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# CERTAIN PROBLEMS CONFRONTING CREDITORS WHEN A REVOCABLE TRUST ACCOMPLISHES TESTAMENTARY SUCCESSION

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UNDER the overwhelming weight of authority the reservation by the settlor of the income from trust property, or of other benefits, during his lifetime, and of the power to revoke the trust and so recover all or any part of the principal does not invalidate the trust; nor does the trust fail because the trust instrument is not executed in accordance with the Statute of Wills.[1] Upon the death of the settlor the corpus of such a trust is distributable by the trustee in accordance with the terms of the trust instrument and does not pass to the executor or administrator of the settlor.[2]

Of course the rule is universal that all transfers of property made with intent to hinder, delay, or defraud creditors, whether present or future, are void as to such creditors whether the transfer is direct or made through a trustee.[3] But creditors who attack such a transfer are saddled with the onerous burden of proving the settlor's fraudulent intent and the remedy is therefore frequently unavailable, either because the settlor had no fraudulent intent at the time the trust was created, or because creditors are unable to establish their burden of proof.

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[1] Union Trust Co. v. Hawkins, 121 Ohio 159, 167 N. E. 389 (1929); Cramer v. Hartford-Connecticut Trust Co., 110 Conn. 22, 147 Atl. 139 (1929); 73 A. L. R. 309 (1931) and cases cited; 28 MICH. L. REV. 603 (1929); Leaphart, "The Trust as a Substitute for a Will," 78 U. PA. L. REV. 626 (1929); Scott, "Trusts and the Statute of Wills," 43 HARV. L. REV. 521 (1930).

[2] See note 1.

[3] 1 PERRY, TRUSTS AND TRUSTEES, 7th ed., sec's 149 and 165 (1929); 12 R. C. L. 473-474 (1916); 27 C. J. 503 *et seq.*, 521 *et seq.* (1922). See also statutory provisions of the various States.

Let us assume, therefore, that the settlor establishes a so-called "revocable living trust," reserving to himself the income for life, the right to withdraw all or any part of the principal during his lifetime, and the further right to revoke the trust and to change the beneficiaries of the ultimate gifts in remainder, at any time during his lifetime, and that such trust, not being revoked by the settlor during his lifetime is, upon his death, not voidable by his creditors either as a fraudulent conveyance or because it was not executed in accordance with the Statute of Wills. Let us further assume that the settlor's estate, in the hands of his executor or administrator, is insufficient to pay in full the claims against his estate, either because the estate would be exhausted by the payment of the federal estate tax (though the trust corpus itself constitutes nearly all of the taxable net estate) or, entirely apart from the question of taxation, because the estate is insolvent.

What is the position of creditors? The decedent accomplishes "that which for all practical purposes is a testamentary disposition of his property."[4] May he also accomplish what he could not accomplish by testamentary disposition? May he give his property to the remaindermen under the trust instrument so as to deprive his creditors of their right to be paid in full, as he could not do by will? Can any legalistic legerdemain enable him to cause his property — which he may fully enjoy during his lifetime by exercising his reserved rights and which, we shall see, could (at least in some jurisdictions) be reached by his creditors during his lifetime[5] — to disappear from the grasp of his creditors at the moment of his death? May he cause his creditors to bear the burden of the federal estate tax while the *cestuis que trust* take their gifts undiminished by the tax? May he cause his creditors to go unpaid while the *cestuis que trust* receive his property under the trust instrument? These questions can all be reduced to two, which will be taken up and discussed in turn.[6]

[4] Leaphart, "The Trust as a Substitute for a Will," 78 U. PA. L. REV. 626 at 638 (1929).

[5] Notes 50, 51, 53, 54 and 55, infra.

[6] The paucity of decisions involving these interesting and, particularly at the present time, important questions would almost lead one to think that decedents invariably leave estates, exclusive of trusts established by them, sufficiently large to pay in full both the federal estate tax and all creditors of the estate.

## I

### *Can the Settlor's Creditors be Required to Bear the Burden of the Federal Estate Tax, While Beneficiaries Under His "Revocable" Trust Take Their Gifts Undiminished by the Tax?*

In determining the amount of the federal estate tax the net estate is first determined by taking the gross estate which includes, among other things, the value at the time of the decedent's death of all property, real or personal, tangible or intangible, including any interest of which the decedent has made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death,[7] and then making certain deductions, including, among others, funeral and administration expenses and claims against the estate.[8] To the net estate, as so determined, is applied the proper tax percentage as scheduled in the statute.[9]

There can be no doubt, if the estate is solvent, that the executor or administrator is required to pay the entire estate tax even though the greater portion of the tax is paid on a trust corpus which will never come into his hands.[10] The serious question is whether he may safely pay the creditors when so doing will prevent him from being able to pay the estate tax in full. The Act expressly charges the executor or administrator with the payment of the tax.[11] And the Act contains no

[7] U. S. C., tit. 26, sec. 1094 (1928) (Act of June 2, 1924, 43 Stat. 304; Act of Feb. 26, 1926, 44 Stat. 70).

[8] U. S. C., tit. 26, sec. 1095 (1928) (Act of June 2, 1924, 43 Stat. 305; Act of Feb. 26, 1926, 44 Stat. 72; Act of May 29, 1928, 45 Stat. 862).

[9] U. S. C., tit. 26, sec. 1092 (1928) (Act of June 2, 1924, 43 Stat. 303; Act of Feb. 26, 1926, 44 Stat. 69).

[10] "Where deeds of trust, executed and delivered by a testator before his death, make no provision for the payment of succession or estate taxes, the entire burden of a federal estate tax, computed by taking the entire corpus of the trusts plus the estate passing by the will as a gross estate, must rest upon the residuary estate in the hands of the executors." Pratt v. Dean, 246 Mass. 300, 140 N. E. 924 (1923).

"The Federal estate tax is laid upon the transfer of the estate as a whole, and, primarily at least, is a charge upon the residue. Gifts in contemplation of death or to take effect upon death, though made by separate instruments, are for that purpose to be consolidated with those passing under the will, and the tax payable by the executor is to be computed according to the net value of the aggregate." In re Oakes, 248 N. Y. 280, 162 N. E. 79 (1928).

[11] "The tax imposed by this chapter shall be . . . paid by the executor to the collector." U. S. C., tit. 26, sec. 1097 (1928) (Act of June 2, 1924, 43 Stat. 308; Act of Feb. 26, 1926, 44 Stat. 74). Of course, "The term 'executor' means the executor

provision for discharging the executor from personal liability except upon payment of the amount of which he is notified under the provisions of the statute.[12] Moreover, the Act furnishes the Government with a cumulative remedy for its collection; the estate is subject to a lien,[13] and the collector is authorized to bring an action to subject the property of the decedent to sale for payment of the tax.[14] The Act further provides:[15]

> "If the tax or any part thereof is paid by, or collected out of that part of the estate passing to or in the possession of, any person other than the executor in his capacity as such, such person shall be entitled to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, *it being the purpose and intent of this chapter that so far as is practicable* and unless otherwise directed by the will of the decedent *the tax shall be paid out of the estate before its distribution.*" [16]

*Quaere,* is it "practicable" and within the express intent and purpose of the Act to require the executor or administrator to pay the portion of the tax imposed by reason of the estate including a trust corpus which never comes under his control, when such payment causes the estate in his hands to be insufficient to pay creditors?

A careful search has failed to reveal any decision in which the rights of creditors were actually involved. Many cases involved disputes be-

or administrator of the decedent. . . . " U. S. C., tit. 26, sec. 1091 (1928) (Act of June 2, 1924, 43 Stat. 303; Act of Feb. 26, 1926, 44 Stat. 69).

[12] U. S. C., tit. 26, sec. 1112 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79).

[13] U. S. C., tit. 26, sec. 1115 (1928) (Act of June 2, 1924, 43 Stat. 312; Act of Feb. 26, 1926, 44 Stat. 80; Act of May 29, 1928, 45 Stat. 876).

[14] U. S. C., tit. 26, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79). The statutes cited in this and the preceding note have, however, been held to pertain merely to the remedy for the collection of the tax, the Circuit Court of Appeals (Sixth Circuit) saying: "It is only when the estate proves insufficient for the purpose that resort may be had . . . to the personal responsibility of the transferee or to the property transferred, and even then a right of action over is given to the transferee." Shwab v. Doyle, (C. C. A. 6th, 1920) 269 Fed. 321 at 325. Reversed on other grounds, 258 U. S. 529, 42 Sup. Ct. 391, 66 L. ed. 747 (1922).

[15] U. S. C., tit. 26, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79).

[16] Italics the writer's.

tween the executor and the trustee, or between the legatees and the beneficiaries under the trust. The law seems well settled that as between the executor and the trustee, the executor must pay the entire tax; that as between the legatees and the beneficiaries under the trust, the trust estate need not reimburse the estate; and that as between the specific legatees and the residuary legatees, the residuum must bear the tax without right of reimbursement.[17] But in all of these cases it appeared that the estate was sufficient to pay the creditors *after* the federal tax was paid. In a decision of the New York Court of Appeals is to be found a dictum asserting the executor's duty to pay the tax before he pays creditors.[18] While in *Newton's Estate* a superior court of Pennsylvania expressed the contrary view:[19]

> "The tax, it is true, was made a lien upon all the property of the gross estate, without regard to any disposition of it that might be made by the will of a testator, but that was an administrative feature introduced for the purpose of making certain the payment. The provisions of section 208 make it the duty of the collector to collect the tax out of the property, and rendered any of the property liable to be sold, but it expressly provided that in case the tax is paid by or collected out of that part of the estate passing to or in possession of any person other than the executor in his capacity as such, such person should be entitled to reimbursement out of any part of the estate still undistributed. In case the estate has been distributed then the person paying, or out of whose property the tax has been collected, was given the right to enforce contribution by the persons 'whose interest in the estate of the de-

[17] Much litigation has also arisen relative to the effect of provisions of the will upon the ultimate burden of the tax. See 51 A. L. R. 454 (1927).

[18] The New York court held:

> "The statute explicitly directs that 'so far as practicable and unless otherwise directed by the will of the decedent, the tax shall be paid out of the estate before distribution.' It is practicable to adopt this method of payment in regard to that portion of the tax which is imposed because the net estate included property which the decedent transferred under a revocable deed of trust to take effect in possession or enjoyment at her death where she has left a residuary estate after the payment of all specific bequests more than sufficient to pay the entire tax, and, the will in suit not containing any direction as to payment of any tax on property which does not pass thereunder, it follows that the executor is bound to pay the entire Federal estates tax without right to reimbursement. . . . " (Syllabus.)
> Farmer's L. & T. Co. v. Winthrop, 238 N. Y. 488, 144 N. E. 769 (1924).

[19] 74 Pa. Super. Ct. 361. Decided July 14, 1920, and therefore prior to the enactment of the present Act; however, the language of the earlier statutes, which the court quoted and construed, was almost identical with the language contained in the present statutes.

cedent would have been reduced if the tax had been paid before the distribution of the estate,' 'or whose interest is subject to equal or prior liability for the payment of taxes, debts or other charges against the estate.' And then follows the explicit declaration of the intent that, 'unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before distribution.' There was here a clear recognition by the Congress that the tax imposed by the statute was not a tax upon each particular legacy; that there might, as between legatees, be different orders of liability for the burden imposed; that the interest of some of those who received might be subject to equal liability, while there might be a prior liability upon the part of others, and *the liability for the tax is by the statute assimilated to that for the payment of debts or other charges against the estate.* . . . It was clearly the intention of Congress that the tax *should be paid by the estate before distribution. . . . When the funeral expenses, costs of administration, claims against the estate, and such other charges as are allowed by the laws of the jurisdiction, have been paid, the tax imposed by this statute is an exaction by the sovereign, to be taken out of the net estate,* and the will, or in case of intestacy, the law of the jurisdiction, comes into operation upon what remains for distribution." [20]

The rule thus laid down in *Newton's Estate* would, of course, justify and require the executor or administrator to pay the funeral expenses, the costs of administration, and the creditors of the estate first, and then to pay the federal estate tax so far as the remaining estate in his hands was sufficient. The unpaid balance of the tax would be collectible by the collector from the trust estate under the cumulative remedies provided by the statutes.[21] The statement, however, was dictum, for creditors had been paid, and the case was merely a contest as to how the tax should be borne by legatees; no rights of creditors were involved. But there can be no question that such a rule is a just one. The creditors are paid and the Government has the ready means of collecting the unpaid balance of the tax. Furthermore, it is the rule applied without question where, as in *Newton's Estate,* the entire estate subject to taxation is in the executor's hands. In such case the taxable net estate is determined by deducting (among other things) the funeral and administration expenses and the claims against the estate; those expenses and claims are bound to be paid in full or there will be

[20] 74 Pa. Super. Ct. 361 at 371 *et seq.* (1920). Italics the writer's.
[21] Notes 13 and 14, supra.

no net estate to be taxed. And it makes no difference in effect whether those claims and expenses are paid before, or after, payment of the estate tax.

But this does not settle the matter. The question still remains whether the estate tax is not a "debt" due the United States within the meaning of the federal statutes, and as such entitled to be "first . . . satisfied." The pertinent sections provide:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied. . . . " [22]

And

> "Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid." [23]

The preference given to debts due the United States is clear. Is the estate tax on the entire net estate, a large portion of which does not come into the executor's or administrator's hands so as to enable him to pay creditors therefrom, a "debt" within the meaning of the above sections?

The answer to this question depends on the meaning of the word "distribution" in section 1114 of the Estate Tax Act.[24] This statute, as we have seen, declares the purpose and intent of the Act to be "that so far as is practicable . . . the tax shall be paid out of the estate before its distribution." Unfortunately, as the Supreme Court of Kentucky said in *Dinning v. Conn's Adm'r*:[25]

> "While the word 'distribution' is generally used to indicate a division among legatees, or heirs of the personal estate of a decedent, it is likewise often used as referring to the payment of the

[22] U. S. C., tit. 31, sec. 191 (1927); Rev. Stat., sec. 3466 (Act of Mar. 3, 1797, 1 Stat. 515; Act of Mar. 2, 1799, 1 Stat. 676).

[23] U. S. C., tit. 31, sec. 192 (1927); Rev. Stat., sec. 3467 (Act of Mar. 2, 1799, 1 Stat. 676).

[24] U. S. C., tit. 31, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79).

[25] 124 Ky. 623 at 627, 99 S. W. 914 (1907).

decedent's debts by the administrator. The expression 'distribution among creditors' is by no means uncommon in the law books."

If "distribution" here means the ultimate turning over of the estate to the legatees, devisees or heirs at law — distribution in the usual sense of the word — then all funeral and administration expenses and all creditors of the estate shall first be paid, and after such payment has been made the executor or administrator shall pay the estate tax before "distribution" is made to the legatees, devisees or heirs at law. Under such a construction of the word "distribution" it is obvious that the estate tax is not a "debt" for the payment of which the statutes give the Government a preference over creditors of the estate.

If, however, "distribution" here have its broader meaning — any payment whatsoever from the estate in the hands of the executor or administrator — then the executor or administrator must, under peril of being personally liable, pay the entire estate tax before any payment is made to creditors of the estate.

The court in deciding *Newton's Estate* gave "distribution" the usual and more restricted meaning of the word.[26] This interpretation is supported by that section of the Estate Tax Act which provides:[27]

> "If . . . the decedent makes a transfer, by trust or otherwise, of any property in contemplation of or intended to take effect in possession or enjoyment at or after his death (except in the case of a bona fide sale for an adequate and full consideration in money, or money's worth) . . . and if . . . the tax in respect thereto is not paid when due, then the transferee, trustee, or beneficiary shall be personally liable for such tax, and such property, to the extent of the decedent's interest therein at the time of such transfer . . . shall be subject to a like lien equal to the amount of such tax. Any part of such property sold by such transferee or trustee to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien and a like lien shall then attach to all the property of such transferee or trustee, except any part sold to a bona fide purchaser for an adequate and full consideration in money or money's worth."

It would appear from this section which furnishes the Government with a complete remedy for the collection of any part of the estate tax not paid by the executor or administrator that Congress intended "dis-

[26] 74 Pa. Super. Ct. 361 (1920).

[27] U. S. C., tit. 26, sec. 1115 (1928) (Act of June 2, 1924, 43 Stat. 312; Act of Feb. 26, 1926, 44 Stat. 80; Act of May 29, 1928, 45 Stat. 876).

tribution" in section 1114 of the Act [28] to have the usual but more restricted meaning; that it intended to provide first for payment of creditors by the executor or administrator and then to require, as a matter of convenience, payment by him of the estate tax, so far as the remaining estate is sufficient therefor, before making distribution to legatees, devisees or heirs at law. It scarcely seems reasonable that Congress could have intended that the executor or administrator be required to pay the entire estate tax when such payment would result in the estate in his hands being insufficient to pay the creditors. Such a construction of the Act seems harsh and shocking; the construction adopted in *Newton's Estate* seems clearly preferable,[29] particularly since the statute expressly gives the Government the means of collecting the tax from the trust corpus, and expressly makes the trustee and the beneficiaries personally liable for the payment of the tax.[30]

Some further light is shed on this problem of interpretation by *United States v. Cruikshank*.[31] In that case the executor filed a return and paid the amount of the estate tax shown by the return. An additional estate tax was thereafter determined to be due by reason of a deficiency in the return. The executor did not pay the deficiency, having previously paid the debts of the estate, administration expenses and executor's commission, and having turned over the entire net assets remaining in his hands to the trustee named in the will. The Government filed suit against the trustee alleging that the deficiency was a lien upon the assets in the trustee's possession and praying that unless the tax were paid the assets be applied in satisfaction thereof. By an amendment to the bill the Government made the executor a party, alleging that he was personally liable for the tax by reason of having paid debts owed by the decedent without satisfying the debt owed to the United States in disregard of R. S. 3467.[32]

[28] U. S. C., tit. 26, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79).

[29] 74 Pa. Super. Ct. 361 (1920).

[30] The requirement that the executor or administrator pay the estate tax is, of course, a convenient method for the Government to collect the tax; and the cases hold that the Government, at least as between the beneficiaries under the trust and the legatees, devisees or heirs at law, "is not concerned with who shall ultimately bear the burden of the tax." Edwards v. Slocum, (C. C. A. 2d, 1923) 287 Fed. 651. These provisions merely relate to the remedy for collection of the tax properly due; they do not determine what is properly due or that the tax is to be paid ahead of creditors. See also note 14, supra.

[31] (D. C. S. D. N. Y. 1931) 48 F. (2d) 352.

[32] U. S. C., tit. 31, sec. 192 (1927); Rev. Stat., sec. 3467 (Act of Mar. 2, 1799, 1 Stat. 676).

It is to be noted that the executor had made "distribution" of the estate in the usual and more restricted meaning of distribution. After paying the debts he failed to apply the balance on the tax payment and, instead, *turned it over to the person entitled thereto under the provisions of the will.*

Here, therefore, was a clear case of personal liability on the part of the executor. The court was not required to decide whether payment of the debts without "distribution" of the balance of the estate would result in the executor being personally liable for the tax. But the court cited R. S. 3467,[33] saying:

> "*As a general proposition*, it cannot be disputed that an executor *who distributes* an estate without payment of the estate tax becomes personally liable for the tax . . . "[34]

and held

> "There will be a decree for the relief prayed for by the United States. The decree will provide *that the tax, with interest and costs, be paid out of the estate assets in possession of the trustee*, in discharge of the tax lien, *and in default of such payment, by the defendant Cruikshank.*"[35]

So far as we can find, the *Cruikshank* case is the only decision holding the executor personally liable for an estate tax,[36] but the case is no authority for the proposition that the executor or administrator makes himself liable personally for the tax if he first pays creditors and then

[33] U. S. C., tit. 31, sec. 192 (1927); Rev. Stat., sec. 3467 (Act of Mar. 2, 1799, 1 Stat. 676).

[34] 48 F. (2d) 352 (1932); italics the writer's.

[35] 48 F. (2d) 352 (1932); italics the writer's.

[36] Loose language of the courts, with reference to the effect of Rev. Stat. 3467 in cases involving a federal estate tax but where the consideration of the effect of Rev. Stat. 3467 was not necessary for a determination of the issues to be decided, gives rise to the possibility that the executor or administrator in the instant situation would pay the creditors at his peril. That admittedly possible result does not bear the test of analysis. In Newton's Estate, 74 Pa. Super. Ct. 361 (1920), the court, though *obiter*, expressly stated that the executor or administrator is merely required to pay the estate tax *after the debts have first been paid in full.*

In Rodenbough v. United States, (C. C. A. 3d, 1928) 25 F. (2d) 13, it was held that the provision of the Act, discharging an executor from personal liability for any additional estate tax on payment of the amount assessed, did not bar an action against him *in his representative capacity* for such additional tax.

In Fleming v. Commissioner of Internal Revenue, 9 B. T. A. 419 (1927), where the executor paid the debts *and then turned over the balance of the estate to the decedent's devisees* without paying a deficiency tax claimed by the Commissioners by reason of the failure to include in the gross estate property claimed to have been transferred in contemplation of death, it was held that the devisees could not be substituted

has not assets of the estate sufficient to pay the tax. On the contrary in the *Cruikshank* case, where there was a clear case of personal liability on the part of the executor who failed to comply with the express purpose and intent of the Act, *the Court ordered the trustee to pay the amount of the tax out of the trust estate and only in default of such payment fixed a personal liability on the executor.*

The Act does not expressly provide that the executor or administrator shall, under peril of personal liability, pay the entire estate tax before he pays the creditors of the estate, where such payment of the tax would result in the inability to pay the creditors in full. The Act merely fixes a lien upon the trust corpus and makes the trustee and beneficiaries personally liable for the tax if not paid when due. The express purpose and intent of the Act is that "*so far as it is practicable* and unless otherwise directed by the will of the decedent *the tax shall be paid out of the estate before its distribution.*" [37] In order to support personal liability of the executor or administrator in the instant situation it must be held "practicable" for him to pay the tax in full, and leave creditors of the estate stranded; it must be held that the word "distribution" does not have its usual meaning — division among legatees, devisees or heirs at law — but has the broader meaning, including any payment to creditors. Such a construction of the Act is obviously a very liberal construction, favoring the Government at the expense of the taxpayer (the executor or administrator) and likewise at the expense of the creditors of the estate. Under the well-known canon of construction, revenue acts and taxing statutes are so construed as to resolve all doubts concerning their scope and meaning in favor of the citizen and taxpayer and against the Government.[38] It seems extremely unlikely that either the Estate Tax Act, R. S. 3466, or R. S. 3467 would, in a properly-presented case, be construed to make the executor or administrator personally liable for the tax if he paid all creditors of the estate and then paid so much of the estate tax as the assets remaining in his hands

for the executor, upon motion of the executor, by reason of Rev. Stat. 3467, but the matter was disposed of by holding that there was no deficiency.

In Neustadter v. Commissioner of Internal Revenue, 15 B. T. A. 839 (1929), it was held, where the Commissioner had determined a deficiency tax but had not determined that the executor was personally liable under the Act and under Rev. Stat. 3467, that the Board had jurisdiction to redetermine the deficiency, but had no jurisdiction to determine whether the executor had been released from personal liability.

[37] U. S. C., tit. 26, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79). Italics the writer's.

[38] First Trust & Savings Bank v. Smietanka, (C. C. A. 7th, 1920) 268 Fed. 230; Ebersole v. McGrath, (D. C. S. D. Ohio 1920) 271 Fed. 995; 36 Cyc. 1189 (1910).

enabled him to pay, before making any distribution to the legatees, devisees or heirs at law.

Furthermore, under the express provisions of the Act[39] the trustee and the beneficiaries under the trust are personally liable for the amount of the tax not paid by the executor or administrator when due, and the trust corpus is subjected to a lien for the amount of the unpaid tax. And while under section 1114[40] there is express provision, if all or part of the tax is paid from the trust corpus, for contribution from "the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts or other charges against the estate," there is, it should be noted, no statutory provision giving contribution from creditors whose claims are paid, with the result that the trust corpus becomes required to pay the tax. Rather, the creditors themselves (as will be shown in the latter part of this article)[41] should have a remedy in equity for reaching the trust corpus if their claims were unpaid as a result of the executor or administrator paying the entire tax and so exhausting the estate in his hands. It therefore follows that since the trust corpus is liable for the tax remaining unpaid by the executor or administrator, and the trustee and the beneficiaries are likewise personally liable therefor, no beneficiary is in a position to complain if the trustee pays from the trust corpus the portion of the tax which the executor or administrator, after paying the creditors of the estate in full, is unable to pay from the estate remaining in his hands.

Conceding, for the sake of the argument, that the executor or administrator is personally liable to the Government if he pays the creditors in full before paying the entire estate tax, the Government can make no claim against such executor or administrator after the tax has been paid from the trust corpus under the express provisions of section 1115.[42] Hence, even if our conclusion were wrong that the executor or administrator is under no personal liability to the Government, and even if a court in its zeal to insure the collection of the tax gave the Act the most liberal construction possible, still the executor or administrator

[39] U. S. C., tit. 26, sec. 1115 (1928) (Act of June 2, 1924, 43 Stat. 312; Act of Feb. 26, 1926, 44 Stat. 80; Act of May 29, 1928, 45 Stat. 876).

[40] U. S. C., tit. 26, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79).

[41] See part II of this article, infra.

[42] U. S. C., tit. 26, sec. 1115 (1928) (Act of June 2, 1924, 43 Stat. 312; Act of Feb. 26, 1926, 44 Stat. 80; Act of May 29, 1928, 45 Stat. 876).

would be discharged from such personal liability when the tax was paid by the trustee from the trust corpus. The beneficiaries could have no claim against the trustee for so doing, since the trustee merely discharged himself and the beneficiaries from personal liability and freed the trust corpus from the lien resulting by reason of section 1115.

Finally, what rights might the beneficiaries have against the executor or administrator? If we concede that the Government once had a right against such executor or administrator, that right, resulting from a very liberal construction of the Act, was merely to accomplish the payment of the tax and is obviously terminated by the payment of the tax from the trust corpus. That right was "not concerned with who shall ultimately bear the weight of the tax." [43] The beneficiaries, obviously, could not avail themselves, by any theory of subrogation, of this right (if we concede that the Government once had such a right) so as to compel the executor or administrator to bear the ultimate burden of the tax.[44]

The executor or administrator, then, should pay the creditors of the estate in full and thereafter should pay the federal estate tax in so far as the assets of the estate, remaining in his hands, are sufficient. The balance of the tax should be paid by the trustee from the trust corpus. And if the tax is fully paid in the manner suggested, it does not seem that either the executor or administrator, or the trustee, can be subjected to any personal liability whatsoever by reason of having so paid the estate tax.[45]

[43] Edwards v. Slocum, (C. C. A. 2d, 1923) 287 Fed. 651.

[44] U. S. C., tit. 26, sec. 1114 (1928) (Act of June 2, 1924, 43 Stat. 311; Act of Feb. 26, 1926, 44 Stat. 79). True, under section 1114 the beneficiaries could have reimbursement "out of any part of the estate still undistributed," and if the executor or administrator had distributed the estate the beneficiaries could have contribution from "the persons whose interest in the estate . . . would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate." But if the creditors are first paid and then the balance of the estate in the executor's or administrator's hands is applied on the estate tax, the statutes give the beneficiaries no right of reimbursement or contribution from the executor or administrator. Any such right would be utterly ridiculous by resulting in the executor or administrator being personally required to bear the ultimate burden of the tax because he paid the creditors, who if not paid by reason of the executor or administrator paying the entire tax from the assets of the estate, should certainly be entitled to recover the amount of their claims from the trust corpus. See part II of this article, infra.

[45] As a practical matter, however, the executor or administrator may not be able to prevail upon the trustee to cooperate in the payment of the estate tax. The trustee may hesitate to do so because the trust agreement contains no provision authorizing him to pay the estate tax. Moreover, the executor or administrator may, and properly so in the

Thus we come to a consideration of the second question within the scope of this article.

## II

### *Do the Beneficiaries Under His "Revocable" Trust Take Their Gifts Undiminished by the Claims of the Settlor's Creditors?*

If a strictly testamentary trust were involved there would be no room for the question here to be considered. Nor would there be any question if an attempted revocable trust were invalid upon the death of

absence of any decision in point and particularly since the courts have loosely suggested that Rev. Stat. 3466 and Rev. Stat. 3467 may apply so as to create a personal liability, be somewhat reluctant to pay the creditors. The executor or administrator may, and properly so, be fearful that the courts would apply the statutes against him and would hold, even in such a case, that "The United States demands payment of the estate tax from the executors, but is not concerned who shall ultimately bear the weight of the tax, which is a question for the state courts to settle" if the executor or administrator can not agree with the trustee. Edwards v. Slocum, (C. C. A. 2d, 1923) 287 Fed. 651.

Both executor and trustee may feel that they can only safely proceed under a proper order of the court. The state statutes frequently provide that the executor or administrator may bring an equitable action against the trustee, or may join with the trustee in an equitable action, to which all parties in interest — the creditors, the legatees, devisees or heirs at law, and the beneficiaries under the trust — should be made party, and thereby procure the direction of the court with respect to the manner in which the estate tax should be paid. The Ohio statute is typical:

> "Any fiduciary may maintain an action in the probate court or court of common pleas against the creditors, legatees, distributees or other parties, asking the direction or judgment of the court in any matter respecting the trust, estate or property to be administered, and the rights of the parties in interest, in the manner, and as fully, as formerly was entertained in courts of equity." Baldwin's Ohio Code Service (May, 1932), Supplementing Throckmorton's 1930 Annotated Code of Ohio, sec. 10504-66.

In Ohio, too, the creditors themselves could bring such an action.

> "After being requested in writing by a creditor, legatee, distributee or other party in interest, to bring such action, if any fiduciary fails for thirty days so to do, any creditor, legatee, distributee or other party making such request, may institute the suit." *Ibid.*, sec. 10504-67. See statutory provisions of other States.

But apparently such an action could be brought in equity, entirely apart from any such statutory provision.

> "Where several persons who are executors of a will also are trustees under a deed previously made by the testator, equity has jurisdiction of a bill in equity brought by all of them for instructions as to where the burden of a federal tax, assessed upon both the trust estate and the estate passing by the will and paid by the executors, should rest." Syllabus, Pratt v. Dean, 246 Mass. 300, 140 N. E. 924 (1923).
>
> "A trustee in doubt as to his powers, has the right to apply to a court of equity to define them, and give judicial sanction to his acts. . . . " Syllabus 10, Wiswell v. First Congregational Church, 14 Ohio St. 31 (1862).

Of course, if the executor or administrator first pay the estate tax and thereby exhaust the estate to such an extent that the creditors can not be paid in full, the situation

the settlor and the trust corpus therefore passed to the executor or administrator of the deceased settlor and not under the provisions of the trust instrument.[46] The trust corpus, administered as a part of the decedent's estate under the supervision of the probate court, would, of course, be subjected to payment of the decedent's creditors before any

is no different from that existing, entirely apart from any question of taxation, if the estate in the hands of the executor or administrator is insolvent, while the corpus of the trust is sufficient to pay the creditors.

[46] It is interesting to note that the original opinion of the Supreme Court of Ohio in the case of Union Trust Co. v. Hawkins, decided in an unreported opinion, which affirmed the decision of the Court of Appeals of Cuyahoga County (reported in 161 N. E. 548), held in effect that a revocable trust was invalid. However, the court reversed itself upon rehearing and held the trust valid. Union Trust Co. v. Hawkins, 121 Ohio St. 159, 167 N. E. 389 (decided June 19, 1929). It held that the trust estate did not pass to the settlor's personal representative upon the settlor's death but was distributed under the provisions of the trust instrument. The court declared "such instrument is testamentary in character" and "not executed in conformity with the law of wills"; that the trust instrument would be invalid in the absence of statute but that the Ohio statute expressly authorized trusts of this character (see note 55, infra).

As to the court's statement that the trust instrument was "invalid in the absence of statute" the editor of a note in A. L. R. properly says:

> "The discussion by the court on this point does not seem to have been necessary to a proper disposition of the case, since, as held by the court, there was a statute expressly authorizing such trusts; and it will be noted that three of the judges concurring in the result on the strength of this statute did not concur in that part of the opinion referred to above." 73 A. L. R., p. 214, note 209 (1931).

Professor Scott also criticizes the case as follows:

> "The Supreme Court of Ohio has recently expressed a strong feeling against the validity of such trusts. . . . The court first held in an unpublished opinion that the trust was testamentary and was invalid, partly because the agreement provided that the trust should terminate on the death of the settlor, partly because of the reservation by the settlor of power to control investments and of the provision with respect to the payment of taxes, in addition to the retention of the life interest in the settlor and the power of revocation. The court expressed a fear that if revocable trusts were upheld they would be employed as a substitute for wills, in order to avoid the jurisdiction of the probate courts. Upon rehearing, however, the court upheld the trust, basing its decision upon a statute which provided that the creator of a trust might reserve power to amend or revoke it without invalidating the trust. The court still insisted, however, that apart from the statute the reservation of a power of revocation would make the trust testamentary. It seemed to consider that a revocable trust is something new in equity jurisprudence. In fact, it has long been common both in England and in the United States to reserve a power of revocation; indeed, in some states it has been held that the absence of such power is presumptively due to a mistake. It is true that in recent years it has become increasingly common to create trusts *inter vivos* with a reserved power of revocation, since the trust companies by extensive advertising have popularized such trusts and given them the familiar name of 'living trusts.' No other court, however, has expressed the view that the mere reservation of a power of revocation invalidates the trust." Scott, "Trusts and the Statute of Wills," 43 HARV. L. REV. 521 at 533 (1930).

distribution could be made to the legatees, devisees or heirs at law. But there is a question as to the position of creditors when the revocable trust is valid and the trust corpus is to be administered by a trustee and not by the settlor's personal representative. This question it will be most convenient to consider with respect to two points of time: first, as to the situation during the settlor's life, and second, as to the situation after his death.

*1. During the Settlor's Life*

Even while the settlor is still living and may obtain the trust corpus by exercising his power of revocation, very respectable authority holds that, except if the trust was created to defraud creditors, subsequent creditors of the settlor can not reach the trust corpus. Perry says:[47]

> "A creditor of the settlor who has settled property in trust for his own benefit as to the income with power of appointment as to principal, cannot reach the corpus of the trust property in default of an appointment provided, provided of course the settlement was not made to defraud creditors. Although the exercise of the general power of appointment may make the corpus liable for the payment of the appointer's debts, it is not liable in default of appointment and the creditors cannot compel its exercise."

*Jones v. Clifton*,[48] decided by the United States Supreme Court in 1879, supports this view. A settlor placed property in trust with power to revoke the trust or to change beneficiaries. Thereafter he was caught in the panic of 1873 and, being unable to pay his subsequent creditors, went into bankruptcy. The Court held:

> "The title to the land and policies passed by the deed; a power only was reserved. That power is not an interest in the property which can be transferred to another, or sold on execution, or devised by will. The grantor could, indeed, exercise the power either by deed or will, but he could not vest the power in any other person to be thus executed. Nor is the power a chose in action. It did not, therefore, in our judgment, constitute assets of the bankrupt which passed to his assignee."

The Supreme Court of Kentucky has likewise held:[49]

> "Where a father conveyed real estate to another in trust for his daughter, reserving 'full power to revoke each or any or some

[47] 1 PERRY, TRUSTS AND TRUSTEES, 7th ed., sec. 386 at p. 654 (1929), and cases cited.

[48] 101 U. S. 225, 25 L. ed. 908 (1880).

[49] Syllabus 2, Hill v. Cornwall & Bro's Assignee, 95 Ky. 512 (1894).

or all of the uses hereby created and to cause them to shift to other person or persons, including himself,' the title passed to the grantee, subject to the power reserved by the grantor to change the use; and the grantor having made a general assignment for the benefit of his creditors without revoking the grant or changing the use, the right to do so did not pass to the assignee. Such a power of revocation is not an interest in the property that can be subjected by the grantor's creditors."

Logically, the rule so announced is unassailable if the proposition be granted that the grantor has no interest in the property. If so, the case becomes one like the case of an absolute gift to beneficiaries. The creditors could not have reached the property if the settlor, under the same circumstances, had made an absolute gift to the beneficiaries, and it is difficult to see how the creditors can reach the vested remainder of the beneficiaries under the trust merely because that remainder is subject to being divested by the settlor exercising the power of revocation.

But this is only one view of the matter. Other courts in the exercise of equity jurisdiction have held that "it is contrary to sound public policy to permit a person to have the absolute and uncontrolled ownership of property for his own purposes, and to be able at the same time to keep it from his honest creditors." [50]

The Supreme Court of Pennsylvania held in *Nolan v. Nolan*:[51]

"We do not doubt that a settlor may, as against everybody, except creditors, make a voluntary conveyance of his property in trust for such lawful purposes and uses as to him may seem proper, reserving to himself the income during life, and providing in the deed that he shall have the right to exercise the appointment of beneficiaries by will, and when such a trust is recognized and acted upon during the life of the settlor and the power of appointment is exercised by will, the beneficiaries take the estate according to its terms, for the reason that it has been acted upon and carried out according to the intention of the settlor, and this is true even if the power of revocation is expressly reserved in the deed, but has not been exercised by the settlor in his lifetime. Such a conveyance would be valid as between the parties, even if the enjoyment of the estate by the beneficiaries is postponed until after the death of the settlor. A very different question arises, however, when the rights of creditors intervene. As against existing creditors such a conveyance would be fraudulent, and in order to make it valid as to

[50] Hallett v. Thompson, 5 Paige (N. Y.) 583 at 585 (1836).
[51] 218 Pa. 135 at 138, 67 Atl. 52, 12 L. R. A. (N. S.) 369 (1907).

subsequent creditors, it must appear that the settlor has divested himself of all rights of ownership in, and control over, the property thus conveyed, reserving only to himself the right to receive the income during life, and it must also appear that no other act on his part is required to be done to complete the title in, or make a transfer of the ownership to, the beneficiaries who are entitled to take the same under the terms and conditions of the conveyance. . . . *It is against public policy, and not consonant with natural justice and fair dealing, as between debtor and creditor, that a settlor should be permitted to play fast and loose with his property, in such a manner as to have the use of the income during life and the right of disposing of the principal by will at any subsequent time he chooses to exercise the power, thus giving him all of the substantial benefits arising from the ownership thereof while he has safely put his property beyond the reach of creditors.*" [52]

The New York Court of Appeals said, in *Ullman v. Cameron*,[53]

"... as to my creditors, property is mine which becomes mine for the asking, and no words can make an instrument strong enough to hold it for me and keep it from them." [54]

[52] Italics the writer's.

[53] 186 N. Y. 339 at 346, 78 N. E. 1074 at 1076 (1906). See also the New York statute treating certain beneficial powers as "property" in respect to the rights of creditors. Cahill's N. Y. Consol. Laws 1930, ch. 51, sec's 149, 150.

[54] See also Brinton v. Hook, 3 Md. Ch. 477 (1850); Scott v. Keane, 87 Md. 709, 40 Atl. 1070, 42 L. R. A. 359 (1898), discussed in 12 HARV. L. REV. 283 (1898); In re Holbrook's Estate, 213 Pa. 93, 62 Atl. 368, 2 L. R. A. (N. S.) 545 (1905); Hutchinson v. Maxwell, 100 Va. 169, 40 S. E. 655, 57 L. R. A. 384 (1902).

This desire of equity to protect creditors of the settlor though at the expense of remaindermen was carried to its extreme in McColgan v. Magee, 172 Cal. 182, 155 Pac. 995 (1916). There the settlor placed property in trust, reserving the income to himself for life with gift over to his wife. *He reserved no right of revocation*, nor the right to change beneficiaries; in fact the trust agreement expressly provided that the settlor's interest was inalienable and exempt from the claims of creditors. A subsequent judgment creditor levied on the property in the hands of the trustee and brought an action to compel the trustee to deliver the property to the creditor. The Supreme Court of California held that the settlor's interest in the income from the trust estate was subject to the claims of creditors, but further held that the trust was of no effect, that the trust corpus remained the property of the settlor and was subject to the claims of creditors to the same extent as any other property:

"The doctrine that one can not by any device make his own property free from the claims of his own creditors is based not upon technical grounds, but upon sound reasons of public policy. . . . *The doctrine we are enforcing does not depend upon fraudulent intent.* The liability of the property to the claims of creditors comes from the fact that the disposition was ineffectual so far as it attempted to exempt the property from liability for his debts and because, as to creditors, it remained his own property, so far as his creditors are concerned, and not because of any intent to

In short, as regards the trust interests of the various parties *prior* to the death of the settlor, there are as we see two diverging lines of opinion. The divergence turns on the nature of the interest which the settlor retains during his lifetime. One view is that he has a mere power of revocation which can not be appropriated by creditors. The other view is that the settled estate remains substantially his, and he should not as regards creditors be permitted to "play fast and loose with his property." Each view is tenable and consistent if we grant its initial assumption as to the nature of the settlor's interest. But which of these assumptions is to be preferred? The choice between them must depend ultimately on considerations of policy. And on this basis that view which treats the settlor as substantially the owner during his lifetime is decidedly preferable; it is more nearly in accord with actual facts, and with ordinary equity principles.[55]

defraud in the creation of the trust." 172 Cal. 182 at 188-190. Italics the writer's.

Here, since there was no intent to defraud creditors, the settlor could have given the property away, yet the Court in its zeal to protect his creditors held that the irrevocable gift in trust to the remainderman after the settlor's life estate *was void at the instance of creditors.*

[55] Cf. Simes, "The Devolution of Title to Appointed Property," 22 ILL. L. REV. 480 at 504-508 (1928).

In Ohio the statutes expressly confer on creditors the right, at least during the settlor's life, of reaching the trust corpus which he could obtain by exercising his reserved right of revocation:

> "All deeds of gifts and conveyance of real or personal property made in trust for the exclusive use of the person or persons making the same shall be void and of no effect, but the creator of a trust may reserve to himself any use or power, beneficial or in trust, which he might lawfully grant to another, including the power to alter, amend or revoke such trust, and such trust shall be valid as to all persons, except that any beneficial interest reserved to such creator shall be subject to be reached by the creditors of such creator, and except that where the creator of such trust reserves to himself for his own benefit a power of revocation, a court of equity, at the suit of any creditor or creditors of the creator, may compel the exercise of such power of revocation so reserved, to the same extent and under the same conditions that such creator could have exercised the same." THROCKMORTON'S ANNOTATED CODE OF OHIO (1930), sec. 8617.

*It is to be noted that the statute makes no reference to the situation after death of the settlor,* yet this is the statute upon which the court expressly based its decision in Union Trust Co. v. Hawkins, 121 Ohio St. 159, 167 N. E. 389, decided June 19, 1929. For further discussion of this case see note 46 and text thereto. *Quaere,* would the court, which held that this statute caused the trust to be valid after the settlor's death as against his administrator, also construe the statute so as to give his creditors after his death the rights expressly given during his lifetime?

### 2. *After the Settlor's Death*

Under the conception of *Jones v. Clifton*[56] the power of revocation reserved to the settlor is personal and ceases to exist on his death. The vested rights of the remaindermen under the gift over can not thereafter be divested by the happening of the condition subsequent — the exercise of the power of revocation. Since the condition subsequent has not happened during the life of the only one entitled to cause it to happen, technically the vested rights of the remaindermen can not be disturbed.

And even in California, where at the instance of creditors an *irrevocable trust* was declared ineffective,[57] it has been held in accordance with the great weight of authority, in an action between the administrator and the remainderman,

> "The reservation of the power to revoke did not operate to destroy, or in anywise restrict the effect of the deed as a present conveyance of a future vested interest. It merely afforded the means whereby such vested future estate could be defeated and divested before it ripened into an estate in possession." [58]

In line with this conception of the settlor's interest — to wit, as a power to revoke during his lifetime — it may be argued that equity can do nothing for creditors after the settlor is dead; equity can reach the trust corpus for creditors while the settlor lives and while equity has jurisdiction over the person who has power to retake the trust corpus by revoking; but equity can not compel the exercise of the power after the settlor is dead and the power has ceased to exist. But this argument, like that already referred to, is only valid if one grant the assumption that the settlor retains an interest which is nothing more than a personal power of revocation. If we look to the substance of the matter and see that the settlor retains, during his lifetime, all the control of an owner we are bound to reach a different result. His power of disposal is no different from that of any owner; the powers of owner and settlor are complete during life,[59] and the powers of both

[56] 101 U. S. 225, 25 L. ed. 908 (1788).

[57] McColgan v. Magee, 172 Cal. 182, 155 Pac. 995 (1916). See note 54, supra.

[58] Tennant v. John Tennant Memorial Home, 167 Cal. 570 at 578, 140 Pac. 242 (1914).

[59] Even the non-exercise of the power of revocation may be said to have caused the property to go indefeasibly to the remaindermen; in any case it can be regarded as an exercise of control by the settlor over the property. Cf. Simes, "The Devolution of Title to Appointed Property," 22 ILL. L. REV. 480 at 504-508 (1928).

terminate at death. The court of equity does not have to rely on the settlor's power to revoke in order to give relief to creditors. The court acts in the exercise of *its own powers*. Thus, for example, equity sets aside fraudulent conveyances, even though the defrauding debtor has no power to have them set aside. So here the court of equity should find no difficulty, if sound policy requires, in setting aside the trust *pro tanto*, or perhaps preferably in holding the trust corpus charged with the payment of debts. The charge for debts depends on the fiat of justice, not on the wish of the settlor or on his exercise or non-exercise of the power to revoke. The confusion here comes from the fact that the settlor's *continuing interest* in the property may be called a power of revocation. But the name should not blind the chancellor to the nature of the settlor's interest. If, as a matter of policy, it is sound to say that a settlor of property can not in this way "play fast and loose with his property"; if, as a matter of policy, it is sound to say that the settlor has more than a mere power to revoke and remains substantially the owner of the settled property, then there is no difficulty, practically or theoretically, in the court's exercising *its* power to appropriate his interest to the satisfaction of his debt.

There are, apparently, only two decisions involving the rights of creditors where the settlor of a revocable trust has died, leaving an estate insufficient to pay his creditors. These decisions were made in cases from Massachusetts and Oregon.

In the Massachusetts case, *Roche v. Brickley*,[60] the settlor set up a revocable trust, reserving the right to receive the income and the power to change the disposition of the corpus. The trust "was of part only of her property, was made at a time when she owed no debts, and was not intended to hinder, delay or defraud her creditors."[61] When the settlor died she left no property, except the trust estate, and her administrator had no funds with which to pay the funeral and administration expenses. There was in addition a creditor who claimed that the decedent was indebted to her in a small amount. The administrator brought suit to recover the trust corpus, asking the court to rule:

> "If the deceased died leaving no property other than that transferred by the trust agreement, but leaving debts which were a charge against her estate, no provision being made in said agree-

[60] 254 Mass. 584, 150 N. E. 866. Decided Feb. 25, 1926.
[61] The court below so found in its findings of fact.

ment for the payment of the same, the trust agreement is voidable by the administrator of her estate";

and,

"If the court finds that the trust agreement was revocable at the will of the deceased and that deceased allowed the said agreement to stand, knowing that she left debts and no assets to pay said debts other than those transferred by said trust agreement, the said agreement was in fraud of her creditors and voidable by the administrator of her estate."

The Supreme Judicial Court of Massachusetts affirmed the lower court's refusal to so rule, and held that the trust was valid and that the administrator could not recover, though the trust "had some aspects of a testamentary character." [62] The Court, however, said that the intestate never became indebted to the creditor since the creditor had agreed to look to a policy of insurance on the decedent's life for payment. This fact lessens to that extent the effect of the decision; however, the funeral and administration expenses were certainly debts of the estate.

Some explanation of the decision may result from the further fact that the decedent's husband had himself appointed administrator and obviously brought the action to recover the entire balance of the trust for himself, although the Court expressly found that the settlor had intended to place her property "in such a way that her husband would not share in its distribution upon her death." In addition the husband was the beneficiary of the policy "and had refused to assent to any change of beneficiary." It may therefore be that even the Supreme Judicial Court of Massachusetts furnished here an example of the well-known adage: "Hard cases make bad law." [63]

The other and more recent case in point is *Coston v. Portland Trust Company*, decided by the Supreme Court of Oregon.[64] In this case

[62] As stated in the syllabus.

[63] The case is criticized by C. W. Leaphart in "The Trust as a Substitute for a Will," 78 U. PA. L. REV. 626 (1929), the author saying:

"While such a trust should not be condemned as testamentary, it does not follow that the creator of the trust may accomplish all that he sets out to do. For example, trusts which effect testamentary results do not thereby escape the Federal Estate Tax. . . . Certainly he should not be able to use it to defraud creditors. Query whether the creditors should not have been allowed to get at the property in *Roche v. Brickley*, where the settlor created a trust with all the necessary strings for pulling the property back for her own enjoyment, and where at her death nothing was left for her creditors."

[64] Decided May 28, 1929, 131 Or. 71, 278 Pac. 586; petition for rehearing denied on Nov. 19, 1929, 131 Or. 77, 282 Pac. 442.

the settlor conveyed property by absolute deed to a grantee who was trustee under a trust agreement. The trust agreement reserved to the settlor the full right to manage and control the property and receive the income therefrom during her life, with full right of revocation; and provided for various gifts over after her death. She died leaving a will in which she, in effect, devised the property held under the trust to the same persons who were remaindermen under the gifts over in the trust agreement. Her executor brought an action against the trustee seeking to set aside the trust and alleging that it was fraudulent as to creditors. The beneficiaries under the trust contended that the indebtedness of the decedent was incurred after the trust deed was executed and therefore could not be collected from the property conveyed by the trust. The Court held:

> "The decree of the court below is affirmed in so far as it holds the trust instrument void as to creditors subsequent to as well as existing at the time said instrument was executed."

It is obvious from a reading of the opinion that the court decided that the trust estate should be subjected to payment of the decedent's debts, and after reaching its decision cast about for reasons to support the decision. The reasons assigned were:

(1) That only a passive trust was created by the trust agreement, citing 2 Perry, Trusts and Trustees, 6th ed., sec. 815a. As to this reason, it should be noted that Perry was referring in the passage cited to the simple case of passive trust where the settlor makes a conveyance in trust for himself, while in the instant case the settlor has also created interests in others and the creditors are setting up claims not only against the settlor but in derogation of the interests of remaindermen. The reason as stated assumes the very point in issue, *viz.*, whether the settlor has or has not retained the entire beneficial interest for himself.

(2) That the trust agreement was not recorded, and, since no change in possession or management had taken place, the trust was constructively fraudulent as to creditors. As to this, no statute required the trust agreement to be recorded and certainly the creditors were not prejudiced from failure to record the agreement. The records disclosed absolute title in the grantee; creditors surely would have been more likely to have advanced credit if the agreement had been recorded, for they would at least have had record notice that the settlor had some interest in the property; and

(3) That the trust was testamentary and therefore void because the right of revocation and the right to manage and control the prop-

erty was reserved during the settlor's life. As to this reason, it has already been pointed out above that under the great weight of authority such a trust is not void, though it be "testamentary in character." [65]

After the decision the Trust Companies' Association of Oregon as *amicus curiae* presented a petition for rehearing. Rehearing was denied, the court delivering an opinion[66] which relied upon two additional reasons:

(1) That the trust agreement was void under a statute voiding "all deeds of gift and conveyances, as well as all transfers or assignments, verbal or written, of goods and chattels, or things in action, made in trust *for the person making the same*[67] as against the creditors, existing or subsequent, of such person." As to this reason it may be urged that the statute did not help, for the creditors were not trying to avoid the trust as against the settlor but as against the remaindermen. But in favor of the court's view it may be said: the language of the provision makes "all deeds . . . and conveyances" void as against creditors; it applies to *all instruments* creating trusts in favor of a settlor, and qualifies the effect thereof; it makes all such conveyances, and the interests created thereby, junior to the claims of the settlor's creditors.

(2) That the will revoked the trust agreement. As to this the will did not state that the trust was revoked thereby; the agreement expressly provided how the trust might be revoked, and there was no revocation in accordance with the provision.

In this Oregon case it should be noted that, by a coincidence, the remaindermen under the trust were also the devisees under the will. Therefore the court was not faced with the problem confronting the Massachusetts court in *Roche v. Brickley*[68] where if the trust were void *in toto* the remainderman would not take the property, but it would pass to the heir at law. In the Oregon case the same result was reached as though the court had held that the executor could recover

[65] Union Trust Co. v. Hawkins, 121 Ohio St. 159, 167 N. E. 389 (1929); Cramer v. Hartford-Connecticut Trust Co., 110 Conn. 22, 147 Atl. 139 (1929); 73 A. L. R. 209 (1931) and cases cited; 28 MICH. L. REV. 603 (1929); Leaphart, "The Trust as a Substitute for a Will," 78 U. PA. L. REV. 626 (1929); Scott, "Trusts and the Statute of Wills," 43 HARV. L. REV. 521 (1930).

[66] Coston v. Portland Trust Co., 131 Or. 71, 278 Pac. 586, rehearing denied, 131 Or. 77, 282 Pac. 442 (1929). It is interesting, too, to note that of the judges who constituted the court, one judge did not participate, one concurred in the result, and two joined in a lengthy dissenting opinion to the effect that "our previous decision was in error."

[67] Italics the writer's.

[68] 254 Mass. 584, 150 N. E. 866. Decided Feb. 25, 1926.

from the trust estate so much, and only so much, as was necessary to pay creditors. Under such a holding the balance of the trust estate would pass to the beneficiaries under the trust — under the Oregon decision the same balance passed under the will to the identical persons.

In the opinion on the rehearing[69] the Oregon court said:

> "Petitioners for rehearing seem to overlook the expression in the former opinion that the arrangement between the trustor and trustee is valid as between them, but invalid as to creditors.
>
> "As the case stands here, it is a contest between Coston as administrator, and . . . beneficiaries of the alleged trust. In other words, *shall the beneficiaries of the trust agreement be preferred to the creditors of the trustor?*" [70]

In using this language the Oregon court was, the writer believes, upon the threshold of the doorway that leads to the solution of this interesting problem. That doorway runs between the strict and technical view, discussed above, that since equity has no jurisdiction over the settlor, by reason of his death, so as to compel the exercise of his power of revocation, his creditors can have no relief, and the view, also discussed above, that the revocable trust is void at the instance of creditors though the vested rights of remaindermen are thereby destroyed and the balance of the trust estate passes under the will or under the laws of intestate succession and not under the provisions of the trust instrument.

The doorway is open and invites a court, in a properly presented case, to hold that the executor or administrator on behalf of the creditors, or the creditors themselves, can recover, upon broad equitable principles and sound public policy, such portion of the trust estate as may be necessary to pay in full the claims proved against the estate and remaining unpaid when the estate has been exhausted. There is no reason to destroy the ultimate vested interests of the remaindermen in order to give the creditors equitable relief. There is no necessity for a court, as did the Oregon court, to grope for reasons upon which to declare such a trust void. Under no circumstances should the court declare the trust totally void. The balance of the trust estate should pass under the provisions of the trust agreement, and if any property in excess of the unpaid claims of creditors be taken from the trust estate, such excess or the proceeds thereof should be returned to the trustee for the benefit of the remaindermen.

[69] 131 Or. 77, 282 Pac. 442 (1929).
[70] Italics the writer's.