

## Title

Shakman v. Dept. of Revenue (Illinois 2020): A trust-declaration tax case from hell

## Text

Client purchases aircraft. Pays \$7370 use tax. Then declares himself owner in his capacity as trustee-settlor of his revocable, inter vivos trust. Illinois deems declaration a taxable “transfer” and assesses him another hefty sum (\$7511). Client loses all appeals. Appellate court warns that de-entrusting aircraft could generate yet a third \$7000+ use tax. The Illinois Aircraft Use Tax Law says what it says: The “transfer” of an aircraft is a taxable event. Presumably this unfortunate deference to form over substance is now being cured legislatively. But wait. In the case of a declaration of trust (settlor and trustee are one and the same), there is no “transfer” of legal title, title being in same person pre and post entrustment. Had court been made aware of this peculiar feature of trust declarations, things might have gone a different way. See 2019 Il App. (1st) 182197, appeal denied, 144 N.E.3d 1203 (Table) (2020). This peculiar feature of trust declarations is taken up generally in §3.4.1 of *Loring and Rounds: A Trustee’s Handbook*, the relevant portions of which section are reproduced in Appendix I below.

Nor did the aircraft’s owner “transfer” some beneficial interest at time of aircraft’s entrustment. As to the non-transfer of the beneficial interest, when a settlor has reserved a general inter vivos power of appointment in the form of a right to revoke, while technically contingent equitable property rights are bestowed on the successors in interest, see *National Shawmut Bank v. Joy*, 53 N.E.2d 113 (1944), the settlor has reserved an “ownership-equivalent” power. See Restatement (Third) of Trusts Sect. 74, cmt. a (such a power enables “elimination” by settlor of the interests of the other beneficiaries). See also the relevant portion of §8.1.1 of *Loring and Rounds: A Trustee’s Handbook* (2020), which portion is reproduced in the Appendix II below.

Thus functionally there was neither a transfer of the legal title nor of the ownership interest when the aircraft was entrusted.

## Appendix I

§3.4.1 *Appointment of Trustee* [from *Loring and Rounds: A Trustee’s Handbook* (2020)].

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**The declaration of trust.** A declaration of trust arises when the owner of an interest in property declares himself or herself to be a trustee of that interest for the benefit of someone. Declarations of trust were not enforceable in England until 1811.<sup>11</sup> “In any event, the rule is now settled, both in England and in the United States, that when the owner of property gratuitously declares himself or herself trustee for another, a trust arises, even if the declaration involves land.”<sup>12</sup> Because a declaration of trust has no deed, delivery, or consideration requirement, it can be a useful fall-back theory for counsel struggling to prove the elements of a gift or a contract.<sup>13</sup>

The appointment of the trustee under a declaration of trust (*i.e.*, when the settlor and trustee are one and

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<sup>11</sup>Ex parte Pye, 18 Ves. 140 (Eng. 1811).

<sup>12</sup>1 Scott & Ascher §3.3.1.

<sup>13</sup>1 Scott & Ascher §3.3.1.

the same) requires no action by the court and no act of property transfer,<sup>14</sup> although §7-101 of the UPC, repealed/withdrawn in 2010, would have required that the trustee register the declaration of trust, whether oral or written, in the court upon assuming the trusteeship.<sup>15</sup> In any case, a declarant becomes trustee simply by manifesting a present intention to impress a trust upon some or all of his property.<sup>16</sup> In North Carolina, no formal transfer of legal title is required, even in the case of real estate, since the trustee already holds legal title.<sup>17</sup> “Kentucky cases have specifically stated that one who is both settlor and trustee of a trust need not transfer the legal title of the trust corpus.”<sup>18</sup>

As a practical matter, however, segregation of entrusted property and re-registration of any securities and other such items of intangible personal property in the name of the declarant-trustee are advisable in order to generate factual evidence of intent-to-entrust.<sup>19</sup> In the case of entrusted real estate, the formal recordation of a deed is advisable. If real estate is involved, the statute of frauds may require a writing for the trust to be enforceable *as to the real estate*.<sup>20</sup>

Again, for a declaration of trust to arise, there is no need of a conveyance from the owner to himself as trustee, or of a conveyance by the owner to a straw who in turn reconveys back to the owner as trustee.<sup>21</sup> In either case, title was already with the owner. Nor, as noted, is there need for some exchange of consideration.<sup>22</sup> In the commentary accompanying §201 of the Uniform Powers of Appointment Act there is the assertion that a declaration of trust “necessarily entails a transfer of legal title from the owner-as-owner to the owner-as-trustee....” No authority is supplied for this general proposition because there is none.

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<sup>14</sup>See 1 Scott on Trusts §17.1; *see, e.g.*, Taliaferro v. Taliaferro, 921 P.2d 803, 809 (Kan. 1996) (“there is no requirement that a settlor who also serves as trustee of a trust established by declaration must transfer legal title to the trust property.”). *See also* Janet A. Lemons, *Trust Law: Creating a Trust by Declaration Does Not Require the Settlor to Transfer Legal Title of the Trust Property to Himself*, 36 Washburn L.J. 511 (1997); UTC §401 (“A trust may be created by:...(2) declaration by the owner of property that the owner holds identifiable property as trustee...”).

<sup>15</sup>See UPC §7-101 (repealed/withdrawn). “The place of registration is related not to the place where the trust was created, which may lose its significance to the parties concerned, but is related to the place where the trust is primarily administered, which in turn is required (Section 7-305 (repealed/withdrawn)) to be at a location appropriate to the purposes of the trust and the interests of its beneficiaries.” UPC Art. VII, Pt.1, Gen. Cmt. (repealed/withdrawn). “Registration shall be accomplished by filing a statement indicating the name and address of the trustee in which it acknowledges the trusteeship.” UPC §7-101 (repealed/withdrawn).

<sup>16</sup>See 1 Scott on Trusts §17.1; *see, e.g.*, Taliaferro v. Taliaferro, 921 P.2d 803, 809 (Kan. 1996) (“there is no requirement that a settlor who also serves as trustee of a trust established by declaration must transfer legal title to the trust property.”). *See also* UTC §401 (“A trust may be created by:...(2) declaration by the owner of property that the owner holds identifiable property as trustee...”).

<sup>17</sup>See *Nevitt v. Robotham*, 762 S.E.2d 267 (N.C. Ct. App. 2014).

<sup>18</sup>*Ladd v. Ladd*, 323 S.W.3d 772 (Ky. Ct. App. 2010).

<sup>19</sup>UTC §401 cmt. (recommending against funding a declaration of trust by attaching a schedule listing the assets in lieu of the formal execution of instruments of transfer, the absence of instruments of transfer making it difficult to later confirm title with third-party transferees). Absence of formal transfer documentation could also set up a conflict between the personal representative of the deceased declarant's estate and the successor trustee.

<sup>20</sup>See generally §8.15.5 of this handbook (statute of frauds).

<sup>21</sup>1 Scott & Ascher §3.1.1.

<sup>22</sup>1 Scott & Ascher §3.1.1.

## Appendix II

### §8.1.1 *Power of Appointment Doctrine* [from *Loring and Rounds: A Trustee's Handbook* (2020)].

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**The general inter vivos power of appointment.** A general inter vivos power over trust principal would give the powerholder, *i.e.*, the donee, the right while alive to direct the trustee to turn over the principal at least to the holder or the holder's creditors.<sup>105</sup> That right is the functional equivalent of ownership of the underlying trust property.<sup>106</sup> This would be the case even if the powerholder were also the trustee.<sup>107</sup> "Also, by implication, a power of revocation or withdrawal of principal...is a power to direct a trustee to distribute principal to another, because such a power permits the donee not only to withdraw principal for himself or herself but also to direct the trustee to distribute principal to another."<sup>108</sup>

*The power of revocation, amendment, or withdrawal.* A power of revocation, amendment, or withdrawal, whether reserved or bestowed on someone other than the settlor, meets the definition of a general inter vivos power of appointment.<sup>109</sup> By "power of revocation," we mean the power to revoke a trust and assume legal title to, and acquire a full beneficial in, the entrusted property. Such ownership-equivalent powers are held by the powerholder "individually and not in a fiduciary capacity," even if the power holder also serves as trustee.<sup>110</sup>

*When a donee may consent to a breach of trust.* The holder of a general inter vivos power of appointment over principal, if of full age and legal capacity, may consent to a breach of trust and in so doing bind the other beneficiaries, including the takers in default.<sup>111</sup> A general inter vivos power of appointment, however, may be limited by the provisions of the trust to the withdrawal of income only.<sup>112</sup> In other words, the appointive property is only the income stream itself.

*The general (as opposed to nongeneral) presumption.* Ordinarily, the terms of a general inter vivos power of appointment will expressly authorize the holder to appoint the appointive property to the holder or the holder's creditors. Absent such express authorization, the Restatement (Third) of Property suggests that language creating an inter vivos power of appointment should be construed as creating a general power unless the language "expressly prohibits" exercise in favor of the donee and the donee's creditors. Presumably an express designation of a limited class of permissible appointees that does not include the

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<sup>105</sup>See Restatement (Second) of Property (Wills and Other Donative Transfers) §11.4; Lewin ¶29-12 (England) (defining general and limited powers under English law).

<sup>106</sup>Restatement (Third) of Trusts §74 cmt. a. See generally 6 Scott & Ascher §41.17; Restatement (Third) of Property (Wills and Other Donative Transfers) §17.4 cmt. f(1) (suggesting that a presently exercisable general power of appointment is an ownership-equivalent power).

<sup>107</sup>See *Fulp v. Gilliland*, 972 N.E.2d 955 (Ind. Ct. App. 2012).

<sup>108</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §19.3(a) & §17.1 cmt. f.

<sup>109</sup>UTC §505 cmt.; UPC §1-108; Restatement (Third) of Property (Wills and Other Donative Transfers) §17.1 cmt. e.

<sup>110</sup>Restatement (Third) of Trusts §74 cmt. a.

<sup>111</sup>UPC §1-108 (acts of holder of general inter vivos power); §8.14 of this handbook (representing the beneficiary); §7.1.4 of this handbook (consenting to a breach of trust); §8.11 of this handbook (duties of trustee of a revocable trust).

<sup>112</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §17.1 cmt. e.

donee and the donee's creditors would constitute such an express prohibition.<sup>113</sup>

*Partial revocations.* The Restatement (Third) of Property proposes that any express limitation on the right to partially revoke (or withdraw), or on the number of partial revocations (or withdrawals) that may be executed, is unenforceable.<sup>114</sup>

*Constructively transferring a nonfiduciary general inter vivos power of appointment.* Inherent in the right to revoke (withdraw) is the right to directly grant a right of revocation (withdrawal) over the entrusted property to another, such as by the exercise of the power in further trust.<sup>115</sup> The Restatement falsely analogizes such a constructive transfer to a delegation of the power of revocation.<sup>116</sup> Rather, such a constructive transfer is analogous to an irrevocable transfer by assignment of the entrusted property itself.<sup>117</sup>

*A power to appoint only to the donee's creditors.* The Restatement (Third) of Property (Wills and Other Donative Transfers) proposes that a power to appoint only to the donee's creditors permits only such an appointment, *even though the power is general*.<sup>118</sup> The Restatement (Second) of Property adopted a similar posture.<sup>119</sup> In neither Restatement, however, is, nor was, any light shed on the policy behind the proposition, in the Reporter's Notes, or anywhere else for that matter. The proposition just hangs there. Presumably the donee could fairly easily circumvent the creditor-only limitation simply by contracting with third parties for goods and services using a credit card.<sup>120</sup>

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<sup>113</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §17.3 cmt. a. *See particularly* illus. 2.

<sup>114</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §19.13 cmt. c.; Restatement (Second) of Property (Wills and Other Donative Transfers) §19.1 cmt. d.

<sup>115</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §19.13 cmt. f.; Restatement (Second) of Property (Wills and Other Donative Transfers) §19.2.

<sup>116</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §19.13 cmt. g; Restatement (Second) of Property (Wills and Other Donative Transfers) §19.2, cmt. b.

<sup>117</sup>*See Marx v. Rice*, 3 N.J. Super. 581, 585–586, 67 A.2d 918, 920–921 (Ch. Div. 1949) (in the case of a general inter vivos power of appointment the analogy is to property, whereas in the case of a nongeneral inter vivos power, the analogy is to agency). *See generally* Charles E. Rounds, Jr., *Old Doctrine Misunderstood, New Doctrine Misconceived: Deconstructing the Newly-Minted Restatement (Third) of Property's Power of Appointment Sections*, 26 Quinnipiac Prob. L.J. 240, 256 (2013).

<sup>118</sup>Restatement (Third) of Property (Wills and Other Donative Transfers) §19.13(b).

<sup>119</sup>Restatement (Second) of Property (Wills and Other Donative Transfers) §19.1 cmt. b.

<sup>120</sup>*See generally* Charles E. Rounds, Jr., *Old Doctrine Misunderstood, New Doctrine Misconceived: Deconstructing the Newly-Minted Restatement (Third) of Property's Power of Appointment Sections*, 26 Quinnipiac Prob. L.J. 240, 280 (2013).