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Trusts - Broad Powers of Control, Right of Revocation, and Retention of Income by Settlor Held Not to Invalidate Inter Vivos Trust

DePaul College of Law

The problem which the certificate of title laws present to the courts is one of statutory construction. Indicating that uniformity is not to be expected, a Utah dissent summarized a key to the solution:

> Only those authorities in states having substantially the same statute as we have will be found helpful, and then only if the facts in each case are carefully considered, for in very few fields of the law is the adage that "circumstances alter cases" more applicable.[20]

[20] Jackson v. James, 97 Utah 41, 51, 89 P. 2d 235, 239 (1939).

TRUSTS–BROAD POWERS OF CONTROL, RIGHT OF REVOCATION, AND RETENTION OF INCOME BY SETTLOR HELD NOT TO INVALIDATE INTER VIVOS TRUST

In a suit by the administrators of the estate of a deceased settlor to determine the validity of declarations of trust and ownership of the corpus of the trust, it was seen that the settlor had purchased stock on four different occasions taking title in his own name as trustee for a beneficiary. At each purchase he had executed an instrument designated "Declaration of Trust-Revocable" in which he recited he held the stock in trust for the beneficiary subject to the following provisions: that all cash dividends were to be paid to him individually for his own personal account and used during his lifetime; that he reserved the right as trustee to vote, sell, redeem, exchange or otherwise deal in or with the stock, but upon any sale or redemption of the stock, the trust would terminate as to the stock sold or redeemed and he would be entitled to the proceeds of the sale or redemption for his own personal account and use; that he reserved the right at anytime to change the beneficiary or revoke the trust, but no such change or revocation except by death of the beneficiary should be effective as to the company until written notice thereof was delivered to the company. In the event the trust was revoked or otherwise terminated, the stock and all rights and privileges thereunder would belong to him. Held, that the trust declarations executed by the deceased constituted a valid inter vivos trust and were not invalid as attempted testamentary dispositions. *Farkas v. Williams*, 5 Ill. 2d 417, 125 N.E. 2d 600 (1955).

The trust "is an institute of great elasticity and generality."[1] The instant case touches the elasticity of the trust in one of its many aspects, namely, the post-mortem distribution of property, or as it is commonly called, the inter vivos trust. Actually, in *effect* it is a testamentary disposition of property which one usually thinks of as being accomplished by a will.[2] By definition, a will is, "the expression, in the manner required by

[1] Maitland, Equity 23 (1936).

[2] The trust does have 2 of the 3 important qualities of a will: it is revocable and it

law, and operative for no purpose until death, of that which one may lawfully require to be done after his death."[3] It would seem therefore that our inter vivos trust falls under this definition and hence, for the purpose of avoiding fraud, would have to comply with the formalities required by the statute of wills.[4] But here we distinguish. If the transferor succeeded in divesting himself *in praesenti* of the interest he wished to transfer, the statute of wills is in no way involved. If he retained an interest which upon his death was to go to another, his effort was testamentary and the statute would have to be complied with.

Generally then, we must find a valid transfer intervivos and not merely an attempt to make a testamentary disposition in order to uphold the trust. It is here that we find our problem, for though judges and jurisdictions will agree on the basic elements of the trust[5] we begin to see a diversity of opinion where they are confronted with the reserved powers of the settlor. They must decide whether or not in the particular instance the combined effect of all the powers, rights, control and dominion reserved by the settlor is such as to leave him virtually the owner of the property and the trustee his mere agent. They must decide what extent of control is sufficient in the settlor to nullify the purported technical vesting of legal title in the trustee. They must draw the line between a valid intervivos trust and an attempted testamentary disposition.[6] This line is not clearly drawn.

Some jurisdictions and judges seem to feel that as long as title passes to

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has the "hereditative" quality, i.e. it appoints someone to represent the settlor after his death and carry out his intentions. The trust lacks the ambulatory quality of a will. II Pollock & Maitland, History of English Law 315 (2d ed., 1903).

[3] Gardner, Wills 1 (2d ed., 1916).

[4] "The legislatures have presumably balanced the hardship to the intended beneficiaries which occrus where there is an intention to create a trust, against the hardship which would result from making false claims; and in order to prevent the making of false claims they have required that the disposition should be evidenced in a certain formal manner." 1 Scott, Trusts § 55.9 (1939).

[5] One of the basic elements is that the trust property must be identified. For cases and analysis see 1 Scott, Trusts § 56.2 (1939). But the enjoyment of the beneficiary may be postponed until the settlor's death, 1 Scott, Trusts § 56.5 (1939). Further, it is well settled that the settlor may reserve the power to revoke and modify the trust, 1 Scott, Trusts § 57.1 (1939).

This is true whether the trust is created by a transfer of the legal title to another or by execution of a declaration of trust by the settlor himself. 1 Scott, Trusts §§ 56.6 and 57.1 (1939).

But when the settlor has reserved not merely a life interest and power to revoke or modify the trust in whole or in part, but also retains power to control the trustee in the administration of the trust we find a diversity of opinion. 1 Scott, Trusts § 57.2 (1939). Also see Rest., Trusts §§ 57 (2) and (3).

[6] The instruments, in the words of Mr. Justice Holmes in Bromley v. Mitchell, 155 Mass. 509, 30 N.E. 83 (1892), have a "testamentary look" and the line must be drawn somewhere.

the trustee, the extent of control retained by the settlor is immaterial. They have difficulty in viewing as a nullity an instrument which not only purports to place legal title in a trustee but purports to do so for the benefit of one or more persons in addition to the settlor. If the interests of such persons can exist notwithstanding the settlor's reservation of absolute power to revoke and notwithstanding the settlor himself is made trustee, they seem to wonder how a settlor's control over another as trustee can be so great as to nullify the interests defined by the instruments. This, one might say, is the liberal modern viewpoint.[7]

For the purpose of analysis, some of the diverse decisions and their factual situations should be considered.

In Kentucky,[8] the decedent made two others and herself trustees for corporation stock, reserving the net income for life and reserving the right during her lifetime to modify, amend or revoke the trust in whole or in part and providing that as long as she remained a qualified trustee and under no disability the trustees should exercise the powers conferred on them only upon written instructions from her. The court recognized that the degree of control is the determining factor in such a case but found a valid inter vivos trust because her power over the trustees was limited by the terms of the instrument.

The case which is most closely analogous to and which is relied on by the instant case is *United Building and Loan Association v. Garrett.*[9] There the decedent executed an instrument entitled "Declaration of a Trust," providing that he held a certificate as trustee for the benefit of the named beneficiaries of certain stock. He reserved to himself as settlor the right and power to sell, assign, transfer, set over, and deliver the stock or any part thereof, "and to collect and use the dividends and proceeds therefrom for the use and benefit" of himself and the right to revoke the trust in whole or part. Subsequently the deceased made a further like purchase of stock, subjected to a similar trust. The court held that it was a valid intervivos trust. They said that the settlor intended to and did effect transfers of present interests to the beneficiaries. Further regarding the interest which passed to the beneficiaries, the court said:

> The policy of the law favors the vesting of interests, and where possible, will construe a provision as a condition subsequent in preference to a condition precedent. The undeviating trend in cases dealing with the validity of trust declarations is to treat reservations such as those involved in this case as conditions subsequent which may operate to defeat the interest of the beneficiaries, but which, unexercised, do not prevent the vesting of equitable title.[10]

[7] For a further study see 1 Bogert, Trusts and Trustees § 104 (1951).

[8] Stouse v. First National Bank, 245 S.W. 2d 914 (Ky., 1951).

[9] 64 F. Supp. 460 (D.C. Ark., 1946).

[10] Ibid., at 465.

In many other decisions on similar facts,[11] inter vivos trusts have been upheld on the theory that the beneficiaries' interest operates as a condition subsequent, and upon the theory that the degree of reserved control in the settlor is not great enough to make the trustee a mere agent of the settlor.

On the other hand, many courts have overthrown trusts as testamentary dispositions on similar facts which we shall now examine for the sake of comparison.

In the District of Columbia the decedent conveyed property upon trust for the use and benefit of decedent during her lifetime with provisions that she should receive the "entire net income" and that the trustees should convey the property as she should direct and that upon her death, unless disposed of as authorized, the property should be conveyed to her daughter.[12] The court concluded the trustees were mere agents with very limited power, that they were a mere channel through which title would flow if all the property were not disposed of by the time of the decedent's death and thus held the trust void.

In Pennsylvania, the decedent assigned $20,000 to a company to be held in trust, paying himself the income during his life, reserving the right to withdraw all or any of the fund at anytime, to add other property, to change the beneficiaries or their shares or the plan of distribution, and to modify, amend, add to or entirely revoke the trust agreement.[13] The court held the writing testamentary on the agency principle.

It is interesting to note that *McEvoy v. Boston Five Cents Saving Bank*,[14] one of the strong cases overthrowing an inter vivos trust and relied on by similar cases[15] has since been overruled in *National Shawmut Bank v. Joy*.[16] The court said the trust instrument in the *McEvoy* case did not appear testamentary to them, and further, that the alternative or additional ground of decision in that case was erroneous in that it implied that a purpose to employ a trust deed to avoid making a will renders the deed testamentary and void.[17]

[11] Among the leading cases are, Leahy v. Old Colony Trust Co., 326 Mass. 49, 93 N.E. 2d 238 (1950); Cleveland Trust Co. v. White, 134 Ohio St. 1, 15 N.E. 2d 627 (1938); In re Sheasley's Trust, 366 Pa. 316, 77 A. 2d 448 (1951); St. Louis Union Trust Co. v. Dudley, 162 S.W. 2d 290 (Mo. App., 1942); City Farmer's Trust Co. v. Charity Org. Soc., 238 App. Div. 720, 265 N.Y. Supp. 267 (1st Dep't, 1933).

[12] Betker v. Nalley, 140 F. 2d 171 (App. D.C., 1944).

[13] In Hurley's Estate, 17 Pa. D & C 637 (1932). See also, In re Tunnel's Estate, 325 Pa. 554, 190 Atl. 906 (1937), holding the trust testamentary and citing the Rest., Trusts, § 57 (3).

[14] 201 Mass. 50, 87 N.E. 465 (1909).

[15] See Warsco v. Oshkosh Savings & Trust Co., 183 Wis. 156, 196 N.W. 829 (1924).

[16] 315 Mass. 457, 53 N.E. 2d 113 (1944).

[17] Other courts and cases which have overthrown intervivos trusts may be found in 1 Scott, Trusts § 57.2 (1939) and 32 A. L. R. 2d 1298-1301 (1953).

The history of Illinois courts shows a definite liberal tendency in upholding trusts where the settlor retains a large measure of control. As early as 1899 in *Kelly v. Parker*[18] the court upheld a trust where the grantor reserved the right during his lifetime, to use, occupy, manage, control, improve and lease the land or any part thereof, to use and enjoy all rents, issues and profits in the same manner as if he were the owner in fee simple; to sell or mortgage the land and retain the proceeds and the power to revoke.

In 1929, in *Bear v. Milliken Trust Co.*,[19] the settlor reserved the right to approve loans made by the trustee; the right to have settlor's debts paid out of the trust estate after his death; the right to all income during his life; the right to make any division of real estate among settlor's children; the right to appoint a successor trustee; the right to vote the stock; and the right to revoke, alter or amend the trust. The trust was upheld.

Following the trend, *Gurnett v. Mutual Life Ins. Co.*[20] in 1934, found the court upholding an insurance trust where settlor retained the right to exercise any option under the policies, the right to change beneficiaries, the right to borrow money on the policies, to receive dividends and other payments under the policies, to surrender any policy for its cash surrender value, and the right to terminate, modify or alter the trust.

This leads us to the instant case where Farkas as settlor and trustee reserved to himself as settlor the cash dividends of the stock for his own personal account and use. He reserved the right as trustee to vote, sell, redeem, exchange or otherwise deal in or with the stock. He also reserved the right to revoke the trust or change the beneficiary. These are the reserved powers and the major facts supporting the finding of an attempted testamentary disposition which must be weighed against the major facts supporting an inter vivos trust. First, the fact that Farkas registered the stock in the name of Farkas *as trustee* for the beneficiary shows that Farkas intended to assume those obligations set out in the instrument as well as those fiduciary obligations implied by law. Second, on the death of Farkas, the beneficiary would become the absolute owner unless Farkas changed the beneficiary or revoked the trust, which was not to be effective as to the company until written notice was delivered to it. These are not the rights of an absolute owner for he can do with his property as he will without securing the approval of or notifying anyone and without being held to the duties of a fiduciary while doing so.

The court balanced these facts against one another, recognizing the lib-

[18] 181 Ill. 49, 54 N.E. 615 (1899).

[19] 336 Ill. 366, 168 N.E. 349 (1929).

[20] 356 Ill. 612, 191 N.E. 250 (1934).

eral trend in Illinois and also drawing analogy to the *Garrett* case[21] which as we have seen is quite similar to the instant case. However, on looking closer, the court seems to base its decision on an added factor; the power of the settlor to revoke and amend the trust at any time. The court says:

> It is obvious that a settlor with the power to revoke and to mend the trust at any time is, for all practical purpose, in a position to exert considerable control over the trustee regarding the administration of the trust. For anything believed to be inimicable to his best interests can be thwarted or prevented by simply revoking the trust or amending it in such a way as to conform to his wishes.[22]

The court there lists some of the powers a settlor might reserve which could render a trust testamentary and says:

> Actually any of the above powers could readily be assumed by a settlor with the reserved power of revocations through the simple expedient of revoking the trust, and then, as absolute owner of the subject matter, doing with the property as he chooses.[23]

Finally, the court looks to the purpose of meeting the formalities required by the Statute of Wills, *viz.*, to prevent fraud. Here, there was clearly no fraud since the stock was issued in compliance with the written declaration of trust, in the name of Farkas as trustee for Williams.

For these reasons the court found a valid inter vivos trust and we are now left to consider the effect of this decision.

Simply, the court seems to be practical. They want to give effect to the settlor's intent. Why frustrate that intent with technicalities? Why try to enforce the Statute of Wills, when the very purpose of its creation, fraud, is clearly not present? As to the reserved powers of the settlor, they admit that a line has to be drawn somewhere, but upon considering the fact that the settlor with a power of revocation and a power to modify, which is allowed freely in all courts, can do with the trust as he wishes, the court indicates that it would be silly to argue the point, as long as they can find any limitation on the settlor. Thus, what the court has done is to recognize the fact that a trust can be invalid as an attempted testamentary disposition, but that it will go practically to the point of fiction to find a valid inter vivos trust.

[21] It is interesting to note that this case relied on a previous Arkansas decision which in turn had relied on the case of Kelly v. Parker, 181 Ill. 49, 54 N.E. 615 (1899).

[22] Farkas v. Williams, 5 Ill. 2d 417, 430, 125 N.E. 2d 600, 607 (1955).

[23] Ibid.