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## 1997 Survey of Rhode Island Law: Cases: Trusts

Karen M. Hagan

*Roger Williams University School of Law*

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**Trusts.** *Pezza v. Pezza*, 690 A.2d 345 (R.I. 1997). The illusory-transfer test is the proper test to determine if an inter-vivos transfer of real property to a trust is sufficient to defeat a surviving spouse's entitlement of a life estate in the real property created under section 33-25-2 of the Rhode Island General Laws.

Pursuant to section 33-25-2 of the Rhode Island General Laws, a surviving spouse is entitled to a life estate in real property that was owned solely by the deceased spouse at the time of his or her death.<sup>1</sup> In *Pezza v. Pezza*,<sup>2</sup> the Rhode Island Supreme Court adopted the illusory-transfer test to determine whether an inter-vivos transfer of real property in a trust can defeat the surviving spouse's statutory right to a life estate in such real property.<sup>3</sup> Under the illusory-transfer test, the court looks at the substance of the inter-vivos transfer and determines whether the deceased spouse had, in good faith, divested himself or herself of ownership of the property.<sup>4</sup> In *Pezza*, the court held that a trust, which is irrevocable at the time of the transferor's death and divests the decedent of all benefits of trust property ownership, is complete, real and not illusory; therefore, it is not subject to the statutory interest of the surviving spouse created under section 33-25-2.<sup>5</sup>

#### FACTS AND CASE TRAVEL

Anthony (Anthony) and Olga (Olga) Pezza married in 1973.<sup>6</sup> They jointly owned a residence in Florida and several bank accounts. On December 29, 1983, Anthony created a revocable inter-vivos trust.<sup>7</sup> He transferred into the trust four parcels of real es-

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1. R.I. Gen. Laws § 33-25-2 (1956) (1995 Reenactment). The statute states in part:

Whenever any person shall die leaving a husband or wife surviving, the real estate owned by the decedent in fee simple at his or her death shall descend and pass to the husband or wife for his or her natural life subject, however, to any encumbrances existing at death; provided that the liability, if any, of the decedent to discharge the encumbrance or encumbrances shall not be impaired.

*Id.*

2. 690 A.2d 345 (R.I. 1997).

3. *See id.* at 350.

4. *See Newman v. Dore*, 9 N.E.2d 966, 969 (N.Y. 1937).

5. *Pezza*, 690 A.2d at 350.

6. *See id.* at 345.

7. *See id.*

tate he acquired prior to his marriage to Olga, along with shares of stock in his garage door business.<sup>8</sup> He named himself a trustee.<sup>9</sup> Anthony's intent in creating the trust was to ensure that children from his previous marriage would attain ownership of the property upon his death.<sup>10</sup> After this conveyance, Anthony still occupied one of the parcels of real estate, collected rents from the other three parcels and retained the power to revoke the trust and the power to demand payment of the trust principal.<sup>11</sup> Anthony's will was executed simultaneously with the trust and contained a "pour-over" provision providing that any remaining assets of the estate became part of the trust upon his death.<sup>12</sup>

On June 25, 1986, when Anthony and Olga were experiencing marital difficulties, Anthony resigned as trustee, appointed his son, Michael, his successor and waived his right to revoke the trust.<sup>13</sup> Olga commenced divorce proceedings on November 14, 1986. On December 5, 1986, Anthony disclaimed his power to demand the trust principal effective June 25, 1986. Anthony died on August 18, 1990 with a valid will and his marriage to Olga still intact.<sup>14</sup>

Olga filed a complaint seeking declaratory relief in the Rhode Island Superior Court on January 17, 1991. She contended that the transfer of the real property was a fraudulent attempt to defeat her statutory right to a life estate in the real property under section 33-25-2.<sup>15</sup> She asked the court to declare the trust invalid and give her a life estate in the real property deeded to the trust.<sup>16</sup> The trial court considered the tests used by courts in other jurisdictions. The court concluded that, of the two tests most utilized, the fraudulent-transfer test<sup>17</sup> and the illusory-transfer test,<sup>18</sup> the lat-

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8. *See id.*

9. *See id.*

10. *See id.* at 346. This was to satisfy a deathbed promise he made to his first wife. *See id.*

11. *See id.*

12. *See id.*

13. *See id.* at 347.

14. *See id.*

15. *See id.*

16. *See id.*

17. *See, e.g.,* *Stoxen v. Stoxen*, 285 N.E.2d 198 (Ill. App. Ct. 1972); *Mushaw v. Mushaw*, 39 A.2d 465 (Md. 1944); *Riggio v. Southwest Bank of St. Louis*, 815 S.W.2d 51 (Mo. Ct. App. 1991); *Hanke v. Hanke*, 459 A.2d 246 (N.H. 1983); *Sherrill v. Mallicote*, 417 S.W.2d 798 (Tenn. Ct. App. 1967).

ter that was the fairest method of analysis.<sup>19</sup> The trial court held a transfer of property with intent to defeat a surviving spouse's statutory share alone was insufficient to invalidate an irrevocable trust. This is because intent is not relevant when a transfer is analyzed using the illusory-transfer test.<sup>20</sup> The court found that at the time of Anthony's death, the trust was real, valid and not illusory because Anthony had resigned as trustee and made the trust irrevocable.<sup>21</sup> Therefore, the trust property is not subject to the statutory life estate of the surviving spouse.<sup>22</sup> Olga appealed to the Rhode Island Supreme Court.

#### BACKGROUND

Because the issue was one of first impression for the Rhode Island Supreme Court, it looked to other jurisdictions for guidance.<sup>23</sup> Primarily, two tests are used when examining whether an inter-vivos transfer can defeat a surviving spouse's statutory interest in property.<sup>24</sup> The Supreme Court of New Hampshire adopted the fraudulent-intent test. This test looks to the transfer and asks whether the transfer was made with the intent to deprive the surviving spouse of his or her statutory share.<sup>25</sup> If the court finds that there was an intent to defeat the statute based on the court's evaluation of the circumstances surrounding the transfer, then the court will invalidate the transfer and the property will be available for distribution to the surviving spouse.<sup>26</sup> This test has been criticized because it casts doubt on the validity of all inter-vivos transfers of property when a spouse retains sole ownership if the transfer was made without the other spouse's knowledge.<sup>27</sup>

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18. See, e.g., *Staples v. King*, 433 A.2d 407 (Me. 1981); (N.Y. 1937); *Newman v. Dore*, 9 N.E.2d 966; *Moore v. Jones*, 261 S.E.2d 289 (N.C. Ct. App. 1980); *Seifert v. Southern Nat'l Bank of South Carolina*, 409 S.E.2d 337 (S.C. 1991).

19. See *Pezza*, 690 A.2d at 348.

20. See *id.* at 348. The intent to defeat the surviving spouse's statutory share is relevant in the fraudulent-transfer test. Analysis under the fraudulent-transfer test would invalidate an inter-vivos trust that was specifically created to defeat a spouse's statutory share. See *id.*; see also *Hanke v. Hanke*, 459 A.2d 246 (N.H. 1983).

21. See *Pezza*, 690 A.2d at 350.

22. See *id.* at 347-48.

23. See *id.* at 348; see also *supra* notes 17-18.

24. See *id.*

25. See *Hanke*, 459 A.2d at 248.

26. See *Pezza*, 690 A.2d at 348.

27. See *Newman v. Dore*, 9 N.E.2d 966, 968 (N.Y. 1937).

The illusory-transfer test, by contrast, was adopted by the New York Court of Appeals in *Newman v. Dore*.<sup>28</sup> The illusory-transfer test focuses on the substance of the transfer rather than the intent of the transferor to defeat a statutory survival statute.<sup>29</sup> In *Newman*, the court held that the only relevant inquiry is whether the transferor-spouse had "in good faith" divested ownership of the property to the transferee.<sup>30</sup> Intent is relevant only to the question of whether the transferor intended to fully divest ownership of the property to a third party, rather than to defraud the surviving spouse of a statutory share of the property.<sup>31</sup> Under the illusory-transfer test, a transferor has the right to transfer ownership of property as he sees fit as long as the transaction substantively accomplishes its intended purpose. A transaction that purports to transfer ownership but in reality allows the transferor to retain substantial ownership rights is said to be illusory. In *Staples v. King*,<sup>32</sup> the Supreme Judicial Court of Maine held that it would be irrational to allow a deceased spouse to defeat the surviving spouse's statutory share by executing trusts to deplete his estate while reserving the benefits of ownership in the trust property.<sup>33</sup>

#### ANALYSIS AND HOLDING

The Rhode Island Supreme Court considered the two prevalent tests, the fraudulent-intent test and the illusory-transfer test, used to evaluate inter-vivos transfers of property by a deceased spouse.<sup>34</sup> The court concluded that the illusory-transfer test should be used to determine whether an inter-vivos transfer of real property will defeat a surviving spouse's statutory share created by section 33-25-2.<sup>35</sup> The court found that the illusory-transfer test balances the policy interest of protecting the continuation of the surviving spouse's interest in the real property with the policy in-

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28. See *id.*; see also *Staples v. King*, 433 A.2d 407 (Me. 1981).

29. See *Pezza*, 690 A.2d at 348.

30. See *Newman*, 9 N.E.2d at 969.

31. See *id.* The requirement of "good faith" in this context "does not refer to the purpose to affect his wife but to the intent to divest himself of the ownership of the property." *Id.*

32. 433 A.2d 407 (Me. 1981).

33. See *id.* at 411.

34. See *Pezza*, 690 A.2d at 348-49.

35. See *id.* at 350.

terest of allowing an owner of real property to freely divest himself of ownership.<sup>36</sup> According to the court, the illusory-transfer test mandates that a conveyance of real property made by a spouse to a trust or other third party be "real, complete and not illusory."<sup>37</sup> When an inter-vivos transfer is made to a trust, the surviving spouse must prove by clear and satisfactory evidence that the deceased spouse did not finally and completely transfer all ownership interest and control over the trust property.<sup>38</sup>

The court applied the illusory-transfer test to the facts of this case and determined that Anthony's transfer of real property to the trust was real and complete when it became irrevocable on December 5, 1986.<sup>39</sup> The court noted that when Anthony first established the trust in 1983, he may not have had the present donative intent to totally divest himself of the real property. But at the time of his death, the trust was not illusory because he named his son successor trustee, and divested himself of the right to revoke the trust and the right to demand payment of the trust principal.<sup>40</sup> Consequently, the real property is not subject to a life estate in favor of Olga.<sup>41</sup>

#### CONCLUSION

In *Pezza*, the Rhode Island Supreme Court acknowledged that section 33-25-2 is a reflection of the policy considerations concerning protection of a surviving spouse's interests in real property owned exclusively by the deceased spouse at the time of death. In adopting the illusory-transfer test to determine if an inter-vivos transfer of real property will defeat a claim under section 33-25-2, the court took the position that a spouse with complete ownership of real property may transfer that ownership if the transfer is complete, real and not illusory at the time of the transferor's death. Therefore, the transaction is judged by its substance, not its form.

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36. *See id.* The court was careful to note that the interest created under section 33-25-2 is only an expectancy interest that vests when one spouse dies while owning real property in fee simple. Therefore, a spouse owning real property in fee simple can transfer his whole interest, in fee simple, to another without interfering in the surviving spouse's interest under section 33-25-2. *See id.* at 349.

37. *Id.* at 350.

38. *See Sleprow v. Robinson*, 324 A.2d 321, 325 (R.I. 1974).

39. *See Pezza*, 690 A.2d at 350.

40. *See id.*

41. *See id.*

Because the intent requirement is irrelevant, the illusory-transfer test evades the argument of a surviving spouse that a presumption of fraud arises whenever the deceased spouse has transferred a part of his estate during his lifetime without the surviving spouse's knowledge.

Karen M. Hagan