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Administrative and Dispositive Powers in Trust and Tax Law: Toward a Realistic Approach

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ADMINISTRATIVE AND DISPOSITIVE POWERS IN TRUST AND TAX LAW: TOWARD A REALISTIC APPROACH*

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I. INTRODUCTION

Distinctions between dispositive and administrative trust powers have long been recognized in all areas of estate and trust law,[1] including estate and gift taxation.[2] In two areas, specific rules have arisen as a direct result of the influence of these distinctions on the estate and trust field. These areas are judicial deviations from the terms of a trust, and inclusion of property in a decedent's gross estate for federal estate tax purposes.

This article will examine the rules in these areas based on the distinction between administrative and dispositive powers, and will attempt to determine the validity of the difference in those rules which are based on the type of power. After reviewing the rules, the article will explore several administrative powers that have been the subject of litigation to determine whether these powers are as limited as the rules suggest. Next, the article will conclude that the effect of administrative powers on trust beneficiaries differs depending on the power involved. Thus, the article will demonstrate that the current rule mandating one result when the power is labeled "dispositive" and another when the power is "administrative" is unwarranted. Furthermore, the distinction ignores the extent to which some administrative powers affect enjoyment between trust beneficiaries. Finally, the article will suggest a new method of analyzing administrative and dispositive powers for both judicial deviation and federal estate and gift tax purposes.[3]

As a preliminary matter, a working definition of administrative and dispositive powers should be developed. Unfortunately, there appears to be no universally accepted definition of "administrative power" or "dispositive power."[4] For the purposes of this article, it

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1. *See, e.g.*, G.G. BOGERT & G.T. BOGERT, HANDBOOK OF THE LAW OF TRUSTS 521-23 (5th ed. 1973); A. SCOTT, ABRIDGMENT OF THE LAW OF TRUSTS 314-19 (1960).

2. R. STEPHENS, G. MAXFIELD & S. LIND, FEDERAL ESTATE AND GIFT TAXATION 4-114-15 (5th abr. ed. 1983); C. LOWNDES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES 158-60 (3d ed. 1974).

3. One terminology problem should be discussed immediately. In trust deviation law, the court may be treating either a power or a provision. Thus a court may consider whether a dispositive provision containing no trustee power may be modified. A court may also consider whether a power given to a trustee may be modified. On the other hand, estate and gift tax law has separate provisions pertaining to interests of the grantor, e.g., I.R.C. § 2033 (property in which decedent had an interest) (1982), and to powers held by the grantor, e.g., I.R.C. § 2036 (transfers with retained life estate), § 2038 (revocable transfers) (West 1985). The distinction between administrative and dispositive powers has been raised under the powers sections. In the remainder of this article, the words "provision"and "power" will be used as appropriate, and will sometimes be used interchangeably.

4. Beausang, *Estate and Gift Tax Consequences of Administrative Powers*, 115 TRUSTS & ESTATES 246 (1976). The *Restatement* does not speak in these terms, but rather states its general rule in terms of allowing the trustee to "deviate from a term of the trust" and qualifies the

will be sufficient to define an administrative provision or power as one that concerns the management of property, is incidental to the substantive terms of the transfer, and is not directly substantive.[5] This definition is broad enough to include the powers most attorneys who work in the field would classify as administrative.[6] A dispositive power or provision, on the other hand, directly affects the substantive provisions of a trust, primarily those provisions identifying the beneficiaries and setting forth their interests.

II. THE JUDICIAL POWER TO DEVIATE FROM THE TERMS OF A TRUST

A. *Dispositive Provisions*

The clear rule in this country is that a court will not permit deviation from the dispositive terms of a trust in favor of a beneficiary if to do so will reduce or eliminate the interests of other beneficiaries.[7] The primary reasons given for this rule are that courts will not rewrite a testator's will or speculate regarding testator's unexpressed

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rule by not allowing deviation if another beneficiary's interest is impaired by the deviation. RESTATEMENT (SECOND) OF TRUSTS §§ 167-168 (1959). For the complete text of these sections, see *infra* notes 7 & 15.

5. *See* Beausang, *supra* note 4, at 246 for a similar definition. The importance of the qualification, that the power not be directly dispositive, is amplified in Section IV, *infra*.

6. Without attempting to be exhaustive, the definition would include investment powers, principal and income powers, powers to appoint successor fiduciaries in inter vivos trusts, powers to sell, lease or mortgage, powers to hold separate shares *in solido* and to hold property in bearer form, powers to collect and pay debts and taxes, powers to make tax elections, clauses relieving the trustee of liability, and similar management clauses.

7. Leonardini v. Wells Fargo Bank & Union Trust Co., 131 Cal. App. 2d 657, 267 P.2d 423 (1954); Staley v. Ligon, 239 Md. 61, 210 A.2d 384 (1965); Mills v. Michigan Trust Co., 124 Mich. 244, 82 N.W. 1046 (1900); *In re* Cosgrave's Will, 225 Minn. 443, 31 N.W.2d 20 (1948); Segelhen v. Segelhen, 26 N.J. Super. 178, 97 A.2d 501 (App. Div. 1953); Hughes v. Federal Trust Co., 119 N.J. Eq. 502, 183 A. 299 (Ch. 1936); Woody v. Christian, 205 N.C. 610, 172 S.E. 210 (1934); Stewart v. Hamilton, 151 Tenn. 396, 270 S.W. 79 (1925); Estate of Boyle, 252 Wis. 511, 32 N.W.2d 333 (1948); *In re* Caswell's Will, 197 Wis. 327, 222 N.W. 235 (1928). *See* G. BOGERT, TRUSTS AND TRUSTEES § 561 (Rev. 2d ed. 1980); 3 A. SCOTT, THE LAW OF TRUSTS § 168 (3d ed. 1967). The Restatement does not speak in these terms. After stating in § 167 that the court may direct or permit the trustee to deviate from a term of the trust under certain circumstances, § 168, entitled "Anticipation of Income and Principal," provides:

> The court may permit or direct the trustee to apply income and principal from the trust estate for the necessary support of a beneficiary of the trust before the time when by the terms of the trust he is entitled to the enjoyment of such income or principal, if the interest of no other beneficiary of the trust is impaired thereby.

RESTATEMENT (SECOND) OF TRUSTS § 168 (1959). The comments, as well as judicial decisions, permit the trustee to invade principal for support of the income beneficiary when the latter is the sole beneficiary. *Id.* at comments a and b. Since the focus of this article is on trusts in which the income beneficiary is not the sole beneficiary, such cases will not be mentioned further since they are beyond the scope of this article. *See* Note, *Deviation from the Distributive Terms of the Trust*, 53 NW. U.L. REV. 268 (1958). *See also In re* Cosgrave's Will, 225 Minn. at 468-70, 31 N.W.2d at 35.

intent.[8] In addition, to do so would be equivalent to taking property from one beneficiary and giving it to another, thus violating constitutional provisions against taking property without due process of law.[9]

The leading case in this area is *In re Van Deusen's Estate.*[10] Florence Lenore Van Deusen created a testamentary trust with income to be paid in equal shares to her two daughters. On the death of the first daughter, the surviving daughter was to receive the entire income for her life. On the death of the survivor of the daughters, the corpus was to be paid to decedent's surviving grandchildren in equal shares and to the issue of any predeceased grandchildren, per stirpes. The daughters initiated a proceeding to interpret the will. The daughters alleged that testatrix's purpose was to provide them with sufficient funds to meet their needs. They further claimed that when the will was executed it was estimated that the net income from the trust would be at least $400 a month and that testatrix intended each daughter to receive not less than $200 per month. Therefore, they requested that the trustee pay each of them at least $200 per month and invade the corpus to pay such amounts if the income was insufficient.

Writing for the California Supreme Court, Justice Traynor ruled that no invasion of the corpus was permitted. The court held that the rights of residuary beneficiaries almost all be protected,[11] and that invading the corpus to provide for the income beneficiaries was impermissible without the consent of the other beneficiaries.[12] Since *Van Deusen,* most courts have refused to deviate from the dispositive provisions of trust instruments.[13]

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8. *In re* Cosgrave's Will, 225 Minn. at 449, 31 N.W.2d at 25; Mills v. Michigan Trust Co., 124 Mich. 244, 248-49, 82 N.W. 1046, 1048 (1900).

9. *In re* Cosgrave's Will, 225 Minn. at 465, 31 N.W.2d at 33 ("The court lacks power to take property from one person and give it to another. A taking of property without authority of law is no less lacking in due process when it is done by the judicial department of the government rather than by some other department thereof.").

10. 30 Cal. 2d 285, 182 P.2d 565 (1947).

11. *Id.* at 294, 182 P.2d at 572.

12. *Id.* at 293, 182 P.2d at 571. Justice Traynor emphasized the result of such an invasion:

> If the courts could increase the payments under testamentary trusts without the consent of all the beneficiaries merely because the income therefrom is not what it was at the time the will was executed and because at one time or another the testator expressed the desire to provide adequately for the beneficiaries, *there would be no stability to any testamentary trust in this state.*

Id. at 295, 182 P.2d at 573 (emphasis added).

13. The Restatement cites two cases in which courts have permitted deviation from dispositive provisions, on the ground that such deviation is necessary to accomplish the settlor's primary purpose. RESTATEMENT (SECOND) OF TRUSTS § 168 reporter's note (1959) (citing Longwith v. Riggs, 123 Ill. 258, 14 N.E. 840 (1887); Petition of Wolcott, 95 N.H. 23, 56 A.2d 641 (1948)). *Wolcott,* which is widely recognized as an exception to the general rule, is discussed in

B. Administrative Powers

In contrast to the rule on dispositive provisions, courts have proved willing to modify administrative provision of trusts. In this area, the deviation doctrine allows a court to authorize a trustee to exercise powers that are either specifically prohibited by the terms of the trust or are not provided for in the trust instrument.[14] The doctrine is employed when circumstances not known to and not anticipated by the testator arise and when compliance with the trust terms

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Section VI, *infra*. The *Wolcott* court believed that the will disclosed a clear intention on the part of the testator primarily to benefit his spouse. Following the rationale of cases on deviation from administrative powers, discussed in Section II-B, *infra*, the court ordered invasion to prevent impairment of testator's primary purpose. Moreover, there was virtual representation of all infants and unborns in this case, and the presumptive remaindermen, the testator's sons, consented to the invasion. The court believed this to be significant. Although the binding effect of consent in this situation is beyond the scope of this article, a similar case of virtual representation, albeit in an accounting proceeding, is *In re* Estate of Lange, 75 N.J. 464, 383 A.2d 1130 (1978). *Longwith*, 123 Ill. at 258, 14 N.E. at 840, similarly involved a mentally incompetent daughter, and a will which clearly evidenced a primary purpose to aid her. *Longwith* has been held inapplicable where there is no clear intention in the will that the testator's primary purpose is to benefit one beneficiary at the expense of others. *See In re* Cosgrave's Will, 225 Minn. at 461, 31 N.W.2d at 31. For a discussion of numerous cases where a clear indication of testator's primary purpose is given in the will, see *In re* Cosgrave's Will, 225 Minn. at 443, 31 N.W.2d at 20. Thorne v. Continental Illinois Nat'l Bank & Trust Co., 18 Ill. App. 2d 163, 151 N.E.2d 398 (1958), which is occasionally cited as justifying a court to deviate from the dispositive provisions of a trust, actually involved a deviation from the provisions of a will of a beneficiary who had a vested two-thirds remainder of a trust and who had predeceased the life income beneficiary. Although the court did discuss deviation, its ruling was based on an extension of the family settlement doctrine. The *Thorne* facts reveal extensive, costly and acrimonious litigation among the parties, a circumstance which greatly influenced the court. While the settlement agreement approved by the court varied the terms of the trust, it did so because of the death of the remainderman prior to the death of the income beneficiary. Thus viewed, the case is more correctly characterized as varying the terms of a will by an extension of the family settlement doctrine than as varying the dispositive terms of the trust.

14. RESTATEMENT (SECOND) OF TRUSTS § 167 (1959) provides:

> § 167. Change of Circumstances
>
> (1) The court will direct or permit the trustee to deviate from a term of the trust if owing to circumstances not known to the settlor and not anticipated by him compliance would defeat or substantially impair the accomplishment of the purposes of the trust; and in such case, if necessary to carry out the purposes of the trust, the court may direct or permit the trustee to do acts which are not authorized or are forbidden by the terms of the trust.
>
> (2) Under the circumstances stated in Subsection (1), the trustee can properly deviate from the terms of the trust without first obtaining the permission of the court if there is an emergency, or if the trustee reasonably believes that there is an emergency, and before deviating he has no opportunity to apply to the court for permission to deviate.
>
> (3) Under the circumstances stated in Subsection (1), the trustee is subject to liability for failure to apply to the court for permission to deviate from the terms of the trust, if he knew or should have known of the existence of those circumstances.

Discussion of subsections (2) and (3) is beyond the scope of this article.

defeats or substantially impairs the attainment of the purposes for which the trust was created.[15]

The leading case in the development of the doctrine is *Curtiss v. Brown*.[16] The case involved the creation of a trust, with the income to Mary Curtiss for the joint lives of her and her husband. Mary would receive the corpus in fee if she survived her husband; if not, she was given a general testamentary power of appointment. The corpus of the trust consisted of two blocks of real estate. The land became valuable, but according the the complaint, was "so situated as to be entirely unavailable and unproductive" to Mary.[17]

Mary requested that the land be mortgaged or sold and that the proceeds be invested to produce an income for her. The Court of Chancery ordered a sale or mortgage and ruled that the proceeds were to be paid directly to Mary.[18] Affirming the decision, the Supreme Court of Illinois stated that in every system of organized society a power must exist to grant relief in cases of absolute necessity.[19] Thus, the court reasoned that it had jurisdiction to order the sale of

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15. *Id.* As previously noted, the rule stated in § 167 does not permit deviation from dispositive provisions if to deviate would impair the interest of another beneficiary. *Id.* § 168. *See supra* Section II A.

The doctrine of deviation as stated in the Restatement applies to leases, RESTATEMENT (SECOND) OF TRUSTS § 189 comment a (1959); to sales of real or personal property, *id.* § 190 comment f; to mortgages, *id.* § 191 comment c; to investments, *id.* § 167 comment c, "as well as to other situations." *id.* § 167 comment a. Under the doctrine, the court may permit or direct the trustee not to perform an act mandated by the trust terms, *id.* § 167 comment a; it may permit or direct the trustee to perform acts not authorized by the trust, *id.*; and it may permit or direct the trustee to do acts prohibited by the trust. However, the doctrine does not apply when the requested deviation would be merely advantageous to the beneficiaries, but not necessary to the accomplishment of the purpose of the trust, *id.* comment b. *See also* Leonardini v. Wells Fargo Bank & Union Trust Co., 131 Cal. App. 2d 657, 267 P.2d 423 (1954); Staley v. Ligon, 239 Md. 61, 210 A.2d 384 (1965); Mills v. Michigan Trust Co., 124 Mich. 244, 82 N.W. 1046 (1900); *In re* Cosgrave's Will, 225 Minn. 443, 31 N.W.2d 20 (1948); Segelhen v. Segelhen, 26 N.J. Super. 178, 97 A.2d 501 (App. Div. 1953); Hughes v. Federal Trust Co., 119 N.J. Eq. 502, 183 A. 299 (Ch. 1936); Woody v. Christian, 205 N.C. 610, 172 S.E. 210 (1934); Stewart v. Hamilton, 151 Tenn. 396, 270 S.W. 79 (1925); Estate of Boyle, 252 Wis. 511, 32 N.W.2d 333 (1948); *In re* Caswell's Will, 197 Wis. 327, 222 N.W. 235 (1928); Note, 53 Nw. U.L. REV. 268 (1958).

16. 29 Ill. 201 (1862).

17. *Id.* at 204.

18. *Id.* at 236. This decree was obviously erroneous in that it did not direct the proceeds to be held in trust. Prior to the appeal, the land was sold and the proceeds were turned over to Mary Curtiss. In this respect the Supreme Court of Illinois vehemently criticized the lower court for allowing the proceeds to be paid to the income beneficiary. However, the court held that because the proceeds of sale had been spent and could not be recovered, to reverse the judgment in this respect would be unjustified because the estate could not be recovered. Indeed, because the record contained no proof that the property was unproductive or could have been invested to make it more profitable, the court stated it would have reversed the decree had it been unexecuted. *Id.* at 235-36.

19. *Id.* at 230.

the property, regardless of whether the facts of the particular case before it justified the use of the power. Additionally, though there was almost no discussion of the specific limits of the doctrine, the court clearly affirmed the power of courts to deviate from the terms of a trust in emergencies.[20]

In *Curtiss*, the court focused on the necessity of the beneficiaries to justify deviation from the trust terms. Forty years later, the case of *Pennington v. Metropolitan Museum of Art*[21] revealed a change in focus. In the *Pennington* case, the trust income was required to be used to pay charges on the trust property. Because the charges exceeded the trust income and would continue to do so, the income was insufficient to fulfill testator's intent to provide an income to two infants named in the trust, and to create an endowment to the Metropolitan Museum of Art. Stating that deviation was appropriate in this case, the court held that the necessity required for deviation was proved where the trustee was unable to administer the trust accord-

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20. The court stated:

> Exigencies often arise not contemplated by the party creating the trust, and which, had they been anticipated, would undoubtedly have been provided for, where the aid of the court of chancery must be invoked to grant relief imperatively required; and in such cases the court must, as far as may be, occupy the place of the party creating the trust, and do with the fund what he would have dictated had he anticipated the emergency.

Id. In further explaining the basis for a court's power to deviate, the court continued:

> This question of jurisdiction does not depend on the necessities of this case, but if it is possible that such a case might have existed as would authorize the court to break in upon the provisions of this trust deed, and order a disposition of the property not in accordance with its terms, then the power to do so is established. The case might exist where the property was unproductive, as in this case, but where the *cestui que trust* was absolutely perishing from want, or forced to the poor-house, or where the trustee could not possibly raise the means to pay the taxes upon the property, and thus save it from a public sale and a total loss. Can it be said that the beneficiary of an estate which would bring in the market one hundred thousand dollars, should perish in the street from want, or be sent to the poor-house for support, or that the estate should be totally lost, because there is no power in the courts to relieve against the provisions of the instrument creating the trust? . . . It is true, that courts should be exceedingly cautious when interfering with, or changing in any way the settlements of trust estates. . . . The most familiar instances in which the court interferes and sets aside some of the express terms of the deed creating the trust, is [sic] in the removal of the trustee for misconduct and the appointment of another in his stead. But this is as much a violation of the terms of the settlement, as is a decree to sell the estate and re-invest it, or to apply the proceeds to the preservation of the estate, or the relief of the *cestui que trust* from pinching want. From very necessity a power must exist somewhere in the community to grant relief in such cases of absolute necessity, and under our system of jurisprudence, that power is vested in the court of chancery. . . . The liability to the abuse or misuse of power can never prove its non-existence, else all powers of government would be at once annihilated.

Id. at 229-30.

21. 65 N.J. Eq. 11, 55 A. 468 (Ch. 1903).

ing to the testator's intent, due to unforeseen circumstances not likely to change.[22] *Pennington* illustrates a shift in emphasis from the beneficiaries' needs to the accomplishment of what the court believed to be the intention of the settlor. No contention was made that any of the beneficiaries were in dire need of the requested deviation. If changed circumstances made the accomplishment of testator's objective uncertain, however, the court could authorize deviation from the administrative terms of the trust.

Over the next thirty years, a rule crystallized that a court could order deviation from administrative provisions of a trust in cases where a change of circumstances threatened the destruction or impairment of the trust property.[23] The deviation in such cases was justified because, in disregarding the specific wishes of the settlor, the court was accomplishing the ultimate purpose of the testator in creating of the trust.[24] The specific intent of the settlor was ignored to preserve his ultimate purpose.[25] The courts viewed these deviations as upholding and furthering the testator's purpose, rather than as violating the terms of the trust. In formulating a scheme for deviation, the court sought to discover what the testator would have provided had he foreseen the circumstances that actually arose.[26]

Even the courts that have denied deviation have recognized the

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22. *Id.* at 27-28, 55 A. at 474. The court stated the purposes of the trust were to benefit the two infants, each of whom was to receive $500 annually (if the income was sufficient), and the Museum, which was to receive the corpus on the death of the survivor of the infants. *Id.* at 24, 55 A. at 473.

23. Note, *Power of Court to Order Disposition of Property Which is Unauthorized or Prohibited by the Trust Instrument*, 23 CALIF. L. REV. 86, 89 (1934-35). Courts have permitted a trustee to subdivide trust property and sell some of the lots, *see* Johns v. Montgomery, 265 Ill. 21, 106 N.E. 497 (1914), and have authorized leases for a term longer than the trust term. *See, e.g.*, Packard v. Illinois Trust & Savings Bank, 261 Ill. 450, 104 N.E. 275 (1914); Denegre v. Walker, 214 Ill. 113, 73 N.E. 409 (1905); Marsh v. Reed, 184 Ill. 263, 56 N.E. 306 (1900). Courts have also authorized the sale of trust property, *see, e.g*, Young v. Young, 255 Mich. 173, 237 N.W. 535 (1931) (prohibited by terms of trust); Stepp v. Stepp, 200 N.C. 237, 156 S.E. 804 (1931) (unproductive land); Bibb v. Bibb, 204 Ala. 541, 86 So. 376 (1920) (unproductive property which would be lost for nonpayment of taxes); Mayall v. Mayall, 63 Minn. 511, 65 N.W. 942 (1896); Matter of Donovan, 153 Misc. 593, 275 N.Y.S. 142 (Surr. Ct. N.Y. Co. 1934); Mann v. Mann, 122 Me. 468, 120 A. 541 (1923); Middleton v. Rigsbee, 179 N.C. 437, 102 S.E. 780 (1920); Upham v. Plankinton, 166 Wis. 271, 165 N.W. 18 (Wis. 1917). Other courts have authorized a mortgage of the property, *see* Bell v. Bell, 44 Ariz. 520, 39 P.2d 629 (1934); permitted trustees not to sell property in spite of a prior court ruling interpreting a will to mandate a sale, *see* Trust Co. of New Jersey v. Glunz, 121 N.J. Eq. 523, 191 A. 795 (1935); permitted the sale of stock in a closely held business when testator, who was president of the company, died and the value of the company decreased, *see* Price v. Long, 87 N.J. Eq. 578, 101 A. 195 (Ch. 1917), and permitted cultivation of land which was prohibited by the will, *see* Low v. First Nat'l Bank & Trust Co. of Vicksburg, 162 Miss. 53, 38 So. 586 (1932).

24. Note, *Judicial Interference with Private Trusts*, 31 COLUM. L. REV. 852, 858 (1930).

25. *See* Note, *supra* note 23, at 89.

26. *See* Note, *supra* note 23, at 89.

propriety of the deviation in certain situations.[27] Thus, by 1935, a court was able to easily summarize the doctrine of deviation and the purpose behind it as an established rule of law.[28] Courts exercising equity powers could, on their own, take actions necessary to effectuate the intention of the grantor or testator.[29] The power to modify the terms of a trust, however, was not to be used to defeat the rights of other beneficiaries.[30] Rather, a court could deviate from the trust terms only to accomplish the settlor's intentions and, then, only to the least extent necessary to facilitate that intent.[31]

Since the expressed reason for permitting deviation is to further and fulfill the testator's intention, a natural question is whether the doctrine of deviation would apply if the terms of the trust expressly stated testator's intent. This question was raised in *In re Pulitzer's Estate*.[32] A codicil to the will created the "Newspaper Trust," with a corpus consisting of testator's shares in the Press Publishing Company and the Pulitzer Publishing Company. Testator gave the trustees power to sell the stock of the Pulitzer Publishing Company, but made very clear his intention that the stock of the Press Publishing Company not be sold.[33]

The Press Publishing Company failed to prosper and the trustees requested the authority to sell a major portion of the assets of the Press Publishing Company. The trustees proved that the company lost an average of more than $800,000 each year from 1926 to 1930

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27. *In re* Caswell's Will, 197 Wis. 327, 222 N.W. 235 (1928) recognized the doctrine, but held that a lease of 99 years, more than the trust term, was beyond the power of the trustees, given that no necessity was proved. The court merely found that the lease would be beneficial to the beneficiaries. In Security-First Nat'l Bank of Los Angeles v. Easter, 136 Cal. App. 691, 29 P.2d 422 (1934), a portion of the trust property was a ten-unit building. The trust prohibited sale during the life of the testator's wife. The income had decreased 40% in the ten years since the testator had died, and, after expenses, the wife was receiving almost no income. The court refused to permit a sale, despite its recognition that it had the power to do so. *Id.* at ____, 29 P.2d at 424-25. The court ruled it should deviate only on clear and satisfactory proof that deviation would be necessary to preserve the estate and implement the testator's purpose. *Id.* at ____, 29 P.2d at 425. There was no showing that the trustee could sell the property for a reasonable price (indeed, the testimony indicated a sale would be difficult), nor was there a showing of how the proceeds could be invested. The court deemed such omissions fatal to the proposed deviation. *Id.* at ____, 29 P.2d at 425.

28. *In re* Stack's Will, 217 Wis. 94, 258 N.W. 324 (1935).

29. *Id.*

30. *Id.* at 100, 258 N.W. at 326.

31. *Id.* at 101, 258 N.W. at 326-27. Among the forms of permissible deviation the court listed are: changes in investments, authorization of a sale and reinvestment of the proceeds, and changes in the form of the payment for an authorized sale. *Id.*

32. 139 Misc. 575, 249 N.Y.S. 87 (Surr. Ct. N.Y. Co. 1931), *aff'd mem.*, 237 A.D. 808, 260 N.Y.S. 975 (1932). The testator involved in the case was Joseph Pulitzer.

33. *Id.* at 578, 249 N.Y.S. at 92. The language of the codicil is reproduced in part in the text accompanying *infra* note 133.

and in 1930 lost almost $2,000,000.[34] The circulation of the three newspapers owned by the company was greatly declining, and present reserves would not permit continued publication for more than three months. Despite the language in the will, the court authorized the sale relying on the doctrine of deviation. Ignoring the statement in the will, the court said that the testator's dominant purposes were to provide a fair income for his sons and to assure the eventual receipt of the corpus by the remaindermen.[35] The court could not imagine that a man of Pulitzer's business acumen would have required the continued publication of the newspapers until the company ceased to exist.[36] Thus, the court disregarded testator's express directions and implied a power of sale.

Three important matters should be noted regarding *Pulitzer.* First, in applying the doctrine of deviation and determining whether necessity exists, the court looked to the testator's plan and the trust assets, rather than to the financial circumstances of the beneficiaries. The interpretation of necessity in *Pennington,* in contrast to that of *Curtiss v. Brown,* prevailed. No allegation of financial need by the beneficiaries is evident from *Pulitzer.*

Second, in most of the prior cases, the sole asset of the trust was threatened, thereby endangering the entire trust. This was not the case in *Pulitzer,* where only one of the two newspaper companies was in peril. Indeed, the Press Publishing Company also owned other assets.[37] *Pulitzer,* therefore, stands for the proposition that deviation can apply to a single asset of a trust or to part of an asset. Lastly, the Court held that it could and would deviate from the terms of a trust despite a strong statement of a contrary intention in the will.[38]

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34. *Id.* at 582-83, 249 N.Y.S. at 97.
35. *Id.* at 580, 249 N.Y.S. at 94-95.
36. The court said:

> It has been satisfactorily established by the evidence before me that the continuance of the publication of the newspapers, which are the principal assets of the Press Publishing Company, will in all probability lead to a serious impairment or the destruction of a large part of the trust estate. The dominant purpose of Mr. Pulitzer must have been the maintenance of a fair income for his children and the ultimate reception of the unimpaired corpus by the remaindermen. Permanence of the trust and ultimate enjoyment by his grandchildren were intended. A man of his sagacity and business ability could not have intended that from mere vanity, the publication of the newspapers, with which his name and efforts had been associated, should be persisted in until the entire trust asset was destroyed or wrecked by bankruptcy or dissolution. His expectation was that his New York newspapers would flourish. Despite his optimism, he must have contemplated that they might become entirely unprofitable and their disposal would be required to avert a complete loss of the trust asset.

Id. at 580-81, 249 N.Y.S. at 94-95.

37. *Id.* at 582-83, 249 N.Y.S. at 97.
38. *See infra* Section V for a discussion of *Pulitzer.*

In recent years, the doctrine of deviation has been raised in another type of case. The profound changes in economic conditions in the United States has led to attempts by beneficiaries to request deviation based on the declining purchasing power of the value of their interest in the trust. *Stanton v. Wells Fargo Bank & Union Trust Co.*[39] was the first major case of this type.

In *Stanton,* the testator created a trust with the income from one half of the corpus to go to Hilda for life and the income from the other half to her three children. Some of Hilda's issue, who were possible contingent remaindermen, were not in being at the time of the litigation. The will expressly restricted investments or reinvestments to certain types of bonds.[40] Deviation from the restrictive investment provisions was requested by the beneficiaries in being on the ground that the change in economic conditions between 1930 and 1951 substantially impaired the accomplishment of the trust purposes.[41]

Relying on the fact that no emergency existed, the court denied the beneficiaries' request. The court noted that the value of the corpus had increased by over $500,000 in the eighteen years since the trustees received the fund.[42] Additionally, the net annual income increased by more than $20,000 from 1938 to 1954.[43] The court also noted that no evidence was presented of need or want of any beneficiary.

Despite reference to the traditional factors of the wants and needs of the beneficiaries, some of the court's arguments are disquieting. The court focused on the economic changes during decedent's life,[44] and noted the conflicting economic predictions for future years.[45] Furthermore, the court cited with approval two cases in which emergencies were found at least in part based on economic conditions.[46]

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39. 150 Cal. App. 763, 310 P.2d 1010 (1957).

40. *Id.* at 764, 310 P.2d at 1011. However, the original corpus of the trust was composed mostly of common stock (49.9%) and real estate (35%). Only 4.2% of the corpus was invested in bonds. *Id.* at 767, 310 P.2d at 1013.

41. *Id.* at 766, 310 P.2d at 1012. These purposes were alleged to be to "assure the beneficiaries a continued income from the corpus in as large an amount as is consistent with reasonable investment safety," and that "the sole purpose of the restrictions was to protect the corpus." *Id.* at 768, 310 P.2d at 1012-14.

42. *Id.* at 771, 310 P.2d at 1015-16. The trustees received assets in 1936 valued at $2,323,718.50. On December 31, 1954, the assets were valued at $2,860,687.21. *Id.*

43. *Id.* at 771, 310 P.2d at 1016. In 1938, the distributable income was $88,890.60. In 1954, it was $109,942.84. *Id.*

44. *Id.* at 771, 310 P.2d at 1015.

45. *Id.* at 771, 310 P.2d at 1016.

46. The court cited Lambertville Nat'l Bank v. Bumster, 141 N.J. Eq. 396, 57 A.2d 525 (Ch. 1948), in which the will prohibited sale of any trust securities. Seventy-seven percent of the securities were highly speculative, and the market value of the trust had declined 19% in the three years following testator's death. The court ordered deviation. The court appeared to

Thus *Stanton* evidences a new and increased focus on changed circumstances and economic conditions, as opposed to the financial circumstances of the beneficiaries or the primary purpose of the settlor.

Just three years after *Stanton,* the factors above noted became increasingly evident.[47] *In re Trusteeship Under Agreement with Mayo*[48] involved a trust instrument with specific restrictions on the forms of investment that were permissible. The investments were restricted to real estate mortgages, municipal bonds, or any other forms of income-producing property, excluding real estate and corporate stock.[49] The court ordered a deviation from the investment restrictions of the trust.[50] The court's reasons for allowing deviation are solely related to the change in economic conditions since the death of the grantor. The court stated that without deviation, the trust purposes would be substantially impaired "because of changed conditions due to inflation since the trusts were created; that unless deviation is allowed the assets of the trusts, within the next 20 years will, in all likelihood, be worth less than one-fourth of the value they had at the time of the donor's death."[51] The court thus makes deviation available to protect the trust against inflation, recession, depression or other economic changes.[52]

The *Mayo* case is just as significant for what it does not say. The court does not examine the purpose of the trusts but merely accepts uncritically the beneficiaries' assertion that the purpose was to preserve the value of the trusts' corpora.[53] The trusts had suffered no loss in value.[54] The court does not discuss the economic circum-

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be influenced heavily by the fact that most of the securities owned by testator, and which the trustee was directed to retain, were highly speculative and would not be legal investments for trustees. *Id.* at 400, 57 A.2d at 527-28. The court also cited is Citizens' Nat'l Bank v. Morgan, 94 N.H. 284, 51 A.2d 841 (1947), in which the trust income had declined to half its former amount in the 14 years since the creation of the trust. The court ordered deviation. Although the statutes of New Hampshire specifically provided for court authorization of deviation from the investment terms of a trust, *Morgan* did find the requisite unforeseen change of circumstances in the decline in the interest paid by savings banks from 4.1% to 1.951%. *Morgan,* 94 N.H. at 286, 51 A.2d at 843.

47. *See In re* Trusteeship Under Agreement With Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960).

48. *Id.* at 92-93, 105 N.W.2d at 902.

49. *Id.* at 92-93, 105 N.W.2d at 902.

50. The court allowed the trustee to invest a reasonable amount of the trust in sound corporate stocks. *Id.* at 100, 105 N.W.2d at 906.

51. *Id.* at 99-100, 105 N.W.2d at 906.

52. *Id.*

53. Indeed, the court spends only three sentences of the opinion on the purposes of the trust. *Id.* at 93, 105 N.W.2d at 902. The opinion contains absolutely no discussion of what was previously perhaps the most important factor in applying the doctrine of deviation. *Id.* at 93-94, 96-97, 105 N.W.2d at 902, 904, 906.

54. In 1940, the corpus of one trust was valued at $957,711.60; at the time of the hearing

stances of the beneficiaries, or the income produced by the trusts. The sole justification given by the court is the inflation from the end of World War II through the date of the decision, and the effect of inflation on the purchasing power of the trust corpora.

Without any explanation for the abandonment of the criteria used in previous cases, the *Mayo* court elevated the factor of unforeseen changed circumstances to the central role in determining whether to modify the terms of the trust. In addition, the changed circumstances did not involve the beneficiaries or the trust purposes. Rather, they involved national economic conditions. Ironically, three years earlier, the *Stanton* court had warned against the danger inherent in attempting to predict economic changes.[55] The *Mayo* court had no such reservations.

The doctrine of deviation has greatly expanded and changed focus in the one hundred twenty years since the decision in *Curtiss v. Brown*. The doctrine of deviation began as a narrow emergency doctrine developed by necessity to prevent the failure of a trust. Originally it focused on the needs of the beneficiary or the possible reduction in the trust corpus as to the extent that the trust assets became practically worthless. The focus gradually changed to what the court believed to be the testator's dispositive plan.[56] Later, the doctrine was expanded to include cases where a serious impairment in value of one asset of the trust existed, though the trust corpus remained of great value and no need or burden on the beneficiaries was proven. Even the stated purpose of the testator could be ignored.

Recent cases have focused on changed circumstances, not of the trust, but of national economic conditions.[57] The trust need not have declined in value, nor need the property be unproductive to invoke deviation. Courts require only a change in national or world-wide economic conditions threatening the purchasing power of the trust assets. Absent from these decisions is any detailed inquiry into the testator's purpose. Indeed, the testator's purpose appears irrelevant to the analysis. Deviation from administrative provisions has therefore become a broad doctrine, though occasionally tempered by some requirement of need by the beneficiaries or impairment of the trust assets.

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it was valued at approximately $1,000,000.

55. *Stanton*, 150 Cal. App. 2d at 771, 310 P.2d at 1016.

56. Some necessity, in the sense of a large portion of the trust being unproductive or declining to little value, was still required.

57. *In re* Trusteeship Under Agreement with Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960); Stanton v. Wells Fargo Bank & Union Trust Co., 150 Cal. App. 763, 310 P.2d 1010 (1957).

III. Treatment of Powers in Federal Estate and Gift Tax Law

A. Dispositive Powers

Generally the treatment of administrative and dispositive powers under the Internal Revenue Code[58] is consistent with the treatment of these powers under trust law. In trust law, the question is whether a court may modify a power. In federal estate and gift tax law, however, the question is what effect a power has on the gross estate of the person possessing the power. Tax law may require a person to include in his gross estate all or a portion of the property which is subject to certain powers.

The inclusion caused by the possession of dispositive powers is well-known to most practitioners and therefore requires only brief discussion. The IRC provides that property will be included in a grantor's gross estate if the grantor retains the power to designate the people who will enjoy or possess the property or its income.[59] Additionally, the property is included if the grantor either retains the power to vote on controlled corporation stock that has previously been given away,[60] or if the grantor retains the power to change the enjoyment of property by altering, amending, revoking or terminating a trust.[61] A person having a general power of appointment at the time of his death will have the property subject to the power included in his gross estate.[62]

Specifically, the broad provisions specified above cause inclusion when the grantor retains the power to accumulate income,[63] the power to have trust income used to discharge the grantor's legal obligations,[64] the power to substitute trust assets,[65] and the power to grant additional powers to the trustee.[66] Most practitioners recognize

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58. All section references to the Internal Revenue Code in this article, except as otherwise indicated, are to the Internal Revenue Code of 1954, as amended.

59. I.R.C. § 2036(a)(2) (West 1985).

60. I.R.C. § 2036(b) (West 1985).

61. I.R.C. § 2038(a)(1) (West 1985).

62. I.R.C. § 2041(a)(2) (1983). Section 2041 does not include powers reserved by the decedent to himself, which are taxed under §§ 2036-2038. Treas. Reg. § 20.2041-1(b)(2) (1983). One substantive power, the special power of appointment possessed by a non-grantor, does not result in inclusion in the gross estate. The reasons for this appear to be largely historical and political, rather than logical. For a short discussion of this history, see D. Kahn & L. Waggoner, Federal Taxation of Gifts, Trusts and Estates 138-45 (2d ed. 1982).

63. United States v. O'Malley, 383 U.S. 627 (1966). Not only is the original corpus of the trust included, but also its accumulated income if it may become subject to the power by some method, such as addition to principal. *Id. See also* Ritter v. United States, 297 F. Supp. 1259 (S.D.W.Va. 1968).

64. Treas. Reg. §§ 20.2036-1(b)(2) (1983).

65. Beausang, *supra* note 4, at 300.

66. Fidelity Union Trust Co. v. United States, 126 F. Supp. 527 (Ct. Cl. 1954).

that, with the exception of the special power of appointment, most retained powers of control have not succeeded in escaping estate taxation.[67]

B. *Administrative Powers*

In general, the possession of administrative powers by a grantor does not affect the estate or gift tax treatment of a trust.[68] In some situations, this result is specified by the regulations. Thus, powers to amend the administrative provisions of a trust, including powers over investment, allocation of principal and income, and other management powers, are not general powers of appointment.[69] Similarly, a gift is complete if the donor transfers the property to a trust and retains only administrative powers as a trustee.[70]

The question of whether the reservation of control over administrative powers results in estate taxation was first decided in *Reinecke v. Northern Trust Co.*[71] The decedent was not the trustee of the inter vivos trusts he created, but he reserved powers to supervise reinvestment, to control leases of trust property, to vote stock held by the trustees, to appoint successor trustees, and to require the trustees to execute proxies to his nominees. The court held, under the predecessor of section 2036, that the property was not includable in his gross estate on the ground that the decedent retained no economic benefits

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67. *See* Beausang, *supra* note 4, at 300.

68. There are some cases in which what seem to be administrative powers have been held to cause taxation. For example, in the now famous Rev. Rul. 79-353, 1979-2 C.B. 325, the power to remove the trustee and appoint a successor corporate trustee was held to cause inclusion of the trust property in the grantor's gross estate. These authorities will be discussed *infra* Section IV.

69. Treas. Reg. § 20.2041-1(b)(1) (1983) provides in part:

> Similarly, a power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the beneficial enjoyment of the trust property or income, is not a power of appointment. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment. Further, the right in a beneficiary of a trust to assent to a periodic accounting, thereby relieving the trustee from further accountability, is not a power of appointment if the right of assent does not consist of any power or right to enlarge or shift the beneficial interest of any beneficiary therein.

See also Treas. Reg. § 25.2514-1(b)(1) (1983) (gift tax).

70. Treas. Reg. § 25.2511-2(g). *See also* Treas. Reg. § 20.2056(b)-5(g)(4) (1983) (administrative powers do not disqualify an interest passing in trust to the spouse from the marital deduction).

71. 278 U.S. 339 (1929).

from the trust property.[72]

Due to the evolution of the estate and gift tax provisions of the Code, the issue was not viewed as fully settled by *Reinecke*. However, the issue of the effect of administrative powers was squarely presented and determined by two cases in the First Circuit: *State Street Trust Co. v. United States*[73] and *Old Colony Trust Co. v. United States*.[74]

In *State Street Trust*, the grantor created three inter vivos trusts of which he was a co-trustee at the time of his death. The trustees had the following powers: (1) to exchange the trust property for other property; (2) to invest in wasting assets, in property that yielded no income and in investments with high interest rates; and (3) complete discretion regarding charges and credits to income and principal. The trustees were to be held liable only for willful acts and defaults, but not for errors in judgment.[75] The government contended that because of these powers, the corpora of the trusts were includable in the grantor's gross estate under the predecessors of sections 2036(a)(2) and 2038.[76] The court agreed and held the trust includable.[77]

The court admitted that it was not unusual to grant a trustee the power to invest in "nonlegals" and to allocate receipts between principal and income, at least when the rule as to such allocations is unsettled.[78] Further, the court recognized that in some cases the exercise of administrative powers can shift benefits between the income beneficiaries and the remaindermen.[79] The court noted, however, that

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72. *Id.* at 346. The court said:

> Nor did the reserved powers of management of the trusts save to decedent any control over the economic benefits or the enjoyment of the property. He would equally have reserved all these powers and others had he made himself the trustee, but the transfer would not for that reason have been incomplete. The shifting of the economic interest in the trust property which was the subject of the tax was thus complete as soon as the trust was made. His power to recall the property and of control over it for his own benefit then ceased. . . .

Id. at 346-47.

73. 263 F.2d 635 (1st Cir. 1959).

74. 423 F.2d 601 (1st Cir. 1970).

75. *State Street Trust*, 263 F.2d at 638.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* Indeed, in terms of the subject of this article, the almost unprecedented recognition by the court of the indirect effect on the beneficiaries of the exercise of administrative powers is the most significant aspect of the opinion. The court said:

> Certainly, in the exercise of one or both of these powers trustees can to some extent affect the interests of the various beneficiaries. Indeed, even in a trust wherein investment is limited to "legals," a trustee can effect some shifting of benefits between life beneficiaries and remaindermen by his choice of investment with respect to rate of in-

in the ordinary case administrative provisions are not a critical factor in determining estate taxation.[80] In *State Street Trust,* though, the court found that the breadth of discretion granted to the trustees, along with the combination of powers, took the case out of the ordinary and gave the trustees the power to shift substantially the economic benefits of the trust between the income beneficiaries and remaindermen. This gave the grantor power equivalent to that required by sections 2036(a)(2) and 2038.[81]

Eleven years later, the First Circuit revisited the problem. In *Old Colony Trust,*[82] the decedent created a trust with eighty percent of the income normally payable to testator's son and the balance added to principal. The trustees were empowered to increase the percentage of income payable to the son when in their discretion such increase was needed for sickness, or was desirable due to changed circumstances. The decedent also gave the trustees the power to stop paying any income to the son and add it all to principal if they deemed such action to be in the son's best interest. The trustees had administrative powers similar to those in *State Street Bank.*[83]

The court held that the powers to accumulate income and add it to corpus and to cease paying income to the son when these actions were in the son's "best interests" required inclusion under sections 2036(a)(2) and 2038.[84] However, the court went out of its way to reexamine *State Street Trust.*[85] Reasoning that management and administrative powers must be exercised for the benefit of the trust as a whole,[86] the court stated that such powers, which are subject to probate court control, could not be ownership powers.[87] The powers were not beyond the court's control because, as the court noted, under Massachusetts law the court can intervene to prevent abuse regardless of the scope of discretion granted the trustee over the administration of the trust. The court held that trustee powers should not be

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come return or growth potential.

Id.

80. *Id.* at 638.

81. *Id.* at 639-40. Chief Judge Magruder dissented on the grounds that a Massachusetts court would limit the exercise of the trustees' powers to enforce a standard of impartiality between income and principal beneficiaries. *Id.* at 640-42 (Magruder, C.J., dissenting).

82. 423 F.2d at 601.

83. *Id.* at 602.

84. *See id.* at 602-04. *See also* I.R.C. § 2036(a)(2) (West Supp. 1985) (tranfers with retained life estate-general rule), § 2038 (West Supp. 1985) (revocable transfers).

85. 423 F.2d at 602-03. Such examination was unnecessary in that the provisions just discussed would have required inclusion regardless of the broad administrative powers given to the trustees, of whom the grantor was one.

86. *Id.* at 603.

87. *Id.*

more broadly construed for tax purposes than a probate court would interpret them for trust purposes.[88] The court concluded by holding that "no aggregation of purely administrative powers can meet the government's amorphous test of 'sufficient dominion and control' so as to be equated with ownership."[89]

In the ensuing years, the *Old Colony Trust* holding that administrative or management powers in a grantor-trustee will not result in the trust property being included in the grantor's gross estate, has been followed repeatedly with regard to many different powers. For example, powers retained by a grantor to vote stock transferred to a trust, to remove a trustee and appoint a successor corporate trustee, and to veto the sale of assets in the trust and reinvestments were held not to result in inclusion of the corpus under section 2036(a)(1) and (2).[90] Strangely enough, the best statements of the rationale for not attributing estate tax consequences to administrative powers are found in charitable deduction cases decided under pre-Tax Reform Act of 1969 rules.[91] Perhaps the clearest example is *Estate of Simon-*

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88. *Id.*

89. *Id.*

90. Byrum v. United States, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir. 1971), *aff'd*, 408 U.S. 125 (1972). See particularly the opinion of the Court, 408 U.S. 125, 132-35, which specifically holds that retention by the grantor of broad managerial and administrative powers will not result in inclusion of the trust assets in the grantor's gross estate, and specifically reaffirms the holding of Reinecke v. Northern Trust Co., 278 U.S. 339 (1929), despite the subsequent enactment of I.R.C. § 2036(a)(2).

Of course, the estate tax consequences of a decedent retaining the right to vote transferred stock have been altered by the amendment of § 2036 in the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009, 90 Stat. 1520, 1893 (1962), and its subsequent amendment by the Revenue Act of 1978, Pub. L. No. 95-600; § 702(i), 92 Stat. 2763, 2931 (1978) (current version at I.R.C. § 2036 (1972). The IRS has not given up the fight as regards the power to remove the trustee and appoint a successor corporate trustee. *See* Rev. Rul. 79-353, discussed *infra* section IV.

Similarly, the power of a trustee to terminate a trust if the corpus is reduced to such an amount as to be impracticable to hold in trust is administrative. *See* Beausang, *supra* note 4, at 248. Powers to approve trust accountings have also been held to be administrative powers not resulting in estate taxation, and control over the allocation of receipts and disbursements has been similarly treated. *See* Beausang, *supra* note 4, at 299. Most importantly, almost all investment powers — including assisting the trustee in decisions on investments, controlling of investment decisions, requiring retention of specific investments, and permitting investments in non-legals — have been held not to result in estate taxation. Beausang, *supra* note 4, at 248-49, 297. *See* Estate of Simonson, 59 T.C. 535 (1973); Estate of Goodwyn, 32 T.C.M. 740 (1973) (de facto control by decedent, who was not a trustee).

91. Under I.R.C. § 2055(a)(2) (West Supp. 1985) (transfers for public charitable, and religious uses) and Treas. Reg. § 20.2055-2(a)-(b) (West 1985), as they existed prior to the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, a deduction was allowed for a remainder interest in a trust which passed to a qualified charitable organization. If the transfer to charity depended on a condition or on the performance of an act, the deduction was allowed only if the possibility that the charitable transfer would not become effective was so remote as to be negligible. For the relevant portions of the statute and regulations as they then existed, see Estate of Simonson, 59 T.C. 535, 540 (1973).

son,[92] in which the testator created a trust with the income payable to his son for life. On his son's death, the trust corpus became distributable to various charities. Among the powers given to the trustees were the power to retain decedent's stock in two corporations, comprising ninety percent of his estate, to extend the time for the partners of a partnership to pay for decedent's interest in the partnership, to retain assets held by decedent at his death, and to invest in certain stocks without regard to legality.[93] He also directed the trustees to offer the stock of the two corporations first to the issuing corporation and next to the other shareholders.

The court held that these powers did not disqualify the remainder interest as a charitable deduction, and the court cited with approval a case in which the trustees held the power to invest in wasting assets and unproductive property and to apportion to income or principal any income earned by the trust.[94] In reaching its conclusion, the court reasoned that:

> 1. The will, construed as a whole, evidenced an intent to make a charitable gift. Thus, the court would not presume that the testator wanted the powers used to prevent the charitable gift.[95]
>
> 2. The trustee's discretion is limited by a state law that requires the trustee to act in the interest of all beneficiaries and as a prudent man, thereby making the interest of the charities ascertainable.[96]
>
> 3. These and similar administrative powers are "nothing more than the traditional boilerplate powers long accorded trustees to give them some freedom of action outside the courts"[97] and to hold that such powers resulted in disqualificiation would "turn what are commonplace trust powers intended simply to provide administrative flexibility into a substantive grant of dispositive flexibility."[98]

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92. 59 T.C. 535 (1973). *See also* Greer v. United States, 448 F.2d 937 (4th Cir. 1971).

93. *Simonson*, 59 T.C. at 537-38.

94. *Id.* at 540-41. The case cited by the court is Estate of Stewart v. Commissioner, 52 T.C. 830 (1969), *rev'd*, 436 F.2d 1281 (3d Cir. 1971).

95. *Simonson*, 59 T.C. at 542.

96. *Id.*

97. *Id.* at 543.

98. *Id.*, *quoting* Estate of Lillie MacMunn Stewart, 52 T.C. 830, 836 (1969).

IV. The Reality of Administrative Powers

A. *Effect on the Interests of the Beneficiaries*

Occasionally courts will recognize the effect of administrative powers on the dispositive provisions of a trust. In most cases, this effect is ignored or dismissed as insignificant.[99] Rarely can one find a court as honest in admitting the effect of such powers on dispositive provisions as was the court in *State Street Trust Co. v. United States*.[100] Even when this effect is recognized, however, the court usually will not carry the recognition to its logical conclusion.

The first step in evaluating the cases previously discussed is to demonstrate that administrative powers affect the interests of the trust beneficiaries. Initially, it is clear that some administrative powers either do not affect the interests of the beneficiaries or affect all interests similarly. For example, the power to hold separate shares of a trust or separate trusts together for investment purposes at most generates economies of scale that will benefit all beneficiaries. Similarly, the power to hire attorneys or accountants will not usually affect the beneficiaries' interests.[101]

The beneficiaries will not, however, always be unaffected. For example, investment decisions by a trustee can clearly affect the interests of the beneficiaries. Suppose a trust agreement contains a broad investment clause permitting a trustee to invest in unproductive property.[102] Suppose further that the trustee bought unimproved land. Shortly before the death of the income beneficiary, a developer decides to construct expensive housing on the land, and the trustee sells the land to the developer. The income beneficiary realizes little or no benefit from this investment, whereas the principal interests increase substantially.[103]

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99. For example, in Reiner v. Fidelity Union Trust Co., 126 N.J. Eq. 78, 8 A.2d 175 (Ch. 1939), *rev'd* 127 N.J. Eq. 377, 13 A.2d 291 (1940), the trustee argued that to allow a change in investments when the trust instrument allowed only investments in legals neither deprived a beneficiary of due process nor impaired the obligation of a contract, because the investment power was a matter of administration and did not involve substantive rights. Nowhere in its opinion did the court show any realization of the effect such a change would have caused on the beneficiary's interest. *Id.*

100. 263 F.2d at 638. The court frankly admitted that the power to invest trust assets in non-legals and to allocate increases to principal and income affects the interests of the beneficiaries. The court's observations are quoted *supra* note 79.

101. Arguably if these fees could be paid from trust corpus which is the usual rule, however, the persons receiving corpus are benefitted at the expense of the income beneficiaries.

102. Gold, art, stamps or coins would be equally good examples.

103. Similar analyses could be made for growth stocks which do not pay a dividend or, indeed, for an underproductive investment. The question of whether, and to what extent, a court would permit such an investment, is discussed *infra* Section V. *See also* Commercial Trust Co. of New Jersey v. Barnard, 27 N.J. 332, 142 A.2d 865 (1958), discussed *infra* Section

Even more obviously, the power to allocate receipts and disbursements between principal and income affects the interests of the beneficiaries. Suppose the trust holds stock in a company that declares a five percent stock dividend. The will contains a provision allowing the trustee discretion to allocate this dividend to principal or income, regardless of any contrary rule of law.[104] The trustee decides to allocate it to principal. Clearly, the interests of the principal beneficiaries have been enhanced and the interests of the income beneficiary diminished.

The above summary illustrates that at least some administrative powers do affect the interests of the beneficiaries in the same way as dispositive powers.[105] Moreover, in the area of equitable adjustments, trust and estate law recognizes this similarity. Under the I.R.C., an executor has an election to deduct administration expenses and certain other payments on the estate tax return[106] or on the fiduciary income tax return.[107] Absent contrary directions in the will or trust agreement, administative expenses are chargeable against the princi-

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V, involving a trust of over $1,000,000 which for 23 years was invested solely in tax-exempt bonds. Presumably, such an investment, depending on economic conditions, would be detrimental to the income beneficiaries, in that higher returns could be earned on other investments. The effect on the remaindermen is unclear, but in a rising economy, the effect would be detrimental. If the income beneficiaries were in high income tax brackets, as was the case in *Barnard*, the investment would be favorable to them and probably detrimental to the remainder interests. *See also* David, *Principal and Income — Obsolete Concepts*, 43 PA. BAR ASS'N Q. 247, 248 (1971-72), which comments:

> Under present economic conditions, there are a number of ways in which a trustee can vary the interests of the income beneficiary and the remainderman. For example, a trustee can invest in high interest bonds with no growth potential, or he can invest in low yield growth stocks. Or he can invest in bonds of identical quality, even with the same obligor, having practically the same yield to maturity. But one may be selling at par and yielding 6 percent, all of which goes to the income beneficiary, and the other may be selling at 80 because it yields only 4 percent. An investment of $8,000 in the 6 percent bond at par would produce income of $480 per year. A like investment in the 4 percent bond at 80 would purchase $10,000 par value and produce an income of $400, but at the maturity of the 4 percent bond there would be a profit of $2,000 which would inure wholly to principal.

Id.

104. A testator or settlor is normally permitted in the will or trust instrument to vary the local law rule regarding apportionment of principal and income. *See, e.g.*, N.Y. EST. POWERS & TRUSTS LAW § 11-2.1(e)(1) (McKinney 1967).

105. The illustrations given in this section are intended not to be exhaustive, but merely to demonstrate that at least some administrative powers indirectly have the same effect as dispositive powers, taking property from one or a group of beneficiaries and giving it to another. The question of whether the theories given by the courts for the differing treatment between administrative and dispositive powers explain and justify such treatment is discussed *infra* Section V.

106. I.R.C. §§ 2053(a)(1), (c)(4) (West 1985), 2054 (1983).

107. I.R.C. § 642(g) (West 1983).

pal of the trust or estate.[108] Estate taxes are ordinarily paid from principal while fiduciary income taxes, except for the capital gains tax, are paid from income.[109] Assuming the executor elects to deduct these expenses on the fiduciary income tax return, the result is a lower fiduciary income tax and a greater estate tax. The principal beneficiaries, therefore, pay an increased estate tax, giving a windfall to the income beneficiaries. This shifting of the tax burden has the same effect as invading principal for the income beneficiaries. At least one court has held[110] that, under the doctrine of equitable adjustment, the principal beneficiaries should be reimbursed for the increase in estate taxes suffered by reason of the election to deduct these expenses on the fiduciary income tax return.[111]

The above discussion demonstrates that certain administrative powers do alter the interests of beneficiaries, and that, in at least one situation, trust law has recognized these effects and provided a remedy. This recognition has not, however, been extended to other areas of trust law.

B. Estate and Gift Tax: Administrative Powers Treated as Taxable

In at least two situations, estate and gift tax law treats powers that are normally thought of as administrative as causing inclusion of the trust property in a grantor's gross estate. First, if the grantor has the power to remove a trustee and appoint himself as successor trustee, the trust property is includable in the grantor's gross estate.[112] This rule is justified by attributing to the decedent the powers of the trustee.[113] Second, if a trustee is given powers which, if retained by the grantor, would cause taxation, and the grantor also retains the right to remove the corporate trustee without cause and appoint a

108. REV. UNIF. PRINCIPAL & INCOME ACT, 7A U.L.A. 429, §§ 5(a), 13(a)(6) (1962) (revising 1931 act).

109. REV. UNIF. PRINCIPAL & INCOME ACT, 7A U.L.A. 429, §§ 5(a), 13(a)(6), (13)(c)(4), (13)(c)(5) (1962) (revising 1931 act).

110. *In re* Estate of Warms, 140 N.Y.S.2d 169 (Surr. Ct. N.Y. Co. 1955).

111. Equitable adjustments is a fascinating and complex area, but it is beyond the scope of this article. For three excellent treatments of the subject, see Carrico & Bondurant, *Equitable Adjustments: A Survey and Analysis of Precedents and Practice*, 36 TAX L. REV. 545 (1983); Dobris, *Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning*, 66 IOWA L. REV. 273 (1981); Dobris, *Equitable Adjustments in Postmortem Income Tax Planning; An Unremitting Diet of Warms*, 65 IOWA L. REV. 103 (1979).

112. Treas. Reg. §§ 20.2036-1(b)(3) & 20.2038-1(a)(3) (1983). This is true even if the settlor did not have the power to remove the trustee, but only the power to appoint himself successor trustee if a vacancy arose. *See* Estate of Farrel v. United States, 553 F.2d 637 (Ct. Cl. 1977). It does assume that the trustee has a power which, if retained by the grantor, would cause taxation.

113. Treas. Reg. §§ 20.2036-1(b)(3), 20.2038-1(a)(3) (1983).

successor corporate trustee, the Internal Revenue Service has ruled that the property is includable in the grantor's gross estate.[114] In addition, two other powers arguably administrative, the such as power to substitute other assets for the original trust corpus[115] and the power to allocate capital gains, but not losses, to the income beneficiary,[116] have been held to cause inclusion of a trust in the grantor's gross estate.

V. Deviation and Estate Tax: The Theory and the Practice

A. Deviation — A Limited Theory Gone Bad

The deviation doctrine derives from the view of the early courts that the power to grant relief in cases of absolute necessity must exist somewhere, and that the power resided in the courts.[117] In *Curtiss v. Brown*[118] the court gave several examples of what it considered absolute necessity. One was the case of unproductive property where the beneficiary was "absolutely perishing from want, or forced to the poor-house, or where the trustee could not possibly . . . pay the taxes upon the property, and thus save it from a public sale and a total

114. Rev. Rul. 79-353, 1979-2 C.B. 325. In Rev. Rul. 81-51, 1981-1 C.B. 458, the Commissioner ruled that Rev. Rul. 79-353 would be applied only prospectively to transfers made to irrevocable trusts after October 28, 1979. The policy given for the ruling is that the decedent could "trustee-shop": that is, could substitute a trustee after ascertaining that the new trustee would comply with his wishes and directions. Rev. Rul. 79-353 has been heavily criticized, both on policy grounds and for legal reasons, that the authorities cited in the ruling do not support its conclusions. *See, e.g.*, Roth, Weinberg & Cummings, *Retained Power to Substitute Corporate Trustees: Is Revenue Ruling 79-353 Correct?* 119 Trusts & Estates 42 (Apr. 1980); Strauss, *Drafting Trustee-Substitution Clauses to Avoid the Adverse Impact of Revenue Ruling 79-353*, 53 J. Tax'n 66 (Aug. 1980); Note, *The Retention of the Power to Remove a Trustee at Will and Appoint a Substitute Corporate Trustee: Do Sections 2036 and 2038 of the I.R.C. Apply?* 1980 Utah L. Rev. 559. The point is not the correctness of the ruling, but that an administrative power is given the effect of a dispositive power in estate taxation. The rule of Rev. Rul. 79-353 has been rejected when a donee of a general power of appointment possessed the power to change the trustee at any time to another corporate trustee. *See* First Nat'l Bank of Denver v. United States, 648 F.2d 1286 (10th Cir. 1981).

115. Commonwealth Trust Co. v. Driscoll, 50 F. Supp. 949 (W.D. Pa.), *aff'd per curiam*, 137 F.2d 653 (3d Cir. 1943).

116. Commissioner v. Hager's Estate, 173 F.2d 613 (3d Cir. 1949). The discretionary power in *Hager* to allocate increases obtained through a sale of principal assets, regardless of whether the increase was due to market increases or any other reason, during the trust term, is quite unusual and clearly benefits the income beneficiary at the expense of the remaindermen, as noted by the court. *Id.* Professors Kahn and Waggoner suggest that this power accounted for the inclusion of the remainder interest in the grantor's gross estate under I.R.C. § 2038. They suggest that the court viewed this power as a power to alter the remainder interest by allocating capital gains to income, as under normal trust accounting law such gains are principal. D. Kahn & L. Waggoner, Teacher's Manual for Federal Taxation of Gift, Trusts, and Estates 134 (2d ed. 1982).

117. Curtiss v. Brown, 29 Ill. 201, 230 (1862).

118. 29 Ill. 201-230.

loss."[119] Indeed, *Curtiss v. Brown* stated that the court would intervene only in cases of emergency, and emergency would be found in one of two situations: serious want on the part of the beneficiaries or the immediate threat of a total destruction of the trust corpus.[120] The court further warned that interference with the testator's directions was not a matter to be undertaken lightly, and that courts should use the doctrine only in circumstances of emergency.[121]

Almost all later cases discussing the doctrine emphasize that the deviation should be ordered only when an emergency exists, because of the deference to be given to testator's wishes.[122] Furthermore, the courts stress that deviation will be ordered only in the case of an emergency or necessity.[123] Yet the results and reasoning in the later cases fail to adhere to the limits expressed in *Curtiss*. In *Pennington v. Metropolitan Museum of Art*,[124] testator bequeathed land and stock to a trustee to pay the charges on the real property, then to pay each of two infants $500 a year. The remainder was to be added to an endowment fund for the Museum. To the extent the income was in-

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119. *Id.* at 229-30.

120. *Id.*

121. *Id.* at 230. The court said: "It is true, that courts should be exceedingly cautious when interfering with, or changing in any way the settlements of trust estates, and especially in seeing that such estates are not squandered and lost." *Id.* On the question of whether an emergency must exist, see RESTATEMENT (SECOND) OF TRUSTS § 167 (1959) ("defeat or *substantially* impair the accomplishment of the purposes of the trust") (emphasis added).

122. *See, e.g.*, Stanton v. Wells Fargo Bank & Union Trust Co., 150 Cal. App. 2d 763, 770, 776, 310 P.2d 1010, 1015, 1019 (1957).

> Except in unusual or emergency situations the courts will limit the trustee to the powers conferred. . . . It is not the function of courts to remake the provisions of trust instruments. . . . A court should not presume to remake a trust instrument even though the court believes that it could do a better job.

Id.; *In re* Trusteeship Under Agreement With Mayo, 259 Minn. 91, 95, 105 N.W.2d 900, 903 (1960) ("With respect to trust provisions restricting investments in which a trustee may invest trust funds, the courts are especially concerned in giving full effect to the donor's intention."); *In re* Cosgrave's Will, 225 Minn. 443, 449, 31 N.W.2d 20, 25 (1948) ("The will is [testator's] and cannot be redrafted by this court."); *In re* Stack's Will, 217 Wis. 94, 102, 258 N.W. 324, 327 (1935) ("Courts of equity will do all within their power to see that the trust is executed in accordance with its terms.").

123. *See, e.g.*, Stanton v. Wells Fargo Bank & Union Trust Co., 150 Cal. App. 2d 763, 770, 310 P.2d 1010, 1015 (1957) (emergency or threat to main purpose of the trust); Johns v. Montgomery, 265 Ill. 21, 25-26, 106 N.E. 497, 499 (1914) (necessary to preserve the trust estate or the rights of beneficiaries); *In re* Trusteeship Under Agreement With Mayo, 259 Minn. 91, 97, 105 N.W.2d 900, 904 (1960) (emergency, urgency or necessity); *In re* Cosgrave's Will, 225 Minn. 443, 467, 31 N.W.2d 20, 34 (1948) (necessity and high expediency); Pennington v. Metropolitan Museum of Art, 65 N.J. Eq. 11, 24, 55 A. 468, 472 (Ch. 1903) (necessity); *In re* Stack's Will, 217 Wis. 94, 102, 258 N.W. 324, 327 (1935) (imperative necessity); *In re* Caswell's Will, 197 Wis. 327, ____, 222 N.W. 235, 237 (1928) (necessary to preserve the corpus of the trust).

124. 65 N.J. Eq. 11, 55 A. 468 (Ch. 1903). *See supra* text accompanying notes 21-24 for a more detailed statement of the facts in this case.

sufficient to pay the charges and the annual payments to the infants, any deficiency was to be made up from the income payable to the Museum under another clause of the will. The charges on the real estate exceeded the trust income and would continue to do so for the foreseeable future. The court ordered deviation in spite of the following facts: (1) there was no evidence that the income beneficiaries were impoverished in any way; (2) there was nothing indicating that the payment of $500 a year to each infant would provide necessities they lacked; (3) the Museum could afford to make up the deficiencies; (4) that there was no danger of the failure of the trust if the Museum continued to make up the deficiencies.[125] Thus, the facts in *Pennington* do not satisfy the test of *Curtiss*. There was no emergency in *Pennington* in respect to either the beneficiaries or the corpus of the trust.

A similar situation exists regarding *Mayo*.[126] The grantor limited investments to real estate mortgages, municipal bonds, or other forms of income-producing property. Investments in real estate and corporate stock were prohibited. Again, no evidence existed that the income beneficiaries were poor or suffering, or that the property was unproductive. Nor could it be successfully argued that unless deviation was ordered the trust would fail. Indeed, the trust assets had a greater value in 1958 than in 1940.[127] Deviation was ordered solely on the ground that the purchasing power of the assets had declined.

Later cases have not followed the limits contemplated by the earlier decisions that courts would order deviation only when true necessity existed. Such necessity arose only when a beneficiary was in dire financial straits, a restriction in the instrument prevented the property from becoming productive, and removal of the restriction would relieve the beneficiary from the situation, or when total or severe loss in the trust assets existed.[128] Thus, the later cases greatly expanded the scope of the doctrine of deviation and permitted the settlor's directions to be thwarted in an increasing number of cases, despite the statements of the courts about respecting the grantor's wishes.

In the cases just discussed, courts ignored the limits placed on the deviation doctrine by the early cases originally justifying the doctrine. In another type of case, courts have ignored the theory justifying deviation.[129] Courts adhering to this theory permit deviation

125. *Id.* at ____, 55 A. at 470, 474.

126. *In re* Trusteeship Under Agreement with Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960).

127. *Id.* at 93, 105 N.W.2d at 902.

128. Curtiss v. Brown, 29 Ill. 201 (1862).

129. *In re* Pulitzer's Estate, 139 Misc. 575, 249 N.Y.S. 87 (Surr. Ct. N.Y. Co. 1931), *aff'd mem.*, 237 A.D. 808, 260 N.Y.S. 975 (1932).

when the circumstances have changed in a way neither known to the settlor nor anticipated by him. The courts' theory justifying deviation of this type is that by ordering deviation they are not defeating the trust or acting contrary to settlor's intent, but instead are furthering that intent by doing what the settlor would have done had he foreseen the change in conditions.[130] In certain cases, a settlor may, by specific direction in the will, provide that his directions shall not be deviated from in a certain manner. The question arises whether the specific direction shall prevent the court from deviating in the manner prohibited by the settlor.

Most courts faced with this problem have held that deviation is permitted in these circumstances in spite of the settlor's directions.[131] The leading case in this area is *In re Pulitzer's Estate*.[132] A codicil to testator's will created the "Newspaper Trust" to which he gave his stock in two publishing companies. He expressly permitted his trustees to sell the stock of one company. He provided, however, that

> [T]his power of sale, however, is limited to the said stock of the Pulitzer Publishing Company of St. Louis, and should not be taken to authorize or empower the sale or disposition *under any circumstances whatever,* by the trustees of any stock of the Press Publishing Company, publisher of "The World" newspaper. I particularly enjoin upon my sons and my descendants the duty of preserving, perfecting and perpetuating "The World" newspaper (to the maintenance and upbuilding of which I have sacrificed my health and strength). . . .[133]

Testator then went on to describe in some detail the motives that prompted his desire to forbid the sale of the stock of the Press Publishing Company.

The court ordered deviation notwithstanding the terms of the will on the ground that Pulitzer's "dominant purpose" was to provide income for his children and an unimpaired corpus for the remaindermen,[134] refusing to believe that a man of Pulitzer's wisdom and busi-

130. Stanton v. Wells Fargo Bank & Union Trust Co., 150 Cal. App. 2d at 770, 310 P.2d at 1015 (1957); Curtiss v. Brown, 29 Ill. 201, 230 (1862); *In re* Cosgrave's Will, 225 Minn. at 467, 31 N.W.2d at 34 (1948); Pennington v. Metropolitan Museum of Art, 65 N.J. Eq. 11, 24, 55 A. 468, 472 (Ch. 1903); *In re* Stack's Will, 217 Wis. 94, 102, 258 N.W. 324, 327 (1935); Upham v. Plankinton, 166 Wis. 271, 276-77, 165 N.W. 18, 19 (1917). *See* Note, *supra* note 24, at 858.

131. *See* RESTATEMENT (SECOND) OF TRUSTS § 167 comment a, illustrations 10-12, reporter's note (1959).

132. 139 Misc. 575, 249 N.Y.S. 87 (Surr. Ct. N.Y. Co. 1931), *aff'd mem.*, 237 A.D. 808, 260 N.Y.S. 975 (1932).

133. *Id.* at 578, 249 N.Y.S. at 92 (emphasis added).

134. *Id.* at 580, 249 N.Y.S. at 94.

ness acumen could have intended that the paper continue to be published until the asset became valueless.[135] With all due respect, it seems mere sophistry for a court to declare a testator's main purpose to be to provide income for his sons and an unimpaired corpus to the remaindermen in light of testator's strong statement prohibiting sale "under any circumstances whatever."[136] Such a statement should render the question of whether testator contemplated the losses suffered by the company irrelevant. Surely it cannot be said that by this deviation the court was fulfilling testator's purpose, nor can it realistically be said that the court gave due regard to testator's statement of his purpose.[137]

In contrast to *Pulitzer* is *In re Cosgrave's Will.*[138] Testator left his residuary estate in trust with income in equal shares to his widow and daughters. On the death of his widow, the trust corpus was distributable to his daughters. The trust provided that if one-third of the income was insufficient to support his widow in the manner in which testator had supported her during her lifetime, additional income for that purpose was to be paid to the widow and the daughters' shares decreased accordingly. The entire income of the trust became insufficient to support the widow, and she petitioned to invade the corpus. The court denied deviation, reasoning that testator had specifically provided what the widow should receive, and that in addition he specifically stated the case in which encroachment on the daughters' shares might be made for the widow.[139] The court interpreted this to mean that by permitting more than one-third of the income to be distributed to the widow in certain instances, the testator intended that corpus not be invaded for the widow.[140]

Thus, the court correctly characterized the case as one requesting a shifting of benefits from the daughters to the widow, which is not permitted,[141] and went on to distinguish carefully between deviation

135. *Id.* at 580-81, 249 N.Y.S. at 95.

136. *Id.* at 578, 249 N.Y.S. at 92.

137. *See also* Will of Pace, 93 Misc. 2d 969, 400 N.Y.S.2d 488 (Surr. Ct. 1977), in which testator directed that certain houses on his property be demolished and that the property be kept vacant until the death of seven persons, including five minors. The court held this clause violates public policy. Testator's residuary clause, which was neither connected in the will to the void trust nor even contained in the same article of the will as the void trust, limited the trustees to investments in U.S. Government securities and day of deposit to day of withdrawal interest accounts. The court, with no explanation, stated that the "apparent purpose" of this limit was to insure that cash would be available to pay taxes, insurance and costs of maintenance on the real property. The court then reasoned that, since it had declared the real estate limits void, the investment restrictions could be expanded by deviation. *Id.*

138. 225 Minn. 443, 31 N.W.2d 20 (1948).

139. *Id.* at ____, 31 N.W.2d at 25.

140. *Id.* at 448-52, 31 N.W.2d at 25-26.

141. *Id.* at 465, 31 N.W.2d at 33.

from matters of administration and deviation which changed the rights of the parties.[142] The contrast between the careful analysis of the Minnesota court and the ignoring of testator's expressed interest in *Pulitzer* is clear.[143] Despite the lack of justification for the result, the rule in *Pulitzer* has become generally accepted and has been adopted by the Restatement.[144]

B. Estate and Gift Tax: Decisions in Search of a Theory

As previously noted,[145] almost all the cases dealing with administrative powers in the estate and gift tax area have concluded that administrative powers, either singly or in combination, without more, will not cause taxation. Basically, this is because the exercise of administrative powers by a trustee is subject to control of the court, and the court will insure that the powers are exercised fairly and impartially and for the benefit of all beneficiaries.[146] Court enforcement of a trustee's fiduciary duty limits the trustee to such an extent that it would be impossible for him to exercise the dominion and control necessary to cause inclusion of the trust property in the grantor's

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142. *Id.* at ____, 31 N.W.2d at 33-36. In explaining the doctrine and limits of deviation, the court showed a clear understanding of what the doctrine was intended to do, and the possible problems in extending it beyond its limits.

143. *See also* Pennington v. Metropolitan Museum of Art, 65 N.J. Eq. 11, 55 A. 468, 472-73 (Ch. 1903), which, after describing the doctrine of deviation, said:

> It is not improper to add that I should find extreme difficulty in applying even the doctrine of necessity to a case where the creator of the trust has plainly disclosed an intent to limit the benefit he intended, by an adherence to a course of conduct expressly mapped out in the management of the trust. In the present case, if we assume that the testator contemplated a situation such as now confronts the trustees, and made express provision for it, how could it be maintained that any necessity existed requiring the court to direct the trustees to take another course of conduct, on the mere ground that it would be more beneficial than that course which the testator prescribed?

Id. The court's examination of the will convinced it that testator had not contemplated the circumstances which occurred. *Id.*

Thus, whether deviation will be ordered in a case may depend on the court's view of either of two variables: the dominant purpose of testator and the circumstances that testator could have anticipated. The first has been discussed in this section. As to the second, *compare* Stanton v. Wells Fargo Bank & Union Trust Co., 150 Cal. App. 2d 763, 310 P.2d 1010 (1957) (changed economic conditions, not to justify deviation because no emergency existed and trust purposes not threatened) *with In re* Trusteeship Under Agreement with Mayo, 105 N.W.2d 900 (Minn. 1960) (changed economic conditions alone held to justify deviation). In most cases, however, the second question becomes irrelevant if the original limits on the deviation doctrine are observed. *See infra* Section V(A).

144. RESTATEMENT (SECOND) OF TRUSTS § 167, comment a, illustrations 10-12 (1959).

145. *See supra* Section III(B).

146. Byrum v. United States, 311 F. Supp. 892, 895 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir. 1971), *aff'd*, 408 U.S. 125 (1972).

gross estate.[147] These cases assume that a local probate court will carefully inquire into each exercise of an administative power by a trustee to make sure the exercise is fair and impartial, and that the discretion exercisable by the trustee as to such powers is severely limited. Unfortunately, this is simply not the case.

In most instances, the trust gives the grantor-trustee absolute or uncontrolled discretion to exercise administrative powers. While it is true that a settlor cannot negate a court's power to control trustees[148] by using language such as "absolute," "sole," or "uncontrolled" discretion, great leeway is given the trustee in making his decisions.

According to the Restatement, a trustee has a duty to deal impartially with the beneficiaries.[149] However, the Restatement provides that if the trustee is given discretion regarding the exercise of a power, he will be subject to control by the court only if he abuses that discretion.[150] In elaboration, the Restatement provides that a court will not interfere unless the trustee acts dishonestly, with an improper motive, fails to use his judgment, or acts beyond the bounds of reasonable judgment.[151]

The above rules deal with the situation in which a trustee is given discretion as to a power. If the discretion is absolute, sole, or unlimited, however, courts will interfere only if the trustee acts dishonestly, in bad faith, or from an improper motive.[152] The standard of reasonableness no longer applies.[153] Clearly, the trustee has broad latitude when given sole and absolute discretion. Two cases will illus-

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147. Old Colony Trust Co. v. United States, 423 F.2d 601, 603 (1st Cir. 1970). Further cases supporting this rationale are discussed *supra* Section III(B).

148. In Stix v. Commissioner, 152 F.2d 562, 563 (2d Cir. 1945), Judge Learned Hand remarked:

> [N]o language, however strong, will entirely remove any power held in trust from the reach of a court of equity. After allowance has been made for every possible factor which could rationally enter into the trustee's decision, if it appears that he has utterly disregarded the interests of the beneficiary, the court will intervene. Indeed, were that not true, the power would not be held in trust at all; the language would be no more than a precatory admonition.

Id.

149. RESTATEMENT (SECOND) OF TRUSTS § 183 (1959).

150. *Id.* § 187. This rule applies both to management and dispositive powers. *Id.* comment c.

151. *Id.* comment e. Furthermore, the fact that the court would have exercised the power differently is not a sufficient reason for the court to intervene. *Id.* As examples, the Restatement provides that if the trustee has the power to invade principal for the support of a beneficiary, the court will not overrule the trustee's judgment, if made honestly and with proper motive, even if he gives the beneficiary too much or too little. *Id.*

152. *Id.* comments i & j. The "dishonest, bad faith and improper motive" standard includes acting contrary to the settlor's intent. *Id.*

153. *Id.* comment j.

trate the extent to which such powers can be used to vary the interests of the beneficiaries without court interference.

Rowe v. Rowe,[154] though dealing with a dispositive power, is instructive. The wills of Enoch and Nellie Peterson created identical testamentary trusts for Nellie's parents. The trustee was to pay the income and principal to the beneficiaries entirely according to the trustee's discretion. The trustee had collected $7,500 income[155] in the trust and had paid only $600 to the beneficiaries. The court held that in setting the standard for the exercise of the trustee's discretion when no specific standard is stated, the standard is a general standard of reasonableness and the court would not interfere if the trustee acted within "the bounds of a reasonable judgment."[156] The trustee testified that, on the basis of conversations with Enoch Peterson, he believed he should pay income to the beneficiaries in case of need, and he interpreted need as meaning want in the strict sense. Given the testimony of Nellie's father as to his financial circumstances,[157] the court held that it would not say that "no reasonable person vested with the power which was conferred upon the trustee in this case could have exercised that power in the manner in which it was exercised"[158] and approved the trustee's standard. The case clearly illustrates how a broad discretion can permit a trustee to formulate a narrow and strict rule as to the exercise of a power, thus indirectly favoring one beneficiary over another, with court approval.

A case illustrative of the extent to which administrative powers can be used to vary the interests of the beneficiaries without court interference is *Commercial Trust Co. of New Jersey v. Barnard*.[159] In this case, the grantor created a trust with income payable to his three daughters for their lives, remainder to their respective issue, per stirpes. The original corpus consisted entirely of Chile Copper Company Trust Gold Bonds due in 1932. The settlor retained absolute control over the investments during his life and, after his death, his brothers and nephews were given the power to veto investments. The brothers and nephews gave up their control over investments in 1937. For the

154. 219 Or. 599, 347 P.2d 968 (1959).

155. The opinion does not provide any figure regarding the size of the corpus of the trusts.

156. 219 Or. at 604, 347 P.2d at 971.

157. Nellie's mother had died prior to the litigation. Nellie's father testified that he had between $8,000 and $10,000 in cash, a pension of $100 a month, monthly social security of $87.90, and a small income from property and investments. He owned his home free of encumbrances, a television set, a car (which was later destroyed), an organ, and furniture and furnishings. *Id.* at 609, 347 P.2d at 973-74. While his assets appear adequate, his income clearly would not make for an extravagant lifestyle.

158. *Id.* at 610, 347 P.2d at 974.

159. 27 N.J. 332, 142 A.2d 865 (1958).

entire trust period from 1920 to 1955, the trustees, exercising their discretion, invested in tax-exempt securities in accordance with a policy formulated by the Guggenheim brothers in 1927 when the Chile Copper Company bonds were redeemed.[160]

The income beneficiaries and remaindermen all objected to the policy of investing in low-yield government securities. The court approved the trustees' actions and dismissed the objections.[161] From 1945 to 1955, the average annual yield of the trust ranged from 2.17 percent to 1.51 percent, while it was alleged that average discretionary trusts were yielding 4.5 percent or more during this period. The court noted that the income beneficiaries were in extremely high tax brackets, and fully taxable yields well above the average for discretionary trusts would have been necessary to equal the yield produced by tax-exempts.[162] The court further held that the facts demonstrated that the trustees were alert to the advantages of the investment policy they pursued. The allegation that the trustees refused to consider other investments was off-handedly dismissed.[163] The beneficiaries also contended that the trustees had breached their duty to diversify investments.[164] The court answered by saying that the purpose of the diversification requirement was to avoid or minimize the risk of large losses, and the trustees' strategy was one of the best methods to do exactly that.[165]

Because of the uncontrolled discretion given to the trustees the court approved the trustee's actions and refused to interfere with the investment policy which at best favored the income beneficiaries over the remaindermen.[166] While the policy of investing only in tax-exempt securities probably benefited the remaindermen during the 1930's by preserving the corpus, it was clearly detrimental to them during the 1940's and 1950's. Despite this inequity, the court refused to interfere with the trustee's discretion. Indeed, nothing in the opinion speaks to the effect of the investment policy on the remaindermen. In only one paragraph of the separate opinion of Justice Heller is any mention made of this problem, and even there it is mentioned briefly and only in reference to a minor aspect of the controversy.[167]

160. *Id.* at 337, 142 A.2d at 868.
161. *Id.* at 343-44, 142 A.2d at 871-72.
162. *Id.* at 340, 142 A.2d at 870.
163. *Id.*
164. *Id.* at 343, 142 A.2d at 871.
165. *Id.*
166. *Id.* This assumes agreement with the court's argument that the income beneficiaries benefited from the investment policy of the trustees.
167. The beneficiaries complained of an unrealized corpus loss after the closing date of the account. Justice Heller voted to modify the lower court opinion to reserve decision on that issue. He stated:

Thus, as evidenced by the Restatement and the cases discussed, trustees with absolute discretion to exercise or not exercise an administrative power have a broad range of choices with respect to the power. Clearly, however, a trustee's decision can affect the interests of the beneficiaries and can often increase the value of the income interest over the remainder and vice-versa. It is difficult, therefore, to conclude that a grantor with administrative powers does not possess sufficient control over the disposition of a trust to generate inclusion of the trust property in his gross estate.

VI. Toward a More Realistic Treatment of Administrative Powers

A. Recapitulation

As discussed previously, the differing treatment of administrative and dispositive powers in trust and federal estate and gift tax law is not justified by either the effects of the two different types of powers or by the theories used to explain the differing treatment. This disparity between treatment and rationale leads to the conclusion that either the theory or the result is wrong, and one or the other should be changed. Indeed, several possibilities exist to coordinate the theory and practice in this area, and they will be examined in this section.

These possibilities are:

1. Continue to treat administrative and dispositive powers differently, but alter the theory for doing so.
2. Allow deviation for both administrative and dispositive powers, and require inclusion of the trust in the grantor's gross estate if he retains administrative powers.
3. Allow no deviation in either administrative or dispositive powers, and amend the Internal Revenue Code so that retention by the grantor of dispositive or administrative powers will not cause inclusion of the trust in the grantor's gross estate.
4. Allow no deviation in either dispositive or administrative powers, but retain the present estate and gift tax treatment with minor modifications to comport with the original ration-

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The trustee is under a dual fiduciary duty to the remaindermen and the income beneficiaries; and diversification of the investments may be the course of prudence for the preservation of the *corpus* depending upon varying economic hazards and conditions. The fiduciary's duty is concerned with the security of the trust *res* and a reasonably adequate income.

27 N.J. at 347, 142 A.2d at 874 (emphasis in original).

ale of taxing certain dispositive powers.
5. Analyze the power held in a given trust and make the decision on deviation and taxation dependent on the effect of the power, either without qualification or with some exceptions.

B. Altering the Theory

The first possibility is to retain the basic rules but change the theory underlying the rules to something more realistic. Among the possible theories for the doctrine of deviation are: (1) that testators rarely contemplate or provide for major changes in economic conditions; (2) that testators generally intend that the purchasing power of the remainder interests be kept intact and protected against inflation; and (3) that the court has the power and duty to do what the testator would have done had he contemplated the current situation. Thus, it is arguable that the key to deviation should be a change in circumstances not contemplated by the grantor, regardless of whether any danger to the trust's purpose or need by a beneficairy is present. Support for the present estate and gift tax rule exists since it can be forcefully argued that the indirect control retained by a grantor by virtue of administrative powers may be necessary for the the successful operation of the trust and the possible shift in enjoyment is de minimus.

Dealing with the estate and gift tax rule first, it may be true that a trustee needs certain administrative powers to manage a trust as the grantor intended. What is *not* necessary is that the grantor retain these powers, whether as trustee or otherwise. Since the inception of the estate tax, Congress has evidenced its intention to tax "testamentary substitutes," those transfers over which the grantor retains certain ownership powers, though the transfer may be regarded as complete for property law purposes.[168]

Horizontal equity is the reason for this treatment. Treating similarly situated persons alike is a fundamental principal of taxation.[169] Thus, the fact that the trustee requires administrative powers to manage a trust is irrelevant when determining estate and gift taxation. The relevant question is: did the grantor retain sufficient powers to warrant treating him as the owner for estate tax purposes.[170] One of the tests adopted by the I.R.C. is whether the owner retains the power to affect the beneficial enjoyment of the property trans-

168. D. KAHN & L. WAGGONER, FEDERAL TAXATION OF GIFTS, TRUSTS & ESTATES 603-04 (2d ed. 1982).
169. *Id.* at 603.
170. *Id.*

ferred.[171] Since the exercise of administrative powers can affect beneficial enjoyment, horizontal equity dictates that retention of administrative powers by a grantor should cause inclusion of the trust property in the grantor's gross estate.

While the possibility exists that these powers are *de minimus,* Congress did not indicate such an exception to sections 2036 and 2038. Moreover, where Congress desired such an exception, it drafted one.[172] Even if an exception can be justified, the cases indicate that some administrative powers, such as the investment power, can substantially shift benefits between income and principal interests.

Similarly, there appears to be no valid theory supporting the retention of the deviation rules. As I previously demonstrated, the rules relied on by the courts to justify deviation do not support the cases which have allowed it. As to the previously suggested justifications, it is at best doubtful that testators do not contemplate drastic economic changes. In *Mayo,* Dr. Charles Mayo created his trusts in 1917 and 1919 and died in 1939.[173] Thus he lived through the expansion period of the 1920's, the Great Depression of the 1930's and the early part of the recovery, some of the greatest economic swings in American history. To say that he could not have anticipated changed economic conditions seems ludicrous. Also, while it is perhaps true that grantors generally intend to protect the purchasing power of the remainder interests against inflation, it does not necessarily follow that all grantors would want the courts to revise their trust provisions if inflation decreases the purchasing power of the remainder. The grantor's primary purpose may have been to protect the income beneficiaries. Even assuming these problems are overcome, to further state that it is the court's duty to change the provisions of a trust to reflect what it believes the testator would have provided had he considered the possibility of changed circumstances is an extremely dubious proposition.

First, the stability of the provisions of wills and trusts is extremely important in estate law. Testators rely on the fact that the provisions in their wills and trust agreements will be respected and enforced.[174] The stability of trusts would be severely compromised if

171. I.R.C. §§ 2036(a)(2), 2038 (West Supp. 1985).

172. *E.g.,* I.R.C. § 2037(a)(2) (West Supp. 1985) (reversionary interest included only if value exceeds 5% of property immediately before decedent's death); I.R.C. § 2041(b)(2) (1982) (lapse of general power of appointment treated as a release only to the extent that property subject to the power exceeds the greater of $5,000 or 5% of the assets from which the exercise of the power could have been satisfied).

173. 259 Minn. at 91, 105 N.W.2d at 901.

174. As the court stated in *In re* Cosgrave's Will, 225 Minn. at 449, 31 N.W.2d at 25:

> [Testator's] preference could not be based upon logic or he could act without regard for

courts could alter provisions merely on a finding of changed circumstances.[175]

Second, and equally important, the will is the expression of the testator's dispositive desires. A judge's priorities, desires and circumstances will almost certainly be different from the testator's. How can a judge predict how the grantor or testator would have acted had he considered the problem at hand? Judges may certainly know how they themselves would have acted. With less confidence they may believe they can say how most testators would have acted. But, lacking any indication in the will or trust agreement, it is extremely difficult to conclude, with any certainty, how a particular grantor or testator would have acted. Not surprisingly, therefore, courts are extremely reluctant to change the provisions of a will or trust agreement when to do so would affect the interests of the beneficiaries. Thus, the proposed justifications for a broad power of deviation fail to support the power.[176]

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it. *The will is his and cannot be redrafted by this court.* Whatever the probabilities may be, we cannot indulge in speculation relating to his intent, but must be controlled by the language of the entire will considered in relation to each part.

Id. (quoting *In re* Winburn's Will, 265 N.Y. 366, 374, 193 N.E. 177, 180 (1934) (emphasis added).

175. In the leading case of *In re* Van Deusen's Estate, 30 Cal. 2d 285, ____, 182 P.2d 565, 573 (1947), the court said:

If the courts could increase the payments under testamentary trusts without the consent of all the beneficiaries merely because the income therefrom is not what it was at the time the will was executed and because at one time or another the testator expressed the desire to provide adequately for the beneficiaries, there would be no stability to any testamentary trust in this state.

Id. at ____, 182 P.2d at 573.

176. The court's power to predict the economic future is no better than its ability to predict what a grantor's reaction would be to changed circumstances. As is so clearly articulated in Stanton v. Wells Fargo Bank & Union Trust Co., 150 Cal. App. 2d 763, 771, 310 P.2d 1010, 1016 (1957):

The existing inflationary cycle has continued for some years. The government has adopted many economic measures to try to control and stop this inflationary trend. Some economists predict an era of deflation and others warn us of a depression. These matters are mentioned to indicate that, while the settlor may not have been omniscient, neither are the beneficiaries nor the courts, omniscient. No one can forecast, with any certainty, future events. . . . [T]he court should not try to guess what economic conditions may be in a few years by permitting deviations when no real emergency exists or is threatened.

Id. at 771, 310 P.2d at 1016.

C. *Allow Deviation from Both Administrative and Dispostive Powers*

Since both dispositive and administrative powers can shift the interests of the beneficiaries, they could be treated similarly. This could be accomplished by broadening the doctrine of deviation to encompass dispositive powers and by ruling that possession by a grantor of administrative powers causes inclusion of the trust property in his gross estate. As previously noted, the IRS has taken this position regarding the power of the grantor to remove trustees and appoint successor trustees.[177] In at least one case, a court came to the same conclusion in a deviation case.

In *Petition of Wolcott*,[178] testator's will created a trust to pay the income to his widow for life, with remainder to testator's then living issue. At the time of the proceeding requesting payments be made to the widow from principal, the widow was age 82, ill, and infirm. The yearly income of the trust was $2,300 and the widow's expenses, including the use of nurses and doctors, exceeded $5,800 a year. Testator's sons supported the petition.[179]

Granting petition for invasion, the court found that the grantor wanted to provide a liberal income for his widow. Recognizing that the majority rule would not permit an invasion, the court stated that implicit in the will was the intention of the testator to provide his wife with reasonable support and that the payment of income was only one means of accomplishing that purpose.[180] Also, the court was apparently heavily influenced by the presumptive remaindermen's consent.

The proposed alteration would treat administrative and dispositive powers similarly, thus recognizing the effects of exercises of administrative powers on the beneficiaries. Moreover, it would have a beneficial effect in the estate and gift tax area in that grantors could not be trustees of trusts they created if estate tax exclusion were desired.[181] The objections discussed in the last section, however, also

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177. *See supra* Section IV for discussion of Rev. Rul. 79-353.

178. 95 N.H. 23, 56 A.2d 641 (1948).

179. *Id.* at 25, 56 A.2d at 642.

180. *Id.* at 27-28, 56 A.2d at 644. Interestingly, the only provisions the court mentioned as evidence of this purpose were the broad investment powers of the trustee (which were not specified in the opinion), the power to determine which receipts were income and which were principal, and the power to do all things which the testator could have done if living. The court could just as easily have decided that these powers were included to protect the remaindermen.

181. This would be beneficial as it would eliminate much litigation over whether retention of certain powers caused inclusion of the trust property in the gross estate. Section 2041 of the I.R.C. dealing with power of appointment would not be greatly affected, because giving the trustee administrative powers would not cause inclusion unless the trustee were also a beneficiary. However, not all administrative powers have dispositive potential. Thus in the estate and

apply here. Courts do not have the power to rewrite testator's will.[182] Even were the courts to accept this power, ascertaining testator's intent is a difficult task at best. As noted, the provisions of the will in *Wolcott* just as easily could have supported a finding that testator intended to protect the remainder interests rather than the income beneficiaries.[183] Courts should never remake a will or try to determine testator's intent by conjecture.[184] It is the testator's intent that should control in will and trust interpretation cases.[185] Consistent with this rule, the court will not substitute its own view of the provisions testator would have made had he considered the problem, if to do so would take property from one beneficiary and give it to another.[186]

Because of the above objections, few courts recognize deviation

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gift tax area, this solution is too broad. *See infra* Section VI(E).

182. *In re* Cosgrave's Will, 255 Minn. 443, 31 N.W.2d 20 (1948).

183. *See supra* note 180.

184. *In re* Cosgrave's Will, 255 Minn. 443, 31 N.W.2d 20, 25 (1948).

185. Elliott v. Hiddleson, 303 N.W.2d 140, 142 (Iowa 1981); Estate of Kalouse, 282 N.W.2d 98, 100 (Iowa 1979); Oxley v. Oxley, 262 N.W.2d 144, 149 (Iowa 1977); Elkader Prod. Credit Ass'n v. Eulberg, 251 N.W.2d 234, 237 (Iowa 1977); Estate of Kruse, 250 N.W.2d 432, 433 (Iowa 1977); Houts v. Jameson, 201 N.W.2d 466, 468 (Iowa 1972).

186. In a well-reasoned and thoughtful article, Professor Paul G. Haskell, an authority in estates and trusts, has suggested that the doctrine of deviation be broadened to include dispositive provisions. Haskell, *Justifying the Principle of Distributive Deviation in the Law of Trusts*, 18 HASTINGS L.J. 267 (1967). Professor Haskell recognizes the justification problems mentioned in this article and suggests that testator's intent is really not the issue. Rather, deviation should be justified by a social preference for protecting individuals to whom the testator was, or felt responsible for, which would prevail over dead hand control. *Id.* at 284. While a detailed discussion of Professor Haskell's article is beyond the scope of this article, it is important to note that nothing exists in the common law, apart from dower, that obligates a testator to provide for persons whom he was responsible for during his life. Apart from his spouse, a testator could choose whether or not to include anyone as a beneficiary. Therefore, to argue that because a testator elected to include his spouse and children as beneficiaries the limits he imposed on his beneficence should be disregarded seems excessive. Further, Professor Haskell would not likely suggest that if testator intentionally omitted his children as beneficiaries, a testamentary trust created for others persons could be invaded for his children in the event of emergencies. Yet Haskell's rationale would support such an invasion. Moreover, estates scholars have long debated the question of whether the testator's wishes should prevail over the wants and desires of living beneficiaries. No consensus on the question seems to exist, much less a social policy favoring living beneficiaries. Articulation of any such policy should come from the legislature, not the courts, as Professor Haskell recommends. Lastly, of the matters Professor Haskell cites in support for his argument, almost all (e.g., spouse's forced share, limits on the Rule Against Perpetuities, U.C.C. § 2-302) are based on legislation. As to the other matters, the cy pres power in charitable trusts is based on a clear policy favoring charities, which was recognized long before the judicial cy pres power existed per se. Even dower is based on an agreed social policy of protection of spouses, not a more questionable one such as the extent of dead hand control. Thus, if any such change should come, it should come from the legislature, which is the proper decision-maker regarding social policy, and which can limit the doctrine to cases in which it believes such extraordinary relief should be available. As will be discussed, legislative changes in this area have been few and limited, indicating the lack of acceptance of Professor Haskell's position.

from distributive powers. Nor it there any indication that courts intend to disturb the inherent stability of trust law by rewriting a grantor's dispositive provisions. This alternative has little merit to recommend it for judicial adoption.

However, in the past 35 years, several legislatures have enacted provisions authorizing deviation from dispositive provisions in certain situations. At least three states, New York,[187] Pennsylvania,[188] and Wisconsin,[189] have such provisions. The New York statute contains different provisions for trusts created prior to and after the enactment of the statute. Under the New York statute, all deviations are subject to a court finding that the original purpose of the trust cannot be carried out and that allowing deviation effectuates the grantor's intentions. For trusts created after the statute's enactment, and for income beneficiaries of trusts created prior to the statute who have indefeasibly vested interests in principal, an allowance from principal can be made to an income beneficiary whose support or education was not sufficiently provided for. For income beneficiaries of trusts created prior to the statute who are not entitled to principal, an additional requirement is imposed that all adult and competent beneficiaries consent to the deviation.[190]

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187. N.Y. EST. POWERS & TRUSTS LAW § 7-1.6 (McKinney Supp. 1983).

188. 20 PA. CONS. STAT. ANN. § 6102 (Purdon Supp. 1983).

189. WIS. STAT. ANN. § 701.12 (West 1981).

190. N.Y. EST. POWERS & TRUSTS LAW § 7-1.6(a), (b) (McKinney 1967 and Supp. 1983). The statute provides as follows:

§ 7-1.6 Application of principal to income beneficiary

(a) Notwithstanding any contrary provision of law, the court having jurisdiction of an express trust, heretofore created or declared, to receive the income from property and apply it to the use of or pay it to any person, unless otherwise provided in the disposing instrument, may in its discretion make an allowance from principal to any income beneficiary whose support or education is not sufficiently provided for, to the extent that such beneficiary is indefeasibly entitled to the principal of the trust or any part thereof or, in case the income beneficiary is not entitled to the principal of the trust or any part thereof, to the extent that all persons beneficially interested in the trust are adult and competent and consent thereto in writing; provided that the court, after a hearing on notice to all those beneficially interested in the trust in such manner as the court may direct, is satisfied that the original purpose of the creator of the trust cannot be carried out and that such allowance effectuates the intention of the creator.

(b) Notwithstanding any contrary provision of law, the court having jurisdiction of an express trust, hereafter created or declared, to receive income from property and apply it to the use of or pay it to any person, unless otherwise provided in the disposing instrument, may in its discretion make an allowance from principal to any income beneficiary whose support or education is not sufficiently provided for, whether or not such person is entitled to the principal of the trust or any part thereof; provided that the court, after a hearing on notice to all those beneficially interested in the trust in such manner as the court may direct, is satisfied that the original purpose of the creator of the trust cannot be carried out and that such allowance effectuates the intention of the creator.

In Pennsylvania, the statute permits an allowance to certain beneficiaries who are income beneficiaries in cases where the original purpose of the grantor cannot be effectuated or is impractible, and if the allowance more nearly accomplishes the grantor's intent.[191] Wisconsin's statute is similar to New York's, and both statutes disallow invasion of principal if the grantor provides otherwise.[192]

(c) In the event that an income beneficiary to whom an allowance is made, as provided in this section, is or becomes entitled to a share of the principal of the trust, such allowance, without interest thereon, shall be a charge upon such share.

(d) If the application or the possibility of the application of this section to any trust would reduce or eliminate a charitable deduction otherwise available to any person or entity under the income tax, gift tax or estate tax provisions of the internal revenue code, the provisions of this section shall not apply to such trust.

Id.

191. 20 PA. CONS. STAT. ANN. § 6102 (Purdon 1975 & Supp. 1985) provides:

§ 6102. Termination of trusts

(a) Failure of original purpose. — The court having jurisdiction of a trust heretofore or hereafter created, regardless of any spendthrift or similar provision therein, in its discretion may terminate such trust in whole or in part, or make an allowance from principal to one or more beneficiaries provided the court after hearing is satisfied that the original purpose of the conveyor cannot be carried out or is impractical of fulfillment and that the termination, partial termination, or allowance more nearly approximates the intention of the conveyor, and notice is given to all parties in interest or to their duly appointed fiduciaries.

(b) Distribution of terminated trust. — Whenever the court shall decree termination or partial termination of a trust under the provisions of this section, it shall thereupon order such distribution of the principal and undistributed income as it deems proper and as nearly as possible in conformity with the conveyor's intention.

(c) Other powers. — Nothing in this section shall limit any power of the court to terminate or reform a trust under existing law.

Id.

192. WIS. STAT. ANN. § 701.12 (West 1981) provides:

701.13 Modification and termination of trusts by court action

(1) Anticipation of directed accumulation of income. When an accumulation of income is directed for the benefit of a beneficiary without other sufficient means to support or educate himself, the court on the application of such person or his guardian may direct that a suitable sum from the income accumulated or to be accumulated be applied for the support or education of such person.

(2) Application of principal to income beneficiary. Unless the creating instrument provides to the contrary, if a beneficiary is entitled to income or to have it applied for his benefit, the court may make an allowance from principal to or for the benefit of such beneficiary if his support or education is not sufficiently provided for, taking into account all other resources available to the beneficiary.

(3) Termination. In the case of a living trust where the settlor is deceased and in the case of any testamentary trust, regardless in either case of spendthrift or similar protective provisions, a court with consent of the trustee may order termination of the trust, in whole or in part, and such distribution of the assets as it considers appropriate if the court is satisfied that because of any substantial reason existing at the inception of a testamentary trust or, in the case of any trust, arising from a subsequent change in circumstances (including but not limited to the amount of principal in the trust, income produced by the trust and the cost of administering the trust) continuation of the trust,

Concerning these statutes, the first thing to notice is that the New York and Wisconsin statutes are limited in scope. Allowances can be made only to beneficiaries for whom support and maintenance are not provided. Invasion cannot be made if the trust instrument directs otherwise. In addition, the Wisconsin statute requires that the other resources of the beneficiary must be considered, and the New York statute makes the allowance a charge on the beneficiary's interest in principal, if he has one.

In general, then, there has been no stampede by state legislatures to extend the judicial deviation doctrine to dispositive provisions by statute. Indeed, in two of the three states which have done so, the invasions permitted are limited and can be negated by the trust instrument. Only Pennsylvania has a broad deviation from principal statute.

This review indicates that legislatures have not perceived any

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in whole or in part, is impractical. In any event, if the trust property is valued at less than $5,000, the court may order termination of the trust and such distribution of the assets as it considers appropriate.

(4) Marital deductions trust. In a trust where the income beneficiary also has a general power of appointment as defined in s. 702.01(4) or where all accumulated income and principal are payable to such beneficiary's estate, any termination, in whole or in part, of the trust under sub. (3) can only be ordered in favor of such beneficiary.

(5) Charitable trusts. Subs. (2) and (3) do not apply to a trust where a future interest is indefeasibly vested in.

(a) The United States or a political subdivision for exclusively public purposes;

(b) A corporation organized exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation, and which does not participate or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office;

(c) A trustee or a fraternal society, order or association operating under the lodge system, provided the principal or income of such trust is to be used by such trustee or by such fraternal society, order or association exclusively for religious, charitable, scientific, literary or educational purposes or for the prevention of cruelty to children and animals, and no substantial part of the activities of such trustee or of such fraternal society, order or association is carrying on propaganda or otherwise attempting to influence legislation, and such trustee or such fraternal society, order, or association does not participate or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office; or

(d) Any veteran's organization incorporated by act of congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(6) Other applicable law. Nothing in this section shall prohibit modification or termination of any trust pursuant to its terms or limit the general equitable power of a court to modify or terminate a trust in whole or in part.

Id.

pressing need to extend the deviation doctrine to dispositive provisions. Those few states that have done so have tended to limit and restrict the doctrine. This legislative record reinforces the conclusion that courts should be reluctant to extend the deviation doctrine to dispositive powers.[193]

D. Abolish the Doctrine of Deviation for Both Administrative and Dispositive Powers

At the opposite extreme, one could argue that no deviation should be allowed from administrative or dispositive provisions. This would cause no change in the current estate tax treatment of administrative and dispositive powers. Additionally, it would have the beneficial effect of treating the two types of powers similarly from a trust law standpoint. It would further prevent the problems courts have faced in recent years when asked to deviate from investment restrictions due to changing economic conditions.

Such a rule would not, however, provide for cases such as *Curtiss v. Brown*,[194] where a court must intervene. Examples of such situations are where the trust consists entirely of unproductive property and the income beneficiary is totally impoverished and unable to provide for the minimum necessities of life,[195] or where the trust is actually threatened with destruction, such as by a public sale of the property because of delinquent taxes.[196] The conclusion that a court must have the power to intervene in some circumstances is clearly correct. Thus a rule abrogating the doctrine of deviation, while superficially appealing, is too rigid and inflexible and should not be adopted.

E. Allowing Deviation Based Upon Analysis of the Power Involved

The problem with the differing treatment of administrative and dispositive provisions is two-fold. First, the deviation doctrine has expanded far beyond the reasonable limits originally imposed on it. Second, courts do not recognize that the exercise of some administrative powers does affect the interests of the beneficiaries of some

193. Some states have statutorily enacted the doctrine of deviation as to administrative powers. *See, e.g.*, IND. CODE ANN. § 30-4-3-26 (Burns 1972) (based on the *Restatement*). Other states have enacted limited deviation provisions regarding certain powers, such as investments. *See, e.g.*, 12 DEL. CODE ANN. § 3.306 (1979) which appears to be the basis of Bank of Delaware v. Clark, 249 A.2d 442 (Del. Ch. 1968), sometimes cited as a case similar to *In re* Trusteeship Under Agreement With Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960), previously discussed.

194. 29 Ill. 201, 229-30 (1862).

195. *Id.*

196. *Id.*

trusts.

To develop a better approach, we begin with the established rule that a court has no power to take property from one beneficiary and give it to another.[197] Thus, the rule that no judicial modification of dispositive provisions is permitted would continue.[198] As to administrative provisions, a better approach would mandate that the court focus on whether the power in question, if exercised, could affect the interests of the beneficiaries. As previously discussed, certain powers, such as investment powers, clearly have the potential to affect the interests of the beneficiaries. Logic would dictate that as to such powers, no deviation from testator's directions should be permitted. The importance of the testator's intent,[199] and the deference accorded to it, reinforce this conclusion.

On the other hand, the considerations that underlie the doctrine of deviation as it originally developed,[200] indicate that some flexibility is needed in this area. Moreover, the effect on the beneficiaries of the modification of an administrative power is neither as direct nor as certain as the exercise of a dispositive provision. Modification of distributive power has an immediate impact on the beneficiaries interests; it takes property from one beneficiary and gives it to another. Modification of an administrative power, however, has no immediate effect on a beneficiary's interest.

The long-term effects of modification of administrative provisions are unclear. They may substitute property which will appreciate to a lesser extent than the original property,[201] or to a greater extent.[202] The modification may benefit both income and remainder interests, or it may benefit one at the expense of the other. Obviously, these factors indicate that deciding whether to allow deviation can be quite difficult. The decision involves a weighing of the strength of testator's intent as evidenced from the language of the will and the circumstances which may have caused the inclusion of the provision, such as the experience and expertise of testator and the economic conditions during his life.

Even if a court decides to allow deviation as to administrative

197. *In re* Van Deusen's Estate, 30 Cal. 2d 285, 182 P.2d 565 (1947).

198. *Id.*

199. Elliott v. Hiddleson, 303 N.W.2d 140, 142 (Iowa 1981); Estate of Kalouse, 282 N.W.2d 98, 100 (Iowa 1979); Oxley v. Oxley, 262 N.W.2d 144, 149 (Iowa 1977); Elkader Prod. Credit Ass'n v. Eulberg, 251 N.W.2d 234, 237 (Iowa 1977); Estate of Kruse, 250 N.W.2d 432, 433 (Iowa 1977); Houts v. Jameson, 201 N.W.2d 466, 468 (Iowa 1972).

200. Curtiss v. Brown, 29 Ill. 201 (1862).

201. An example might be allowing a trustee to invest in stocks where the testator directed the trustee to retain real property.

202. An example might be allowing a trustee to invest in stocks where the testator permitted investment only in United States bonds.

provisions, clearly this deviation must be strictly limited. The limits should be determined by those situations which justified the doctrine in the first place: the existence of unproductive property and severe want of the beneficiary, or the immediate threat of destruction of the trust.[203] The effect on the beneficiaries of modification of administrative provisions makes decisions such as *Mayo*[204] clearly erroneous under the analysis proposed.

Moreover, if a testator clearly prohibits modification of the power, no deviation should be allowed since the testator has expressed his intent. The prime example is the *Pulitzer*[205] case. Under the proposed analysis, no sale of the publishing company would be permitted.[206]

Some administrative provisions do not affect the interests of the beneficiaries. Some examples include holding separate shares or separate trusts *in solido* for investment purposes, hiring attorneys or accountants for an estate or trust, leasing the property for a normal period for such property and selling property on credit. Another example is a will provision authorizing a sale of property with the purchase price to be made in the bonds of a certain state, where the court authorizes the trustee to accept cash as payment.[207] In these cases, deviation should clearly be allowed, and may be allowed under the Restatement rules.[208] The justification that the court is really effectuating testator's intent by modifying an administrative provision is correct in such cases, because the interests of one beneficiary or group of beneficiaries is not being favored over another.

The proposed analysis creates a difficult task for the courts in cer-

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203. Curtiss v. Brown, 29 Ill. 201, 229-30 (1862). Of course, the other requirements of deviation would have to be satisfied. *See* RESTATEMENT (SECOND) OF TRUSTS § 167 (1959).

204. *In re* Trusteeship Under Agreement With Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960).

205. Matter of Estate of Pulitzer, 139 Misc. 575, 249 N.Y.S. 87 (Surr. Ct. N.Y. Co. 1931), *aff'd mem.*, 237 A.D. 808, 260 N.Y.S. 975 (1932).

206. The strength of testator's intent, as indicated by the language of the will or trust provision, may be a factor here if the court adopts a rule allowing limited deviation from administrative powers affecting beneficial interests. In *Pulitzer*, testator used the strongest language possible to express his intent, indicating no deviation should be ordered. Moreover, he particularly designated the property, the Press Publishing Company, which he did not want sold. In comparison, in *Mayo* the grantor merely prohibited investments in real estate and corporate stock. The language was not nearly as strong or specific as that in *Pulitzer* and the *Mayo* trust instrument did not even explain the restriction. Thus, if an immediate threat of destruction of the trust or severe want of the beneficiary occurred, and the other requirements for deviation were met, a court adopting the limited deviation rule could perhaps order deviation. This would not occur often, given the strict limits of the proposed test on the circumstances under which a court could order deviation. Of course, if a court adopted a "no deviation" rule for such powers, deviation would not be allowed in either case.

207. Title Guarantee & Loan Co. v. Holverson, 95 Ga. 707, 22 S.E. 533 (1895).

208. RESTATEMENT (SECOND) OF TRUSTS § 167 (1959).

tain circumstances. Undeniably, to estimate the effects of modification of some powers would not be easy. For example, suppose the trust instrument says nothing about selling trust property.[209] A beneficiary petitions the court to modify this provision to allow a sale of a trust asset because it is unproductive. The question arises whether this is a power that affects the interests of the beneficiaries. A court could decide that the power of sale itself does not. However, after the sale, the decisions of what assets the proceeds will be invested in may certainly affect the beneficiaries, and the two decisions are linked. One solution, of course, would be to deny the sale on the ground that the sale and reinvestment would affect the interests of the beneficiaries and no threat of the destruction of the trust or severe want of the beneficiaries is shown. Alternatively, perhaps, a court could order the sale and reinvestment of the trust in more productive property of the same type. While this approach might create some difficult cases, it would restrict deviation to the cases for which it was designed, curb the unwarranted recent extensions of the doctrine, and enunciate standards that focus on the significant question, the effect of the modification on the interests of the beneficiaries.

The suggested analysis would also provide exemplary results in the estate and gift tax area. Administrative powers that have the effect of changing the interests of beneficiaries will cause inclusion of the property in a decedent's gross estate if he retains the power.[210] Thus, some administrative powers will be treated as dispositive powers for estate tax purposes. The only major change caused by such a rule, then, would be to prevent grantors from being trustees of trusts they create containing such powers. This not only promotes consistency in the estate tax area, but because fewer grantors will be trustees, it should reduce the volume of litigation involving sections I.R.C. §§ 2036(a)(2) and 2038. Of course, administrative powers that do not affect the interests of the beneficiaries would not cause inclusion in the grantor's gross estate, in accordance with the current treatment of almost all administrative powers.[211]

VII. CONCLUSION

Dispositive and administrative powers are treated differently in

209. This example assumes that no local statute gives all trustees a power of sale unless contrary language is contained in the trust instrument.

210. I.R.C. §§ 2036(a)(2), 2038 (West Supp. 1985).

211. A side effect of the proposal would require the withdrawal of Rev. Rule 79-353, discussed *supra* Section IV, since the power to remove a trustee and appoint a successor corporate trustee is not a power which affects the interest of the beneficiaries by favoring income interests over remainder interests. Thus, such a power would not cause inclusion of the trust in the grantor's gross estate.

both trust law and estate and gift tax law. The cause of this treatment is a combination of the belief that administrative provisions are merely an adjunct to a grantor's main dispositive purpose, and the failure to recognize the effect that some administrative powers have on beneficiaries. This article demonstrates that in trust deviation law, these views have caused expansion of the deviation doctrine far beyond its original, carefully circumscribed limits without any theory to support this expansion. In the estate and gift tax area, the cases differentiating dispositive and administrative powers lack any rational basis. A new theory is suggested for evaluating these provisions depending on the effect the provisions have on the interests of the trust beneficiaries. Under estate and gift tax law, if an administrative power affects the interests of a beneficiary, and otherwise satisfies the requirements of sections 2036 and 2038 of the I.R.C., it should be treated in the same manner as a dispositive power. Similarly, an administrative power that does not affect the beneficial interests of the trust should not cause taxation. Finally, in the trust deviation area, administrative provisions that affect beneficial interests should be treated in the same manner as dispositive provisions; no modification should be ordered.[212] In any event, where the grantor clearly reveals his intentions, those intentions should be respected. Deviation is permissible only if it does not affect the beneficiaries interests.

212. Or, at most, limited modification should be allowed. *See supra* text accompanying notes 197-206.