Title

Beware of conflating power of appointment doctrine and merger doctrine in the trust context

Summary

Assume a trust that was initially for the benefit of its settlor (who is now dead) has the following additional terms: All net trust-accounting income to settlor's surviving spouse (X) for life; trustee may invade principal for X's health, maintenance and support; upon X's death, the trust corpus is to be distributed outright and free of trust to X's children, who are currently minors. X is the sole trustee. X also possesses an express, implied, or constructive right/power to invade principal for X's personal benefit without court review or the appointment of a guardian ad litem. It is a common misconception that such a trust would have terminated by operation of law at the death of the settlor, all interests having "merged" outright and free of trust in X. Here is why there is no merger: The existence of the children's contingent equitable quasi-remainders, evanescent though they may be, prevents termination by merger of all legal and equitable interests. Or, to put it another way, the existence of an express, implied, or constructive general inter vivos power of appointment in and of itself, whether the power is of the fiduciary or non-fiduciary variety, will not trigger a merger in the powerholder. See *National Shawmut Bank of Boston v. Joy*, 53 N.E.2d 113 (1944) ("And where an estate is given over in default of appointment, the nature of the estate of the remaindermen is not affected by the power of disposition until that power is exercised."). The conflation of power of appointment doctrine and merger doctrine in the trust context is taken up in *Loring and Rounds: A Trustee's Handbook* §8.7 (merger) [page 1041 of the 2015 ed.].The text of §8.7 is reproduced in its entirety below.

The Text

§8.7 Merger [Reference: *Loring and Rounds: A Trustee's Handbook* §8.7, 2015 ed.]

> *Because one cannot be under an obligation to oneself, the same individual cannot be settlor, trustee, and sole beneficiary, and the trust parties can never be fewer than two*.[1]

> *[E]ven*[2] *where the legal and equitable titles are both vested in the same person, equity will under certain conditions refuse to recognize a merger which might exist in law, as where such result would be contrary to the intention of the trustor and would destroy a valid trust*.[3]

The doctrine of merger is occasionally a trap for the unwary; more often it is invoked in situations where it is inapplicable.[4] Thus, the trustee needs to understand the concept if only to recognize when the

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[1]Bogert, Trusts and Trustees §1.

[2]For a discussion of the concept of merger in Roman law, *see* §8.15.36 of this handbook.

[3]90 C.J.S. §283 (citing to Dennis v. Omaha Nat'l Bank, 153 Neb. 865, 46 N.W.2d 606 (1951); Mesce v. Gradone, 1 N.J. 159, 62 A.2d 394 (1948); Quinn v. Pullman Trust & Sav. Bank, 98 Ill. App. 2d 402, 240 N.E.2d 791 (1st Dist. 1968); In re Haskell's Trust, 59 Misc. 2d 797, 300 N.Y.S.2d 711 (Sup. 1969)). *See also* Tretola v. Tretola, 2004 WL 1586999 (Mass. App. Ct.) (footnote 10 and accompanying text).

[4]As a general rule, a trust may be created solely for the benefit of the settlor, provided the settlor is not also the sole trustee. See Uniform Trust Code §402 cmt., specifically the commentary on §402(a)(5). The Bogert treatise, however, appears to have fallen into the false merger trap by suggesting that one of

doctrine is not a concern.[5]

Merger occurs when one person possesses the entire legal interest and the entire beneficial interest in property.[6] In such a case, there is no trust;[7] the person simply owns the property outright and free of trust, all interests having "merged" in that person.[8] Thus, the creditors, the spouse, and the taxing authorities might well have greater access to the property than would be the case were the property the subject of a viable trust.[9] If merger has occurred, at death the property passes in accordance with the terms of the person's will or by intestate succession, not in accordance with the terms of the instrument governing the purported trust.[10] Obviously, if those who are mentioned in the trust instrument are different from those mentioned in the will, merger will benefit the latter. Merger may have consequences as well in the welfare eligibility and recoupment area.

Merger would trigger a termination of a valid trust, for example, if a beneficiary with the entire equitable interest transfers that interest to the trustee, provided there is no cotrustee.[11] The equitable interest, however, would have to be transferable; the beneficiary would have to be of full age and legal capacity and fully understand the applicable law and facts; and there could not be any undue influence on the part of the trustee.[12] Assuming the trustee managed to get over these hurdles, the trustee would then have the full ownership interest with rights of personal consumption, even if all the trust purposes had not

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the three "requirements" for the establishment of a valid private trust is "an expression of intent that property be held, at least in part, for the benefit of one other than the settlor." *See* Bogert, Trusts and Trustees §1, in which Uniform Trust Code §402(a)(3) is cited as authority for the proposition. It does not appear, however, that §402(a)(3) even addresses the settlor-as-sole-beneficiary question. Some courts also have inappropriately invoked the doctrine of merger, such as to invalidate self-declarations of trust in which the settlor is the sole current beneficiary but other persons are designated as beneficiaries of the remainder. *See* Uniform Trust Code §402 cmt. (available on the Internet at <http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>). Presumably a so-called adapted trust would not fall prey to this particular misapplication of the merger doctrine as an adapted trust may not arise by declaration. *See* Restatement (Third) of Trusts, Reporter's Notes on §46, specifically on cmt. f thereto. The adapted trust is generally discussed in §9.29 of this handbook.

[5]*See, e.g.*, Hansen v. Bothe, 10 So. 3d 213 (Fla. App. 2009) (reversing the Circuit Court's finding that a trust had terminated by merger, the Circuit Court having failed to appreciate the fact that the continued existence of remainder beneficiaries under the trust meant that the legal and beneficial interests thereunder were not "completely coextensive," which they would have to be for a termination by merger to occur).

[6]*See generally* Restatement (Third) of Trusts §69; 5 Scott & Ascher §34.5; 2 Scott on Trusts §99; Restatement (Second) of Trusts §99; Bogert, Trusts and Trustees §§129, 1003.

[7]2 Scott on Trusts §99. *See also* Uniform Trust Code §402(a)(5) (available on the Internet at <http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>).

[8]Bogert, Trusts and Trustees §129; 5 Scott & Ascher §34.5. *See generally* Larry D. Scheafer, Annot., *Trusts: merger of legal and equitable estates where sole trustees are sole beneficiaries*, 7 A.L.R.4th 621 (1996).

[9]*See generally* 2 Scott on Trusts §99.

[10]2 Scott on Trusts §99.

[11]Restatement (Second) of Trusts §343 cmt. a; 5 Scott & Ascher §§34.7 (Conveyance by Beneficiary to Trustee), 34.5.2 (When Sole Beneficiary Does Not Become Sole Trustee). *See generally* 5 Scott & Ascher §34.5 (Merger).

[12]*See generally* 5 Scott & Ascher §34.7 (Conveyance by Beneficiary to Trustee) (a spendthrift restraint could render ineffective the transfer itself); Restatement (Third) of Trusts §69 cmt. d (an effective merger will extinguish spendthrift restraints). *See generally* §§6.1.3.5 of this handbook (acquisition by trustee of equitable interest: the loyalty issues) and 7.1 (the beneficiary's informed consent to a trustee's act of self-dealing).

been accomplished.[13] Under the Restatement (Third) of Trusts, this would be the case even if there had been a spendthrift restraint in place.[14] The property is said to be “at home,” the equitable interest having been “swallowed up” in the full ownership.[15] Of course, merger could be avoided if the trustee were to resign in a timely fashion, or to execute a timely disclaimer of the equitable interest.[16]

Going the other way, there would be a merger in the beneficiary of a single-beneficiary trust if the legal title were to pass from the trustee to the beneficiary and to no other,[17] whether or not this was done at the instigation of the beneficiary and whether or not the purposes of the trust had been fulfilled.[18] Under the Restatement (Third) of Trusts, any spendthrift protections would extinguish.[19] Thus, if that is not the desired result, the beneficiary should either disclaim the trusteeship or see to it that there is a cotrustee in place.[20] The Restatement (Second) of Trusts took the position that “when the sole beneficiary of a spendthrift trust, without his or her consent, became the sole trustee, he or she should be able to procure the appointment of a new trustee and have the trust reconstituted as a spendthrift trust.”[21] One learned commentator finds the position of the Third Restatement plainly “more consonant with the surrounding doctrine”).[22]

A state of merger also could exist *ab initio*. If, for example, *X* purports to declare himself trustee of certain property for a period of ten years after which the property is to pass outright and free of trust to *X*, there is no trust. All interests, both legal and equitable, remain merged in *X*.[23] A trust was never created.[24]

But more often than not there is no merger. Let us assume a trust, *A* to *B* for *C* for life, then to *D*. If the same person is the sole trustee and the sole income beneficiary, and if upon death the property passes to the person’s executor or administrator—in other words to the estate—then there is a merger.[25] In other words, if *B, C*, and *D* are the same person, there is no trust—in fact there never was one. *A* simply made a gift to the person that was outright and free of trust. Nowadays one seldom runs across trust instruments where the one who possesses the equitable life estate also possesses the equitable remainder interest (*i.e.,* where the trust property ultimately passes into the probate estate of the life tenant), with the possible exception of nominee or realty trusts.[26] The property usually passes directly by purchase to someone’s relatives.[27]

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[13]*See generally* 5 Scott & Ascher §34.7 (Conveyance by Beneficiary to Trustee).

[14]Restatement (Third) of Trusts §69 cmt. d.

[15]Lewin on Trusts ¶1-09 (England). *See also* 5 Scott & Ascher §34.5 (U.S.) (“The equitable interest is said to merge into the legal title”).

[16]Restatement (Third) of Trusts §69 cmt. d. *See generally* §5.5 of this handbook (voluntary or involuntary loss of the beneficiary's rights) (in part discussing the subject of disclaimers of equitable interests under trusts).

[17]5 Scott & Ascher §34.5 (Merger).

[18]5 Scott & Ascher §34.6 (Conveyance by Trustee to or at the Direction of the Beneficiaries).

[19]Restatement (Third) of Trusts §69 cmt. d. *See generally* 5 Scott & Ascher §34.5.1 (Acquisition of Legal Title by Beneficiary of Spendthrift Trust).

[20]Restatement (Third) of Trusts §69 cmt. d; 5 Scott & Ascher §34.5.1.

[21]5 Scott & Ascher §34.5.1 (referring to Restatement (Second) of Trusts §341(2) cmt. c & illus. 4, 7).

[22]5 Scott & Ascher §34.5.1.

[23]*See* Odom v. Morgan, 99 S.E. 195 (1919).

[24]Restatement (Third) of Trusts §69 cmt. e.

[25]Uniform Trust Code §402 cmt. (available on the Internet at <http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>).

[26]*See* §9.6 of this handbook (trusts that resemble corporations or agencies) (discussing the nominee trust).

[27]*See generally* National Shawmut Bank v. Joy, 315 Mass. 457, 462–467, 53 N.E.2d 113, 117–120 (1944).

Where the group of trustees and the group of beneficiaries are identical, the fact that the trustees hold the legal title jointly with right of survivorship and the beneficiaries hold the equitable interest as tenants in common ought to prevent the destruction of the trust through merger.[28] One learned commentator is of the view that on policy grounds alone, namely, the policy of effectuating settlor intent whenever possible, there should be no merger in such cases.[29]

As one can see, not much need be done to prevent a merger of interests. The simple introduction of a cotrustee into the formula should avoid such a result.[30] Or if upon the death of *C* the property passes to the then-living issue of *C* rather than to *C*'s estate there is no merger.[31] "…[A]…trust is created even though the only interests of other beneficiaries are contingent, subject to revocation, or otherwise uncertain."[32] In this day and age, one has to work hard to back into a merger.

The trustee should always keep in mind that, as we have alluded to above, a right to revoke or the possession of a general inter vivos power of appointment is not what triggers a merger.[33] Thus, if *A, B*, and *C* are the same but *D* is the *issue* of *B/C* living at the termination of the trust, there is no merger even in the face of a reserved right of revocation or general inter vivos power of appointment in *B/C*.[34] It is when *D* is the estate of *B/C* and *B/C* are the same person that merger comes about. The existence of a reserved right of revocation or general inter vivos power of appointment does not affect the situation one way or the other.[35]

With the revocable living trust now the core of most estate plans, it is important that the trustee separate issues relating to merger from issues relating to powers of revocation and general inter vivos powers of appointment. These powers are technically personal rights of disposition, not interests in property.[36]

There is no merger even in a case where title to the entire beneficial interest in a nominee trust[37] is held by the trustee of some other trust and the same person is the sole trustee of each trust, unless that same person also possesses the entire beneficial interest in the other trust.

As suggested in the introductory quotation, the coalescing of all property interests, both legal and equitable, in one person may not effect a merger in every case. Nor would the chance merger of the legal interest away from the trustee necessarily mean that in equity the trust itself extinguishes.[38] It may be that

[28]*See generally* 2 Scott on Trusts §99.5; First Ala. Bank of Tuscaloosa, N.A. v. Webb, 373 So. 2d 631 (Ala. 1979).

[29]2 Scott & Ascher §11.2.5.

[30]Restatement (Third) of Trusts §69 cmt. c. *See, e.g.*, First Ala. Bank of Tuscaloosa, N.A. v. Webb, 373 So. 2d 631 (Ala. 1979); Smith v. Francis, 221 Ga. 260, 144 S.E.2d 439 (1965).

[31]*See generally* 2 Scott on Trusts §99.3. *See also* Fratcher, *Trustor as Sole Trustee and Only Ascertainable Beneficiary*, 47 Mich. L. Rev. 907, 934 (1949).

[32]Restatement (Third) of Trusts §69 cmt. e.

[33]*See* National Shawmut Bank v. Joy, 315 Mass. 457, 469–478, 53 N.E.2d 113, 124–126 (1944).

[34]*See* Harrison, *Structuring Trusts to Permit the Donor to Act as Trustee*, 22(6) Est. Planning 331 (Nov./Dec. 1995).

[35]*See* Restatement (Third) of Property (Wills and Other Donative Transfers) §7.1 cmt. b (Tentative Draft No. 3, Apr. 4, 2001) (providing that "the fact that the interest of the remainder beneficiary is subject to the settlor's power to revoke or amend the trust…does not transform the inter vivos trust into a will").

[36]*See* National Shawmut Bank v. Joy, 315 Mass. 457, 474, 53 N.E.2d 113, 124 (1944). *See also* In re Armstrong, 17 Q.B.D. 521, 531 (1886).

[37]*See generally* §9.6 of this handbook (trusts that resemble corporations or agencies) (discussing the nominee trust).

[38]*See generally* 5 Scott & Ascher §33.2.

the one in whom the legal interest merges holds the legal interest as constructive trustee for the benefit of the trust beneficiaries, unless that person is a BFP.[39] As constructive trustee, he or she would then have a duty to transfer title to the subject property to an appropriate successor trustee, presumably one appointed by the court.[40]

The merger concept is not new. It was woven into the fabric of Roman law, as we have noted in Section 8.15.36 of this handbook.

[39]*See generally* 5 Scott & Ascher §33.2. *See generally* §8.15.63 of this handbook (doctrine of bona fide purchase and the BFP).

[40]*See generally* 5 Scott & Ascher §33.2. *See generally* §3.3 of this handbook (the remedial constructive trust).