Private Law: Trusts and Estate Planning

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In *T. L. James & Co. v. Montgomery*, the Louisiana Supreme Court will determine the rights of community spouses and forced heirs in retirement plan death benefits. Montgomery was married twice, one son being born of each marriage. His first marriage ended in divorce; a legal separation from his second wife was pending at his death. Montgomery commenced work for T. L. James during the first marriage and remained so employed until his death. During that time he earned vested interests in the company pension plan and profit sharing plan, accruing death benefits worth some $64,800. A week before his second wife filed for separation, he secretly entrusted $11,000 in community cash to his older son and named him as sole beneficiary of both retirement plans plus $22,500 of company group life insurance. His widow, alleging that these acts were in fraud of her rights as surviving spouse in community, claimed a half-interest in the retirement plan death benefits. The younger son claimed one-fourth of the plan death benefits and one-fourth of the group insurance proceeds as forced heir.

The older son relied upon courts of appeal decisions analogizing plan death benefits to life insurance, arguing that since forced heirs and community spouses have no rights to life insurance proceeds they have no comparable rights in these closely analogous death benefits. The spouse relied on a series of intermediate appellate cases involving divorce, all of which recognize, to some extent, the right of a non-employee spouse in potential retirement benefits that accrued during the existence of the community. The younger son argued...

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1. 308 So. 2d 481 (La. App. 1st Cir.), cert. granted, 310 So. 2d 850 (La. 1975).
2. Both plans were "qualified" pursuant to INT. REV. CODE of 1954, § 401 (f).
3. The profit sharing plan was noncontributory. The pension plan was a defined contribution plan (defined benefit). Both plans were fully vested.
4. Succession of Mendoza, 288 So. 2d 673 (La. App. 4th Cir. 1973); Succession of Rockvoan, 141 So. 2d 438 (La. App. 4th Cir. 1962).
that recent fourth circuit decisions requiring the payee of U.S. Government "or" bonds to account to the spouse and to forced heirs entitled him to his legitime both in the death benefits and insurance proceeds. The First Circuit Court of Appeal held the group insurance proceeds payable to the named beneficiary (older brother) free of the forced heir's claim and, applying the same reasoning by analogy, rejected the claims of both the spouse and the younger son to death plan benefits.

Suppose an employer agrees to pay death, disability and retirement benefits to his employees but the company cannot afford the actuarial risk out of operating income. The company could purchase insurance to cover all or part of the risk. Premium cost could be defrayed through payroll deductions or as a form of additional but deferred compensation. Or, to reduce its cost, the company might bypass insurance in favor of direct investment in the stock market, in effect becoming "self-insured." The employee would receive the same benefits whether the company plan is "funded" with life insurance or with other investments; he is "insured" by his employer's promise. To this point, the treatment of plan benefits as though they were insurance proceeds appears quite logical.

A life insurance beneficiary need not be named in a will. It suffices that the form complies with the insurer's requirements. Applied by analogy to retirement plan benefits, compliance with the formalities required by the plan itself should suffice—a practical solution. Many large payrolls necessarily cross state lines, making it inconvenient if not impossible to design a form which would comply with the testamentary requirements of every applicable state. Moreover, the practice in Louisiana as elsewhere is to pay plan benefits according to the employer's designation form as though plan benefits were insurance. So long as most employees die intestate, and most who die testate make no mention of retirement benefits in their wills, requiring testamentary form for beneficiary designation seems impractical.

6. Succession of Guerre, 197 So. 2d 738 (La. App. 4th Cir. 1967); Succession of Videau, 197 So. 2d 655 (La. App. 4th Cir. 1967).
8. The term "self-insured" is admittedly illogical but conveys the sense that one omits insurance in circumstances when others similarly situated would likely purchase it.
Assume that the decedent, an insured employee, is the husband. Unless the wife or the husband's estate is named beneficiary, the wife has no community right to the proceeds of his life insurance. As head and master, he is free to pay the premiums with community funds and to name a third person as beneficiary. Although she would be entitled to an accounting for her separate funds used to pay premiums, or for community funds used to maintain his separate policy, dictum in Succession of Brownlee\textsuperscript{12} suggests that she is not entitled to an accounting for community funds used to pay premiums on community policies even if the proceeds are payable to another. Nevertheless, she is deemed to have made a taxable gift of half the proceeds to the extent she receives less than half the proceeds of all community policies.\textsuperscript{13}

The decisions and Louisiana R.S. 22:647\textsuperscript{14} likewise exempt insurance proceeds from the claims of forced heirs. When his potential legitime is diverted to premiums on policies insuring the decedent's life, and the proceeds are payable to third persons, a forced heir seems to be without a remedy.\textsuperscript{15}

\begin{itemize}
\item \textsuperscript{10} LA. Civ. Code art. 2404 provides the wife with an action against the heirs of her husband, in support of her claim in one-half of the property, on her satisfactorily proving fraud, but the writer knows of no instance in which this provision has been urged against the husband for mere designation of a third party as beneficiary of a community-owned life insurance policy.
\item \textsuperscript{12} 44 La. Ann. 917, 11 So. 590 (1892).
\item \textsuperscript{13} Kaufman v. United States, 462 F.2d 439 (5th Cir. 1972). To the same effect see Rev. Rul. 75-240, 1975-2 Cum. Bull. Where a qualified retirement plan is community property and the employee-husband dies having named a third person as beneficiary, the widow is deemed to have made a gift of one-half the benefits, even though she knew nothing of the plan, had not joined in the designation of the beneficiary and was powerless under state law to alter the situation.
\item \textsuperscript{14} “The lawful beneficiary . . . of a life insurance policy . . . shall be entitled to the proceeds . . . against the heirs and legatees . . . [of the insured].” LA. R.S. 22:647 (1950), as amended by La. Acts 1958, No. 125. See also Sizeler v. Sizeler, 170 La. 128, 127 So. 388 (1930).
\item \textsuperscript{15} The result seems odd in contrast to the rigid defense of forced heirs by the Louisiana courts. One can only speculate as to what first motivated the Louisiana Supreme Court to treat life insurance proceeds as sui generis. Perhaps the first cases involved only term insurance, or the cash value element was not adequately identified or understood. Perhaps the court thought it would encourage the purchase of life insurance by permitting its free disposition, or at least foster the quick and certain payment of the proceeds. Or perhaps this new and peculiar asset—worth so little during life
\end{itemize}
Life insurance and retirement plan death benefits represent the principal value most Louisiana decedents transmit at death. So far the decisions have made no real distinction between them, treating both as insurance. In deciding *Montgomery*, the Louisiana Supreme Court may re-examine its traditional *sui generis* approach to life insurance itself.

The term insurance premium buys nothing but "real insurance," protection from untimely death. By contrast, cash value insurance (whole life insurance) includes an excess premium in the early years of the policy. This excess premium later becomes the cash value or "savings element," and, together with a modest interest build-up over the life of the policy, may represent a significant portion of the proceeds at death. As the cash value portion increases, the real insurance portion decreases correspondingly. The proceeds of cash value insurance are really two funds—"real insurance" plus cash value. The cash value is really a savings account created out of part of each premium dollar. Thus, to the extent of cash value, or more precisely, "interpolated terminal reserve plus unearned premium," the proceeds are not insurance but accumulated savings left with the insurer at interest. It is arguable that this savings account, like any other, should be subject to the claims of community spouses and forced heirs, while the remaining proceeds representing "real insurance" should remain exempt.16 Direct claims against the insurer by

and so much after death—so defied traditional property classifications that the court felt compelled to create a new category. Recent decisions dealing with ownership of policy rights during the life of the insured may provide a clue. In *Catalano v. United States*, 429 F.2d 1058 (5th Cir. 1969), the court held that the naming of the wife as owner of a life insurance policy under the forms provided by the insurance company was sufficient to transfer all "incidents of ownership" to her. In support it cited a series of Louisiana cases holding that the naming of an *irrevocable* beneficiary was equivalent to the transfer of ownership to him. *Succession of Desforges*, 135 La. 49, 64 So. 978 (1914); *Lambert v. Penn. Mut. Life Ins. Co.*, 50 La. Ann. 1027, 24 So. 1627 (1898); *Putnam v. New York Life Ins. Co.*, 42 La. Ann. 739, 7 So. 602 (1890); *Pilcher v. New York Life Ins. Co.*, 33 La. Ann. 322 (1881). It has been suggested that in each of these cases the beneficiary had been *irrevocably* designated and policy ownership thereby passed to the beneficiary. Nothing was left to pass to the beneficiary from the insured at the latter's death to which the rights of forced heirs could attach. (Policies giving the wife the power to revoke the designation of a beneficiary did not come into common use until the twentieth century.)

16. The decisions so far have made no distinction between the proceeds of term insurance and those of cash value insurance, although it was argued unsuccessfully in *Succession of Videau*, 197 So. 2d 655 (La. App. 4th Cir. 1967),
spouses and forced heirs might unduly interfere with the speed and certainty of settlement, but the widow Montgomery pointed to U.S. Savings Bond cases as an alternative, arguing that payment of the proceeds to the named beneficiary of the retirement plan, subject to an accounting to the spouse and forced heirs, should be ordered. The court rejected this approach.

An employee’s retirement account usually represents compensation diverted to a trust fund and held for payment on death, retirement or disability. Such account is quite analogous to the cash value of an ordinary life policy, and the two should probably be treated alike. The only remaining question is: what treatment? In Montgomery, the traditional restraints of community property and forced heirship inevitably will collide with contemporary pressures for freedom of disposition. There is respectable authority on both sides.

In Jochum v. Estate of Favre, aggregate payroll deductions of some $6,400 refunded under the State of Louisiana retirement plan were omitted from the descriptive list of the decedent’s estate. The parties stipulated that the fund represented “annuity proceeds.” The executrix argued that since Louisiana R.S. 47:2404(C) excludes both life insurance and “retirement or pension plans including annuities” from inheritance tax, the annuity should be treated like insurance for all purposes—including exemption from the claims of forced heirs. The Fourth Circuit Court of Appeal held that the refund should have been included on the descriptive list. The result suggests that upon retirement, death benefits, treated as life insurance, are transformed into pension benefits, now to be treated as annuities.18

DONATIONS BY THE TRUSTEE

In 1969, Mrs. Nannie Mae Simpson created an irrevocable trust naming herself as sole beneficiary and one of her sons that with respect to the phrase “proceeds and avails” found in La. R.S. 22:647 (1950), as amended by La. Acts 1958, No. 125, the term “proceeds” refers to the risk portion of the proceeds while “avails” refers to the cash value portion.

17. 313 So. 2d 870 (La. App. 4th Cir. 1975).

18. The stipulation that the fund represented “annuity proceeds” was unfortunate, and probably erroneous; although similar in some respects, the courts and commentators have traditionally drawn sharp distinctions between life insurance proceeds and annuity proceeds. Succession of Rabouin, 201 La. 227, 9 So. 2d 529 (1942); see 1 J. Appleman, Insurance Law & Practice § 83 at 114 (2d ed. 1965).
as trustee. She gave the trustee power to make inter vivos donations of trust property "to such persons as Trustee deems advisable, provided that the written consent of settlor . . . shall be required to each such donation." Subsequently, the trustee, joined by the settlor, made various donations of land and cattle to eight of her twelve children.

Three disappointed children attacked the validity of these donations, claiming that the trustee could not be given the power to donate trust property. The Second Circuit Court of Appeal, in Succession of Simpson, concluded that section 2061 of the Louisiana Trust Code is broad enough to permit the trustee to donate trust property and that the trust instrument had adequately created that power. However, the court noted that with each donation the trustee acted contrary to the interests of the sole beneficiary and would thus breach his duty of loyalty to his mother unless validly released after disclosing to her all the material facts. The trustee benefited personally from some, but not all of the donations. He bore the burden of proving adequate disclosure.

The evidence revealed no disclosure other than a reading aloud of each act of donation to the settlor immediately prior to affixing her mark. The court found this to be inadequate. As a result, he breached the duty of loyalty, he lacked the power to make the donations, and the donations were null.

The court seemed impressed by what it considered the "manifest unfairness" of the various donations. In one instance Mrs. Simpson had given away her home, then donated additional trust property in order to recover its use for the remainder of her life. In addition, the trustee, with her approval, had sold an option covering nearly all of the remaining trust property at an option price that the court found to be wholly inadequate and unfair. As to her motives, a letter in the record reflected that she had excluded some of her children from the donations "to punish them" for failure to allow her trustee-son to manage their interests in the family property.

The court's approach finds only implied support in the Trust Code but accords with the Restatement Second of

19. 311 So. 2d 67 (La. App. 2d Cir.), cert. denied, 313 So. 2d 839 (La. 1975).
The court invoked sections 2062, 2082, and 2083 of the Louisiana Trust Code as well as sections 2085 and 2091 by analogy. In essence, these sections would invalidate a trust provision purporting to limit a trustee's duty to administer the trust solely in the interests of the beneficiary, prohibit him from buying trust property or selling to the trust, obligate him to preserve and maintain trust property and, whenever dealing on his own account, to "communicate all material facts in connection with the transaction that the trustee knows or should know." The Trust Code does not seem to go as far as the Restatement in requiring that all transactions necessitating the beneficiary's consent be "fair and reasonable" as well. However, the court in Simpson suggests by implication that had the beneficiary been fully advised of the unfairness and unreasonableness of these transactions, she would not have consented.

Simpson does not mandate that a mechanism for the donation of trust property is always improper or unworkable. A settlor might wish to create an irrevocable trust to manage his property, realizing that trust property and income might exceed his needs and should be donated to reduce his ultimate taxable estate. An analogous provision is found in Louisiana R.S. 9:1022 for donations on behalf of interdicts by their curators under certain circumstances when the interdict has a prior pattern of making such donations. It is only in the trustee's overreaching that Simpson would cause concern.

DELEGATION OF TRUSTEE'S POWERS

In Holladay v. Fidelity National Bank, settlor sued to

22. RESTATEMENT (SECOND) OF TRUSTS § 170 comment (w), § 216 comments (m), (n) (1957).
23. "A provision of the trust instrument that purports to limit a trustee's duty of loyalty to the beneficiary is ineffective, except to the extent permitted by this Part." LA. R.S. 9:2062 (Supp. 1964).
25. "A trustee in dealing with a beneficiary of the trustee's own account shall deal fairly with him and communicate to him all material facts in connection with the transaction that the trustee knows or should know." LA. R.S. 9:2083 (Supp. 1964).
26. LA. R.S. 9:2085 (Supp. 1964) prohibits a sale of trust property to the trustee unless the trust instrument specifically permits it.
27. "A trustee is under a duty to a beneficiary to take reasonable steps to take, keep control of, and preserve the trust property." LA. R.S. 9:2091 (Supp. 1964).
29. 312 So. 2d 683 (La. App. 1st Cir. 1975).
remove the trustees of two trusts which named her as income beneficiary and her two nephews as principal beneficiaries. The defendant bank was trustee of one trust. The other trust, apparently composed of Texas lands, named Fidelity's president and one of its trust officers as individual co-trustees. They retained Fidelity as agent for the Texas trust because the bank was not authorized to act as trustee under Texas law. The court said it was "unable to approve" the practice notwithstanding the fact that Texas had not complained. Otherwise, the court entirely rejected the settlor's manifold complaints.

Settlor had complained of self-dealing in that she had purchased a home individually from one of the individual co-trustees and subsequently transferred it to the trust. She also complained that the trustee had delayed in recording the trust instrument in those parishes where immovable trust property was situated as required by Louisiana Trust Code section 2092.30 Lastly, she complained that the trustee's investment policy of retaining low-yield municipal bonds in the Louisiana trust for several years after a decline in income from the Texas trust was a breach of the "prudent man" principle.31

In response, the court found no self-dealing; on the contrary, the trustees had previously refused her request to purchase the home out of existing trust assets. With respect to the delay in recordation, the court seemed satisfied that the failure to record was consonant with the settlor's desires to withhold, temporarily, details of the trust from the principal beneficiaries. Finally, as to the municipal bonds, the court found:

With regard to the substitution of high yield securities when the income from the Texas trust declined, we find . . . that the test is not that the trustee must always have his judgment vindicated by the market, but that he exercise such skill and care as a man of ordinary prudence would exercise in dealing with his own property.

The evidence convinces us that the investment practices of the trustee, the constant review of the trust

30. "If at any time the trust property . . . includes immovables . . . a trustee shall file the trust instrument for record in each parish in which the [trust] property is located." LA. R.S. 9:2092 (Supp. 1964).
portfolio by the directors, are sound and comply with the above statutory provision.\(^32\)

The court's comment expressing disapproval as to the arrangement for indirect management of the Texas trust by a Louisiana bank seems unwarranted. The settlor obviously desired bank management of the Texas trust and the agency agreement provided it. So long as each state remains jealous of its own trust business, such arrangements will likely continue.\(^33\) One might ask how many "Louisiana trusts" are managed indirectly by Texas banks under similar arrangements. So long as the settlor approves such delegation, there should be no cause for complaint.

Some practitioners complain that requiring that the trust instrument be recorded is counterproductive. They argue that the conveyance of immovable property to a trust may raise title problems (as a presumed donation) and that the very confidentiality some settlors desire is violated by recordation.

Faced with discontented beneficiaries or settlors, trustees are often tempted to resign. Yet those who seek third party management need assurance that corporate trustees will not willingly step aside merely because someone is dissatisfied, even in the face of litigation. Continuing trust administration in the face of litigious adversity is part of the service.

Most trustees generally remain, even if unwelcome, although section 1788 of the Trust Code\(^34\) permits them to resign at any time. If the settlor wants someone empowered to substitute trustees, the trust instrument should expressly so provide. The evidence necessary to prove grounds for removal of a corporate trustee seldom exists.\(^35\)

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33. "A trustee must be a natural person enjoying full capacity to contract who is a citizen of the United States, or a Louisiana bank or trust company, or a bank or trust company . . . domiciled in this state" (emphasis added). LA. R.S. 9:1783 (Supp. 1964).
