TRUSTS IN DIVORCE: PROBLEMS AND SOLUTIONS

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Chapter 3

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by

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I. INTRODUCTION. This Article distinguishes express trusts from resulting, and constructive trusts. It identifies the commonly-used estate planning trusts. It discusses the requirements for creating an express trust under Texas law. The Article analyzes consensual modification or termination of trusts in a Texas divorce, and lays out the procedural and substantive law issues that can arise with contested litigation over trusts. The Article ends with a discussion of marital property issues relating to express trusts.

II. GIFT. Since most trusts are funded by gift, we consider the legal issues surrounding making of a gift as our first topic. A gift is a transfer of property made voluntarily and gratuitously. *Hilley v. Hilley*, 342 S.W.2d 565, 568 (Tex. 1961).A gift requires:1) an intent to make a gift; 2) delivery of the property; and 3) acceptance of the property. *See* State Bar of Texas Pattern Jury Charges PJC 202.3 (Family & Probate 2020). *See Grimsley v. Grimsley*, 632 S.W.2d 174, 177 (Tex. App.--Corpus Christi 1982, no writ).The burden of proving a gift is on the party claiming the gift. *Woodworth v. Cortez*, 660 S.W.2d 561, 564 (Tex. App.--San Antonio 1983, writ ref'd n.r.e.). If the claim of gift relates to property acquired by a spouse during marriage, the burden of proving separate property by gift is clear and convincing evidence. Tex. Fam. Code § 3.03(b). If the gift is to a trustee to hold the property in trust for a spouse, the property is not owned by the spouse, and is neither separate nor community property. While there is no case on point, it seems that the burden of proof that property is trust property is a preponderance of the evidence.

A. LACK OF CONSIDERATION. Lack of consideration is an essential characteristic of a gift; an exchange of consideration precludes gift. *Pemelton v. Pemelton*, 809 S.W.2d 642, 647 (Tex. App.--Corpus Christi 1991), *rev'd on other grounds sub nom. Heggen v. Pemelton*, 836 S.W.2d 145 (Tex. 1992); *Kunkel v. Kunkel*, 515 S.W.2d 941 (Tex. Civ. App.--Amarillo 1974, writ ref'd n.r.e.). "Gift" and "onerous consideration" are exact antitheses and a recital of onerous consideration "negatives the idea of a gift." *Pemelton*, 809 S.W.2d at 647; *Ellebracht v. Ellebracht*, 735 S.W.2d 658, 659 (Tex. App.--Austin 1987, no writ); *Kitchens v. Kitchens*, 372 S.W.2d 249, 255 (Tex. Civ. App.--Waco 1963, writ dism'd). An exchange of consideration precludes a gift. *Williams v. McKnight*, 402 S.W.2d 505, 508 (Tex. 1966). *See Saldana v. Saldana*, 791 S.W.2d 316, 319 (Tex. App.--Corpus Christi 1990, no writ) (wife's testimony that she paid $ 10.00 to husband's mother in exchange for real estate was sufficient to support the trial court's finding that the property was community property and not a gift).

B. DONATIVE INTENT. Another essential factor in establishing a gift is the donative intent of the grantor at the time of the conveyance. *Ellebracht*, 735 S.W.2d at 659. In *Scott v. Scott*, 805 S.W.2d 835, 839-40 (Tex. App.--Waco 1991, writ denied), the jury found that the wife did not make a gift of money to the husband, even though she put a $ 100,000 certificate of deposit in his name alone. A gift cannot occur without the intent to make a gift. *Campbell v. Campbell*, 587 S.W.2d 513,

514 (Tex. Civ. App.--Dallas 1979, no writ). In *Scott*, the wife testified she had no donative intent, the jury believed her, and the appellate court affirmed. *See Haile v. Holtzclaw*, 414 S.W.2d 916, 927 (Tex. 1967) (it was proper to find gift based on circumstances, despite the transferor's testimony of no donative intent.)

C. TRANSFER FROM PARENT TO CHILD IS PRESUMPTIVELY A GIFT. A conveyance of property from parent to child is presumed to be a gift, but the presumption is rebuttable by evidence showing the facts and circumstances surrounding the deed's execution in addition to the deed's recitations.*Woodworth v. Cortez*, 660 S.W.2d 561, 564 (Tex. App.--San Antonio 1983, writ ref'd n.r.e.). The burden of proof to overcome this presumption of gift is clear and convincing evidence. *Bogart v. Somer*, 762 S.W.2d 577 (Tex. 1988) (involving transfer to son-in-law). No case was found that applied this presumption to a transfer to a trustee for the benefit of a child.

D. GIFT TO BOTH SPOUSES. A gift made by a third party to both spouses leaves the spouses owning the gifted asset in equal undivided one-half separate property interests. *Roosth v. Roosth*, 889 S.W.2d 445, 457 (Tex. App.--Houston [14th Dist.] 1994, writ denied) (engagement gifts and wedding gifts to both spouses were one-half the separate property of each); *Kamel v. Kamel*, 721 S.W.2d 450, 452 (Tex. App.--Tyler 1986, no writ) (where husband's father made payments on a liability owed by both spouses, the payments were a gift one-half to each spouse).

E. GIFT BETWEEN SPOUSES. A spouse can make a gift of community property to the other spouse. *See Pankhurst v. Weitinger & Tucker*, 850 S.W.2d 726, 730 (Tex. App.--Corpus Christi 1993, writ denied) (husband gave one-half of his community property interest in a cause of action to wife, to hold as her separate property).When one spouse makes a gift of property to the other spouse, the gift is presumed to include all the income or property which arises from the property given.TEX. CONST. art XVI, § 15; TEX. FAM. CODE § 3.005.

F. GIFT OF COMMUNITY PROPERTY TO THIRD PERSONS. Community property is under the sole management of the husband, or the sole management of the wife, or the joint management of both spouses. Tex. Fam. Code § 3.102. A spouse who has management authority over a community property asset can give it away. However, Texas law recognizes a fiduciary duty running between spouses as to management of the community estate. *E.g.*, *Knight v. Knight*, 301 S.W.3d 723, 731 (Tex. App.--Houston [14th Dist.] 2009, no pet.) ("A fiduciary duty exists between a husband and a wife as to the community property controlled by each spouse"). If a spouse violates his/her fiduciary duty to the other spouse when disposing of community property, the community estate is injured and the community estate has a claim against the wrongdoing spouse, and in some instances against the third-party recipient of community property. The claim is called "fraud on the community." In dealing with allegedly improper conveyances of community property, Texas courts have had to reconcile the fact that the Family Code gives sole management and control to a spouse over property that s/he would have owned if single, but at the same time the spouse owes fiduciary duties to the other spouse with respect to the other spouse's one-half interest in the property. The quandary was described in *Givens v. Girard Life Ins. Co. of Am.*, 480 S.W.2d 421, 427-28 (Tex. Civ. App.--Dallas 1972, writ ref 'd n.r.e.):

> Reconciliation of the managerial power of one spouse with the interest of the other spouse as equal owner is a problem inherent in the concept of management by one spouse of marital property owned in common. This concept has come down to us from the laws of Spain and Mexico, and is carried forward in the statutes above mentioned without substantial change,

> except that the managerial powers of the husband have been restricted and those of the wife have been extended with respect to classes of property not now before us.
>
> Our review of the authorities reveals that the husband's power to make gifts of community property has always been limited, though the limits have never been clearly defined . . . .
>
> Over the last 40 years, Texas courts have been moving toward more clearly defining the limits on a spouse's right to manage community property, and a consensus has emerged on how those limits should be defined. Now the rule can be stated:
>
> Although a spouse has the right to dispose of community property under his or her control, he may not dispose of his spouse's interest in community funds if actual or constructive fraud exists.

See Greco v. Greco, No. 04–07–00748–CV, 2008 WL4056328, *5 (Tex. App.--San Antonio Aug. 29, 2008, no pet.) (mem. op.) ("A fiduciary duty exists between a husband and a wife regarding the community property controlled by each spouse.... Although a spouse has the right to dispose of community property under his or her control, he may not dispose of his spouse's interest in community funds if actual or constructive fraud exists") (citation omitted). The issues of actual fraud and constructive fraud on the community estate are discussed in Section IX.J.6 below.

G. GIFT OF ENCUMBERED PROPERTY. A grantor may make a gift of encumbered property even if the grantee assumes an obligation to extinguish the encumbrance. *Taylor v. Sanford*, 108 Tex. 340, 193 S.W. 661, 662 (1917); *Kiel v. Brinkman*, 668 S.W.2d 926, 929 (Tex. App.--Houston [14th Dist.] 1984, no writ) (no showing that parents transferred land to son *in exchange* for his extinguishing the debt); *Van v. Webb*, 237 S.W.2d 827, 832 (Tex. Civ. App.--Amarillo 1951, writ ref'd n.r.e.). The gift extends to the equity in the property. To the extent the debt is assumed by the grantee, the transaction is a purchase. If the grantee is married, the credit is community credit.

III. DEVISE AND DESCENT. Property acquired by a spouse by devise or descent is separate property. Tex. Const. art. XVI, § 15, and TEX. FAM. CODE § 3.001(2). State Bar of Texas Pattern Jury Charges - Family & Probate (2020). PJC 202.03 defines "devise" as "acquisition of property by last will and testament. PJC 202.03 defines "descent" as "acquisition of property by inheritance without a will." A "testamentary trust" is an express trust created in a last will and testament. The assets bequeathed to the trustee of a testamentary trust for the benefit of a married beneficiary are owned by the trustee not by the spouse, and are therefore not martial property. However, the beneficiary's *beneficial interest* in the trust property is owned by the spouse, and since it was acquired by devise, it is separate property.

Under Texas law, legal title vests in estate beneficiaries immediately upon the death of the decedent. TEX. ESTATES CODE § 101.001(a)(1); *Dyer v. Eckols*, 808 S.W.2d 531, 533 (Tex. App.--Houston [14th Dist.] 1991, writ dism'd by agr.). An argument can be made that a spouse's share of the income of a decedent's estate is community property of the spouse, even before the assets are titled in the decedent's name and even though the income arising from the assets may still be in the hands of the executor. However, if the bequest is made in trust for the benefit of a spouse, the income would belong to the trustee, and would not be marital property.

IV. THREE CATEGORIES OF TRUSTS. The Supreme Court of Texas has recognized three types of trusts: express trusts, resulting trusts, and constructive trusts. *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948). These terms are defined below.

A. Express Trust. An express trust comes into existence by the execution of an intention to create it by one having legal and equitable dominion over the property made subject to the trust. *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948). The essence of an express trust is the dividing of the ownership property into the legal title in one person (the trustee) and an equitable interest in another person (the beneficiary).

Express trusts were controlled by the common law in Texas, until April 19, 1943. On that date, the Texas Trust Act went into effect. *See* TEX. REV. CIV. STAT. art. 7425a *et seq.*; *Land v. Marshall*, 426 S.W.2d 841, 845 (Tex. 1968). The Texas Trust Act controlled express trusts until its repeal, effective December 31, 1983. On January 1, 1984, the Texas Trust Code went into effect. *See* TEX. PROP. CODE chs. 101, 111-115. The old Texas Trust Act still controls the validity of trusts created while the Act was in effect, and actions taken relating to express trusts while the Act was in effect. The newer Texas Trust Code applies to trusts created on or after January 1, 1984, and to transactions relating to prior trusts, but which occur on or after January 1, 1984.

B. Resulting Trust. A resulting trust arises by operation of law when title is acquired by one party while consideration is provided by another. *Cohrs v. Scott*, 338 S.W.2d 127, 130 (Tex. 1960). Generally, a resulting trust can arise only when title passes, not at a later time. *Id*. at 130. This rule, often stated in the case law, does not apply in certain instances between spouses. If before marriage a person acquires a right to later acquire title to property, and then marries and actually acquires title during marriage, the property is separate property under the inception of title rule, because the right to acquire the property had its inception prior to marriage. The rule of consideration underlying resulting trust does not apply in that instance, even if community property consideration is provided in connection with taking title to the property. A resulting trust also arises when a conveyance is made to a trustee pursuant to an express trust, which fails for any reason. *Nolana Development Ass'n v. Corsi*, 682 S.W.2d 246, 250 (Tex. 1984). Ordinarily, the proponent of a resulting trust has the burden of overcoming the presumption of ownership arising from title by "clear, satisfactory and convincing" proof of the facts giving rise to the resulting trust, *Stone v. Parker*, 446 S.W.2d 734, 736 (Tex. Civ. App.--Houston [14th Dist.] 1969, writ ref'd n.r.e.). However, when marital property is in issue, the presumption of community prevails over the presumption of ownership arising from title, so proof that property is possessed by a spouse during marriage is sufficient to establish, prima facie, community property even where title is held in the name of one spouse alone. *See* TEX. FAM. CODE § 3.003(a). Resulting trusts are excluded from coverage in the Texas Trust Code. TEX. PROP. CODE § 111.003(2).

C. Constructive Trust. A "constructive trust" is not really a trust; it is an equitable remedy. The court imposes a "constructive trust" when an equitable title or interest ought to be, as a matter of equity, recognized in someone other than the taker or holder of legal title. The Supreme Court described the doctrine as follows:

> A constructive trust does not, like an express trust, arise because of a manifestation of intention to create it. It is imposed by law because the person holding the title to property would profit by a wrong or would be unjustly enriched if he were permitted to keep the property.

Omohundro v. Matthews, 341 S.W.2d 401, 405 (Tex. 1960), *accord*, *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, (1948). Constructive trusts are excluded from coverage in the Texas Trust Code. Tex. Prop. Code § 111.003(2).

V. "RESULTING TRUST" VS. "CONSTRUCTIVE TRUST."In *Mills v. Gray*, 147 Tex. 33, 210 S.W.2d 985, 987-88 (1948), the Texas Supreme Court drew the following distinction between a resulting trust and a constructive trust:

> Resulting and constructive trusts are distinguishable, but there is some confusion between them. From a practical viewpoint, a resulting trust involves primarily the operation of the equitable doctrine of consideration - the doctrine that valuable consideration and not legal title determines the equitable title or interest resulting from a transaction - whereas a constructive trust generally involves primarily a presence of fraud, in view of which equitable title or interest should be recognized in some person other than the taker or holder of the legal title.[Citing 54 AM. JUR. 22, § 5.]

VI. EXPRESS TRUSTS. Property held by a trustee for the benefit of a beneficiary is not owned by the beneficiary. See Paragraph XII.B below. Instead, the trustee owns legal title and the beneficiary has a beneficial interest in the trust property. *Bradley v. Shaffer*, 535 S.W.3d 242, 248 (Tex. App.--Eastland 2017, no pet.). However, where the beneficiary has an unconditional right to have the property free of trust, then the property is treated as if it is owned by the beneficiary, even if legal title is the trustee. *See Sharma v. Routh*, 302 S.W.3d 355 (Tex. App.--Houston [14th Dist.] 2009, no pet); *In Re Marriage of Long*, 542 S.W.2d 772 (Tex. Civ. App.--Texarkana 1976, no writ).

A. Different Kinds of Express Trusts.

1. What is an "Express Trust"? An express trust is defined in the Texas Trust Code as a fiduciary relationship with respect to property "which arises as a relationship and which subjects the person holding title to the property to equitable duties to deal with the property for the benefit of another." TEX. PROP. CODE § 111.004. Under Texas law, a trust is not an entity, like a corporation. It is a *relationship*, between the trustee, holding certain property, and the beneficiary for whose benefit the trustee holds the property. Thus, it is not really accurate to talk about "trust property;" we should instead say "property held in trust." You do not sue a trust; you sue the trustee.

2. "Trust" Accounts. In Texas, "trust accounts" were once governed by case law but are now governed by the Texas Estates Code. Under the Common Law, the mere act of depositing funds in an account designated as a "trust account" for the benefit of another person did not establish an express trust. Case law required that the beneficiary/claimant demonstrate the intent to create a trust "by a larger number of acts than in the case of an ordinary trust." *Frost Nat. Bank of San Antonio v. Stool*, 575 S.W.2d 321, 322 (Tex. Civ. App.--Beaumont 1978, writ ref'd n.r.e.). If a trust was found to have been intended, it was a revocable trust, which matured only upon the death of the settlor/trustee, at which time the proceeds became payable to the beneficiary. *See Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654, 657 (Tex. Civ. App.--Eastland 1978, writ ref'd n.r.e.) (involving certificate of deposit held "in trust"). Recitals on the bank signature card that the funds in the account were held "in trust" for another were considered to be evidentiary only, and did not give rise to a presumption that a trust was intended. *Fleck v. Baldwin*, 141 Tex. 340, 172 S.W.2d 975, 978 (1943).

In 1979, the Legislature adopted a statutory framework for multiple-party accounts, including trust accounts. Tex. Probate Code §§ 436-449. That statutory framework was replaced in 2015 by the Texas Estates Code, which governs accounts created on or after September 1, 2015. (Prior law continues to govern accounts formed previously). The current statutory framework is conceptually similar to the previous statutory framework. Under the Estates Code, a "trust account" is one form of a multi-party account governed by Chapter 113 of the Texas Estates Code. Tex. Estates Code § 113.004(3). The Code defines a "trust account" as an account in the name of one or more parties as trustee for one or more beneficiaries. Tex. Estates Code § 113.004(5). The trust relationship is established by the form of the account and deposit agreement with the financial institution. *Id.* There can be no subject of the trust other than the sums on deposit in the account. *Id.* The deposit agreement does not have to address payment to the beneficiary. The term "trust account" does not include a "regular trust account" under a testamentary trust or trust agreement that is separate from the trust account. Tex. Estates Code § 113.004(5)(A). The term also does not include a "fiduciary account" arising from a fiduciary relationship such as the attorney-client relationship. Tex. Estates Code § 113.004(5)(B).

Texas Estates Code Section 113.104 provides that the funds in a trust account, during the trustee's lifetime, belong beneficially to the trustee, unless the terms of the account or deposit agreement "manifest a contrary intent," or other clear and convincing evidence exists of "an irrevocable trust." Where there two or more trustees of such a trust account, their rights in the funds are governed by Section 113.102, meaning that the funds belong to the person who contributed them to the account. When the trust account is an irrevocable trust, the beneficial interest belongs to the beneficiary. Tex. Estates Code § 113.104(c). The statute bears further analysis. First, if the "trust" is revocable, the statute makes the trustee the true beneficiary during the trustee's lifetime. If the "trust" is irrevocable, the statute makes the account beneficiary the true beneficiary during the trustee's lifetime. Second, the "terms of the account or the deposit agreement" prevail over the statutory allocation of the beneficial interest. Third, the statute creates a rebuttable presumption that the "trust" is revocable, unless the terms of account or deposit agreement indicate irreversablity, "other clear and convincing evidence of an irrevocable trust exists." This suggests that the presumption of revocable trust does not vanish in the face of evidence of contrary intent, but instead carries through to the end of the case when the fact-finders makes the ultimate decision. Fourth, where there are multiple trustees, the rule of ownership in proportion to net contributions applies.

A succinct summary of the law of trust accounts is set out in the statutory form prescribed for setting up a trust account. It says:

> The parties named as trustees to the account own the account in proportion to the parties' net contributions to the account. A trustee may withdraw funds from the account. A beneficiary may not withdraw funds from the account before all trustees are deceased. On the death of the last surviving trustee, the ownership of the account passes to the beneficiary. The trust account is not a part of a trustee's estate and does not pass under the trustee's will or by intestacy, unless the trustee survives all of the beneficiaries and all other trustees.

There are two blanks in the form to enter the names of the trustees, and two blanks to enter the name(s) of the beneficiaries, and two blanks to enter the name(s) of the convenience signer(s). Tex. Estates Code § 113.052(7).

To sum up, if a person puts funds in an account in her name, but the account indicates that she is "trustee" for someone, it is presumed that the trustee/depositor continues to "own" the funds and is

free to withdraw the funds. The account is essentially a revocable trust. The beneficiary's right to the funds does not mature until all named trustees die. Tex. Estates Code § 113.104. However, this can be altered if the terms of the account or deposit agreement manifest a contrary intent, or if other clear and convincing evidence exists of an irrevocable trust. Tex. Estates Code § 113.104(1) & (2). This statute establishes a presumption that depositing funds into a "trust account" is not a conveyance of an interest (including a beneficial interest) to a third party, and that no fiduciary obligations are owed to the beneficiary during the trustee's lifetime. That presumption can be overcome, and an irrevocable trust established, but only if the terms of account or deposit agreement say so, or there is other clear and convincing evidence.

When a "trust account" becomes an issue in a divorce, because the arrangement is presumed to be a revocable trust, there is no special theory of recovery that must be asserted to establish the depositor-trustee's functional ownership of those funds. Under the law, the funds on deposit belong to the trustee and not the beneficiary. If the trustee is getting divorced, the court may award the funds on deposit according to the normal rules of property division. If the beneficiary is getting divorced, the funds on deposit are neither separate nor community property of the beneficiary. However, it is possible for a party to claim that the trust is irrevocable, and if the terms of account or deposit agreement make the trust irrevocable, or if they can prove their claim on clear and convincing evidence, then the funds on deposit do not belong to either the trustee or the beneficiary, but are instead property held in trust.

3. Investment Securities Held "as Trustee." The question arises whether the rules discussed above for funds on deposit "held in trust" for another also apply to investment securities held in a trust account for the benefit of another. In *Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654 (Tex. Civ. App.--Eastland 1978, writ ref'd n.r.e.), the issue was whether the settlor/trustee intended to create a trust when she acquired a certificate of deposit in her own name, "as Trustee for" another person. The jury found, and judgment was rendered, that the settlor/trustee intended to establish a *revocable* trust for the benefit of the third person. The Court of Civil Appeals affirmed the judgment, finding that such an inter vivos revocable trust is permissible under Texas law, and that it becomes irrevocable and payable upon the death of the settlor/trustee. The Court also extended the rule to stock certificates held in the name of the purchaser "in trust" for another, where the purchaser so intends. The Court wrote:

> The ultimate and controlling question is the intent of the purchaser. The recitals on the certificate that such is held "in trust" for another are evidentiary only, and do not give rise to a presumption that a trust was intended.

Id. at 658.

The Texas Estates Code says that the rules regarding multiple-party accounts apply to "accounts" at a "financial institution." The terms "accounts" includes checking, savings, CD, share account, or "other similar arrangement," at a financial institution. Tex. Estates Code § 113.001(1). "Financial institution" is defined to include a bank, savings bank, building and loan association, credit union, and securities brokerage firm. Tex. Estates Code § 113.001(3). However, in describing trust accounts Texas Estates Code Section 113.004(5) refers to "sums on deposit," so an argument can be made that cash in a "share account" is governed by the Estates Code Chapter 13 while securities (stock and bonds) are not. *But see In re Estate of Dillard*, 98 S.W.3d 386 (Tex. App.--Amarillo 2003, writ denied), which applied the multiple-party account provisions in the Probate Code to a Merrill Lynch account containing "more than a million dollars of property." *Id.* at 398 n. 4.

Where shares of stock or bonds are held "in trust" in certificated form and not through registration with a securities brokerage firm, Estates Code Chapter 13 does not apply, and it would seem that the law of *Citizens National Bank of Breckenridge* would apply. Special note: With U.S. government bonds, Federal law preempts Texas marital property law. *Free v. Bland*, 369 U.S. 663 (1962) (Treasury regulation governing U.S. savings bond prevailed over Texas community property laws.

4. Revocable Trust. A revocable trust is a trust that can be revoked or amended at will by the settlor. Texas Property Code § 112.051(a) makes all Texas trusts revocable unless they are made irrevocable in writing. A revocable trust is a full-fledged trust while it is in effect, and it is subject to the terms of Chapter 112 of the Texas Property Code. Section 112.051 of the Texas Property Code says this about revocable trusts:

> Sec. 112.051 REVOCATION, MODIFICATION, OR AMENDMENT BY SETTLOR.
>
> (a) A settlor may revoke the trust unless it is irrevocable by the express terms of the instrument creating it or of an instrument modifying it.
>
> (b) The settlor may modify or amend a trust that is revocable, but the settlor may not enlarge the duties of the trustee without the trustee's express consent.
>
> (c) If the trust was created by a written instrument, a revocation, modification, or amendment of the trust must be in writing.

If the trust is revocable and does not specify how revocation can occur, no specific procedure need be followed, but the settlor's intent to revoke must be manifestly clear. *Jenkins v. Jenkins* 522 S.W.3d 771, 782 (Tex. App.--Houston [1st Dist.] 2017, no pet.). An unanswered question is whether one settlor acting alone can revoke a revocable trust that contains a provision that both settlors of the trust must consent to revocation. If not, then can one co-trustee revoke the trust as to the property she conveyed into trust? Can a divorce court order a spouse to revoke a revocable trust, where the trust principal was community property?

It is safe to say that the complications mentioned in this Article about amending or unwinding trusts, or removing assets from trust, may not apply to a revocable trust. A settlor of a revocable trust has constructive possession and control over property held in revocable trust. While the case law does not address this specifically, an argument can be made that income earned on trust assets during the settlor's marriage can be treated by a divorce court as community property once it has been distributed to the settlor spouse or if the trust is revoked.

5. Irrevocable Trust. No specific language is needed to make a trust irrevocable. However, the action in question must clearly reflect the settlor's intent that the trust be irrevocable. *Jenkins v. Jenkins* 522 S.W.3d 771, 782 (Tex. App.--Houston [1st Dist.] 2017, no pet.). Irrevocable trusts establish rights in beneficiaries that are protected both by trust law and property law, so they cannot be revoked without their consent or due process of law.

See Section XII G for a discussion of marital property issues with revocable trusts.

6. Spendthrift Trust. A spendthrift trust is a trust that contains a clause prohibiting a beneficiary or her creditors from obtaining trust principal or income before it is distributed to the beneficiary. Tex. Prop. Code § 112.035(a). Assets held in a discretionary distribution spendthrift trust are

impervious to creditor's claims. All that is required to make a trust a spendthrift trust is a declaration in the trust instrument. Tex. Prop. Code § 112.035(b). However, where the settlor is also a beneficiary of the trust, they assets are not exempt from creditor's claims. Tex. Prop. Code § 112.035(d). Various exceptions to this rule are set out in Section 112.035. *Shurley v. Tex. Comm. Bank–Austin, N.A.*, 115 F.3d 333, 338 (5th Cir. 1997) ("We have recognized that a beneficiary's interest in a spendthrift trust is not subject to claims of creditors under Texas law '[u]nless the settlor creates the trust and makes himself beneficiary.' The rationale for this 'self-settlor' rule is obvious enough: a debtor should not be able to escape claims of his creditors by himself setting up a spendthrift trust and naming himself as beneficiary. Such a maneuver allows the debtor, in the words of appellees, to 'have his cake and eat it too.'" (citation omitted))

7. Self-Settled Trust. A self-settled trust is a trust where the settlor and the beneficiary are the same persons; said differently, a self-settled trust is where the settlor conveys property to a trustee for the benefit of the settlor as beneficiary. Self-settled trusts are not protected from creditors' claims. See Section VI.A.5. Does the self-settled trust doctrine apply where a beneficiary conveys her own property into an irrevocable discretionary trust settled by a third party? It would seem so.

VII. ESTATE PLANNING TRUSTS. The most popular estate planning trusts are:GST (generation-skipping dynasty trust; QPRT (qualified personal residence trust); CRT (charitable remainder trust); GRAT (grantor retained annuity trust), and GRUT (grantor retained unitrusts). *If you run into one of these trusts in a divorce, consult with an estate planning lawyer*. Actions taken in a divorce that alter trust terms may have income, gift, or estate tax consequences, or may impermissibly alter what secondary or contingent beneficiaries will receive under the estate plan.

A. (GST) GENERATION-SKIPPING DYNASTY TRUST. A GST is created by the older generation for the benefit of children, grandchildren, and even great-grandchildren. The trust corpus remains in the trust for as many generations as possible, sometimes to the limit set by the Rule Against Perpetuities.

1. The Rule Against Perpetuities. The Texas Constitution provides that "[p]erpetuities ... are contrary to the genius of free government, and shall never be allowed." Tex. Const. art. I, § 26.Texas courts have enforced this provision by applying the common law Rule Against Perpetuities. *Trustees of Casa View Assem. of God Ch. v. Williams*, 414 S.W.2d 697, 702 (Tex. Civ. App.--Austin 1967, no writ).Under the Rule Against Perpetuities, no interest is valid unless it must vest, within twenty-one years after the death of some life or lives in being at the time of the creation of the interest. *Peveto v. Starkey*, 645 S.W.2d 770, 772 (Tex. 1982); *Foshee v. Republic Nat'l Bank of Dallas*, 617 S.W.2d 675, 677 (Tex. 1981). The Rule of Perpetuities applies to all Texas trusts except charitable trusts. Tex. Prop. Code § 112.036 which adds to lives in being "a period of gestation").

The Rule Against Perpetuities relates only to the vesting of estates or interests, not vesting of possession, and is not applicable to present interests, or future interests which vest at their creation. *Kelly v. Womack*, 153 Tex. 371, 268 S.W.2d 903 (1954). You must, therefore, examine the challenged conveyance as of the date the instrument was executed, and the conveyance is void if, under any possible contingency, the interest could vest outside the perpetuities period. *Peveto v. Starkey*, 645 S.W.2d at 772; *Brooker v. Brooker*, 130 Tex. 27, 106 S.W.2d 247, 254 (1937).

2. Irrevocable, Spendthrift Trust. A GST is ordinarily an irrevocable, spendthrift trust with multiple beneficiaries in successive generations who become primary beneficiaries when the older generations die off. The "spendthrift" provision prohibits the beneficiary or her creditors from

obtaining the trust assets, other than by distributions according to the terms of the trust. *Bradley v. Shaffer*, 535 S.W.3d 242, 248 (Tex. App.--Eastland 2017, no pet.). Because the trust property is owned by the trustee and not the beneficiaries, the trust assets are not included in the taxable estate of a trustee or beneficiary who dies. The trustee usually has the "power to invade," meaning the power to distribute not only trust income but also trust principal, to beneficiaries. However, the settlor can specify mandatory distribution of trust principal or income. If the distributions exceed what is needed for the beneficiary's "best interest," the trust principal may be included by the IRS in the beneficiary's taxable estate at death. If the beneficiary is also the sole trustee with the power to make trust distributions to herself or for her own benefit, distributions must be limited to an "ascertainable standard," such as only what is required for the beneficiaries' health, education, maintenance, and support (a "HEMS" standard), or else the trust assets on date of death may be included in the beneficiary's estate for estate tax purposes. Sometimes the beneficiaries will have limited powers of appointment that permit them to control how the assets flow when the beneficiary dies.

B. QPRT (QUALIFIED PERSONAL RESIDENCE TRUST). A QPRT is an irrevocable trust created by homeowners, into which they convey their principal residence or vacation home, retaining the right to live there rent-free, for a specified term of years. The plan is to outlive this rent-free period. The grantors usually can direct the trustee to sell one home and buy another. If the house is sold and a new house is not purchased, the proceeds are usually invested in an annuity paid to the grantors. At the end of the specified trust term, the residence goes to the remainder beneficiaries (usually the grantors' children, or a trust for the children). If the grantors are still alive, they can rent from the children.

Sometimes the house is partitioned before it is conveyed into trust, and sometimes a community property house is conveyed into trust. The conveyance into trust will be reflected by a deed which is recorded. This arrangement reduces the value of the gift into trust to the extent of the free tenancy retained by the grantors. The value of the remainder interest at the time of the conveyance into trust is usually very small, using up only a small part of the homeowners' lifetime gift tax exemption, which is presently set at $11.7 million.

C. CRT (CHARITABLE REMAINDER TRUST). A CRT is an irrevocable trust that provides for a specified annual payment to the grantors or other non-charitable beneficiaries for life or a term of years, and with the remainder to a charity.Some CRTs generate an income tax charitable deduction and some generate a gift tax charitable deduction.Under a CRT, the wealth leaves the family upon the death of the income beneficiaries or end of the term certain.

D. GRAT (GRANTOR RETAINED ANNUITY TRUST) AND GRUT (GRANTOR RETAINED UNITRUSTS). GRATs are trusts that reserve to the grantor an annual payment of a fixed sum (i.e., an annuity), determined by a percentage of the value of the trust assets at the time of initial funding. GRATs can be funded only once, at the beginning. GRUTs reserve to the grantor an annual payment of a fixed percentage of the value of trust assets, determined annually. GRUTs can receive additional contributions over time. For both GRATs and GRUTs, the remainder beneficiaries are usually the grantors' children.

GRATs and GRUTs remove assets from the estate at a fixed value, with later appreciation accruing to the GRAT, while retaining a finite stream of payments for the grantor. There is no gift except to the extent that the remainder interest exceeds the value of the annuity payments. The assets of the

trust are not included in the grantor's estate upon death, and appreciation on the trust principal during the life of the trust passes to the remainder beneficiaries without gift or estate tax.

E. "DEFECTIVE" TRUST. If the settlor retains certain powers over trust property, such as the power to substitute assets in the trust, the trust is "defective" and the trust income is taxed to the settlor. The settlor's estate is thus diminished by the income taxes paid after transfer in trust, without incurring a gift tax. The "defective" tax status in no way suggests that the trust is "defective" under state law.

VIII. CONSENSUAL UNRAVELING OF AN ESTATE PLAN. In this day and time, a spouse sometimes comes into the lawyer's office seeking a divorce when the spouses have conveyed some or most of their assets into an estate planning vehicle, like a trust or family limited partnership. There can be tax consequences to unraveling an estate plan, so the family lawyer should get the assistance of a CPA, or estate planning or tax lawyer, before taking steps to dismantle the estate plan. Where both spouses agree to the unraveling, the attorney who created the estate plan may be the best person to undo what was done. However, if the spouses have different ideas about what should be done, the estate planning lawyer may have a conflict of interest and be disqualified from acting for either or both parties in the unwinding process absent a waiver of conflict by both spouses and possibly beneficiaries.

A. REVOCABLE VS. IRREVOCABLE TRUST. If the estate planning device is a revocable trust, the trust can be terminated, or all the property distributed from trust back to the settlor(s), without regard to the rights of beneficiaries. Where, however, the trust is an irrevocable trust ("IRT") with beneficiaries other than the two spouses, the rights of the other beneficiaries cannot be impaired by the actions of the settlors, or the trustees, or primary beneficiaries, without the consent of *all* the beneficiaries. See Tex. Prop. Code § 112.054(d) ("The court may not take the action permitted by subsection (a)(5) unless all beneficiaries of the trust have consented to the order or are deemed to have consented to the order").

B. CONSENT OF BENEFICIARIES. You would expect that a grateful child would not object, if his/her parents are divorcing, to the parents taking some or all of their estate back, due to the changes in life plans resulting from divorce. However, it would be imprudent to dissolve a IRT, or distribute all or substantially all of the assets held in an IRT, without the consent of the beneficiaries, who might otherwise later sue for breach of fiduciary duty. An adult child-beneficiary can consent to the unwinding transaction, with or without legal and financial advice. Due to the disabilities of minority, a minor child-beneficiary would not be bound to consent given while a minor. And unborn or unascertained beneficiaries may have interests that must be protected in any action to rescind or modify the trust instrument. The safest practice and the statutory requirement is to have a guardian ad litem appointed by the court to advise minor children and represent the interests of unborn or unascertained beneficiaries. See Tex. Prop. Code § 112.054(d). The court has the authority to appoint a guardian ad litem and attorney ad litem under Tex. Prop. Code § 115.014.

C. JUDICIAL VS. NON-JUDICIAL MODIFICATION. The court in *Musik v. Reynolds*, 798 S.W.2d 626 (Tex. App.–Eastland 1990, no writ), said that an IRT can be modified by an agreement with no court participation but only on the condition that the settlor and all beneficiaries consent and no beneficiary is under any incapacity. This case may be taken to be an expression of the common law of Texas on non-judicial modification of trusts. Texas Property Code § 112.054 governs judicial modification, reformation, or termination of express trusts. Texas Property Code § 112.054(d) requires the consent of *all* beneficiaries, and minors and unborn or unascertained beneficiaries

cannot consent except through court-appointed representatives. Even if all beneficiaries are adult and consenting, a court order approving the settlement is desirable, because once the judgment goes final it establishes a res judicata bar against beneficiaries later claiming fraud or breach of fiduciary duty, and the bar can only be circumvented by proving extrinsic fraud in a bill of review proceeding brought within four years. Also, a court finding of statutory grounds for modification or termination would be an effective shield if the IRS were to later argue that the beneficiaries made a gift back to the settlors. Special note: the start of the limitations period can be delayed if there is "fraudulent concealment." *ExxonMobil Corp. v. Lazy R. Ranch, LP*, 511 S.W.3d 538, 544 n.21 (Tex. 2017) ("The doctrine of fraudulent concealment tolls the statute of limitations until the fraud is discovered or could have been discovered with due diligence.")

D. PRECAUTIONARY PARTITION AND EXCHANGE. If separate property was conveyed into an IRT and the desire is to have the property come back out of trust as separate property, it would be a wise precaution to have the spouses partition and exchange the property upon distribution to assure its separate property character. There is no case law on point, but consider the idea behind *Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.--Dallas 1987, writ ref'd n.r.e.) (property held by partnership has no marital property character, so tracing into and back out of a partnership is not possible). However, if the property recovered from trust will be divided by agreement in the property division upon divorce, a partition and exchagne would not add value.

E. CREATING TWO POST-DIVORCE TRUSTS. Tex. Prop. Code § 112.057 provides that "[t]he trustee may, unless expressly prohibited by the terms of the instrument establishing the trust, divide a trust into two or more separate trusts without a judicial proceeding if the result does not impair the rights of any beneficiary, or adversely affect achievement of the purposes of the original trust." Divorcing spouses can agree to leave the trust framework unchanged as to residual beneficiaries, while creating two post-divorce trusts, one under the control of each former spouse, with liberal discretion for each former spouse to use his or her trust property or distribute income or principal to him/herself according to an ascertainable standard. This has the advantage of giving each former spouse sole post-divorce control over his/her share of the spouses' former community estate, while preserving the estate tax benefits of the generation-skipping trust framework.

F. DECANTING. Under the rules of "decanting" a trust, it is possible to move the assets of an old trust into a new trust with more desirable features (like decanting wine from a bottle to a crystal decanter). Some trusts have this decanting power built in by express language. Absent that, the litigants must rely on the applicable state decanting statute or common law. The Texas decanting statutes are Tex. Prop. Code §§ 112.072 - 112.087. There are articles in the State Bar's on-line library and on the internet about decanting. Decanting should be done by an estate planning lawyer, not a divorce lawyer. A fundamental requirement of the decanting process is that alternate beneficiaries' rights should not be impaired. Under the Texas decanting statutes, a trustee with "full discretion to distribute the principal of a trust" has the power to favor some beneficiaries over other beneficiaries in the decanting process. Tex. Prop. Code § 112.072. A trustee with "limited discretion to distribute the principal of a trust" cannot alter the rights of beneficiaries under the trust. Tex. Prop. Code § 112.073. In either situation, the trustee exercising statutory decanting power must give notice to the trust beneficiaries. Tex. Prop. Code § 112.074. If a charity is a beneficiary, the trustee must give written notice to the Texas Attorney General of the intent to decant. Tex. Prop. Code § 112.074(c). If the trust to be decanted contains a choice-of-law clause, a question may arise as to whether the law of the specified jurisdiction controls the decanting process, or the law of Texas. See Section IX.A.5 below. Decanting can be a simple solution to some problems, but the availability of decanting and the method to accomplish it are matters for an estate planning expert.

IX. CHALLENGES TO VALIDITY OF EXPRESS TRUSTS. What appears to be an express trust may in fact not be a trust, or it may be vulnerable to attacks which would defeat the trust or cause selected assets to be removed from trust. Several possible methods to defeat or penetrate express trusts are discussed below.

A. PROCEDURAL CONSIDERATIONS. There are procedural aspects of trust litigation to consider when litigating against or about trusts in connection with divorce.

1. What State? The answer to the question "in what state should I file the trust-related claim," is obviously the state where the divorce is pending. However, if the trustee lives in South Dakota, the trust agreement chooses South Dakota law to apply to formation and operation, and the agreement selects South Dakota courts as the exclusive forum for litigation, a Texas court may be induced to dismiss a claim brought in a Texas court in favor of litigation in South Dakota courts.

Forum-selection clauses are generally enforceable and are presumptively valid. *In re Laibe Corp.*, 307 S.W.3d 314, 316 (Tex. 2010) (per curiam). A forum selection clause in a Mexican trust agreement electing jurisdiction of the courts of Reynosa, Tamaulipas, Mexico was upheld in *In re Longoria*, 470 S.W.3d 616, 624 (Tex. App.–Houston [14th Dist.] 2015, orig. proceeding).

Bogert's THE LAW OF TRUSTS AND TRUSTEES § 292, Judicial Jurisdiction says:

> Before exercising jurisdiction in proceedings relating to a multistate trust, the forum court must have jurisdiction over one or more of the trust, the trust parties, or the trust property. Whether the court will choose to exercise its jurisdiction, and the extent of its exercise, will depend upon a number of factors, including the parties properly before it; the nature of trust assets subject to the court's jurisdiction, interests which may be affected by a decree; and the type of relief sought. [FN 27] Whether to exercise jurisdiction will usually require a very factually-intensive analysis.

If the ties between the settlor, trustee, beneficiary, and trust assets and the selection forum are tenuous or non-existent, a Texas court could be persuaded that a forum selection clause should not be enforced. If the Texas court does not have personal jurisdiction over a trustee or beneficiary, there is a constitutional barrier to altering that beneficiary's property rights. *See International Shoe v. Washington*, 326 U.S. 310 (1945); *Dawson-Austin v. Austin*, 968 S.W.2d 319, 326 (Tex. 1998) (minimum contacts necessary to litigate property rights in a Texas divorce).

2. What Court? The district court and the statutory probate court have concurrent jurisdiction over suits relating to trusts. Tex. Prop. Code § 115.001; Tex. Estates Code § 32.006;Tex. Estates Code § 32.007. The court in which a claim relating to a trust is first-filed, has dominant jurisdiction. If the trust-related claim is first-filed in the probate court, and a divorce is later filed, and the trust-related claim is included in the divorce proceeding, does the divorce court have to wait for the trust-related claim to be resolved in the probate court before the divorce can be concluded? This is a difficult question.

If the trust is a testamentary trust established in a last will and testament that has been admitted to probate, then the probate court that probated the will has a residual claim to exclusive jurisdiction. If the estate is still open when a claim is brought against a testamentary trustee in a divorce, the question arises whether the claim will likely fall within the probate court's exclusive jurisdiction, or pendent and ancillary jurisdiction. If the claim targets property of an estate that is then in probate,

or requires the interpretation of a will, particular attention should be paid to exclusive jurisdiction in the probate court.

The case of *Soefje v. Jones*, 270 S.W.3d 617, 627 (Tex. App.–San Antonio 2008, no pet.), raises an important point. In that case, the county court had jurisdiction over probating a will, but not court proceedings relating to a trust created by the testator before she died, which had to be litigated in the district court. Even though the county court did not have jurisdiction over the trust proceedings, the district court considered certain factual issues resolved in the county court proceeding to create a collateral estoppel bar in the trust-related proceeding. So the litigant who sought an trust accounting in district court was held to have lost that right in connection with the county court proceeding. As a result, the issues within the exclusive jurisdiction of the district court were effectively decided by the county court.

3. What County? Venue of a suit under Section 115.001 of the Texas Property Code (including suits to construe a trust instrument, determine applicable law, appoint or remove a trustee, etc.) is governed by Tex. Prop. Code § 115.002. That statute says that where there is a single, non-corporate trustee, venue is in the county in which the trustee resides or has resided at any time during the four-year period preceding the date the action is filed; or where the situs of administration of the trust is maintained or has been maintained at any time during the four-year period preceding the date the action is filed.

If there are multiple non-corporate trustees, then the suit must be brought in the county that is the situs of administration or in which the trustee has maintained an office during the preceding four years. Other permutations are set out in Section 115.002. Courts have held that Section 115.002 is a mandatory venue provision. *In re Green*, 527 S.W.3d 277, 279 (Tex. App.--El Paso 2016, orig. proceeding); *In re Wheeler*, 441 S.W.3d 430, 434 (Tex. App.--San Antonio 2014, orig. proceeding). However, upon agreement of all parties, the court can transfer a case to any other county. Tex. Prop. Code § 115.002(e).

4. What Parties? As to possible plaintiffs, Texas Property Code § 112.054(a) provides that a court can entertain a request to replace a trustee, or modify, reform, or terminate a trust "[o]n the petition of a trustee or a beneficiary." The settlor of the trust is not included on the list. However, Tex. Prop. Code § 115.011 permits "[a]ny interested person" to bring a suit under Section 115.001, which permits the court to take a wide array of actions respecting trusts. Tex. Prop. Code 111.004(7) says that "[w]hether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding." In *Lemke v. Lemke*, 929 S.W.2d 662 (Tex. App.--Fort Worth 1996, writ denied), the court ruled that a spouse of a settlor was not an interested person who could bring suit to challenge the validity of a trust when she was not a trustee or beneficiary, and had no community property interest in property held in trust. Tex. Prop. Code § 113.019 says that "[a] trustee may compromise, contest, arbitrate, or settle claims of or against the trust estate or the trustee."

The Supreme Court in *Ray Malooly Tr. v. Juhl*, 186 S.W.3d 568, 570 (Tex. 2006), said: "The general rule in Texas (and elsewhere) has long been that suits against a trust must be brought against its legal representative, the trustee."

Both trustees and beneficiaries can be made parties to suits involving trust property. *Starcrest Trust v. Berry*, 926 S.W.2d 343, 355 (Tex. App.--Austin 1996, no writ). However, beneficiaries need not

be joined in the action if the dispute does not involve a conflict between the trustee and beneficiaries, or between the beneficiaries themselves. *Id*. at 355. Also, the beneficiaries need not be joined if the trust instrument places the power to litigate exclusively in the trustee. *Hedley Feedlot, Inc. v. Weatherly Trust*, 855 S.W.2d 826, 833 (Tex. App.--Amarillo 1993, writ denied). The terms of the trust instrument and the purpose of the suit must be examined to determine whether a suit may be prosecuted with the trustee without joining the beneficiaries. *Id*. at 833.

Where the proceeding is brought under Texas Property Code § 115.001, there is a statutory provision regarding "necessary parties." Contingent beneficiaries designated as a class are not necessary parties. Section 115.001(b). However, the following are necessary parties: (i) a beneficiary of the trust on whose act or obligation the action is predicated; (ii) a beneficiary of the trust designated by name (unless the interest has been distributed, extinguished, terminated or paid); (iii) a person who is actually receiving trust distributions at the time suit is filed; and (iv) the trustee. Section 115.001(b). In this context, "necessary parties" probably equates to "Persons to be Joined if Feasible" under Tex. R. Civ. P. 30(a), meaning that the plaintiff must name the person as a party, and if s/he fails to do so the court must order that s/he be joined as a party (defendant or involuntary plaintiff).

Also, a beneficiary of the trust may intervene and contest the right of a plaintiff to recover trust assets for a tortious or contractual claim against the trustee acting in his representative capacity. Section 115.001(d).

Texas Property Code § 115.015 contains a notice provision regarding contract and tort claims against a trustee in his representative capacity. The court cannot render judgment on a tort or contract claim unless the plaintiff proves that s/he gave notice to each beneficiary known to the trustee who then had a present or contingent interest. Section 115.015(a)(1). If the trust is a charitable trust, notice must be given to the Attorney General and any corporate beneficiary. Section 115.015(a)(2).

The case of *Cleaver v. George Staton Co.*, 908 S.W.2d 468, 470 (Tex. App.--Tyler 1995, writ denied), involved a suit brought by an estranged husband against a trust of which his wife was beneficiary. The Court said that "[t]he trust provides for current mandatory payments of income from the corpus to the Wife for life; she was conveyed no ownership interest in the corpus of the trust and has no present possessory interest in the corpus. The trust income payments to the Wife are thus her separate property." *Id*. at 470. The court held that "Wife is a necessary party in Husband's suit for the recovery of trust funds for their community estate." *Id*. at 479. There is a host of other cases discussing who is and who is not a necessary party to various claims bought by or against a trustee. See the annotations to Tex. Prop. Code § 115.011 on Westlaw.

As to suits brought on behalf of a trust, the trustee is the proper party to bring suit. "It is only when the trustee cannot or will not enforce the cause of action that he has against the third person that the beneficiary is allowed to enforce it. In such a case, the beneficiary is not acting on a cause of action vested in him, but is acting for the trustee ...." *Interfirst Bank-Houston, N.A. v. Quintana Petrol. Corp.*, 699 S.W.2d 864, 874 (Tex. App.--Houston [1st Dist.] 1985, writ ref'd n.r.e.); *accord*, *Rideau v. Keller Indep. Sch. Dist.*, 819 F.3d 155, 162 (5th Cir. 2016).

5. Which State's Law? The case law on conflict-of-laws in trust litigation is sparse. The older cases apply the principles in the Restatement (First) of Conflict of Laws (1935) (lex loci contractus; law of domicile as to personal property; law of situs as to realty). The principles of the Restatement

(Second) of Conflict of Laws (1971) (the most significant relationship test) would now be applied. *See* James P. George & Randy D. Gordon, *Conflict of Laws (2017)*, 3 SMU ANNUAL TEXAS SURVEY 129 (2017); *Hughes Wood Prods, Inc. v. Wagner*, 18 S.W.3d 202, 204 (Tex. 2000) ("Since 1979, this Court has applied the Restatement's 'most significant relationship' test to decide choice of law issues").

Trust agreements often contain a choice-of-law clause, specifying the law governing validity and the law governing operation of the trust, or both. The Texas Supreme Court has upheld the validity of choice-of-law clauses in contracts generally. The seminal modern Texas case is *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 677 (Tex. 1990), *cert. denied*, 498 U.S. 1048 (1991), where the Court said:

> When parties to a contract reside or expect to perform their respective obligations in multiple jurisdictions, they may be uncertain as to what jurisdiction's law will govern construction and enforcement of the contract. To avoid this uncertainty, they may express in their agreement their own choice that the law of a specified jurisdiction apply to their agreement. Judicial respect for their choice advances the policy of protecting their expectations. This conflict of laws concept has come to be referred to as party autonomy. See R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 269–271 (1971) ["Weintraub"]. However, the parties' freedom to choose what jurisdiction's law will apply to their agreement cannot be unlimited. They cannot require that their contract be governed by the law of a jurisdiction which has no relation whatever to them or their agreement. And they cannot by agreement thwart or offend the public policy of the state the law of which ought otherwise to apply. So limited, party autonomy furthers the basic policy of contract law. With roots deep in two centuries of American jurisprudence, limited party autonomy has grown to be the modern rule in contracts conflict of laws. See SCOLES, supra at 632–652; WEINTRAUB, supra at 269–275; RESTATEMENT (SECOND) OF CONFLICT OF LAWS ["THE RESTATEMENT"] § 187 (1971).

Restatement (Second) of Conflict of Laws § 268(1) provides that a choice-of-law clause in a will or other instrument creating a trust in movables should be honored if it relates to matters within the power of the testator or settlor. Comment (b) to this section says that "it is not necessary that this state have any connection with the trust." As to validity of the trust, Section 270(a) says to apply the chosen law "provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship ...." Comment (b) to Section 270 says that a substantial relationship exists if at the time the trust is created: (1) the trustee or settlor is domiciled in the state; (2) the assets are located in the state; and (3) the beneficiaries are domiciled in the state. The question is well-analyzed in *In re Zukerkorn*, 484 B.R. 182 (9th Cir. Bnkr. Panel 2012), a split decision in which the court's majority held that Hawaii's law, not California's law, regarding spendthrift trusts would be applied in the bankruptcy of a trust beneficiary residing in California, where the trust agreement specified that Hawaii law would apply. The dissenting Justice laid out strong arguments as to why California law should apply. For more context, see Thomas P. Gallanis, *The Use and Abuse of Governing-Law Clauses in Trusts: What Should the New Restatement Say?*, 103 IOWA L. REV. 1711 (2018).

6. Title to Land. In Texas, a dispute involving a claim of superior title and the determination of possessory interests in real property must be brought as a trespass-to-try title action. *Jenkins v. Jenkins* 522 S.W.3d 771, 786 (Tex. App.--Houston [1st Dist.] 2017, no pet.) (holding that the Texas Declaratory Judgment Act cannot be used to adjudicate rights to land held in a testamentary trust).

It is simply a matter of pleading a claim relating to real estate as a trespass-to-trial-title claim, instead of a declaratory judgment claim.

7. Time Limitation Bar. In Texas, prior to 1967, limitations were tolled for married women who suffered under the disabilities of coverture. V.A.T.S. 5535. *Padgett v. Padgett*, 487 S.W.2d 850, 852 (Tex. Civ. App.–Eastland 1972, writ ref'd n.r.e.). Later the tolling statute was changed to include married persons while under age 21. V.A.T.S. 5535. The tolling provision was repealed in 1985, so at this time there is no tolling due to marriage.

A cause of action accrues, and the statute of limitations begins to run, when facts come into existence that authorize a claimant to seek a judicial remedy. *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 514 (Tex. 1998). The four-year statute of limitations applies to claims of fraud and breach of fiduciary duty. Tex. Civ. Prac. & Rem. Code § 16.004(a). The residual limitations period of four years applies to all claims not covered by a specific statute of limitations. Tex. Civ. Prac. & Rem. Code § 16.051. However, Section 16.0051 expressly does not apply to "an action for the recovery of real property." The fraudulent concealment doctrine exists as an affirmative defense to the statute of limitations. "Where a defendant is under a duty to make disclosure but fraudulently conceals the existence of a cause of action from the party to whom it belongs, the defendant is estopped from relying on the defense of limitations until the party learns of the right of action or should have learned thereof through the exercise of reasonable diligence." *Borderlon v. Peck*, 661 S.W.2d 907, 908 (Tex.1983). In *Ford v. Exxon Mobil Chem. Co.*, 235 S.W.3d 615, 618 (Tex. 2007), the Supreme Court held that an action to set aside a *voidable* deed for fraud or on equitable grounds was governed by the four-year statute of limitations. Where the suit is to set aside a deed, the four-year statute of limitations begins to run when the deed is recorded, if the claimant had actual or imputed knowledge of the deed. *Renfro v. Cavazos*, No. 04-10-00617-CV *10 (Tex. App.–San Antonio Sept. 12, 2012, pet. denied) (memo. op.). In *Dyer v. Dyer*, 616 S.W.2d 663, 664-65 (Tex. App.–Corpus Christi 1981, writ dism'd), the court held that the wife's claim in a divorce to set aside a conveyance of land from her to her husband was barred by the four-year statute of limitations.In *Williams v. Wachovia Mortg. Corp.*, 407 S.W.3d 391, 397 (Tex. App.–Dallas 2013, pet. denied), the court held that the four-year statute of limitations applied to a suit to invalidate a home equity loan that was not signed by both spouses, as required by law. *Accord*, *Kyle v. Strasburger*, 520 S.W.3d 74, 79 (Tex. App.--Corpus Christi 2015, no pet.) (agreeing with the *Williams v. Wachovia Mortg.* decision).

There is no statute of limitations on a suit to remove a trustee from a trust. *Ditta v. Conte*, 298 S.W.3d 187, 190 (Tex. 2009). This is because the trustee-beneficiary relationship is ongoing, rather than an event in time, and removal turns not on a particular breach of fiduciary duty, but rather the "special status of the trustee as a fiduciary and the ongoing relationship between trustee and beneficiary ...." *Id*. at 191.

8. Trustee's Attorney-Client Privilege. In *Huie v. DeShazo*, 922 S.W.2d 925 (Tex. 1996), the Supreme Court held that the attorney-client privilege applies to communications between a trustee and the lawyer hired by the trustee, even as against beneficiaries of the trust. There is a crime-fraud exception to the attorney-client privilege. Tex. R. Evid. 503(d)(1).

9. Attacking Charitable Trusts. If someone wants to break up or break into a charitable trust, there are special problems relating to the Attorney General set out in Chapter 123 of the Texas Property Code.

a. Attorney General's Participation. The Texas Property Code gives the Texas Attorney General the right to participate in litigation relating to charitable trusts. The relevant section provides:

> § 123.002. Attorney General's Participation
>
> For and on behalf of the interest of the general public of this state in charitable trusts, the attorney general is a proper party and may intervene in a proceeding involving a charitable trust. The attorney general may join and enter into a compromise, settlement agreement, contract, or judgment relating to a proceeding involving a charitable trust.

TEX. PROP. CODE § 123.002.

b. Notice to the Attorney General. The Texas Property Code requires that the Texas Attorney General be given notice of litigation relating to charitable trusts. The relevant section provides:

> § 123.003. Notice
>
> (a) Any party initiating a proceeding involving a charitable trust shall give notice of the proceeding to the attorney general by sending to the attorney general, by registered or certified mail, a true copy of the petition or other instrument initiating the proceeding involving a charitable trust within 30 days of the filing of such petition or other instrument, but no less than 25 days prior to a hearing in such a proceeding. This subsection does not apply to a proceeding that is initiated by an application that exclusively seeks the admission of a will to probate, regardless of whether the application seeks the appointment of a personal representative, if the application:
>
> (1)is uncontested; and
>
> (2)is not subject to Subchapter C, Chapter 256, Estates Code.
>
> (b) Notice shall be given to the attorney general of any pleading which adds new causes of action or additional parties to a proceeding involving a charitable trust in which the attorney general has previously waived participation or in which the attorney general has otherwise failed to intervene. Notice shall be given by sending to the attorney general by registered or certified mail a true copy of the pleading within 30 days of the filing of the pleading, but no less than 25 days prior to a hearing in the proceeding.
>
> (c) The party or the party's attorney shall execute and file in the proceeding an affidavit stating the facts of the notice and shall attach to the affidavit the customary postal receipts signed by the attorney general or an assistant attorney general.

TEX. PROP. CODE § 123.003.

c. Voidable Judgment or Agreement. The Texas Property Code makes a judgment involving a charitable trust voidable if the Texas Attorney General was not notified of the proceeding. The relevant section provides:

> § 123.004. Voidable Judgment or Agreement

> (a) A judgment in a proceeding involving a charitable trust is voidable if the attorney general is not given notice of the proceeding as required by this chapter.On motion of the attorney general after the judgment is rendered, the judgment shall be set aside.
>
> (b) A compromise, settlement agreement, contract, or judgment relating to a proceeding involving a charitable trust is voidable on motion of the attorney general if the attorney general is not given notice as required by this chapter unless the attorney general has:
>
> (1) declined in writing to be a party to the proceeding; or
>
> (2) approved and joined in the compromise, settlement agreement, contract, or judgment.

TEX. PROP. CODE § 123.004.

Judicial modification of an irrevocable trust with a charitable beneficiary requires notice to the Attorney General, Tex. Prop. Code § 112.074(c), unless the AG waives the requirement in writing, § 112.074(e-1).

B. CHALLENGING INTENT TO CREATE THE TRUST. Before there can be a trust, the settlor must intend the creation of the trust. *See* TEX. PROP. CODE § 112.002 ("A trust is created only if the settlor manifests an intention to create a trust"); *Gonzalez v. Gonzalez*, 457 S.W.2d 440 (Tex. Civ. App.--Corpus Christi 1970, writ ref'd n.r.e.); *Tolle v. Sawtelle*, 246 S.W.2d 916, 918 (Tex. Civ. App.--Eastland 1952, writ ref'd).

Some trust arrangements, such as funds deposited in a financial account with a depositor's agreement or signature card reading "in trust," or securities held "as trustee" for another, or land taken "in trust" for an unspecified beneficiary, are so vague that a clear intention to create a trust is not readily ascertainable from the documentation. Texas case law has traditionally treated such "trust" designations as no more than weak evidence of intent or no more than a revocable trust. Special statutory rules for "trust" financial accounts are discussed in Section VI.A.2 & 3 above. These statutory rules make such "trusts" presumptively revocable, absent explicit language in the account agreement or clear and convincing evidence to the contrary.

The issue of intent can arise even in connection with formal trust documents. For example, in the case of *In re Estate of Daniels*, 665 P.2d 594 (Colo. 1983), the decedent executed a formal trust agreement, but never funded it. She never advised the co-trustee of the trust's creation, and the co-trustee never signed the trust agreement. The decedent's attorney testified to giving the decedent legal advice that the trust agreement would have no effect until it was signed by the co-trustee and funded. The trial court concluded that, notwithstanding the settlor's signing the agreement, she never intended the trust agreement to take effect. That judgment was affirmed by the Colorado Supreme Court.

Thus, intent of the settlor to create the trust is the first thing to check when considering an attack on an express trust.

1. Extrinsic Evidence of Intent, Generally. The Parol Evidence Rule normally prohibits the use of extrinsic evidence to add to or vary the terms of a written document, absent allegations of ambiguity, fraud, duress, or mistake. *Guardian Trust Co. v. Bavereisen*, 132 Tex. 396, 121 S.W.2d 579, 583 (1938). However, the court may consider parol evidence as to the circumstances

surrounding the creation of the document, for the purpose of applying the document to the subject with which it deals, and for the purpose of ascertaining the real intention of the parties. *Id*. at 583. *See* McClung, *A Primer on the Admissibility of Extrinsic Evidence of Contract Meaning*, 49 TEX. BAR. J. 703 (1986).

On the other hand, some courts have taken a more restrictive approach to parol evidence. In the case of *Otto v. Klement*, 656 S.W.2d 678 (Tex. App.--Amarillo 1983, writ ref'd n.r.e.), the court refused to consider parol evidence on intent where the proof was offered to vary a survivorship provision contained on a bank signature card. In *Isbell v. Williams*, 705 S.W.2d 252 (Tex. App.--Texarkana 1986, writ ref'd n.r.e.), parol evidence was admitted only because a conflict between printed language and writing on a financial account signature card created an ambiguity.

2. Intent to Create a Trust. There is specific authority that parol evidence may be considered in determining whether a person intended to create a trust in a particular circumstance. As stated by the Texas Commission of Appeals in connection with funds deposited in an account "in trust" for the benefit of another:

> The ultimate controlling fact to be determined is the intention of the donor. Such a transaction does or does not create a trust according as the donor intended. Since in this case no one but Mrs. Baldwin knew or could have known what were her real intentions in these transactions, that fact must be arrived at by a consideration of her relevant acts and declarations, prior to, at the time of, and subsequent to the various transactions. As stated in the application for writ of error:
>
> "The intention referred to is to be ascertained, not by the application of barren concepts to a single fact, but 'by rational deductions' based upon all the facts."

Fleck v. Baldwin, 141 Tex. 340, 172 S.W.2d 975, 978-79 (1943).

Other states have held that evidence of the settlor's words and conduct is admissible on the issue of the settlor's intent to create a trust. *See Porreca v. Gaglione*, 358 Mass. 365, 265 N.E.2d 348, 350 (1970) (parol evidence admissible where parties were not attempting to vary or contradict terms of trust agreement, but rather were challenging the very existence of the trust); *See* RESTATEMENT (SECOND) OF TRUSTS §§ 23 & 24 (1959).

C. FAILURE IN MECHANICS OF CREATION. The Texas Trust Code has requirements for express trusts that must be observed. When these conditions are not met, an express trust cannot be recognized in a court proceeding.

1. Must be in Writing. The Texas Trust Code provides that, as a general rule, an express trust containing real or personal property is unenforceable unless it is created by a written instrument, signed by the settlor, containing the terms of the trust. TEX. PROP. CODE § 112.004. The mere designation of a party as "trustee" on an instrument does not alone create a trust. *Nolana Development Ass'n v. Corsi*, 682 S.W.2d 246, 249 (Tex. 1985).

There are exceptions to this rule.

a. No exception to the requirement of a writing exists for realty. Where one person holds title to real estate as "trustee," and no written trust agreement exists, the relationship is not an express trust. It may, however, be a resulting trust, if the consideration was provided by someone other than the holder of title.

b. Personalty Transferred to Another With Intent Expressed. Where the trust includes only personalty, the trust is enforceable if the personalty is transferred to a trustee who is not a beneficiary or settlor, and the settlor expresses the intention to create a trust, either before or at the time of the transfer. TEX. PROP. CODE § 112.004. In such a situation, written evidence of the trust is not required.

c. Personalty Retained by Settlor With Writing Reflecting Trust. A trust of personalty is also enforceable where an owner of personalty states *in writing* that certain personalty is held by that person as trustee for another, as beneficiary, or for himself and another, as beneficiaries. Tex. Prop. Code § 112.004. Under the case law, this exception would apply to funds which the party has deposited in a financial institution, where the account reflects the party as "trustee" for another. *See Jameson v. Bain*, 693 S.W.2d 676 (Tex. App.--San Antonio 1985, no writ). But under the current statutory framework in the Estates Code, the recital of "in trust" or "trustee" on a financial account presumptively creates a revocable trust. Under case law, the exception would apply to stocks and bonds in certificate form held in the name of the party "as trustee" for another. *See Citizens Nat. Bank of Breckenridge v. Allen*, 575 S.W.2d 654, 658 (Tex. Civ. App.--Eastland 1979, writ ref'd n.r.e.). Whether non-cash assets in a brokerage account are covered by Tex. Estates Code 113.004(5) is not clear. See Section VI.A.3 above.

d. Resulting and Constructive Trusts Are Outside of the Rule. The Texas Trust Code, by its very terms, does not apply to resulting or constructive trusts. Tex. Prop. Code § 111.003. Also, cases hold that the requirement of a writing, contained in the old Trust Act, and in the statute of frauds provisions of the Trust Code, do not apply to resulting and constructive trusts. *Rankin v. Naftalis*, 557 S.W.2d 940, 944 (Tex. 1977); *Rowe v. Palmer*, 277 S.W.2d 781, 783 (Tex. Civ. App.--Texarkana 1955, no writ).

2. A Transfer is Necessary. There must be a present transfer of legal title of property from the settlor to the trustee for the trust come into existence. *Cutrer v. Cutrer*, 334 S.W.2d 599, 605 (Tex. Civ. App.--San Antonio 1960), *aff'd*, 345 S.W.2d 513 (1961). However, the settlor may "transfer" legal title to the property to herself as trustee as long as her words or acts clearly reflect her intent to relinquish individual ownership in favor of holding the property merely as trustee for the beneficiary. *Westerfeld v. Huckaby*, 474 S.W.2d 189 (Tex. 1972). *Accord*, TEX. PROP. CODE § 112.004(2). The settlor may retain rights in the property, or may be the initial trustee, and may retain the right to revoke the trust, without violating this rule. *Westerfeld*, *supra* at 193.

D. PASSIVE OR DRY TRUST. The Texas Supreme Court has said that "[w]hen a trustee has no duties to perform, the purposes of the trust having been accomplished, it becomes a simple, passive or dry trust, as it is termed in the law, and the cestui que trust is entitled to have the full legal title and control of the property, because no other person has an interest in the property." *Lanius v. Fletcher*, 101 S.W.2d 1076, 1078 (1907). Under these circumstances, the beneficiary is entitled to possession of the contents of the trust. *Hall v. Rawls*, 188 S.W.2d 807, 815 (Tex. Civ. App.--Beaumont 1945, writ ref'd). Similarly, if the trustee is not given affirmative powers and duties in the trust instrument, the trust is passive or dry, and legal title is vested in the beneficiaries, not the trustee. *Nolana Development Ass'n v. Corsi*, 682 S.W.2d 246, 249 (Tex. 1984). Consider, however,

the effect of Section 112.004 of the Texas Trust Code, which recognizes the enforceability of a trust of personalty in certain situations, even though the terms of the trust are not specified. Finally, "a trust cannot be created unless there is trust property." Tex. Prop. Code § 112.005.

Passive or dry trust issues arose in *Rife v. Kerr*, 513 S.W.3d 601, 612 (Tex. App.--San Antonio 2016, pet. denied). The court repeated the standard descriptions of when a trust is a passive or dry trust, but also stated that "[a] trustee of a dry or passive trust has no power to convey the trust property without the direction and consent of the beneficiary.… The trustee of a passive trust 'generally is responsible only for conveying the property to the beneficiary or in accordance with his directions.'"). Passive or dry trusts were discussed in *Estate of Lee*, 551 S.W.3d 802, 814 (Tex. App.--Texarkana 2018, no pet.). The court cited earlier case authority that "[a] trustee who has no duty except to make payments as they become due is the trustee of a 'passive' or 'dry' trust." *Id*. at 814. The court went on to hold that a passive or dry trust could not be a spendthrift trust, because legal title is vested in the beneficiaries, not the name trustee. *Id*. at 814.

The doctrine of "dry trust" was explored in the case of *Zahn v. National Bank of Commerce*, 328 S.W.2d 783 (Tex. Civ. App.--Dallas 1959, writ ref'd n.r.e.). The settlor's will provided that land was to be held for two years after her death and if at that time, oil or minerals were not found, the land was to be sold and the oil and mineral rights reserved and placed in trust for the benefit of five cousins. The trustee asked for a construction of the will to determine if this trust was valid. The Court of Civil Appeals determined that it was permissible for the trust to remain "dry" or unfunded for the two-year period. If the oil or mineral rights were found within that period, the beneficiaries would receive title in fee simple. If not, the trust would be funded (with the oil and mineral rights as the *res*) for administration on behalf of the beneficiaries.

The doctrine of dry trusts has been adjudicated in other states.

The Pennsylvania Supreme Court addressed the doctrine of dry trust in connection with a post-divorce dispute. In *Eaves v. Snyder*, 368 Pa. 459, 84 A.2d 195 (1951), Snyder, Sr., conveyed certain real estate to his son, Snyder, Jr., and his son's wife. At the same time, the grantees signed a "deed of trust" back to Snyder, Sr. The deed to Snyder, Jr., and wife was recorded, but the deed of trust was not. Shortly thereafter, Snyder, Sr., filed for bankruptcy. Some years after the bankruptcy was closed, and shortly before Snyder, Jr., and his wife were divorced, the deed of trust was filed of record. Ten years later, the ex-wife sued Snyder, Jr., for her half of the land, arguing that although a fraudulent conveyance is void as against creditors, it is valid as against the fraudulent grantor. The Court rejected the argument, saying it applied only where there is a mere agreement to reconvey, or where the grantor seeks to establish a resulting or constructive trust. In this case, the deed and the deed of trust must be construed together, with the result that the transaction created a dry trust in the hands of Snyder, Jr., and wife, who held legal title merely for conveyance back to Snyder, Sr. Both the legal and equitable estates in the land vested immediately in Snyder, Sr., who was the beneficiary of the dry trust.

E. ILLUSORY TRUST. An express trust can be challenged on the ground that it is an "illusory trust." The leading Texas case on illusory trusts is *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968). In *Land v. Marshall*, the husband had created an inter vivos trust using almost all of the community property. He retained, however, the power to revoke the trust, the right to consume the principal, to control the trustee, and other beneficial interests during his lifetime. Upon his death, the trust passed title in the community property to the parties' daughter. In a challenge brought by

the wife after the husband's death, the entire trust was held by the Supreme Court to be invalid. The test announced by the Supreme Court for an "illusory trust" was:

> Did the decedent, by his conveyance in his lifetime, retain such a large interest in the property that, at least as to his wife, his inter vivos trust was illusory?

Id. at 848. If so, then the trust was "illusory," and failed as to the wife's one-half community property interest. This happened in *Land v. Marshall*. However, in *Land v. Marshall*, the Court also nullified the trust as to the husband's one-half of the property, because the removal of the wife's one-half interest in the property was seen as defeating the husband's testamentary intent. *Id*. at 849. As a result, the husband's one-half interest in that property belonged to his estate, to pass under his will.

See generally Simpkins, TEXAS FAMILY LAW § 21:24 (5th ed. 1976); Comment, *Husband as Manager of the Community Estate: Illusory Trusts*, 10 S. TEX. L.J. 301 (1968);W. Richard Jones, *The Illusory Trust and Community Property*, 22 SW. L.J. 447 (1968); Annot., 39 A.L.R.3d 14 (1971). *See also* Bell, *Community Property Trusts--Challenges by the Non-Participating Spouse*, 22 BAY. L. REV. 311 (1970). A similar concept was described in *Hunter v. Clark*, 687 S.W.2d 811, 814 (Tex. App.--San Antonio 1985, no writ), that a spouse could not defeat the other spouse's survivor's homestead right by conveying the homestead during lifetime.

1. Is It Only Upon Death? The "illusory trust" doctrine was developed in common law jurisdictions to defeat attempts by the husband, by means of a lifetime conveyance, to circumvent the wife's survivor-interest in his property. *Land v. Marshall*, 426 S.W.2d at 847. The doctrine was transplanted to Texas in *Land v. Marshall*, where the husband sought to make an essentially testamentary disposition of his wife's community interest in property through the use of an inter vivos trust. Texas law prohibited the husband from bequeathing his wife's community interest in the property. The question in *Land v. Marshall* was whether the husband could do by inter vivos trust what he could not do by will. *Id*. at 846. The Texas Supreme Court concluded that, where the conveyance into trust was illusory, the trust failed as to the wife's one-half community interest. The case was seen by the Court to involve "a problem created by our community property protection of the wife's distribution share." *Id*. at 848.

One may ask whether the illusory trust doctrine can be used during the settlor's lifetime, to nullify a conveyance into trust. There is no statement in Texas cases that the illusory trust argument can only be raised after the settlor's death. Also, the trust in *Land v. Marshall* was a *revocable* trust. Had the trust been irrevocable, and the contest had arisen before the husband's death, the wife would want to add fraud-on-the-community remedies in addition to a claim of illusory trust.

2. Only When Non-Consenting Spouse's Property is Used to Fund a Trust. The illusory trust doctrine "is limited to instances in which a non-consenting spouse's property is used to fund a trust." *Westerfeld v. Huckaby*, 474 S.W.2d 189 (Tex. 1971). Consequently, the remedy is available only to the extent that the complaining spouse's separate property, or share of the community property, is used without her consent. As explained in *Westerfeld*, the trust in *Land v. Marshall* was an illusory trust only as to the wife's interest in the property. *Westerfeld*, 74 S.W.2d at 191. However, in *Land v. Marshall*, the entire trust failed, even as to the husband's interest in the property, because the loss of half of the trust corpus was deemed to defeat the husband's plan of distribution. *Id*. at 849.

3. Excessive Control Not Sole Basis of "Illusory Trust" Attack. In *Land v. Marshall*, the Supreme Court determined that the inter vivos trust was invalid. The Court said:

> The Marshall trust was invalid. The trustor transferred the legal title of the corpus to a trustee, but he retained complete control over the trustee. Marshall had and could exercise every power over the corpus of the trust after the creation of the trust that he possessed before its creation. As expressed by respondent, Marshall created a trust, but nothing happened. Mr. Justice Holmes in *Leonard v. Leonard*, 181 Mass 458, 63 N.E. 1068 (1902), expressed the same idea when he said that the transfer took back all that it conveyed except legal title.

Id. at 846-47. However, as explained by a majority of the Supreme Court in *Westerfeld v. Huckaby*, 474 S.W.2d 189, 191 (Tex. 1972), the trust in *Land v. Marshall* did not fail simply because the husband reserved too much control over his own property. In *Westerfeld* the Court said:

> *Land v. Marshall* dealt with a problem created by our community property protection of the wife's distributive share. We therefore could not look solely to the husband's reservation of powers over his own property but had to bring additional policy considerations to bear.

Id. at 191.

In *Westerfeld*, the administratrix of a decedent sought to set aside inter vivos trusts created by the decedent, on the grounds that the decedent had retained too much control and the trusts were "illusory." The administratrix's attack was rejected by a majority of the Supreme Court which felt that the decedent could create valid trusts even though she reserved in herself broad beneficial rights, as well as the right to revoke the trusts and the right to control or manage the trustees. *Id*. at 192. There was no problem of community property in *Westerfeld*, because the decedent was a single woman (feme sole). Had the settlor been married and conveying community property, the issues and the outcome could have been different.

4. Spouse's Participation Forecloses Attack. In one case the court held that an illusory trust attack cannot be raised by a spouse who participated in the original conveyance into trust. *United States v. Gordon*, 406 F.2d 332, 343 (5th Cir. 1969). One would expect a claim of fraudulent inducement or mistake in such a situation.

5. Law From Other Jurisdictions. The illusory trust doctrine has been litigated in a number of other jurisdictions.

a. Massachusetts. The high court of Massachusetts considered the illusory trust doctrine, in the case of *Sullivan v. Burkin*, 390 Mass. 864, 460 N.W.2d 572 (1984). Reversing precedent, the Court announced that the estate of the decedent would, for purposes of the surviving spouse's heirship rights, include "the value of assets held in an inter vivos trust created by the deceased spouse as to which the deceased spouse alone retained the power during his or her life to direct the disposition of those trust assets for his or her benefit, as, for example, by the exercise of a power of appointment or by revocation of the trust." *Id*. at 574-75. The rule was to be applied prospectively only. The Court preferred its definite standard to the "rather unsatisfactory process of determining whether the inter vivos trust was, on some standard, 'colorable,' 'fraudulent,' or 'illusory.'" *Id*. at 577. The Court also saw itself as bringing the heirship law into line with the equitable distribution law applicable to divorce proceedings in Massachusetts. The Court observed:

> The interests of one spouse in the property of the other have been substantially increased upon the dissolution of a marriage by divorce. . . . It is neither equitable nor logical to extend to a divorced spouse greater rights in the assets of an inter vivos trust created and controlled by the other spouse than are extended to a spouse who remains married until the death of his or her spouse.

Id. at 577.

The rule announced in *Sullivan* accomplishes much the same effect as the illusory trust doctrine in Texas and some other states. However, the rule in Massachusetts is probably a matter of law for the court, whereas the illusory trust doctrine in Texas may involve fact issues. Note that the illusory trust doctrine of *Land v. Marshall* was applied to community property. There is reason to question whether the doctrine of illusory trust applies in a death case where the property belonged to only one spouse under the law of the state where the parties were domiciled at the time of acquisition. *Compare Cameron v. Cameron* 641 S.W.2d 210 (Tex. 1982) *to Estate of Hanau v. Hanau*, 730 S.W. 2d 663 (Tex. 1987).

b. New York. One of the leading cases on illusory trusts is *Newman v. Dore*, 275 N.Y. 371, 9 N.E.2d 966 (1937), a case cited in *Land v. Marshall*. In *Newman*, the husband by will created a trust for the benefit of his wife, to contain one-third of his property, and to pay her the income for life. Under New York law, this provision in his will eliminated the wife's right to elect to partake of the husband's estate, as if he died intestate. Three days before his death, the husband conveyed all of his property into a trust. If the trust was valid, his widow would get none of his estate, since the provision in the will eliminated her widow's election, and there was no property on hand to fund her testamentary trust. The trial judge invalidated the inter vivos trust, finding that the husband's motive was to evade the laws of the state. The high court, however, concluded that "[m]otive or intent is an unsatisfactory test of the validity of a transfer of property." *Id*. at 968. "The fact that the [person] desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you intentionally may go as close to it as you can if you do not pass it." *Id*. at 967 (quoting *Bullen v. Wisconsin*, 240 U.S. 625 (1916)). The Court adopted the "illusory trust" doctrine, saying:

> The test has been formulated in different ways, but in most jurisdictions the test applied is essentially the test of whether the husband has in good faith divested himself of ownership of his property or has made an illusory transfer. "The 'good faith' required of the donor or settlor in making a valid disposition of his property during life does not refer to the purpose to affect his wife but to the intent to divest himself of the ownership of the property. It is, therefore, apparent that the fraudulent intent which will defeat a gift inter vivos cannot be predicated on the husband's intent to deprive the wife of her distributive . . . share as a widow." *Benkart v. Commonwealth Trust Co., of Pittsburgh*, 269 Pa. 257, 259, 112 A. 62, 63.

Id. at 969. In *Newman*, the husband retained the income for life, and the power to revoke the trust, and also the right to control the trustees. Thus, "[j]udged by the substance, not by the form, the testator's conveyance [was] illusory, intended only as a mask for the effective retention by the settlor of the property which in form he had conveyed." *Id*. at 969. Although the judgment is not stated in the opinion, it appears that the property was included in the husband's estate, and therefore passed into the testamentary trust, for the benefit of the widow.

Newman was followed in *President & Directors of Manhattan Co. v. Janowitz*, 172 Misc. 290, 14 N.Y.S.2d 375 (1939), which said that the test was whether the settlor in good faith divested himself

of ownership, or instead made an illusory transfer to hide the effective retention of the property. An illusory trust was found because the settlor reserved the right to revoke the trust, reserved income from the trust for life, and reserved substantial control over the trust during his lifetime.

An illusory trust was also found in *Burns v. Turnbull*, 266 App. Div. 779, 41 N.Y.S.2d 448 (1943), where the settlor was one of two trustees, and reserved the authority to replace the other trustee, and retained exclusive control over the corpus, and reserved the right to amend or revoke the trust.

c. Oklahoma. Oklahoma has case law applying the illusory trust doctrine. In *Thomas v. Bank of Oklahoma*, 684 P.2d 553 (Okl. 1984), the Supreme Court of Oklahoma determined that a forced heir election under Oklahoma statutes could not be defeated by placing assets in a revocable inter vivos trust. The Court acknowledged that, under Oklahoma law, a spouse could freely give away his or her separate property, in that neither the spouse nor the children had a claim to the separate property, except insofar as the donor is liable for their support. *Id*. at 554. However, the gift must be bona fide and complete. "A gift is not a gift if the donor retains right of complete control and dominion, and especially the right to take back the "gift" at any time." *Id*. at 554. The Court relied upon Oklahoma cases holding that a gift, in which the donor retains during lifetime complete control of the property and acts as if he still owns it, creates a resulting trust only, and beneficial interest remains with the donor. The Court also cited New York and Kansas cases involving the illusory trust doctrine. The trustee argued that the Uniform Testamentary Addition to Trust Act, which declared that "pour-over" provisions in a will were valid even though the inter vivos trust to be funded upon death was revocable, established the validity of the trust. The Court rejected this argument, saying:

> We also distinguish between the general revocability of a trust, the legality of which there is not doubt, and the effect of revocability on a forced heir's right under [Oklahoma law]. Such revocable power cannot be allowed to defeat a survivor's rights to the estate.

Id. at 556. The retention by the settlor, in *Thomas*, of the right to revoke the inter vivos trust, subjected the trust assets to forced heirship.

The *Thomas* case demonstrates three important points: (i) the Court acknowledged the illusory trust doctrine; (ii) in Oklahoma, a gift to a third party creates merely a resulting trust, where the donor retains control over the property, and especially where the gift is revocable; thus, although legal title may pass, beneficial title remains with the donor, and is subject to forced heirship; (iii) the law permitting trusts to be revocable does not insulate revocable trusts from forced heirship.

In *Roberts v. South Oklahoma City Hospital Trust*, 742 P.2d 1077, 1082-83 (Okla. 1986), the Court, after citing *Newman v. Dore*, 275 N.Y. 371, 9 N.E.2d 966 (1937), wrote:

> Although a trust instrument may purport to name a beneficiary, if the settlor reserves a substantial interest or unbridled control over management of the operations, – i.e., not for the benefit of the purported beneficiary, the trust may be found to be illusory. Subsequently, the settlor remains the owner of the property and ther is no beneficiary.[23]
>
> [23] G. Bogart and G. Bogart, "The Law of Trusts and Trustees," p. 127 § 161 (2nd ed. 1984).

d. West Virginia. The illusory trust doctrine was examined by the Supreme Court of West Virginia in *Davis v. KB & T Co.*, 309 S.E.2d 45 (W. Va. 1983). There the husband conveyed his

non-tangible personalty into a trust, retaining the right to the income for life, and if his wife survived him, then to her for her life, with a remainder interest to certain named beneficiaries. The widow sued asserting a dower interest in the property conveyed by the husband into trust. The Court said:

> The question of the validity of an inter vivos trust which impairs the statutory right of the surviving spouse to share in the settlor's estate is an issue which has been addressed in numerous jurisdictions. . . . Generally, in resolving the issue, courts have taken one of two approaches. The first approach involves a determination of whether the transfer of property is real and bona fide, or whether the settlor has reserved such powers of ownership and control over the trust property as to make the transfer illusory or testamentary in character. . . .The second approach involves examination of the question whether the transfer of property in trust constituted a fraud upon the rights of the spouse.

Id. at 49. The West Virginia Court applied both tests to the case.

In *Davis*, the primary basis for the illusory trust attack was that the husband reserved the right to amend or revoke the trust during lifetime. The Court said that "[i]t is well established, however, that the retention by the settlor of the power to revoke or modify a trust is insufficient, standing alone, to render the trust illusory or testamentary." *Id*. at 49 (citing I.A. Scott, THE LAW OF TRUSTS § 57.1 (3d ed. 1967). The Court also quoted RESTATEMENT (SECOND) OF TRUSTS § 57 (1959) in support of the rule. The illusory trust attack was rejected.

F. COLORABLE TRUST. The "colorable trust" doctrine may be a tool available to dismantle a trust. In *Land v. Marshall*, 426 S.W.2d 841, 846 (Tex. 1968), the Texas Supreme Court said the following about a colorable trust:

> Under the doctrine, the husband has the power to create an inter vivos trust as a part of his managerial powers over the wife's share [of the community property]; but when her share is involved, the wife can require the trust to be real rather than illusory, genuine rather than colorable.[4]

Footnote 4 provides:

> 4.". . . The term "colorable" as used herein, indicates a transfer which may be absolute on its face, but which, actually, is not a transfer at all because, through some secret or tacit understanding, the parties intend that ownership is to be retained by the donor . . . ." Edward A. Smith, 44 MICH. L. REV. 151, 153; *Martin v. Martin*, 282 Ky. 411, 138 S.W.2d 509 (1940).

Id., at 846 n. 4.

The "colorable trust" doctrine was discussed in a 1970 law review article by John L. Bell, Jr. Mr. Bell quotes different authorities on the meaning of the term "colorable," as used in this context. He concludes:

> The heirs of the settlor who would be deprived of the assets if the testamentary provisions of the purported trust instrument were given effect, may seek a judicial declaration of the invalidity of the colorable transfer on the grounds that the transaction is fraudulent. This is purely a fraud doctrine and is not affected by community property considerations.

Bell, *Community Property Trusts--Challenges by the Non-Participating Spouse*, 22 BAY. L. REV. 311, 319 (1970). Although the doctrine was discussed in a death-related case, there is no reason why it should be limited to death.

G. EXCESSIVE RETENTION OF CONTROL. In recent decades, it has become popular for estate planners to create trusts in which the beneficiary is the trustee of her own trust. Sometimes the settlor, trustee, and beneficiary are the same person, wearing three different hats. The IRS will permit this "hat trick" if the trustee-beneficiary's power to distribute trust property to herself is limited by an "ascertainable standard," usually articulated as the "HEMS standard" of health, education, maintenance, and support of the beneficiary. Distributions by the trustee to herself as beneficiary that violate the HEMS standard could be used as evidence that the legal title and equitable title are separate in name only. A trustee's distribution of trust income to himself as beneficiary was the issue in *Sharma v. Routh*, 302 S.W.3d 355 (Tex. App.--Houston [14th Dist.], discussed in Section XII. F.2 below. The *Sharma v. Routh* case bears close scrutiny, not just as to the marital property character of distributed income, but also in the context of one spouse conveying community property into trust during marriage (not an issue in *Sharma v. Routh*). Chief Justice Hedges' original Majority Opinion (withdrawn) deserves renewed attention when the issue involves a claim brought by a spouse during divorce to set aside a conveyance of community property into trust. Apart from disregard of the HEMS standard that was central to *Sharma v. Routh*, the power of the trustee-beneficiary to "appoint" trust assets to beneficiaries not fixed by the trust agreement may be considered to be evidence that the conveyance into trust was not complete enough to constitute a true relinquishment of control, so that the conveyance into trust was not genuine. All aspects of the trust, not just the HEMS standard and the power of appointment, should be examined to see if they support a claim of incomplete conveyance or excessive retention of control.

H. ALTER EGO. Family lawyers know that the independence or separateness of a corporation or other business entity can be attacked under the "alter ego" doctrine, or more broadly, on several grounds for disregarding the separate identity of an entity. The doctrine could be used to contest whether certain property is truly "held in trust." The Court of Civil Appeals, in *In re Marriage of Burns*, 573 S.W.2d 555, 557 (Tex. Civ. App.--Texarkana 1978, writ dism'd), acknowledged this potential attack, when it noted that the wife in that case had not challenged the husband's trust as being the alter ego of the husband. The same is true of *Lemke v. Lemke*, 929 S.W.2d 662, 664 (Tex. App.–Fort Worth 1996, writ denied). The doctrine of alter ego was applied to trusts in the following cases cited by in a State Bar of Texas CLE article: *U.S. v. Rigler*, 885 F. Supp.2d 923, 933 (S.D. Iowa 2012) (concluding that trust was Rigler's alter ego because Rigler "is in no way independent of the Trust," "denies knowing of any Trust beneficiaries,"and "Rigler also acknowledged that the Trust has no bank account and no taxpayer identification number"); *Greenspan v. LADT*, No. B222539 (Cal. Ct. App. 2d Dist. 2010) ("Based on a trio of California cases as well as out-of-state authority, we conclude the alter ego doctrine may apply to a trustee but not a trust."); *Schwerin v. Kuhns*, No. A138444, 2014 WL 1435898 (Cal. Ct. App. 1st Dist. 2014); *In re Gillespie*, 269 B.R. 383,(E.D. Arkansas) (finding that "[a]lthough the doctrine [of alter ego] is most often applied with regard to corporations, it also applies to trusts, and 'the trust functioned merely as an appendage of Ms. Gillespie and her various businesses,' 'no respect for separate corporate or trust identities,' and 'the only evidence that the trust or corporate entities even existed were the documents which created them. For all other purposes, the trust and corporations were virtually nonexistent."); *FPP Enterprises v. U.S.*, 830 F.2d 114, 118 (8th Cir. 1987) (holding "on this record, the district court's finding that the trusts are shells acting as alter egos for the Beasons and therefore not separate persons from the taxpayers will not be disturbed"). [Author unknown] *The Perfect Storm: Estate*

Planning and the Crossover with Divorce (State Bar of Texas 13th Annual Fiduciary Litigation Course (December 6-7, 2018) p. 13.

The necessary legal standards to establish a trust as an alter ego can be adapted from cases where a spouse has sought to pierce the corporate veil. *See Spruill v. Spruill*, 624 S.W.2d 694 (Tex. Civ. App.--El Paso 1981, writ dism'd); *Duke v. Duke*, 605 S.W.2d 408 (Tex. Civ. App.--El Paso 1980, writ dism'd); *Humphrey v. Humphrey*, 593 S.W.2d 824 (Tex. Civ. App.--Houston [14th Dist.] 1980, writ dism'd); *Goetz v. Goetz*, 567 S.W.2d 892 (Tex. Civ. App.--Dallas 1978, no writ). *Martin v. Martin*, 628 S.W.2d 534 (Tex. App.--Fort Worth 1982, no writ). *See generally* Tex. Prop. Code §112.008(c) (settlor and beneficiary may be trustee, except where merger would occur). It should be noted that a trust may be operated as an alter ego of the settlor, or of the trustee, or of the beneficiary.

However, alter ego is just one of several grounds to disregard the separate identity of an entity, as discussed below.

1. ***Castleberry v. Branscum*.** The Supreme Court examined the contours of piercing the corporate veil in *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986). There the Court discussed seven recognized grounds for disregarding the corporate fiction: (i) alter ego; (ii) because "the corporate form has been used as part of a basically unfair device to achieve an inequitable result; (iii) fraudulent conveyance; (iv) the trust fund doctrine; (v) breach of fiduciary duties; (vi) the denuding theory; and (vii) inadequate capitalization. *Id*. at271-73. As to the alter ego theory the Court said:

> Alter ego applies when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice. *First Nat. Bank in Canyon v. Gamble*, 132 S.W.2d 100, 103 (Tex. 1939). It is shown from the total dealings of the corporation and the individual, including the degree to which corporate formalities have been followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes. [Citations omitted.] Alter ego's rationale is: "if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors."

Id. at 272.

The policy reasons which support disregarding the corporate fiction may well also apply to situations where an ostensible trust relationship in property is conducted in a manner that meets the conditions for disregarding the separate identity of an entity. If the facts warrant it, plead the cause of action, and if the trial judge will not allow it, take it up on appeal.

2. Colorable Trust vs. Alter Ego. One can draw some distinctions between a "colorable" trust and a trust relationship which can be disregarded on recognized grounds. To prove that a trust is colorable, the proponent must show an agreement between the settlor and the trustee such that the settlor retains the benefit of the principal and income of the trust, notwithstanding the apparently completed conveyance to the trustee. To establish that a trust is being operated as an alter ego, the proponent would show that the settlor, or trustee, or beneficiary, as the case may be, dealt with the trust property as if it was not subject to the limitations in the trust instrument. Thus, even if the

attempt to prove an *agreement* between the trustee and the settlor is unsuccessful, and the colorable trust attack fails, the trust relationship may be disregarded on other grounds.

Where the beneficiary is also the trustee (and especially also the settlor), the situation becomes very problematic. Past behavior may demonstrate that the trust structure is a pretense, driven by estate tax motives but not real in the actual operation.

I. TRUST AS INSTRUMENT OF FRAUD. No published Texas appellate case has disregarded a conveyance into trust on the ground that it was used to perpetrate a fraud. However, this cause of action exists in some other jurisdictions. In this subsection, an analogy is drawn to Texas precedent disregarding the corporate fiction, and some case law from other states is examined.

1. Comparison to Cases Disregarding the Corporate Entity. In the case of *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986), the Supreme Court discussed disregarding the corporate fiction where the corporate entity is used to perpetrate a fraud. The Court indicated that the corporate veil could be pierced upon a showing that the corporate form had been used in such a way as to amount to constructive fraud. The Court said:

> Because disregarding the corporate fiction is an equitable doctrine, Texas takes a flexible fact-specific approach focusing on equity.

Id. at 273. There are a number of Texas cases discussing constructive fraud-on-the-spouse, in situations involving the conveyance of community property by a spouse to a third party. However, these cases would address only the conveyance by a spouse of property into trust. One can imagine other instances of constructive fraud in connection with a trust, apart from a spouse's conveyance of community property into trust. Take, for example, the woman who, shortly prior to marriage, conveys all of her income-producing property into trust, and then, either as trustee or through control over the trustee, uses undistributed trust income to acquire assets such as the car which she drives, the house in which she lives, etc.--items which would have been community property had the income been received by her free of trust. This activity would not constitute a constructively fraudulent conveyance of community property, but might constitute use of an express trust in a constructively fraudulent manner. If the principles that apply to use of a corporation to perpetrate a fraud can be adapted to express trusts, equity would allow the court in a divorce to disregard the trust "fiction."

J. RESCISSION, CANCELLATION AND REFORMATION FOR FRAUD, DURESS, MISTAKE, ETC. Conveyances into trust, like every other transaction, are subject to rescission, cancellation or reformation on the grounds of fraud, accident, mistake, undue influence, duress, failure of consideration, etc. *See* 72 TEX. JUR.3d *Trusts* § 154 (1990).

1. Fraud in the Inducement as Basis for Rescission. In order to rescind a conveyance for fraud in the inducement, it must be shown that: (1) a false representation was made by the victim; (2) the victim detrimentally relied upon the false representation; and (3) the victim suffered resultant injury. *Citizens Standard Life Ins Co. v. Muncy*, 518 S.W.2d 391, 194 (Tex. Civ. App.--Amarillo 1974, no writ). The misrepresentation must relate to a material fact. *Runfield v. Runfield*, 324 S.W.2d 304, 406 (Tex. Civ. App.--Amarillo 1959, writ ref'd n.r.e.). The speaker need not know the falsity of the representation. *Citizens Standard Life Ins. Co. v. Muncy*, 518 S.W.2d 391, 195 (Tex. Civ. App.--Amarillo 1974, no writ). The failure to disclose a material fact will not support rescission, unless the wrongdoer had a duty to disclose arising from the nature of the relationship between the

wrongdoer and the victim. *Anderson v. Anderson*, 620 S.W.2d 815, 819 (Tex. Civ. App.--Tyler 1981, no writ). A promise regarding future behavior will not support rescission unless the wrongdoer had no intent to carry out the promise at the time it was made. *Bassett v. Bassett*, 590 S.W.2d 531, 533 (Tex. Civ. App.--Houston [1st Dist.] 1979, writ dism'd). Where the victim had knowledge of the falsity, rescission is not available. *Shaw Equipment Co. v. Hoople Jordan Const. Co.*, 428 S.W.2d 835, 839 (Tex. Civ. App.--Dallas 1968, no writ).

In the context of an express trust, it can be imagined that the settlor, or someone claiming through her, might assert fraud in the inducement as a ground to rescind the conveyance into trust. Consider the following scenario. Assume that the wife is induced by her husband to join in a conveyance of their community property into trust, with the income from the trust to be paid in equal portions to husband and wife, for their lives, and then to the survivor, for life, and with the remainder to go to the spouses' children. Shortly after the conveyance, the husband files for divorce, and moves in with his girlfriend. The wife's lawyer wants to rescind the conveyance into trust. Given the fiduciary relationship which exists between spouses, and the husband's failure to disclose the existence of a girlfriend or his intent to seek a divorce, rescission of the conveyance into trust would be appropriate, based on fraud in the inducement and breach of fiduciary duty. Proof of actual fraud eliminates the need to show a fiduciary relationship. *Meadows v. Bierschwale*, 516 S.W.2d 125 (Tex. 1974).

The reader should differentiate fraudulent inducement from actual fraud and constructive fraud/breach of fiduciary duty. Fraudulent inducement requires only a false inducement, not a knowingly false inducement. Actual fraud involves scienter. Constructive fraud involves only unfairness to the victim to whom a fiduciary or special duty is owed.

2. Accident. The Texas Supreme Court discussed what constitutes an accident sufficient to rescind or cancel a transaction, in *Henry S. Miller Co. v. Evans*, 452 S.W.2d 426, 432 (Tex. 1970). The Court described such an accident as:

> an unforeseen and unexpected event, occurring externally to the party affected by it, *and of which his own agency is not the proximate cause*, whereby, contrary to his own intention and wish, he loses some legal right or becomes subject to some legal liability and another acquires a corresponding legal right, which it would be a violation of good conscience for the latter person, under the circumstances, to retain . . . . If the party's own agent is the proximate cause of the event, it is mistake rather than an accident.

See Lott v. Kaiser, 61 Tex. 665, 668-69 (Tex. 1884).

3. Mistake. Equity recognizes "mistake" as a ground for reformation, rescission or cancellation of a transaction. It should be noted that if rescission or cancellation is not available, and the doctrine of mistake applies, a divorce court can order the settlor to reform the trust agreement to make it revocable, and then exercise his power to revoke the trust.

a. Mistake as Basis for Rescission and Cancellation. To rescind or cancel an agreement for mistake, the mistake in most instances must be mutual. *Hanover Ins. Co. v. Hoch*, 469 S.W.2d 717, 722 (Tex. Civ. App.--Corpus Christi 1971, writ ref'd n.r.e.). The mistake must relate to a material and essential issue, not an incidental one.*Simpson v. Simpson*, 387 S.W.2d 717, 719 (Tex. Civ. App.--Eastland 1965, no writ). The mistake cannot have resulted from the negligence of the party seeking to negate the transaction. *Plains Cotton Cooperative Assn. v. Wolf*, 553 S.W.2d 800, 803

(Tex. Civ. App.--Amarillo 1977, writ ref'd n.r.e.). Ordinarily, an error in predicting the future will not support rescission or cancellation. *City of Austin v. Cotten*, 509 S.W.2d 554, 557 (Tex. 1974). A mistake as to a party's existing legal rights can support rescission. *Plains Cotton Cooperative Assn. v. Wolf*, 553 S.W.2d 800, 803 (Tex. Civ. App.--Amarillo 1977, writ ref'd n.r.e.).

Unilateral mistake, that is not known to or induced by the other party, ordinarily will not support rescission or cancellation of an agreement. *Johnson v. Snell*, 504 S.W.2d 397, 399 (Tex. 1973). However, unilateral mistake can support rescission where the mistake is of such a magnitude that to enforce the contract would be unconscionable, the mistake involves a material feature of the agreement, the mistake was made despite the exercise of ordinary care, and the parties can be returned to the status quo ante after rescission. *Taylor v. Arlington Ind. School Dist.*, 335 S.W.2d 371, 373 (Tex. 1960).

"Unilateral mistake by one party, and knowledge of that mistake by the other party, is equivalent to mutual mistake." *Davis v. Grammar*, 750 S.W.2d 766, 768 (Tex. 1988).

b. Mistake as Basis for Reformation. Reformation is an equitable proceeding in which a document which is erroneously written is caused to conform to the true agreement between the parties. *Continental Oil Co. v. Doornbos*, 402 S.W.2d 879, 883 (Tex. 1966). Ordinarily, the mistake in the document must be mutual, and not unilateral, in order to support reformation. To warrant reformation, the proponent must prove the true agreement of the parties, and that the written memorandum deviates from the true agreement as a result of mutual mistake. *Brown v. Havard*, 593 S.W.2d 939, 942 (Tex. 1980). However, unilateral mistake by one party will support reformation where it is accompanied by fraud or inequitable conduct by the other party. *Ace Drug Marts, Inc. v. Sterling*, 502 S.W.2d 935, 939 (Tex. Civ. App.--Corpus Christi 1974, writ ref'd n.r.e.). For example, where the other party knows of the mistake but fails to mention it, inequitable conduct exists to support reformation based upon unilateral mistake. *Cambridge Companies, Inc. v. Williams*, 602 S.W.2d 306, 308 (Tex. Civ. App.--Texarkana 1980), *aff'd*, 615 S.W.2d 172 (Tex. 1981).

c. Cancellation of Trust Agreements. American Law Reports, Second Edition, contains an annotation on the subject of when an irrevocable inter vivos trust can be cancelled on the ground of mistake or misunderstanding. Annot., 59 A.L.R.2d 1229 (1958).

One federal judge concluded that, under Texas law, a settlor may reform a trust agreement to insert a power of revocation where that power was omitted from the trust agreement by mistake. *See DuPont v. Southern Nat. Bank of Houston, Texas*, 575 F. Supp. 849, 859 (S.D. Tex. 1983), *aff'd in part, rev'd part on other grounds*, 771 F.2d 874 (5th Cir. 1985). The Court also dealt with rescission of a trust on the grounds of mistake as to tax consequences, and suggested that Texas law would require the following showing before rescinding the trust: (1) that the trust was created solely for tax considerations; (2) that these tax considerations had been definitely changed or frustrated by an actual assessment of tax liability or by a change in law that would lead an expert to conclude that a transfer tax liability would more likely than not accrue on the transaction; (3) that the changed tax circumstance amounts to a material mistake; (4) that the settlor proves that but for the mistake he would not have entered into the transaction; and (5) that when plaintiff knew or should have known of the mistake he acted immediately to remedy the situation. *Id*. at 861.

d. Undue Influence. Undue influence can support rescission or cancellation of a transaction. It is a form of legal fraud. *Bounds v. Bounds*, 382 S.W.2d 947, 951 (Tex. Civ. App.--Amarillo 1964, writ ref'd n.r.e.). (mother's suit against son to cancel warranty deed). In the area of will contests,

where undue influence usually arises, the term is defined as such an influence as would subvert or overpower the mind at the time of the transfer in question, and without which influence the transfer would not have been made. *Bohn v. Bohn*, 455 S.W.2d 401, 409 (Tex. Civ. App.--Houston [1st Dist.] 1970, writ dism'd). *See In Re Estate of Willenbrock*, 603 S.W.2d 348, 350 (Tex. Civ. App.--Eastland 1980, writ ref'd n.r.e.). The same definition was applied to a suit to rescind a real estate conveyance, in *Edwards v. Edwards*, 291 S.W.2d 783, 786 (Tex. Civ. App.--Eastland 1956, no writ), where a daughter sought to rescind a conveyance of real estate by her mother to her half-brother. Where the conveyance is made in the context of a confidential or fiduciary relationship, and the fiduciary thereby profits, a presumption of fraud may arise and a different burden of proof (i.e., proving fairness) may apply. *Mason v. Mason*, 366 S.W.2d 552 (Tex. 1963), is an example of a testamentary trust that was invalidated when the will creating it was held invalid for undue influence.

e. Duress. Duress may be used as a basis to cancel instruments. Duress exists when: (1) there is a threat to do some act which the party threatening has no legal right to do; (2) there is some illegal exaction or fraud or deception; and (3) the restraint is imminent and such as to destroy free agency without present means of protection. *Housing Authority of City of Dallas v. Hubbell*, 325 S.W.2d 880 (Tex. Civ. App.--Dallas 1959, writ ref'd, n.r.e.); *Hailey v. Fenner & Beane*, 246 S.W. 412, 412 (Tex. Civ. App.--Dallas 1923, no writ).

4. Fraudulent Conveyances. A conveyance into trust can be set aside if it violates one of the fraudulent transfer statutes. The general features of these doctrines are discussed below.

Chapter 24 of the Texas Business and Commerce Code sets out the Uniform Fraudulent Transfer Act. By using this Act, a spouse can perhaps undo a conveyance into trust.

The provisions of Chapter 24 apply to "transfers," including every mode of or parting with an interest in an asset. TEX. BUS & COM. CODE § 24.002(12) [UFTA]. A spouse is a "creditor" who can invoke the provisions of the statute. UFTA § 24.002(4).

a. Transfers Made with Intent to Defraud. Section 24.005(a)(1) of UFTA voids transfers made with the intent to hinder, delay or defraud creditors. Transferred property cannot be recovered from a bona fide purchaser who gave a reasonably equivalent value for the transfer. UFTA § 24.009(a). Cases involving spouses under earlier law include: *Lott v. Kaiser*, 61 Tex. 665 (1884) (for transfer made during divorce in which wife sought alimony); *Goodwin v. Goodwin*, 451 S.W.2d 532 (Tex. Civ. App.--Amarillo), *rev'd on other grounds*, 456 S.W.2d 885 (Tex. 1970) (regarding transfer by husband occurring between date of rendition and date of signing of decree of divorce awarding wife judgment against husband); *Spence v. Spence*, 455S.W.2d 365 (Tex. Civ. App.--Houston [14th Dist.] 1970, writ ref'd n.r.e.) (regarding transfer by husband between the date the decree of divorce was signed and the date it became final, where wife received an unsecured money judgment against husband); *Rilling v. Schultze*, 95 Tex. 352, 67 S.W.2d 401 (1902) (regarding transfer by ex-husband after entry of divorce decree ordering him to pay child support to ex-wife). *See generally White v. White*, 519 S.W.2d 689 (Tex. Civ. App.--San Antonio 1975, no writ), in which the husband was held not to be a creditor of the wife where the spouses had partitioned their property and exchanged deeds dividing their community estate.

b. Debtor's Transfer Not for Value. Section 24.005 of the Texas Business and Commerce Code states that a transfer made by a debtor without receiving a reasonably equivalent value is void with respect to an existing creditor if: (1) the debtor was about to engage in a transaction for which his/her assets were unreasonably small; (2) the debtor believed that he/she would incur debts beyond

the debtor's ability to pay as they come due. UFTA § 24.005(a)(2). Intent by the debtor to defraud a creditor or interested person is not an issue under this provision. *See First State Bank of Mobeetie v. Goodner*, 168 S.W.2d 941, 944 (Tex. Civ. App.-- Amarillo 1943, no writ). The burden of proving insolvency is on the creditor. *Wester v. Strickland*, 87S.W.2d 765, 767 (Tex. Civ. App.--Amarillo 1935), *aff'd* 112 S.W.2d 1047 (Tex. 1938).

5. Conveyances During Divorce. Section 6.707 of the Texas Family Code provides that a transfer of community property, or the incurring of community debt, by a spouse while a divorce is pending is void as against the other spouse, if done with the intent to injure the rights of the other spouse. Tex. Fam. Code § 6.707. The statute further provides, however, that the transfer or debt is not void as to the transferee or lender who had no notice of the intent to injure. The complaining spouse has the burden to prove such notice. While the mere pendency of the divorce is not constructive notice to third parties of fraudulent intent, *First Southern Properties, Inc. v. Gregory*, 538 S.W.2d 454, 458 (Tex. Civ. App.--Houston [1st Dist.] 1976, no writ), it would seem that courts might be more inclined to negate gratuitous transfers into trust made during the pendency of a divorce, where the transferee would suffer no loss of consideration paid, etc. were the transfer into trust rescinded.

6. Fraud-on-the-Spouse Doctrine. There are many Texas cases stating that actual or constructive fraud can arise when a spouse gives community property to a third party. In such a situation, the court will reconstitute the community estate based on the injury to the community estate. Tex. Fam. Code § 7.009. Most actual and constructive fraud-on-the-spouse cases have involved either outright gifts to third parties or the designation of a third party as beneficiary of a community property life insurance policy. However, the conveyance of community property into an inter vivos or testamentary trust can just as easily support a fraud-on-the-spouse case. This was recognized by the Texas Supreme Court, in dicta, in *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968).

a. Actual Fraud on the Community Estate. Bogert's TRUSTS AND TRUSTEES, Section 211, says:

> A trust, like any other transfer, conveyance, or contract, may be invalid because it is intended to accomplish an illegal purpose. Trusts for which the settlor's primary purpose was to defraud private persons or corporations of their common law or statutory rights, or defraud the government, or encourage crime or other highly unsocial conduct, will not be carried out by the courts and will be set aside on application of interested and innocent parties.

No Texas cases were found where a conveyance into trust was attacked as constituting actual fraud upon a spouse. However, the issue was examined in *Martin v. Martin*, 282 Ky. 411, 138 S.W.2d 509 (1940). In that case, the issue was whether a man who was about to marry could transfer his property to a third party with the intent to deprive his intended spouse of a distributive share of his estate, upon his death. The Kentucky Supreme Court made the following statement of the law:

> [A] man may not make a voluntary transfer of either his real or personal estate with the intent to prevent his wife, *or intended wife*, from sharing in such property at his death and that the wife, on the husband's death, may assert her marital rights in such property in the hands of the donee. [Emphasis added.]

Id. at 515.The TEXAS PATTERN JURY CHARGES (FAMILY & PROBATE) (2020) PJC 206.2A gives the following instruction regarding actual fraud of a spouse's interest in community property:

A spouse commits fraud if *that spouse transfers community property or expends community funds for the primary purpose of depriving the other spouse of the use and enjoyment of the assets involved in the transaction*. Such fraud involves dishonesty of purpose or intent to deceive. [Italicized language is subject to substitution of different language, depending on facts of case]

b. Constructive Fraud on the Community Estate. Texas case law establishes that, even without proof of actual intent to defraud the spouse, the court will rescind or otherwise compensate for a transaction whereby one spouse unfairly transfers community property. *See Greco v. Greco*, No. 04–07–00748–CV, 2008 WL4056328, *5 (Tex. App.--San Antonio Aug. 29, 2008, no pet.) (mem. op.); *Mazique v. Mazique*, 742 S.W.2d 805, 807-08 (Tex. App.--Houston [1st Dist.] 1987, no writ). The doctrine of constructive fraud is one tool the practitioner can use to undo one spouse's conveyance of community property into a trust. *See Stephens County Museum, Inc. v. Swenson*, 517 S.W.2d 257 (Tex. 1975) (a non-marital case remanded to trial court for determination of constructive fraud issue regarding transfer into trust).

The TEXAS PATTERN JURY CHARGES (FAMILY & PROBATE) (2020) PJC 206.4A gives the following instruction regarding constructive fraud as to a spouse's interest in community property:

A spouse may make moderate gifts, transfers, or expenditures of community property for just causes to a third party. However, a gift, transfer, or expenditure of community property that is capricious, excessive, or arbitrary is unfair to the other spouse. Factors to be considered in determining the fairness of a gift, transfer, or expenditure are—

1. *the relationship between the spouse making the gift, transfer, or expenditure and the recipient*;

2. *whether there were any special circumstances tending to justify the gift, transfer, or expenditure; and*

3. *whether the community funds used for the gift, transfer, or expenditure were reasonable in proportion to the community estate remaining*. [Italicized language is subject to substitution of different language, depending on facts of case]

i. Conveyances During Lifetime. The following cases, among many others, have addressed the issue of constructive fraud-on-a-spouse in inter vivos conveyances to third parties: *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd) (wife sought to recover from husband in divorce proceeding for gifts of community property he made to his children from a prior marriage); *Carnes v. Meador*, 533 S.W.2d 365 (Tex. Civ. App.--Dallas 1976, writ ref'd n.r.e.) (widow sued to negate gifts of community property from deceased husband to his children from prior marriage); *Logan v. Barge*, 568 S.W.2d 863 (Tex. Civ. App.--Beaumont 1978, writ ref'd n.r.e.) (widow sued step-children to recover one-half of gifts of community property made to them by her deceased husband); *Jackson v. Smith*, 703 S.W.2d 791, 795 (Tex. App.--Dallas 1985, no writ) ("A presumption of constructive fraud arises where one spouse disposes of the other spouse's one-half interest in community property without the other's knowledge or consent"); *Zieba v. Martin*, 928 S.W.2d 782, 789 (Tex. App.--Houston [14th Dist.] 1996, no pet.) ("A presumption of constructive fraud arises where one spouse disposes of the other spouse's one-half interest in community property without the other's knowledge or consent"); *In re Estate of Vackar*, 345 S.W.3d 588 (Tex. App.–San Antonio 2011, no pet.) (husband leaving $100,000 in insurance proceeds to his

sister was set aside as unfair). In *Barnett v. Barnett*, 67 S.W.3d 107, 112 (Tex. 2001), where the husband surreptitiously named his estate as beneficiary of a community property life insurance policy, and after his death the proceeds were immediately transferred by the executor to other family members, the Supreme Court said that under Texas law the wife had a cause of action for fraud on the community, and the court could impose a constructive trust on one-half of the proceeds; however in this instance state law was preempted by ERISA.

ii. Conveyances Effective Upon Death. The following cases have addressed the issue of constructive fraud-on-a-spouse in conveyances taking effect upon death: *Barnett v. Barnett*, 67 S.W.3d 107 (Tex. 2001) (deceased husband designated his estate as beneficiary of community property life insurance, with his mother and not his wife receiving the insurance proceeds; wife's fraud claim was viable under Texas law but was preempted by ERISA); *Givens v. Girard Life Ins. Co. of America*, 480 S.W.2d 4211 (Tex. Civ. App.--Dallas 1972, writ ref'd n.r.e.) (widow sued deceased husband's girlfriend to recover proceeds from community property life insurance policy on life of deceased husband); *Murphy v. Metropolitan Life Ins. Co.*, 498 S.W.2d 278 (Tex. Civ. App.--Houston [14th Dist.] 1973, writ ref'd n.r.e.) (decedent's mother sued insurance company and decedent's wife for proceeds of community property life insurance policy on decedent's life);

L. MERGER. The essence of an express trust is the separation of the legal title from the equitable title in property, with the trustee holding legal title and the beneficiary holding equitable title. *Jameson v. Bain*, 693 S.W.2d 676, 680 (Tex. App.--San Antonio 1985, no writ). Whenever legal title and equitable title to trust property are joined in the same person, the two interests merge, and the property is no longer in trust.

The doctrine of merger is expressly set out in Section 112.034 of the Texas Trust Code. The Section provides:

> (a) If a settlor transfers both the legal title and all equitable interests in property to the same person or retains both the legal title and all equitable interests in property in himself as both the sole trustee and the sole beneficiary, a trust is not created and the transferee holds the property as his own . . . .
>
> (b) Except as provided by subsection (c) of this section, a trust terminates if the legal title to the trust property and all equitable interests in the trust become united in one person . . . .

TEX. PROP. CODE § 112.034. The Code further provides that merger cannot occur for the beneficiary (other than the settlor) of a spendthrift trust, and that if such occurs, the court must appoint a new trustee or co-trustee to administer the trust.

Merger can occur at the outset of the trust, or as a result of a design defect in the trust instrument, or it can result from a subsequent act of the beneficiary. For example, when the beneficiary of an express trust conveys equitable title to the trustee, so that legal title and equitable title are merged in the trustee, the trust is terminated and the trustee has an unrestricted right to the property. *See Becknal v. Atwood*, 518 S.W.2d 593 (Tex. Civ. App.--Amarillo 1975, no writ). In *Becknal*, where the father conveyed real property to his wife as trustee for their children, and the children later conveyed their remainder interest back to their mother, for her use and enjoyment during her lifetime, and then to the trustor-father, for his use during his lifetime, legal and equitable title merged

and the property in question exited the trust. However, other trust property not involved in the re-conveyance continued to remain in trust.

Note that the merger provision of the Texas Trust Code speaks of merger of legal and equitable title in *one* person. Note the Code's use of the words "sole trustee" and "sole beneficiary." There is a general view that, where there are multiple trustees or multiple beneficiaries, a unification of legal and equitable title in just one of the trustees and beneficiaries does not constitute merger. *See* Annot., 7 A.L.R.4th 621 (1981). However, this argument did not avoid merger in the *Becknal* case, discussed above, where there were two trustees.

In sum, whenever the legal and equitable titles to property held in trust are combined, the possibility of merger arises.

M. STANDARDS IN THE INTERNAL REVENUE CODE. The Internal Revenue Code addresses issues analogous to the "illusory trust," "colorable trust," and alter ego doctrines in connection with taxation of trust income and the inclusion of trust property in the estate of a decedent. While there is a distinction between the validity of a transaction under state property law and the validity of the transaction for tax purposes, the parallels are of interest. The similarity was touched upon in *Sullivan v. Burkin*, 390 Mass. 864, 460 N.E.2d 572, 575 (1984).

1. Income Tax Considerations. The Internal Revenue Code recognizes a trust as a separate taxable entity only when there is a genuine relinquishment of the settlor's control over his wealth. If the settlor retains too much control over the trust, the income of the trust will be taxed to the settlor. The Code also taxes trust income to the settlor if the income is used to make payments which the settlor is obligated to make, such as child support. I.R.C. 674(b)(1), 677(b); Regs. §§ 1.674; 1.677. While recognition of a trust as a taxable entity under the Internal Revenue Code differs from recognition of a trust under state property law, in most instances the Code standards relate to the true "separateness" of the trust from the settlor. Also, the failure to meet Code requirements makes the trust's income taxable to its grantor, creating a liability for his community estate, and perhaps bolstering the claim that if income is taxable to the community, then the conveyance into trust should be declared to be ineffective. [If the trust is nonetheless valid under property law, then perhaps a right of reimbursement arises for community property used to pay taxes on the income of the trust.] For a discussion of the specific questions addressed by the Internal Revenue Code on the subject, see 33 AM. JUR.2d *Federal Taxation* § 3000-3038 (1996).

2. Estate Tax Considerations. The Internal Revenue Code also contains provisions which cause property conveyed into a trust to be included in the decedent's estate, for estate tax purposes. The rules are similar to those discussed above in connection with income taxation. See 34A AM. JUR.2d *Federal Taxation* § 143,179 (1996).

X. CONTESTED MODIFICATION/TERM-INATION OF TRUST. There may be instances where divorcing spouses may want to leave an existing trust in place, but modify certain terms of the trust. There are common law grounds for modification of express trusts, and statutory grounds.

A. DOCTRINE OF DEVIATION. Two Texas courts have recognized a "doctrine of deviation implicit in the law of trusts." According to that doctrine, "a court of equity will order a deviation from the terms of the trust if it appears to the court that compliance with the terms of the trust is impossible, illegal, impractical or inexpedient, or that owing to circumstances not known to the settlor and not anticipated by him, compliance would defeat or substantially impair the

accomplishment of the purpose of the trust." *Amalgamated Transit Union, Local Div. 1338 v. Dallas Pub. Transit Bd.*, 430 S.W.2d 107, 117 (Tex. Civ. App.--Dallas 1968, writ ref'd n.r.e.). As support, the Texas court cited a 1947 Ohio Court of Appeals case, and the Restatement (Second) of the Law of Trusts § 167, p. 351. The Ohio case was subsequently cited by Ohio courts, most recently twenty years ago. More recently, the doctrine of deviation was confirmed in *Conte v. Ditta*, 287 S.W.3d 28, 37 (Tex. App.–Houston[1st Dist.] 2007), *rev'd on other grounds*, 298 S.W.3d 187 (Tex. 2009).

B. STATUTORY-BASED MODIFICATION OR TERMINATION. Texas Property Code Section 112.054, entitled "Judicial Modification, Reformation, or Termination of Trusts," governs court proceedings to modify or terminate trusts. A suit to modify or terminate a trust can be brought by a trustee or beneficiary. The statute does not include settlors. However, Tex. Prop. Code § 115.011 permits "[a]ny interested person" to bring a suit under Section 115.001, which permits the court to take a wide array of actions respecting trusts. Tex. Prop. Code 111.004(7) says that "[w]hether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding."

The grounds for modification or termination are stated in Texas Property Code Section 112.054(a):

> (1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill;
> (2) because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust;
> (3) modification of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trusts administration;
> (4) the order is necessary or appropriate to achieve the settlors tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlors intentions; or
> (5) subject to Subsection (d):
> (A) continuance of the trust is not necessary to achieve any material purpose of the trust; or
> (B) the order is not inconsistent with a material purpose of the trust.

However, action under Section 112.054(a)(5) requires the consent of all beneficiaries. Tex. Prop. Code §113.054(d).

Tex. Prop. Code § 112.054(b) provides that--

> The court shall exercise its discretion to order a modification or termination under Subsection (a) or reformation under Subsection (b-1) in the manner that conforms as nearly as possible to the probable intention of the settlor. The court shall consider spendthrift provisions as a factor in making its decision whether to modify, terminate, or reform, but the court is not precluded from exercising its discretion to modify, terminate, or reform solely because the trust is a spendthrift trust.

Under Section 112.054(b-1),"reforming" the trust is differentiated from modifying the trust. Section 112.054(b-1) permits reformation upon petition by a trustee or beneficiary (not a settlor) if:

> (1) reformation of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trusts administration;

> (2) reformation is necessary or appropriate to achieve the settlors tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlors intentions; or
>
> (3) reformation is necessary to correct a scriveners error in the governing document, even if unambiguous, to conform the terms to the settlor's intent.

However, Section 112.054 (e) provides that reformation under Section 112.054(b-1)(3) requires proof of the settlor's intent by clear and convincing evidence.

The Legislature set out in Section 112.054(f) the following powerful provision:

> Subsection (b-1) is not intended to state the exclusive basis for reformation of trusts, and the bases for reformation of trusts in equity or common law are not affected by this section.

In *Willa Peters Hubberd Testamentary Trust*, 432 S.W.3d 358 (Tex. App.–San Antonio 2014, no pet.), the court evaluated agreed-upon amendments to a testamentary trust by ascertaining the intent of the testator who created the trust as reflected in the unambiguous language of the will. The court found that some of the modifications were permissible and they were affirmed, while others were impermissible and they were reversed.

XI. REMOVAL OF TRUSTEE. In some instances, a divorce client may wish to leave a trust in force, but want to remove the trustee of the trust, whether that be the other spouse or a third person. If the method for naming a replacement trustee set out in the trust agreement is not desirable, a request to remove a trustee could be coupled with a request to modify the terms of the trust pertaining to the appointment of a successor trustee. Texas Prop. Code § 112.054, entitled "Judicial Modification, Reformation, or Termination of Trusts," permits a court to order that a trustee be changed, or prohibited from certain actions authorized by the trust.

"The Trust Code provides courts wide latitude in deciding whether to remove a trustee...." *Ditta v. Conte*, 298 S.W.3d 187, 191 (Tex. 2009). Tex. Prop. Code § 113.082(a) provides:

> (a) A trustee may be removed in accordance with the terms of the trust instrument, or, on the petition of an interested person and after hearing, a court may, in its discretion, remove a trustee and deny part or all of the trustee's compensation if:
>
> (1) the trustee materially violated or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust;
> (2) the trustee becomes incapacitated or insolvent;
> (3) the trustee fails to make an accounting that is required by law or by the terms of the trust; or
> (4) the court finds other cause for removal.

An "interested person" means "a trustee, beneficiary, or any other person having an interest in or a claim against the trust or any person who is affected by the administration of the trust. Whether a person, excluding a trustee or named beneficiary, is an interested person may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding." Tex. Prop. Code § 111.004(7). An "interest" is defined as "any interest, whether legal or equitable or both, present or future, vested or contingent, defeasible or indefeasible." Tex. Prop. Code § 111.004(6). In *Davis v. Davis*, 734 S.W.2d 707, 709–10 (Tex. App.--Houston [1st Dist.]

1987, writ ref'd n.r.e), the court found that a claimant who would inherit an interest in the trust only upon the death of a prior beneficiary who dies intestate did not have a sufficient interest to have standing to sue the trustees for breach of duty and for an accounting. In *Aubrey v. Aubrey*, 523 S.W.3d 299, 302 (Tex. App.–Dallas 2017, no pet.), the court found the claimant to be an interested person when he had a remainder interest that would vest when his mother died. *Jenkins v. Jenkins* 522 S.W.3d 771, 781 (Tex. App.--Houston [1st Dist.] 2017, no pet.), explained that *a remainder interest is vested* if the remainder interest is in an ascertainable person and no condition precedent exists other than termination of the prior estates.

Hostility between the trustee and other trustees or beneficiaries can be grounds for removal of a trustee. The RESTATEMENT (THIRD) OF TRUSTS § 37(b) addresses removal of a trustee. Comment e(1) illustration 7, provides the following example of grounds for removal of a trustee:

> The settlor named two of her five children as co-trustees of a trust for all of the children and their families. Over several years, extreme ill will has developed among the children and is now impairing the proper functioning of the trust. It is within the reasonable discretion of the court to remove and replace the trustees.

See Bergman v. Bergman Davison Webster Charitable Tr., No. 07-02-0460-CV (Tex. App.–Amarillo Jan. 2, 2004, no pet.) (memo op.) (trial court properly removed trustee who harassed and intimidated other trustees).

XII. MARITAL PROPERTY ISSUES. There is some uncertainty about certain aspects of the intersection between trust law and marital property law. An article on the subject that discusses Texas cases is Steve D. Baker *The Texas Mess: Marital Property Characterization of Trust Income*, 5 Est. Plan. & Community Property L.J. 217 (Summer 2013).

A. BENEFICIAL INTEREST. A spouse's beneficial interest would be separate property for a trust established prior to marriage or a testamentary trust established during marriage. Where a trust is created as a gift to a spouse, the beneficial interest in the trust is separate property. *Hardin v. Hardin*, 681 S.W.2d 241, 243 (Tex. Civ. App.--San Antonio 1984, no writ).

B. UNDISTRIBUTED ASSETS HELD IN TRUST. According to the following cases, property held in trust for a spouse is not marital property: *Buckler v. Buckler*, 424 S.W.2d 514 (Tex. Civ. App.--Fort Worth 1967, writ dism'd) (undistributed income in a spendthrift trust not part of the estate of the parties, where distribution of such income was discretionary with the trustee); *In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd) (undistributed income inside discretionary distribution trust not "acquired" by the spouse during marriage, and was therefore not part of the community estate); *Currie v. Currie*, 518 S.W.2d 386 (Tex. Civ. App.--San Antonio 1974, writ dism'd) (property inside of discretionary distribution trust was not community property of the husband; property inside another trust, as to which husband was remainder beneficiary, was not "acquired" by the spouse, and was therefore not part of the community estate). This is not so, however, when through the passage of time or otherwise the assets are no longer held in trust but have been voluntarily left in the ownership of the trustee.

In *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ), the husband was the beneficiary of a trust created prior to marriage by his parents. Prior to the divorce, the husband's right to receive half of the corpus free of trust had matured, but the husband left that half in the hands of the trustee. The Court held that once the husband's right to receive half of the corpus

matured, the income on such half began to belong to the community. However, the half of the corpus which emerged from trust was itself the husband's separate property, and the income on the other half of the corpus, which remained in trust, did not belong to the community since it still "belonged to the trust." It appears to have been important to that last determination that the distribution of income was discretionary with the trustee. *Id*. at 718. *Long* can be read as tacitly agreeing that distributed income from a trust can be community property in certain circumstances.

C. INCOME IN SELF-SETTLED TRUST. A "self-settled" trust is a trust in which the settlor is also the beneficiary. See Section VI.A.7 above. In *Mercantile National Bank at Dallas v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.), the Court held that the undistributed income of a trust created by wife for her own benefit, prior to marriage, is community property. *See In re Marriage of Burns*, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd) (income on separate property corpus of trust created by spouse for his own benefit was community property to the extent it was received by husband). In *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App.--Corpus Christi 1997, no writ), the appellate court said that the income a spouse receives from a trust is community property.The court also said that if the spouse does not receive income from the trust and has no more than an expectancy interest in the corpus, the income remains separate property. *Id*. at 148.In *Ridgell* some of the trusts were funded by gift or devise and one was funded by the spouse prior to marriage. Also in *Ridgell*, the court recognized that separate property principal distributed out of the self-settled trust was received by the spouse as separate property. *Id*. at 150.

The question is impacted by Tex. Prop. Code § 112.035 regarding self-settled spendthrift trusts. Section 112.035(d) says:

> (d) If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of the settlor's beneficial interest does not prevent the settlor's creditors from satisfying claims from the settlor's interest in the trust estate. A settlor is not considered a beneficiary of a trust solely because:
>
> (1) a trustee who is not the settlor is authorized under the trust instrument to pay or reimburse the settlor for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by the settlor under the law imposing the tax; or
>
> (2) the settlor's interest in the trust was created by the exercise of a power of appointment by a third party.

In *Lemke v. Lemke*, 929 S.W.2d 662, 664 (Tex. App.--Fort Worth 1996, writ denied), the court of appeals considered a self-settled spendthrift trust created by a husband before marriage, to hold damages he recovered in a medical malpractice case for a brain injury he suffered. The self-settled trust had husband as sole beneficiary, and an independent trustee with sole discretion to distribute principal or income to husband for his health, education, maintenance and welfare. The remainder beneficiaries were husband's parents, brother, and their descendants. The trustee made distributions during marriage for trust expenses and for the spouses' living expenses. Citing *In re Marriage of Burns*, the Fort Worth Court of Appeals held that the income held in trust was not marital property because the it had not been distributed and husband had no right to require distribution. The Fort Worth Court of Appeals rejected the wife's claim that the self-settled trust exception to the spendthrift trust rule in Tex. Prop. Code § 112.0359(d), applied, without any explanation other than referring to *Burns*.

The Fort Worth Court of Appeals adopted the same position in *Lipsey v. Lipsey*, 983 S.W.2d 345 (Tex. App.--Ft. Worth 1998, no pet.), where before marriage the husband rolled over a pension into a 401(k) "Capital Accumulation Plan." The plan manager was a trustee, and under the plan husband deferred receipt of any distributions until he attained age 70-1/2. The trial court found the increase on the Capital Accumulation Plan during marriage to be community property. The Fort Worth Court of Appeals noted that the Plan was a trust created prior to marriage, and that no trust assets had been distributed during marriage, and husband had no right to compel distributions during marriage. Therefore he had not acquired the income, and it was not community property. *Id*. at 350-51. No import was given to the fact that the trust was self-settled.

D. TRUST CREATED OR FUNDED BY GIFT OR DEVISE. Where a trust is created as a gift, the beneficial interest in the trust is separate property. *Hardin v. Hardin*, 681 S.W.2d 241, 243 (Tex. Civ. App.--San Antonio 1984, no writ). There are a number of older cases that say that income from a trust that was created by gift or inheritance is received by the spouse/beneficiary as separate property. These cases do not address the question of whether a trust created by a spouse for his own benefit, using separate property, gives rise to separate or community income.

McClelland v. McClelland, 37 S.W. 350 (Tex. Civ. App. 1896, writ ref'd), is probably the most often quoted of these older cases. *McClelland*, which involved a testamentary trust created for the husband by his father, presented the issue as being a contest between the intent of the testator and community property claims of the wife. In *McClelland*, the intent of the testator won out. Thus, a monthly allowance paid by the trustee to the husband, pursuant to a provision in the will, as well as other discretionary distributions made by the trustee under the will, were held to be the husband's separate property. *See Sullivan v. Skinner*, 66 S.W. 680 (Tex. Civ. App. 1902, writ ref'd) (where wife received a life estate in land under her father's will, which provided that she was to receive the income for her sole and separate use, the rentals from the land were wife's separate property). *But see Arnold v. Leonard*, 273 SW.799 (Tex. 1925) (rents and revenues from the wife's separate property are community property, per the Texas Constitution).

Several other old cases, involving a conveyance by one spouse into trust for the benefit of the other spouse, held that income from the property held in trust was also separate property. *See Hutchinson v. Mitchell*, 39 Tex. 488 (1873) ("We can find nothing in any of the Constitutions or laws of the state or republic which would prevent a man from declaring an express trust in favor of his wife, and giving her the exclusive use and enjoyment of all the rents, revenues and profits of the trust estate, provided there is no fraud in the transaction against creditors . . ."); *Shepflin v. Small*, 23 S.W. 432 (Tex. Civ. App.--El Paso 1893, no writ) (where husband and wife joined in conveyance of wife's separate property to trustee, to collect the income and use it to support the wife and children, the income was withdrawn from the community estate). In 1980, the Texas Constitution, art. XVI, § 15, was amended to provide that if one spouse makes a gift of property to the other that gift is presumed to include all the income or property which might arise from that gift of property. The Constitution thus recognized a gift between spouses of future income.

In the case of *In re Marriage of Thurmond*, 888 S.W.2d 269, 272-75 (Tex. App.--Amarillo 1994, no writ), the court of appeals without explanation treated a trust distribution from a testamentary trust as entirely separate property, even though the distribution included interest earned by the trust.

A Federal Court of Claims case reviewed the broad panorama of Texas cases on marital property law and trusts, and concluded that, where a trust is established by gift, the correct view is that distributions from the trust to a married beneficiary are the beneficiary's separate property,

notwithstanding some authorities to the contrary. *Wilmington Trust Co. v. United States*, 4 Ct. Cl.6 (1983), *aff'd*, 753 F.2d 1055 (Fed. Cir. 1985). The Court stated:

> It is concluded that, under the law of Texas, as developed and expounded by the Texas courts, the income derived during the marriage of [the spouses] from the seven trusts that are involved in the present case constituted the separate property of [the wife], and was not community property of [the spouses]. [The wife] never "acquired"--and she will never acquire--the corpus of any of these trusts. The corpus of each trust is to be held and controlled by the trustee or trustees during [the wife's] lifetime, and, upon [the wife's] death, the corpus will pass to her issue. Accordingly, the corpus of each trust was not [the wife's] separate property, and the trust income was not from [the wife's] separate property.
>
> What [the wife] "acquired"--and what she used to purchase the stocks and establish the bank accounts that are involved in the litigation--was the income from the trust property. As the income resulted from the gifts made to trustees for [the wife's] benefit, the income necessarily constituted her separate property under section 15 of article XVI of the Texas Constitution.

Id. See also Taylor v. Taylor, 680 S.W.2d 645, 649 (Tex. App.--Beaumont 1984, writ ref'd n.r.e.) (trust distributions held to be separate property where trust instrument said that income of trust became part of the corpus and the parties had stipulated that corpus was separate property).

In *Cleaver v. George Staton Co.*, 908 S.W.2d 468, 470 (Tex. App.--Tyler 1995, writ denied), the wife was a beneficiary of a testamentary trust that provided for mandatory payments of income from the corpus to the wife for life, but she was conveyed no ownership interest in the corpus of the trust and had no present possessory interest in the corpus. The Court said: "The trust income payments to the Wife are thus her separate property," citing *In re Marriage of Long*, 542 S.W.2d 712, 717-18 (Tex. App.--Texarkana 1976, no writ).

Ridgell v. Ridgell, 960 S.W.2d 144, 149 (Tex. App.--Corpus Christi 1997, no writ), contains language that suggests that the court might have found trust distributions to be separate property if the settlors had included language in the trust instruments indicating a desire for the trust income not be treated as community property in the event the beneficiary married. The court cited *Commissioner v. Porter*, 148 F.2d 455, 568 (5th Cir. 1945) for the proposition that trust distribution might be separate property if the trust instrument indicates that desire "in a precise and definite way, with language of 'unmistakable intent'".

On the other hand, there are several cases suggesting that income on property held in trust is community property, even where the trust is established by gift or devise.

In re Marriage of Burns, 573 S.W.2d 555 (Tex. Civ. App.--Texarkana 1978, writ dism'd), the Court determined that undistributed income in several trusts was not community property because it had been neither received nor constructively received by the husband during marriage. This rule was applied not only to several trusts established for the husband by his parents and grandparents, but also to a trust established by the husband for himself, three months after marriage, using husband's separate property. The opinion suggests, albeit somewhat obliquely, that if the income from the trusts had been received by the husband, either actually or constructively, that the income would have been community property.

In *Commissioner of Internal Revenue v. Porter*, 148 F.2d 566 (5th Cir. 1945), the Fifth Circuit Court of Appeals concluded that income distributed from a trust established by the spouse's father was received by the spouse/beneficiary as community property. The Court said that while the income remained in the hands of the trustee, it was "protected," but once it was distributed it became subject to the "ordinary impact of the law."

In *Commissioner of Internal Revenue v. Wilson*, 76 F.2d 766 (5th Cir. 1955), the Fifth Circuit Court of Appeals held that income from property held in trust for a married man was received by him as community property, although the corpus was not community property. However, some of the distributed trust income derived from royalties and bonuses on "separate property" corpus. Also, delay rentals were received by the trustee. According to the Fifth Circuit, the delay rentals would be community property, while the royalties and bonuses would not; therefore, whatever portion of the trust income could be shown to be derived from royalties and bonuses would be separate property when received by the beneficiary. This analysis required tracing of the distributions to income received by the trust. In this regard, the Court said:

> In the accounting, outlays by the trustee specially connected with [royalties] are to be considered, and also a fair proportion of the general expenses of the trust, so as to ascertain what part of the net payment to the beneficiaries really came from royalties.

Id. at 770. Proceeds from sale of trust assets was not an issue in the case.

E. FIFTH CIRCUIT *McFADDIN* CASE. In *McFaddin v. Commissioner*, 148 F.2d 570 (5th Cir. 1945), a tax case, a trust was created by the mother and father of the McFaddin children. The parents conveyed two large cattle ranches into trust, subject to the debts secured by the properties and further subject to an annual payment to the mother of $30,000 per year, payable from income or, if insufficient, from the corpus.

The Tax Court ruled that children who are beneficiaries of a trust, which is created by gift of their parents, hold that interest as separate property. The Tax Court further found that the rights of the beneficiaries did not attach to the gross income, but rather to the distributable net income, of the trust, and that the gross income of the trust used by the trustees to purchase additional property could not be community income of the beneficiaries. The Tax Court further held that the fact that the property was conveyed into trust subject to debts and liens did not convert what was otherwise a gift into a transfer for onerous consideration. And oil royalties and bonuses distributed by the trustee remained the beneficiaries' separate property.

The Fifth Circuit agreed that the res of the trust was a gift, and thus separate property. *Id*. at 572. Therefore, the oil royalties, bonuses and profits from the sale of the land "came to" the McFaddin children as separate property, taxable as separate income.

Nonetheless, the Court held that property acquired by the trust during the beneficiaries' marriages was community because separate and community funds had been commingled within the trust. The Court stated:

> The theory of the Tax Court that none of the commingled property with which the afteracquired property was purchased was community property because, under the terms of the trust instrument, gross income was treated as corpus, the rights of the beneficiaries did not attach to gross income but only to the distributable net income, and the gross income used by the trustees

> was, therefore, not community property, will not at all do. The taxpayers were the beneficial owners of the trust properties, and every part and parcel of them, including income from them, belonged beneficially to them, either as separate or as community property, in the same way that it would have belonged to them had the property been deeded to the taxpayers and operated by themselves. The greater part of the normal income from the property during the years preceding the tax years in question was community income. When it was commingled in a common bank account with other funds of the trust so that the constituents had lost their identity, the whole fund became community; and when it was used by the trustees to purchase additional properties, those properties, taking the character of the funds which bought them, were community property. [footnotes omitted]

Id. at 573.

The Fifth Circuit Court of Appeals also rejected the Commissioner of Internal Revenue's argument that because the trusts were spendthrift trusts, they were in effect conveyances of income to the separate use of the beneficiaries. *Id*. at 574.

In sum, the *McFaddin* case stands for proposition that income received by a trust is community or separate by the same rules as would apply had the income been received outside of trust. And if those funds are commingled, then the separate property in trust can be lost to the community, upon subsequent distributions to the beneficiaries.

This rule was applied to the gross income of the trust, not just to the distributable net income. *Id*. at 573. Since the gross income was commingled in trust bank accounts with separate property receipts, the whole fund became community property, and the subsequently-acquired property was community in nature, and the oil income therefrom was similarly community.

F. TRUST DISTRIBUTIONS.

1. Trust Principal. *In re Marriage of Long*, 542 S.W.2d at 718, supports the view that a distribution of principal from trust to a married beneficiary is received as separate property if the principal was conveyed into trust by gift or devise or was funded prior to marriage. It would seem that, where a spouse conveys separate property into trust and then recovers it back as a trust distribution during marriage, it would be received by the beneficiary spouse as separate property. *Ridgell v. Ridgell* 960 S.W.2d 144, 150 (Tex. App.--Corpus Christi 1997, no writ). However, an argument can be made that conveying the separate property into trust destroys the identity of the asset as separate property, so that the property has no marital property character while held in trust, and that the character of the distributed principle will be determined without tracing principles. *See Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.--Dallas 1987, writ ref'd n.r.e.) (tracing not allowed when separate property is contributed to partnership and is then distributed out); *see Lifshutz v. Lifshutz*, 199 S.W.3d 9 (Tex. App.--San Antonio 2006, pet. denied) (distribution from partnership was community property even though the asset distributed was not cash but was a business entity owned by the partnership before marriage). Special note: Both *Marshall* and *Lifshutz* involved entities (partnerships), whereas a trust is not an entity. Whether the inception of title rule comes into play is yet to be determined.

2. Trust Income (*Sharma v. Routh*). The case of *Sharma v. Routh*, No. 14-06-00717-CV (Tex. App.--Houston [14th Dist.] 2009) (opinion withdrawn), *opinion on rehearing*, 302 S.W.3d 355 (Tex. App.--Houston [14th Dist.] 2009, no pet.), has had an impact on the question of the character of

distributions from trust to a married beneficiary. Because the case is more recent than many, and perhaps because the issues were more sharply drawn, more ably briefed, and more comprehensively analyzed by the appellate court, *Sharma v. Routh*, has been given significant weight by practitioners and forensic experts. On rehearing the Court reversed its decision and issued a new Ospinion, and the case was actually a close call, so it would be beneficial to examine the Court of Appeals' activity in some detail.

a. Four Opinions: Two Rulings. In *Sharma v. Routh*, the Fourteenth Court of Appeals initially held that trust distributions received by a husband (Sharma) during marriage were community property. The initial Majority Opinion was written by Chief Justice Adele Hedges, joined by Justice Eva Guzman; the Dissenting Opinion was written by Justice Kem Frost. [Chief Justice Hedges' Opinion, later withdrawn, has been officially destroyed; however, the copy retained on www.leagle.com is included as Appendix A.] After this initial decision, University of Texas School of Law Professor Stanley M. Johanson wrote a letter to the Court, disagreeing with the Court's analysis and explaining why. [A copy of this letter brief is attached as Appendix B.] On rehearing, Justice Guzman changed her vote. Justice Frost, who dissented first time around, wrote the new Majority Opinion, joined by Justice Guzman. Chief Justice Hedges changed her vote as well, but she issued a Concurring Opinion. The Court's final Majority Opinion determined that the trust distributions received by the husband during marriage were his separate property.

b. The Facts. In *Sharma v. Routh*, the husband's previous wife established in her last will and testament two trusts, the "Marital Trust" and the "Family Trust." The husband was both trustee and beneficiary of the Marital Trust. The Marital Trust agreement required mandatory distribution of trust income to the husband. The Marital Trust agreement also gave the trustee (i.e., the husband) the discretion to distribute trust principal for his own health, support and maintenance, "in accordance with the standard of living to which [he] is accustomed." As to the Family Trust, husband was named as both trustee and beneficiary, and husband as trustee had the discretion to distribute trust principal and income as necessary for his own health, support and maintenance, in order to maintain himself at the standard of living to which he had become accustomed. A charitable foundation was the remainder beneficiary of both trusts. Husband, acting as trustee of both trusts, sold the real estate held in both trusts, taking in exchange promissory notes with payments of principal and interest.

Mr. Sharma remarried and then a short time later got divorced from his second wife. The evidence showed that the husband had deposited principal and interest payments received by both trusts into his personal account for approximately four years, including one year during his second marriage. The Marital Trust had mandatory distribution of income, which amounted to $2,272,063 during marriage. The interest on the Family Trust note during marriage was $32,955. The husband reported the interest payments as his personal income on his tax returns and on a loan application. The trial court found that the interest on the promissory notes held in trust that accrued during marriage was community property, and divided it 50-50.

c. The Husband's Arguments. On appeal, husband attacked the characterization finding on three grounds:

(1) The trust income was not community property because husband had no remainder interest in the trust corpus (principal);
(2) Husband did not own the trust income; and
(3) The trust income was husband's separate property, received by gift or devise.

d. The Initial Majority Opinion. The initial Majority Opinion, written by Chief Justice Adele Hedges, said that the distributions of trust income during marriage were community property because the husband had an interest in the trust corpus.

Chief Justice Hedges explained:

> Courts have articulated the following rule: if a married beneficiary has an interest in trust principal and receives income from the principal, the income is characterized as community property. *Ridgell v. Ridgell*, 960 S.W.2d 144, 148 (Tex. App.--Corpus Christi 1997, no pet.) (holding that trust income is community property where the spouse beneficiary maintains an interest in trust corpus); *In re Marriage of Long*, 542 S.W.2d 712, 718 (Tex. Civ. App.--Texarkana 1976, no writ) (concluding that income received on trust corpus is community property if married beneficiary is entitled to corpus); *Mercantile Nat'l Bank at Dallas v. Wilson*, 279 S.W.2d 650, 654 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.) (holding that income on trust corpus during the marriage is community property where spouse has interest in corpus); *c.f. Cleaver v. Cleaver*, 935 S.W.2d 491, 493-94 (Tex. App.--Tyler 1996, no pet.) (holding that trust income is separate property only where trust prohibits distributions from corpus). Thus, if the record reveals that Sharma (1) has an interest in the corpus and (2) received trust income, the interest is community property.[7] *See Ridgell*, 960 S.W.2d at 148; *Long*, 542 S.W.2d at 718; *Wilson*, 279 S.W.2d at 654. [Endnote omitted.]

Chief Justice Hedges went on to say that the husband's interest in the trust corpus was undisputed. All principal payments made on the notes were transferred into the husband's personal account for a period of sixteen months, thus "invading the corpus." The Marital Trust provided that the trust principal should be used to pay any estate tax resulting from the inclusion of Marital Trust principal in his taxable estate. Additionally, husband reported the payments made on the notes held in the Marital Trust as income on his personal tax return and on a bank loan application. Chief Justice Hedges wrote:

> A spouse beneficiary, in the context of a discretionary trust, becomes entitled to trust corpus when a distribution from the principal is made to the spouse beneficiary. Because Sharma invaded the corpus, possessed the corpus in his personal account, and later donated the corpus to his charity, we conclude that Sharma has an interest in the corpus of the Marital and Family trusts. [Endnotes omitted.]

Chief Justice Hedges also noted that husband received distributions of income from the two trusts, and she wrote:

> Because Sharma has interest in the corpus and made distributions from the corpus to himself, the income that rose from the corpus is community property.

Chief Justice Hedges rejected the husband's assertion of gift or inheritance, writing:

> Courts have further interpreted income from trust corpus, identical to the disputed property in the instant case, to be community property. *See Ridgell*, 960 S.W.2d at 148; *Long*, 542 S.W.2d at 718; *Wilson*, 279 S.W.2d at 654.
> * * *
> There is not "clear and convincing" evidence that Sharma acquired the interest payments prior to marriage or during marriage by gift, devise, or descent. Because we cannot expand the

> definition of separate property beyond what the Texas Constitution provides and courts have interpreted income from trust corpus as community property, the disputed property in this case cannot be characterized as separate property. Sharma has failed to rebut the statutory presumption that the interest payments, received during marriage, are community property. *See* Tex. Fam. Code § 3.003(b); *Stavinoha*, 126 S.W.3d at 607; *see also Ridgell*, 960 S.W.2d at 148; *Long*, 542 S.W.2d at 718.

e. The Initial Dissenting Opinion. Justice Kem Thompson Frost wrote the initial Dissenting Opinion. Justice Frost stated her review in these terms:

> In the context of a spouse who receives distributions of trust income under an irrevocable trust during marriage, case law indicates that the income distributions are community property if the receiving spouse owns the trust corpus but that the distributions are separate property if the receiving spouse does not own the trust corpus.

Justice Frost saw the Majority as saying that the distributed income was community if the spouse had an interest in the corpus. Justice Frost wanted the distributed income to be community property only if the recipient has a "present possessory right to part of the corpus." Because the husband had no present possessory right to the corpus of either trust, Justice Frost thought that the distributions of corpus and income were the husband's separate property.

Justice Frost also believed that the income distributed from the mandatory-distribution-of-income Marital Trust was received by the husband by devise from his former wife (and thus separate property).

Justice Frost then went on to posit four possible rules for charactering trust distributions to a married beneficiary.

- Rule A - the beneficiary is effectively an owner of the trust corpus so all distributed income is community property.
- Rule B - distributions of income are community property if the beneficiary has some potential right to the corpus even if not yet reduced to possession, because the beneficiary is effectively an owner of the trust corpus.
- Rule C - distributions of trust income are community property because the recipient has a present possessory right to the corpus, even if the recipient has chosen not to exercise that right and is therefore effectively an owner of the corpus.
- Rule D - distributions of trust income are community property only if the beneficiary has exercised a possessory right to the corpus because the recipient is effectively the owner of the corpus.

Justice Frost cited cases she said supported Rule C, and she adopted Rule C, rejecting the other rules. Justice Frost gave no weight to the fact that the husband was trustee as well as beneficiary, saying that as trustee he held bare legal title to the trust property.

f. Professor Johanson's Amicus Curiae Letter. After the Fourteenth Court of Appeals issued its original decision, University of Texas School of Law Professor Stanley Johanson filed a nine-page amicus curiae letter brief with the Court. [A copy of the letter brief is attached to this Article as Appendix B.] Professor Johanson opened the brief with a quotation of his commentary from his own Johanson's Probate Code Annotated, § 116.002, p. 992 (2008). The quotation is Professor

Johanson's opinion that, where a trust provides that "the trustee shall pay all trust income to my daughter for life," the "gift is of the income interest itself (and not the underlying assets that generate the income) ...." Professor Johanson wrote that under such a trust arrangement the income distributed by the trust was acquired by the married beneficiary by gift or devise and was therefore separate property. He cited as authority *"Wilmington Trust Co. v. United States*, 4 Ct. Cl. 6 (1983), *aff'd*, 753 F.2d 1055 (Fed. Cir. 1985) (extended discussion of Texas cases); *but see Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App--Corpus Christi 1997, no writ)." [Note that Professor Johanson sided with the opinion of the Court of Claims and against a Texas court of appeals' opinion on point. Note also that his assertion applies only to mandatory-distribution-of-income trusts.]

Professor Johanson argued that the husband did not have an interest in the trust principal because his power to "invade" and distribute principal to himself was "limited by an ascertainable standard relating to the health, support, or maintenance" as described in Internal Revenue Code Sections 2041(b) and 2514. The Professor called this a "HEMS" standard. With regard to both trusts, Professor Johanson says that husband as trustee did not have the power to distribute trust principal to himself "for his 'benefit'".

Professor Johanson called the court's attention to recently-enacted legislation in Texas (which he says he prompted), creating a HEMS standard by default if no standard was specified for making discretionary distributions to a beneficiary. [The law applies only to trusts created or becoming irrevocable after September 1, 2009, so it did not apply to the *Sharma v. Routh* case.]

Professor Johanson called the Court's attention to the "Spendthrift" provision in Texas Trust Code § 112.005. Under that statute, if a trustee can distribute trust principal to "herself" as beneficiary, spendthrift protection is lost unless the power of the trustee to distribute to herself is limited by a HEMS standard.

Professor Johanson also contrasted a HEMS standard exercisable "without regard to other resources available for such person" (quotation in original text), under which "very generous distributions could be made, most likely up to 65% of the beneficiary's gross income in the year of his former wife's death. With the two trusts in *Sharma v. Routh*, however, distribution could be made to the husband only when 'necessary', after taking into account "other funds reasonably available...from all other sources known to by Trustee." Professor Johanson suggested that, with husband receiving $1 million per year in interest income that was mandatorily distributed to him, husband could not justify making distributions of principal "without committing a breach of trust" with respect to the remainder beneficiary. Professor Johanson attributed the distribution of all principal payment from the Marital Trust to a mistake, subjecting husband to a suit to return it to the trust.

Professor Johanson noted that "sole discretion" is not absolute but is subject to court oversight measured by a reasonableness and good faith standard.

Professor Johanson disagreed with the Majority's conclusion that husband's interest in the trust principal was evidenced by the fact that the Marital Trust provided that any estate tax, levied on husband's estate due to the Marital Trust, would be paid out of the principal of the Marital Trust. Professor Johanson wrote that the estate tax was due based on the former wife's estate, but payment was deferred under the Internal Revenue Code, until husband's death.

Professor Johanson distinguished two cases cited in the Majority Opinion, *In re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App.--Texarkana 1976, no writ), and *Mercantile Nat.'l Bank v. Wilson*, 279 S.W.2d 650 (Tex. Civ. App.--Dallas 1955, writ ref'd n.r.e.).

In *Long*, the beneficiary's right to part of the trust corpus had matured, and he was entitled to receive that part of the corpus. That did not exist in the *Sharma* case. In *Wilson*, the wife's trust was self-settled. Professor Johanson said "not surprisingly, you can't defeat the 'income from separate property is community property' rule by putting your separate property in a trust."

g. The Final Majority Opinion. Justice Frost's final Majority Opinion on rehearing restated her original Dissenting opinion. She stated the controlling rule of law: "We hold that, when a spouse receives distributions of trust income under an irrevocable trust during marriage, the income distributions are community property only if the recipient has a present possessory right to part of the corpus" 302 S.W.3d at 357. Justice Frost restated the four possible rules listed in her previous Dissenting Opinion, and said: "We adopt Rule C." *Id*. at 364.

h. The Final Concurring Opinion. Chief Justice Hedges issued a Concurring Opinion on rehearing. Perhaps reflecting the influence of Professor Johanson's amicus curiae letter brief, she treated the distributions of trust principal during marriage as improper handling of trust property, because no evidence suggested that the husband as trustee complied with the trust requirements that trust principal could be distributed only when needed for husband's health, support, or maintenance. Chief Justice Hedges continued to adhere to her rule that distributions of trust income are community property only if the recipient has an interest in the trust corpus. Chief Justice Hedges, thus, applying her own test, changed her mind and agreed that the income distributions were separate property.

i. Take-Away from the Case.

- On rehearing, Justice Frost (joined by Justice Guzman) adopted a narrow test that distributions of income from a testamentary trust are community property only if the beneficiary has a *present possessory right* to part of the corpus. Chief Justice Hedges adopted a broader rule that the distributed income is community property if the beneficiary has *an interest in* trust corpus.

- Justice Frost believed that the husband did not receive distributions of corpus. Chief Justice Hedges believed that principal payments on the trust notes were deposited into the husband's person accounts, but improperly, so that they were not truly distributions.

- Professor Johanson's argument that the HEMS standard was violated appears to have won over Chief Justice Hedges, even absent a fact-finding on the point.

- Both final Opinions on rehearing noted that husband was not the remainder beneficiary of either trust. That probably would not have mattered under Justice Frost's "present possessory right to part of the corpus" test, but it may have mattered under Chief Justice Hedges' "interest in the trust corpus" test.

- Justice Frost's view was dictated by the unambiguous language of the two trust instruments. Chief Justice Hedges' view was influenced by the facts, particularly (initially) that the husband deposited both principal and interest payments on the promissory notes in his personal account, reported the income on his personal tax return, and listed trust property on his personal financial

statement. In the end however, the absence of evidence that the HEMS standard had been respected was treated by Chief Justice Hedges as an indication that the HEMS standard had been violated. This is an interesting assumption; one could argue that the presumption of community would have put the burden on the husband to prove that he had violated his duties as trustee owed to the remainder beneficiaries.

- Justice Frost accepted the view that income on trust corpus held pursuant to a testamentary trust, when distributed, is received by the beneficiary as a gift or inheritance.

- Justice Frost's discernment of previous trust cases as a unified body of law tends to minimize differences in the factual circumstances of prior cases. The wide variety of facts in trust cases makes it difficult to derive a consistent rule to apply in all future cases.

j. Agreement from San Antonio. The San Antonio Court of Appeals agreed with the *Sharma* rule that distributions from a testamentary or inter vivos trust to a married beneficiary are community property only if the recipient has a present possessory right to part of the corpus. *Benavides v. Mathis*, 433 S.W.3d 59, 63 (Tex. App.--San Antonio 2014, pet. denied).

G. REVOCABLE TRUSTS. While no Texas appellate opinions address the subject, there are reasons to consider the income on property held in a spouse's revocable trust to be community property. The settlor of a revocable trust has an interest in the property held in trust, in that s/he can reacquire the property at will. *Moon v. Lesikar* 230 S.W.3d 800, 804 (Tex. App.--Houston [14th District] 2007, pet. denied), held that a remainder beneficiary under a revocable trust has no standing to sue over the settlor's management of the revocable trust, since the beneficiary had no pecuniary interest in the revocable trust, but Justice Guzman concurred, arguing that standing existed but no claim existed. The El Paso Court of Appeals followed Justice Guzman's concurrence, in *Mayfield v. Peck*, 546 S.W.3d 253, 262 (Tex. App.--El Paso 2017, no pet.).

Professor Featherston has written: "Community assets and quasi-community property held in trust where one or both of the spouses hold a power of revocation are likely part of the 'estate of the parties' subject to division by the divorce court in a just and right manner pursuant to Sec. 7.001 ofthe Texas Family Code." Thomas M. Featherston, Jr., *Handbook on Texas Marital Property Law For Estate Administration and Planning*, ch. 3, p. 66 (State Bar of Texas 40th Annual Advanced Estate Planning & Probate Court June 22-24, 2016).

H. REMAINDER INTERESTS. Some trusts, like GSTs, go on for generations. Most Texas trust-related divorce appellate opinions to date have dealt with distributions made to a primary or lifetime beneficiary, as opposed to a remainder beneficiary. What happens when the spouse is a remainder beneficiary, and the primary beneficiary dies and the trust terminates and trust principal and accumulated undistributed income are conveyed to the beneficiary free of trust? *Currie v. Currie*, 518 S.W.2d 386, 389 (Tex. Civ. App.--San Antonio 1974, writ dismissed), held that a contingent beneficiary, who acceded to benefits upon the death of a life beneficiary, had no right to income or principal prior to accession. In *Dickinson v. Dickinson*, 324 S.W.3d 653, 658-59 (Tex. App.--Fort Worth 2010, no pet.), where the husband was a remainder beneficiary who would receive benefits after the death of his father and another person, the court held that the husband's remainder interest was received by devise and was his separate property.