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"POUR-OVER" PROVISIONS IN PENNSYLVANIA

In recent years, the validity of the "pour-over" provision in a will has become the subject of vexatious controversy and conflicting judicial opinion.[1] There are many variations to the problem but fundamentally it arises when a man executes a will in which it is provided that his estate, or a part of it, shall be distributed to an inter vivos trust created by the testator or another, either contemporaneously with, or prior to the execution of the will. The difficulty is encountered when the trust is amendable or revocable or both; and the controversy is highlighted when the testator thereafter amends the trust but leaves the will untouched.

In order to explore the legal justification and background of such testamentary dispositions, it is necessary to examine two separate theories. The first is the doctrine of "incorporation by reference" whereby the reference in a will to a trust has the effect of making the terms of the trust a part and parcel of the will, notwithstanding the fact that the trust instrument does not meet the statutory requirements for the execution of wills.[2]

This is perhaps a convenient method of explanation when the pour-over is to an irrevocable trust in existence at the time the will is executed; however, beyond that, this theory has only served as the source of a large portion of the confusion surrounding this area of the law of wills.[3] For example, there is considerable disagreement among the proponents of this doctrine as to the validity of the pour-over when the trust instrument permits the trust to be revoked or altered. The salient objection here is that a testator should not be permitted to reserve to himself the power to change the testamentary devolution of his property by an instrument or means not in compliance with the wills act.[4] This objection has been met by an equal number of authorities who contend that a mere unexercised power should not be sufficient to prevent the operation of the incorporation by reference, particularly when the effect is to

[1] See Lauritzen, *Pour-Over Wills—Cautions in Light of Recent Statutes and Decisions,* 95 TRUSTS AND ESTATES 992 (1956); Palmer, *Testamentary Dispositions to the Trustee of an Inter-vivos Trust,* 50 MICH. L. REV. 33 (1950); Lauritzen, *Can a Revocable Trust be Incorporated by Reference?,* 45 ILL. L. REV. 583 (1950); Shattuck, *Pour-Over Trust—A Renewed Warning to Draftsmen,* 91 TRUSTS AND ESTATES 207 (1952); 28 PA. BAR ASS'N. Q. 343; PA. FIDUCIARY REVIEW, March 1957.

[2] This doctrine has long been recognized and accepted by Pennsylvania Courts. For a collection of cases on the subject see the PA. FIDUCIARY REVIEW, October 1946 and December, 1952.

[3] Compare Atwood v. Rhode Island Hospital Trust Co., 275 Fed. 513 (1st Cir. 1921), *cert. denied,* with Koeninger v. Toledo Trust Co., 49 Ohio App. 490, 197 N.E. 419 (1934). See also Scott, *Trusts and the Statute of Wills,* 43 HARV. L. REV. 521 (1930); Palmer, *supra* note 1, at 37.

[4] Atwood v. Rhode Island Hospital Trust Co., *supra* note 3; Boal v. Metropolitan Museum of Art. 298 Fed. 894 (2nd Cir. 1924); Matter of Jones, [1942] 1 Ch. 328, [1942] 1 All E.R. 642.

thwart the clear intent of the testator.[5] However, when this power to revoke or amend is in fact exercised, the courts and writers adhering to this doctrine are almost unanimous in declaring that since the reference must be to the trust as it existed at the time of the execution of the will, the bequest must either fail completely or pass according to the original terms of the trust.[6] Regardless of the alternative chosen, the net effect is to defeat the obvious intent of the testator.

The second theory upon which the courts and writers have proceeded in determining the validity of a pour-over provision is the doctrine of "independent legal significance." [7] In order to give meaning to the terms of the will, the courts resort to extrinsic facts which have significance apart from their effect upon the testamentary disposition. The trust is regarded as a separate entity. The identity of the beneficiaries, their respective shares, the trustee, the trust property and the purpose of the trust may all be ascertained by reference to the terms of the independently significant trust mentioned in the will.[8]

The adoption of this doctrine enables a court to look to the trust as it existed at the time of death. Thus, the pour-over provision serves as a flexible and convenient means of property distribution upon death, and not a mere trap for the unaware which may lead to the frustration of the testator's intent. As was pointed out by Professor Scott:

> "If the testamentary trust can be upheld upon the ground that the terms of the testamentary trust are determined by facts of independent significance, and the inter vivos trust as it exists from time to time is such a fact, there would seem to be no objection to permitting the property passing by the will to be added to the inter vivos trust in accordance with the terms of that trust as they are at the death of the testator, even though they were modified after the execution of the will." [9]

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[5] Montgomery v. Blakenship, 217 Ark. 357, 230 S.W. 2d 51 (1950); Swetland v. Swetland, 102 N. J. Eq. 294, 140 Atl. 279 (1928); Bolles v. Toledo Trust Co., 144 Ohio 195, 58 N.E. 2d 381 (1944). Pennsylvania is clearly in accord with this line of cases. Wilson's Estate, 363 Pa. 546, 70 A.2d 354 (1950). It appears that this view represents the weight of authority in the United States. 1 Scott, THE LAW OF TRUSTS, § 543, at 297 (1939).

[6] President and Directors of Manhattan Co. v. Janowitz, 260 App. Div. 174, 21 N.Y.S. 2d 232 (1940) (the entire bequest was invalidated); Koeninger v. Toledo Trust Co., 49 Ohio App. 490, 197 N.E. 419 (1934) (Bequest invalidated). Generally the courts have favored the latter alternative, and have allowed the property to pass in accordance with the terms of the original trust. Old Colony Trust Co. v. Cleveland, 291 Mass. 380; 196 N.E. 920 (1935); Fifth-Third Union Trust Co. v. Wilensky, 79 Ohio App. 73, 70 N.E. 2d 920 (1946).

[7] See Evans, *Nontestamentary Acts and Incorporation by Reference*, 16 U. OF CHI. L. REV. 635 (1949); RESTATEMENT, TRUSTS, § 54 (1935). See also the articles in note 1, *supra*, and the cases collected therein.

[8] Professors Scott and Bogert strongly advocate the adoption of this theory. Scott, LAW OF TRUSTS, § 53 (1939); Bogert, LAW OF TRUSTS AND TRUSTEES, § 106 (1935).

[9] Scott, *op. cit. supra* note 8 at 299.

The inevitable, but not insuperable, objection to this view is raised by the proponents of a strict adherence to the traditional rules governing the creation of testamentary trusts. They contend that:

> ". . . no multiplication words or refinements can alter the results above stated that [the testator] had by this plan sought prospectively to create for himself the power to dispose of property vested in him at the time of his death by instruments not executed in accordance with the Statute of Wills." [10]

Upon closer analysis, it can be at least questioned whether these two views are as inconsistent as they appear at first blush. Certainly courts talk of ascertaining the meaning of a will from within its "four corners"; but it is equally certain that language in the will must be related to extrinsic facts. It will be conceded that a bequest to "my wife," or to "such persons who may be in my employ at death," is a perfectly valid testamentary disposition even though the eyes of the court may stray from the traditionally sacred "four corners." Moreover, in the latter example the mere fact that the testator "hires and fires" after the execution of the will does not in any way alter the validity of the bequest. A bequest to X charity is unquestioned notwithstanding the fact that the ultimate use to which the gift is made stems from the charter of the charity and not from a recital in the will.

However a judicial step away from the historically embedded formalities of a will is one not quickly taken. In many instances, it is a step that the courts will refuse to take at all unless it is with the statutory consent of the legislature.

The foregoing brief analysis of the common law gives little comfort, however, to the lawyer engaged in formulating an estate plan free from "thin ice." At the moment he is not at all interested in winning litigation; but rather, his primary interest is avoiding it, and at the same time satisfying the needs and desires of his client. Nevertheless, it does serve to illuminate the need for legislation on the subject. As was most aptly pointed out by one noted author on trusts and estates, the lawyer who undertakes to make use of a pour-over provision in an estate plan is ". . . plunging into the treacherous currents of this not yet fully charter section of the sea of wills." [11]

The 1957 session of the Pennsylvania Legislature, prompted by both bench and bar, took up the challenge of this confusing dilemma, and has, in

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[10] Atwood v. Rhode Island Trust Co., 275 Fed. 513, 523 (1st Cir. 1921); In re Doane's Estate, 190 Cal. 412, 213 Pac. 53 (1923); Lawless v. Lawless, 187 Va. 511, 47 S.E. 2d 421 (1948). See also the Articles by Lauritzen, *supra* note 1.

[11] Lauritzen, *Pour-Over Wills*, 95 TRUSTS AND ESTATES 992 (1956).

this writer's opinion, successfully navigated and charted this area of doubt. A new section of the Wills Act of 1947 provides as follows: [12]

> SECTION 14.1. Devise or Bequest to Trust. A devise or bequest in a will may be made to the trustee of a trust (including an unfunded life insurance trust although the settlor has reserved any or all rights of ownership in the insurance contracts) established in writing by the testator or any other person before or concurrently with the execution of such will or to such a trust to be established in writing at a future date provided that any such future trust instrument or amendment thereto shall be signed by the settlor. Such device or bequest shall not be invalid because the trust is amendable or revocable or both or because the trust was amended after execution of the will. Unless the will provides otherwise the property so devised or bequeathed shall not be deemed held under a testamentary trust of the testator but shall become and be a part of the principal of the trust to which it is given to be administered and disposed of in accordance with the provisions of the instrument establishing such trust and any amendment thereof. An entire revocation of the trust prior to the testator's death shall invalidate the devise or bequest unless the will directs otherwise.

The legislature, apparently adopting without reservation the theory of "independent legal significance," has settled the law in at least the following respects:

(a) Pour-over provisions are valid even though the pour-over is made to a revocable trust.

(b) If the power of alteration is reserved in the trust, the pour-over is made to the trust as it exists at the time of the testator's death. The settlor (whether it be the testator or a third person) may now control the ultimate distribution of the property passing under the pour-over provisions through alterations subsequent to the execution of the will.

(c) The trust may be created by a third party.

(d) The trust may be an unfunded life insurance trust even though the settlor has reserved any or all the incidents of ownership in the insurance contracts. This answers the questions raised by critics of similar statutes adopted in other states, as to whether a trust consisting only of unassigned insurance contracts has sufficient existence before the death of the insured.

(e) The property passing under the pour-over becomes an addition to the inter vivos trust, and not a separate testamentary trust, unless the testator

[12] Act of April 24, 1947, P.L. 80 § 4 (1), PA. STAT. ANN. tit. 20, § 1.4 (1947). The comments to this new section point out that its passage was prompted by the discussion of the pour-over question in the March, 1957 issue of the *Pa. Fiduciary Review* and by the paper presented by the Hon. William S. Rahauser at the Judicial Conference held at Pittsburgh on January 29, 1957. See also the report by the Hon. Hugh C. Boyle in 28 PA. BAR ASS'N. Q. 335, 343 (1957). It is interesting to note that a Pennsylvania court has never had occasion to directly pass upon the question of the validity of the pour-over provision when an amendment has been made subsequent to the execution of the will.

provides otherwise. Thus the statute gives full recognition to the trust as a separate entity to which the property may be awarded at distribution without the necessity of probating the trust instrument.

(f) A complete revocation of the trust prior to the testator's death will invalidate the pour-over provision unless the will directs otherwise. Note that by the qualification, *unless the will directs otherwise,* the section makes allowance for the expressed intent of the testator, and apparently adopts, in this respect, the theory of incorporation by reference in order to reach such result.

(g) The pour-over may now be made *to a trust to be established in writing at a future date* so long as such future trust instrument or amendment thereto is signed by the settlors. This presumably will require the instrument to be signed "at the end thereof," and in all other respects conform to the requirements of a signature to a will.

It should be noted in reference to the latter provisions that the Pennsylvania Act has gone beyond any reported appellate case or similar statute in other jurisdictions.[13] An even greater departure may be observed when this provision is integrated into the provision which permits the trust to be one created by a third person. The net result of the combination is that the pour-over may then be made to a trust created subsequent to the execution of the will by a person *other* than the testator. To the advocate of strict adherence to testamentary formality, this result may be somewhat shocking. However the extension seems to be justified when one considers the Pennsylvania policy of extreme liberality in the execution of wills—perhaps the most liberal in the United States.[14] Moreover, this result is entirely consistent with the theory underlying the doctrine of "independent significance"; and in fact, carries the theory to its logical conclusion. The will is merely interpreted by resorting to extrinsic facts of independent significance, existing not at the time of the execution of the will, but at the time of the testator's death.

Viewing this new section as a whole, it would seem that the legislature has squarely faced and conquered the difficulties that have confronted the courts of other jurisdictions. Consideration has also apparently been given to the manifest deficiences in similar statutes outside Pennsylvania. Of course, one could indulge in predicting new judicial encounters which could possibly arise under the present provision. For instance, suppose that the living trust

[13] ILLINOIS: ILL. REV. STAT. c 3, § 194a (1955).
INDIANA: IND. ANN. STAT. § 6-601 (Supp. 1953).
N. CAROLINA: GEN. STAT. N. CAR. § 31-47. (Supp. 1955) c. 388.
WISCONSIN: WISC. STAT. § 231. 205 (1955).
None of these statutes have gone so far as the Pennsylvania Act in validating the pour-over into a trust to be established in the future.

[14] Pennsylvania is unique in that the only formality required for the valid execution of a will is the signature at the end thereof.

has no assets prior to the testator's death, or if assets are included, they are insignificant in amount. Certainly in such a case the trust has no independent significance. Perhaps for that reason the court would invalidate the pour-over. But to proceed with such legal pessimism would serve no useful purpose since such examples are few and can be easily avoided by simply following the liberal provisions of the new section.

The legislative intent is unquestionable. It is to validate completely the many variations of the pour-over provision, and thus supply the lawyer with a new and useful means of safety meeting the needs and desires of his client. Further, it is safe to assume that the courts will be able to find ample statutory language to carry out such intent. As a small addition to this concerted effort, the following are suggested as form clauses in providing for the pour-over:

(1) POUR-OVER FROM A WILL TO AN EXISTING TRUST.

ITEM ....: I give, devise and bequeath all the residue of my estate, of whatever nature and wherever situated to the .... Trust Company, trustee of the trust created by me (or by ....) on the ...... day of ...., 1958, for the following uses and purposes:

(a) To add such residue of my estate to the property constituting said trust so as to make such residue a part thereof.

(b) To have, hold, manage and dispose of the same in accordance with the terms of said trust agreement, and any amendments or alterations thereto.

Unless the trust agreement so provides, there may be a serious question as to whether the trustee has the power to receive additional property into the trust. This is particularly true when the addition is attempted to be made by a person other than the settlor. An extended discussion of the ramifications of this problem is, however, beyond the scope of this note. For present purposes, it will suffice to point out that a provision giving the trustee power to receive additional property is most desirable. The trust agreement might contain the following such provision:

The settlor (and/or ....) shall have and possess the right and power to direct by his (their) will(s) the payment and delivery of his (their) net estate, or any part thereof, to this trust to be held in accordance with the terms and conditions herein specified; provided, the trustee shall not be required to receive additional property without his (its) consent, if such receipt would involve additional duties, unless satisfactory arrangement is made for the compensation of the trustee for administering such additional property.

(2) POUR-OVER FROM A WILL TO A TRUST TO BE ESTIMATED IN THE FUTURE.

In providing for a pour-over from the will to a trust to be established subsequent to the execution of the will, caution should be observed so as to comply exactly with the requirements of the statute. However, this may be readily accomplished by executing the future trust instrument with the same simple formalities as are required for Pennsylvania wills *i.e.* a proper signature at the end thereof. The provision in the will could be as follows:

> ITEM ....: I give devise and bequeath all the residue of my estate, of whatever nature and wherever situated to the trustee of a trust that I (............................) may hereafter create by written instrument signed by me (the settlor) at the end thereof, for the foling uses and purposes:
>
> (a) To add such residue of my estate to the property constituting said trust so as to make said residue a part thereof.
>
> (b) To have, hold, manage and dispose of the same in accordance with the terms of said trust agreement and any written amendments or alterations thereto.
>
> ITEM ....: In the event that no such trust is created by me (............................) during my lifetime, or should the bequest or devise to such trust be invalid for any reason whatsoever, I give, devise and bequeath all the residue of my estate, of whatever nature and wherever situated, as follows: ....

(3) POUR-OVER FROM AN INTER VIVOS TRUST TO A TESTAMENTARY TRUST CREATED BY THE WILL.

In many estate plans it may be desirable and convenient to utilize the pour-over provision in reverse, *i.e.* from an inter vivos or insurance trust into a testamentary trust. Generally, the principles heretofore discussed are equally applicable to this situation, and need not be repeated. In addition to the terms of the inter vivos trust directing the distribution of the property to the trust created by the testator, and the usual provisions for the establishment of a testamentary trust, there should be a provision in the will authorizing the receipt of such a pour-over:

> ITEM .... In the settlement of my estate and during the continuance of the foregoing trust, my executor and the trustee of such trust, shall possess among others, the following powers:
>
> 1. ....
> 2. To receive additional property from any inter vivos or insurance trust created by me (..............................) during my life-

> time, and to administer such property as a part of my trust estate in accordance with the terms hereinbefore specified. The trustee shall not be required to receive such additional property without his consent if such receipt would involve additional duties, unless satisfactory arrangement is made for the compensation of the trustee for administering such additional property.

Undoubtedly one of the most desirable features of the new provision is that it specifically provides for the pour-over into, or from, a funded or unfunded life insurance trust. For that reason, this survey of the law on the pour-over provision in Pennsylvania would be incomplete without brief reference to the statutory counterpart of section 14.1 *i.e.* the new section 8 of the Estates Act of 1947 which provides as follows: [15]

> Section 8. Designation of Insurance Beneficiaries Not Testamentary. The designation of beneficiaries of life insurance shall not be considered testamentary regardless of whether the insurance contract designates the ultimate beneficiaries or makes the proceeds payable directly or indirectly to a trustee of a trust under a will or under a separate trust instrument which designates the ultimate beneficiaries and regardless of whether any such trust is amendable or revocable or both or is funded or unfunded and notwithstanding a reservation to the settlor of all rights of ownership in the insurance contracts. Unless otherwise expressly provided in the conveyance funds or other property so passing to a trust under a will shall become and be a part of the testamentary trust to be administered and disposed of in accordance with the provisions thereof without forming any part of the testator's estate for administration by his personal representative.

The primary purpose of the new section is to remove the problems and legal uncertainties created by the decision in *Brown's Estate* [16] which had held that an unfunded life insurance trust was a testamentary disposition and as such, subject to a surviving spouse's right of election. It is now clear that a life insurance trust, whether it be funded or unfunded, shall *not* be considered testamentary, notwithstanding the fact that the incidents of ownership are retained by the insured. The result of this section is to open the door to greater use of the insurance trust, and to the flexible and convenient combination of such a trust with a pour-over provision. It makes certain that the insurance funds are freed from administration expenses and from the claims of the testator's creditors even though such proceeds may be payable to a testamentary trustee. It is, however, still an open question whether the insurance funds become subject to Pennsylvania inheritance taxes. This uncertainty

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[15] PA. STAT. ANN., tit. 20 § 301.7a.

[16] 384 Pa. 99, 119 A.2d 513 (1956). Noted, *Pa. Fiduciary Review*, March, 1955, February, 1956; 1 VILLA. L. REV. 367 (1957).

stems from the Supreme Court decision in *Meyer's Estate*.[17] There the court ruled that where a deed of trust of life insurance policies names no beneficiaries of the trust but provides that the principal shall be distributed in accordance with the terms of the settlor's will, and reserves to the settlor the right to revoke or alter the trust, the proceeds of such policies are subject to transfer inheritance tax. The decision rested on the fact that the deed created no interest, vested or contingent, in any named beneficiaries. Distribution of the principal was wholly dependent upon the terms of the will which could not take effect until death.

This decision was reaffirmed and carried one step further in the subsequent case of *Kenin's Estate* [18] where the deed of trust provided that the trustee of the insurance trust should collect the proceeds and distribute them to a testamentary trustee named in the will, to be held by him in accordance with the terms and conditions of the testamentary trust set forth in the will. The settlor reserved the power to amend and revoke the insurance trust. On these facts, the trust was held to be testamentary under the principles announced in *Meyer's Estate* to the effect that only where the trust instrument is complete in itself, by naming the beneficiaries of the policy, is the fund realized from such policy free of tax. So long as post-mortem control over the proceeds of the life insurance policy is exercised, such proceeds must be treated, for inheritance tax purposes, as though they were made payable to the settlor's estate.[19]

What effect, if any, the new statutory provision may have on these decisions is quite uncertain. It is clear that the intent of the legislature is to remove the taint of testamentary characterization from the act of designating insurance beneficiaries regardless of the identity of such beneficiaries. It would seem, therefore, that the conflict should be resolved in favor of the taxpayer but to rely on such an assumption is dangerous, particularly where a 15% tax is involved.[20] For that reason, perhaps this should well be a matter of consideration in the contemplated revision of the Pennsylvania inheritance tax laws .[21]

Notwithstanding this area of doubt, the new section provides the estate planner with the long recognized advantages of the insurance trust—flexibility, privacy, and ease of preserving the principal for the benefit of future gen-

[17] 309 Pa. 581, 164 Atl. 611 (1932). See also Schulman, *The Personal Insurance Trust in Pennsylvania,* 12 TEMP. L. Q. 216 (1937).
[18] 343 Pa. 549, 23 A.2d 837 (1942).
[19] *Id.* at 557, 23 A.2d at 843.
[20] See Cooper, *Testamentary Trust for Insurance,* 97 TRUSTS AND ESTATES, 113 (1958.)
[21] The Joint State Government Committee on Decedent's Estates Law has already commenced work on the revision of the Pa. Inheritance tax laws.

erations. When coupled with a pour-over provision, these advantages are retained, and added to them are the factors of even greater flexibility in the overall estate plan and reduced administration expenses and costs of probate. All this can now be achieved without the danger that the insurance trust may be considered testamentary, and subject to the resultant undesirable consequences inherent in a testamentary disposition.

Taken together the two new sections supply the foundation for countless variations of the pour-over provision, tailored to the equally varied requirements of a sound estate plan. Where the testator dies domiciled in Pennsylvania, such sections have made certain that which is most uncertain in other jurisdictions. Unfortunately the security and protection stops at the state's boundaries.[22] Beyond them, the confusing state of affairs, pointed out earlier in this note, continues in full force.

CARL F. BARGER.

[22] Thus precaution must be taken on behalf of the testator who might acquire real estate in a foreign jurisdiction, and thus be subjected to the foreign law insofar as it concerns the devolution of such real estate. RESTATEMENT, CONFLICT OF LAWS, § 245, 249 (1934). This may not be true if there is a statute in such foreign jurisdiction embodying the provisions of the uniform Wills Act. UNIFORM LAWS ANN., Vol. 9, page 343 (1957). The same danger is present when a person relies upon the liberal provisions of the Pennsylvania Act, and then prior to his death changes his legal residence, or where the very question of the state of his legal residence is in doubt. Consequently, it is most advisable to review, republish and in some cases redraft the will, when for example, amendments are made to the trust, or when the pour-over is to be made to a future trust, and such trust is created.