Public Interest,* 10 Boston Univ. Pub. Int. L.J. 91 (2000).

§ 14 Modification and Termination [107-112]

A. Beneficiaries' Consent

If the settlor has not reserved a power to revoke, a trust cannot be terminated without all the beneficiaries' consent. Here there are two catches. First, all of the beneficiaries might not consent.

Second, and more likely, some of the beneficiaries may be unidentified or unborn, and obtaining consent on their behalf can be difficult. Two different theories have arisen to help solve the latter problem. Guardians ad litem might be appointed to represent the unborn, or the doctrine of "virtual representation" might allow older relatives to waive claims of ones not yet on the scene. UPC § 1-403 codifies both doctrines. See *In re Wolcott*, 56 A.2d 641 (N.H. 1948).

B. Material Purpose

A trust cannot be changed without the settlor's consent if to do so would violate a material purpose of the trust. Since in most cases, the settlor is dead, changes are particularly hard to achieve.

Courts have struggled to determine what a trust's "material purpose" might

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

be, and whether a particular change would violate it. See *Claflin v. Claflin*, 20 N.E. 454 (Mass. 1889). Courts typically have interpreted the inclusion of spendthrift, discretionary or support trusts as indications that a "material purpose" of the trust would be thwarted if the trust were modified or ended early. This approach may be changing. Under UTC § 411(c), a spendthrift clause "is not presumed to constitute a material purpose of the trust." See also Restatement (Third) of Trusts § 65, comment.

C. Indestructible Trusts

The Rule Against Perpetuities has served to limit the time landowners and settlors can tie up wealth. In recent years, however, the Rule has been under attack. See text pages 316-317 for discussion of that issue, but note that indestructible trusts could become a problem. The guardian ad litem and virtual representation approaches cannot help, because terminating the trust would deprive those unknown beneficiaries of benefits they might enjoy if the trust continued.

§ 15 Charitable Trusts [112-116]

Charitable trusts operate under some different rules. First, a charitable trust need not have definite beneficiaries. Second, a charitable trust is not subject to the Rule Against Perpetuities. Finally, there is a long tradition allowing courts to modify charitable trusts to further trust purposes in the face of changed circumstances.

A. Charitable Purposes

The basic concept of a charitable purpose is something that benefits the community in general. According to Restatement (Third) of Trusts § 28, "Charitable purposes include: (a) the relief of poverty; (b) the advancement of education; (c) the advancement of religion; (d) the promotion of health; (e) governmental or municipal purposes; (f) other purposes the accomplishment of which is beneficial to the community." Accord UTC § 405(a).

B. Modification (Cy Pres)

Sometimes settlors give property for charitable purposes which later become impossible or impractical to pursue. If the settlor also had a general intention to support charitable purposes, a court can apply the trust proceeds to another charitable purpose consistent with the settlor's general intention. See Restatement (Third) of Trusts § 67; UTC § 413.

§ 16 Trusts and Pour-Over Wills [116-118]

"Pour-over" is the name given to wills that designate a trust as one beneficiary. Often pour-over wills include a number of dispository provisions (cash to

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

individuals, real estate or specifically identified items of personal property to particular family members), and then give the rest of the testator's property to a preexisting trust. The effect is to pour probate assets into the trust.

The most common estate plans using the pour-over device work this way (see Figure 4-1 on text page 117):

- the client creates a living trust, but intends it as a shell to be activated later.
- the client creates a will naming the trustee of the living trust as a will beneficiary.
- the client names the trustee as beneficiary of life insurance policies.
- after the client's death, the will pours probate property, and the life insurance policy pours insurance proceeds, into the trust.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 5
OTHER NONPROBATE DEVICES

§ 17 Lifetime Gifts [119-122]

A. Personal Property

Traditionally, to make an effective gift of personal property, the donor must deliver the property to the donee with the intention to make a gift. Manual delivery is a particularly important element because it is such strong evidence of intention. Some tangible items (like a piano) are too big for easy delivery, so constructive delivery may suffice. Donors can transfer intangible property (like stocks or bank accounts) by manually delivering the stock certificate or bank book evidencing the property.

There is now developing a rule allowing the donor to use an intervivos donative document instead manual delivery, even if the tangible item could have been delivered. Restatement (Third) of Prop. § 6.2, comment c.

1. Gifts *Causa Mortis*

Gifts of personal property made in fear of death then imminent (gifts *causa mortis*) require delivery and an intention to make a present gift, but unlike most other gifts, they are both revocable and conditional (on the donor dying). If the donor changes her mind, she can get the property back. Moreover, if the donor survives, the gift is automatically revoked.

B. Real Property

Gifts of real property must meet the Statute of Frauds writing requirements and must also be "delivered." A common problem is that lay people often do not appreciate the law's distinction between a lifetime gift and one intended to take effect only at death (and thus requiring Statute of Wills compliance). See *Ferrell v. Stinson*, 11 N.W.2d 701 (Iowa 1943).

§ 18 Joint Interests [122-125]

The right of the survivor to own the whole is the distinguishing feature of these interests. When one owner dies, her interest simply disappears, leaving the survivor(s) owning the whole. Most estate planning problems involving joint interests center around whether and when grantors intended a completed gift.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

A. Real Property

Joint tenancy can be an effective probate avoidance device. However, a deed creating a joint tenancy, unlike a will identifying a beneficiary, is not revocable. See *Gross v. Gross*, 781 P.2d 284 (Mont. 1989).

B. Personal Property [Especially Bank Accounts]

In an estate context, perhaps the most common controversy about a jointly held account is whether it was opened only for the "convenience" of one depositor. If so, there was no completed gift and the property remains in the estate of the depositor. See *Franklin v. Anna National Bank of Anna*, 488 N.E.2d 1117 (Ill. App. 1986).

If banks and others were to offer accounts clearly designated as convenience accounts, much litigation could be avoided. For example, the UPC provides a "check off what you want" form, which includes a "multiple-party account without right of survivorship." See UPC § 6-204.

A form of ownership peculiar to savings accounts is the so-called "Totten Trust," sometimes also known simply as a "savings account trust." In form, the depositor opens an account in his own name, "as trustee" for someone else. In fact, there is really no trust relationship established. Rather, the depositor can withdraw the funds at any time for his own use and the "beneficiary" gets what is left when the depositor/trustee dies. See *In re Totten*, 71 N.E. 748 (N.Y. 1904).

§ 19 Life Insurance and Other Contracts [125-127]

Despite its functional similarity to wills, life insurance has escaped the "testamentary transfer" label. The enforceability of life insurance policies is governed by contract law, not the law of wills.

§ 20 Retirement Funds [127-129]

The rules surrounding pension plans are extraordinarily complex, and detailed descriptions are beyond the scope of this text. As a practical matter, most pension plans are governed by the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 et seq., and the Internal Revenue Code (IRC).

Employer plans fall into two broad categories. "Defined benefit" plans establish each employee's benefit according to a formula. "Defined contribution" plans either require or allow employer contributions at various levels. Accounts are kept for each employee, and whatever has been accumulated before retirement becomes available to that person.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

§ 21 Using a Will to Change a Will Substitute [129-130]

Sometimes testators will attempt to use their wills to transfer property not subject to probate court jurisdiction. Often those attempts seek to change who benefits from various will substitutes. Generally the efforts fail, but the law is not consistent. Compare *In re Schaech's Will*, 31 N.W.2d 614 (Wis. 1948) (will could not change title to will substitutes), with *Burkett v. Mott*, 733 P.2d. 673 (Ariz. Ct. App. 1986) (will could change a life insurance beneficiary designation).

UPC § 6-213(b) prohibits changing by will rights of survivorship or payable-on-death designations in bank accounts, but takes no position regarding other will substitutes. UTC § 602(c)(2)(A) allows a will to revoke a lifetime trust.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 6
PLANNING FOR INCAPACITY

§ 22 Property Management [131-138]

A. Guardianship

Much like the way the law of intestacy serves as a foundation for the law of wills, guardianship law undergirds other approaches to property management for incapacitated people. When someone is a minor or is unable to make various kinds of decisions, the law provides for a "guardian" (though many different titles are used) to make decisions on that person's behalf. The disabled person is called a "ward." In general, in order for a court to appoint a guardian, the ward must be "incompetent."

1. Limited Guardianships

Traditionally, guardianship was an all-or-nothing proposition almost everywhere: a ward lost virtually all decision making authority. Many states have reformed their laws to allow "limited" or "partial" guardianships, so that a guardian's authority is tailored to the needs of the particular ward. Under this approach, someone might be incompetent for one purpose, but competent for another.

2. Guardian of the Person

A guardian of the person has the responsibility to care for the personal needs of the ward. These guardians handle topics like setting bedtimes and monitoring TV viewing for a minor or supervising travel plans or personal hygiene for an adult.

3. Guardian of the Property

A court may also appoint the same person or another (including an institution) as guardian of the property of the ward. This person would handle some or all of the ward's financial affairs.

Guardianship over property offers the advantage of court-supervised administration, which can help avoid arbitrary or fraudulent activity, but guardianship presents significant disadvantages. By labeling the ward as at least partially "incompetent," guardianship carries a stigma which may hurt the ward's self-esteem. Because it is court-supervised, guardianship is also costly, in terms of both time and money. Also, the list of permissible investments may limit flexibility. Many people decide to leave guardianship as a last resort.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

B. Durable Powers of Attorney

By executing a power of attorney, someone who is competent, but plans for the possibility of incompetence, can often avoid the need for guardianship. A power of attorney is an arrangement under which one person (the principal) gives another person (the agent) the power to act on behalf of the person executing the power. Under traditional agency law, the power of the agent ends if the principal becomes incompetent. See Restatement (Second) of Agency §§ 120 & 122 (1958). To overcome the restrictions of agency law, all states have authorized some form of a "durable" power of attorney, under which the agent retains authority despite the principal's incapacity. See, e.g., UPC §§ 5-501 to 5-505.

1. "Springing" Powers

Powers of attorney can either be immediately effective, or can be written to "spring" into action upon the happening of a future event, usually the disability of the principal.

§ 23 Health Care Decisionmaking [135-138]

Clients regularly ask their lawyers to prepare appropriate documents to allow the client some control over end-of-life decisions. The law has responded in three stages to these needs.

The first stage, running roughly in the 1970s, involved the advent of living wills. See *In re Quinlan*, 355 A.2d 647 (N.J. 1976). Created by analogy to wills disposing of property, living wills speak directly for the patient. They try to anticipate various medical situations which could arise, and say what care the patient would want. Many states impose various execution requirements similar to those applying to wills of property.

The second stage, beginning in the 1980s, brought a surge of interest in durable powers for health care decisions. See *Cruzan v. Director*, *Mo. Dep't of Health*, 497 U.S. 261 (1990). These documents name someone else to act on behalf of the patient. The grant of authority may be broad, or may be limited to particular situations.Basically, the agent directs the patient's care as the agent believes the patient would have wanted it.

The 1990s brought two significant changes. First, more states adopted "family consent" statutes, which establish procedures for naming surrogate decisionmakers if the patient has not done so. These statutes serve as backstops for advance directives. The second movement is toward merging living wills and durable powers into a single, simplified document. The Uniform Health-Care Decisions Act (UHCDA) pushes both of these developments forward, while eliminating many

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

of the restrictive rules many states have established for advance directives. See 9 (Part IB) Unif. Laws Anno. 143 (Supp. 1999).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 7
CHANGING THE SHARE

§ 24 Advancements and Gifts in Satisfaction [139-142]

Suppose that during her lifetime a parent gave substantial gifts — of different amounts — to two of her three children. When she dies, should a court adjust the children's shares of the estate so that the combination of lifetime and at-death transfers treats each child equally? That is the basic question addressed by the related doctrines of "advancements" and "satisfaction."

A. Advancements

Lifetime gifts intended to come out of an intestate share are called advancements. Two questions predominate.

1. Identifying an "Advancement"

The most common candidate for an advancement is a gift from a parent to a child. To decide whether to characterize a gift as an advancement, we look to the donor's intention regarding the impact of the gift on the donee's share of the estate. Was it intended to be independent from, or part of, the donee's inheritance? See, e.g., *Miller v. Richardson*, 85 S.W.2d 41 (Mo. 1935)

Traditionally, the law presumed that gifts of land or a substantial amount of personalty from parents to children were advancements. To avoid litigation, several states treat gifts as advancements only if the donee acknowledges them as such, or if the donor indicates in a contemporaneous writing that the gift is meant as an advancement. See UPC § 2-109.

2. Calculating the Shares from a "Hotchpot"

If a particular gift is considered an advancement, courts conduct what is called a "hotchpotch" calculation. Each advancement is added to the total amount available for distribution from the estate. Each heir's respective share is then calculated with reference to this "hotchpotch," the donee is credited with the gifts already received, and the rest of the property is distributed. For an example, see text pages 140-141.

B. Satisfaction

Lifetime gifts intended to take the place of gifts made by will are gifts in satisfaction of the bequest. Because will beneficiaries need not be heirs, satisfaction potentially covers a wider range of lifetime gifts than does the advancements doctrine. For example, depending upon the donor's intention, a will provision giving "$15,000 to Knox College" might have been satisfied by a

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

lifetime gift of that amount to the college. Also, UPC § 2-609 allows a lifetime gift to one person to satisfy a testamentary gift made to another.

Because the doctrine centers on intention, the same sorts of proof problems surrounding advancements arise here as well. The UPC again requires a writing. See UPC § 2-609.

Once a lifetime gift is identified as one which changes the testamentary gift, the shares under the will must be adjusted accordingly. Sometimes a hotchpotch calculation will be necessary.

§ 25 Misconduct [142-145]

Another way an expected share can change is for a beneficiary to lose the share by the beneficiary's own misconduct. Most commonly, slayers are denied the benefits of their crimes. Sometimes courts have imposed a "constructive trust" on the slayer's share and ordered it transferred to someone else. Most jurisdictions now have relevant statutes, but many are incomplete, so the common law may fill gaps.

A. Constructive Trusts

The constructive trust is a flexible device for remedying bad conduct in a broad range of situations. Here, it serves to remove title from the slayer who would otherwise get it, and pass that ownership to someone else. Despite the label, a constructive trust is not really a trust, but a remedy, a way of shifting title. See *In re Estate of Mahoney*, 220 A.2d 475 (Vt. 1966).

B. Statutes

A large number of states have statutes denying slayers property in certain circumstances. Because many statutes cover some topics but not others, here is a series of questions you can ask about whatever statute you face:

- What bad actions disqualify the slayer?
- What property interests are affected?
- What is the effect of applying the statute?
- Is a bona fide purchaser who takes from the slayer protected?

States with incomplete statutes would do well to consider UPC § 2-803.

§ 26 Assignments of Expectancies [145-146]

Someone might expect to come into some money after a relative dies, but want to give someone else the right to get those funds when the time comes. The tenuous nature of such an "expectancy" has led courts to restrict severely the situations in

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

which any transfer would be effective. According to orthodox doctrine, outright transfers of expectancies are not allowed. Courts will, however, enforce contracts to transfer expectancies, if the agreement is supported by fair consideration. See *Scott v. First National Bank*, 168 A.2d 349 (Md. 1961).

§ 27 **Disclaimers** [146-149]

Beneficiaries use disclaimers (a/k/a "renunciation") to change the distribution of an estate by refusing to accept its benefits, most commonly to save taxes. Both state and federal law apply to disclaimers. See UPC § 2-801, IRC § 2518. State law determines ownership; federal law determines tax consequences. Thus, it is possible to disclaim property effectively under state law, but at the same time, fail to follow the federal rules, and lose the tax benefits.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 8
PROTECTING THE FAMILY

§ 28 Disinherited Spouses [151-176]

We are now in the midst of a reform movement that is restructuring family law and, in the process, changing the way we view spousal inheritance rights. This section reflects how the law is responding to the changing roles of women, as the traditional prototype becomes increasingly less representative of the modern family.

A. Community Property

Community property states have created a form of property ownership that recognizes the mutuality of marital relationships. In particular, rather than treat spouses' earnings as the separate property of each, this doctrine lumps together "the fruits of the marriage" and calls them "community property."

1. Separate Property

Property that each spouse brings into the marriage (or acquires by gift or inheritance intended for themselves individually) is called "separate property."

2. An Example

Consider Sam and Nina, a "traditional" couple in which Sam works outside the home and produces a paycheck and Nina maintains the household and takes primary responsibility for raising the children. In a common law state, Sam's paycheck is his, as are assets he acquires with those funds. In a community property state, the paycheck is community property, with each spouse owning half. Under a community property regime, the radio Nina owned before they were married is her separate property, but the TV they bought later out of Sam's paycheck is community.

Assets acquired over time pose special problems. For example, Sam may have purchased a house before the marriage, but continued after the marriage to make mortgage payments out of his earnings. Community property states recognize both the separate and the community character of the property: a single asset can be part separate and part community.

3. Testamentary Power

Each spouse has the power to dispose of their own separate property and half of the community property.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

B. Dower

In creating protections for surviving spouses, the common law distinguished between widowers and widows. A widower got a life estate in all of the lands his wife owned during the marriage, if issue who could inherit the land were born of that marriage. The widower's right came to be called "curtesy." A widow, on the other hand, got a life estate in one-third of the lands her husband owned during the marriage; children were not required, *but the estate to which the right attached had to be one that issue could inherit if they were born*. The widow's right was called "dower." Most states have abolished both doctrines, but some retain various versions of dower and apply them to both men and women.

C. The Right to Elect

1. Traditional Approaches

Regardless of a will's provisions, under traditional statutes a surviving spouse can claim a share of the decedent's probate estate. Note there is no claim to joint tenancy property, property held in trust, life insurance, or other will substitutes.

a. Capturing Nonprobate Assets

Some courts have found troubling the specter of someone "emptying" the probate estate before death to defeat a surviving spouse's claim. In response, these courts have fashioned various theories to protect a disinherited spouse by extending the right of election to nonprobate assets. Most of the cases take one of these approaches:

i. Intent

Some courts focus on the testator's intent (sometimes "fraudulent" intent), and tend to consider a variety of factors, giving different weight to each in particular instances. Some examples:

- How soon before death a gift was made. See *McClure v. Stegall*, 729 S.W.2d 263 (Tenn. Ct. App. 1987).
- The amount of support otherwise available to the spouse. See *Warren v. Compton*, 626 S.W.2d 12 (Tenn. App. 1981).
- The relationship of the spouses. See *In re Estate of Fisher*, 440 N.Y.S.2d 519 (N.Y. Sur. Ct. 1981).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

ii. Illusory Transfer

Other courts ask if the lifetime transfer was "illusory." See *Newman v. Dore,* 9 N.E.2d 966 (N.Y. 1937).

iii. An Objective Test

Sullivan v. Burkin, 460 N.E.2d 572 (Mass. 1984), adopted an objective test. If, during the marriage, the deceased spouse created an inter vivos trust over which he or she alone retained a general power of appointment, the assets in the trust would be subject to spousal election.

2. Weaknesses in the Traditional System

When views from the perspective of marriage as a relationship to which both spouses contribute and from which both benefit, traditional elective share statutes produce two kinds of unfair results.

a. Under-protection

When will substitutes leave only a few assets in the decedent's estate, the survivor is left with an unfairly small share to elect against. Moreover, if the marriage has lasted for some time, the survivor's percentage claim may be much smaller than an equal sharing of the fruits of the marriage.

b. Over-protection

A survivor who benefits substantially from non-probate transfers can get even more by electing against a will. Moreover, if the marriage has been short, the survivor's percentage claim may be much greater than an equal sharing of the fruits of the marriage.

3. The Uniform Probate Code

The drafters of the Uniform Probate Code have sought to address the basic weaknesses in the traditional approach to spousal election. The UPC's reforms have come in two stages.

a. The First Augmented Estate

The original version of the UPC created the concept of an "augmented estate" against which a disappointed spouse could elect. UPC (pre-1990) § 2-202. In some ways, it is a system made not to be used. The theory is that by making it virtually impossible for one spouse to defeat

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

the other's share, or for a survivor who was well cared for to "double dip" by electing and taking more, people would not bother.

The augmented estate includes both will substitutes that do not benefit the surviving spouse, and those that do. The survivor can claim a one-third share of that larger pot, but is credited with the value of property already received. For examples, see text pages 162-163.

b. A New Approach

In the 1990's UPC reshaped the spousal election machinery: the survivor's share now increases over the length of the marriage, and spouses now share the total assets of the marital unit. The revised version also mandates a minimum $50,000 share. See UPC §§ 2-202 to 2-208.

Working through a problem under this system requires four basic steps:

(1) Identify the "elective share percentage" to which the surviving spouse is entitled by referring to a chart showing increasing percentages over the length of a marriage.

(2) Calculate the augmented estate by including all assets of both spouses, regardless of how title is held.

(3) Determine the elective share by multiplying (1) and (2). If the amount is less than $50,000, a "supplemental elective-share amount" is available to bring the total up to $50,000.

(4) Identify the property used to satisfy the elective share. If the surviving spouse already has that much, we need look no further. If not, the spouse can get property from the decedent's other beneficiaries.

For details and examples, see text pages 164-168.

4. Incompetent Spouses

Usually courts will allow a guardian to elect on behalf of an incompetent surviving spouse if that would be in the "best interests" of the survivor. They disagree on whether to consider all the circumstances or only whether election will produce the most economic value for the survivor. See *In re Estate of Clarkson*, 226 N.W.2d 334 (Neb. 1975).

UPC § 2-212(b) takes a different approach. To the extent that the elective share includes the decedent's property and nonprobate property the spouse

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

transferred to others, that property is placed in trust for an incompetent survivor. The trustee uses the money to support the survivor (and others dependent upon the survivor). Anything left after the survivor's death passes under the predeceased spouse's will or goes to that spouse's intestate heirs.

D. Migrating Couples

Because of the different systems of marital property in common law and in community property jurisdictions, couples who move between the two face a variety of problems. Under traditional conflict of laws rules, different laws can apply to different aspects of marital property. The law of the situs of real property controls that property; the law of the marital domicile at the time personal property is acquired determines its character (community or separate); and the law of the marital domicile at death determines the surviving spouse's rights. See William M. Richman & William L. Reynolds, Understanding Conflict of Laws, 3d ed. 233-238 (2003).

1. An Example: Revisiting Sam and Nina

Suppose that during Sam's working years, they live in a common law state and hold everything in Sam's name. After retirement, they move to a community property state, which would characterize the property as Sam's separate property. Because community property states rely on their basic system to allocate wealth between spouses, these states generally do not provide survivors a right of election against their predeceased spouse's property. Nina could be left with neither community property nor a right to elect.

Couples moving from a community property state to a common law state may be creating a situation in which a surviving spouse can double dip. Unless elective share laws reflect the presence of community property, the survivor could retain his or her half of the community and still elect to take part of the decedent's half. See Uniform Disposition of Community Property Rights at Death Act, 8A Unif. L. Ann. (2002 Pocket Part).

E. Agreements Waiving Marital Rights

In deciding when to enforce agreements to waive a claim that comes with marriage, courts face conflicts between wanting to allow freedom of contract generally, wanting to encourage marriages which might not happen without these agreements, and wanting to protect against abuse. To resolve these issues, courts tend to use either one or both of two different approaches. One view focuses on process, as courts ask whether the parties have made fair disclosures to each other about how much property they own and what the other is giving

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

up. Another tack is to judge the substantive fairness of the agreement itself. See *Rosenberg v. Lipnick*, 389 N.E.2d 385 (Mass. 1979).

§ 29 Omitted Family Members [176-181]

Another way in which the law protects families is to guarantee a minimum share to family members omitted from a will. The typical scenario is of someone who makes a will and sometime later marries or has a child (or additional children), but neglects to amend the will. A person not covered is often called "pretermitted," or overlooked. Virtually all states have statutes protecting such family members, especially children.

The statutes vary in detail but pose similar issues:

- Which categories of relatives are protected?
- Does other evidence preclude application of the statute? Two types of evidence might prevent that person from taking: evidence of the testator's intention, or statutorily-identified family circumstances.
- What share does the relative take?
- Where does the money come from?

See UPC §§ 2-301 & 2-302. For examples, see text pages 177-181.

§ 30 Charitable Gifts [181]

At one time, a number of states had so-called "mortmain statutes," which limit gifts to charity. These statutes might limit the percentage of property which testators can give to charity, or they might prohibit (or limit) charitable gifts made in a set period before death. Virtually no states retain these limitations, but the move away from mortmain statutes has been a relatively recent development.

§ 31 Public Policy Limits [182-184]

The public policy doctrine nicely illustrates a question central to this chapter and to much of wills and trusts law: How much freedom should we give people to control the use of property after their deaths? By its very nature, a doctrine labeled "public policy" defies precise definition. This mushiness appropriately restrains many courts when applying the doctrine, for they understand that they might easily use it to justify judicial second-guessing of all sorts of testators' decisions. See, e.g., *Shapira v. Union National Bank*, 315 N.E.2d 825 (Ohio Common Pleas 1974); *Hecht v. Superior Court*, 20 Cal. Rptr. 2d 275 (Ct. App. 1993).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 9
PRESENT AND FUTURE INTERESTS

This chapter presents an overview of the system of present and future interests. It assumes both that you have seen most of these terms and concepts before, and that a new look may be helpful.

In the main text, this chapter offers is a new set of diagrams to represent graphically how various interests act.

§ 32 Why Bother? [185-186]

Many students, confronted with a seemingly impenetrable mass of concepts developed in the Middle Ages, reasonably ask why they should bother to learn this stuff. From the narrow view of a course in trusts and estates, the strongest is that these concepts are the basic building blocks for estate plans. A broader reason for studying this material stems from law schools' mission of training people to analyze legal problems, irrespective of the particular subject matter. Learning how to handle densely tangled topics takes practice. The law of present and future interests provides an excellent opportunity for getting that practice: this law is complicated; it presents unfamiliar terminology; and it requires attention to detail. Consider this topic as affording a chance to develop skills useful for your professional lifetime.

§ 33 Present v. Future Interests: Dividing Time [186-187]

Here are some basic principles:

- The law separates the notion of ownership from the thing owned. We own "interests" in land, rather than the dirt itself.
- We can divide our interests among different people, according to when they have the right to use the land.
- We treat these individual interests as if they were things in themselves. We give them characteristics.

§ 34 Present Interests [187-196]

A. Fee Simple Absolute

In terms of dividing ownership according to time, the fee simple absolute is everything. (See Figure 9-1.) At common law, deed drafters seeking to create this interest had to use words like, "To Suzanne *and her heirs*." The "and her heirs" (or "and his heirs") language was critical. Courts interpreted those words not as words of purchase indicating who got the property—Suzanne's heirs got nothing from such a grant; rather, courts treated the magic words as words of limitation describing the estate granted. The words "and her heirs" came to indicate a grantor's intention to give an estate that would extend beyond the

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

grantee's lifetime and go on forever. The requirement of including "and her heirs" language is almost dead, and this text will not include it in future examples.

B. Defeasible Fees

Defeasible fee simple estates get their name because they could go on forever, but also can be lost. (See Figures 9-2 to 9-5.)

1. Expiration v. Divestment

A Defeasible fee can end by expiring, if the grantor has placed a limit on the grant. For example, Shannon might give property "to the School Board so long as the land is used as a school." The school board might keep the property forever, but if they stopped using it as a school, their ownership would end. Language like "so long as," "while," and "until" is called "limitational" language because of the notion that it limits the estate from the start. When used in conjunction with a fee simple's potential for infinite duration, limitational language creates a *fee simple determinable*.

The other way for a defeasible fee simple to end is by being divested, or cut short. This result is possible if the grantor has used "conditional" language like "but if," "provided, however," or "on the condition that." The law recognizes two types of defeasible fees subject to being divested. Which label we use depends upon who holds the future interest that follows.

- If the grantor retains the future interest, we call the *present* interest a *fee simple subject to a condition subsequent*.
- If someone other than the grantor has the future interest following a defeasible fee created by conditional language, we call the *present* interest a *fee simple subject to an executory limitation*.

C. Life Estate

The life estate is both easy to recognize and easy to understand. (See Figure 9-6.) If Cletus gives property "to Helen for life," Helen has a life estate. If the property is realty, Helen has the right to possession during her lifetime. If the gift is in trust, Helen usually will have a right to trust income during her life.

1. Defeasible Life Estates

Grantors can also create life estates that may end before the death of the life tenant. Like defeasible fees, these life estates can either expire or be divested. If Cletus says "to Helen for life or until she remarries," he would create a life estate determinable, sometimes called a life estate subject to a special limitation. (See Figure 9-7.) Helen's interest can now expire either

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

of two ways, her remarriage or her death. Life estates can also be subject to divestment, either by a right of entry or by an executory interest.

2. Life Estate for the Life of Another

If Cletus gives property "to Helen for the life of Menelaus," Helen has a life estate for the life of another (a/k/a a "life estate *pur autre vie*.") (See Figure 9-8.) When Menelaus dies, Helen's estate ends.

D. Fee Tail

At common law, if a grantor gave land "to Kelly and the heirs of her body," Kelly would have a fee tail. That interest would then pass to her children, their children, and so on, until the death of Kelly's last descendant. At that point, ownership would either come back to the grantor (who retained a reversion) or move on to someone else identified in the original document (who would have a remainder).

Because the fee tail promoted family dynasties and interfered with the marketability of land, virtually all states have abolished it. Sometimes old wills or lay-drafted wills use the "heirs of the body" language. You need to know to check the applicable local statute to see what interests those words create under modern law.

§ 35 Future Interests [196-211]

A. In the Grantor

Interests which a grantor retains are called "reversionary" interests. There are three:

- A *possibility of reverter* follows a fee simple determinable.
- A *right of entry* (a/k/a a power of termination) follows a fee simple subject to condition subsequent.
- A *reversion* is the interest a grantor retains if he creates only a life estate, or a life estate and contingent remainders.

B. In Grantees

Grantees can hold two kinds of future interests: executory interests and remainders. Both are held by third party grantees. One way to help distinguish between the two categories is by assigning each a personality characteristic. Executory interests (with one exception) are aggressive; they go around cutting short other interests; they have hatchets. In contrast, remainders are patient;

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

they snuggle up against a present interest and wait for its natural expiration; they have pillows.

1. Executory Interests

Developed after the Statute of Uses in 1536, executory interests made possible the fee simple subject to an executory limitation. They also allowed a third party to take following a fee simple determinable. (This latter situation is the one exception to the rule that executory interests take possession by divesting. Because a fee simple determinable expires on its own, the executory interest has nothing to divest.)

2. Remainders

a. Vested Remainders

A remainder is "vested" if it satisfies three tests:

- The holder of the remainder must be someone who has been born.
- That person must be identified.
- There can be no express or implied condition precedent to that person taking.

i. Indefeasibly Vested

An indefeasibly vested remainder is just a fee simple absolute, pushed out into the future. Suppose Joseph's will gives property "to Rose for life, remainder to Barbara." Rose has a life estate, and Barbara has an indefeasibly vested remainder. (See Figure 9-9.)

ii. Subject to Complete Defeasance

Many vested remainders subject to complete defeasance are just defeasible fees, pushed out into the future. Others are life estates in future garb. Like their present interest counterparts, these remainders can end either by expiration or by divestment.

Suppose Jenn leaves the farm "to Pat for life, then to the School Board so long as they use the land for school purposes." Pat has a life estate, the Board has a vested remainder subject to complete defeasance, and Jenn has a possibility of reverter. (See Figure 9-10.)

If Jenn had said, "to Pat for life, then to the School Board, but if the land is not used as a school, then to Beneth if she is then living," the Board still would have a vested remainder subject to complete

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

defeasance. Beneth would have an executory interest. (See Figure 9-11.)

If Cletus gave property in trust, with the income “to Helen for her life, and then to Carol for her life, and after her death distribute the principal to Ryan, ” Helen has a life estate; Carol has a vested remainder for life; and Ryan has an indefeasibly vested remainder. (See Figure 9-12.)

iii. Subject to Open

Sheppe may give property “to my wife Mindel for life, and then to our children.” Because later children could qualify as class members, we say the class is “open” during Mindel’s life. If Sheppe and Mindel have one child, Frieda, her remainder is vested. To account for that the chance that Frieda will have to share her remainder with a later-born sibling, we say her remainder is *vested, subject to partial divestment*. Because this situation arises only when we have an open class, many lawyers use the shorter term “vested, subject to open.” (See Figure 9-13.)

Vested remainders can be subject to complete defeasance and subject to open at the same time. (See Figure 9-14.)

b. Contingent Remainders

If remainders are not vested, they are contingent. (See Figure 9-15.) Recalling the definition of vested remainders, ask:

(1) Is the holder of the remainder someone who has not yet been born?
(2) Is the holder of the remainder unidentified?
(3) Is there any express or implied condition precedent to that person taking?

If the answer to any question is “yes,” the remainder is contingent. When you identify a remainder as contingent, be sure you also identify *why* it is contingent. That way you will know whether the remainder vests if facts change. Also, remember that if you have a contingent remainder, you also have a reversion.

1. Alternative Contingent Remainders

If Joanne grants property “to Scott for life, then to Taylor if he survives Scott, and if he does not, to Todd.” Scott has a life estate. Taylor has a contingent remainder, contingent on survival. Todd has

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

a contingent remainder, contingent upon Taylor's non-survival of Scott. (See Figure 9-16.) Joanne has a reversion.

2. Contingent Remainders Subject to Open

If Joanne transfers land "to Scott for life, then to his children who graduate from college." While Scott is alive and his children have not yet graduated, the children have contingent remainders, subject to open. (See Figure 9-17.)

c. Vested or Contingent?

When drafters create alternative future interests following a life estate, it may be particularly difficult to classify those interests. Usually two possible constructions appear. There may be a vested remainder and an executory interest, or two alternative contingent remainders and a reversion. Most of the time, reading the words in order will tell you whether particular language creates a vested or a contingent remainder.

The key to classification in this context usually is the first remainder. If it is contingent, then an alternative contingent remainder construction likely will follow. If the first remainder is vested, then the second interest probably will be an executory interest. See *In re* Krooss, 99 N.E.2d 222 (N.Y. 1951).

Classic doctrine says that the law favors vested interests. The best argument for the rule may be that a vested construction will tend to avoid cutting off one line of a family. Suppose Eva's will creates a trust for Hope for life, with ambiguous remainders to her children, Carleton and Channey. Suppose also that Channey survives Eva, but dies before Hope. If a court construed Channey's gift as contingent upon his surviving Hope, Channey's family may lose out. If, as under the traditional rule, Channey need not survive, his family could be expected to take the remainder by his will or intestacy.

§ 36 Putting It Together [211-212]

Use the chart on text page 212 as a guide, taking classification one step at a time.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 10
POWERS OF APPOINTMENT

Powers of appointment are the lifeblood of trusts' adaptability over time. A power of appointment is a power one person has to designate who will take property subject to the power or what shares the takers will receive. *See* Restatement (Second) of Prop. § 11.1. A trustee's powers to allocate income among various beneficiaries or to invade the trust principal on someone's behalf are powers of appointment. This chapter concerns powers individuals have to allocate the shares of a trust long after it was created.

§ 37 The Basics [214-219]

A. Postponed Decisionmaking

Powers of appointment are useful because they can buy time. Suppose Edna wants to set up a trust for her son, James, a young adult without children. She might give James the trust income for his life, with the principal distributed equally among his (yet unborn) children at James' death. The problem is that Edna cannot know if James will have children, or how many, or what their needs will be by the time James dies. Rather than arbitrarily fixing the shares ahead of time, Edna instead could give James (or someone else) a power of appointment to identify who should take the trust principal, and in what shares. By creating a power of appointment, Edna can keep her trust adaptable to changed circumstances.

B. The Players

The **donor** is the person who creates the power. The person who gets the power is called the **donee**. The donee can give the property only to people the donor identifies as **objects** of the power, which may or may not include the donee. If the donee exercises the power, the recipient is called an **appointee**. To the extent the donee does not exercise the power, the property goes to a **taker in default**, if the donor so provided. The same person may assume several roles.

C. Classification of Powers

1. Permissible Donees

The breadth of the class of objects is one criteria for dividing powers:

- A **general** power is one in which a donee can give the property to himself, his creditors, his estate, or creditors of his estate.
- A **special** power is one in which a donee is limited to a particular class of objects.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

- A **hybrid** power (usually created for tax savings) is one that can be exercised to benefit anyone except the donee, his creditor, his estate, or its creditors.

Lawyers and courts usually refer to either "general" or "special" powers. In most situations, "general" probably means a power exercisable in favor of the donee, his estate, his creditors, or the creditors of his estate. If the question involves tax, "special" probably means "not general." If the question does not involve tax, "special" means "for a limited class of objects" (excluding the donee, the donee's creditors, the donee's estate or creditors of the donee's estate as class members).

2. Method of Exercise

Powers are also classified by how and when they can be exercised:

- **Inter vivos powers** are ones exercisable by a deed during the donee's lifetime
- **Testamentary powers** are exercisable by a will at death

These two basic lines of division overlap. We can have general inter vivos powers and special inter vivos powers. We can also have general testamentary powers and special testamentary powers.

D. Estate Tax Treatment

The details can get very complex, but the general principles are straightforward. If a donee dies holding a general power of appointment, the property subject to that power will be included in the donee's gross estate for tax purposes. Property subject to a special power will not suffer the same fate. I.R.C. § 2041.

E. Who Owns the Property?

1. Relation-back

Traditionally, the law viewed a donee of a power almost as an agent of the donor, who retained ownership of the property until the donee exercised the power. Under this view, the exercise of the power then relates back to the power's creation, so the exercise fills in blanks which had been left in the document creating the power. The appointee thus gets the property from the donor, not the donee. Because the property subject to the power was not the donee's, claimants against the donee came away empty-handed. See *Quinn v. Tuttle*, 177 A.2d 391 (N.H. 1962).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

The relation-back theory makes sense in the context of a special power. Because the donee cannot appoint the property to herself, the property is not in any practical sense hers.

2. General Powers

Because the donee of a general power is only a paper-thin line away from absolute ownership, however, treating the property as the donor's, and thus not subject to claims against the donee, is hard to justify.

The law is split. Property subject to general powers is part of the donee's gross estate under the federal estate tax. I.R.C. § 2041(a). In many states, however, creditors of the donee of a general, presently exercisable power cannot force the donee to exercise the power in their behalf. See Restatement (Second) of Property § 13.2. Several state statutes and UTC § 505(b) have reversed the rule so creditors can to get the appointive property after they have exhausted the donee's property.

3. Choice of Law

Because donors and donees often live in different places, choice of law issues are often critical to powers of appointment cases. For example, disputes may arise about whether the donee of a general power properly exercised the power. The relation-back doctrine, which views the donee as merely filling in blanks in the donor's document, leads to the traditional view that the law of the donor's domicile controls. See *Beals v. State St. Bank & Trust Co.,* 326 N.E.2d 896 (Mass. 1975). A less doctrinaire approach recognizes, however, that the donee's will is likely to be drafted with the law of the donee's domicile in mind, so the donee's law should control questions surrounding the adequacy of the exercise. See *White v. United States*, 680 F.2d 1156, 1160 (7th Cir. 1982).

§ 38 Creating Powers [219]

A careful draft of the document creating a power of appointment can avoid many of the problems which can arise when a donee executes the power. Sadly, testators sometimes say something like "to my son, Keoka, for life, and at his death to his executors." From the context it is clear that the executors are not meant to take a remainder in their personal capacities, but guessing at what the testator really intended can be difficult. Compare *In re Thompson's Estate*, 80 N.Y.S.2d 1 (N.Y. App. 1948), with *Bredin v. Wilmington Trust Co.,* 216 A.2d 685 (Del. Ch. 1965). Powers are wonderful tools, but like most tools, you should treat them with respect.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

§ 39 Exercising Powers [220-227]

A. Getting It Done

The first step for someone about to exercise a power of appointment is to check carefully the document creating the power. It can (and should) specify not only who has the power, but the steps the donee must take to exercise it. Failure to follow the instructions probably means failure of the attempted exercise. See *Catch v. Phillips*, 86 Cal. Rptr. 2d 584 (Cal. App. Ct. 1999).

Among the most common problems involving powers of appointment is whether a residuary clause in a donee's will exercises a power. The will may use general, "all of my property" language, or a "blending" clause like "including all property over which I have a power of appointment." Sometimes a donee's residuary clause refers to "the rest of my property," but does not mention the power of appointment in question. Courts reach a variety of conclusions. See *Beals v. State Street Bank & Trust Company,* 326 N.E.2d 896 (Mass. 1975). Under UPC § 2-608, a general residuary clause, without more, will not exercise a power.

B. Problems of Scope

1. General Powers

The donee of a general, presently exercisable power can use the power to create new property interests just as if she owned in fee simple the property subject to the power. The same rule applies, although perhaps somewhat less universally, to general testamentary powers. Restatement (Second) of Property § 19.1.

2. Special Powers

The most common approach to interpreting special powers is that a donee has the power to create whatever interests she desires, except as the donor has restricted that use. Because special powers limit donees' choices of appointees, however, some courts have viewed special powers as somehow smaller than general powers in other respects as well. For example, in *Loring v. Karri-Davies,* 357 N.E.2d 11 (Mass. 1976), the holder of two special powers was not allowed to exercise them to create trusts for the appointees.

A special power can be either **exclusive** or **nonexclusive**. "Exclusive" means having the power to exclude some of the objects of the power in favor of others. Courts disagree as to whether a donee should be presumed to have the power to exclude. See *Harlan v. Citizens National Bank of Danville,* 251 S.W.2d 284 (Ky. 1952). If a special power is nonexclusive,

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

the donee must give each object something. Courts disagree about whether each object must get a substantial part of the assets subject to the power or whether nominal gifts to some will do.

C. Failure to Appoint

Well-drafted powers of appointment include takers in default. To the extent that the power is unexercised, they usually will take the appointive property. Sometimes, however, a donor will not name takers in default, or the takers in default will be unable take the property, or the donee will indicate a desire to claim the property for herself if the appointment fails.

1. General Powers

An unexercised general power simply leaves the property where it was, in the hands of the donor.

An ineffective exercise of a general power, however, raises the question of whether the donee intended to assume control over the property for more than the limited purpose of exercising the power. If so, the donee may have "captured" the property for his own estate. See *Talbot v. Riggs,* 191 N.E. 360 (Mass. 1934). Commentators have identified four factors that may convince a court that a donee intended to capture the property:

- a blending clause
- a residuary clause that is presumed to exercise a power
- a residuary clause revealing an intent to exercise the power because the donee's estate would otherwise be insufficient to satisfy the donee's gifts
- an appointment in trust.

2. Special Powers

If there are no takers in default, the property of an unexercised special power usually will go equally to the objects of the power, rather than return to the donor. Some courts imply a gift in default to the objects. See *Loring v. Marshall*, 484 N.E.2d 1315 (Mass. 1985). Others say the donee has a "power in trust," sometimes called "an imperative power," with a duty to exercise the power. See *Daniel v. Brown*, 159 S.E. 209 (Va. 1931).

§ 40 Drafting Powers of Appointment [227-229]

Careful drafting can avoid most of the problems discussed in this chapter. For an example, see the form (and commentary) on text pages 228-229.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 11
PROBLEMS OF INTERPRETATION

§ 41 Introduction [231-239]

This chapter discusses a number of doctrines governing what documents mean. Some of these doctrines developed as part of wills law, some as part of future interests law, and others as statutory responses to perceived inadequacies in each.

A. The Donor's Intention [?]

Deeply imbedded within our law is the notion that a court seeking the meaning of a donative document should attempt to identify the donor's intention. The canonization of "intention" causes confusion, however, as courts struggle to attribute to donors subjective intentions they almost certainly never had. The document might apply in a situation unanticipated at the time it was drafted. The donor may not have understood it. The language may not be clear, because it is tangled or when applied to the real world, it does not fit.

B. Mistake and Extrinsic Evidence

Courts traditionally have been reluctant to look beyond the language of a document when they try to determine its meaning. They may give effect to the "plain meaning" of particular technical words, or stretch a bit further and consider the whole document. The problem is that what is plain to a particular judge may not be so plain to other people. Understanding the bigger picture, however, requires a court to admit extrinsic evidence, and courts traditionally have been unwilling to do so unless that evidence is needed to resolve ambiguity.

1. Patent and Latent Ambiguities

A patent ambiguity is one apparent from the face of a document. For example, "I give Arnie one of my two houses in Toledo." Traditionally, no extrinsic evidence is admissible to resolve the problem, and the gift fails.

A latent ambiguity is one only discoverable by considering evidence extrinsic to the document. See *In re Estate of Gibbs*, 111 N.W.2d 413 (Wis. 1961). Latent ambiguities can arise in either of two ways:

- Two or more items meet the description
- Nothing meets the description.

Traditionally, extrinsic evidence is admissible to resolve a latent ambiguity.

The direction of the law, but perhaps not yet the majority position, is to

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

allow extrinsic evidence to resolve ambiguity, whether patent or latent. Restatement (Third) of Property § 11.1 comment a.

2. Interpretation or Reformation?

Because traditional rules preclude reforming wills, courts faced with mistakes in drafting often purport to "interpret" or "construe" a document in order to correct the mistake. In a comprehensive and influential article, Professors Langbein and Waggoner propose that courts instead recognize a reformation doctrine for wills. John H. Langbein & Lawrence W. Waggoner, *Reformation of Wills on the Ground of Mistake: Change of Direction in American Law?*, 130 U. Pa. L. Rev. 521 (1982). The Restatement has endorsed their approach. Restatement (Third) of Property § 12.1. Not only would such a development allow courts to be more honest about what they are doing, but it would also bring wills law more into line with the law of will substitutes.

The text discusses two illustrative cases (one about a trust, the other, a will). Each involves perhaps the most frequent source of litigation about documents — ones that fail to anticipate what actually happens. Compare *Brinker v. Wobaco Trust Ltd.,* 610 S.W.2d 160 (Tex. Civ. App. 1980), with *Flannery v. McNamara*, 738 N.E.2d 739 (Mass. 2000).

The current UPC, while not providing for reformation, allows it. Section 2-601 notes that the Code's rules of construction apply "[i]n the absence of a finding of contrary intention." The earlier version had referred to "contrary intention indicated by the will." The comments explain that "[t]he striking of this sentence removes [a] possible impediment to the judicial adoption of a general reformation doctrine for wills . . . ."

§ 42 Independent Significance [239-240]

Courts must also rely upon extrinsic evidence in many situations not involving mistake. Suppose Akiko's will reads "all the books in my library to Mitsuo Matsushita" or "$500 to each of the members of the Galesburg Sewing Circle." In order to interpret these gifts, a court might rely upon a library catalog or an after-death inventory, a sewing circle mailing list or a dues record. Courts routinely consider such evidence under the doctrine of independent significance.

The key to the doctrine is the notion of significance *independent of the will*. Some situations straddle the line. Suppose Naomi leaves a will giving "everything in my right-hand desk drawer to Beth and everything in my left-hand desk drawer to Andrea." The designation might be innocent. If the evidence showed, however, that Naomi moved things from one side to the other as she changed her mind about who should get what, the gifts should fail. In that case, Naomi would have used the drawers to change testamentary gifts without complying with the Statute of Wills

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

§ 43 Class Gifts [240-243]

A. What Is a Class?

Most class gifts are easily recognizable, like gifts to "children" or "issue." Some are not. On the margin, courts seeking to identify class gifts ask two related questions: Was the testator "group minded"? Did the testator intend for the size of the group to fluctuate? As a practical matter, courts often look first to the consequences of applying the "class gift" label, and then work backward to see if calling something a class gift will make sense in a particular situation. See *Sullivan v. Sullivan*, 529 N.E.2d 890 (Mass. App. 1988).

B. When Does a Class Close?

Virtually everyone who has attended college has had the experience of being shut out of an academic class that closed. The same idea applies to class gifts. Class closing rules set the maximum size of a class. Just as students can drop out of academic classes, so can members drop out of donative classes, making them smaller. The class closing rules, then, do not establish the exact size of a class, but only its ceiling.

1. Physiological Closing

Classes close physiologically when all the persons who can feed the class are dead. For example, if a trust provides income "to Jessica's children," the class cannot grow after Jessica's death. A gift "to my nieces and nephews" would close physiologically only after the deaths of all of the donor's siblings.

2. The Rule of Convenience

Classes will close according to the rule of convenience when any class member has a right to demand possession. Because income can be reallocated as new class members arrive, the rule only applies to gifts of principal. The examples below are simply applications of the basic principle: once one class member has a right to his or her share, afterborn class members are cut out. Assume that the class feeders are alive.

Immediate Gifts. Suppose Howard's will gave $10,000 "to Ethel's children." If Ethel has a child, the class closes at Howard's death. If Ethel has no children, the class remains open until Ethel's death, even if she later has a child who could take.

Suppose Helen's will gave $3,000 "to each of my grandchildren." Because the total amount of the gift varies with the number of grandchildren, the

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

class closes at Helen's death to allow closing of Helen's estate. This result would follow even if Helen had no grandchildren. We can neither keep the estate open until the class closes physiologically, nor know how many $3,000 shares to set aside for possible future grandchildren. If, instead of coming from an estate, the funds would come from a trust, this rationale would not apply. See *In re Earle's Estate*, 85 A.2d 90 (Pa. 1951).

Postponed Gifts. Suppose Rivke established a trust to pay income to "Noyich for life, remainder to Sylvia's children." At Rivke's death, Sylvia has one child, David. Before Noyich dies, Sylvia has Ricky. The class does not close until Noyich's death, when David can demand distribution. Ricky shares the fund.

§ 44 Special Cautions [244-256]

When you draft or review documents, the phrases below should jump off the page as ones that you should either not use, or use only with great care.

A. "To Delison and His Children"

Suppose Evelyn gave her farm "to Delison and his children." See *Wild's Case*, 77 Eng. Rep. 277 (K.B. 1599). Delison and his two daughters, Susan and Angela, survived Evelyn. Consider some possible interpretations, each with some supporting authority:

- Delison, Susan and Angela own the farm as co-tenants.
- Delison has a fee simple.
- Delison has a life estate, and the daughters have vested remainders, subject to open.

The bottom line: avoid this formulation.

B. "If Dorthea Dies Without Issue"

When the fee tail was still in use, English courts read "if Dorthea dies without issue" to mean "if her line runs out." Most states now adopt a definite failure of issue construction, which means we ask if Dorthea has died leaving issue surviving her death. Another conflict surrounds what to do if Dorthea had a child, but the child died before Dorthea. The standard rule is that "dies without issue" means "dies without issue surviving her (or him)."

1. Substitutional v. Successive

Suppose George's will leaves property "to Dorthea, but if she dies without issue, to William." Some authorities say if Dorthea survives George, she gets a fee simple absolute and William gets nothing. The theory here is that

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

"dies without issue" means "dies without issue before George dies." This is a *substitutional* construction; William is an alternative beneficiary of George's will.

Other authorities give Dorthea a fee simple subject to an executory limitation, and William, an executory interest. Under this view, the language means "dies without issue whenever Dorthea dies." This is a *successive* construction; William can divest Dorthea if she later dies without issue. When the gift involves a present interest, the successive construction is preferred, but not universal. See Restatement of Property § 263.

Similar construction problems arise if someone uses a phrase like "dies with issue." The question remains: When? See *Pyne v. Pyne,* 154 F.2d 297 (D.C. Cir. 1946).

C. "To Vernon's Youngest Grandchild"

Suppose a testator says a trust "shall be maintained for the benefit of my grandchildren and shall not be sold until the youngest of said grandchildren has reached twenty-one years of age." See *Lux v. Lux*, 288 A.2d 701 (R.I. 1972). Someone might qualify as the "youngest grandchild" at any of four times:

(1) when the will was executed,
(2) when the will was effective,
(3) when the youngest alive at any time reached 21, or
(4) when no more grandchildren could join the class.

Lux chose the third option, but the drafter should have clarified the point.

D. "To Joyce's Heirs" or "To My Heirs"

1. Identifying Heirs

A court deciding who fits the description of "Joyce's heirs" starts by looking at an intestate statute. Two principal problems emerge.

a. What Statute Should Apply?

Suppose Edwin died an Illinois resident in 1970, leaving personal property in trust "to Lois for life, remainder to Joyce's heirs." Joyce, who lived in Indiana, died in 1980. Should the law of Illinois (the testator's domicile) or Indiana (the designated person's domicile) identify Joyce's heirs? There is authority for each position

Suppose Illinois law applies, but the statute was revised in 1975. Should the new or the old version control? The authorities are split.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

b. When?

As a starting place, we expect to determine someone's heirs at the time of her death, but in many situations such a reading would not match a donor's likely intention. Problems can arise both with immediate gifts and with gifts of future interests. For some examples, see the discussion surrounding Chart 11-2 in the text.

2. "To Joyce for Life, Remainder to Her Heirs": The Rule in Shelley's Case

The rule applies to gifts of land to a life tenant, with an attempted remainder to the heirs of the life tenant. Regardless of the intention of the donor, the rule invalidates the attempted remainder to the heirs, and substitutes in its place a remainder owned by the life tenant.

If Edwin gave realty "to Joyce for life, remainder to her heirs," the rule would change that grant to read "to Joyce for life, remainder to Joyce." Then, the doctrine of merger would apply to create a fee simple absolute in Joyce. Be careful not to collapse the analysis and jump straight to the fee simple. All *Shelley* does is convert the remainder. Whether to apply merger is a separate question.

The Rule in Shelley's Case is dying, but not dead. It lingers on in a few states and has only recently been abolished in others.

3. "To Joyce for Life, Remainder to My Heirs": The Doctrine of Worthier Title

The doctrine establishes a presumption that a grantor's gift of a remainder to the grantor's own heirs was not intended as a remainder at all but, rather, as a way of retaining a reversion. An easy way to remember the doctrine's impact is to say it simply invalidates remainders to heirs of the grantor. Thus, if Edwin created a trust giving "income to Joyce for life, remainder to my heirs," the doctrine would have us strike the remainder, leaving only "income to Joyce for life." Without more granted, Edwin has a reversion.

Oddly, saying "remainder to my heirs" is not enough to overcome the presumption; something more is required. Though disputes are legendary, language like the following ought to be enough: "By this grant I fully intend to overcome the Doctrine of Worthier Title and to create a remainder in my heirs, and not to retain a reversion for myself."

UPC § 2-710 abolishes Worthier Title, but the doctrine persists.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

4. A Checklist

Often a gift to heirs will present several problems at once. See *Warren-Boynton State Bank v. Wallbaum*, 528 N.E.2d 640 (Ill. 1988). If you see a remainder to the "heirs" of some person, ask:

- **Is the person alive?** If so, the remainder is probably contingent.
- **Is the person a life tenant?** If so, *Shelley* may apply.
- **Is the person the grantor?** If so, Worthier Title may apply.
- **When should "heirs" be determined?**

E. "To Linda's Issue" or "To Linda's Children"

1. Allocating Shares

Suppose Hope's will gave property "to my descendants." Hope dies leaving one son, Gordon, and his three children, Gord, Chuck and Kathy. Hope's other son has predeceased, leaving two children, Kendra and James. (See Chart 11-4(A).) Do the descendants take per capita, so each gets 1/6? Or do they take by representation, so Gordon gets half and James and Kendra share the other half? If Gordon has also predeceased (see Chart 11-4 (B)), do the grandchildren take equally, or do Gord, Chuck and Cathy share one half while James and Kendra share the other? The document should have covered these questions.

When they need clarification, courts often interpret documents according to the way the local intestate statute would handle the problem. The First Restatement endorsed that approach. *See* Restatement of Property § 303. The Second Restatement established its own rule. Restatement (Second) of Property § 28.2. UPC § 2-708 follows the First Restatement.

2. Identifying Takers

Additional problems arise if individuals claim membership in a class by way of adoption, or if they are nonmarital children. In addition to the fairness issues considered regarding intestate statutes, when interpreting documents we should consider what the donor intended. In the absence of an identifiable intent to include nonmarital children in class gifts, traditional rules excluded them.

Adopted children were presumed included in an appropriate class gift created by their adopting parents, but they were excluded from class gifts created by others who did not know of the adoption. The idea was that "strangers to the adoption" should not have adopted family members foisted upon them. Presently, both adopted and nonmarital children are

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

more likely than they were in the past to be included in class gifts. See *In re Estate of Coe*, 201 A.2d 571 (N.J. 1964); *Will of Hoffman*, 385 N.Y.S.2d 49 (N.Y. App. 1976); 755 Ill. Comp. Stat. 5/2-4(f).

UPC § 2-705 distinguishes between class gifts from parents (biological or adoptive) and class gifts from "strangers" to the conception or adoption.

§ 45 Changes After Drafting: People [256-278]

A. Arrivals

We have already discussed, in different places, various doctrines affecting documents in light of new arrivals. If someone gets married, his whole will may be revoked. The new spouse may have a "pretermitted spouse" claim. If a testator has a child, the child may be able to take a share of the estate. If a will or trust creates a class gift, a newborn or newly adopted class member may be able to qualify for it, if the class is still open. In various ways, all these doctrines address the problem of how to handle those who arrive on the scene after a document has been drafted.

B. Departures

1. Divorce of the Donor

Suppose Glenn and Tracy marry and have two children. Glenn executes a will giving everything to Tracy or, if she does not survive him, to the children. He makes an identical beneficiary designation for his life insurance. Later the marriage collapses and the parties divorce, but the decree does not mention either the will or the insurance policy. When Glenn dies without having revised either document, Tracy claims the proceeds of each. In most states Tracy would lose under the will, but still take the life insurance. The reason for the different treatment is that virtually every state has a statute denying will benefits to a former spouse, but the statutes seldom apply to will substitutes.

Some courts have stretched doctrine or statutes to cover will substitutes. See *Miller v. First National Bank & Trust Co.,* 637 P.2d 75 (Okla. 1981); *Clymer v. Mayo,* 473 N.E.2d 1084 (Mass. 1985). Others have been more direct at simply applying the wills rule to the life insurance context. See *Vasconi v. Guardian Life Insurance Co.,* 590 A.2d 1161 (N.J. 1991).

UPC § 2-804 cuts across a range of will substitutes. It revokes appointments and beneficiary designations of, and severs joint tenancies with, the former spouse. Property which would otherwise go to the former spouse passes as if the spouse, and the spouse's relatives, had disclaimed.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

2. Death: The Need for Survivorship

The most common way for beneficiaries to drop out of a donative document is by dying. In this context, timing is everything. Traditionally, survival of the donor, even by a moment, is enough for someone to qualify. Moreover, unless the document provides otherwise, once someone acquires a future interest, it usually remains valid even if the holder dies before the time for possession.

a. Survival: Simultaneous Death

Questions about whether one person survives another have two aspects: one medical, the other legal. Suppose Carol and Greg had wills giving everything to each other, but then died in a plane crash. Who should inherit from whom?

An early version of the Uniform Simultaneous Death Act provided that where "there is no sufficient evidence that the persons have died otherwise than simultaneously, the property of each person shall be disposed of as if he had survived." Unif. Simultaneous Death Act § 1, 8A U.L.A. 561 (1953). The idea was to solve the dilemma of insufficient evidence and to distribute property to living people as much as possible. The statute was drafted too narrowly, however. Claimants were able to produce evidence of bare survival and thereby overcome the statute, defeating its second purpose of not giving property to dead people. See *Estate of Rowley v. Bunnell*, 65 Cal. Rptr. 139 (Cal. App. 1967).

In response, UPC § 2-702 created a legal definition of survival, requiring one person to have survived another by 120 hours before being deemed to have survived for the purpose of interpreting documents, including will substitutes.

b. Surviving the Donor: Lapse

Suppose James leaves a will giving his piano to Jessamal, but that she predeceases him. At common law, Jessamal's gift would "lapse," or fail. The piano would be distributed under the residuary clause, or, if the will lacked one, by intestacy. Because legislators thought that in some cases such a result would be contrary to a common testator's intention, they passed "antilapse" statutes. See Restatement (Third) of Property § 5.5, statutory note.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

i. Traditional Antilapse Statutes

Because antilapse statutes vary in detail, it can be helpful to have a series of questions you can ask about whatever statute you face:

Is the predeceased beneficiary in a class protected by the statute? The answer depends upon the relationship between the testator and the beneficiary. Some jurisdictions protect gifts to all beneficiaries; some apply only to gifts to relatives; some only cover gifts to descendants.

Did the beneficiary die before the will was executed? Under the common law, a gift to someone dead when the will was executed did not lapse; rather, it was "void." Most statutes expressly cover both lapsed and void gifts, but some do not.

Did the beneficiary leave survivors who qualify under the statute to take the gift? This time the key is the relationship between the predeceased beneficiary and that person's survivors. If appropriate survivors exist, they will take the gift. By far the most common substitute takers are issue of the beneficiary.

How does the document's language affect the statute? Antilapse statutes will yield to contrary expressions of intent.

> ***Survivorship.*** Much confusion surrounds the impact of adding survivorship language to a gift. Authorities sometimes say a mere survivorship requirement is enough to override the statute. See *Estate of Rehwinkel*, 862 P.2d 639 (Wash. App. 1993). The law is not clear, however, so relying upon that approach is risky. UPC § 2-603, comment.
>
> ***Class gifts.*** Many statutes expressly apply to class gifts. When the statute is not clear, courts are divided. The Restatement's position is that antilapse statutes do apply to single-generation class gifts (e.g., children), but not to multiple-generation gifts (e.g., descendants). See Restatement (Third) of Prop. § 5.5 cmt. j.
>
> ***Powers of Appointment***. When the testator is exercising a general power, courts usually will apply an antilapse statute, if its other terms are met. On the other hand, if the power is special, courts may refuse to apply the statute.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Does the statute apply to documents other than wills? By their terms, virtually all antilapse statutes apply only to wills. Some authorities extend the coverage to will substitutes. See *Estate of Button v. Old Nat'l Bank*, 490 P.2d 731 (Wash. 1971).

ii. The UPC

UPC § 2-603 expands and clarifies antilapse statutes while covering class gifts, testamentary exercises of powers of appointment, and void gifts. Sections 2-706 and 1-201 extend antilapse protection to a variety of will substitutes.

Its most ambitious and controversial step is to clarify the rules surrounding what language will preclude the application of the statute and who the alternate takers ought to be in various circumstances. The language "if she survives me," without more, is not enough to prevent the statute from substituting alternative takers if the named beneficiary does not survive. Only if testators clearly express another intention can they avoid the statute's solutions. The best way to avoid the statute is to provide an alternative gift.

For examples, consult text pages 266-269, the comments to UPC § 2-603, and the comments to Restatement (Third) of Property § 5.5.

c. Future Interests: Surviving Until Possession?

Suppose Peggy's will left property "to my husband Ricky for life, remainder to Todd," and Todd survived Peggy, but not Ricky. Under traditional rules, when Todd survived Peggy, he got a vested remainder. In the absence of a survivorship requirement, Todd does not lose his interest by dying before Ricky. See *Swanson v. Swanson*, 514 S.E.2d 822 (Ga. 1999). This subsection discusses rules that change that result and require a future interest holder to survive until possession.

i. Express Survival Requirements: When?

In general, the law presumes that words of survivorship refer to the time the beneficiary would come into possession of the property. See *In re Gustafson,* 547 N.E.2d 1152 (N.Y. 1989). Although the tendency is to require survivorship until the time of distribution, courts often depart from that rule in particular cases. Sometimes they say "survive" means "survive the testator." Sometimes "survive" means "survive your immediate ancestor."

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

ii. Implied Survival Requirements

In general, courts do not imply survivorship requirements in gifts of future interests. The principal exceptions are:

Multi-generational classes. Courts will imply conditions of survivorship when donors give to multi-generational classes, like "issue," "heirs," and "descendants." Courts generally define these terms as having a built-in survivorship requirement and alternative gift to those who survive. See UPC § 2-707, comment.

"To Thomas for life, remainder to George or Martha." If a gift is phrased in alternative terms, courts usually will read it to mean that the gift to the first person is contingent upon survival. If both of them predecease Thomas, the general rule would not imply a survivorship condition with respect to Martha's gift, so Martha's successors would take.

"To Anton for life, remainder to Stanley at 21." If a gift is to someone "at" a particular age, many courts will read "at" as "if he reaches" and require the donee to survive until that age. On the other hand, courts would probably read "to Stanley, payable at 21" to give Stanley a vested interest, with no survival requirement. Under this reading, if Stanley dies, his successors can demand payment when Stanley *would have reached* 21 (or at Anton's death later). These different interpretations got their start in *Clobberie's Case*, 86 Eng. Rep. 476 (K.B. 1677).

iii. The UPC

Taking an approach paralleling the antilapse statutes discussed above, Section 2-707 applies to future interests under the terms of trusts. The future interests reform takes two basic steps. It requires beneficiaries to survive until the time of distribution, and it provides an alternative distribution of a predeceased beneficiary's interest. The UPC radically alters traditional learning about future interests by making any future interest in trust contingent upon survival.

iv. Applying the Rules

As a vehicle for understanding how the survival rules apply in the context of future interests, see the family tree and discussion of *Security Trust Co. v. Irvine,* 93 A.2d 528 (Del. Ch. 1953), on text pages 276-278.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

§ 46 Changes After Drafting: Property [278-286]

Imagine that Javier drafts a will leaving Antonio 50 shares of Computerwiz stock. Before Javier dies, the stock might split, with additional shares issued for each share owned. Computerwiz might merge with, or be purchased by, another company. Javier might sell, or give away, the stock. Miriam, acting as Javier's guardian or under a power of attorney, might sell it on his behalf. Javier might die owning the stock, but fewer total assets than he had anticipated. This section addresses the doctrines that determine what Antonio would get in these various circumstances

A. Classification of Gifts

Courts and legislatures have identified four classes of gifts:

- Specific: "my oak desk," "my 100 shares of General Motors Preferred Stock," and "my house and lot in Pullman."
- General: "$3,000 to Marsha" and "my land to Calvin."
- Demonstrative: "$6,000 to come first from my credit union account, but if the account is too small, from my other funds."
- Residuary: "everything else I own."

The biggest problem is trying to distinguish—on the margin—between specific and general gifts. One reason for the trouble is that the characterization has different consequences in different circumstances. Predictably, courts may read similar language in different ways as they strain to push a gift into a particular category to produce the result they believe makes the most sense in the case before them. Compare *Haslam v. De Alvarez,* 38 A.2d 158 (R.I. 1944), with *In re Estate of DeVoss*, 474 N.W.2d 542 (Iowa 1991). Sometimes it can help to ask whether the testator was primarily thinking of the gift or of the beneficiary.

B. Increases

People often acquire assets derived from property they already own. Bondholders may receive interest. Stockholders may receive dividends in the form of cash or additional stock. Stocks may split, with the company offering two new shares for each old one. When these changes occur between the time of a will's execution and the testator's death or during the estate administration, questions can arise about which beneficiaries get the "add-ons."

Recall Javier's gift to Antonio. Suppose that after the will's execution, Computerwiz sends Javier a cash dividend. All authorities would agree that Antonio would have no claim to that dividend after Javier's death. The cash would be an estate asset, just like any other money Javier earned before he died. If the dividend were paid in Computerwiz stock, however, Antonio might argue that he should get the additional shares as part of his Computerwiz gift. Most

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

courts say stock dividends do not go along with the underlying gift, because stock dividends, like their cash counterparts, are paid out of corporate earnings. See *Hicks v. Kerr*, 104 A. 426 (Md. 1918). Other courts note that after a stock dividend, the total shares the stockholder owns still reflect the same percentage ownership of the company. Therefore, these courts give stock dividends to the beneficiaries of the underlying stock. See *Butler v. Dobbins*, 53 A.2d 270 (Me. 1947). Accord UPC § 2-605.

Suppose that before Javier's death, Computerwiz splits its stock, two for one, so that Javier dies owning100 shares of their stock. The traditional approach of deciding whether Antonio gets 50 or 100 shares was to ask whether his gift was specific or general. If specific, the new shares would go along as part of the basic gift. If general, they would not. A newer view gives the donee the additional shares after a stock split, regardless of the form of the gift, absent a showing of the testator's different intention. See *Bostwick v. Hurstel,* 304 N.E.2d 186 (Mass. 1973). The UPC adopted the modern approach in 1990. *Compare* UPC (pre-1990) § 2-607 *with* UPC § 2-605. See also Restatement (Third) of Property § 5.3.

C. Ademption

Suppose that by the time Javier died, he no longer owned the stock his will gave Antonio. The dominant approach relies upon classifying the gift as general or specific. If the gift is general, Javier's executor uses general estate assets to buy the stock for Antonio. If the gift is specific, Antonio loses out under the "identity" theory, which says that a specific gift fails if the subject matter is not an estate asset at death

The identity theory can be harsh when assets are missing even though testators have taken no action to remove the assets from the estate. See *McGee v. McGee,* 413 A.2d 72 (R.I. 1980). In response, courts have developed avoidance devices:

- trace assets when someone acting on behalf of the incompetent has transferred property See *Morse v. Converse*, 113 A. 214 (N.H. 1921).
- manipulate the general/specific distinction to avoid the ademption issue altogether. See *In re Buck's Estate*, 196 P.2d 769 (Cal. 1948)
- Apply a "change-in-form" rule. See *In re Estate of Watkins*, 284 So. 2d 679 (Fla. 1973).

UPC § 2-606 adopts an intention-driven rule, expands the change-in-form rule, details specific situations in which tracing is appropriate, and sets up a presumption *against* ademption by extinction. See also Restatement (Third) of Property § 5.2 and comment d. But see *Wasserman v. Cohen,* 606 N.E.2d 901 (Mass. 1993) (noting that the identity rule's "so-called harsh results" can be avoided by careful drafting).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

D. Abatement and Exoneration

These doctrines relate not so much to changes in property as to creditors' claims, but they traditionally depend so heavily upon the classification of gifts that it makes sense to consider them here.

1. Abatement

Abatement addresses what to do when there is not enough money to go around. Typically, gifts to will beneficiaries "abate," or fail in the face of inadequate funds, in the following order: (1) residuary, (2) general, and (3) demonstrative and specific as a single class. Multiple gifts in the same class abate proportionately.

2. Exoneration

Exoneration decrees that a specific gift transfers free from any outstanding mortgage or lien, which then has to be paid by the residuary estate. Some jurisdictions recognize the doctrine, while others do not. Compare A*shkenazy v. Estate of Ashkenazy*, 140 So. 2d 331 (Fla. Dist. Ct. App. 1962) (yes), with UPC § 2-607 (no right of exoneration). The important point for document drafters is that if you include a specific gift, say whether it passes free from creditors' encumbrances, or subject to them.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 12
THE RULE AGAINST PERPETUITIES

> *No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.* John C. Gray, The Rule Against Perpetuities § 201 (Roland Gray ed., 4th ed. 1942).

§ 47 Introduction [287-288]

Among law students, the Rule Against Perpetuities has a bad, and somewhat inaccurate, image. Unquestionably, it is complex, both in its own right, and especially because it builds so much on other technical material. With some work, however, the basics of the Rule are understandable. The goals of this chapter are to provide tools you can use to identify and solve perpetuities problems, and to leave you with a healthy respect for the Rule's intricacies.

§ 48 A Framework for Analysis [289-293]

Three ideas permeate the analysis:

- First, the Rule is concerned about questions that stay unresolved for too long.
- Second, the Rule judges each interest based on facts we know at the time the interest becomes indestructible in a grantee.
- Third, the Rule applies a *possibilities* test, so that if anything could go wrong, you must assume it will.

These ideas prompt a series of questions to ask about each interest you test.

First, is this interest contingent? Here you must consider rules of construction. In general, the Rule applies to all contingent remainders and executory interests, and it does not apply to vested interests. (The Rule also applies to some commercial transactions, like options.) There are some refinements to that principle, however. A contingent gift to a second charity, following a gift to a first charity, is not subject to the Rule. More importantly, vested remainders subject to open, despite their "vested" label, *are* subject to the Rule.

Possibilities of reverter and rights of entry are not subject to the Rule because they are retained interests. See *Brown v. Independent Baptist Church of Woburn*, 91 N.E.2d 922 (Mass. 1950).

Second, what will it take to resolve the contingency? The point here is to be precise. Identify exactly what we will need to know in order to say the interest has vested.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Third, is there someone (or some group) you can identify and say, "Within your lifetime(s) or 21 years thereafter, this contingency will be resolved, one way or the other"? Identifying this "validating life" poses the biggest initial problem formost students. Take it in two steps. First, narrow your search to "relevant lives," those persons who have something to do with the contingency. Once you have identified the people who might make a difference, try them out. As to each person, ask "Can we be sure we will have resolved the problem by the time of your death (plus 21 years)?" If so, that life can be a "validating life," establishing that the interest satisfies the Rule. If the answer is no, try another life. When you run out of relevant lives, and none works, the interest is void under the Rule.

Imagine a typical estate plan, with a life estate, a remainder for life, and an ultimate remainder. The life estate is presently vested, not subject to the rule. The remainder for life is likely to be valid, because often the contingencies surrounding it will be resolved at the end of the first life estate. If that is the case, the first life tenant will be someone alive when the interests were created and can serve as validating life. The ultimate remainder, however, is more likely to be in trouble. The problem will arise because the lives relevant to that interest often will be those who hold the intermediate remainder for life. Those people may not qualify as validating lives because they might not have been alive at the beginning of the perpetuities period. Like all generalizations, these must be used with care, because they will not always apply. For a series of examples, see text pages 289-293.

§ 49 Craziness: If *Anything* Can Go Wrong [293-297]

The Rule will snare a drafter making reasonable assumptions about the way life works, rather than considering remote possibilities. Scholars have categorized these kinds of mistakes into three types.

A. Fertile Octogenarians

The Rule assumes that anyone can have children. See *Jee v. Audley*, 1 Cox 324, 29 Eng. Rep. 1186 (Ch., 1787) (people in their 70's). Now that adopted children increasingly qualify as class members, the presumption of fertility makes some sense. It covers the possibility that an old person might still adopt. The presumption is dangerous for drafters, however, because it is so easy to forget in particular circumstances. When clients describe elderly aunts, uncles, and grandparents, we must fight to remember that, theoretically, they could have or adopt more children, when we know in fact that they will not.

B. Unborn Spouses

You cannot use as a validating life someone identified by description unless the description precludes the possibility that an afterborn might fit it. Consider a testamentary grant in the following form: "To my son for life, then to his widow

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

for her life, and at her death to his children then surviving." See *Pound v. Shorter,* 377 S.E.2d 854 (Ga. 1989). The final gift to the grandchildren is void because the son might marry someone not alive when the testator died. The "wife" could not serve as the validating life. Although its most common application is to spouses, the principle applies to anyone identified by description, rather than by name.

C. Administrative Contingencies

This category involves references to events which people expect will be completed within the perpetuities period, but which might not be. *In re Campbell's Estate,* 82 P.2d 22 (Cal. App. 1938), involved a will giving the residue to the "four chair officers [of an Elks lodge] in office at the time of distribution of my estate." Because the estate might not be distributed within the lives of people alive at the testator's death, the court invalidated the gift to the officers.

§ 50 Class Gifts [298-304]

Class gifts pose special problems under the Rule, because all of the individual interests hang together. See *Leake v. Robinson*, 2 Mer. 363, 35 Eng. Rep. 979 (Ch. 1817). In order for *any* class member's gift to be valid, the uncertainties surrounding *all* class members must be resolved in time. Moreover, one of the "uncertainties" which must be resolved is whether the class will remain open: vested remainders subject to open are, despite their "vested" label, subject to the Rule.

A. All or Nothing

First, ask whether the class will close in time. Ask whether there is some validating life (or set of lives) you can look to and be sure that within 21 years after that life (or set), there will be no more "feeders" for the class. Ask also whether there is someone whose claim on the gift will be certain to close the class under the rule of convenience. If neither search uncovers a validating life, the gift is void. *If you do find someone to close the class in time, be sure not to stop there, but to ask the second question*.

Second, ask whether all conditions precedent for every class member will be resolved in time. This inquiry may yield different validating lives than the ones used to close the class. For a series of examples, see text pages 298-302.

When working on class gift problems, keep your eyes open for reasons a class might stay open, because feeders are still alive or you cannot count on the rule of convenience. Secondly, notice carefully the terms of any conditions precedent attached to the gift. Be especially wary of age conditions over 21.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

B. Subclasses

A partial exception to the all or nothing approach is the rule that gifts to different subclasses stand or fall separately. For example, you could create subclasses by directing a trustee to "pay income to my children for each of their respective lives, and upon the death of each, distribute the share from which that child has been receiving income to his or her children then surviving." The gifts of principal following each child's gift would each be treated separately. Within a single class, a gift to one subclass may be valid while a gift to a different subclass will be void. See *American Security & Trust Co. v. Cramer,* 175 F. Supp. 367 (D.C. 1959).

C. Per Capita Gifts

Consider will language giving "$5,000 to each of my grandchildren, whether born before or after my death, who reach age 30." The "each" language means than rather than being grouped together, every grandchild is treated separately. Those grandchildren alive at the testator's death take valid gifts. If the testator had not included the language "whether born before or after my death," standard class closing rules would have closed the class at the testator's death and left the then-living grandchildren as their own validating lives, without need for using the per capita perpetuities rule.

§ 51 Powers of Appointment [304-309]

To solve powers of appointment problems ask a series of questions:

- What kind of a power do we have?
- Is the power itself valid?
- Are *each* of the appointed interests valid?

A. General Presently Exercisable Powers

The power itself is *valid if it can be exercised within* the period. Apply standard perpetuities analysis, treating the question of when the power will become exercisable as you would any other contingency. Usually the question will be whether the donee will be identified (or whether the power will fail for want of a donee) within the period.

Similarly, each appointed interest created by the power's exercise is valid if contingencies surrounding it will be resolved within lives in being (+21) at the power's exercise. Exercising the power is just like creating other interests.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

B. General Testamentary and Special Powers

Because general testamentary and special powers do not allow a donee to take the property for herself, they begin limiting the donee's freedom at the time the donor creates the power. Thus, the policies of the Rule require ending those limitations within lives in being plus 21 years of the power's creation.

1. Validity of the Power

A general testamentary or special power is *void if it can be exercised beyond* the period. The lesson: unless you take special precautions, do not create a general testamentary or a special power for someone not yet alive.

2. Validity of the Appointed Interests

The validity of interests created by the exercise of a general testamentary or a special power is measured from the time of the power's *creation*. Here the Rule is following the notion that the donee of a special power is the agent of the donor. The donee merely fills in words in the donor's document to identify who takes the property.

a. A Second Look

Though we read the words as if the donor had written them, we *do* consider facts we know at the time the donee actually exercises the power. This ability to consider facts at the time of exercise is called the "second look" doctrine. Sometimes a second look saves the gift, sometimes not. See *Second National Bank of New Haven v. Harris Trust & Savings Bank*, 283 A.2d 226 (Conn. Super. 1971); *Marx v. Rice*, 67 A.2d 918 (N.J. Ch. Div. 1949).

b. Marshalling

A different way to save appointed interests is to apply the doctrine of marshalling of assets, sometimes called allocation. It applies to those cases in which a donee has blended assets subject to the power and assets from elsewhere. A court might save the exercise by allocating assets subject to the power to persons whose gift would not violate the Rule. See Restatement (Second) of Property §§ 22.1, 22.2.

C. Takers in Default

Conceptually, gifts in default are remainders subject to divestment by the exercise of the power. There is no perpetuities problem unless the default gift is to an open class or subject to a condition precedent. Many gifts in default, however, add these uncertainties.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Case law is slim and the commentators disagree about whether the second look doctrine applies to gifts in default. See *Sears v. Coolidge,* 108 N.E.2d 563 (Mass. 1952).

The usual rule to take perpetuities problems one step at a time applies with particular vengeance when powers are involved. When identifying the type of power, watch for sleepers. On questions of whether the power or the appointed interests are valid, recall all of the traditional traps. When judging the validity of interests created under a general testamentary or a special power, be sure to measure the time period from the power's creation.

§ 52 Savings Clauses [309-311]

Because the Rule is so technical and so easily violated, drafters have developed fail-safe devices called "savings clauses." These clauses have two functions. First, they protect the plan from the possibility that the Rule will strike some gifts, sending property back through the grantor's estate. Second, properly drafted savings clauses can extend a trust so that a grantor can make gifts which the Rule would prohibit.

The availability of these clauses is not, however, a good excuse for ignoring the Rule. Savings clauses build upon, rather than replace, the Rule. Further, a poorly drafted savings clause can squander the opportunity to preserve most or all of a grantor's plan. See *In re Lee's Estate,* 299 P.2d 1066 (Wash. 1956).

§ 53 Reform [311-317]

A. Wait and See

The basic idea is to wait after a testator's death to see if the horrible things the Rule imagines actually take place. The basic problem is: How long should we wait? Three major approaches have emerged for determining how long to wait:

- identify people who are causally connected to the resolution of the contingency, and then wait to see whether the problem is resolved within their lives plus 21 years.
- The Restatement recommends a related approach, but creates a series of categories for identifying the lives. Restatement (Second) of Property § 1.4.
- Wait 90 years.

The third technique, adopted through the Uniform Statutory Rule Against Perpetuities (USRAP), is the most popular. Originally a free-standing act, USRAP is now also part of the UPC. See UPC §§ 2-901 to 2-906.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

B. Reformation [a/k/a "*cy pres*"]

Another method for easing the Rule's harshness is for courts to reform offending documents to bring them into compliance with the Rule. Courts either might reform the document immediately upon discovering the perpetuities violation, or they might first wait and see how things turn out, and then reform if they must. In either case, the basic problem is: How do we reform?

The goal of reformation is to follow the donor's intention as nearly as possible while still meeting Rule's limits. Some courts could have benefited by taking more nuanced approaches to pursuing that goal. See *Estate of Chun Quan Yee Hop,* 469 P.2d 183 (Haw. 1970); *Berry v. Union Nat'l Bank*, 262 S.E.2d 766 (W. Va. 1980).

C. Abolition

Spurred by wealthy individuals who would like to create perpetual trusts (and by the banks who would administer those trusts), a substantial block of states have effectively repealed the Rule as it applies to trusts in which the trustee has the power to transfer trust property. The principal motivation of these donors is to take advantage of the exemptions created by the generation-skipping transfer tax (GST). See Ira Mark Bloom, *The GST Tax Tail is Killing the Rule Against Perpetuities*, 87 Tax Notes 569 (2000).

States allowing perpetual dynasty trusts may be creating serious problems that will haunt society in the future. Such trusts can concentrate enormous wealth—and the power wealth brings—in the hands of a relative few. Similarly, the influence of financial institutions that manage those trusts will grow. Administrative nightmares could arise as over time a trust for "my descendants" includes thousands of beneficiaries. Sources of venture capital could become scare as trustees—traditionally bound by more conservative investment rules—hold a greater percentage of the nation's wealth. Whether other legal doctrines will arise or expand in order to meet whatever problems arise, only time will tell.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 13
PROBLEMS OF ADMINISTRATION

§ 54 Introduction [319-320]

The jobs of administering estates or of administering trusts involve different considerations. Personal representatives of estates face a shorter time span, with limited goals. Estate administration has the feel of holding things together. See *Estate of Beach*, 542 P.2d 994 (Cal. 1975); but see *In re Estate of Janes*, 681 N.E.2d 332 (N.Y. 1997). Trust administration, on the other hand, usually has a longer time horizon. Trustees must be attuned to the changing personal needs of the beneficiaries and the changing markets affecting the management of the trust assets. Trust administration has more of a pro-active feel.

Despite these differences, fiduciaries engaged in either type of administration face very similar problems, and the legal principles governing them tend to cut across the particulars of individual situations. See UPC §§ 7-302 and 3-703(a); UTC § 804. The legal doctrine itself also tends to flow together. For example, a single investment decision may involve the duty of loyalty, a question of adequate care, and the interpretation of a will clause seeking to exonerate a trustee from liability. See *In re Estate of Collins*, 139 Cal. Rptr. 644 (Cal. App. 1977).

§ 55 Relationships with Beneficiaries [321-331]

A. The Duty of Loyalty

The duty of loyalty distinguishes fiduciary duties from other obligations the law imposes. Fiduciaries must place the beneficiaries' interests above their own.

1. Fiduciary-Beneficiary Conflicts

Because some kinds of conflicts are virtually inevitable, the law recognizes degrees of conflict of interest between fiduciaries and beneficiaries. In addition, the settlor or the beneficiaries can consent to the conflict. See UPC § 3-713; Restatement (Second) of Trusts § 216.

a. Self-Dealing

Suppose Martin, as executor, owns land that Martin, as real estate developer, would love to purchase. Because of the temptation for the executor to give the developer a really good price, the law follows a *"no-further-inquiry"* rule in self-dealing situations. Any beneficiary can undo the deal, regardless of its underlying fairness. By making transactions voidable at a beneficiary's option, the rule hopes to prevent self-dealing in the first place.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Self-dealing often arises when family members are fiduciaries. See *In re Estate of Allison,* 488 N.E.2d 1035 (Ill. App. 1986); UTC § 802(c).

b. Other Conflicts of Interest

The duty of loyalty extends well beyond self-dealing, to any situation in which the interests of a fiduciary and those of the beneficiaries are in conflict. When such conflicts arise, courts will examine the underlying fairness of the situation. See *In re Estate of Rothko,* 372 N.E.2d 291 (N.Y. 1977).

2. Impartiality

Conflicts are particularly common among income beneficiaries, and between them and those who expect to take the remainder. A fiduciary must treat each individual beneficiary impartially. See UTC § 803.

a. Investment Strategy

Income beneficiaries may want high income to live on, or they may prefer low current income and capital growth. Persons who hope to take the remainder will be concerned primarily with being sure the value of their interest has not eroded over time because of inflation. Compare *Commercial Trust Co. of New Jersey v. Barnard,* 142 A.2d 865 (N.J. 1958), with *In re Dwight's Trust*, 128 N.Y.S.2d 23 (N.Y. Sup. Ct. 1952).

b. Taxes

Tax rules also pose a conflict when they allow the fiduciary to allocate tax benefits or burdens among beneficiaries. For example, the tax code gives the executor the choice of claiming the expenses of estate administration against the income taxes due from the estate or against estate taxes. I.R.C. § 642(g). Claiming against income taxes might make income beneficiaries happy while incurring the wrath of remainder beneficiaries. See *In re Estate of Bixby,* 295 P.2d 68 (Cal. App. 1956).

c. Principal-Income Allocation

A common question is whether particular receipts and disbursements should be credited or charged to the income beneficiaries or to the trust principal. The basic vehicle for addressing these problems is the Uniform Principal and Income Act. The Act was promulgated in 1931, revised in1962, and revised again in 1997. See 7B Unif. Law Ann. 1 (2000). Among the most important innovations of the 1997 version is Section 104, which gives the trustee the authority to adjust between

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

principal and income instead of applying traditional rules that would be inappropriate for the trust in question.

For a decision highlighting a few of the more notorious trouble spots, see *First Wyoming Bank v. First National Bank & Trust Co. of Wyoming,* 628 P.2d 1355 (Wyo. 1981).

i. Unitrusts

A relatively new way of conceptualizing trusts makes allocation arguments irrelevant. A "unitrust" (a/k/a "total return trust") views the trust assets as a whole. Instead of paying out "income," a unitrust typically distributes to the current beneficiary a pre-determined percentage of the trust's total market value.

B. The Duty to Communicate

Ethics rules require lawyers to keep their clients informed. See Model Rules of Professional Conduct, Rule 1.4 (2002). Probate rules and trust documents regularly require that fiduciaries account to the beneficiaries. See *Jacob v. Davis*, 738 A.2d 904 (Md. Ct. Spec. App. 1999). UPC § 7-303(b) requires trustees to answer beneficiaries' reasonable requests for information. UTC § 813(a) requires trustees to keep beneficiaries "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests."

Sometimes the duty may go beyond telling what has happened. Before making a major decision, a fiduciary should check with the beneficiaries to get their input. See *Allard v. Pacific National Bank,* 663 P.2d 104 (Wash. 1983).

§ 56 Managerial Issues [332-340]

Perhaps the most important point about fiduciary management is that good intentions are not enough. See *Witmer v. Blair*, 588 S.W.2d 222 (Mo. App. 1979).

A. Investments

Determining the propriety of any trust investment requires asking two questions. The first is general: what *types* of investments can the trustee make? Statutes, case law, or the trust document may preclude investment in common stocks or real estate, for example. The second question is specific: assuming the type of investment is appropriate, is the *particular* investment proper? Although a document may authorize a trustee to buy common stocks, obtaining shares in Widgets, Inc., a company on the verge of bankruptcy, may be imprudent.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

1. The Traditional "Prudent Man"

The prudent man rule got its start in *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830), and has had differing amounts of influence throughout its history.

a. An Example

Visualize Stewart, the prudent man. He is, most of all, cautious. He dresses in blues and greys. He drives a four-door sedan with front and side airbags. He shuns football pools and has given up smoking. He plays not to lose.

As trustee of a family trust, Stewart is concerned most about safety. His primary goal is preservation of capital, without much regard for the corrosive effects of inflation. He does not "speculate," but instead relies on investments with guaranteed returns, like government bonds or, at least, stocks with established records of paying dividends. If he makes loans, he gets plenty of security. Diversification is perhaps his most important device for achieving safety. He tends to think about the rate of return in absolute terms: is he generating enough income to meet the needs of the income beneficiaries? He tends not to focus on the total return of the whole portfolio over time. Avoiding individual losses is more important than achieving overall gains.

One of the dominant features of the traditional prudent man rule is its one-investment-at-a-time approach. See *First Alabama Bank of Montgomery v. Martin,* 425 So. 2d 415 (Ala. 1982).

2. The Prudent Portfolio Investor

To modernize fiduciary investment law, the American Law Institute in 1990 approved new "prudent investor" rules. See Restatement (Third) of Trusts §§ 227-229. The Uniform Prudent Investor Act (UPIA) followed in 1994. See 7B Unif. Law. Ann. 56 (1998 Supp.). The most significant impact of the prudent investor rules is likely to be furthering the movement toward judging investments as part of a whole, rather than on a one-at-a-time basis.

a. An Example

Imagine Jessica, a "prudent investor." She shares many traits with her conservative cousin, the prudent man. She is careful, sensible. She has her share of dark suits, but occasionally wears pinks or reds for variety. She drives a two-door sporty car, but paid extra for airbags. She does not smoke, but buys a lottery ticket occasionally.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Like her older counterpart, Jessica cares about risk and return, but she views a larger picture, based upon her understanding of modern portfolio theory and related concepts. She sees "return" as including both income and capital appreciation.

b. Diversification

Under a prudent investor approach, there is more attention to balancing the portfolio among investments that are unlikely to move in the same direction in the face of particular events. The insight that purchase of a "risky" stock actually can *lower* the overall risk to the portfolio means that the traditional, one-investment-at-a-time approach is counterproductive. Because the prudent investor must judge each investment decision in light of the overall portfolio and the needs of the trust, no investment is imprudent *per se*.

B. Other Managerial Duties

Other principal duties that can present problems include:

- to take control of the assets
- not to commingle funds from one trust account with those of another
- to identify trust assets as such by "earmarking" them, though many states eliminate or soften the earmarking rule for securities
- not to delegate to others obligations they ought to perform themselves. (UTC § 807 allows trustees with lower skill levels to delegate more.)

C. Liability for Contracts and Torts

Traditionally, fiduciaries could be sure of avoiding contract liability only if the contract explicitly excludes personal liability. In contrast, UTC § 1010(a) absolves the trustee of personal liability on a contract "properly entered into in the trustee's fiduciary capacity . . . if the trustee in the contract disclosed the fiduciary capacity."

Traditionally, fiduciaries could they may be personally liable for torts even when they have personally done no wrong. See *Johnston v. Long,* 181 P.2d 645 (Cal. 1947). In contrast, under UPC § 7-306(b) and UTC § 1010(b) a trustee is personally liable for torts only if personally at fault.

§ 57 Drafting: Powers and Duties [340-346]

Testators and settlors can alter virtually all of the rules described in this chapter. Because issues of powers and duties tend to fold back onto each other, and all operate in the context of legislation, the topics are considered together.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

A. Legislation

Some states give fiduciaries either a few particular powers or a longer list, and leave it to the drafter to "opt out" of those not wanted. See UTC § 816. Others list powers, but say they only apply if a document specifically refers to the list. The lesson: check your local staute before drafting a document that reads "in addition to all other powers granted by law . . . ."

B. Language in the Document

Documents can either help or hurt fiduciaries trying to perform their jobs. This subsection describes a selection of common problem areas.

1. Principal and Income Allocation

Because questions about how to allocate receipts and disbursements between income and principal can get very complex, drafters may simply give fiduciaries broad discretion to allocate items as they wish. Courts often read these clauses narrowly. See *American Security & Trust Co. v. Frost,* 117 F.2d 283 (D.C. Cir. 1940); *In re Clarenbach's Will*, 126 N.W.2d 614 (Wis. 1964).

2. Power to Sell

Even if a document has given the fiduciary a power to sell, related duties – like the prudent investment rules or the duty to communicate – may still restrict the power. See *Durkin v. Connell,* 92 A. 906 (N.J. Ch. 1915); *Allard v. Pacific National Bank,* 663 P.2d 104 (Wash. 1983).

3. Continuing a Decedent's Business

If a document gives an executor the power to continue a business, she still must be able to exercise it competently. See *Estate of Baldwin*, 442 A.2d 529 (Me. 1982). Moreover, without more specific language a court would be unlikely to allow the executor to borrow money or to spend other estate assets to ease cash flow or conduct repairs.

4. Identifying Investment Strategy

Documents sometimes tell a trustee what investment strategy to follow or absolve the trustee from liability for holding onto particular stock. Donors who authorize only some kinds of investments can hurt the beneficiaries if conditions change. See *In re Trusteeship Agreement with Mayo,* 105 N.W.2d 900 (Minn. 1960).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

5. Exculpatory Clauses

Language that has the effect of relieving fiduciaries of liability can come in different forms. Sometimes a grant of authority is read to override a fiduciary duty. See *In re Heidenreich,* 378 N.Y.S.2d 982 (N.Y. Sur. 1976); *Robertson v. Central N. J. Bank & Tr. Co.*, 47 F.3d 1268 (3d Cir. 1995). Sometimes settlors insert very broad exculpatory clauses in their documents. In general, courts honor these clauses except in situations of gross negligence or willful default, but states range from being very restrictive to very liberal when enforcing the clauses.

UTC § 1008(a) bars enforcement of exculpatory clauses to the extent they (1) protect the trustee against breaches "committed in bad faith or with reckless indifference to the purpose of the trust or the interests of the beneficiaries" or (2) are "inserted as a result of" the trustee's abuse of a fiduciary or confidential relationship to the settlor.

§ 58 Remedies [346-347]

Beneficiaries who have suffered from breaches of duty have available a wide range of remedies against their fiduciaries. They can invalidate deals, get specific performance, impose constructive trusts, deny fiduciary fees, remove fiduciaries, and recover damages (surcharges). See UTC § 1001.

Setting damages poses special problems. See *In re Estate of Rothko,* 372 N.E.2d 291 (N.Y. 1977) (assessing "appreciation damages" for loss of art). The "anti-netting" rule says that a trustee who breaches trust duties may not offset gains against losses if the breaches were separate and distinct. Sometimes deciding whether two breaches are separate and distinct can be difficult. Restatement (Second) of Trusts § 213 provides a list of factors to help.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 14
A SKETCH OF FEDERAL WEALTH TRANSFER TAXES

§ 59 Introduction [349-350]

This chapter introduces the federal system for taxing wealth transfers. It is not a comprehensive summary. The goal is to help you identify situations calling for more expertise than you have acquired.

The current system began in 1916 with the estate tax and has been evolving ever since. In 2001, Congress started phasing out the system until there will be no estate and generation-skipping taxes for decedents dying in 2010. The gift tax will remain, but at lower rates. In an interesting political game with future Congresses, much of the system is scheduled to be reinstituted in 2011 (at levels that would have been reached before the 2001 amendments). 26 U.S.C.A. §§ 2210 and 2664 (2002).

§ 60 A Unified System [350-353]

The unified gift and estate tax system works rather like a large beaker, with a scale printed on the side. Each time we make a lifetime taxable transfer, we pour a little water into the beaker. Later additions are assessed at a higher rate, but we do not actually pay any tax until we fill past the threshold Congress has set. Until then we use bits and pieces of our "unified credit" to offset tax we would otherwise owe. See IRC §§ 2010, 2505. If we run out of credit by filling the beaker too high, we (or our estates) have to start paying tax.

For some examples see Figures 14-1 through 14-3 and the accompanying text.

§ 61 The Gift Tax [353-357]

The Internal Revenue Code imposes a tax on any "transfer of property by gift," while also excluding many gifts of $11,000 (indexed for inflation) or less. IRC §§ 2501(a)(1) & 2503(b)(2). As a practical matter, deductions for qualifying gifts to a charity or to a spouse mean that those gifts escape tax. IRC §§ 2522 & 2523.

A. What Is a Gift?

Deciding whether something is a "gift" for gift tax purposes often involves questions of valuation and of whether a transfer is complete. Suppose Monica sells Mark her car for $2,000. If the car is worth $5,000, Monica has made a $3,000 gift. On the other hand, if the car is worth $1,000, Mark made a $1,000 gift to Monica. Thus valuation determines both *whether* there is a gift and the *size* of that gift.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Sometimes donors will give away property, but hold onto some strings. Then the question is whether the strings are strong enough to mean there was no completed gift. There is a gift only if the donor has parted with all "dominion and control."

B. The Annual Exclusion

To avoid the recordkeeping that would follow if all gifts, including birthday presents, were taxable, IRC § 2503(b) created the annual exclusion, allowing each donor to give $11,000 (indexed to rise with inflation) annually to *each* donee. Note how the exclusion encourages wealthy taxpayers to reduce their estates by making lifetime gifts.

The annual exclusion applies only to unrestricted rights to the use, possession, or enjoyment of property or its income. Treas. Reg. § 25.2503-3(b). However, the Code allows the annual exclusion for future gifts to minors in some circumstances, and lawyers have invented creative devices to use the exclusion. See *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).

§ 62 The Estate Tax [357-366]

A. The Gross Estate

1. Basic Provisions

The gross estate is an accounting concept which attributes to a decedent property in the decedent's probate estate and nonprobate property which benefited the decedent. One of the most important points to get across to clients is that avoiding probate does not mean avoiding federal estate taxes. Moreover, married couples need to think in terms of their total wealth.

A few basic provisions bring in most of the assets of typical families:

- the estate at death (§ 2033)
- joint property (§ 2040)
- life insurance (§ 2042) and
- retirement benefits (§ 2039).

2. Some Complications

a. Gifts Within 3 Years of Death

IRC § 2035 brings into the gross estate the value of certain gifts made within three years of the decedent's death, and it brings in the value of *taxes paid* on all gifts made during that period. The reason for this rule is to negate—during the three-year period—the tax advantage of making

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

taxable gifts instead of leaving the property to be part of one's estate.

b. Gifts With Retained Interests

IRC §§ 2036 to 2038 capture for the gross estate the value of lifetime transfers in which taxpayers retain beneficial interests. These provisions have generated a great deal of litigation, as taxpayers seek to retain benefits without suffering tax consequences. In general, the courts have looked at the substance, rather than the form, of the arrangements in question. See *United States v. Estate of Grace*, 395 U.S. 316 (1969).

c. General Powers of Appointment

IRC § 2041 brings in property subject to a general power of appointment, with the caveat that if the owner is properly restricted by an ascertainable standard, it is not a general power. IRC § 2041(b)(1)(A). Because property subject to a non-general power will not suffer the same fate, lawyers use combinations of these powers to achieve tax and personal planning objectives.

3. Stepped-Up Basis

For income tax purposes, property that transfers at death takes on a new, "stepped-up" basis, its value in the decedent's gross estate. IRC § 1014. As part of the phase-out of the estate tax, the stepped-up basis approach is scheduled to end in 2010. If the estate tax comes back as scheduled in 2011, a revised "carryover basis" will replace the historic stepped-up approach.

B. The Marital Deduction

Once the value of the gross estate is established, various deductions apply, reducing the gross estate to the "taxable estate." For our purposes, the most important deduction is the one for transfers to surviving spouses. IRC § 2056. The basic principle is straightforward: the law treats married couples as units, not individuals. It allows each spouse to give unlimited amounts of property to the other without incurring transfer taxes, so long as the property will be exposed to tax once it leaves the marital unit. Four types of transfers qualify:

- Outright gifts
- Trusts giving the surviving spouse a life estate plus a general power of appointment
- Trusts of "qualified terminable interest property" (QTIP)
- Estate trusts.

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C. Using the Unified Credit

Because the unified credit is personal to each taxpayer, its value can be lost in large estates if it is not fully utilized. By making lifetime transfers between each other, or by structuring the estate plan in various ways, married clients can maximize the use of both of their unified credits, in 2006 effectively shielding $2 million from estate tax.

Efficient use of both spouses' unified credits requires two steps:

- Balance the sizes of both estates during the lifetimes of both spouses
- Create a "credit shelter trust."

See Examples 14-1 through 14-4 on text pages 364-366.

§ 63 The Generation-Skipping Transfer Tax [366-367]

As part of the phasing-out of the estate tax, the generation-skipping transfer tax (GST) is scheduled for abolition in 2010 (and reintroduction in 2011). IRC ch. 13. The rules surrounding the GST, and lawyers' strategies for coping with those rules, are very complex.

The overall goal is to plug holes in the estate tax system in order to tax wealth once in each generation. The credit shelter trusts noted above are just one variety of a common species: a life estate in trust with considerable benefits, but not so many as to subject the trust to tax. When trusts line up such life estates in succession, property can escape estate tax for several generations.

To curb this result, the GST taxes transfers to a "skip person," someone two or more generations below the transferor's generation. Consider gifts from Genevieve, to her daughter Peggy, and to Peggy's son, Troy. From Genevieve's perspective, Troy is a skip person.

The GST is a wealthy person's tax. Each transferor has a $1 million exemption (indexed to increase with inflation), which the transferor can allocate among GST transfers. IRC § 2631(c).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

Chapter 15
LOOKING AHEAD

One of the few things that can be said with confidence about the future is that it will be different from the present. Change makes our lives interesting, but throws us off our bearings from time to time. Part of preparing for a career is developing a set of personal and professional values to help you through those challenges.

Whatever changes occur during your career, one thing will remain: you will have the power to affect people's lives. Every day, you will be influencing how families function. With that power comes the responsibility to structure plans with a sensitivity to the different needs of different clients.

Finally, as you strive to balance the needs of your private and professional lives, consider some advice from Charles Schultz. Linus wonders, "If you work real hard, and you get everything you've always wanted, is it worth it?" Snoopy responds, "Not if your dog doesn't like you." For a copy of the cartoon, see Andersen & Bloom, Fundamentals of Trusts and Estates 589 (2d ed. 2002).

Copyright © 2003 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.