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Illegal Trusts

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In a fairly recent case³⁷ the facts were very analogous to those of the principal case, with the exception that no option was involved. There an agency relationship was created orally between the parties that the agent was to purchase a certain building for his principal, but the agent ultimately bought the property for himself with his own money. It was held that a constructive trust arose in favor of the principal based upon such fiduciary breach. There was the added element, it appears, that the parties were old friends and had aided each other in other financial matters (a type of confidential relation), but no particular point was made of this fact.

It would thus appear the modern tendency is towards holding the agent as trustee of any real property which he buys for himself when such purchase is in violation of the agent's fiduciary duty, even though the agency is created by oral agreement. The distinction leading to avoidance of the Statute of Frauds is a fine one, but seems justified to give relief for breach of a fiduciary relation to unjust enrichment.

Landon T. Carlson.

ILLEGAL TRUSTS

THIS comment considers express trusts which fail because of illegality. Not included in the discussion are trusts which fail or are unenforceable for noncompliance with formal statutory requisites. A trust may fail because of illegality for any one of several reasons: where performance requires criminal or tortious acts on the part of the trustee, where enforcement will be contrary to public policy, where the trust is motivated by a fraudulent purpose, or where consideration for the trust is illegal.

Perhaps the most important and recurring of these is the trust created for a fraudulent purpose. Thus, a trust may be illegal because of the motive of the settlor in creating it, even though its

³⁷ *Kuzlik v. Swasney*, 383 Ill. 354, 49 N. E. (2d) 212 (1943).

provisions are otherwise lawful. The most usual illustration of this principle is the case where the owner of property transfers it to another upon trust for himself for the purpose of defrauding creditors. The rule is universal that the defrauded person can reach the property.¹ However, as between the parties, the conveyance is valid, and the settlor usually cannot recover the trust corpus.² The recent case of *Gore v. Gore*³ exemplifies the attitude of the courts. It was there said:

"It is elementary that property conveyed to a trustee with the view of defrauding creditors or other persons, the conveyances actually having effect, is not recoverable by the grantor or his heirs or personal representatives. In such case, no trust results to the grantor, and equity will leave the parties to such transaction in the position in which they have placed themselves, refusing all affirmative aid to either of the fraudulent participants."⁴

The majority of courts limit this doctrine to cases where there actually were creditors who may have been injured by the conveyance. Thus, they enforce the trust where the property conveyed is exempt, or where in reality there were no creditors, regardless of the fraudulent intent of the grantor.⁵ Adherence to this view in Texas was early laid down in the case of *Rivera v. White*.⁶ In this case a husband, fearing that alimony would be decreed against him in a divorce suit, conveyed property to his sister on agreement that she would reconvey later. It was determined that the grantor's wife did not have a valid claim for alimony, and the

¹ *La Force v. Brackin*, 163 S. W. (2d) 239 (Tex. Civ. App. 1942) affirmed 169 S. W. (2d) 465; *Sullivan v. Fant*, 110 S. W. 507 (Tex. Civ. App. 1908) writ of error refused; RESTATEMENT, TRUSTS § 63 (1935); and 42 TEX. JUR., *Trusts*, § 63 (1936).

² *Biccochi v. Casey-Swasey Co.*, 91 Tex. 259, 42 S. W. 963 (1897); *Elliott v. Elliott*, 120 S. W. (2d) 631 (Tex. Civ. App. 1938) writ of error dismissed; *O'Laughlin v. Moran*, 250 S. W. 774 (Tex. Civ. App. 1923) writ of error dismissed; and *Scarborough v. Blount*, 154 S. W. 312 (Tex. Civ. App. 1913).

³ 203 S. W. (2d) 262 (Tex. Civ. App. 1947).

⁴ *Id.* at 263.

⁵ *Harmon v. Schmitz*, 113 Tex. 198, 39 S. W. (2d) 587 (1931); *Wells v. Jamison*, 252 S. W. 1023 (Tex. Com. App. 1923); RESTATEMENT, TRUSTS § 63 (1935); 3 SCOTT ON TRUSTS § 422 (1939); and 42 TEX. JUR., *Trusts* § 63 (1936).

⁶ 94 Tex. 538, 63 S. W. 125 (1901).

property was ordered reconveyed to the husband by the court. In rejecting the argument that the grantor's fraudulent intent precluded recovery, the Court declared: ". . . no policy of the law is thwarted by a mere motive which cannot work injury to creditors."⁷

A few jurisdictions proceed on the "clean hands" doctrine, and refuse to enforce such a trust; this, as has been suggested,⁸ is perhaps the more logical view, if the policy is to suppress fraudulent conveyances. Nevertheless, the majority rule is deeply entrenched and consistently followed.⁹

The public policy supporting the rule of the *Gore* case would also render unenforceable a trust where, instead of conveying property which he already owns, a person purchases property in the name of another for the purpose of defrauding creditors or other claimants. This appears to be true whether an express trust or resulting trust is claimed.¹⁰

Similarly, the general rule condemns a trust where the purpose is to clothe the transferee with apparent ownership in order that he may defraud others. However, some Texas cases hardly seem consistent with this doctrine. For example, in *Citizens Nat. Bank v. Sturgis Nat. Bank*¹¹ a wife transferred bank stock to her husband to enable him to qualify as a director in the bank. The understanding was that he would reconvey as soon as he was elected a director. The husband reconveyed to the wife, and a creditor of the husband sought to garnish the stock. The judgment was that the husband held in trust for his wife, even though the transaction was an evasion of the Federal banking laws, and the creditor was denied relief. Another case has held that a conveyance by a mother to her son for the purpose of enabling him to secure a loan, he to reconvey after the loan was repaid, created a valid

⁷ *Id.* at 541, 63 S. W. 125, 126.

⁸ Note, 5 TEX. L. REV. 101 (1927).

⁹ See note 5, *supra*.

¹⁰ RESTATEMENT, TRUSTS § 63 (1935); and 1 SCOTT ON TRUSTS § 63 (1939).

¹¹ 81 S. W. 550 (Tex. Civ. App. 1904) writ of error refused.

trust which the mother could enforce.¹² While these cases do not definitely repudiate the general rule, it is thought that the current trend is toward an opposite result.¹³

A trust may fail because its performance involves the commission of criminal or tortious acts by the trustee. This is true where the trust is to carry on an illegal business or where the trust is in restraint of trade. Thus, a provision that the trustee should carry on the business of manufacturing and selling intoxicating liquor is invalid where it would be illegal to carry on the business;¹⁴ similarly, a trust to engage in the illegal practice of medicine is invalid.¹⁵

However, where a trust provides that the trustee shall do an act which is legal at the time of the creation of the trust, and subsequently a change in law or circumstances renders it illegal, the provision becomes unenforceable and nugatory.¹⁶ The effect of such a provision on other provisions of the trust instrument is considered *infra*.

It should be here noted that if a trust is created for purposes which are not illegal, the fact that the trust property was acquired by the grantor in an illegal transaction does not, of itself, invalidate the trust. In the case of *Smith v. Barnes*¹⁷ the plaintiff, who had made a profit through the illegal sale of liquor, used the money so acquired in purchasing securities in the name of the defendant. The court decreed that the defendant held the securities on a resulting trust for the plaintiff, and that the trust was enforceable in spite of the illegality of the means by which the plaintiff had made the profit.¹⁸ However, if the settlor was under a duty to restore the property, the true owner can reach the prop-

¹² *Watts v. Wofford*, 239 S. W. 321 (Tex. Civ. App. 1922) writ of error refused.

¹³ RESTATEMENT, TRUSTS § 63, comment c. (1935).

¹⁴ *Stout v. Stout*, 192 Ky. 504, 233 S. W. 1057 (1921).

¹⁵ *Joe Gouy Shong v. Joe Chew Shee*, 254 Mass. 366, 150 N. E. 225 (1926).

¹⁶ RESTATEMENT, TRUSTS § 61, comment b. (1935).

¹⁷ 129 Ore. 138, 276 Pac. 1086 (1929).

¹⁸ 42 TEX. JUR., *Trusts*, § 62 (1936).

erty in the hands of the trustee, provided that no bona fide purchaser intervenes.

A trust or a provision in the terms of a trust, may fail for illegality because the enforcement of the trust or the provision is against public policy, for example, where the enforcement of the trust tends to induce the commission of illegal or immoral acts. Thus, where the benefits of a trust are conditioned upon the securing of a divorce or upon a separation or refusal to support one's wife, the condition is invalid.¹⁹ Similarly, a disposition of property may be illegal on the ground of its tendency to restrain marriage.²⁰ But a disposition, the object of which is to provide for a person so long as that person remains unmarried, is not illegal although it may offer something of an inducement to remain single.²¹

A trust created in violation of some statutory prohibition will not be enforced. In *Zundell v. Gess*²² it was held that where an alien buys property, taking title in the name of a citizen to evade the statute relating to alien ownership, no resulting trust arose in his favor.

It has been determined that a disposition is illegal if it tends to restrain performance of public duties. A condition divesting the interest of a devisee if he should enter into the military service of his country has been held to be against public policy.²³ A fortiori, such a condition would be invalid where a statute provides for compulsory military service.

A trust or a provision in the terms of a trust may be invalid as being within the inhibition of the Rule against Perpetuities, that is, where an interest is created which will not vest within twenty-one years after some life in being at the time of the creation of the

¹⁹ *Potter v. M'Alpine*, 3 Dem. 108, 124 (N. Y. 1885); RESTATEMENT, TRUSTS, § 62 (1935); and 65 C. J., *Trusts*, § 95 (1933).

²⁰ *Matter of Liberman*, 279 N. Y. 458, 18 N. E. (2d) 658 (1939); and 65 C. J., *Trusts* § 95 (1933).

²¹ *Irwin v. Irwin*, 179 App. Div. 871, 167 N. Y. Supp. 76 (1917); and RESTATEMENT, TRUSTS, § 62, comment g. (1935).

²² 73 Tex. 144, 10 S. W. 693 (1899).

²³ *In re Beard*, 1 Ch. 383 (1908).

trust. Thus, any contingent beneficial interest which may vest beyond the period of the rule is invalid.²⁴ Implicit in the rule against perpetuities is the public policy against restraints on alienation. Direct restraints on the trustee have been sustained, but only to serve the purpose of proper trust administration; in *Dulin v. Moore*²⁵ a provision that the trustee should not alienate the property except for purposes of reinvestment was held valid.

A provision in the terms of the trust relating to the administration of the trust is unenforceable if to enforce it would prevent proper administration of the trust. For example, a provision relieving the trustee of all liability to account for the administration is opposed to public policy. Similarly, a provision which would prevent the court from removing a trustee where such removal is necessary for proper administration of the trust is invalid.²⁶

While ordinarily trusts are created gratuitously, consideration is sometimes given for the creation of a trust. And where consideration passes, the trust may be illegal because of illegality of consideration. On this ground trusts created in consideration of unlawful cohabitation, or of the compounding of a felony, have been held to fail.²⁷

A trust may provide that upon the happening of a certain event, the interest of a beneficiary shall be divested, and that his interest shall vest in another. Where the condition is for any reason illegal, the courts usually hold that the interest to which the condition is attached is absolute; the interest survives whether or not the condition is performed. Such a provision—terminating an interest already vested—is a condition subsequent. A more difficult problem is posed in the case of a condition precedent where the event must happen before the beneficiary is vested with the interest. The

²⁴ *Brooker v. Brooker*, 130 Tex. 27, 106 S. W. (2d) 247 (1937); *Clarke v. Clarke*, 121 Tex. 165, 46 S. W. (2d) 658 (1932); and *Anderson v. Menefee*, 174 S. W. 904 (Tex. Civ. App. 1915) *writ of error refused*.

²⁵ 17 Tex. 135, 70 S. W. 742 (1902).

²⁶ 1 SCOTT ON TRUSTS § 62.15 (1939).

²⁷ *Taylor v. Ashe*, 284 Mass. 182, 187 N. E. 548 (1933).

leading case of *Matter of Liberman*²⁸ is illustrative of decisions in this regard. There, the testator devised property in portions in trust, one son to share should he marry with the consent of his brother and sister; otherwise, the income and principal of that portion of the trust were to go to the brother and sister. It appeared that the dominant purpose was to induce the son to marry within his faith, which would have been valid as a reasonable restraint on marriage. The terms of the will, however, did not limit the condition but required that his marriage be with consent of the very persons who would profit by withholding their consent. The court reasoned that the tendency of this provision might be to induce the beneficiary to live in celibacy or adultery, and adjudged the condition void. Regarding the effect of the invalidity of the condition, the court said:

“... [T]o declare the condition void without at the same time giving effect to the gift made upon the void condition, would be a mockery of the beneficiary and by indirection would permit a testator to accomplish a result which we hold to be contrary to the ‘common weal’.”²⁹

Where illegality appears in a trust instrument, there is always the problem as to how far-reaching its effects will be. In many of the situations discussed here, the whole trust fails. However, if the purposes for which the trust is created are legal, the mere fact that the settlor directs a method of administration which is illegal does not invalidate the trust if the desired result may be obtained through other methods which are not illegal. Frequently only a provision or term of a trust is invalid; whether the entire trust will fail depends upon whether such provision may be separated from the remainder without defeating the purpose of the settlor in creating the trust. In *Clarke v. Clarke*,³⁰ a remainder was void as in violation of the Rule against Perpetuities. The Court held that the trust was valid and the beneficiaries took the estate in fee, and

²⁸ 279 N. Y. 458, 18 N. E. (2d) 658 (1939).

²⁹ 279 N. Y. 458, _____, 18 N. E. (2d) 658, 662 (1939).

³⁰ 121 Tex. 165, 46 S. W. (2d) 658 (1932).