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# REVOCABLE TRUSTS IN ESTATE PLANNING

*James V. Heffernan and Laurens Williams†*

There is an unfortunate, although understandable, tendency among lawyers who frequently engage in "estate planning" to think principally in terms of devices or arrangements which result in substantial savings in taxes. The spectacular savings in estate and income taxes that often can be achieved for the owner of a substantial estate by the use, for example, of gifts to an irrevocable inter vivos trust should not cause a lawyer to lose sight of the fact that there are many very practical uses for revocable inter vivos trusts, notwithstanding their limited effect on taxes.

Simply because revocable trusts and irrevocable trusts are both trusts, there is an initial temptation to think of them as competing devices. This is not so. For estate planning purposes, the revocable trust is not simply another type of trust, an alternative to, or substitute, for an irrevocable one. Rather, it is a device of a completely different nature. If a revocable trust can be said to be a substitute for anything, it is a substitute, *pro tanto*, for a will.

In order that the revocable trust may be viewed in the proper perspective, this article will first examine the nature of a revocable trust, with emphasis on the implications of the power to revoke. Next, the tax consequences of the use of such trusts will be developed. Finally, the article will explore what may be accomplished by the use of revocable trusts in estate planning.

## I. NATURE OF A REVOCABLE TRUST

In this article, unless otherwise indicated, the term "revocable trust" will refer to an inter vivos trust under which the settlor retains the power, acting alone, to revoke, alter, amend or terminate the trust, the exercise of which power results or can result in the corpus of the trust being returned to him. For example, *X* transfers certain securities to *Y* Trust Company in trust. The trust instrument provides that *X* is to be paid all of the net income for life, and that upon his death the remainder should be held in trust for the benefit of *X*'s lineal descendants, the distribution to be made as provided in the trust instrument. The trust instrument also provides that *X* can change the trustee and that he can amend, alter, or revoke the trust at any time by notice in writing to the trustee.

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† See Contributors' Section, Masthead, p. 558, for biographical data. The authors wish to express their appreciation to Charles L. Saunders, Jr., associated with the authors, who assisted in the preparation of this article.

It will be noted that the settlor of the trust has retained for the duration of his life the principal rights and powers of ownership. He has the right to all of the income, he can retake possession of the property at any time he chooses, he can give the property to whomsoever he chooses during his life or upon his death. So long as he retains such control over the trust property, he can change his mind as to who shall take the property, just as he could in respect to property to which he has retained legal title. If, in addition to reserving the above powers, he retains others relating to the management of the trust property and to the administration of the trust, it begins to appear as if he has actually parted with very little in making his conveyance and will not part with anything consequential until death puts his conveyance beyond recall. These considerations give rise to several problems not present where an irrevocable trust is used. The common denominator of these problems is: to what extent is a conveyance by revocable trust an *inter vivos* conveyance; to what extent is it really a testamentary disposition?

Since the revocable trust, when used, is quite often a substitute for a will, this question most often has been raised in connection with a claim that the disposition of the trust property after death was actually an attempted testamentary conveyance, and is void for failing to comply with the requirements of the Statute of Wills. It is now generally accepted everywhere that the retention of only a power to revoke, even where the settlor retains a beneficial life interest, will not render the conveyance testamentary.<sup>1</sup> However, where, in addition to a power to revoke, the settlor retains administrative powers over the trust, the question is not as well settled. Powers of administration may include the power to sell, loan, pledge, or lease the trust property, to approve or disapprove trust investments, to borrow from the trust, to vote stock held in the trust, to remove trustees, or to substitute trust property. The question is whether the settlor has retained so much dominion and control over the trust property and its management as to render the trustee his mere agent. If he has done so, then it is reasoned that no substantial interests in the property are created in third persons until the settlor's death, and that the disposition of the property to such persons is therefore of a testamentary nature and void unless the trust instrument complies with the Statute of Wills. This has been the traditional approach to the problem and was the approach taken by the original Restatement, Trusts, section 57, adopted in 1935:

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<sup>1</sup> See Scott, Trusts § 57.1 (1956). Professor Scott cites cases from practically every state sustaining this proposition. For a more detailed discussion of the entire problem of revocable trusts as testamentary dispositions, see Scott, Trusts §§ 57-57.2 (1956).

Where the settlor transfers property in trust and reserves not only a beneficial life estate and a power to revoke and modify the trust *but also such power to control the trustee as to the details of the administration of the trust that the trustee is the agent of the settlor*, the disposition so far as it is intended to take effect after his death is testamentary and is invalid unless the requirements of the statute relating to the validity of wills are complied with. (Emphasis added.)

This approach makes the decision turn on the degree of control retained by the settlor rather than upon the ultimate question involved—whether an interest has been conveyed inter vivos to a third person. It assumes that the idea of any interest passing before the settlor's death, may be negated by the settlor's retention of control. The degree of control must be such as to make the trustee the settlor's agent, but this answers very little for two obvious reasons. First, there is little agreement between courts as to what quantum of control effects this result. Second, a given court's decision on particular facts may be largely controlled by the weight it gives to the policy behind the Statute of Wills.

It should be noted that some states have statutes allowing a settlor of a trust to reserve any power, beneficial or in trust, which he may lawfully grant to another, and providing that the powers so retained shall be treated as though granted to another.<sup>2</sup> At least one court has held that such a statute saves a revocable trust from being treated as testamentary because of the powers of control the settlor has retained.<sup>3</sup> It is at least questionable, however, that such statutes are of reliable help in this area. Their thrust may be simply that a trust can be validly created even though the settlor reserves power over the trust property and its management. So construed and applied, such statutes do not necessarily answer the question whether so much control has been retained by the settlor that, as against the policy behind the Statute of Wills, the dispositions upon death should be considered testamentary.

Another approach to the problem is to look directly to the ultimate question—the inter vivos passing of an interest to a third person—rather than to the retention of control by the settlor. Section 57 of the Restatement, Trusts, Second, adopted in 1957, takes this approach:

*Where an interest in the trust property is created in a beneficiary other than the settlor, the disposition is not testamentary and invalid for failure to comply with the requirements of the Statute of Wills merely because the settlor reserves a beneficial life interest or because he reserves in addition*

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<sup>2</sup> E.g., Ala. Code Ann. tit. 47, § 80 (1940); N.Y. Real Prop. Law § 144; S.D. Code § 59.0415 (1939). A typical statute, D.C. Code Ann. § 45-1009 (1951), reads:

The grantor in any conveyance may reserve to himself any power, beneficial or in trust, which he might lawfully grant to another, and every power thus reserved shall be subject to the provisions of this chapter as if granted to another.

<sup>3</sup> Union Trust Co. v. Hawkins, 121 Ohio St. 159, 167 N.E. 389 (1929).

a power to revoke the trust in whole or in part, and a power to modify the trust, and a power to control the trustee as to the administration of the trust. (Emphasis added.)

Professor Scott has emphasized the practical considerations which ought to be taken into account in reaching a solution to this problem.<sup>4</sup> He points out that the real problem in this area is whether the danger of fraud, guarded against by the Statute of Wills, is increased because the settlor retained administrative powers. As he points out, it is apparent that it is not. More in point is the nature of the trust deed itself: is it informal, leaving much of its terms to conjecture or inference and the possibility of fraud? If not, if the terms of the trust have been formally manifested to disinterested third parties during the settlor's lifetime, then the danger of fraud is nil and there should be no need to require that the trust deed conform with the Statute of Wills. In other words, as long as some beneficial interest is presently conveyed to a party other than the settlor, the trust conveyance should not be considered testamentary merely because the settlor has retained a large quantum of powers, provided the terms of the trust are formally manifested during the settlor's lifetime.<sup>5</sup>

An increasing number of courts have come to treat revocable trusts with retained administrative powers as valid inter vivos conveyances, not testamentary in nature.<sup>6</sup> These courts have taken the position that so long as a present interest is created in a third party, the trustee is not to act wholly at the direction and whim of the settlor, and the terms of the trust are expressly and formally manifested in a trust instrument, then the inter vivos nature of the conveyance should be upheld, even though it is acknowledged that the trust is being used as a substitute for a will.

The estate planner considering the use of a revocable inter vivos trust should examine the applicable local law to ascertain to what extent there may be a problem in this area. Danger that the trust may be considered testamentary may be eliminated by giving up enough administrative powers. It is the view of many that the problem is eliminated by lim-

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<sup>4</sup> See Scott, *Trusts* § 57.2, at 450-51 (1956).

<sup>5</sup> In *Farkas v. Williams*, 5 Ill. 2d 417, 125 N.E.2d 600 (1955), the court upheld as not testamentary a revocable trust over which the settlor had retained a large measure of control. In so doing the court emphasized the fact that the possibility of fraud was not present since the decedent's intention had been formally manifested to disinterested third parties during his lifetime.

<sup>6</sup> Perhaps the landmark case in this area, sustaining such a trust against a claim that it was testamentary, is *National Shawmut Bank of Boston v. Joy*, 315 Mass. 457, 53 N.E.2d 113 (1944). See also *Denver Nat'l Bank v. Von Brecht*, 137 Colo. 88, 322 P.2d 667 (1958); *Lewis v. Hanson*, 128 A.2d 819 (Del. 1957); *Merchants National Bank v. Weinold*, 12 Ill. App. 2d 209, 138 N.E.2d 840 (1956); *Ridge v. Bright*, 244 N.C. 345, 93 S.E.2d 607 (1956); *Farkas v. Williams*, 5 Ill. 2d 417, 125 N.E.2d 600 (1955); *Krueger v. Central Trust Co.*, 101 Ohio App. 383, 136 N.E.2d 121 (1956); and cases cited Scott, *Trusts* § 57.2 n.2 (1956).

iting the power to revoke by a provision that revocation shall be effective only on 30 days notice. In other instances it might be advisable to have the execution of the trust instrument and all amendments thereto comply with the Statute of Wills so that all would not be lost even if the disposition were held to be testamentary.<sup>7</sup>

Closely allied to the testamentary problem is the question of whether the settlor's surviving spouse, in asserting her claim to her statutory share of the settlor's estate, can reach the trust estate over which he reserved a power to revoke during his lifetime. In other words, for purposes of the surviving spouse's statutory share, is property which the deceased transferred to a revocable inter vivos trust included in his estate? If the conveyance in trust is found to have been really testamentary, the property so conveyed would be included in his estate for all purposes, including the determination of the surviving spouse's statutory share. Moreover, at least one jurisdiction has taken the position that it is not necessary that the trust be found to be testamentary to allow the wife to claim her statutory share.<sup>8</sup> Its courts reasoned that its statutory provisions giving the surviving spouse a share of the decedent's estate express a public policy which should not be easily overcome. The policy of providing for the widow was held strong enough to overcome an inter vivos conveyance in trust when the decedent retained the power to revoke and various powers of management over the property during his lifetime. Where the policy aspect is emphasized, perhaps it would be material to determine whether the trust was created for the purpose of reducing the spouse's statutory share.<sup>9</sup> Other states have not emphasized the strong policy considerations that oppose precluding a surviving spouse from sharing in the estate, and have dealt with the surviving spouse's claim on the basis of whether the trust was really illusory or a testamentary disposition, or whether there was a valid inter vivos conveyance.<sup>10</sup>

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<sup>7</sup> However, as testamentary, the dispositions would be governed by the laws of the settlor's domicile. If the trust had been created in another state for the specific purpose of avoiding the undesired impact of the laws of the settlor's domicile, e.g., to avoid a restrictive rule against perpetuities, see p. 542 *infra*, this purpose would be defeated and the dispositions rendered invalid despite compliance with the Statute of Wills.

<sup>8</sup> See, e.g., *Harris v. Harris*, 147 Ohio St. 437, 72 N.E.2d 378 (1947); *Bolles v. Toledo Trust Co.*, 144 Ohio St. 195, 58 N.E.2d 381 (1944). Pennsylvania, by statute, allows the surviving spouse to elect to take her statutory share in property transferred by the decedent during his lifetime where he retained a power of revocation, Pa. Stat. Ann. tit. 20, § 301.11 (1950).

<sup>9</sup> Cf. *Wanstrath v. Kappel*, 356 Mo. 210, 201 S.W.2d 327 (1947); *Payne v. Tatem*, 236 Ky. 306, 33 S.W.2d 2 (1930).

<sup>10</sup> One of the leading cases is *Newman v. Dore*, 275 N.Y. 371, 9 N.E.2d 966 (1937), where the court found the trust illusory, but emphasized that the creation of a revocable trust for the purpose of excluding the surviving spouse was not fatal. See also *Burnet v. First Nat'l Bank*, 12 Ill. App. 2d 514, 140 N.E.2d 362 (1957); *Kerwin v. Donaghy*, 317 Mass. 559, 59 N.E.2d 299 (1945) (trusts upheld against spouse's claim).

The reservation of a power to revoke has also raised special problems with respect to the extent to which creditors can reach the trust estate. Does the settlor's reserved power to revoke give the settlor's creditors a basis for reaching the trust estate which they otherwise would not have if the trust were irrevocable? Absent a statute, the answer is generally no. The power to revoke is a personal power. It is not a property interest which can be sold for the benefit of creditors, and the settlor's creditors cannot compel its exercise.<sup>11</sup> Of course, where the retention of a power to revoke plus other powers is so extensive as to render the trust illusory, doubtless the trust res would be deemed the property of the settlor, available to his creditors.

This question has been resolved by statute in many states. Most of these statutes state that where a settlor has reserved a power to revoke, he will be deemed the absolute owner of the property conveyed as far as creditors are concerned.<sup>12</sup> Another type of statute, less common, provides that where a settlor has retained a power to revoke, a court of equity, upon petition by his creditors, may compel its exercise to the same extent as the settlor could exercise it.<sup>13</sup> In addition, section 70(a) of the Bankruptcy Act<sup>14</sup> would seem to permit the creditors of a settlor of a revocable trust to reach the trust property. Under this section, the trustee in bankruptcy is vested with all powers which the bankrupt might have exercised for his own benefit. A power to revoke, which is exercisable inter vivos, would seem to fall within this class and could be exercised by the trustee in order to place the trust estate in his hands for the benefit of creditors.

It is quite common for a state to have a statute rendering conveyances void as against creditors, where made for the exclusive use of the conveyor.<sup>15</sup> If a settlor creates a revocable trust, reserving the income to himself for life with the remainder over to his estate or as he may appoint, his creditors doubtless could reach the trust estate under such a statute. But suppose the remainder is vested in some third person. Does

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<sup>11</sup> *Jones v. Clifton*, 101 U.S. 225, 230-31 (1879).

<sup>12</sup> E.g., Ind. Ann. Stat. § 56-610 (1951); Kan. Gen. Stat. Ann. § 67-414 (1949); N.Y. Real Prop. Law § 145. The New York statute reads:

Where the grantor in a conveyance reserves to himself for his own benefit, an absolute power of revocation, he is to be still deemed the absolute owner of the estate conveyed, so far as the rights of creditors and purchasers are concerned.

<sup>13</sup> See Ohio Rev. Code § 1335.01 (Page 1953). Cf. D.C. Code Ann. tit. 45 § 1016 (1951), authorizing "the execution in whole or in part of any trust power" by a decree in equity for the benefit of the creditors of the holder of the power where the interest of the objects of the trust is assignable.

<sup>14</sup> 11 U.S.C. § 110(a) (1952).

<sup>15</sup> E.g., Neb. Rev. Stat. § 36-201 (1943); N.J. Rev. Stat. § 25:2-1 (1952); Ohio Rev. Code § 1335.01 (Page 1953). Mich. Stat. Ann. § 26.921 (1953) provides:

All deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels or things in action, made in trust for the use of the person making the same, shall be void, as against the creditors existing and subsequent, of such person.

the settlor's retention of the power to revoke make the trust one for his own benefit? It should not. However, at least one court has held that the power to revoke does make the trust one for the settlor's exclusive benefit within the terms of the statute making such trusts void as to creditors.<sup>16</sup>

The subject of pouring over by will to an inter vivos trust<sup>17</sup> also has involved some troublesome problems where the trust is revocable. Of course, the principal problem of pouring over by will to a trust created by the testator during his lifetime is not restricted to revocable trusts. Common to all pour overs is the fact that the testator is making a testamentary disposition in accordance with terms not spelled out in the will. Therefore, the pour over will be invalid unless the terms of the trust can be incorporated into the will by applying the doctrine of "incorporation by reference," or unless the existence of the trust is a fact of significance independent of the will, so that recourse may be had to the trust in order to ascertain its terms. The latter conclusion is the universally recognized doctrine of "independent significance."

Where the trust is irrevocable, pour overs are upheld under one of the two doctrines, except perhaps where, during the life of the settlor, the trust is purely passive and the doctrine of incorporation by reference cannot be used. In such a case it is questionable whether the existence of the trust would be a fact of independent significance. Similarly, there is generally no trouble in pouring over to a revocable trust where the power to revoke has not been exercised.<sup>18</sup>

But suppose that subsequent to the execution of his will the settlor revokes his trust. It would seem that he would not want any part of his estate distributed in accordance with the trust instrument. On the other hand, assuming the jurisdiction follows the doctrine of incorporation by reference, there is no reason why the trust instrument, if still in existence, could not be so incorporated; and not giving effect to the pour over would permit the testator partially to revoke his will without the necessary formalities. The solution to this problem is not certain, although it probably should be approached by determining whether there is opportunity for fraud. If it is clear that the settlor does not want the pour over to be given effect, and if his revocation has been formally manifested, then the bequest should lapse.<sup>19</sup>

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<sup>16</sup> Herd v. Chambers, 158 Kan. 614, 149 P.2d 583 (1944).

<sup>17</sup> I.e., a bequest or devise to the trustee of a trust created by the testator during his lifetime, the property bequeathed or devised to be held, administered, and distributed by the trustee in accordance with the terms of the inter vivos trust.

<sup>18</sup> See e.g., Montgomery v. Blankenship, 217 Ark. 357, 230 S.W.2d 51 (1950); Swetland v. Swetland, 102 N.J. Eq. 294, 140 Atl. 279 (1928).

<sup>19</sup> For a complete discussion of pouring over from a will to an inter vivos trust, see Scott, Trusts § 54.3 (1956).



There are pour over problems where the inter vivos trust is not revoked, but is altered or amended subsequent to the execution of the will. Should the pour over be given effect according to the terms of the trust at the time of death, or according to the terms of the trust at the time the will was executed, or not at all? It could not be given effect according to the terms of the trust at death under the doctrine of incorporation by reference unless the will was republished by codicil subsequent to the amendment of the trust, for the instrument, as amended, was not in existence at the time of the original execution of the will. However, incorporating by reference could sustain the pour over in accordance with the terms of the trust at the time the will was executed on the ground that the testator intended this. This would be analogous to the doctrine of "dependent relative revocation." But a jurisdiction which, on the theory of independent significance, would uphold a pour over to a revocable or amendable trust where these powers are not exercised, should, under the same doctrine, uphold a pour over to an amended trust in accordance with the terms of the trust as they existed at death. The existence of the *trust* itself is just as much a fact of independent significance before execution of the will as it is after execution, and the amendment of its *terms* should not make it less so.

A number of states have attempted a statutory solution to the entire problem of pour overs to an inter vivos trust. Some of these statutes uphold pour overs to a revocable and amendable trust according to the terms of the trust as they existed at the death of the settlor, even though the trust was amended subsequent to the execution of the will. Others invalidate the pour over where the trust is amended after the will has been executed.<sup>20</sup> Of course, many of the problems in this area can be avoided by republication of the will after each amendment to the trust.

## II. TAX CONSEQUENCES OF A REVOCABLE TRUST<sup>21</sup>

The creation of a revocable inter vivos trust will not reduce the settlor's federal income, gift or estate taxes either during his lifetime or at the time of his death. This is not surprising if one recognizes that the crea-

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<sup>20</sup> For example, Neb. Rev. Stat. § 30.1806 (1943) provides that the pour over to a revocable or amendable inter vivos trust is valid even though the trust instrument is amended subsequent to the execution of the will, and that the bequest shall be distributed according to the terms of the trust at the settlor's death. If the trust is revoked prior to death, the bequest is void. Ill. Rev. Stat. ch. 3, § 194a (1955) is similar. On the other hand, Conn. Gen. Stat. § 45-173 (1958) provides that the pour over shall not be invalid, provided the trust instrument is executed by the testator, his spouse, parent, or child and witnessed by two witnesses [a will requires 3 witnesses]. However, if the trust is amended or revoked after execution of the will, the pour over will be invalid. The statute specifies certain acts which will not be considered amendments of the trust within the meaning of the statute.

<sup>21</sup> The tax discussion in this article is confined to federal income, gift and estate taxes.

tion of a revocable trust is more akin to the execution of a will than to the creation of an irrevocable trust. However, as in the case of testamentary trusts, a properly drafted revocable inter vivos trust can result in a saving of both income and estate taxes that would otherwise be imposed on *beneficiaries* of the trust (other than the creator of the trust).<sup>22</sup>

Granting that no federal tax advantages are to be gained through the use of a revocable inter vivos trust in lieu of a will, the estate planner should be satisfied that no substantial tax disadvantages result from its use.

#### A. *Income Taxes*

(1) *Taxation of trust income.* The settlor is treated as the owner of trust property as to which there is a power to revest title in the settlor, whether such power is exercisable by the settlor or a *non*-adverse party or both.<sup>23</sup> Thus, in the case of every revocable inter vivos trust, the income, deductions and credits of the trust are included in computing the taxable income and credits of the settlor.<sup>24</sup> This is true whether the income is actually paid to the settlor or accumulated for future distribution to him, and even where the income is actually paid to someone other than the settlor.

There are a number of other instances in which the settlor of an inter vivos trust will be considered the owner of the trust even though he does *not* reserve a power to revoke the trust. Thus, if the settlor has retained certain reversionary interests in the trust,<sup>25</sup> if he or a non-adverse party

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<sup>22</sup> Thus, income tax savings can be effected after the settlor's death if the dispositive provisions of the trust permit the trustee, in his discretion, to accumulate the income of the trust or distribute any part or all of the income or principal to or among a class of beneficiaries consisting perhaps of a child of the settlor and his lineal descendants. With such an arrangement the income from the trust property can be kept out of the taxable income of high income tax bracket beneficiaries if they do not have need for it. If the trustee is to be a corporate trustee, it may be advisable to have a committee composed of individuals who are close to the beneficiaries and who would be given the power to control the exercise of the trustee's discretion. Estate and inheritance tax savings can also be effected with this or other arrangements whereby the corpus of the trust will not be included in the estate of a beneficiary when he dies, notwithstanding the fact that the income and, under these arrangements, the principal are available to him as a practical matter. This freeing of the trust property from the estate and inheritance taxes at the death of the beneficiary is often referred to as "the saving of the second tax", although, in fact, the saving of death taxes for several generations can be achieved if the permissible period of the applicable rule against perpetuities is sufficiently long. The importance to possible tax savings of the rule against perpetuities and of related matters such as the right of the trustee to accumulate income is one of the factors which soundly may lead a person to create a revocable inter vivos trust to be governed by the laws of a state other than that of his domicile rather than to use a will which would be governed by the laws of his domicile. See pp. 541-42, *infra*.

<sup>23</sup> Int. Rev. Code of 1954, § 676(a). See also §§ 672(a) and (b) which define what is an adverse and a non-adverse party.

<sup>24</sup> Int. Rev. Code of 1954, § 671.

<sup>25</sup> Int. Rev. Code of 1954, § 673.

has certain powers over the beneficial interests in the trust,<sup>26</sup> if certain administrative powers over the trust exist under which he can or does benefit,<sup>27</sup> or if he or a non-adverse party has the power to distribute income to or for his benefit,<sup>28</sup> he will be deemed to be the owner of the trust. In the typical revocable inter vivos trust, several of the foregoing factors that cause the trust income to be taxed to the settlor may be present. The relinquishment or termination of some, but not all, of these features will not change the situation—so long as any one exists, the settlor is treated as owner of the trust property for federal income tax purposes.<sup>29</sup> In short, a transfer of property to a revocable inter vivos trust neither reduces nor increases the settlor's income tax liabilities—for his individual income tax purposes, the property, and the income from it, are still treated as his.

(2) *Basis for trust property after settlor's death.* In considering the use of a revocable inter vivos trust as a substitute, in whole or in part, for a will, it is important to know whether the trust property acquires a new basis upon the death of the settlor. Property passing under the settlor's will or by intestacy acquires a new basis in the hands of the estate and its distributees. It is usually assumed that the acquisition of a new basis will be advantageous for determining gain or loss on subsequent sale and for other income tax purposes, such as depreciation, because such new basis (the value at the date of the decedent's death or the applicable alternate valuation date) will more often than not, be higher than the basis otherwise determined.

Under the Internal Revenue Code of 1939, provision was made for a new basis only where the income was payable to the settlor or at his direction.<sup>30</sup> For this reason, there was then doubt as to the advisability of the creation of a revocable inter vivos trust with income to be paid to a person other than the settlor. However, under Section 1014 of the Internal Revenue Code of 1954, it is clear that property in a revocable inter vivos trust *will* acquire a new basis, even though the income is not to be paid to the settlor or at his direction.<sup>31</sup> Provision was made for a new basis for *all* property acquired from the decedent by reason of death, the form of ownership, or other conditions, and not otherwise provided

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<sup>26</sup> Int. Rev. Code of 1954, § 674.

<sup>27</sup> Int. Rev. Code of 1954, § 675.

<sup>28</sup> Int. Rev. Code of 1954, § 677.

<sup>29</sup> Items of income, deductions and credits of a trust which are treated as those of the settlor under these provisions are not reported by the trust on the fiduciary income tax return, Form 1041. They are to be shown on a separate statement to be attached to that form and filed by the trustee. Treas. Reg. § 1.671-4 (1956).

<sup>30</sup> Int. Rev. Code of 1939, § 113(a)(5).

<sup>31</sup> Section 1014(b)(2) of the Internal Revenue Code of 1954 continues to provide for a new basis where the income is to be paid to the settlor or at his direction.

for in Section 1014 (with certain exceptions not relevant here) *if* the property was includible in the decedent's gross estate.<sup>32</sup>

Section 1014 is limited in its application to cases where the property is "not sold, exchanged, or otherwise disposed of before the decedent's death" by the person who acquires the property from the decedent. Although such words are new, they apparently were not intended to achieve anything different from the words of the Internal Revenue Code of 1939, which provided that the basis "in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, *after such death*," be a new basis.<sup>33</sup> In other words, neither the 1954 Code provisions nor the 1939 Code provisions were applicable with respect to property acquired from the decedent during his lifetime and disposed of before the decedent's death by the person who acquired the property from the decedent.<sup>34</sup> Shortly after the passage of the Internal Revenue Code of 1954, it was suggested that because of the wording of Section 1014, a question might arise where the trustee of the inter vivos trust sold the property before the decedent's death and reinvested the proceeds in other property.<sup>35</sup> But the regulations subsequently issued make it clear that the basis of any property acquired by the trustee in exchange for the original property, or of any property acquired by the trustee through reinvesting the proceeds from the sale of the original property, shall be the fair market value of the property thus acquired at the date of decedent's death (or the applicable alternate valuation date).<sup>36</sup> Since any such property acquired by exchange or reinvestment during the decedent's lifetime would not, strictly speaking, be "property transferred by the decedent during his lifetime" as provided in Section 1014(b)(2), such property probably would acquire a new basis by reason of Section 1014(b)(9), the "catchall provision." In the case of property in a revocable inter vivos trust, the result would appear to be the same regardless of whether the property acquires a new basis by reason of Section 1014(b)(2) or Section 1014(b)(9). Although Section 1014(b)(9) requires that the basis be reduced by the amount allowed to the transferee as deductions for depreciation and like factors, such reductions do not include deductions allowed to the decedent himself<sup>37</sup> in respect of the

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<sup>32</sup> Int. Rev. Code of 1954, § 1014(b)(9).

<sup>33</sup> Int. Rev. Code of 1939, § 113(a)(5).

<sup>34</sup> See Treas. Reg., § 1.1014-1(a) (1957).

<sup>35</sup> Casner, "The Internal Revenue Code of 1954: Estate Planning," 68 Harv. L. Rev. 222, 224-6 (1954).

<sup>36</sup> Treas. Reg. § 1.1014-3(d) (1957). Presumably, although the regulations do not expressly cover the matter, the same would be true with respect to property acquired by the trustee before the decedent's death from the income of the trust property.

<sup>37</sup> Treas. Reg. § 1.1014-6(c)(1) (1957).

property, as would always be the situation in the case of a revocable inter vivos trust.

### B. Gift Tax

It is clear that no gift tax liability is incurred upon the creation of a revocable inter vivos trust regardless of whether the income is to be paid to the settlor or to some other person. The regulations provide that "a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself."<sup>38</sup> A donor is considered as having the power to accomplish such reversion where the power is exercisable in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom.<sup>39</sup> It should be noted, however, that an inter vivos transfer to a trust is not deemed an uncompleted gift where only third persons, with or without an adverse interest, have the power to revest the property in the settlor. Thus, a gift tax liability might be incurred in such a case, even though the grantor is not relieved of income tax liability on the trust income.<sup>40</sup>

Where the revocable inter vivos trust provides that the income is to be paid to a person other than the settlor, the distributions of the trust income to the beneficiaries constitute gifts in the years the distributions are made.<sup>41</sup> Similarly, where the settlor later relinquishes the control he retained which made the gift incomplete, the settlor thereby completes the gift, thus subjecting himself to gift tax liability in the year of such release.<sup>42</sup>

### C. Estate Tax

(1) *Inclusion in gross estate.* As indicated above, the settlor of a revocable inter vivos trust is treated as the owner of the trust property for income and gift tax purposes. This is also true for estate tax purposes. The value of the trust property is included in the settlor's gross estate if the settlor reserved the right to income from the trust,<sup>43</sup> if the settlor reserved the right, either alone or in conjunction with any other person,

<sup>38</sup> Treas. Reg. § 25.2511-2(c) (1958). See also Rev. Rul. 58-395, 1958 Int. Rev. Bull. No. 32, at 14. However, the regulations require that the transaction be disclosed in a gift tax return. See Treas. Reg. § 25.2511-2(j) (1958).

<sup>39</sup> Treas. Reg. § 25.2511-2(e) (1958). There is also no completed gift where the settlor reserves the power to change beneficial interests even though no power to revoke is reserved. Treas. Reg. § 25.2511-2(c) (1958).

<sup>40</sup> See Int. Rev. Code of 1954, § 676.

<sup>41</sup> Treas. Reg. § 25.2511-2(f) (1958); *Commissioner v. Warner*, 127 F.2d 913 (9th Cir. 1942).

<sup>42</sup> Treas. Reg. § 25.2511-2(f) (1958); *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939); *Burnet v. Guggenheim*, 288 U.S. 280 (1933).

<sup>43</sup> Int. Rev. Code of 1954, § 2036.

to designate the persons who shall enjoy the income or corpus of the trust,<sup>44</sup> or if the settlor had, at the time of his death, the right, either alone or in conjunction with any other person, to alter, amend, revoke or terminate the trust, or where any such power was relinquished in contemplation of death.<sup>45</sup>

(2) *Alternate valuation date.* The alternate valuation provision permits the executor to elect to value the property in the gross estate, (i) in the case of property distributed, sold, exchanged or otherwise disposed of within 1 year after the decedent's death, as the value on the date of distribution, sale, exchange, or other disposition, and (ii) in the case of property not so distributed, sold, exchanged or otherwise disposed of, as the value on the date one year after the decedent's death.<sup>46</sup> This provision may be of particular importance where the gross estate consists to a large extent of property which substantially fluctuates in value (such as certain listed common stocks) and where some substantial part of such property may have to be liquidated to pay estate taxes.

It is clear that the alternate valuation provisions are applicable to property in a revocable inter vivos trust as well as to other property includible in the gross estate.<sup>47</sup> However, optimum use of the alternate valuation may be lost in the case of a revocable inter vivos trust if certain pitfalls are not foreseen. Thus, the trust may provide that, immediately upon the settlor's death, the corpus shall be divided into several new, separate trusts, one trust qualifying for the marital deduction and one separate trust for each of the children of the settlor and their lineal descendants. If such a division into separate trusts was required immediately after the settlor's death, it probably would constitute a "distribution" which would freeze the alternate valuation date of the trust property as of a date long before one year after the settlor's death. This can be avoided by permitting the trustee of the inter vivos trust to hold the trust property intact for a year following the settlor's death if he should deem it advisable to do so.<sup>48</sup>

(3) *Deduction for debts, administration expenses, etc.* The enactment of the Internal Revenue Code of 1954 brought with it amendments that eliminated two previously existing potential tax disadvantages that accompanied the use of a revocable inter vivos trust as a substitute for

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<sup>44</sup> Ibid.

<sup>45</sup> Int. Rev. Code of 1954, § 2038(a).

<sup>46</sup> Int. Rev. Code of 1954, § 2032.

<sup>47</sup> For example, the regulations under the alternate valuation provision speak in terms of property held by a trustee and included in the gross estate under §§ 2035 through 2038. Treas. Reg.-§§ 20.2032-1(c) (2) and (3) (1958).

<sup>48</sup> By this method the trustee of the inter vivos trust is given the same powers he would have if he were the executor of the estate.

a will. In computing the net taxable estate under the Internal Revenue Code of 1939, the amount allowed as a deduction for debts, administration expenses, and the like was limited to the value of the decedent's property which was subject to the payment of such claims.<sup>49</sup> Moreover, there was no provision in the Internal Revenue Code of 1939 for the deduction of expenses of administering property not subject to claims. Consequently, if too large a part of the decedent's property was in a revocable inter vivos trust, and if the local law exempted such property from claims, a substantial part of the estate tax deductions for claims against the estate and for administration expenses could have been lost. In any event, no deduction for administration expenses of the trust property was allowable. However, under the Internal Revenue Code of 1954, the deduction of debts and expenses in excess of the property subject to claims is allowed provided such amounts are paid before the date prescribed for the filing of the estate tax return.<sup>50</sup> Accordingly, it is now possible to transfer virtually all of a person's property to a revocable inter vivos trust without jeopardizing these estate tax deductions so long as the trustee (or executor) is authorized to, and does, pay such debts and expenses of administration within the required period. Similarly, the Internal Revenue Code of 1954 permits the deduction of expenses incurred in administering property not subject to claims but included in the gross estate, provided such expenses are paid before the expiration of the period of limitation for assessment of the estate tax.<sup>51</sup> Thus, trustees' commissions, attorneys' fees and like expenses are deductible in the same way as are corresponding expenses of a probate estate.

### III. USING THE REVOCABLE TRUST

First and foremost, the revocable trust is a substitute for a will—an alternative method of testamentary disposition. Secondly, it is an inter vivos conveyance which can be recalled or changed. In the writers' opinion, failure to keep this priority in mind has led many estate planners to overlook important practical advantages attending the use of a revocable trust. If the revocable trust is viewed merely as an alternative to an irrevocable trust, its advantages appear limited; approached as a means of disposing of property upon death, it becomes a streamlined and flexible estate planning tool with many practical uses.<sup>52</sup>

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<sup>49</sup> Int. Rev. Code of 1939, § 812(b).

<sup>50</sup> Int. Rev. Code of 1954, § 2053(c)(2).

<sup>51</sup> Int. Rev. Code of 1954, § 2053(b).

<sup>52</sup> Some very helpful discussions relating to the use of revocable inter vivos trusts in estate planning may be found in Casner, "Estate Planning," *supra* note 35 at 99-106 (1956); Stanford, "Twenty Questions", Comparison of Revocable and Testamentary Trusts" 93 *Trusts & Estates* 608 (1954); Trachtman, "Estate Planning," *P.L.I. Current Problems in*

During his lifetime, the settlor of a revocable trust is able to exert a large measure of control over his property and, if he wishes, he may have the beneficial enjoyment of it. The plans which he has made for its disposition upon his death may be modified from time to time as changing circumstances make such modifications desirable, either by revoking the trust and creating a new one or by exercising retained powers to alter or amend. Thus, the settlor may add, remove, or substitute beneficiaries, change the nature of their interests, change the powers of the trustee, and augment, diminish, or change the trust property. Moreover, during his life, the settlor will have the sense of security which his retained power to revoke and have the trust property returned to him inevitably brings. He need never experience the bitter frustration of suddenly needing property which he has previously irrevocably conveyed.

In some respects the settlor of a revocable trust has advantages analogous to retention of his property during his lifetime. Yet, upon his death, none of the property in trust will be part of his probate estate. The advantages of avoiding probate are often very real. These advantages, combined with the flexibility which the settlor has retained during his lifetime, in many cases make an inter vivos revocable trust a workable substitute for a will. Property also may be kept out of the probate estate by an irrevocable inter vivos conveyance. But once an irrevocable conveyance is made, flexibility is lost. The revocable trust combines some of the advantages of an inter vivos conveyance with some of the advantages of retention of property until death, without many of the disadvantages of either.

1. *Savings in Probate Expense.* In many cases, a worthwhile saving in the expense of probate and administration of a decedent's estate can be achieved by placing a portion of the estate into a revocable trust during the decedent's lifetime. Executor's, attorney's, and appraiser's fees are usually in part "ad valorem"—based upon the value of the probate estate. If, for example, stock and securities belonging to the decedent are placed in a revocable trust prior to his death, they will not form part of the probate estate, and the above mentioned fees will be reduced pro tanto. To some extent these savings may be offset by the attorney's fees incurred in establishing the trust and the trustee's commissions. However, an attorney's fee for drafting a trust instrument may well be less than his fee in connection with the drafting of a will and the probate and administration of the same property on death. Moreover, the trustee's commissions will not be paid in whole dollars, since they are



deductible for federal income tax purposes. If the trust res includes stock and securities, there will be a transfer tax upon their conveyance in trust and again when the corpus is ultimately distributed. There is no transfer tax on the transfer of stock and securities from the probate estate, since the transfer is by operation of law.

2. *Avoiding Ancillary Proceedings.* Where real estate or tangible personal property is situated outside the state of the owner's domicile, the problem of ancillary probate proceedings upon death is present. Ancillary proceedings are expensive and time consuming. The executor or administrator will have to qualify in the foreign state or, if he cannot, an ancillary administrator who is a resident of the foreign state will have to be appointed and qualified. Complicated problems concerning distribution of the assets of the estate may be encountered where ancillary proceedings are necessary. These problems may be avoided by placing the foreign property in a revocable inter vivos trust. When the settlor dies, this property will not be part of his probate estate and will be distributed in accordance with the terms of the trust without the necessity of ancillary probate proceedings.

In addition to retaining a life estate and power to revoke, the settlor may retain sufficient administrative powers to give him adequate control over the management of his foreign property during his lifetime. He might consider transferring only a remainder interest in the property to a revocable trust in the foreign state, retaining a legal life estate; but if this is done, it would seem important to insure that the trust is not treated as merely passive, with the consequence that the transfer would be considered testamentary. It might be advisable to include other property in the trust with respect to which the trustee would have real management responsibilities during the settlor's life.

3. *Providing for Family Support During the Period of Probate and Administration.* Property in the probate estate may be tied up for a considerable length of time during which the widow and children are in need of support. Most states provide for immediate payments from the estate for this purpose, but the amount as fixed by the court may be inadequate, and the duration of the payments is limited. This problem is eliminated where there is a revocable inter vivos trust of which the decedent's dependents are the income beneficiaries after the settlor's death. Furthermore, the trustee may be given power to invade the corpus for the benefit of the dependents, should the trust income be inadequate, or the trust agreement may provide for transfer of the property outright to the spouse or other beneficiaries upon the settlor's death. Of course, the latter ar-

range may not be advisable where there is a likelihood that the trust will be attacked as an attempted testamentary disposition.

4. *Minimizing Disruptive Effect of Death on Decedent's Business.* The owner's death almost inevitably has a disruptive effect upon a going business. Where the business becomes part of the probate estate, it can continue operation only under the restrictive supervision of the probate court during the period of administration. There is, thus, not only the disruptive effect of the loss of the decedent's management, but the additional complications entailed in court supervision and limitations on the new operators. If the business has been placed in a revocable trust, none of the assets will fall into the probate estate upon the owner's death, and the difficulties of operating a going business through probate are avoided. By reserving powers to revoke, alter, and amend, and perhaps some administrative powers, the settlor still will have a hand in the control of his business during his lifetime. The settlor may select, as trustee, the natural successor to the management of his business, e.g., his son. By the time the settlor dies, his son will have gained familiarity with the business and thus be able to continue it without interruption.

5. *Protection against Incompetence.* Closely allied with the problem of avoiding the disruptive effects of probate is the problem of protecting an estate against the results of its owner's incompetence. The owner (e.g., an aged widow) of an estate consisting largely of stock and securities may have neither the time nor the financial acumen to manage it properly. An agency account may provide very good management, but a revocable inter vivos trust may be more advisable, as where she is frail, in poor health and approaching senility. The power of revocation will give her the same control she would have had under an agency arrangement and the sense of security that comes with that control. Having her property in trust, rather than under the management of an agent, will be highly advantageous should she become incompetent and unable to manage her affairs. Incompetence will terminate an agency arrangement and require the appointment of a committee or guardian to manage her property. She will have no right to select her guardian, who well may not be her former agent. Moreover, strict procedures of accounting and restrictions on investment will be imposed on a guardian. Incompetence will have no such effect upon the management of property in trust. The trustee, selected by the settlor, will continue to manage the property under the terms and conditions originally specified.<sup>53</sup>

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<sup>53</sup> One of the authors has used revocable inter vivos trusts several times where, by reason of approaching senility (and inadequate business ability), a widow's future, as well as present, ability to manage her own property was in doubt. All business assets and the home and furnishings were placed in trust, with a corporate fiduciary and an adult member

6. *Avoiding Tie-ups of Commonly Owned Property.* Guardianship can tie up not only the property of the incompetent, but also the interests of those who own property jointly with him. Death of one of the common owners may have the same effect, particularly if the decedent's successor in interest is an infant under a long period of disability. In any event, the interest of the decedent, incompetent, or infant will be placed under the restrictive management of an executor or guardian. Since this interest is in common with that of others, the interests of all the common owners will be disrupted. This danger can be avoided if the common owners place the property in a revocable inter vivos trust. For the reasons noted above, neither death nor disability will interrupt the management and operation of the property, and the interests of all will be protected.

7. *Avoiding Publicity and Attacks upon Disposition.* An incident of probate against which some may wish to guard is the publicity of, and the opportunity for attack upon, the disposition of the decedent's property. Probate requires public notice, which in turn focuses attention upon the will, the decedent's property, and its appraised value. The decedent's estate and his directions for disposition are exposed to public view; this is the period during which claims in respect of his property are most likely to occur. Property which has been placed in an inter vivos trust will not be subjected to such publicity. Moreover, an attack upon a disposition by inter vivos trust is somewhat less likely to occur than is an attack upon a disposition by will. If the attack upon the trust is made during the settlor's life, he will be present for the defense; if made after his death, the existence and operation of the trust for a period of time will probably make the attacker's burden more difficult. Of course, this may not apply to a claim of the surviving spouse to her statutory share in the trust property. As noted above, some states have placed her in a preferred position vis-a-vis the right of her husband to dispose of his property by a revocable inter vivos trust.

8. *Freedom from Testamentary Restrictions.* The use of a revocable inter vivos trust as a substitute for a will enables the settlor to avoid certain restrictive rules placed upon testamentary dispositions. For example, in many states, bequests to charity are void or voidable if the will is executed within a certain period prior to death. Other states limit the proportion of the estate which can be bequeathed or devised to charity. These rules are not applicable to a charitable interest in a trust

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of the family as co-trustees. In each instance, incompetence later occurred—but the property was not “tied up” by guardianship. On death, no probate was necessary. By using a revocable, rather than an irrevocable, trust, the parties were able to avoid a substantial gift tax which they did not wish to incur.

created during the settlor's life, even though the interest is created within the prohibited period prior to death.

More important, however, is the fact that the settlor of an inter vivos trust can select the state law which will govern his disposition. A testamentary disposition will be controlled by the law of the state in which the decedent is domiciled at the time of his death. A testator can "select" the state law which will govern his testamentary dispositions only by becoming and remaining domiciled therein until his death. On the other hand, the administration of a trust is generally governed by the situs of administration. Thus, the settlor of an inter vivos trust, by the choice of trustee and by the terms of the trust instrument, can choose this situs during his lifetime. For example, a settlor domiciled in state *A* who wishes the laws of state *B* to govern the disposition of his property, may convey the property in trust to a trustee domiciled in state *B*, the trust to be administered in that state. To assure his choice, he should expressly set forth in the trust instrument that the laws of state *B* are to govern the construction and interpretation of the trust instrument, the extent and nature of the interests the beneficiaries are to have, and other questions which may arise in the course of administration.

This can be a very important estate planning tool. Suppose the rule against perpetuities in the state of the testator's domicile provides that the power of alienation shall not be suspended for a period longer than the continuance of the lives in being at the creation of the estate.<sup>54</sup> Suppose further that the testator wishes to make the following disposition upon death: to his spouse for life, then to his youngest son for a ten year term, with a remainder to the testator's lineal descendants then living. The ten year term and remainder would be void. On the other hand these gifts would be valid if, at death, the testator were domiciled in a state which has the traditional rule against perpetuities—that the interests must vest within the life or lives in being plus twenty-one years. The testator may avoid the more restrictive rule of his domicile by creating a revocable inter vivos trust in a state which applies the traditional rule, reserving a life estate and specifying the above disposition upon his death. It should be noted that where a revocable inter vivos trust is used, the period specified in the rule against perpetuities is generally measured from the death of the settlor rather than from the transfer in trust.<sup>55</sup>

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<sup>54</sup> E.g., N.Y. Real Prop. Law, § 42 and N.Y. Pers. Prop. Law § 11, as amended by N.Y. Laws, 1958, Chapters 152 and 153. Prior to the 1958 amendments, the rule was even more restrictive: the power of alienation ("absolute ownership" in the case of personal property) could not be suspended for a period longer than two lives in being at the creation of the estate. As in the present rule, there was no period in gross.

<sup>55</sup> See Simes, "The Law of Future Interests" § 1226 (1956).

Suppose a testator wishes to leave his property in trust after his death and desires that the trustee have the power to accumulate income and make discretionary distributions to the beneficiaries. This arrangement might be desired to avoid high income taxes which would be imposed on the beneficiaries if the trust income were currently distributable.<sup>56</sup> If the domiciliary state prohibits the accumulation of income,<sup>57</sup> a testamentary trust would not be given effect, even though the testator were to name a foreign trustee. However, the prohibition against accumulations could be avoided by the creation of a revocable inter vivos trust in a state which has no such prohibition. In a similar fashion, the testator may avoid the restrictive rules of his domicile with respect to the alienability of beneficial interests and the selection of trustees. As previously noted, however, the ability of the settlor in this way to control the rights of his surviving spouse to claim her statutory share in the corpus of a revocable trust over which he has retained broad administrative powers is not absolute. If there is a strong public policy in the state of the settlor's domicile in favor of giving the surviving spouse her statutory share, it might override the fact that the trust has been created and is being administered in another state which recognizes the power of the settlor to place his property beyond the claims of the surviving spouse.

Several intensely practical problems arise where a trust, administered in state *B*, is attacked in the courts of state *A* (the settlor's domicile at his death), on the ground that the conveyance in trust was an attempted testamentary disposition. The first question is whether the courts of state *A* can make a binding determination. The courts of state *A* may not have jurisdiction to render any decision if the trustee is considered an indispensable party and personal jurisdiction over him cannot be had.<sup>58</sup> If and when the court in state *A* has jurisdiction, the question is what law state *A* will apply. There is no absolute assurance that the courts of state *A* will apply the law of state *B* in determining whether the disposition is testamentary, particularly if the settlor was domiciled

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<sup>56</sup> See note 22, *supra*.

<sup>57</sup> E.g., *Ariz. Rev. Stat. Ann.* § 33-238 (1956); *N.D. Rev. Code* § 47.0304 (1943). Until the recent 1959 amendments, *N.Y. Real Prop. Law* § 61 and *N.Y. Pers. Prop. Law* § 16 prohibited accumulations except during minority.

<sup>58</sup> In *Hanson v. Denkla*, 357 U.S. 235 (1958), the Supreme Court had to decide whether the courts of the settlor's domicile at death (Florida) had jurisdiction to determine whether his revocable inter vivos trust, administered in Delaware, was actually an attempted testamentary disposition void for failure to comply with the Statute of Wills, and whether a Florida court's decision on this question should be given full faith and credit by the courts of Delaware, the situs of the trust. The Florida court, applying its own law, found that the trust was testamentary. The Delaware courts had upheld the trust. The Supreme Court decided that Florida did not have jurisdiction to render a decision, since, under Florida law, the Delaware trustee was an indispensable party and the Florida court did not have personal jurisdiction over it. Thus, the Delaware decision sustaining the trust was upheld.

in *A* when he created the trust or, while domiciled in *A*, exercised his power to alter, modify, or amend.

In considering the use of a revocable inter vivos trust to avoid the disadvantages attendant upon probate and administration, a further problem should be considered if there is to be a pour over from the will to the inter vivos trust. A bequest to an inter vivos trust is, of course, testamentary. As a result of the pour over, the entire trust, as augmented, may thereafter be treated as a testamentary trust and the trustee subjected to the often more strict requirements applicable to such trusts. The bequest may also be treated as creating a separate testamentary trust rather than as an addition to the already established inter vivos trust. In either event, the settlor would find his dispositive plan hindered by some of the consequences of judicial supervision of testamentary trusts—consequences which he intended to avoid through the use of an inter vivos trust. If it were held that a separate testamentary trust is created, there might be a disadvantage in having the decedent's property managed in two separate funds. Administrative duties would be duplicated and expenses of management would likely be increased. Total income from the trusts might well be curtailed, for neither might be large enough to permit diversified investment. Similarly, many states require that the trustee of a testamentary trust be a resident of the state having jurisdiction over the probate estate. If the entire inter vivos trust, as augmented, is to be supervised as a testamentary trust, substitution of trustees might be necessary where the trustee of the inter vivos trust is not a resident of the decedent's domicile. Moreover, trustees of testamentary trusts are subject to strict bonding requirements not imposed upon trustees of inter vivos trusts.

Several of those states which have attempted a statutory solution to the problem of pour overs have specified that an inter vivos trust receiving a pour over will not be treated as a testamentary trust for purposes of judicial supervision, at least where the trustee is authorized to act as an administrator or executor in the decedent's domicile.<sup>59</sup> Where there is no controlling statute, the result may turn on whether the theory upon which the state has upheld the pour over is that of "incorporation by reference" or "independent significance." Application of the doctrine of incorporation by reference would make the terms of the trust instrument a part of the will as though the will created the trust. Application of the doctrine of independent significance would not result in the trust being treated as testamentary, since under that doctrine, reference might be

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<sup>59</sup> E.g., Conn. Gen. Stat. § 45-173 (1958); Neb. Rev. Stat. § 30-1806 (1943); N.C. Gen. Stat. § 31-47 (1950).

made to an instrument *aliunde* without importing its terms into the will. Of course this is sheer legalistic formalism, but there appears to be no other basis for subjecting an inter vivos trust to testamentary supervision where it is the beneficiary of a bequest.

#### CONCLUSION

Recent trends and developments have made the use of a revocable inter vivos trust increasingly attractive as compared to the use of a will in a substantial number of situations. But it has not received the use and attention it deserves. The foregoing discussion is not intended to be comprehensive, but rather to point out, in a summary way, some of the possibilities for advantageous use of the revocable trust technique, and some of the pitfalls to be avoided. We do suggest, however, that no estate planning project should be regarded as complete until some consideration has been given to the advisability of creating a revocable inter vivos trust for property over which the client wishes to retain control.