Title

One Illinois court misconstrues and misapplies long-settled merger doctrine in the trust context

Text

Assume X is sole designated trustee of Blackacre and sole designated life beneficiary. Assume also that upon X's death Blackacre is to pass outright and free of trust into X's probate estate. In such a case there never was a trust, all interests, both legal and equitable, having merged in X. X simply held Blackacre outright and free of trust from the outset. On the other hand, if upon X's death Blackacre is to pass outright and free of trust, say, to those who would be X's heirs at law, then there would be no merger. Reason: X would be sharing the equitable interest with others. What if X were also to possess a fiduciary or non-fiduciary power of appointment? That would have no bearing on whether or not there is a merger. This has long been settled doctrine. *See* Nat'l Shawmut Bnk v. Joy, 315 Mass 457, 53 N.E.2d 113 (1944). One Illinois court, however, still has not gotten the message. *See* Chicago Police Sergeants' Assn. v. Pallohusky, 128 N.E.3d 436 (Ill. App. 1 Dist. 2019). Merger doctrine is discussed generally in §8.7 of *Loring and Rounds: A Trustee's Handbook* (2019). The section is reproduced in the appendix immediately below.

Appendix

§8.7 Merger [from *Loring and Rounds: A Trustee's Handbook*]

> *Because one cannot be under an obligation to oneself, the same individual cannot be settlor, trustee, and sole beneficiary, and the trust parties can never be fewer than two.*[1]
>
> *[E]ven where the legal and equitable titles are both vested in the same person, equity will under certain conditions refuse to recognize a merger which might exist in law, as where such result would be contrary to the intention of the trustor and would destroy a valid trust.*[2]

The doctrine of merger is occasionally a trap for the unwary; more often it is invoked in situations where it is inapplicable.[3] Thus, the trustee needs to understand the concept if only to recognize when the

[1]Bogert §1.

[2]90 C.J.S. §283 (citing to Dennis v. Omaha Nat'l Bank, 153 Neb. 865, 46 N.W.2d 606 (1951)); Mesce v. Gradone, 1 N.J. 159, 62 A.2d 394 (1948); Quinn v. Pullman Trust & Sav. Bank, 98 Ill. App. 2d 402, 240 N.E.2d 791 (1968); *In re* Haskell's Trust, 59 Misc. 2d 797, 300 N.Y.S.2d 711 (Sup. 1969)). *See also* Tretola v. Tretola, 61 Mass. App. Ct. 518 (2004) (see footnote 10 in the court's opinion and accompanying text). For a discussion of the concept of merger in Roman law, *see* §8.15.36 of this handbook.

[3]As a general rule, a trust may be created solely for the benefit of the settlor, provided the settlor is not also the sole trustee. See UTC §402 cmt., specifically the commentary on §402(a)(5). The Bogert treatise, however, appears to have fallen into the false merger trap by suggesting that one of the three "requirements" for the establishment of a valid private trust is "an expression of intent that property be held, at least in part, for the benefit of one other than the settlor." *See* Bogert §1, in which UTC §402(a)(3) is cited as authority for the proposition. It does not appear, however, that §402(a)(3) even

doctrine is not a concern.[4]

Merger occurs when one person possesses the entire legal interest and the entire beneficial interest in property.[5] In such a case, there is no trust;[6] the person simply owns the property outright and free of trust, all interests having "merged" in that person.[7] Thus, the creditors, the spouse, and the taxing authorities might well have greater access to the property than would be the case were the property the subject of a viable trust.[8] If merger has occurred, at death the property passes in accordance with the terms of the person's will or by intestate succession, not in accordance with the terms of the instrument governing the purported trust.[9] Obviously, if those who are mentioned in the trust instrument are different from those mentioned in the will, merger will benefit the latter. Merger may have consequences as well in the welfare eligibility and recoupment area.

Merger would trigger a termination of a valid trust, for example, if a beneficiary with the entire equitable interest transfers that interest to the trustee, provided there is no cotrustee.[10] The equitable interest, however, would have to be transferable; the beneficiary would have to be of full age and legal capacity and fully understand the applicable law and facts; and there could not be any undue influence on the part of the trustee.[11] Assuming the trustee managed to get over these hurdles, the trustee would then have the full ownership interest with rights of personal consumption, even if all the trust purposes had not been accomplished.[12] Under the Restatement (Third) of Trusts, this would be the case even if there had been a spendthrift restraint in place.[13] The property is said to be "at home," the equitable interest having been

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addresses the settlor-as-sole-beneficiary question. Some courts also have inappropriately invoked the doctrine of merger, such as to invalidate self-declarations of trust in which the settlor is the sole current beneficiary but other persons are designated as beneficiaries of the remainder. *See* UTC §402 cmt. Presumably a so-called adapted trust would not fall prey to this particular misapplication of the merger doctrine as an adapted trust may not arise by declaration. *See* Restatement (Third) of Trusts, Reporter's Notes on §46, specifically on cmt. f thereto. The adapted trust is generally discussed in §9.29 of this handbook.

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

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

[6]2 Scott on Trusts §99. *See also* UTC §402(a)(5).

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

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

[9]2 Scott on Trusts §99.

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

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

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

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

"swallowed up" in the full ownership.[14] Of course, merger could be avoided if the trustee were to resign in a timely fashion, or to execute a timely disclaimer of the equitable interest.[15]

Going the other way, there would be a merger in the beneficiary of a single-beneficiary trust if the legal title were to pass from the trustee to the beneficiary and to no other,[16] whether or not this was done at the instigation of the beneficiary and whether or not the purposes of the trust had been fulfilled.[17] Under the Restatement (Third) of Trusts, any spendthrift protections would extinguish.[18] Thus, if that is not the desired result, the beneficiary should either disclaim the trusteeship or see to it that there is a cotrustee in place.[19] The Restatement (Second) of Trusts took the position that "when the sole beneficiary of a spendthrift trust, without his or her consent, became the sole trustee, he or she should be able to procure the appointment of a new trustee and have the trust reconstituted as a spendthrift trust."[20] One commentator finds the position of the Third Restatement plainly "more consonant with the surrounding doctrine").[21]

A state of merger also could exist *ab initio*. If, for example, *X* purports to declare himself trustee of certain property for a period of ten years after which the property is to pass outright and free of trust to *X*, there is no trust. All interests, both legal and equitable, remain merged in *X*.[22] A trust was never created.[23]

But more often than not there is no merger. Let us assume a trust, *A* to *B* for *C* for life, then to *D*. If the same person is the sole trustee and the sole income beneficiary, and if upon death the property passes to the person's executor or administrator—in other words to the estate—then there is a merger.[24] In other words, if *B, C,* and *D* are the same person, there is no trust—in fact there never was one. *A* simply made a gift to the person that was outright and free of trust. Nowadays one seldom runs across trust instruments where the one who possesses the equitable life estate also possesses the equitable remainder interest (*i.e.*, where the trust property ultimately passes into the probate estate of the life tenant), with the possible exception of nominee or realty trusts.[25] The property usually passes directly by purchase to someone's relatives.[26]

Where the group of trustees and the group of beneficiaries are identical, the fact that the trustees hold the legal title jointly with right of survivorship and the beneficiaries hold the equitable interest as tenants in common ought to prevent the destruction of the trust through merger.[27] One commentator is of the view that on policy grounds alone, namely, the policy of effectuating settlor intent whenever possible, there

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

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

[16]5 Scott & Ascher §34.5 (Merger).

[17]5 Scott & Ascher §34.6 (Conveyance by Trustee to or at the Direction of the Beneficiaries).

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

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

[20]5 Scott & Ascher §34.5.1 (referring to Restatement (Second) of Trusts §341(2) cmt. c & illus. 4, 7).

[21]5 Scott & Ascher §34.5.1.

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

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

[24]UTC §402 cmt.

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

[26]*See, e.g.*, Bowen v. Bowen, 2011 UT App 352 n.8, 264 P.3d 233 n.8 (Utah Ct. App. 2011). *See generally* Nat'l Shawmut Bank v. Joy, 315 Mass. 457, 462–467, 53 N.E.2d 113, 117–120 (1944).

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

should be no merger in such cases.[28]

As one can see, not much need be done to prevent a merger of interests. The simple introduction of a cotrustee into the formula should avoid such a result.[29] Or if upon the death of *C* the property passes to the then-living issue of *C* rather than to *C*'s estate there is no merger.[30] "… [A]… trust is created even though the only interests of other beneficiaries are contingent, subject to revocation, or otherwise uncertain."[31] In this day and age, one has to work hard to back into a merger.

The trustee should always keep in mind that, as we have alluded to above, a right to revoke or the possession of a general inter vivos power of appointment is not what triggers a merger.[32] Thus, if *A, B,* and *C* are the same but *D* is the *issue* of *B/C* living at the termination of the trust, there is no merger even in the face of a reserved right of revocation or general inter vivos power of appointment in *B/C*.[33] It is when *D* is the estate of *B/C* and *B/C* are the same person that merger comes about. The existence of a reserved right of revocation or general inter vivos power of appointment does not affect the situation one way or the other.[34] Merger is not about control.[1]

With the revocable living trust now the core of most estate plans, it is important that the trustee separate issues relating to merger from issues relating to powers of revocation and general inter vivos powers of appointment. These powers are technically personal rights of disposition, not interests in property.[35]

There is no merger even in a case where title to the entire beneficial interest in a nominee trust[36] is held by the trustee of some other trust and the same person is the sole trustee of each trust, unless that same person also possesses the entire beneficial interest in the other trust.

As suggested in the introductory quotation, the coalescing of all property interests, both legal and equitable, in one person may not effect a merger in every case. Nor would the chance merger of the legal interest away from the trustee necessarily mean that in equity the trust itself extinguishes.[37] It may be that the one in whom the legal interest merges holds the legal interest as constructive trustee for the benefit of the trust beneficiaries, unless that person is a BFP.[38] As constructive trustee, he or she would then have a duty to transfer title to the subject property to an appropriate successor trustee, presumably one appointed

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[28]2 Scott & Ascher §11.2.5.

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

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

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

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

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

[34]*See* Restatement (Third) of Property (Wills and Other Donative Transfers) §7.1 cmt. b (providing that "the fact that the interest of the remainder beneficiary is subject to the settlor's power to revoke or amend the trust … does not transform the inter vivos trust into a will").

[1] *See* Miller v. Kresser, 34 So.3d 172 (Fl. 2010).

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

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

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

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

by the court.[39]

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

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