#L-640 06/05/84

Memorandum 84-25

Subject: Study L-640 - Trusts (Oral Trusts)

At the last meeting the Commission considered the question whether all trusts should be required to be in writing, thereby abolishing the oral trust in personal property. The Commission asked for further investigation of the consequences of requiring a writing, specifically whether constructive and resulting trusts would adequately deal with any injustice that might result from abolishing oral express trusts.

## Background

Oral trusts are objectionable for two reasons. Permitting oral express trusts is an invitation to perjury--an extreme form of "post mortem estate planning". The concern over the use of manufactured evidence to establish an oral trust was the motivating factor in the elimination of oral trusts in the new Indiana Trust Code. See Ind. Code Ann. § 30-4-2-1 comment (copy in Exhibit 1); Ard, A Proposed Trust Code for Indiana--An Effort at Reform, 45 Notre Dame Law. 427, 442-43 (1970).

The second problem is that the terms of an oral trust are likely to be vague and incomplete as compared with most written trusts. Statutory trust law assumes that there is a trust instrument which is expected to set out the trust property, purpose, beneficiaries, trustees and deal with powers, duties, compensation, bond, and other issues in administration. Since a trust is a will substitute, it does not seem burdensome to require that the essential terms of a trust be in writing. As noted in Memorandum 84-34, there may also be some question as to whether an oral trust can satisfy the statutory requirements for irrevocability since Civil Code Section 2280 requires that the trust instrument expressly make the trust irrevocable to overcome the presumption of revocability.

Some protection is provided against exceedingly sloppy oral trusts, at least in theory, by the requirement that the parol evidence of the elements of a trust "must at all times be clear and unequivocal." E.g. Lefrooth v. Prentice, 202 Cal. 215, 227, 259 P. 947 (1927). Courts have also applied the "clear, satisfactory and convincing" test applicable to prove a trust by parol under a conveyance absolute in its terms. See Kobida v. Hinkelmann, 53 Cal. App.2d 186, 188-93, 127 P.2d 657 (1942);

see also Monell v. College of Physicians & Surgeons, 198 Cal. App.2d 38, 48, 17 Cal. Rptr. 744 (1961) ("full, clear and convincing evidence"); but cf. Fahrney v. Wilson, 180 Cal. App.2d 694, 696, 4 Cal. Rptr. 670 (1960) (circumstantial evidence along with statement of deceased insured and acquiescence of widow supported express oral trust for creditors of decedent).

It is also important to remember that an oral trust is necessarily an inter vivos trust. Consequently, the trust must create an interest in a beneficiary (who may be an unborn person) before the death of the trustor. The Statute of Wills invalidates attempted oral testamentary dispositions in trust. See Cohen v. Meyers, 6 Cal. App.3d 878, 881, 86 Cal. Rptr. 456 (1970); Monell v. College of Physicians & Surgeons, supra, at 49; Restatement (Second) of Trusts § 56 (1957).

## Consequences of Abolishing Oral Trusts

What harm could result from requiring a writing for all trusts? In a significant number of cases the proponents fail to establish the oral trust. A number of cases also involve Totten trusts which are not covered by the draft statute. There remain some cases where, typically, recent immigrants or elderly or dying people apparently created arrangements that we would probably characterize as trusts but did so without a written trust instrument. For example, in Kobida v. Hinkelmann, supra, relatively illiterate but hardworking and shrewd Czech immigrants (adjectives from court's opinion) created an oral "trust" in which the mother took care of the son's money as he earned it over a 16-year period with the understanding that he would have it when she died. After the mother died intestate, the son successfully sought to establish and enforce a trust against the estate.

We can conclude that in a certain number of cases where oral trusts are an issue, it would be unjust if the intended disposition of the property were invalidated. For example, in Kobida it would not be fair to divide the accumulations of the son's earnings over 16 years among his brother and his stepfather. But the achievement of justice need not depend on proof of an oral express trust.

## Remedies for Potential Injustices

If oral trusts are abolished, the disposition of the failed trust in certain circumstances may be saved by a resulting trust. In the Kobida situation a resulting trust could be declared with the effect

that the executor (successor of the transferee) would hold the property upon a resulting trust for the son (transferor). A resulting trust is said to be an intention-enforcing device based on the presumed or implied intention of the transferor. See generally Restatement (Second) of Trusts § 411 (1957); G. Bogert, Handbook of the Law of Trusts §§ 71, 75 (5th ed. 1973); Costigan, The Classification of Trusts as Express, Resulting, and Constructive, 27 Harv. L. Rev. 437 (1914). The standard of proof seems to be the same for an oral express trust under existing law and a resulting trust. Compare Monell v. College of Physician & Surgeons, supra, with Baskett v. Crook, 86 Cal. App.2d 355, 362, 195 P.2d 39 (1948) ("clear and conclusive" evidence to establish resulting trust in real or personal property) and Moulton v. Moulton, 182 Cal. 185, 190, 187 P. 421 (1920) ("clear and convincing").

A constructive trust normally arises without regard to the intentions of the parties; a constructive trust is an equitable remedy used to compel a person who would otherwise be unjustly enriched to convey property to another. See Restatment of Restitution § 160 & comments (1937); 5 A. Scott, the Law of Trusts § 404.2, at 3215 (3d ed. 1967); 7 B. Witkin, Summary of California Law Trusts § 131, at 5487 (8th ed. 1974); Bogert, supra, § 77; Costigan, supra. Constructive trusts are also called fraud-rectifying trusts, but in this sense the concept of fraud is very broad and is not limited to intentional false representation. See Bogert, supra. It would be appropriate for a court to impose a constructive trust in a case where a person fraudulently induced another to transfer property to him on a trust that the "trustee" did not intend to carry out. Cf. Hays v. Gloster, 88 Cal. 560, 26 P. 367 (1891) (incompetent farmer induced to part with real and personal property on representation that transferee would manage property and pay farmer's debts). Like the resulting trust and the terms of an oral trust, a person seeking imposition of a constructive trust must prove his case by clear and convincing evidence. Bogert, supra, § 78.

An important distinction between express trusts on the one hand, and resulting and constructive trusts on the other, is that the duty of a trustee under a resulting or constructive trust is simply to transfer the property. See B. Witkin, supra, § 123, at 5481, § 131, at 5487; Restatement of Restitution § 160 (1937); Restatement (Second) of Trusts, introductory note preceding § 404 (1957). Professor Scott has noted

that a person is not compelled to transfer because he is a constructive trustee, but is a constructive trustee because he can be compelled to transfer the property. A. Scott, supra, § 462, at 3413. In theory, an oral express trust could continue in operation after being proven in court, the trustee being subject to the terms of the trust as shown by clear and convincing evidence. However, it appears from the cases that by the time an oral trust gets to court, it is no longer intended to be operational even taking the proponent's evidence as true.

Another distinction between types of trusts is that the statute of limitations runs from repudiation or breach of an express or resulting trust, whereas the right to seek imposition of a constructive trust runs from the time the plaintiff has notice or should know of the wrongful holding of the property. See B. Witkin, supra, § 84, at 5444.

## Law of Other States

It appears that most states permit oral express trusts. See G. Bogert, The Law of Trusts and Trustees § 65 (2d ed. 1965). However, in Alaska, Colorado, Georgia, Louisiana, and Oregon, a writing is required for trusts of personal property as well as real property. Id. Apparently in Georgia relief from this requirement is achieved by way of implied trusts. See cases cited id. n. 7. As noted previously, two states which have revised their trust law in recent years have reacted against oral express trusts, bringing the total to seven states. An article in 1944 reported that only Georgia invalidated oral trusts of personal property, so there seems to be a trend of sorts toward limiting such trusts. See Moorhead, The Texas Trust Act, 22 Tex. L. Rev. 123, 129 (1944). Indiana requires the terms of a trust to be proved in writing in all cases. A copy of the Indiana provision, which is recommended as a model, is in Exhibit 1.

Texas recognizes oral trusts of personal property in one limited situation: where the tranferor expresses the trust at or before a transfer to another person who is not a beneficiary. A copy of the Texas statute is also attached. The staff recommends the Texas statute as a preferable alternative to existing law if the Commission is unwilling to recommend a complete ban on oral trusts.

Respectfully submitted,

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EXHIBIT 1

State Statutes Relating to Oral Trusts

INDIANA

## 30-4-2-1 Formal requirements

Sec. 1. (Formal Requirements)

(a) A trust in either real or personal property is enforceable only if there is written evidence of its terms bearing the signature of the settlor or his authorized agent.

(b) Except as required in the applicable probate law for the execution of wills, no formal language is required to create a trust, but its terms must be sufficiently definite so that the trust property, the identiy [1] of the trustee, the nature of the trustee's interest, the identity of the beneficiary, the nature of the beneficiary's interest and the purpose of the trust may be ascertained with reasonable certainty.

1. So in enrolled Indiana Code. Should read "identity".

**30-4-2-1 Formal requirements**

**Trust Code Study Commission Comments**

(a) This subsection requires written evidence to enforce a trust. It replaces IC 1971, 30-1-9-1 and extends the rule of that statute to include personal property. [The former statute] applied only to trusts of real estate. Union Trust Co. v. Children's Aid Assn., 77 Ind.App. 575, 134 N.E. 207 (1922). See also Restatement (Second), Trusts § 52 (1959).

The decision to require a trust in personal property to be substantiated by written evidence is motivated by the Commission's concern for the risk that manufactured evidence might be used to enforce an oral trust. This risk has been recognized in Indiana. See Hinds v. McNair, 235 Ind. 34, 129 N.E.2d 553 (1955). It is believed that the rules relating to trusts created by operation of law provide a sufficient remedy to avoid injustice in most oral trust cases. See the discussion on this point in A Proposed Trust Code for Indiana—An Effort at Reform, 45 Notre Dame Lawyer 427 (1970).

This continues the existing law that a trust need only be proved in writing, Gaylord v. City of Lafayette, 115 Ind. 423, 17 N.E. 899 (1888); Kintner v. Jones, 122 Ind. 148, 23 N.E. 701 (1890); Nesbitt v. Stephens, 161 Ind. 519, 59 N.E. 256 (1903); Holsapple v. Schrontz, 65 Ind.App. 390, 117 N.E. 547 (1917); Lehman v. Pierce, 109 Ind.App. 497, 36 N.E.2d 952 (1941). Accordingly, letters, receipts, memoranda or other writings signed by the trustee may be sufficient to establish a trust. Ransdel v. Moore, 153 Ind. 393, 53 N.E. 767, 53 A.L.R. 753 (1899); McCabe v. Grantham, 108 Ind.App. 695, 31 N.E.2d 658 (1886).

**Section 112.004. STATUTE OF FRAUDS.** A trust in either real or personal property is enforceable only if there is written evidence of the trust's terms bearing the signature of the settlor or the settlor's authorized agent. A trust consisting of personal property, however, is enforceable if created by:

(1) a transfer of the trust property to a trustee who is neither settlor nor beneficiary if the transferor expresses simultaneously with or prior to the transfer the intention to create a trust; or

(2) a declaration in writing by the owner of property that the owner holds the property as trustee for another person or for the owner and another person as a beneficiary.

**§ 112.004. Statute of Frauds.**

Section 112.004 replaces the proviso which appears at the conclusion of Section 7 of the Act.

Prior to passage of the Act, effective April 19, 1943, it was possible to create Texas trusts of both realty and personalty by parol. Court decisions of that era, however, enforced parol trusts of land only when there had been a conveyance of realty and the grantee had agreed, before or at the time of delivery of the deed, to hold title for the benefit of the grantor or a third person. *See Jones v. Siler*, 100 S.W.2d 352 (Tex. Comm'n. App. 1937, opinion adopted); Guittard, *Express Oral Trusts of Land in Texas*, 21 TEXAS L. REV. 719 (1943).

With the passage of the Act, a writing was required for the creation of a trust of lands, but there was no statutory impediment to creation of a parol trust of personalty. *See* Moorhead, *supra*, p. 1.

The initial sentence of § 112.004 continues the requirement that trusts in real property be created in writing and expands the writing requirement to trusts of personal property. However, the second sentence exempts certain types of trusts of personal property. Subdivision (1) provides that a trust of personalty can be created by parol when personal property is transferred to a trustee who is a third party simultaneously with an expression by the transferor of intent to create a trust. Subdivision (2) permits a written declaration by the property owner that the owner holds the property as trustee for another person or for the owner and another person as beneficiary to satisfy the writing requirement. The provision does not require that the written declaration of trust include the terms of the trust; these may be established by parol. Subdivision (2) should also be read with TEX. PROB. CODE ANN. §§ 436, 438, 439, 447 and 450 (Vernon 1980).