

Memorandum 84-17

Subject: Study L-640 - Trusts (Formalities for Creating Trusts)

Methods of Creating Trusts

This study is primarily concerned with express trusts. The staff anticipates that the trust provisions to be included in the Probate Code will use the definition of "trust" added to the Probate Code on Commission recommendation during the 1983 legislative session. (See 1983 Cal. Stats. ch. 842, operative January 1, 1985.) This definition is as follows:

82. "Trust" includes any express trust, private or charitable, with additions thereto, wherever and however created. It also includes a trust created or determined by judgment or decree under which the trust is to be administered in the manner of an express trust. "Trust" excludes other constructive trusts, and it excludes resulting trusts, guardianships, conservatorships, personal representatives, Totten trust accounts, custodial arrangements pursuant to the Uniform Gifts to Minors Act of any state, business trusts providing for certificates to be issued to beneficiaries, common trust funds, voting trusts, security arrangements, liquidation trusts, and trusts for the primary purpose of paying debts, dividends, interest, salaries, wages, profits, pensions, or employee benefits of any kind, and any arrangement under which a person is nominee or escrowee for another.

The Field Code provisions governing creation of voluntary trusts are set forth in Civil Code Sections 2221 and 2222. They read as follows:

2221. Subject to the provisions of Section 852, a voluntary trust is created, as to the trustor and beneficiary, by any words or acts of the trustor, indicating with reasonable certainty:

1. An intention on the part of the trustor to create a trust, and,
2. The subject, purpose, and beneficiary of the trust.

2222. Subject to the provisions of Section 852, a voluntary trust is created, as to the trustee, by any words or acts of his indicating, with reasonable certainty:

1. His acceptance of the trust, or his acknowledgment, made upon sufficient consideration, of its existence; and,
2. The subject, purpose, and beneficiary of the trust.

(Section 852, referred to in both of these sections, is a codification of the Statute of Frauds as applied to trusts.)

In addition, Civil Code Section 2251 provides, somewhat anomalously: "The mutual consent of a trustor and trustee creates a trust of which the beneficiary may take advantage at any time prior to its rescission."

Stating general rules governing creation of trusts in terms of the person "as to" whom the trust is created is not the best approach. The staff recommends adoption of a statute based on Section 17 of the Restatement (Second) of Trusts, which would read as follows:

§ . Methods of creating a trust

_____. A trust may be created by any of the following methods:

(a) A declaration by a property owner that the owner holds the property as trustee for another person.

(b) An inter vivos transfer of the property by a property owner to another person as trustee for the transferor or for a third person.

(c) A testamentary transfer by a property owner to another person as trustee for a third person.

(d) An appointment under a power of appointment to another person as trustee for the donee of the power or for a third person.

(e) A promise to another person whose rights under the promise are to be held in trust for a third person.

Comment. Section _____ is the same in substance as Section 17 of the Restatement (Second) of Trusts (1959). Section _____ supersedes parts of former Civil Code Sections 2221 and 2222.

Subdivision (e) is confusing on first reading. It refers to a situation where a promisee of an enforceable promise holds those rights as promisee in trust for a third person. See Restatement (Second) of Trusts § 26 comment n (1959). Hence, if a person makes an enforceable promise to pay money to A as trustee for B, a present trust is created, the right to enforce the promise being considered the trust corpus. The recently enacted Texas Trust Code contains a provision similar to the above draft and drawn from Section 17 of the Restatement. Section 112.001, in 1983 Tex. Sess. Law Serv. ch. 567, art. 2, § 2, (Vernon).

The factor of trustee acceptance of the trust (see Civil Code Section 2222) is not continued in this material since acceptance relates to the trustee's liability, not the formation of the trust.

Requirement of a Writing

California law allows oral inter vivos trusts of personal property and applies the Statute of Frauds to inter vivos trusts of real property. See Civil Code § 852; 7 B. Witkin, Summary of California Law Trusts §§ 14-16, at 5377-79 (8th ed. 1974). The California Statute of Frauds, as applied to trusts, is Civil Code Section 852:

852. No trust in relation to real property is valid unless created or declared:

1. By a written instrument, subscribed by the Trustee, or by his agent thereto authorized in writing;
2. By the instrument under which the Trustee claims the estate affected; or,
3. By operation of law.

In trust law, as elsewhere, the Statute of Frauds brings its usual baggage of doctrines such as part performance and voidability rather than voidness, notwithstanding the statutory language. See Restatement (Second) of Trusts § 50 (1959) (part performance); *Feeney v. Howard*, 79 Cal. 525, 530, 21 P. 984 (1889) (part performance exception not satisfied); Restatement (Second) of Trusts § 51 (1959) (only trustee or successor can take advantage of unenforceability of trust); *Cardoza v. White*, 219 Cal. 474, 476, 27 P.2d 639 (1933) (same).

The problem with oral trusts is to determine whether the evidence clearly indicates the intention to create a trust and then to determine the terms of the trust. The staff has doubts about the modern utility of oral trusts; the doctrine appears to be an invitation to perjury. In the case where a gross injustice would result, the courts have an adequate arsenal of equitable remedies and do not need to strain to find an oral express trust. Cases in this area involve extended verbiage over the existence of the trust, the intention of the purported trustor, and what was said by whom and when on one side of these matters or the other. This does not result in much detail concerning the matters we would normally like to see covered in a trust such as its purpose, the specific nature of the interests of beneficiaries, the extent of the trust property, and other matters concerning administration of the trust.

The staff suggests that the Commission consider eliminating or further restricting oral express trusts. The staff proposes to require trusts to be in writing and signed by the trustor.

If the Commission decides to restrict but not eliminate oral trusts, you should consider Section 112.004 of the Texas Trust Code (1983 Tex. Sess. Law Serv. ch. 567, art. 2, § 2 (Vernon)):

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.

If the Commission decides to retain existing law, there is probably no benefit in attempting any further codification. This is not the time to try to make sense out of the Statute of Frauds.

Mr. Robert A. Schlesinger, a member of the Executive Committee of the State Bar Estate Planning, Trust and Probate Law Section, has written the Commission concerning a related problem:

Whenever revocable trusts purport to distribute property after the death of a trustor, the signing requirements for the trust should be the same as for a will. The revocable trust is a will substitute and there is no logical reason why the law governing a signing should not be the same. The use of witnesses will insure the validity of the document as well as the capacity of the trustor.

Letter from Robert A. Schlesinger to John H. DeMouilly (Nov. 30, 1983). The staff is not prepared to suggest that the Statute of Wills be applied to trusts, but the problems surrounding revocable inter vivos trusts will be considered in a later memorandum.

Intention to Create Trust

An express trust is not created unless the trustor intended to create a trust. This is made explicit in Civil Code Section 2221(1). Section 23 of the Restatement (Second) of Trusts provides: "A trust is created only if the settlor properly manifests an intention to create a trust." Section 112.002 of the new Texas Trust Code adopts this language except for the word "properly". The staff proposes adoption of the Restatement formulation in California, absent the word "properly". If the Commission decides to restrict oral trusts, this section may require a writing.

Trust Property

Civil Code Sections 2221 and 2222 require that the trust property be indicated with reasonable certainty. This requirement is equivalent to Section 74 of the Restatement (Second) of Trusts which provides: "A trust cannot be created unless there is trust property." Section 112.005 of the new Texas Trust Code states the Restatement formulation verbatim.

The broad Restatement rule is followed by quite a few qualifying and amplifying provisions:

§ 75. Non-existent Interests

An interest which has not come into existence or which has ceased to exist cannot be held in trust.

§ 76. Indefinite Subject Matter

A trust cannot be created unless the subject matter is definite or definitely ascertainable.

§ 77. Limited Interests in Definite Subject Matter

An interest in a thing may be held in trust although the interest is not the complete property in the thing.

§ 78. Transferable Property

Any property which can be voluntarily transferred by the owner can be held in trust.

§ 79. Non-transferable Property

Except as stated in §§ 80 and 81, property which the owner cannot transfer cannot be held in trust.

§ 80. Property Non-transferable for Reasons Inapplicable to a Declaration of Trust

If property is not transferable for a reason applicable only to the transfer of the legal title to the property, it can be held in trust.

§ 81. Non-transferable Interest Created in Trust or Accruing to the Trustee

An interest which is of such a character that a person holding it for his own benefit could not transfer it may be held in trust, if

- (a) it is created in trust; or
- (b) it accrues to a trustee of a trust already created.

§ 82. Intangible Things

Interests in intangible things, if transferable, can be held in trust.

§ 83. Equitable Interests

An equitable interest, if transferable, can be held in trust.

§ 84. Interest Subject to be Divested

An interest which is subject to be divested, if transferable, can be held in trust.

§ 85. Contingent Interests

A contingent interest, if transferable, can be held in trust.

§ 86. Expectancies

An expectation or hope of receiving property in the future cannot be held in trust.

The staff proposes to continue the general statement that property is required for there to be a trust. We suggest the following language: "A trust is not created unless there is trust property." The comment to this provision would then refer to the Restatement rules just quoted and also to Probate Code Section 62 which defines property to include "both real and personal property or any interest therein and means anything that may be the subject of ownership."

Civil Code Sections 2221 and 2222 require that the trust property and other essential elements be "manifested with reasonable certainty." This requirement is in line with the common law. See, e.g., Lefrooth v. Prentice, 202 Cal. 215, 227-28, 259 P. 947 (1927). Nothing will be lost if the "reasonable certainty" language is not continued in the statutes as it would apply to the trust property. Insofar as the certainty requirement has been applied to trust purposes and beneficiaries, see Memorandum 84-19.

Permissible Trust Purposes

Civil Code Section 2220 provides:

2220. A trust in relation to real and personal property, or either of them, may be created for any purpose or purposes for which a contract may be made.

We are not aware of any practical problems that may have resulted from this provision. Restrictions on contracts are provided in Civil Code Sections 1667-1669 and include the traditional prohibitions against contracts contrary to express provisions of law, contrary to the policy of express law, or contrary to "good morals", and contracts to excuse liability for fraud or willful or negligent injury of persons or property.

Section 59 of the Restatement (Second) of Trusts provides with like effect that a "trust can be created for any purpose which is not illegal." Illegality is fleshed out in Sections 60-65 as follows:

§ 60. General Rule as to Illegality

An intended trust or a provision in the terms of a trust is invalid if illegal.

§ 61. Performance Criminal or Tortious

An intended trust or a provision in the terms of the trust is invalid if the performance of the trust or of the provision involves the commission of a criminal or tortious act by the trustee.

§ 62. Enforcement against Public Policy

A trust or a provision in the terms of a trust is invalid if the enforcement of the trust or provision would be against public policy, even though its performance does not involve the commission of a criminal or tortious act by the trustee.

§ 63. Fraudulent Purpose

(1) Except as stated in Subsection (2), a trust is invalid if the purpose of the settlor in creating the trust is to defraud his creditors or other persons.

(2) If the beneficiary of the trust is a third person who at the time of the creation of the trust had no notice of the fraudulent purpose of the settlor, he can enforce the trust, except so far as he is precluded from so doing because of the claims of the defrauded persons.

§ 64. Illegal Consideration

A trust is invalid if it is created for a consideration which is illegal.

§ 65. Consequences of Illegality

If a provision in the terms of the trust is illegal, the trust fails altogether if, but only if, the illegal provision cannot be separated from the other provisions without defeating the purpose of the settlor in creating the trust.

The Restatement rules are more informative than California law, but the staff does not sense a need to enact them as statutes. When the staff draft was reviewed in May 1983, the Commission approved the following language: "A trust may be created for any purpose for which a contract may be made." As an alternative, this section could be conformed to the Restatement language by substituting "not illegal" for the reference to contract law, but the comment to the section would need to refer to the Restatement sections that explain illegality. Section 112.031 of the Texas Trust Code apparently reflects the notion that Section 59 of the Restatement would not be adequate. Texas law provides: "A trust may be created for any purpose that is not illegal. The terms of the trust may not require the trustee to commit a criminal or tortious act or an act that is contrary to public policy." On balance it is probably simplest to keep the formulation of existing California law.

Consideration

Civil Code Section 2222, quoted above, refers to consideration in connection with creation of a trust "as to" the trustee. However, no consideration is necessary where the trustor declares himself trustee for another as provided in Civil Code Section 2221. Shedding no light on the subject is Civil Code Section 2251 which speaks of trusts by mutual consent of the trustor and trustee without any mention of consideration.

One eminent authority suggests that these provisions inevitably lead to an absurdity, concluding with the plea: "Surely we can draft better legislation than that." Evans, "Observations on the State, Etc., of California Laws of Uses and Trusts", 28 S. Cal. L. Rev. 111, 119-20 (1955). Professor Evans was referring to the problem of deciding whether the consideration language in Section 2222 applies to acceptances of trusts as well as acknowledgments. If it applies only to acknowledgments, an enforceable trust arises without consideration where the formalities of a writing and delivery of the trust property are satisfied. But if these formalities are not satisfied, the intended trustee to whom property is conveyed can declare himself trustee without consideration even though he can't bind himself by an acknowledgment without consideration.

If we are talking about the enforceability of a promise to create a trust, then consideration is required as a function of contract law. See Estate of Webb, 49 Cal. 541, 545-46 (1875); Restatement (Second) of Trusts § 30 (1959). The staff does not think this needs to be covered by the trust statute.

The Restatement (Second) of Trusts provides as follows:

§ 28. The owner of property can create a trust of the property by declaring himself trustee of it although he receives no consideration for the declaration of trust.

§ 29. The owner of property can create a trust of the property by transferring it to another person in trust although there is no consideration other than the transfer of the property.

Section 112.003 of the Texas Trust Code simply states:

Consideration is not required for the creation of a trust. A promise to create a trust in the future is enforceable only if the requirements for an enforceable contract are present. (1983 Tex. Sess. Law Serv. ch. 567, art. 2, § 2.)

The staff suggests that the Commission consider a provision like the first sentence of the Texas statute. This would eliminate the confusing and unclear language of existing law. The provision on contracts to make trusts in the future seems unnecessary as part of a trust statute. The general rule that consideration is unnecessary, when coupled with a provision governing the methods of creating trusts like that set out in the first part of this memorandum, would continue the general law applicable to the creation of trusts, but in a form that enlightens rather than confuses.

Respectfully submitted,

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