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Owen B. Marron

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# THE USE OF REVOCABLE INTER VIVOS TRUSTS IN ESTATE PLANNING

OWEN B. MARRON\*

There has long been an interest in this country in finding an acceptable replacement for probate to settle estates. Both laymen and lawyers have expressed great displeasure with the time and expense involved in current probate procedures. Interest is growing at present in the revocable inter vivos trust as such a replacement.

Many laymen have become familiar with the inter vivos or "living" trust—at least to a degree—through such writings as Dacey's book, *How To Avoid Probate*,<sup>1</sup> and the recent *Reader's Digest* article, "You Can Avoid the Probate Trap."<sup>2</sup> Both of these authors have pointed out the great advantages possible with a revocable inter vivos trust without burdensome discussions of the finer points involved. They leave the reader with a rosy picture of the possibilities, but largely unaware of the pitfalls that await the unwary or unprofessional draftsman. Taylor's article does have the redeeming quality of recommending that an attorney draft the trust agreement, while Dacey prefers to avoid this expense by furnishing forms for selection and use by his readers.

The purpose of this article is to discuss the use of the revocable inter vivos trust to avoid probate proceedings with certain estates. It will be seen that this estate planning device offers two main advantages over a will:

1. Much of the delay of probate can be avoided;<sup>3</sup>

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\*Member of the New Mexico Bar; Partner in the law firm of Marron, Houk, and McKinnon, Albuquerque, New Mexico. The author wishes to express his appreciation to Mr. Robert Hilton for the latter's assistance in the preparation of this article.

1. N. Dacey, *How To Avoid Probate* (1966).

2. F. Taylor, *You Can Avoid the Probate Trap*, *Reader's Digest*, Jun. 1970, at 93-96.

3. Absent a will, the probate court appoints an administrator for the estate [N.M. Stat. Ann., § 31-1-9 (1953)] who publishes notice of his appointment once a week for 3 consecutive weeks (§ 31-1-23). Persons having claims against the estate must file them with the administrator within 6 months from the date of the first publication of notice of appointment (§ 31-8-3). Ordinarily the administrator is appointed within 20 days from the death of the decedent, thus 6 months and 20 days is required to determine the identity of all claims against the estate. During the 6 months interval, succession and estate taxes have ordinarily been paid, claims in favor of the estate against debtors of the decedent have been enforced, and property requiring liquidation converted into cash. The administrator then files a final account, and a hearing thereon may be conducted by the probate court after notice of such hearing has been published for 4 consecutive weeks, and 20 days has expired following the last publication (§ 31-12-7 and § 10-2-10). The total time required from the death of the decedent for the speediest possible conclusion of the probate proceedings is thus 8 months. If the decedent leaves a will, an additional 24 days is required for the publication of Notice of Hearing on Petition for Probate of Will (§ 30-2-4). The executor or administrator, and the attorney representing either, is entitled to compensation equal to 10% of the first \$3,000, and 5% of all amounts in excess thereof upon the appraised value of the personal property, excluding proceeds of insurance policies, cash and government bonds; plus such amount for administration of real estate as may be allowed by the court (§ 31-10-1). The

2. Some of the expense of probate can be avoided.<sup>4</sup> Further advantages of the inter vivos trust will be seen below as we discuss the structure of the trust agreement.

By properly planning and drafting the trust agreement the attorney can assure his client of satisfactory management of his property during his lifetime and distribution according to his wishes after death.

The power to revoke the trust is essential to avoid a present gift and liability for gift taxes. The settlor must also retain unlimited powers of alteration and amendment of the trust agreement to accommodate a change in plans for post mortis disposition of his estate. These powers should also include use of the principal during the settlor's lifetime.

The retention by the settlor of the right to receive the trust income<sup>5</sup> and the right to revoke at will<sup>6</sup> does not invalidate the trust and defeat its purpose after the settlor's death; nor is the agreement invalidated by the concurrence of both.<sup>7</sup>

There is no doubt that the settlor can become the beneficiary of his own trust agreement, but the doctrine of merger prevents the formation of a valid trust if the settlor is the sole trustee and beneficiary.<sup>8</sup>

Advantages are obtainable by naming a trustee other than the settlor. With such a trustee acting at the settlor's direction he can be assured of proper management of his property during his lifetime. If the settlor should become incapable, though not legally incompetent, of handling his own affairs—such as during an extended illness—the estate will continue to be protected and managed by the trustee. A provision should be included in the trust agreement to direct the actions of the trustee in the event the settlor is adjudged incompetent.

If clear and unambiguous provisions are made for the distribution or management of the estate after the settlor's death there will be an uninterrupted management of the estate according to the settlor's

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costs, including filing fee, publication of notices, and appraiser fees for the average estate amount to about \$85 to \$90.

4. The cost of probate proceedings should not be the prime consideration in electing the use of the inter vivos trust over a will. The fees for drafting the instrument, trustee's fees, fees for filing separate state and federal tax returns for the trust during the settlor's life and after death, and final accounting costs may well offset any financial advantages dreamed of.

5. *Dessar v. Bank of America*, 353 F.2d 468 (9th Cir. 1965).

6. *Id.*

7. *National Shawmut Bank v. Joy*, 315 Mass. 457, 53 N.E.2d 113 (1944); *Investors Stock Fund, Inc. v. Roberts*, 179 F. Supp. 185 (1959).

8. I. Scott, *Trusts* § 99 at 210 (1968).

instructions. This continuity of management is an important consideration in many, if not all, estates.

By the appointment of a trustee, the settlor will be freed from many of the troublesome and time-consuming problems of property management. A competent trustee, such as a bank, can manage the property efficiently and capably. Retired persons will probably find the third party trustee arrangement particularly convenient, especially around income tax time. The trust agreement should be so drafted that the settlor retains broad powers of control of the property, but so that discretion is allowed the trustee in ordinary dealings. With such an agreement the trustee comes to know the preferences and wishes of the settlor, and can furnish management according to his wishes after the settlor's death. The trustee will also handle all tax returns and final accountings upon the death of the settlor, a task made easier by his prior dealings with the estate property.

In New Mexico, the community property laws practically require that both husband and wife join in the trust agreement. There are several reasons for this, misunderstanding of which can result in difficulties. First, it may be that the husband, even though he is granted management and control of the community personalty, has no power to dispose of the personalty by gift. New Mexico courts have not passed on the issue, but other state courts have so held. *See Annot.*, 49 A.L.R.2d 521, 576-78 (1954). Thus, if the husband attempted to transfer all the community property into an inter vivos trust without consent of the wife, the transfer and the trust could be held invalid. Second, since the husband does not have power to dispose by will of more than one-half of the community property, an attempted post-mortis disposition by him of more than one-half of such property through an inter vivos trust would probably be held invalid. Finally, because the wife has a one-half interest in every individual item of community property, any attempted separation of the community property for purposes of the inter vivos trust is virtually prevented.<sup>9</sup>

If the husband and/or wife wish to provide for beneficiaries in addition to or in lieu of each other, the trust agreement is a convenient vehicle for doing so.<sup>10</sup> Moreover, the trust agreement should provide that only the husband may revoke the trust.

9. The relevant New Mexico statutes are N.M. Stat. Ann. §§ 57-2-6, 57-4-3, and 29-1-9 (1953).

10. *Id.*, § 57-2-6 provides that husband and wife may contract with each other as if unmarried. *See Brown v. Brown*, 53 N.M. 379, 208 P.2d 1081 (1949). The trust agreement thus becomes a contract binding on the surviving spouse with regard to the disposition of the trust property for the benefit of such contingent beneficiaries as the husband and wife agree upon.

The revocable inter vivos trust is most advantageous for the estate invested in inactive securities. If the client is actively engaged in business making frequent credit arrangements involving his property, it may be advantageous to probate his estate on his death in order to determine the identity of all claims against the estate within the 6-month period provided by law.<sup>11</sup>

It has been pointed out here that the revocable inter vivos trust can be effectively used as an estate planning device with many estates. The estate will be handled without the delays of the probate proceedings, but the six month limit for filing claims after the settlor's death is lost. Some of the expense of probate proceedings may be avoided, but this will vary with the complexity of the estate. It must be recognized that it is advisable to select a reliable third party as trustee of the estate, both for continuity of management and for protection against challenges to the validity and legality of the trust agreement. There will probably be no tax advantages involved, but the other advantages to the settlor make the revocable inter vivos trust a valuable estate planning tool.

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11. "If administration of an estate has not been applied for within 20 days from the death of the decedent by an executor or next of kin, a creditor may be granted administration" N.M. Stat. Ann. § 31-1-9 (1953). "If no administration is obtained within 6 years from the date of death, all claims against the estate are barred" (§ 31-8-4). "If the estate is administered, all claims not filed within 6 months from the date of the first publication of notice of the appointment of the executor or administrator are barred" (§ 31-8-3).

If the entire estate is conveyed to the trustee, a creditor would probably have 6 years within which to apply for administration, seek title to the property as against the trustee and beneficiaries of the trust, and determine the question as to whether the rights of creditors could be cut off by the trust thus depriving them of the resort to the estate provided by the probate court.