

Comments

ESTATE OF WALL V. COMMISSIONER: AN ANSWER TO THE PROBLEM OF SETTLOR STANDING IN TRUST LAW?

*Michael R. Houston**

I.	INTRODUCTION.....	1723
II.	BACKGROUND.....	1731
	A. <i>An Historical Perspective on Trusts and Settlor Enforcement</i>	1731
	B. <i>Modern Trusts and Trustee Function</i>	1734
	C. <i>The Argument for Settlor Standing</i>	1742
	D. <i>Settlor Standing Under the Internal Revenue Code</i>	1745
III.	SETTLOR REPRIEVE: <i>ESTATE OF WALL V. COMMISSIONER</i>	1749
	A. <i>The Power to Substitute Trustees</i>	1749
	B. <i>Estate of Wall v. Commissioner</i>	1750
	C. <i>Aftermath of Wall</i>	1754
IV.	DISCUSSION.....	1756
	A. <i>Estate of Wall: A Settlor's Nirvana?</i>	1756
	B. <i>The Trustee Removal Power Versus Settlor Standing</i>	1757
	C. <i>The Court's View in Wall: Fact or Fiction?</i>	1759
	D. <i>Reconciling the Trustee Removal Power with Traditional Trust Law</i>	1763
V.	CONCLUSION.....	1766

I. INTRODUCTION

A settlor's ability to enforce the terms of a private irrevocable trust remains an open question, both in the courts and in the larger legal community, despite many commentators' encouragement to resolve the issue.¹ The

* J.D., Northwestern University School of Law, 2005; Ph.D., University of California at Berkeley, 1996; B.S., Georgia Institute of Technology, 1992. I am extremely grateful to Professor Robert H. Sitkoff for his active participation in the genesis and preparation of this Comment. I would also like to thank Professor Charlotte Crane and the members of the Northwestern University Law Review for their invaluable advice and comments. This work is dedicated to my wife, MaryKate Houston, for her unwavering support, and to my son, Robert Fisher Houston, for being the gold at the end of our rainbow.

¹ See, e.g., Note, *Right of a Settlor to Enforce a Private Trust*, 62 HARV. L. REV. 1370 (1949); John T. Gaubatz, *Grantor Enforcement of Trusts: Standing in One Private Law Setting*, 62 N.C. L. REV. 905, 911 (1984); David J. Hayton, *Developing the Obligation Characteristic of the Trust*, 117 L.Q. REV. 96, 106 (2001); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625 (1995);

issue is important to living settlors who want to both subject their donations of wealth to restrictions or conditions, and simultaneously minimize their overall tax liability.² Trust restrictions imposed by settlors may include provisions for asset management by a skilled trustee,³ controlled asset disbursement to beneficiaries based on the trustee's discretion or the beneficiaries' needs,⁴ or other criteria specified by the settlor.⁵ In many cases, the settlor also wants to retain some degree of control over the trust, even if only in a supervisory role, in order to ensure that the trust functions as envisioned.⁶ Even more ideal for the settlor would be the ability to impose his or her ongoing wishes over trust operation as circumstances change and evolve.⁷

Although a settlor is ostensibly free to incorporate such wishes into the trust terms, adverse tax consequences may result where a settlor retains control over the disposition of trust assets up until the time of his death.⁸ This

Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621 (2004).

² As an aside, the tax reform laws enacted in 2001 dictate that the estate tax will recede over the following decade, and will completely vanish with respect to decedents dying after December 31, 2009. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §§ 501(a), 511, 115 Stat. 38, 69–70. Under the sunset provisions of the Act, however, the estate tax is to be resurrected again beginning in 2011 as if the Act had never been enacted. *See id.* § 901(a)(2), (b), 115 Stat. at 150. Some commentators have expressed skepticism that this reversion will actually occur. *See, e.g.*, Lawrence A. Frolik, *The Developing Field of Elder Law Redux: Ten Years After*, 10 ELDER L.J. 1, 8 n.12 (2002) (“Whether [reversion to the pre-2001 estate tax laws] will actually occur at that time is uncertain.”); Kenneth H. Ryesky, “*In Employers We Trust*”: *The Federal Right of Contribution Under Internal Revenue Code Section 6672*, 9 FORDHAM J. CORP. & FIN. L. 191, 222 n.150 (2003) (noting the legislative efforts underway to make the estate tax repeal permanent). *But see* Alana J. Darnell, *Toward an Integrated Tax Treatment of Gifts and Inheritances*, 34 SETON HALL L. REV. 671, 672 n.9 (2004) (discussing how the disappearance of federal budget surpluses may favor at least partial retention of the estate tax). Despite the uncertainty surrounding the sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, it has been noted that, the receding estate tax notwithstanding, this tax is ensnaring more and more Americans who consider themselves middle class. *See, e.g.*, Albert B. Crenshaw, *The Debate on Death and Taxes; Estate Levy Raises Questions of Fairness, Class Inequities*, WASH. POST, Mar. 21, 1999, at H2. This Comment is therefore directed toward the estate tax laws as they currently stand, and may yet stand again. For a brief history of the estate tax, see M.C. Mirow & Bruce A. McGovern, *An Obituary of the Federal Estate Tax*, 43 ARIZ. L. REV. 625 (2001).

³ Sitkoff, *supra* note 1, at 633 (“[I]n addition to classic but still relevant context-specific rationales such as minimizing taxes and asset protection, the modern donative trust is also used more generally to bring together portfolio management skills with investment capital.”).

⁴ *See, e.g.*, Laurence M. Friedman, *The Dynastic Trust*, 73 YALE L.J. 547, 547 (1964) (discussing “caretaker” trusts in which a primary motivation of the settlor is to protect and serve the interests of incapable beneficiaries).

⁵ *See* WILLIAM P. STRENG, TAX MANAGEMENT: ESTATES, GIFTS, AND TRUSTS PORTFOLIOS: ESTATE PLANNING 11-11TH A-17 (1995) (describing the variety of purposes that trusts might serve). By way of example, “spendthrift” trusts, which contain provisions preventing the disbursement of trust assets to a beneficiary's creditors, have become so popular that they are approaching the default norm. *See generally* RESTATEMENT (THIRD) OF TRUSTS §§ 58–60 (2003).

⁶ *See* STRENG, *supra* note 5, at A-66.

⁷ *Id.*

⁸ *See, e.g.*, RICHARD B. STEPHENS ET AL., FEDERAL ESTATE AND GIFT TAXATION ¶ 1.02[2][b] (8th

reflects a “favored” tax status for outright inter vivos gifts (i.e., gifts given while the donor is living) as opposed to testamentary transfers that are not completed until death.⁹ The settlor’s desire to minimize taxes is therefore in tension with the desire to reserve control over the disposition of trust assets beyond the date of trust inception.¹⁰

Settlors often attempt to balance these concerns by creating an irrevocable trust.¹¹ In a typical irrevocable trust, settlors specify the terms and conditions governing the operation of the trust prior to the trust’s creation.¹² A trustee is then empowered to fulfill the trust provisions.¹³ The settlor often confers a great deal of discretion on the trustee, especially in modern-day trusts,¹⁴ in order to deal with unanticipated events or changed conditions regarding asset investments or the beneficiaries’ financial situations, for example. Assuming the trustee adheres to the trust terms and faithfully fulfills his duties, the settlor’s wishes are generally carried out. Relinquishing control over the trust property to the trustee in this manner will usually satisfy the tax code provisions requiring the surrender of control by the settlor.¹⁵ Albeit imperfect, inter vivos irrevocable trusts are often the best solution for

ed. 2002).

⁹ *Id.* at 26.H.R. REP. No. 94-1380, pt. 1, at 3 (1976), *reprinted in* 1976-3 C.B. 735, 739, 746. Discussing the rationale for the Estate and Gift Tax Reform Act of 1976, the Report states:

Under this unified structure, the total tax on cumulative lifetime and deathtime transfers will result in treating taxpayers who have transferred a portion of their property during lifetime somewhat better than taxpayers who retain their property for transfers at death (the preference for gifts provided by present law [i.e., pre-1976], however, is significantly reduced).

Id. Some authors have argued that there really is not and should not be a Congressional “preference,” but rather that any existing discrepancies are only a product of an imperfect system. See Theodore S. Sims, *Timing Under a Unified Wealth Transfer Tax*, 51 U. CHI. L. REV. 34, 34–36 (1984) (noting that the current wealth transfer tax system is less than “unified” due to the more lenient tax treatment afforded gifts made while the grantor is living compared with transfers occurring at death). *But see id.* at 56–57 nn.112–13 (describing various justifications for a preference for lifetime gifts over testamentary transfers).

¹⁰ See, e.g., STEPHENS ET AL., *supra* note 8, ¶ 1.02[2][b][iv].

¹¹ STRENG, *supra* note 5, at A-17 (“The irrevocable trust may be created to reduce the grantor’s estate tax liability through the pre-death transfers of assets [T]he usual purpose is to shift both the property itself and its income from the grantor’s gross estate.”).

¹² Aside from the general trust provisions covering the property transfer and trustee and beneficiary designation, the settlor can additionally provide for various schemes for income and corpus distribution, as well as powers of appointment (which allow the recipient of this power to designate future trust beneficiaries, for example). See STRENG, *supra* note 5, at A-19 to A-20, A-64 to A-65 (describing common trust distribution schemes and the power of appointment).

¹³ See generally GRAHAM MOFFAT ET AL., TRUSTS LAW: TEXTS AND MATERIALS 157–64 (3d ed. 1999).

¹⁴ GEORGE T. BOGERT, TRUSTS § 174, at 659 (6th ed. 1987) (“Quite often the settlor grants one or more trust powers to be exercised in the discretion of the trustee, rather than directing the trustee when and how to use his powers under all conditions.”).

¹⁵ See, e.g., I.R.C. §§ 2036, 2038 (2004); STEPHENS ET AL., *supra* note 8, ¶ 1.02[2][b][iv].

settlers wishing to make a conditional transfer of wealth while minimizing their tax burden.¹⁶

One problem that can arise in irrevocable trusts, however, is that the trustee's actions may not always conform to the settlor's wishes. This problem is exacerbated where the trustee has been granted a great deal of discretion, or new circumstances or information arise after the trust terms are finalized.¹⁷ Such infidelity may be the result of unclear trust terms, differences of opinion, or outright trustee misconduct, including collusion between the trustee and beneficiaries to thwart the trust provisions. In such cases, settlers naturally want the ability to enforce the terms of a trust, especially when preventing trustee or beneficiary misconduct.¹⁸ Unfortunately for these settlers, the weight of authority rejects the ability of an otherwise disinterested settlor to enforce the trust terms or to ensure that the trustee adheres to his other fiduciary duties.¹⁹ This result stems from the historical perception of trusts as a conveyance of property, which viewed the settlor's role as complete once the property was conveyed in trust.²⁰

Some have suggested that a possible remedy for settlers is to contract directly with the trustee.²¹ With such a contract, a breach by the trustee

¹⁶ See *supra* note 5.

¹⁷ See, e.g., Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 25 (1994). Marty-Nelson also notes that in discretionary trusts, beneficiaries are at the mercy of the trustee's whim:

The trustee may decide, in exercising his discretion, to provide no funds to the beneficiary. Thus, a settlor has no assurance that intended beneficiaries will ever benefit from the trust assets. The trustee in these cases possesses absolute power to determine the method by which the funds will be distributed, and the settlor's ultimate donative intent could be frustrated.

Id. at 26.

¹⁸ GEORGE G. BOGERT & GEORGE T. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 560, at 212 (2d ed. rev. 1980).

Although [the settlor] gives his trustee great freedom of action in the administration of the trust, he surely must intend the qualification that the trustee shall act with some regard to the purposes of the trust and not make decisions which frustrate the accomplishment of the settlor's intent, and that he employ his discretion deliberately and with some thought and not recklessly or capriciously but in a spirit of good faith and honesty.

Id.

¹⁹ *Ex parte* Ingalls, 93 So. 2d 753 (Ala. 1957); *Sanders v. Citizens Nat'l Bank*, 585 So. 2d 1064 (Fla. Dist. Ct. App. 1991); *Culbertson v. Matson*, 11 Mo. 493, 507 (1848); *In re Reynolds' Estate*, 268 N.W. 480 (Neb. 1936); *Werbelovsky v. Mfrs. Trust Co.*, 209 N.Y.S.2d 564 (N.Y. App. Div. 1961); *Scott v. United Carolina Bank*, 503 S.E.2d 149, 153–54 (N.C. Ct. App. 1998); *Thompson Coal Co. v. Pike Coal Co.*, 412 A.2d 466 (Pa. 1979); *Padelford v. Real Estate-Land Title & Trust Co.*, 183 A. 442 (Pa. Super. Ct. 1936); *Child v. Hayward*, 400 P.2d 758 (Utah 1965); *Barrette v. Dooly*, 59 P. 718 (Utah 1899); GEORGE G. BOGERT & GEORGE T. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* §§ 17, 42, 1002 (2d ed. rev. 1984); 3 AUSTIN W. SCOTT & WILLIAM F. FRATCHER, *THE LAW OF TRUSTS* § 200.1, at 211 (4th ed. 1988); RESTATEMENT (SECOND) OF TRUSTS § 200 cmt. b (1959). For a brief discussion of the situations in which settlers do have the ability to bring suit, see *infra* Part II.A. See generally *Sanders*, 585 So. 2d at 1066; BOGERT & BOGERT, *supra*, §§ 861–960; 3 SCOTT & FRATCHER, *supra*, §§ 197–226; Gaubatz, *supra* note 1.

²⁰ See *infra* Part II.A.

²¹ RESTATEMENT (SECOND) OF TRUSTS § 200 cmt. b (“[I]f the settlor makes a contract with the trus-

could be remedied by the settlor in a suit not for a breach of trust, but for a breach of contract. The primary difficulty with this approach is that it is unknown whether such a contract will cause the trust assets to be included in the settlor's gross estate upon death. Because of the complicated rules governing when sufficient control has been retained to trigger adverse tax consequences,²² undertaking a separate settlor-trustee contract would be tricky business at best as even some of the most carefully planned trusts can fall victim to these rules at the hands of the Internal Revenue Service ("IRS").²³ Thus, to the extent that the contract functions as desired and allows the settlor to enforce its terms, the settlor may face a correspondingly increased risk of the adverse tax consequences that result upon a retention of settlor control.²⁴

While the trustee is bound by fiduciary duties even without an explicit contract outside of the trust itself,²⁵ the enforcement of fiduciary duties can be a difficult and uncertain process as well. For example, even where the settlor retains the power to enforce trustee faithfulness and trust terms by including such rights in either the trust agreement or an outside contract with the trustee, the settlor faces uncertain judicial remedies.²⁶ Such uncertainty burdens settlors (and estate planners) who wish to make use of trust law to convey assets to third parties in trust while the settlor is still living and with the assurance that the settlor's wishes will be carried out.²⁷

In tension with current law which defaults against settlor standing, a number of commentators have come out in favor of at least limited settlor standing, which would allow settlors to enforce trust terms and the trustee's adherence to his fiduciary duties.²⁸ Professor Langbein, for example, advances a contractarian view of trusts under which the trust is analogized to a

tee, he can maintain an action on the contract against the trustee." See John C. Welsh, *Estates and Trusts*, 46 SYRACUSE L. REV. 567, 596–97 (1995) (citing *E. River Sav. Bank v. Samuels*, 31 N.E.2d 906, 909 (1940)).

²² See STRENG, *supra* note 5, at A-66 ("The principles in the estate tax area, unlike the income tax context, are premised primarily on court decisions. Those principles are highly elusive, and planning in this area is intricate and risky.").

²³ BOGERT & BOGERT, *supra* note 19, § 261, at 389 (drafting of trusts has been made increasingly complex due to the development of a large body of trust taxation law); STEPHENS ET AL., *supra* note 8, ¶ 1.01.

²⁴ Sitkoff, *supra* note 1, at 667 n.239 and accompanying text.

²⁵ See, e.g., Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 447 (1998).

²⁶ Such uncertainties include the question of whether and to what extent the trustee could use a "best interests of the beneficiaries" defense against a suing settlor, whether beneficiaries themselves could enjoin settlor suits against trustees, and the general uncertainty surrounding fiduciary litigation. On the first two of these points, see Sitkoff, *supra* note 1, at 668–69; for the latter point, see *infra* note 45.

²⁷ Sitkoff, *supra* note 1, at 663–65 (arguing that trustee infidelity toward the trust terms, the best interests of the beneficiaries, or both exacerbates agency costs in the settlor-trustee-beneficiary relationship).

²⁸ See, e.g., *supra* note 1 and references therein.

third-party beneficiary contract.²⁹ Langbein argues that since the promisee in a third-party beneficiary contract can bring suit to enforce such contracts, the analogous actor in trust law, the settlor, should likewise be able to bring suit to enforce the trust terms agreed upon with the trustee.³⁰ Similarly, Professor Sitkoff makes an argument for settlor standing based upon an agency costs theory of trusts.³¹ Sitkoff reasons that the inability of the settlor to enforce trust terms increases the net agency costs associated with the three-party relationship between the settlor, trustee, and beneficiary, thereby retarding efficient trust operation.³²

There also do not appear to be any doctrinal problems with recognizing settlor standing. Settlor suits presumably would not run afoul of any underlying principles of trust law, since it is well-established that settlors can create revocable trusts in which they maintain a large degree of control over trustees and trust operations.³³ In addition, settlor standing has already won approval in the context of charitable trusts,³⁴ although it is unclear whether this change will carry over into conventional trusts as well. The question of settlor standing is left untouched in the newly promulgated Uniform Trust Code (“UTC”),³⁵ and the text of section 94 of the revised *Restatement (Third) on Trusts*, entitled “Standing to Enforce a Trust,”³⁶ is not yet publicly available.

While the debate over settlor standing continues, this Comment argues that many of the goals sought through settlor standing can be achieved in a far easier manner: the settlor’s retention of a right to replace the trustee. In fact, settlors who wish to retain implicit control over trust operations without adverse tax consequences need look no further than *Estate of Wall v.*

²⁹ Langbein, *supra* note 1.

³⁰ *Id.* at 664.

³¹ Sitkoff, *supra* note 1.

³² *Id.* at 668–69.

³³ Adam Chase, *Tax Planning for Same-Sex Couples*, 72 DENV. U. L. REV. 359, 399 (1995) (“The primary disadvantage of an inter vivos trust is that the value of the trust property is included in the gross estate of the grantor, and is taxable if the grantor retains a beneficial interest in, or control over, the trust property.”).

³⁴ In a break from previous authority, the latest version of the Uniform Trust Code provides for settlor standing in the case of charitable trusts. See UNIF. TRUST CODE § 405(c) (amended 2003), 7C U.L.A. 184 (Supp. 2004) [hereinafter UTC] (trust enforcement); *id.* § 410(b), 7C U.L.A. at 188 (trust modification). One argument advanced in the case of charitable trusts, which would be inapplicable to the private trust setting, is that there is no beneficiary capable of policing the administration of charitable trusts, thus leaving the settlor as the only appropriate party to perform this function. See also Ronald Chester, *Grantor Standing to Enforce Charitable Transfers Under Section 405(C) of the Uniform Trust Code and Related Law: How Important Is It and How Extensive Should It Be?*, 37 REAL PROP. PROB. & TR. J. 611, 628–29 (2003).

³⁵ UTC, *supra* note 34, at 143. The UTC does not prevent the settlor from contracting for such rights, although it is somewhat unclear how a court would treat such a clause in a trust agreement.

³⁶ *But see* RESTATEMENT (THIRD) OF TRUSTS § 5 cmt. i (2003) (suggesting the likely continuation of the rule that settlors who are not also beneficiaries may not sue for trust enforcement).

Commissioner.³⁷ *Wall* addressed a situation in which a settlor of an irrevocable private trust retained the unfettered right to replace the current trustee with a new trustee. Under such circumstances, the U.S. Tax Court held, a settlor who retains such a power will not be subject to the adverse estate tax consequences associated with retaining improper trust control, so long as the replacement trustee is and continues to be independent of the settlor.³⁸ The decision in *Wall* was subsequently accepted by the IRS in a revised ruling, superseding all previous rulings on the issue.³⁹

While the decision in *Wall* may not be flawed from a doctrinal perspective, in practice, it ignores the enormous potential for settlor influence over the trustee, which emerges from such a replacement power. For example, where fee-paid professionals are used to manage trust assets,⁴⁰ a threat by the settlor to take his trust business elsewhere is almost certain to exert some pressure on trustee decisionmaking. At the same time, so long as the settlor's request for trustee action is not overly egregious, there is little incentive for the trustee not to cooperate, since beneficiaries may be unlikely to bring suit in opposition to the wishes of a living settlor, especially if the settlor still possesses or controls significant estate assets yet to be disposed.⁴¹ Nonetheless, convinced that such a replacement power would be sufficiently limited by the requirement of trustee independence, the *Wall* court dismissed IRS concerns that trustees would be improperly swayed by settlors, despite the latter's reservation of a removal power.⁴² The court also pointed out that settlors and trustees would be checked by the beneficiary's right to bring action against wayward trustees since the duties of care and loyalty require the trustee to faithfully serve only the best interests of the beneficiary, regardless of any settlor replacement power.⁴³

Despite the court's delicate treatment, the replacement power conceded in *Wall* is likely to far exceed the power that would result from settlor standing. For example, any remedy requested via settlor standing would at the very least be subject to judicial proceedings and oversight,⁴⁴ where the settlor would face a significant burden of proof in showing that the trustee breached his assumed duties.⁴⁵ In contrast, under *Wall* and the subsequent

³⁷ 101 T.C. 300 (1993).

³⁸ *Id.* at 313–14.

³⁹ Rev. Rul. 95-58, 1995-2 C.B. 191 (revoking Rev. Rul. 79-353, 1979-2 C.B. 325).

⁴⁰ 1 SCOTT & FRATCHER, *supra* note 19, § 1.8, at 28.

⁴¹ Interview with Robert H. Sitkoff, Associate Professor of Law, Northwestern University School of Law, in Chicago, Ill. (Fall 2003). *See also* Sitkoff, *supra* note 1, at 679–80 (describing other disincentives to beneficiary suits).

⁴² *Wall*, 101 T.C. at 311–12.

⁴³ *Id.* at 313.

⁴⁴ By definition, settlor standing simply gives the settlor the ability to bring suit in a court of law; the settlor must still make a case that the trustee breached a fiduciary duty, or alternatively that the trustee breached a contract term outside of the trust terms themselves.

⁴⁵ For example, it is a widely-held belief that oversight powers derived from fiduciary obligations

IRS ruling, there is no requirement for judicial oversight of the trustee replacement process.⁴⁶ Therefore, unless and until the beneficiaries step in to assert their rights under fiduciary law,⁴⁷ there will be no judicial scrutiny of the possible coercive effects such a replacement power may exert on trustee behavior. Thus, *Wall* grants the settlor a heretofore unavailable opportunity to exert significant influence over the disposition of trust assets without subjecting the settlor to adverse tax consequences.⁴⁸

Given this realization, the purpose of this Comment is to address the question of whether *Wall* offers an appropriate surrogate for settlor standing. One could argue that the effects of *Wall* go too far and overshoot the rationale behind the calls for settlor standing. On the other hand, perhaps the decision in *Wall* appropriately balances the congressional mandate against settlor control over trust assets with the need to address legitimate settlor grievances with minimal judicial intervention. Given the desire of settlors to retain a check over noncompliant trustees,⁴⁹ this author espouses the latter view, notwithstanding the potential for abuse by settlors. In any event, *Wall* provides fresh impetus for renewing the inquiry into the need for, and desirability of, settlor oversight in private irrevocable trusts.

Part II of this Comment will discuss the circumstances that have led to the push for some degree of settlor control over irrevocable trusts (sections A–C), as well as the rationale for, and tax consequences of, the policy of limiting settlor control (section D). Part III examines the decision in *Wall* and its potential effects in comparison to settlor standing and in light of the congressional stance toward irrevocable trusts. The discussion in Part IV concludes with a rationalization of the trustee removal power given the movement of trust function away from its historical use, in spite of the congressional tax policy that generally disfavors the settlor's retention of any power over trust assets or operation.

provide a poor method of governance for corporations. Since trusts largely involve the same fiduciary duties, some of these same deficiencies are likely to be present in the trust context as well. See Sitkoff, *supra* note 1, at 678 (suggesting that better established standards governing trustee performance mitigate the failings of corporate fiduciary enforcement in the context of trusts); see also Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J. CORP. L. 565, 570–82 (2003).

⁴⁶ *Wall*, 101 T.C. at 300; Rev. Rul. 95-58, 1995-2 C.B. 191.

⁴⁷ As stated previously, this is something beneficiaries may be reluctant to do in the face of a contrary settlor agenda. See *supra* note 41 and accompanying text.

⁴⁸ This assumes that no other provision in the trust would qualify as a “string” under I.R.C. §§ 2036–38.

⁴⁹ This conclusion is evidenced by the growing popularity of trust protectors. See *infra* note 153 and accompanying text.

II. BACKGROUND

A. *An Historical Perspective on Trusts and Settlor Enforcement*

The trust is “a device for making dispositions of property,”⁵⁰ and it may be created for any purpose that is not illegal or against public policy.⁵¹ Trust formation requires only trust property (the trust res) and an intention by the property owner that the property be transferred under the guardianship of one or more trustees to one or more beneficiaries. The end result is that the trustee holds the legal interest in the trust res, and the beneficiaries hold equitable interests.⁵² This separation of legal and equitable interests in the trust res creates a fiduciary relationship between the trustee and the beneficiaries,⁵³ which represents the essence of the trust.⁵⁴

Although their exact origin is debated,⁵⁵ trusts were introduced in England near the time of the Norman Conquest.⁵⁶ From that time until well into the nineteenth century, the transfer of ancestral lands was the primary use for private trusts.⁵⁷ The trust was useful for this purpose because it allowed one party to hold legal title to the land (i.e., the trustee), and another party to hold a beneficial interest in the land (i.e., the beneficiary).⁵⁸ This separation of legal and beneficial ownership interests sheltered landowners from the many burdens associated with holding and passing legal title to land,⁵⁹ and the trust was used primarily for this purpose for hundreds of years.⁶⁰

⁵⁰ 1 SCOTT & FRATCHER, *supra* note 19, § 1, at 2.

⁵¹ *Id.* (“The purposes for which trusts can be created are as unlimited as the imagination of lawyers.”).

⁵² ROGER W. ANDERSEN, UNDERSTANDING TRUSTS AND ESTATES § 2[B][1], at 8 (3d ed. 2003).

⁵³ RESTATEMENT (THIRD) OF TRUSTS § 2 (2003) (“A trust . . . is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.”).

⁵⁴ ANDERSEN, *supra* note 52, § 12[C], at 87; MOFFAT ET AL., *supra* note 13, at 109. With respect to the separation of ownership and control, a trust is like a corporation. *See* Sitkoff, *supra* note 45, at 570.

⁵⁵ *See, e.g.*, BOGERT, *supra* note 14, § 2, at 6–7.

⁵⁶ Frederic W. Maitland, *The Origin of Uses*, 8 HARV. L. REV. 127, 129–30 (1894) (suggesting these early settlers were perhaps motivated by the fact that they were leaving England to crusade, and wished their land to be held in their absence for the benefit of their wives and children).

⁵⁷ ELIAS CLARK ET AL., GRATUITOUS TRANSFERS: WILLS, INTESTATE SUCCESSION, TRUSTS, GIFTS, FUTURE INTERESTS AND ESTATE AND GIFT TAXATION 412–30 (West 3d ed. 1985); 1 SCOTT & FRATCHER, *supra* note 19, § 1.7, at 26.

⁵⁸ *See* ANDERSEN, *supra* note 52.

⁵⁹ Some of these burdens were the requirement that land pass by descent rather than by will, that “relief” payments were due when land passed to an heir, that rights of “wardship” and “marriage” attached when the heir was a minor, and that “aids” arose upon certain other events in the lord’s family. *See, e.g.*, BOGERT, *supra* note 14, § 2, at 7–8; Langbein, *supra* note 1, at 632–33.

⁶⁰ 1 SCOTT & FRATCHER, *supra* note 19, § 1.4, at 17.

Early on, trustee positions existed as honorary obligations only, as there was no legally recognized duty imposed upon the trustee.⁶¹ However, the development of the court of chancery in England led to the eventual recognition of the equitable interests of the beneficiary.⁶² This occurred as a result of complaints to the chancellor by beneficiaries whose trustees had failed to hold or convey the trust property as directed.⁶³ In reply, the chancery court came to recognize beneficiary rights, which comprised both personal obligations imposed on the trustee, and the beneficiary's equitable interest in the enjoyment of the trust property.⁶⁴ The dual characterization of the beneficiary's overall interest, which began to be recognized and enforced early in the fifteenth century,⁶⁵ was perhaps the most important aspect of trust development in early English law.⁶⁶ This newly created form of equitable ownership⁶⁷ proved to be a far more flexible device for enjoying and conveying property, since the passing of equitable interests was not subject to the same feudal restrictions as applied to legal interests.⁶⁸

In light of the historical development of the trust, it is unsurprising that trust law does not typically recognize attempts by the settlor or other non-beneficiary parties to challenge trust provisions or their operation.⁶⁹ Instead, current trust law default rules give the beneficiaries, and the beneficiaries only, the right to bring suit.⁷⁰ This result seems natural when one recalls that under the historical view, upon trust inception the beneficial interest in the trust res passes to the beneficiaries, and the legal title passes to the trustee, thus eliminating the settlor from the equation.⁷¹ The trust was thus perceived as a conveyance of property rights,⁷² whereby the settlor abandoned all future interests in the property and lost the ability to determine the future disposition of trust assets, even under conditions of changed circumstances.⁷³ "Since trust is a property relationship, the settlor who no

⁶¹ BOGERT, *supra* note 14, § 3, at 9.

⁶² *Id.*

⁶³ *Id.* at 9–10; 1 SCOTT & FRATCHER, *supra* note 19, §§ 1, 1.4, at 5, 14.

⁶⁴ *Id.* § 1, at 5.

⁶⁵ BOGERT, *supra* note 14, §§ 2, 3, at 5–10.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*; 1 SCOTT & FRATCHER, *supra* note 19, §§ 1, 1.4, at 6–7, 16.

⁶⁹ *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 200 cmt. b (1959) ("Neither the settlor nor his heirs or personal representatives, as such, can maintain a suit against the trustee to enforce a trust or to enjoin or obtain redress for a breach of trust.").

⁷⁰ *See, e.g., id.* § 200 ("No one except a beneficiary or one suing on his behalf can maintain a suit against the trustee to enforce the trust or to enjoin or obtain redress for a breach of trust.").

⁷¹ Early trust law was largely proprietary in nature, an off-shoot of the law of property conveyancing, since trusts were used primarily to transfer real property. Langbein, *supra* note 1, at 633.

⁷² Indeed, the Restatement states, "[t]he creation of a trust is conceived of as a conveyance of the beneficial interest in the trust property rather than as a contract." RESTATEMENT (SECOND) OF TRUSTS § 197 cmt. b.

⁷³ 3 SCOTT & FRATCHER, *supra* note 19, § 200.1, at 211–212; Jesse Dukeminier & James E. Krier,

longer owns the property cannot enforce the trust.⁷⁴ The beneficiary therefore has historically been the party to bring suit because the legal concept of the trust came into being, and exists today in its current form, specifically in response to the equitable claims of the beneficiary, as the above discussion highlights. The trust is by definition an answer to the equitable claims of the beneficiary and no other.⁷⁵

Another reason settlor rights likely did not materialize during the trust's formative years was the relative simplicity of the trustee's original duties. When the trust res consisted primarily of real property, the trustee, the legal owner of the trust property, had little to do other than hold the title and convey it when directed by the beneficiary. For example, commentators have stated that

[t]he trustees of these early trusts were mere stakeholders, little more than nominees, with no serious powers or responsibilities of management. Commonly, the beneficiaries lived on the land and managed it. . . . [T]he trustees' only significant duty was to hold until the settlor's death, and then to put themselves out of business by conveying the freehold to the remainder beneficiaries.⁷⁶

Consequently, the trustee neither needed nor had discretion in exercising his duties—the trustee could either transfer the property when directed by the beneficiary, or not transfer it, and nothing more.⁷⁷

Because trust operation entailed little discretion on the part of the trustee and was rather straightforward in the proprietary regime of old,⁷⁸ any failure on the part of the trustee to follow the mandate contained in the trust agreement would be easily recognized by the beneficiary, who could then pursue legal action. There was thus no practical reason to encourage trust enforcement by the settlor, so long as trusts functioned primarily to hold and transfer land, since the beneficiary was the more directly affected party and could easily do the same job. Thus developed the current default rule that settlors do not have standing to enforce trust terms.

The Rise of the Perpetual Trust, 50 UCLA L. REV. 1303, 1327–28 (2003).

⁷⁴ Langbein, *supra* note 1, at 664 (summarizing the tautology on which the Restatement rests its position).

⁷⁵ MOFFAT ET AL., *supra* note 13, at 31 (“It appears that the word ‘trust’ came to be used during the sixteenth century to mean, in effect, unexecuted uses [i.e. rights in a property interest] which the Chancery would enforce.”). It is further noteworthy that the typical discussion of the historical development of trusts that appears in the modern treatises makes no mention of settlor enforcement of early trusts.

⁷⁶ Langbein, *supra* note 1, at 633, *citing* William F. Fratcher, *Trust*, in 6 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 11, 16 (1973) (pamphlet edition).

⁷⁷ In fact, if the trustee denied that he held the property as trustee and instead appropriated it to his own use, he could do so with impunity prior to about the mid-fifteenth century. BOGERT, *supra* note 14, § 3, at 9, *citing* JAMES BARR AMES, LECTURES ON LEGAL HISTORY 236, 237 (1913); 3 SCOTT & FRATCHER, *supra* note 19, § 197, at 188–89.

⁷⁸ Langbein, *supra* note 1, at 640–41 (stating that the powers granted to trustees were few since the trustee's job was relatively simple and did not call for the need to transact with others).

Every rule has its exceptions, however, and Professor Gaubatz has pointed out that under certain circumstances, settlors do in fact have standing to bring suit.⁷⁹ For instance, settlors can typically sue trustees to enforce trust terms where the settlors have suffered an actual injury as a result of some act, or omission, on the part of the trustee.⁸⁰ Examples include situations where the settlor is a co-trustee, is a guardian for a beneficiary, or has a legal interest in having the trust terms followed, such as in the performance of a divorce decree.⁸¹ Along these lines, Gaubatz has used standing analysis to argue that

if the grantor has an economic, expectation, or representational interest in the trust, such that he can be trusted to fully and fairly litigate the validity of the transactions that he challenges, and his interest was foreseeable at the time the trust was created, he . . . [should be allowed to] maintain the action.⁸²

The leading authorities do not embrace Gaubatz's examples as evidence of limited settlor standing, however. Instead, it appears that where the settlor possesses a legal interest in having the trust terms followed, the settlor is more properly characterized as a beneficiary.⁸³ That is, the settlor's ability to bring suit in such situations is not indicative of settlor standing *per se*, but rather arises from the settlor's retention of a beneficial interest in the trust. A better view is thus that the settlor is allowed to sue in his capacity as a co-beneficiary, not in his capacity as settlor.⁸⁴ In any event, settlor oversight can only be invoked when the settlor retains a beneficial interest in the trust, which is precisely something the settlor often wishes to avoid for tax reasons. Gaubatz's examples of settlor standing thus seldom aid settlors, despite their desire to protect their overall trust scheme. Unfortunately, the settlor's plight has only worsened with trust modernization, as the next section discusses.

B. Modern Trusts and Trustee Function

1. The Evolution of Wealth and Its Effect on Trust Operation.—The historical development of the trust form helps explain and reinforce the current doctrine that precludes settlor standing to enforce trust terms. As this section discusses, however, the trust has evolved to meet the demands of modern wealth transfers.⁸⁵ As a result, trust objectives and the role of the

⁷⁹ Gaubatz, *supra* note 1, at 906.

⁸⁰ *Id.* at 914 (commenting on the easier application of this standard to decided cases, versus the more usual "economic interests" test).

⁸¹ *Id.* at 916–27.

⁸² *Id.* at 941.

⁸³ RESTATEMENT (SECOND) OF TRUSTS § 200 cmt. b (1959).

⁸⁴ *Id.*

⁸⁵ MOFFAT ET AL., *supra* note 13, at 31–36; *see also id.* at 31 (positing that the root cause behind trust evolution was "a fundamental alteration in the nature of wealth-holding").

trustee and beneficiaries have not remained so simple in modern times.⁸⁶ As we will see, it is the modern trust form, used in ways simply not imagined during the development of the historical proprietary trust, that prompts the desire for settlor oversight.

Many commentators have noted the massive shift in family wealth over the past several centuries from land holdings to personal property.⁸⁷ Modern wealth increasingly comprises income-producing financial assets such as stocks, bonds, pensions, and insurance policies, which are replacing the traditional real property land holdings.⁸⁸ One effect of this change is that trust assets can now more easily be distributed piecemeal over time.⁸⁹ Whereas previously the trustee merely held the trust property and then conveyed it when called upon, now trustees may be asked to mete out trust assets over a drawn-out period of time based upon criteria or rationales specified by the settlor.⁹⁰

Under these circumstances, asset disbursement often entails significant discretion on the part of the trustee,⁹¹ especially where the settlor injects need-based factors into the trust governance provisions, such as “for health and maintenance,” or where the trustee is called upon to divide assets and income between a lifetime beneficiary and a remainder beneficiary.⁹² The end result is that modern trustees are frequently vested with much more discretionary power over the disbursement of trust assets than occurred centuries ago.⁹³

Another effect of the change in trust assets is that trustees are increasingly expected to manage trust assets with an eye toward portfolio growth,⁹⁴

⁸⁶ *Id.* at 31–36 (noting that modern wealth holdings, unlike land holdings, entailed a whole new level of managerial investment responsibilities).

⁸⁷ *See, e.g.,* MOFFAT ET AL., *supra* note 13, at 31–33; 1 SCOTT & FRATCHER, *supra* note 19, § 1.7, at 26.

⁸⁸ *See, e.g.,* Langbein, *supra* note 1, at 638; John H. Langbein, *The Twentieth-Century Revolution in Family Wealth Transmission*, 86 MICH. L. REV. 722 (1988).

⁸⁹ *See, e.g.,* Langbein, *supra* note 1, at 638 (“Modern forms of wealth allow the settlor to devolve more options on the trustee in the dispositive provisions of trusts, that is, in allocating and distributing beneficial interests. By comparison with the interests possible in a trust of ancestral land, the modern trust fund invites greater flexibility to accumulate, distribute, or spend trust funds on behalf of beneficiaries.”).

⁹⁰ *See, e.g.,* STRENG, *supra* note 5, at A-64 to A-65 (describing the many ways in which a trustee may be asked to distribute trust income and corpus).

⁹¹ *See, e.g.,* Langbein, *supra* note 1, at 642 (“[M]odern trustees’ powers law confers vast managerial discretion.”).

⁹² ANDERSEN, *supra* note 52, § 13[A], at 97–98; *see also* Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273 (1983).

⁹³ *See, e.g.,* Joseph M. Dodge, *Simplifying Models for the Income Taxation of Trusts and Estates*, 14 AM. J. TAX POL’Y 127, 131 (1997) (noting that even when trustee discretion is subject to standards such as “health,” “support,” or “comfort,” such “standards are rarely so precise as to wholly eliminate the judgment or discretion of trustees”).

⁹⁴ *See, e.g.,* MOFFAT ET AL., *supra* note 13, at 32 (noting that modern trust assets increasingly require an eye toward active investment duties, namely the timely sale of assets and reinvestment of the

in addition to the traditional functions of holding, protecting, and transferring assets. Professor Langbein notes that “[t]he modern trustee conducts a program of investing and managing the assets that requires extensive discretion to respond to changing market forces.”⁹⁵ This new responsibility is evidenced by the recently promulgated Prudent Investor Rule,⁹⁶ which admonishes trustees to assess their own abilities with respect to portfolio asset management skills, and to delegate trust management to professionals when appropriate.⁹⁷ In general, current default rules give the trustee wide latitude in managing trust assets, so long as sound investment principles are followed.⁹⁸

One side effect of the trustee’s increased managerial responsibilities is that modern trustees are more likely to be fee-paid professionals who seek settlor clients and who attempt to profit from their position.⁹⁹ As noted by Langbein, settlors are also more likely to confer on trustees a greater degree of discretion in performing their modern duties.¹⁰⁰ One side effect of increased trustee discretionary power is that beneficiaries are increasingly dependent upon fiduciary law to protect their interests.¹⁰¹ These changes merely illustrate some of the ways in which the trust has evolved from historical times. As discussed in the next section, these changes have the potential to wreak havoc on the traditional trust operation, especially in light of modern tax laws, which can significantly complicate or even frustrate the settlor’s ability to have his intentions carried out.

2. *Conflicting Trust Objectives.*—“[T]he normal private trust is essentially a gift, projected on the plane of time and so subjected to a management regime.”¹⁰² Thus, viewed simply, trusts are gifts.¹⁰³ However, trusts are often used in place of outright asset transfers when the settlor

proceeds).

⁹⁵ Langbein, *supra* note 1, at 641.

⁹⁶ RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE (1992); *see also* UNIF. PRUDENT INVESTOR ACT § 1, 7B U.L.A. 286 (2000).

⁹⁷ RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 171.

⁹⁸ *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. e (1959) (stating that discretionary powers conferred upon a trustee for trust management or asset distribution purposes are not subject to court control except in cases of abuse of discretion); Sitkoff, *supra* note 1, at 652–53.

⁹⁹ Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 775 (2000) (“Today, the vast majority of trusts are administered by large financial institutions, such as trust companies and trust developments of commercial banks.”); Langbein, *supra* note 1, at 638 (“[T]he prototypical modern trustee is the fee-paid professional . . .”). *But see* Sitkoff, *supra* note 1, at 633 n.57 (noting some disagreement regarding the supposed increasing prevalence in fee-paid professional trustees).

¹⁰⁰ Langbein, *supra* note 1, at 644.

¹⁰¹ *Id.* at 642 (“Empowering the trustee to transact freely in the financial markets has shifted the locus of protection for beneficiaries from powers law to fiduciary law.”).

¹⁰² *Id.* at 632 (quoting Bernard Rudden, *Gifts and Promises by John P. Dawson*, 44 MOD. L. REV. 610, 610 (1981) (book review)).

¹⁰³ Langbein, *supra* note 1, at 632.

wants to impose certain conditions on the transfer of the gift,¹⁰⁴ or alternatively, to avoid imposing burdens on the beneficiaries.¹⁰⁵ As discussed above, the nature of modern wealth gives the settlor plenty of reasons to desire skilled management of trust assets. Modern trusts may also be advantageously used where the beneficiaries' access to trust assets is in need of oversight, as in the case of minors or beneficiaries who depend on trust income as their only means of support.¹⁰⁶ In all of these cases, a primary rationale for using the trust form to convey property is the settlor's ability to dictate trust operation and the distribution of assets to achieve such goals.

Another settlor objective is the minimization of taxes, which can be thought of conversely as the maximization of the gift.¹⁰⁷ Trusts are useful in this regard because they allow the settlor to immediately remove certain assets from the taxable estate¹⁰⁸ while delaying or metering the delivery of those assets to the intended beneficiaries as discussed above.¹⁰⁹ In addition, taxes can sometimes be saved by placing into trust those assets which may be expected to appreciate considerably during the life of the settlor.¹¹⁰

Unfortunately, the goal of tax minimization conflicts with the settlor's desire to maintain control over the disposition of trust assets.¹¹¹ This is because tax policy "favors" outright inter vivos gifts in which settlor interests in trust property are surrendered, as opposed to transfers that can be altered by the settlor up to the point of death or which occur at death.¹¹² This pref-

¹⁰⁴ See, e.g., Friedman, *supra* note 4, at 547 (describing two possible settlor motivations as the desire to provide for incapable beneficiaries ("caretaker" trusts) or the desire to keep wealth within the family through successive generations ("dynastic" trusts)); see also STRENG, *supra* note 5, at A-62, A-64 to A-65 (describing the many potential settlor motives in settling an inter vivos irrevocable trust).

¹⁰⁵ ANDERSEN, *supra* note 52, § 11, at 81.

¹⁰⁶ See, e.g., Friedman, *supra* note 4, at 547 ("caretaker" trusts); Sitkoff, *supra* note 1, at 668.

¹⁰⁷ See, e.g., ANDERSEN, *supra* note 52, § 11, at 82; 1 SCOTT & FRATCHER, *supra* note 19, § 16B, at 220-24.

¹⁰⁸ Another advantage is that assets removed from the gross (i.e., taxable) estate are also removed from the probate estate as well, thus avoiding probate costs. See, e.g., ANDERSEN, *supra* note 52, § 11, at 82; STRENG, *supra* note 5, at A-17.

¹⁰⁹ See *supra* notes 89, 90.

¹¹⁰ It is true that the settlor's heirs would get the tax advantage of a stepped-up basis for the appreciated assets were they to pass upon the settlor's death. That is, neither the donor nor the donee would have to pay income tax on the amount of appreciation during the donor's lifetime. If the assets were passed during the settlor's lifetime, however, there would be no stepped-up basis and the beneficiary would be liable for income tax on the entire amount of appreciation when the asset is liquidized. However, when the settlor's estate is large enough to be subjected to the estate tax, the current estate tax rates are sufficiently high to more than offset the income taxes that would be paid by the beneficiary, especially where these are subject to the capital gains rate instead of ordinary income rates. Thus, under most circumstances, although not all, when the settlor's estate will be subject to the estate tax, there is a benefit to passing assets via inter vivos gifts versus testamentary transfers. See generally *supra* notes 9-11; *infra* notes 112-113.

¹¹¹ See, e.g., BOGERT, *supra* note 14, § 145, at 516.

¹¹² See H.R. Rep. No. 94-1380, at 3, 12 (1976), reprinted in 1976-3 C.B. 735, 739, 746 (discussing the rationale for the Estate and Gift Tax Reform Act of 1976). For more concrete examples of how this

erence, manifested by a lower effective tax rate applicable to outright gifts,¹¹³ requires that the settlor fully relinquish control over trust assets in order to qualify for gift treatment and the reduced tax liability.¹¹⁴ If the settlor is found not to have sufficiently relinquished control over the trust assets, the asset value can be swept into the gross estate upon death,¹¹⁵ subjecting the estate to a higher effective tax rate and losing the benefit of the gift tax-exclusivity.¹¹⁶ This congressional stance¹¹⁷ places the settlor's two goals, control over the disposition of trust assets and minimization of taxes, in tension with each other.

In order to reconcile these two opposing objectives, albeit imperfectly, the settlor often establishes an irrevocable trust.¹¹⁸ This type of trust is called irrevocable because its terms generally cannot be changed by the settlor once property is conveyed to the trust. Releasing control over trust assets in this manner satisfies Congress's insistence on the surrender of control for gift treatment.¹¹⁹ Thus, while the settlor's freedom to fashion trust terms is limited only by one's imagination,¹²⁰ the private irrevocable trust

preference works in practice, see STEPHENS ET AL., *supra* note 8, ¶ 2.01[4].

¹¹³ Technically, the tax rates for gifts and estates are the same. *See, e.g.*, PAUL R. MCDANIEL ET AL., FEDERAL WEALTH TRANSFER TAXATION 71 (5th ed. 2003). However, Congress has consistently chosen to distinguish between gift and estate taxes in other, somewhat more subtle ways. For example, the gift tax is tax-exclusive, meaning that tax is computed on the amount of the gift only, which then must be separately paid by the giftor. *Id.* at 74. In contrast, the estate tax is tax-inclusive, meaning that tax is computed on the total estate value from which the estate tax is then subtracted. *Id.* Thus, gifts are effectively taxed less than identical transfers that are deemed to be includible in the estate. Another indirect difference involves the manner in which the value of trust assets are imputed to the estate for determining the progressive estate tax rate. If a given transfer is deemed complete, the value used is that at the time of the transfer, whereas if the settlor retained enough control over the trust assets to render the transfer incomplete, then the value of the assets at the time of the settlor's death, including any appreciation since the transfer occurred, will be used, likely resulting in a higher tax rate and a higher overall tax liability. *Id.* at 73. This is another reason why settlors often want transfers of property to be deemed completed gifts as opposed to testamentary transfers at death.

¹¹⁴ I.R.C. §§ 2036, 2038 (2004).

¹¹⁵ A decedent's gross estate represents the cumulative value of all property owned or subject to control by the decedent. The taxable estate is that amount remaining from the gross estate after subtraction of allowable deductions, such as those assets transferred to a living spouse. *See, e.g.*, STEPHENS ET AL., *supra* note 8, ¶¶ 2.01, 4.01.

¹¹⁶ *See, e.g., id.* ¶ 2.01[4]. This assumes that the total estate value, including lifetime gifts, exceeds the estate tax exemption, which as noted previously (*supra* note 2) is a moving target under current tax law. *See infra* Part II.D for a more detailed description of the relevant revenue code provisions regarding when certain assets may be swept into the gross estate.

¹¹⁷ It has been suggested by Professor Charlotte Crane that Congress does not necessarily favor one type of transfer over the other, but that the difference is simply a result of a complicated and perhaps difficult-to-reconcile tax code. Interview with Professor Charlotte Crane, Professor of Law, Northwestern University School of Law, in Chicago, Ill. (Feb. 7, 2005); *see also supra* note 9. Whatever the case, the end result is that inter vivos transfers are usually taxed less than transfers at death, and are thus "favored" in that respect.

¹¹⁸ *See, e.g.*, STRENG, *supra* note 5, at A17, A66.

¹¹⁹ *Id.*

¹²⁰ It should be mentioned that there are some default rules that the settlor cannot avoid even if

ideally achieves the two interests of the settlor, asset management and controlled income distribution to the various beneficiaries on the one hand, and the minimization of taxes paid (or maximization of the gift) on the other hand—all without the possibility of future modification or input by the settlor.

3. *Frustration of the Settlor's Intent.*—Irrevocable trusts are imperfect from the settlor's perspective partly because they require the settlor to specify in advance all of the controlling parameters that will dictate the disposition of trust assets. Unfortunately, there are many circumstances that can work to frustrate the settlor's original intent at the time of trust creation.¹²¹ Perhaps the most alarming of these from the settlor's viewpoint is that colluding trustees and beneficiaries can apparently abolish the trust outright, provided that the trustees and all beneficiaries concur.¹²² This may occur, for example, when beneficiaries want access to the entire trust corpus as opposed to waiting for it to be disbursed piecemeal according to the settlor's schedule. While such an action may flout the well-established *Clafin* doctrine,¹²³ which prohibits beneficiaries from obtaining judicial dissolution of trusts when a material trust purpose remains,¹²⁴ there would appear to be no settlor recourse against the trustee should he act at the behest of all the beneficiaries and distribute the trust assets despite settlor instructions to the contrary.¹²⁵

stated otherwise in the trust terms; examples include the settlor's inability to dictate how a beneficiary may use his new-found wealth and the prohibition on dispensing with fiduciary duties. *See generally* UNIF. TRUST CODE § 105 (amended 2001), 7C U.L.A. 159 (Supp. 2004); Hansmann & Mattei, *supra* note 25, at 449; John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105 (2004). Moreover, trust provisions that intrude on the personal lives of the beneficiaries are also disfavored. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 29(2) cmts. j–l (2003).

¹²¹ Evidence of this problem is manifested by the recent trend toward loosening trust interpretation rules and giving effect to the settlor's wishes when possible. *See generally* Edward C. Halbach, Jr., *Uniform Acts, Restatements, and Trends in American Trust Law at Century's End*, 88 CAL. L. REV. 1877, 1883–90 (2000).

¹²² *See* RESTATEMENT (SECOND) OF TRUSTS § 216, at 342 (1959); ANDERSEN, *supra* note 52, § 14, at 110 (“Beneficiaries seeking to terminate the trust can, of course, simply ask the trustee. If the trustee complies, there should be no problem.”); 4 SCOTT & FRATCHER, *supra* note 19, § 342, at 529–32.

¹²³ *Clafin v. Clafin*, 20 N.E. 454 (Mass. 1889) (preventing trust dissolution at the request of all beneficiaries when a material trust purpose still exists); *see* RESTATEMENT (THIRD) OF TRUSTS § 65 cmt. a; *see also* Sitkoff, *supra* note 1, at 658–63. Note, however, the hypothetical discussed here differs from the situation in *Clafin* because there the trustee opposed trust dissolution, whereas here we are assuming trustee complicity.

¹²⁴ Identifying a material trust purpose “frequently involve[s] a relatively subjective process of interpretation and application of judgment to a particular situation.” Specific purposes may be evidenced by a settlor's “concern with regard to a beneficiary's management skills, judgment, or level of maturity.” RESTATEMENT (THIRD) OF TRUSTS § 65 cmt. d (2003). Other commentators have opined that courts have little difficulty in discerning a material trust purpose. Sitkoff, *supra* note 1, at 659 (“[C]ourts have had little difficulty finding a ‘material purpose’ that would be offended by a modification or termination.”).

¹²⁵ *Shelton v. King*, 229 U.S. 90, 94 (1913) (“That the respective legacies are vested and absolute is

Trustee acquiescence in trust dissolution is in fact only one example of the larger problem of improper or undesirable trustee conduct. For instance, it has been pointed out that poor oversight by beneficiaries is likely to encourage trustee shirking and mismanagement.¹²⁶ While trustee misbehavior was easy to detect in historical times—since the trustee’s function was so simple¹²⁷—the rise of the modern trust has changed the playing field in such a way as to exacerbate and potentially even encourage trustee delinquency.¹²⁸ In modern trusts consisting of a portfolio of various financial instruments, beneficiaries cannot necessarily be expected to monitor trustee actions effectively, especially where the beneficiaries have a poor understanding of investment principles. Indeed, ensuring proper asset management is one of the reasons a settlor may choose the trust form to begin with.¹²⁹ The wide latitude given trustees in making investment decisions makes trustee oversight quite difficult.¹³⁰ As might be expected from these developments, “problems of shirking and monitoring” difficulties abound in trust administration.¹³¹

The increased reliance upon fee-paid professionals who seek to profit from their positions as trustees may also encourage, albeit indirectly, increased trustee misbehavior.¹³² When trustee fees are based on the overall trust value,¹³³ trustees have an incentive to grow the trust value through investments and to minimize payments to beneficiaries.¹³⁴ Alternatively, when trustee fees are at least partly based on the number of trust transactions in a given year, trustees may be tempted to execute more trust transac-

undeniable. No other person has any interest in them, and if the trustees should disregard the time of payment and pay over to each legatee his or her legacy when they are competent to give a valid discharge, there would be no one who could call them to account.”); *Wash. Loan & Trust Co. v. Colby*, 108 F.2d 743, 746 (D.C. Cir. 1939) (denying recoupment by the trustee despite the poor judgment and unlawful conduct of the beneficiaries, since the trustee and beneficiaries all agreed to disburse trust assets and the trustee should have investigated and prevented the disbursement); *Hagerty v. Clement*, 196 So. 330 (La. 1940); *Partridge v. Clary*, 117 N.E. 332 (Mass. 1917); *In re Will of Ceribelli*, 554 N.Y.S.2d 130 (N.Y. App. Div. 1990) (granting income beneficiaries petition for principal invasion for education and support of remaindermen); see also W. W. Allen, Annotation, *Beneficiary’s Consent to, Acquiescence in, or Ratification of, Trustee’s Improper Allocation or Distribution of Assets*, 29 A.L.R.2d 1034 (1953).

¹²⁶ See Sitkoff, *supra* note 1, at 664.

¹²⁷ See discussion *supra* Part II.A.

¹²⁸ See, e.g., Sitkoff, *supra* note 1, at 664.

¹²⁹ ANDERSEN, *supra* note 52, § 11, at 81; Sitkoff, *supra* note 1, at 668 (noting that settlors often choose trust form due to a lack of faith in the beneficiaries).

¹³⁰ Sitkoff, *supra* note 1, at 658 (“The modern managerial trust vests greater discretion in the hands of the trustee, which broadens the range of the trustee’s hidden action.”).

¹³¹ *Id.* at 623.

¹³² *But see id.* at 633 n.57 (noting disagreement regarding this supposed trend); see also *supra* note 99.

¹³³ ANDERSEN, *supra* note 52, § 13, at 100.

¹³⁴ *Id.* (stating that trustee fees based on a percentage of trust assets is one reason for trustees to hold onto trust assets, albeit unjustifiably).

tions than are perhaps necessary. These fee structures create an inherent conflict when trustees are faced with the decision of what investments to make, how much to disburse each year, or even whether to disburse trust assets at all. Such a conflict becomes even more acute when the trust terms are vaguely worded or make the trustee's position highly discretionary. This is another area where feeble monitoring on the part of the beneficiaries fails to check the problem, as highlighted by the reported increase in trustee shirking.¹³⁵

Frequently, undesirable trustee behavior may not be the trustee's fault. As the previous discussion of modern trusts indicates, trustees are being granted an increasing amount of discretion in carrying out the trust terms.¹³⁶ This increasing discretion stems from modern, more fungible forms of wealth, which in turn has led to more liberalized trust investment law.¹³⁷ While liberalized trust investment law is presumably a good thing, the resulting high level of discretion vested with the trustee inevitably leaves more room for trustee judgments and decisions with which the settlor may disagree. Although the settlor's wishes may be thwarted in some cases, such outcomes are to be expected in a regime where trustees are asked to do significantly more than simply hold and convey property. Undesirable trustee behavior in this regime may be simply a result of not knowing what the settlor would want under a particular set of circumstances, as opposed to intentional misconduct. Thus, conflicting trustee motivations in portfolio management and disbursement decisions, poor or vague instructions by the settlor, and increased trustee discretion resulting from liberalized investment laws can all contribute to the frustration of a settlor's original intentions, ongoing wishes, or both.¹³⁸ All of these problems may be further compounded by poor trustee supervision by the beneficiaries.

Unfortunately, the establishment of an irrevocable trust leaves the settlor with few options to correct trustee or beneficiary intransigence.¹³⁹ Yet, in light of the increased complexity of trusts and their widespread utilization to accomplish the particularized goals of the settlor, perhaps now more than ever, the settlor has an interest in seeing that the trust terms are faithfully carried out by the trustee. It is perhaps not surprising then that calls for settlor standing have surfaced in the past decade, as discussed next.

¹³⁵ See *supra* note 130.

¹³⁶ See *supra* Part II.B.

¹³⁷ See *supra* notes 14, 17–18. Also note that settlors are free to specify trust terms to whatever degree of detail they wish, meaning that trustee discretion is not a necessary result of settlor freedom, although it is a common one.

¹³⁸ See generally Sitkoff, *supra* note 1 (discussing the various agency costs associated with the irrevocable private trust).

¹³⁹ See *supra* note 1 and references cited therein; see also *supra* note 19 and accompanying text.

C. The Argument for Settlor Standing

Given that the settlor is the party responsible for dictating the substantive trust terms and negotiating with trustees prior to trust inception,¹⁴⁰ it seems only natural that the settlor should have the right to ensure that the trust terms are properly carried out. This is especially so when wayward trustees and beneficiaries covertly dissolve the trust or deviate substantially from its terms for personal gain. Current trust law does not bear this out,¹⁴¹ however, as it has been commonly stated that the settlor has no ability to enforce the terms of a private trust.¹⁴²

Some commentators have advanced arguments for the reversal of the rule against settlor standing, partly or largely in response to the developments and concerns mentioned above.¹⁴³ For example, Professor Langbein advances a contractarian basis for trust law from which, according to him, settlor standing flows naturally.¹⁴⁴ Quoting Maitland, Langbein points out that when the English Chancellor first began to enforce the trust, it “generally had its origin in something that we can not but call an agreement.”¹⁴⁵ “[The] trust was originally regarded as an obligation, in point of fact a contract though not usually so called.”¹⁴⁶ Thus “the three-cornered relation of settlor, trustee, and [beneficiary] . . . is easily explained in the modern law in terms of a contract for the benefit of a third party.”¹⁴⁷ Since the promisee (i.e., settlor) in a third-party beneficiary contract has standing to bring suit against the promisor (i.e., trustee) to enforce the contract,¹⁴⁸ the contractarian viewpoint strongly supports a settlor’s right to enforce the trust terms against trustee deviance or nonperformance.¹⁴⁹

Langbein’s argument does not stop there, however, for he also notes the degree to which trust law has become default law. In a default law regime the proper question is

¹⁴⁰ See, e.g., STRENG, *supra* note 5, at A-64 to A-65 (describing the types of provisions that may be specified by the settlor); Langbein, *supra* note 1, at 639, 651. But see Sitkoff, *supra* note 1, at 644 n.109 (pointing out that in fact very little negotiation may occur between the settlor and trustee).

¹⁴¹ RESTATEMENT (SECOND) OF TRUSTS § 200 cmt. b (1959); 3 SCOTT & FRATCHER, *supra* note 19, §§ 200–200.1, at 207–12; Note, *supra* note 1.

¹⁴² BOGERT & BOGERT, *supra* note 19, § 42, at n.5; 3 SCOTT & FRATCHER, *supra* note 19, § 200.1, at 211; see also *supra* notes 19, 125 and the cases cited therein. Recall that this Comment is concerned with those trusts in which the settlor has chosen not to reserve oversight or revocation powers for himself, generally for tax reasons, despite his freedom to do so. See, e.g., BOGERT, *supra* note 14, § 145, at 514.

¹⁴³ See generally Langbein, *supra* note 1; Sitkoff, *supra* note 1.

¹⁴⁴ See generally Langbein, *supra* note 1.

¹⁴⁵ *Id.* at 628 (quoting FREDERIC W. MAITLAND, EQUITY: A COURSE OF LECTURES 28–29, 110 (John Brunyate rev. ed., 2d ed. 1936) (A.H. Chaytor & W.J. Whittaker eds., 1st ed. 1909)).

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 629 (quoting F.H. LAWSON, A COMMON LAWYER LOOKS AT THE CIVIL LAW 200 (1953)).

¹⁴⁸ See RESTATEMENT (SECOND) OF CONTRACTS §§ 305, 307 (1981).

¹⁴⁹ Note, *supra* note 1, at 1372–73; Langbein, *supra* note 1, at 646.

[w]hat was the intention of the parties to the trust deal respecting this point, and if they did not articulate their intention on this matter, which default rule captures the likely bargain they would have struck had they thought about it? When such an intention-seeking standard is applied, as it is, for example, to third-party-beneficiary contracts, the parties are routinely assumed to have intended enforcement by the promisee (the settlor-equivalent person) as well as the beneficiary.¹⁵⁰

Langbein thus maintains that had the settlor and trustee considered the issue, absent other exigencies,¹⁵¹ they would likely have bargained for at least some degree of settlor oversight.¹⁵²

That settlor oversight would be preferred by the parties is evidenced in part by the growing popularity of so-called “trust protectors.”¹⁵³ The trust protector, who may be a close friend or perhaps the family lawyer, steps into the shoes of a settlor as if the settlor had not revoked governance powers over the trust.¹⁵⁴ So empowered, the protector may approve modifications to the trust in the event of changed circumstances, as well as generally oversee trustee performance, up to and including replacement of the trustee.¹⁵⁵ Increased reliance on trust protectors, coupled with the fact that such protectors are often given the power to bring suit or remove trustees in the event trust provisions go unfulfilled, suggests a settlor preference for the retention of standing rights,¹⁵⁶ thus supporting Langbein’s argument for a default rule which grants settlor standing.¹⁵⁷

Professor Sitkoff makes a separate case for settlor standing based upon an agency costs theory of trusts. Sitkoff’s model assumes a trustee’s duty to maximize the welfare of the beneficiaries, subject to the constraints imposed by the settlor in the trust agreement.¹⁵⁸ When the agency costs are analyzed within the typical three-party settlor-trustee-beneficiary relationship, Sitkoff highlights that both positive and negative effects are likely to

¹⁵⁰ Langbein, *supra* note 1, at 664.

¹⁵¹ Two constraints that might counteract the preference for inclusion of settlor standing rights in the trust deal are tax considerations, discussed *infra* Part II.D, and the increased commissions charged by the trustee to cover the greater liability. See Sitkoff, *supra* note 1, at 667.

¹⁵² Langbein, *supra* note 1, at 664.

¹⁵³ *Shelley v. Shelley*, 354 P.2d 282 (Or. 1960) (acknowledging trust advisors); ANDERSEN, *supra* note 52, § 12, at 91; Sitkoff, *supra* note 1, at 670 n.249 (citing James Dam, *More Estate Planners Are Using “Trust Protectors,”* LAW. WKLY. U.S.A., Oct. 29, 2001, at 14, 14).

¹⁵⁴ See Sitkoff, *supra* note 1, at 670; Donovan W. M. Waters, *The Protector: New Wine in Old Bottles?*, in TRENDS IN CONTEMPORARY TRUST LAW 63 (A. J. Oakley ed., 1996).

¹⁵⁵ See, e.g., Hayton, *supra* note 1, at 104–07.

¹⁵⁶ There are other benefits to trust protectors besides the ability to bring suit against the trustee, thus making it difficult to determine the predominant reasons for their increasing prevalence. See, e.g., Sitkoff, *supra* note 1, at 671 (“Unlike settlor standing, however, [the use of a trust protector] does not trigger undesirable tax consequences and it continues to function even after the settlor’s death.”).

¹⁵⁷ *Id.* at 667 (arguing that the proliferation of the trust protector indicates a desire among settlors to maintain some form of trustee oversight).

¹⁵⁸ See generally *id.* at 624.

result from settlor standing. On the one hand, settlor standing might increase agency costs “by introducing a second master over the trustee.”¹⁵⁹ As a result, already cautious trustees may become even more so due to a fear of possible litigation on multiple fronts, an effect which would run counter to a general desire for less trustee conservatism.¹⁶⁰

On the other hand, Sitkoff points out that other agency costs may be sufficiently reduced to offset this concern.¹⁶¹ For example, a settlor often chooses to transfer assets by trust instead of an outright gift because of a “lack of faith” in the beneficiary’s ability to manage the trust assets.¹⁶² Additionally, settlor standing might be expected to minimize agency costs caused by suboptimal trustee performance, according to Sitkoff, by deterring the trustee delinquency and mismanagement that are prone to occur when disinterested or incapable beneficiaries fail to adequately oversee trust operations.¹⁶³ No matter how bad her performance may be, it is unlikely that a trustee would ever step down voluntarily absent a court decree, partly because most trustees are paid and enjoy their fees.¹⁶⁴ In such situations, better trustee performance would be expected to result when settlors have the ability to oversee and ultimately remove and replace poor performers. Finally, in addition to curbing managerial agency costs, settlor standing may also decrease the probability that the trustee and beneficiary will enter into a side-agreement to avoid the constraints imposed by the settlor and thereby circumvent the settlor’s wishes.¹⁶⁵

Sitkoff concludes that the current rule prohibiting the settlor’s enforcement of trust terms may hinder efficient trust operation by increasing the overall agency costs associated with the three-party relationship between the settlor, the trustee, and the beneficiary.¹⁶⁶ Conversely, an alternate rule allowing settlor standing would reduce overall agency costs, and to the extent that the settlor is assured the trust terms will be followed despite recalcitrant trustees and beneficiaries, gifting by trust will be encouraged to the ultimate gain of all potential beneficiaries.¹⁶⁷

¹⁵⁹ *Id.* at 668.

¹⁶⁰ *Id.* Trustee conservatism refers to the tendency of trustees to invest trust assets very cautiously, perhaps more cautiously than is warranted or desirable. On the reform movement toward less trustee conservatism, see John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 641–42 (1996). See also Edward C. Halbach, Jr., *Trust Investment Law in the Third Restatement*, 27 REAL PROP. PROB. & TR. J. 407, 411–18 (1992).

¹⁶¹ Sitkoff, *supra* note 1, at 668–69.

¹⁶² *Id.* at 668.

¹⁶³ *Id.* at 668–69.

¹⁶⁴ REGIS W. CAMPFIELD ET AL., *TAXATION OF ESTATES, GIFTS AND TRUSTS* ¶ 18,184, at 390 (22d ed. 2002).

¹⁶⁵ *Id.* ¶ 18,184, at 390–91.

¹⁶⁶ Sitkoff, *supra* note 1, at 669.

¹⁶⁷ *Id.* at 659.

It should be noted that settlor standing has recently been acknowledged in the enforcement of charitable trusts.¹⁶⁸ In a reversal of the common law position, the newly promulgated Uniform Trust Code states, “[t]he settlor of a charitable trust, among others, may maintain a proceeding to enforce the trust.”¹⁶⁹ Admittedly, charitable trusts provide an incomplete analogy since there are no identifiable beneficiaries, and hence no party to enforce the trust terms and the trustee’s adherence to fiduciary standards absent settlor standing.¹⁷⁰ Because beneficiaries are normally relied upon to enforce trust terms in the ordinary trust setting,¹⁷¹ the absence of this actor in charitable trusts is certainly one justification for granting the settlor an ability to enforce charitable trust terms. Obviously, this justification does not readily apply to traditional three-party trusts.

On the whole, it can be seen that only under special circumstances does the settlor have the ability to bring suit to enforce trust terms. Because such circumstances rarely exist in the private donative inter vivos trust setting, the settlor is therefore often left without standing to bring suit against wayward trustees and beneficiaries. Although the settlor can potentially contract for the ability to bring suit, such an action makes the settlor vulnerable to attack under IRS rules, which discourage most forms of settlor control over trust operation, as discussed in the following section.

D. *Settlor Standing Under the Internal Revenue Code*

The Internal Revenue Code manifests congressional preference for outright inter vivos gifts versus testamentary transfers in part by applying a “completeness” test for transfers of assets in trust.¹⁷² The rationale is that “taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed.”¹⁷³ Thus, in order for a transfer of assets into trust to be deemed complete for tax purposes, the settlor must surrender virtually all of the “sticks” in the bundle of rights tradition-

¹⁶⁸ See *supra* note 34.

¹⁶⁹ UNIF. TRUST CODE § 405(c), 7C U.L.A. 184 (Supp. 2004).

¹⁷⁰ See RESTATEMENT (SECOND) OF TRUSTS § 112 cmt. h (1959) (noting that charitable trusts are exempted from the general rule requiring ascertainable trust beneficiaries); Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593, 596 (1999) (“Unlike private trusts, charitable trusts have no specific individuals identified as beneficiaries who can sue to enforce the trust.”). *But see id.* at 627 (noting that courts sometimes recognize standing for parties with “special interests” in the performance of a charitable trust).

¹⁷¹ RESTATEMENT (SECOND) OF TRUSTS § 200 (“No one except the beneficiary or one suing on his behalf can maintain a suit against the trustee to enforce the trust. . .”). Case law is collected in 3 SCOTT & FRATCHER, *supra* note 19, § 200.1, at 211–12 n.2.

¹⁷² Treas. Reg. § 25.2511-2 (as amended in 1999); see also STEPHENS ET AL., *supra* note 8, ¶¶ 1.03[2][a], 10.01[4] (cautioning that although the general test for completeness is whether the donor has relinquished dominion and control over the property, the actual rules governing the completeness tests for estates and gifts are overlapping and not necessarily consistent with each other).

¹⁷³ Estate of Sanford v. Comm’r, 308 U.S. 39 (1939).

ally associated with property ownership.¹⁷⁴ When the settlor fails to relinquish all beneficial interest in trust assets, such assets are likely to be swept into the gross estate upon the settlor's death.¹⁷⁵ This results in at least two negative consequences for the settlor. One is a higher effective tax rate due to the tax-inclusive nature of the estate tax.¹⁷⁶ The other is that the value of trust assets for tax purposes is calculated at the time of death as opposed to the date of the transfer, during which time assets may have appreciated considerably.¹⁷⁷

Internal Revenue Code ("IRC") §§ 2036 and 2038 often come into play when the IRS has to distinguish between gifts and testamentary transfers with respect to retained settlor rights. Section 2036(a) provides:

(a) General Rule—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer . . . by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) *the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.*¹⁷⁸

Note that were it not for § 2036, avoidance of estate taxes would be a "trivial endeavor" for estate planners and their wealthy clients.¹⁷⁹ One would only need to set up a trust with a retained life interest at an early age.¹⁸⁰ At this point a gift tax would be owed only on the amount originally transferred to the trust in excess of the amount of the gift tax exemption. This approach would leave decades of trust asset appreciation largely un-

¹⁷⁴ See STEPHENS ET AL., *supra* note 8, ¶ 1.03[2][a].

¹⁷⁵ See, e.g., I.R.C. § 2036 (2004); STEPHENS ET AL., *supra* note 8, ¶ 1.02[2][b][iv].

¹⁷⁶ See *supra* note 113.

¹⁷⁷ See, e.g., STEPHENS ET AL., *supra* note 8, ¶ 1.03[2][a]; Martin K. Collie, *Estate and Gift Tax Revision*, 26 NAT'L TAX J. 441, 443 (1973) ("The lower gift tax rates also can be justified . . . by the fact that the gift tax is collected earlier than a corresponding estate tax . . ."). It is only fair to mention that there are also positive tax consequences to testamentary transfers. One such advantage is that assets passing at death are afforded a "stepped-up" basis, meaning that the donee only pays income or capital gains taxes on the asset appreciation above and beyond the asset value at the time of transfer. Although a myriad of scenarios exist regarding tax rates, appreciation rates, and estate and gift values, this Comment is directed toward those circumstances where it is more advantageous from a tax standpoint to transfer an asset while the donor is living as opposed to at death. The author believes this is often the case when an estate is large enough to be subjected to estate tax.

¹⁷⁸ I.R.C. § 2036 (emphasis added).

¹⁷⁹ CAMPFIELD ET AL., *supra* note 164, ¶ 18,001, at 343.

¹⁸⁰ See, e.g., Comment, *Estate Taxation of Life Insurance Policies Held by the Insured as Trustee: Estate of Skifter v. Commissioner*, 32 MD. L. REV. 305, 313 (1972).

taxed while retaining for the settlor substantial enjoyment of the trust property.¹⁸¹ Section 2036 prevents such schemes by subjecting to the estate tax those assets in which the settlor retains a substantial interest.¹⁸²

In addition to capturing trust assets in which the transferors have retained an interest (§ 2036(a)), the statute also provides that trust assets are to be included in the estate of the transferor upon death if the transferor retains the ability to dictate who will benefit from the assets (§ 2036(b)).¹⁸³ Thus, even though the transferor may relinquish all right to reclaim, use, or benefit from the property in the future, retaining the ability to designate future trust beneficiaries is alone sufficient to warrant taxation in the eyes of Congress.¹⁸⁴

Similarly, § 2038 sweeps into the gross estate all property transferred by an individual who retains the power to alter, amend, revoke, or terminate enjoyment of the property. It makes no difference if the power is exercisable alone or in conjunction with others.¹⁸⁵ These Code sections explain the popularity of irrevocable trusts, as even the slightest retention of power on the part of the settlor has often been found to trigger one or both provisions for including assets in the estate value for taxation purposes.¹⁸⁶

A review of the case law indicates that the IRS and the courts advance a broad interpretation of these provisions. In *Struthers v. Kelm*, for example, the settlor was one among a number of trustees who collectively had discretion in the disbursement of trust income and principal; the trust value was included in the estate under § 2036(a).¹⁸⁷ And in *Porter v. Commissioner*, where the grantor of a trust maintained a right to amend the trust but expressly disclaimed the ability to alter or modify the trust terms in any manner that would favor the grantor or her estate, the trust assets were likewise included in the estate under § 2038.¹⁸⁸ Finally, even in *Lober v. United States*, a case where a grantor-trustee was obligated to distribute the trust corpus to the beneficiaries upon their attainment of the age of twenty-five, and retained only the ability to distribute the corpus earlier if he chose, the Court found the trust assets to be encompassed by the “power to alter, amend, revoke” language of § 2038.¹⁸⁹

¹⁸¹ *Id.*

¹⁸² *Id.* at 314.

¹⁸³ I.R.C. § 2036(a)(2), (b).

¹⁸⁴ CAMPFIELD ET AL., *supra* note 164, ¶ 18,001, at 344.

¹⁸⁵ I.R.C. § 2038. Note that settlors can serve as trust administrators without invoking § 2036 or 2038, but in order to avoid application of these provisions, their powers must be limited in the trust instrument by an “ascertainable standard” which, in effect, proscribes any meaningful control over trust assets. *See, e.g.*, *Old Colony v. United States*, 423 F.2d 601 (1st Cir. 1970).

¹⁸⁶ *See, e.g., infra* notes 187–189.

¹⁸⁷ *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955).

¹⁸⁸ *Porter v. Comm’r*, 288 U.S. 436 (1933). This case was actually decided under section 302(d) of the 1926 Revenue Act, the predecessor of § 2038 in the 1986 Code.

¹⁸⁹ *Lober v. United States*, 346 U.S. 335, 337 (1953) (holding that the mere power to accelerate or

In light of the wide net cast by IRC §§ 2036 and 2038, a settlor would risk significant adverse tax consequences by retaining the right to bring suit against a trustee for breach of fiduciary duties.¹⁹⁰ For example, as the above determinations make clear, there need not be any power to shift assets between beneficiaries, nor any personal benefit to the settlor, in order for § 2036 or 2038 to apply. Perhaps most alarming is that the mere power to accelerate or postpone enjoyment of the assets is enough to trigger the application of § 2036 or 2038.¹⁹¹

The broad application of these Code sections suggests trouble for settlor standing. For example, imagine the situation where a settlor of an irrevocable trust contracts with the trustee for the standing necessary to bring suit in the event of a breach of trust terms or fiduciary duties. Should the settlor subsequently bring suit to enjoin the trustee from distributing trust income or principal, even where trust terms are not being followed, adverse tax consequences may follow because this action could be viewed as delaying the beneficiaries' enjoyment of trust assets. Thus, for nothing more than a desire to enforce trust terms, the settlor who contracts for standing could be inviting the adverse tax consequences of § 2036 or 2038—consequences which the settlor specifically tried to avoid in the first place by making the trust irrevocable.

It is tempting to think that a settlor might be willing to run this risk in return for the ability to challenge an egregious breach of the trust terms, all the while hoping that this option will never be used, thus avoiding the sanctions of §§ 2036 and 2038. Unfortunately for the settlor, the language of the statutes, supported by many cases, clearly indicates that the settlor need not actually exercise any right held under the trust agreement for §§ 2036 and 2038 to apply.¹⁹² In fact, it is not even necessary that the settlor be able to exercise the power. For instance, where the settlor becomes incompetent and is therefore unable to exercise a power, the mere theoretical existence of the power has triggered inclusion.¹⁹³ In light of these cases, were the settlor to retain an ability to bring suit in a court of law and thereby delay

postpone payments fell under § 2038).

¹⁹⁰ The adverse tax consequences resulting from inclusion versus exclusion under §§ 2036 and 2038 were discussed previously at *supra* note 113.

¹⁹¹ See CAMPFIELD ET AL., *supra* note 164, ¶ 19,019, at 419; see also *Lober*, 346 U.S. at 337.

¹⁹² *E.g.*, *Estate of Farrell v. United States*, 553 F.2d 637 (Ct. Cl. 1977) (including trust assets in grantor's estate under § 2036(a)(2) where a grantor, who was determined to have had the right under state law to appoint herself trustee in the event of a trustee vacancy, died without ever doing so). Under § 2038, not only is it irrelevant whether the grantor ever exercised a prohibited power, but such a power must have been relinquished more than three years prior to death to escape operation of this Code section. However, if the power was not actually exercisable at the time of the grantor's death, such as would have been the case under the facts of *Farrell* if there had been no vacancy at the time of the grantor's death, then § 2038, unlike § 2036, would be inapplicable. CAMPFIELD ET AL., *supra* note 164, ¶ 19,139, at 435–36.

¹⁹³ See, *e.g.*, *Round v. Comm'r*, 332 F.2d 590 (1st Cir. 1964).

the enjoyment of trust assets, those assets would likely fall under the scope of §§ 2036 and 2038, even if such actions were never taken.

III. SETTLOR REPRIEVE: *ESTATE OF WALL V. COMMISSIONER*

A. *The Power to Substitute Trustees*

Since calls for settlor standing are largely driven by the need to curb the wayward or poorly performing trustee, one option for the settlor is to retain the ability to replace the trustee. Such a trust provision could stipulate that the settlor may not take the trustee's place, and must name a replacement trustee without delay. Under these circumstances, the settlor has presumably not retained any control over the trust assets, nor the ability to postpone the enjoyment of any trust assets. Until recently, however, the IRS refused to accept this view.

For example, in Revenue Ruling 79-353, the IRS considered the case where the settlor of an irrevocable private trust reserved the unfettered right to replace the trustee with anyone other than the settlor. The IRS first stated its position that

[u]nder sections 20.2036-1(b)(3) and 20.2038-1(a)(3) of the regulations,¹⁹⁴ reservation of the power by the grantor to appoint himself trustee is equivalent to reservation by him of the trustee's powers. Therefore, even where the decedent has not actually appointed himself trustee, a determination that he has the power to do so, where the trustee has significant powers over trust property, will result in inclusion of the trust property in his gross estate under sections 2036 or 2038.¹⁹⁵

The IRS next cited an income tax case, *Corning v. Commissioner*,¹⁹⁶ which stated:

[Petitioner's] continued power to substitute trustees without cause, when considered together with the power of the trustee to charge the beneficial enjoyment of income or corpus of the trust, gave to petitioner such a degree of dominion and control over the trust that its income must be taxable to him [Petitioner] argues that . . . he is precluded from appointing himself as trustee and would be permitted to appoint only a corporate trustee in the event that he chose to substitute trustees In any event, petitioner could substitute an independent corporate trustee after first ascertaining that such trustee would follow his directions. Should this corporate trustee subsequently fail to follow his instructions, petitioner could then replace it with another. Petitioner's

¹⁹⁴ Treas. Reg. § 20.2038-1(a)(3) (as amended in 1962); Treas. Reg. § 20.2036-1(b)(3) (as amended in 1960).

¹⁹⁵ Rev. Rul. 79-353, 1979-2 C.B. 325, at 3.

¹⁹⁶ 24 T.C. 907 (1955), *aff'd per curiam*, 239 F. 2d 646 (6th Cir. 1956).

power to substitute trustees was subject to no restrictions and, in practical terms, gave him the broad powers possessed by the trustee.¹⁹⁷

The IRS concluded its ruling by determining that a “reservation by the settlor of the power to remove the trustee at will and appoint another trustee is equivalent to reservation of the trustee’s powers.”¹⁹⁸ In reaching this conclusion, the IRS apparently embraced the view espoused in *Corning* that a settlor who retained the right to replace a trustee at will would retain a sufficient degree of control over the trustee’s behavior to justify the application of §§ 2036 and 2038.

B. Estate of Wall v. Commissioner

1. *Background.*—Fourteen years later, in 1993, the IRS decision in Revenue Ruling 79-353 came under court scrutiny in the case of *Estate of Wall v. Commissioner*.¹⁹⁹ In that case, the decedent, Helen S. Wall, established three inter vivos irrevocable trusts—one for the benefit of her daughter, Kathryn Barth, and one for each of her granddaughters.²⁰⁰ In all three trusts, the trustee was given wide discretionary latitude to manage the trust and distribute income to the beneficiaries. With regard to trustee removal, the trust instrument establishing the Kathryn Barth trust provided in part that, “[t]he Grantor or the beneficiary, Kathryn Barth, may remove the Trustee on written notice and appoint a successor Trustee.²⁰¹ However, any successor Trustee must be a corporation qualified to conduct a trust business in the United States and be *completely independent* from the Grantor.”²⁰²

Similarly, the trust instrument establishing the granddaughters’ trusts provided in part that, “[t]he Grantor, during her lifetime, may substitute Trustees, but any successor Trustee shall be other than the Grantor or any firm or corporation in which the Grantor has an interest, and shall, in all events, be an independent corporate trust company.”²⁰³

Thus, Mrs. Wall had no power to appoint herself as trustee of any of the three trusts. The initial trustee of all three trusts, a large and reputable trust company and bank in Wisconsin, held the position of trustee of the three trusts continuously from its initial appointment up until the time of the case.²⁰⁴ Mrs. Wall never had any significant ownership interest in the bank,

¹⁹⁷ Rev. Rul. 79-353, 1979-2 C.B. 325, at 6 (quoting 24 T.C. at 914-15).

¹⁹⁸ *Id.* at 5.

¹⁹⁹ 101 T.C. 300 (1993).

²⁰⁰ *Id.* at 301-02.

²⁰¹ It is not uncommon for trust beneficiaries to be given the right to substitute the trustee with another independent trustee. See Sitkoff, *supra* note 1, at 665 n.227 and references cited therein.

²⁰² *Wall*, 101 T.C. at 302 (emphasis added).

²⁰³ *Id.*

²⁰⁴ *Id.*

and at no time during her life or by will did Mrs. Wall attempt to remove or change the trustee.²⁰⁵ Mrs. Wall retained no other power over or interest in the trusts.

Upon Mrs. Wall's death almost nine years after establishing the trusts, her estate's representative filed a Federal estate tax return which did not include the value of the trust assets in the gross estate, although Mrs. Wall's contributions to the trusts were reported as taxable gifts on the return in the amount of \$101,015.²⁰⁶ Based on Revenue Ruling 79-353, the IRS claimed that the trust values should have been included in the gross estate and determined a deficiency of \$44,948 in the federal estate tax due.²⁰⁷

Against this position, the estate argued that Revenue Ruling 79-353 was largely based upon *Corning*, an income tax ruling that was not binding upon estate tax determinations.²⁰⁸ Moreover, the estate argued, *Corning* was decided under pre-1954 Code provisions, and the 1954 Code statutorily overruled the case doctrine on which *Corning* was decided.²⁰⁹ The court in *Wall* agreed with the estate's argument and also dismissed the other case relied upon by the government, *Van Beuren v. McLoughlin*,²¹⁰ by noting that it turned on the fact that the settlor had retained the right to appoint himself trustee.²¹¹

Deciding that the cases cited by the government were not pertinent to the case at hand and did not justify the conclusion generated in Revenue Ruling 79-353,²¹² the court subsequently turned to the statutory provisions, §§ 2036 and 2038. After examining the language of the statutes at issue, the court conceded that the power to change the corporate trustee was, in fact, a power to alter, amend, revoke, or terminate the trust under § 2038(a)(1).²¹³ The inquiry did not end there, however. The court instead formulated the dispositive question as “whether this power was such that it could affect the *enjoyment* of the property [under either §§ 2036(a)(2) or 2038(a)(1)].”²¹⁴

²⁰⁵ *Id.* at 302–03.

²⁰⁶ *Id.* at 301. Recall that the value of taxable gifts, even if not includable in the gross estate of the decedent, must be factored into the estate value to determine the appropriate graduated tax rate applicable to the estate itself.

²⁰⁷ *Id.*

²⁰⁸ *Id.* at 307 (citing *Galt v. Comm’r*, 216 F.2d 41, 45 (7th Cir. 1954)), *aff’g in part and rev’g in part* 19 T.C. 892 (1953); *see also* *Bilingual Montessori Sch. of Paris v. Comm’r*, 75 T.C. 480, 485 (1980).

²⁰⁹ *Wall*, 101 T.C. at 308. The estate was referring to the *Clifford* case doctrine, resulting from *Helvering v. Clifford*, 309 U.S. 331 (1940).

²¹⁰ 262 F.2d 315 (1st Cir. 1958).

²¹¹ *Wall*, 101 T.C. at 309.

²¹² *Id.* at 311.

²¹³ *Id.* at 304.

²¹⁴ *Id.* (emphasis added). Although § 2036 refers to the settlor's “right” to affect the enjoyment of the trust property, and § 2038 refers to the settlor's “power” to affect enjoyment, the court in *Wall* does not make a distinction between the “rights” of § 2036 and the “powers” of § 2038. Instead, the court

2. *Byrum and “Legally Enforceable” Rights.*—To help answer this question, the court turned to the case of *Byrum v. United States*.²¹⁵ The settlor in *Byrum* established an irrevocable inter vivos trust which held a controlling block of shares in three corporations. The trust instrument retained several powers to the settlor, namely the voting rights in the stock, veto power over any sale of trust assets, and the ability to remove the designated trustee and appoint a successor corporate trustee.²¹⁶ Arguing for inclusion of the trust assets in the settlor’s estate, the government pointed out that the settlor retained sufficient voting rights to appoint a majority of the directors in the companies. Through this mechanism, the government contended, the settlor could indirectly manipulate the amount of income paid into the trust by controlling the dividend payouts by the companies. The end result, according to the government, was that the settlor could determine the amount of trust income available to the beneficiaries.²¹⁷

The courts, however, disagreed with the government’s argument. Interestingly, in ruling for the settlor, not one of the courts up the ladder of appeal focused on the clause retaining to the settlor an ability to replace the trustee. Both the district court and the court of appeals acknowledged this clause but dismissed out of hand its ability to cause inclusion of the trust assets in the gross estate.²¹⁸ One distinction between the trusts in *Wall* and *Byrum*, however, was that the trustee’s freedom to distribute trust income and principal in *Byrum* was largely circumscribed.²¹⁹ Since the trustee in *Wall* was given wide discretion in the distribution of trust assets, the court found *Byrum*’s analysis of the trustee removal power inapposite to the case before it.²²⁰

Nonetheless, the court in *Wall* continued to analyze *Byrum*, focusing instead on the Court’s determination of whether the settlor had retained a sufficient “right” as contemplated under § 2036(a)(1) to trigger application of the statute.²²¹ The Supreme Court stated in *Byrum* that “[t]he term ‘right,’ certainly when used in a tax statute, must be given its normal and customary meaning. It connotes an *ascertainable and legally enforceable power*, such as [the right to control the income paid to the beneficiaries].”²²² *Byrum* ultimately concluded that both the settlor and directors were constrained in their actions by corporate fiduciary duties to the company share-

focuses on whether either the retained right or power to replace the trustee is significant enough to constitute control over the beneficiaries’ enjoyment. *Id.*

²¹⁵ 311 F. Supp. 892 (S.D. Ohio 1970), *aff’d*, 440 F.2d 949 (6th Cir. 1971), *aff’d*, 408 U.S. 125 (1972).

²¹⁶ *Byrum*, 311 F. Supp. at 893.

²¹⁷ *Id.* at 895.

²¹⁸ *Id.*; *Byrum*, 440 F.2d at 952.

²¹⁹ *Byrum*, 408 U.S. at 127–29 n.1.

²²⁰ *Wall v. Comm’r*, 101 T.C. 300, 309 (1993).

²²¹ *Id.* at 310.

²²² *Byrum*, 408 U.S. at 136 (emphasis added).

holders.²²³ Such duties, *Byrum* reasoned, sufficiently circumscribed the settlor's control over dividend payments so as to preclude any legally ascertainable "right" under § 2036(a) to affect the beneficial enjoyment of the trust property.²²⁴

According to the *Wall* court, the outcome of *Byrum* turned on whether the right to replace a trustee connoted an ascertainable and legally enforceable "right"—i.e., the right to exercise the powers of the trustee.²²⁵ Answering this question in the negative, the *Wall* court looked to whether the settlor had any legal right to influence trustee behavior.

3. *Fiduciary Duties to the Rescue.*—In its discussion, the *Wall* court first called attention to the fact that under existing trust law, "[t]he trustee has a duty to administer the trust in the sole interest of the beneficiary, to act impartially if there are multiple beneficiaries, and to exercise powers exclusively for the benefit of the beneficiaries."²²⁶ These duties remain unchanged by the degree of discretion conferred upon the trustee in managing and distributing trust property.²²⁷ Moreover, in the court's view the trustee would breach these duties if, in response to pressure from the settlor, the trustee were to take any action regarding the beneficial enjoyment of any trust property that otherwise would not have been taken in the absence of such pressure.²²⁸ Thus, just as the settlor and directors in *Byrum* were held to corporate fiduciary duties which prevented them from ignoring the shareholders' best interests and indiscriminately extending or withholding dividends and thereby affecting trust income, the trustee in *Wall* was held to similar fiduciary duties requiring that actions be taken only in the best interests of the beneficiaries. The *Wall* court therefore concluded that a mere retention of a trustee replacement power could not constitute a legal right to control trust operation because, regardless of which trustee the settlor appoints at any given time, the trustee would at all times be legally precluded from taking actions inconsistent with the beneficiaries' interests.²²⁹

The court also considered the possibility that the settlor and trustee might make a fraudulent side agreement allowing the settlor to manipulate or participate in the administration of the trust.²³⁰ However, the court had refused to acknowledge a similar inference of trustee-settlor collusion in a prior case where the trustee had been allowed to invest in a closely held corporation of the settlor and the trustee and settlor had a close business re-

²²³ *Id.* at 137–38.

²²⁴ *Id.*

²²⁵ *Wall*, 101 T.C. at 313.

²²⁶ *Id.* at 312.

²²⁷ *Id.* at 313.

²²⁸ *Id.* at 312.

²²⁹ *Id.* at 313.

²³⁰ *Id.*

lationship.²³¹ In addition, the court again placed its faith in the trustee's allegiance to beneficiaries, remarking,

[S]ince the language of the trust indentures provides maximum flexibility as to distributions of income and principal, the trustee would be expected to look to the circumstances of the beneficiaries to whom sole allegiance is owed, and not to Mrs. Wall, in order to determine the timing and amount of discretionary distributions.²³²

Finally, the court opined that Mrs. Wall may have wished to retain trustee replacement powers for entirely benign reasons, such as the possibility that one or more of the beneficiaries might move to a distant state, or that the corporate trustee might merge with an out-of-state bank in a way that would detrimentally affect its trust department.²³³ Such motives, if they existed, did not rise to the level of a retained right under § 2036(a)(2).²³⁴ The court thus held that Mrs. Wall did not retain an ascertainable and legally enforceable right or power to affect the beneficial enjoyment of the trust property under either § 2036(a)(2) or 2038(a)(1), as defined by the Supreme Court's *Byrum* decision, and the value of the trust property was therefore excluded from the gross estate.²³⁵

C. Aftermath of Wall

Two years after the decision in *Wall*, in Revenue Ruling 95-58 the IRS capitulated and revoked Revenue Ruling 79-353, their original decision disfavoring trustee replacement powers. The IRS was not only reacting to *Wall*, but also a related case, *Estate of Vak v. Commissioner*,²³⁶ with facts similar to *Wall* but challenged under the gift tax statutes.²³⁷ In *Vak*, the settlor established an inter vivos trust in which the petitioner was an eligible beneficiary, subject to the trustee's discretion. The settlor also retained the right to remove the trustees with or without cause and to replace them with other independent trustees.²³⁸ Trustee "independence" was qualified by re-

²³¹ Estate of Beckwith v. Comm'r, 55 T.C. 242 (1970).

²³² *Wall*, 101 T.C. at 313.

²³³ *Id.*

²³⁴ *Id.*

²³⁵ *Id.* at 313-14.

²³⁶ 973 F.2d 1409 (8th Cir. 1992), *rev'g* 62 T.C.M. (CCH) 942 (1991). Note that *Vak* is only partly analogous to the discussion at hand because, due to definitional differences in the estate and gift tax bases, certain transfers may still be swept into the gross estate under § 2036 or 2038 even if they were treated as completed lifetime gifts. See MCDANIEL ET AL., *supra* note 113, at 73; STEPHENS ET AL., *supra* note 8, ¶¶ 1.03[2][a], 10.01[4] (cautioning that although the general test for completeness is whether the donor has relinquished dominion and control over the property, the actual rules governing the completeness tests for estates and gifts are overlapping and not necessarily consistent with each other). However, it may also be noteworthy that *Vak* is a decision from the court of appeals and thus carries more authority than the tax court decision in *Wall*.

²³⁷ I.R.C. §§ 2501, 2511 (2004).

²³⁸ *Vak*, 973 F.2d at 1410.

quiring that any successor trustee not be related or subordinate to the petitioner within the meaning of I.R.C. § 672(c).²³⁹ The trust stakeholders argued that the transfers of trust property to beneficiaries, of which the settlor himself was one, completed the gift, and therefore subjected the property to the gift tax at the time the transfers were made.²⁴⁰ The IRS considered the gift incomplete, however, arguing that the settlor's retention of the ability to remove and replace the trustees was sufficient to give him complete control over the trust, especially considering the trustee's discretionary authority to direct the distribution of trust assets to the settlor himself.²⁴¹ Ruling against the government, the court emphasized that any replacement trustees were required to be independent from the settlor, and concluded that "[t]he IRS overstates its position when it contends that 'Mr. Vak had the power to replace the trustees with individuals who would do his bidding.'"²⁴²

In Revenue Ruling 95-58, the IRS finally accepted the combined position expounded in *Wall* and *Vak* and adopted the independence standard utilized in *Vak* which was based on I.R.C. § 672(c). Revenue Ruling 95-58 concludes that "even if the decedent had possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate to the decedent (within the meaning of § 672(c)), the decedent would not have retained a trustee's discretionary control over trust income."²⁴³ Interestingly, while trustee independence is apparently a critical requirement for any replacement trustee, no such requirement exists for the original trustee.

²³⁹ *Id.* Section 672(c) of the IRC states:

(c) Related or subordinate party. For purposes of this subpart, the term "related or subordinate party" means any nonadverse party who is—

(1) the grantor's spouse if living with the grantor;

(2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

For purposes of subsection (f) and sections 674 and 675, a related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

I.R.C. § 672(c).

²⁴⁰ *Vak*, 973 F.2d at 1411.

²⁴¹ *Id.* at 1414. Section 25.2511-2(c) of the Gift Tax Regulations provides that a gift of property is incomplete to the extent that the donor reserves the power to revest the beneficial title to the property in himself or herself or the power (other than a fiduciary power limited by a fixed or ascertainable standard) to name new beneficiaries or to change the interest of the beneficiaries among themselves. Treas. Reg. § 25.2511-2(c) (as amended in 1999).

²⁴² *Vak*, 973 F.2d at 1414.

²⁴³ Rev. Rul. 95-58, 1995-2 C.B. 191, at 5-6.

IV. DISCUSSION

A. Estate of Wall: *A Settlor's Nirvana?*

Given its decision that a settlor can retain the power to replace trustees at will without triggering adverse tax consequences, does *Wall* represent a settlor's nirvana? Recall the settlor's primary reasons for using the irrevocable trust: minimizing overall taxes while imposing the settlor's will over the management and disposition of trust assets, especially on an ongoing basis if possible (i.e., even after the trust has been funded and begins to operate). With respect to taxes the settlor's wish is granted, since *Wall* holds that trustee removal powers do not trigger the adverse tax consequences of Code §§ 2036 and 2038, thus allowing the settlor to apply the lowest possible tax rate available under the circumstances. The degree to which *Wall* represents a best-case scenario for the settlor therefore turns on whether and to what extent a trustee replacement power grants to the settlor the desired control over trust assets and their ultimate disposition.

To analyze the potential strength of the trustee removal power it is helpful to consider how this provision is likely to operate in practice. As has been discussed, modern trusts tend to grant the trustee considerable discretion with respect to both the investment and distribution decisions.²⁴⁴ Trustees are likely and even expected to make judgments based on their own knowledge and skill set, and with such a wide array of choices, they are bound to sometimes reach conclusions that differ from those the settlor would reach under the same circumstances. In some cases, this divergence between a trustee's actions and the settlor's wishes will be caused by the trustee's inability to discern what the settlor's wishes are concerning a given set of circumstances. In other cases, trustees may be swayed from exact adherence to trust terms by a particular fee structure or by pleading beneficiaries. In any case, when the trustee makes decisions within the discretionary bounds of his power, neither the settlor nor the beneficiaries have much recourse against the trustee under current trust law.

When the settlor is allowed to remove and replace a given trustee, however, the situation is changed. After *Wall*, trustees may no longer rest easy with the knowledge that they are acting within their powers and in accordance with the duties owed the beneficiary, since a settlor may nonetheless replace the trustee when trust management or disbursements are displeasing to the settlor. Whereas once trusteeships were honorary positions accepted gratuitously by friends or family members,²⁴⁵ modern profit-seeking trustees are not likely to be indifferent to the possibility of lost business and profits. Thus, it seems almost undeniable that the settlor who retains a replacement power in accordance with *Wall* will possess a degree

²⁴⁴ See *supra* Part II.B.

²⁴⁵ BOGERT, *supra* note 14, § 3, at 21.

of influence over trustee decisionmaking not previously available to settlors.

Curiously, commentators that have spoken on the subject have almost unanimously called for the recognition of settlor standing to address the shortcomings of inter vivos irrevocable trusts,²⁴⁶ rather than calling for a trustee replacement power. Perhaps this is because few realized that a trustee removal power was an option.²⁴⁷ Alternatively, perhaps it is because settlor standing is the better option. A comparison of the operation and utility of settlor standing versus the trustee removal power is therefore in order.

B. The Trustee Removal Power Versus Settlor Standing

The most salient feature of the trustee removal power is that settlors can at least be sure of their power to remove and replace trustees when they desire, albeit under the limitations of Revenue Ruling 95-58 requiring the independence of the replacement trustee. A settlor's position is far less certain with standing, however, which currently must be contracted for with the trustee outside of the actual trust agreement. Even if settlor standing were to be recognized as a default rule of trust law, the settlor would still face uncertain legal remedies and unknown tax consequences under §§ 2036 and 2038.²⁴⁸

For example, pursuit of trustees under the auspices of settlor standing at best gets the settlor his day in court. Once in court, the settlor would be faced with the prospect of proving a breach of contract or a breach of fiduciary duty. In addition, trustees must be notified of proceedings brought for their removal, and are given the opportunity to defend themselves.²⁴⁹ Such judicial proceedings will thus drain trust assets since the trustee can utilize those assets to mount a legal defense.²⁵⁰ It has also been suggested that higher trustee fees might be expected to result from retained settlor standing rights in anticipation of possible litigation, further decreasing the appeal of standing.²⁵¹

Perhaps even more importantly, settlor standing will likely prove impotent when undesirable trustee action falls within the trustee's sphere of legally permissible behavior. Because of an understandable desire to have trust assets managed well in the modern marketplace and to provide the trustee with the needed flexibility to meet unknown, future beneficiary cir-

²⁴⁶ See *supra* note 1.

²⁴⁷ As the cases discussed *supra* at Part III illustrate, at least some estate planners have apparently recognized the potential desirability of a trustee replacement power vested with the settlor, even though this option has not been formally recognized or discussed in the academic community.

²⁴⁸ See *supra* notes 22–26 and accompanying text.

²⁴⁹ 2 SCOTT & FRATCHER, *supra* note 19, § 107, at 115.

²⁵⁰ 3 *id.* § 188.4, at 62–69 (discussing the ability of trustees to pay for attorneys' fees using trust funds).

²⁵¹ Sitkoff, *supra* note 1, at 667.

cumstances, the settlor may be tempted to confer vast discretionary powers on the trustee.²⁵² Such a decision would weaken any advantages of settlor standing since the trustee will undoubtedly defend his actions as falling within those same discretionary powers. Thus, the settlor who relies on standing for recourse faces not only increased costs and difficulties at trial, but also a new dilemma—determining how much discretion to afford the trustee. Chances for success in court only decrease as more and more discretion is conferred on the trustee in order to effect the efficient operation of the modern trust.

In sharp contrast, the settlor who possesses a simple replacement power need not incur the time and expense of obtaining a favorable judgment, nor risk an unfavorable one. Additionally, because trustee replacement is such a powerful yet easy tool to use, the settlor can likely expect the mere retention of the power to lead to increased trustee compliance with both the explicit trust terms and the settlor's implicit wishes. It is also possible that trustee fees would not rise as predicted with settlor standing, since the trustee subject to removal does not face the prospect of wasted effort or a damaged reputation that might accompany potentially protracted (and public) litigation.

Perhaps even more important to the settlor is the ongoing influence over trustee decisions that a replacement power would likely provide the settlor, since no trustee wants to be removed and many potential trustees are waiting in the wings for a chance to earn business. As a result, trustees would be likely to recognize and act upon modest changes in settlor preferences over time with respect to both investment tastes and disbursement inclinations. This would seem especially true where the suggested changes fall within the scope of the trustees' permitted actions, thus minimizing the likelihood of protest from the beneficiaries. In this respect, the retention of a removal power actually encourages the settlor to confer more discretion on the trustee, not less as with standing, since greater trustee discretion decreases the chances of running afoul of the explicit trust terms and the protections afforded beneficiaries.

Similar arguments apply to cases in which the trustee is engaged in misconduct (as opposed to actions within the trustee's discretion). When the trustee behaves egregiously enough to justify court intervention, the beneficiaries are normally expected to bring the issue before the court. Such an action not only entails the same costs and risks as mentioned above, but also assumes adequate monitoring by the beneficiaries, which is not always present.²⁵³ The trustee removal power, however, would again alleviate most of these concerns. The mere retention of such a power by the settlor would serve to put a trustee "on notice" that his actions may be monitored by the settlor in addition to the traditional oversight by benefi-

²⁵² Recall the discussion of the evolution of the modern trust *supra* Part II.B.1.

²⁵³ See *supra* note 129.

aries. Trustee misbehavior will be minimized not only because of a second observer, but also by the fact that settlors are often better situated to monitor trustee performance in the first place. The removal power should therefore function effectively not only to remove noncompliant trustees, but also to deter trustee misconduct in the first place.

In sum, the power to remove and replace a trustee appears to provide a simpler, more direct, and more efficient means for dealing with poorly performing trustees. Additionally, to the extent that trustees are not being asked to violate trust terms or their fiduciary duties to beneficiaries, settlors can probably expect to be able to exert modest influence over trustee decisions on an ongoing basis. While these benefits may stop short of giving settlors free reign over trust operation, the replacement power should certainly be viewed as a desirable tool in their future monitoring of inter vivos irrevocable trusts.

C. *The Court's View in Wall: Fact or Fiction?*

The foregoing analysis argues that trustee removal powers do in fact give the settlor significant control over trustee behavior, and may be especially useful in those areas where beneficiary oversight is likely to be muted by vast trustee discretionary powers. However, the notion of significant settlor influence contradicts the view expounded in *Wall* regarding the settlor's ability to sway trustee behavior through a power of replacement. Recall that one of the government's main arguments in *Wall* against the removal power was that "even a corporate trustee will be compelled to follow the bidding of a settlor who has the power to remove the trustee."²⁵⁴ In response the court stated, "[i]n irrevocable trusts such as those under scrutiny, the trustee is accountable only to the beneficiaries, not to the settlor, and any right of action for breach of fiduciary duty lies in the beneficiaries."²⁵⁵ The court's decision thus made much of trust law's duty of loyalty, which requires the trustee "to administer the trust solely in the interest of the beneficiaries."²⁵⁶

The court's reasoning seems questionable, however, because it rests so heavily on the assumption that since the trustee's sole duty is to the beneficiaries, the trustee will not be swayed from the beneficiaries' best interests by any outside influence. While trustees are ideally "only accountable to the beneficiaries," the removal power adds a new dimension to make the trustee at least somewhat accountable to the settlor as well. While the beneficiaries may possess the right of action for breach of a fiduciary duty, the settlor possesses the right of replacement.

²⁵⁴ *Wall v. Comm'r*, 101 T.C. 300, 311 (1993); *see also supra* note 197 and accompanying quote.

²⁵⁵ *Id.* at 313.

²⁵⁶ RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959), *continued in* RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 170(1) (1992).

In the apparently unlikely event that the settlor's influence *does* affect the trustee's behavior, the *Wall* court was presumably satisfied that the beneficiaries' right to bring action for breach of fiduciary duty would rectify the situation. Recall, however, that the *Wall* court based its decision, at least in part, on the Supreme Court's opinion in *Byrum v. United States*.²⁵⁷ In *Byrum*, the Court was unwilling to recognize more than de minimus trust influence where the settlor, and the corporate directors appointed by the settlor, were answerable to the shareholders.²⁵⁸ The well-recognized existence of this duty of loyalty was the basis for the Court's decision that the settlor did not have an ascertainable and legally enforceable "right" to take action that would have influenced payments into the trust.²⁵⁹ The settlor's actions in *Byrum* were thus constrained since the *settlor* was bound by a corporate duty of loyalty.²⁶⁰

The facts of *Wall*, however, contrast markedly in this respect to those in *Byrum*. Most obviously, there was no duty of any type imposed upon the *settlor* of the three trusts in *Wall*, as was imposed on the corporate directors, including the settlor, in *Byrum*. The only duties present in *Wall* were those owed to the beneficiaries by the trustee. Thus, the settlor, Mrs. Wall, was completely free to attempt to influence the trustee's decisionmaking process however she saw fit, up to and including the replacement of an uncompromising trustee—exactly the concern voiced by the IRS. In analogizing to *Byrum*, the *Wall* court appears to have equated the corporate duty of loyalty imposed on the settlor as a result of his close involvement in the corporations whose stock funded the trust, with the duty of loyalty imposed on the trustee in *Wall* by virtue of the trust agreement itself. Not only are these duties fundamentally different,²⁶¹ but in these cases they also apply to different actors involved in the various trusts.

This distinction seems particularly noteworthy because the court's ultimate decision in *Wall* rested on the finding that Mrs. Wall, the settlor, held no ascertainable and legally enforceable right. Whereas the settlor in *Byrum* was truly constrained by a duty of loyalty, Mrs. Wall was not similarly constrained. Given the court's recognition that "Mrs. Wall's power to change the corporate trustee *was* a power to alter, amend, revoke, or terminate [the trust under § 2038(a)(1)],"²⁶² the court apparently perceived this power as being mooted by the trustee's fiduciary duties to the beneficiaries.

The court in *Vak* was even less concerned, as governmental concerns were dismissed simply by stating "[t]he IRS overstates its position when it

²⁵⁷ 408 U.S. 125 (1972).

²⁵⁸ *Id.* at 136–40.

²⁵⁹ *Id.*

²⁶⁰ Presumably the beneficiaries could have been shareholders under this scenario, making the settlor directly answerable to the beneficiaries by way of the corporate duty of loyalty to shareholders.

²⁶¹ See, e.g., Sitkoff, *supra* note 45.

²⁶² *Wall v. Comm'r*, 101 T.C. 300, 304 (1993) (emphasis added).

contends that ‘Mr. Vak had the power to replace the trustees with individuals who would do his bidding.’²⁶³ In that case, the court was apparently satisfied that the independence requirement placed on new trustees, combined with their attendant fiduciary duties, would suitably insulate the beneficiaries from the settlor’s whims, which comports with the implicit outcome in *Wall*.

Two main concerns stem from the decisions in *Wall* and *Vak*. The first is that the courts appear to be both unconvinced and unconcerned that the settlor’s replacement power will afford significant influence over the trustee’s behavior. However, current default trust law regarding beneficiaries’ replacement powers belies this assumption, because in the absence of express trust provisions to the contrary, beneficiaries are only allowed to seek judicial removal of trustees for fairly serious breaches of trust.²⁶⁴ Setting the removal bar high ensures that trustees are able to carry out the settlor’s wishes without fear of removal.²⁶⁵ But this would only be necessary if there were some truth to the possibility that a removal power could in fact exert significant influence over the trustee’s decisionmaking. Were the courts and major authorities confident in a trustee’s ability to adhere to his assumed fiduciary duties in the face of threatened removal by beneficiaries, then there would appear to be little need for such a high threshold for removal. Consequently, one must presume that a similar replacement power vested in the settlor would similarly be capable of generating tangible influence over the trustee.

Further calling into question the *Wall* and *Vak* courts’ indifference to the possibility of trustee influence are the decisions regarding self-settled asset-protection trusts (“APTs”). APTs have been held to be mere shams where the settlor retains the unfettered right to replace a trustee who has been given wide discretionary powers over asset disbursement.²⁶⁶ This is so even though settlors claim to have no controlling powers over trustees since the latter are held to fiduciary standards. In APT cases, courts have taken the view that the removal power equals the power to control the actions of

²⁶³ Estate of Vak v. Comm’r, 973 F.2d 1409, 1414 (8th Cir. 1992).

²⁶⁴ See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 37e(1) (2003); RESTATEMENT (SECOND) OF TRUSTS § 107 cmts. b–c (1959); 2 SCOTT AND FRATCHER, *supra* note 19, § 107, at 109–11.

²⁶⁵ Sitkoff, *supra* note 1, at 663–64; see also Ronald Chester & Sarah Reid Ziomek, *Removal of Corporate Trustees Under the Uniform Trust Code and Other Current Law: Does a Contractual Lense Help Clarify the Rights of Beneficiaries?*, 67 MO. L. REV. 241 (2002) (discussing the traditional difficulties faced by beneficiaries attempting to remove corporate trustees and recent relaxation of this rule).

²⁶⁶ Marine Midland Bank v. Portnoy, 201 B.R. 685, 700–01 (Bankr. S.D.N.Y. 1996) (ruling that an offshore APT was under the control of the settlor where the trust instrument gave wide distribution powers to the trustee, and freely allowed the settlor to replace the trustee).

the trustee and, therefore, the trust assets.²⁶⁷ This stance appears to be clearly at odds with the decisions in *Wall* and *Vak*.²⁶⁸

Another concern rising from the decisions in *Wall* and *Vak* is that beneficiaries only have recourse to the extent that they can prove the trustee's actions were inconsistent with their best interests. However, where trustees are given wide discretion in whether and how to disburse trust property, the trustee's permitted behavior will encompass a potentially wide range of acceptable actions. As a result, the "best interests of the beneficiary" standard may be difficult to apply in cases where the trustee's actions fall within her broad scope of permitted behavior. It thus seems feasible that the settlor could exert enormous influence over the trustee's actions, and at the same time the trustee could effectively shield herself from beneficiary claims that their best interests were not followed by pointing out that her actions were sanctioned by the wide discretionary powers granted in the trust agreement. Such a result would deprive the beneficiaries of the legal recourse relied upon by the courts in *Wall* and *Vak* to counteract settlor influence over trustees.

An argument legitimizing some degree of settlor control is that trustees who possess wide discretion were specifically so empowered by none less than the settlor. It must be recalled that the settlor did not need to create an irrevocable trust at all, but likely did so to minimize tax liability, which ultimately leads to a larger gift for the beneficiaries or to more gifts in general. Thus, if it was the settlor's desire to allow the trustee a wide range of action, for whatever reason, then perhaps the beneficiaries should not be the ones to complain after the fact. After all, the irrevocable trust does prevent the settlor from changing his mind and confers significant rights on the beneficiaries in terms of their ability to enforce the trustee's fiduciary duties.

In addition, concerns over settlor abuse could be mitigated if needed. For example, one important limit on settlor influence not discussed by either court is the ability, when given, for the beneficiaries themselves to replace the trustee. As discussed above, beneficiaries have a limited right to pursue trustee removal in cases of explicit misconduct, but settlors can grant an unfettered replacement power to beneficiaries if desired, as was the

²⁶⁷ See Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035, 1088 (2000).

²⁶⁸ It must be admitted that trustee removal powers held by settlors in APT cases, or by beneficiaries in general, are imperfectly analogous to a settlor's similar power in a typical three-party trust. This is because APTs typically name the settlor as the only or at least one of the beneficiaries. Thus, in APTs as with beneficiaries in regular trusts, the party seeking trustee removal is the same as the party that is responsible for enforcing the trustee's fiduciary duties. The situation is obviously different in the topic covered here since the beneficiaries can act to enforce trustee fiduciary duties independent of the settlor's decision to replace the trustee. Nonetheless, the rationale found in APT cases should at least caution courts against summarily dismissing the significant influence which can be exerted over trustees when the settlor maintains a power of removal.

case with one of the three trusts set up in *Wall*.²⁶⁹ Although the court in *Wall* did not seize upon this provision as a check on settlor behavior,²⁷⁰ obviously a beneficiary with such a replacement power could thwart a settlor who attempts to replace a noncompliant trustee. No sooner would a settlor-favored trustee be appointed than would the beneficiary remove that trustee, to be replaced with a trustee favored by the beneficiary. Although this may be an imperfect solution to undue settlor influence over trustees, such a power vested in beneficiaries should preclude many instances of settlor behavior that would lead to detrimental effects on the beneficiaries.

In sum, the holdings in *Wall* and *Vak* appear to have taken an idealistic view regarding the potential for settlors to influence trustee behavior using the threat of replacement. Trust default law would not likely provide such a high barrier to trustee removal by beneficiaries were the potential for trustee influence not tangible. Similarly, the private parties in *Wall* and *Vak* would not likely have sought this power had it been perceived as entirely toothless.

Despite this oversight, however, the courts also struck upon perhaps the saving grace for the removal power. While it admittedly allows for trustee influence by the settlor even after the trust has been settled, it does so with minimal danger to the beneficiaries. Regardless of the settlor's retention of the removal power, the trustee's ultimate allegiance nonetheless remains with the beneficiaries. Fortunately, this is likely where the settlor's allegiance lies also, for if not, the settlor probably would not have made the gift and set up the trust in the first place. Beneficiaries should take comfort in the notion that any settlor influence over trustee behavior is not likely to harm them, but rather to prod the trustee into a more desirable course of action. Ultimately, should the trustee's performance prove measurably detrimental to the beneficiaries, fiduciary law should step in to protect the beneficiaries' interests.

Even more important to beneficiaries would be the ability to replace the trustee themselves. Although not required by the court in *Wall* to escape tax liabilities when the settlor retains such a right for himself, granting similar rights to beneficiaries should discourage settlors from exercising their removal power for reasons not in the best interests of the beneficiary. Should a pattern of settlor abuse develop in the future, courts could demand that replacement rights be granted jointly to the beneficiaries as well as the settlor, which would ensure further oversight of settlor actions without court intervention.

D. Reconciling the Trustee Removal Power with Traditional Trust Law

Trust law revolves around the idea that beneficiaries retain the equitable interests in the trust property, while trustees merely hold the legal ti-

²⁶⁹ See *supra* note 201 and accompanying quote.

²⁷⁰ Admittedly, this provision was not included in all three trusts at issue in the case. See *supra* note 203 and accompanying text.

tle.²⁷¹ This mantra is often repeated in the historical accounts of trust law development.²⁷² What ties this separation of equitable and legal ownership together is the fiduciary relationship requiring trustees to always act in accordance with the best interests of the beneficiaries.²⁷³ A troublesome question, then, is whether granting the settlor the power to influence trustee conduct cuts against the traditional view that the trustee owes his allegiance to the beneficiaries and the beneficiaries only.

A similar concern has been voiced in the corporate world, where it has been said that “a manager told to serve two masters . . . has been freed of both and is answerable to neither.”²⁷⁴ Although the authors of this statement were preaching against allowing corporate managers to answer to any constituency other than shareholders, this concern is likewise applicable to the issue of settlor influence over trustee behavior.²⁷⁵ That is, one may question whether a trustee who agrees to serve and administer the trust for the advantage of the beneficiaries should be simultaneously answerable to both the beneficiaries and the settlor for his performance. Perhaps more important, however, is the question of whether insertion of the settlor back into the trustee-beneficiary relationship does violence to the traditional notion of the trust.

From the outset it should be noted that settlor control over assets is not prohibited or even disfavored in trust law. For example, the settlor is perfectly free to name himself as trustee. Alternatively, he may create a revocable trust instead of an irrevocable one,²⁷⁶ albeit at the expense of a higher tax bill. In either case, the settlor can, within limits, maintain a great deal of control over trust assets if he so chooses.²⁷⁷ The prevalence of the irrevocable trust, then, does not result from any inherent prejudice in trust law, but rather owes its popularity instead to the tax policies discussed previously which encourage nearly complete relinquishment of control by the trustee.

The desire for settlor control over trust operation can be seen as a natural consequence of the evolution of the modern trust. In feudal times, trusts helped beneficiaries as much as or more than settlors in avoiding the bur-

²⁷¹ See, e.g., ANDERSEN, *supra* note 52, § 12[B], at 87.

²⁷² See, e.g., BOGERT, *supra* note 14; 3 SCOTT & FRATCHER, *supra* note 19; Maitland, *supra* note 56.

²⁷³ See generally Sitkoff, *supra* note 45 (describing how fiduciary law is an answer to this separation in both trust and corporate law).

²⁷⁴ FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 38 (1991).

²⁷⁵ Sitkoff, *supra* note 1, at 668.

²⁷⁶ See, e.g., ANDERSEN, *supra* note 52, § 12, at 91 (“Living trusts will be recognized even though the settlor reserves a power to revoke.”).

²⁷⁷ In the position of trustee, the settlor will still be subjected to fiduciary duties on behalf of the beneficiaries. See, e.g., *Farkas v. Williams*, 125 N.E.2d 600 (Ill. 1955). See generally John H. Langbein, *The Nonprobate Revolution and the Future of the Law of Succession*, 97 HARV. L. REV. 1108, 1126–30 (1984).

dens of feudal landholding. The beneficiary was no more anxious to hold legal title to the land than was the settlor. To the contrary, the beneficiary was quite content to allow the trustee to hold the legal title, provided that the beneficiary's equitable rights were preserved and the beneficiary was able to make provisions for the future passing or other disposition of the property.

In contrast, in modern times settlors are more prone to use the trust in order to manage the investment of various financial securities, while cautiously metering the assets to beneficiaries over time.²⁷⁸ At the same time, the abolition of feudal restrictions and the fungibility of modern wealth holdings cause most beneficiaries to desire immediate possession of the trust assets. There is little reason for beneficiaries to not want ownership sooner rather than later. In modern trusts, therefore, the trustee's preservation of assets in the trust corpus is much more likely to be in accordance with the settlor's instructions, while simultaneously being against the preferences of the beneficiaries. Another conflict of interest arises when trustee fee structures are based on asset value or trust transactions, and the trustee is given wide discretion in investment and distribution decisions. Allowing a settlor to interject his wishes when needed may dissipate such tensions and prevent an adversarial relationship between the trustees and beneficiaries. In this respect, by exerting his influence in whatever form, the settlor may play the role of referee in order to minimize disputes or conflicts of interest between the trustee and beneficiary. Although such settlor involvement was not typical with historical trusts used to convey family land holdings, it might best be viewed as a natural result of modern trusts which increasingly entail both significant trustee discretion and specific restrictions on disbursement of trust property. In other words, perhaps a supervisory role for the settlor is nothing more than a natural extension of trust law given the newfound potential for conflicts of interest in modern trusts.

Finally, to the extent that trust use is indicative of disinterested or incompetent beneficiaries, the settlor's involvement should be welcome so far as it discourages trustee shirking or other misconduct. To keep things in perspective, it should not be forgotten that any oversight power vested in the settlor will exist only so long as the settlor is alive and able to exercise it. This is to be contrasted with the much-discussed erosion of the rule against perpetuities, which is resulting in trusts that might continue to function for several hundreds of years.²⁷⁹ Given the increasing longevity of trusts in general, allowing settlor input during a settlor's lifetime should be viewed as decreasingly significant.

In addition, the acceptance of trust protectors, whose function can be similar to that of a settlor with removal powers, belies any doctrinal objection to settlor input regarding discretionary matters or trustee misbehavior.

²⁷⁸ See, e.g., *supra* note 90 and accompanying text.

²⁷⁹ Dukeminier & Krier, *supra* note 73.

The rising prevalence of trust protectors is a clear indication of settlors' desire to install some type of trustee oversight above and beyond the normal function of the beneficiaries. From the beneficiaries' viewpoint, involvement by the settlor, whether through a trust protector or directly through a replacement power, may postpone enjoyment of the trust property but only in accordance with the terms of the original trust agreement. Thus, so long as trust terms are followed, beneficiaries can hardly be heard to complain, especially since certain types of settlor involvement, such as oversight of trustee behavior and management of trust assets, should help beneficiaries by reducing their monitoring costs and increasing the trust value.

Considering the acceptance of revocable trusts and trust protectors as well as the nature of modern trust goals, there should be no inherent conflict between the trustee removal power and traditional notions of the trust. Given that the beneficiaries retain the ability to oversee trustee behavior to the extent that it wanders from their best interests, settlor involvement should be a welcome development in trust law.

V. CONCLUSION

As we have seen, the tax code expresses a preference for outright *inter vivos* gifts as opposed to transfers that the settlor can control up until the time of death.²⁸⁰ To take advantage of this preference, settlors often convey gifts by means of an irrevocable trust. This method has the advantage of reducing taxes paid (which benefits settlors and beneficiaries alike), while giving the settlor the ability to specify the terms and conditions governing the trust and trustee. Unfortunately for settlors, the tax code provisions §§ 2036 and 2038 are so far-reaching that even the slightest interference by the settlor after trust creation can negate the desired tax advantages. This, combined with the traditional rule that withholds settlor standing in suits against trustees of irrevocable trusts, leaves the settlor with little recourse in the face of misbehaving or poorly performing trustees.

While commentators have addressed the issue by calling for settlor standing, the courts have indirectly provided an alternate solution by embracing a trustee removal power vested in the settlor. Despite initial IRS objections, the courts are apparently satisfied that in preserving a trustee removal power, settlors retain insufficient control over the trust property to trigger the adverse tax treatment of § 2036 or 2038. The decisions in *Wall* and *Vak* represent good news for settlors because a comparison of settlor standing and the trustee removal power shows that the latter is likely to be more useful to settlors than standing rights. Compared to settlor standing, retention and exercise of a right to remove the trustee is relatively straight-

²⁸⁰ As noted previously, this preference has been called into question by the "phase-out" of the estate tax through the year 2010, during which time the gift tax exemption will presumably remain unchanged. Since the estate tax repeal is set to expire in 2011, however, it is unclear what preferences and policies will emerge as that date approaches.

forward. Moreover, since exercising the right does not require any proof of trustee misconduct, the removal power, as compared with standing, favors the granting of greater trustee discretion, which is an increasingly important component in modern trust management.

Although the decisions in *Wall* and *Vak* downplayed the possibility for significant trustee influence by the settlor who retains a trustee replacement power, the opinions struck solid ground in pointing to the ever-present fiduciary duties owed by the trustee to the beneficiaries. These underlying rights give the beneficiaries the ability to enjoin detrimental behavior by the trustee, and their retention keeps the decisions in *Wall* and *Vak* well within the confines of traditional trust law. This protection remains even if the trustee were to act at the suggestion of a settlor engaged in active oversight of trust operations. In the end, beneficiaries are not harmed by a retained trustee removal power, and they may in fact benefit as a result of increased trustee monitoring. To the extent that settlor comfort levels rise with their confidence that trust administration will be carried out diligently and efficiently, including adherence to the settlor's specific wishes, beneficiaries should also profit from increased donations via the trust medium. Should settlors ever be found to be abusing their removal power, courts could always insist upon a joint grant of the removal power to both the settlor and the beneficiaries (at least while the settlor is alive). This added layer of protection should inhibit trustee replacements designed to achieve results adverse to the beneficiaries, regardless of whether the actions rise to the level of breaching fiduciary duties.

Given the settlor's desire to minimize taxes while simultaneously maintaining the ability to influence trustee decisions on an on-going basis, *Wall* and *Vak* could scarcely have turned out better for the settlor. In short, trustee replacement powers serve the functions that settlor standing would, without (1) adverse tax consequences, (2) the uncertainties and cost of trial, or (3) doing violence to traditional trust law. Welcome to settlor's nirvana.

