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The Unitrust in Estate Planning: A Partial Panacca*†

I. Introduction

The traditional conveyance, "To T in trust, to pay the income to B for life, remainder to R," was adequate, from the trustee's viewpoint, for administration of a realty trust, where little confusion arose concerning what was corpus and what was income. The trustee normally maintained the original corpus (the real estate), collected the income, paid expenses of administration, distributed net income to the life tenant, and eventually conveyed the reality to the remainderman. So long as buildings were kept in good repair, there could be little complaint that the remainderman's interest was improperly handled, and if the estate was managed with reasonable care, the life tenant had little cause for objection.

When settlors began creating trusts consisting of corporate securities, however, the task of the trustee became more difficult. Since shares of stock are, generally speaking, freely alienable, the conscientious trustee would often find it necessary to buy and sell on the market in order best to increase the value of the corpus while maintaining a reasonable income for the life tenant. If the corporation whose stock were held in the trust reinvested earnings rather than paying them out in dividends, the life tenant would be prejudiced, since the reinvested earnings were potential trust income on the investment of trust corpus. On the other hand, the less the corporation reinvested its earnings, the less its stock would appreciate in value, and the remainderman would be relatively prejudiced. This conflict between remainderman and life tenant has been compounded by the introduction of stock splits, stock dividends, stock rights, mutual funds and inflation.

To alleviate the confining pressures of this inherent conflict, and thereby to free the trustee to pursue an investment policy geared to maximum benefit for all beneficiaries, Mr. Robert M. Lovell has proposed creation of the "unitrust,"[1] a trust administration device whereby both life tenant and remainderman are benefited equally by a growth-oriented investment policy.[2]

* The author of this note received the 1968 Dean's Award, given to the student in the graduating class who is adjudged to have submitted the best senior dissertation.

† This note was awarded third prize in the 1968 Estate Planning Competition sponsored by the First National Bank of Chicago.

1. Lovell, *The Unitrust—A New Concept to Meet an Old Problem,* 105 Trusts & Estates 215 (1966).

2. Mr. Lovell suggests that the unitrust concept will eliminate income-principal allocation problems, will permit the settlor's primary concern with the welfare of the

This note explores applications of the unitrust in estate tax planning. Part II presents general characteristics of the unitrust, including its advantages and limitations. Part III discusses the use of the unitrust as a marital deduction trust, including prescription for administration of the marital deduction unitrust in various situations involving different sizes of estates. Part IV presents income tax considerations involved in the use of the unitrust, under subchapter J of the Internal Revenue Code. Finally, Part IV suggests amendments to the basic unitrust form for maximizing its effectiveness in estate planning.

II. WHAT IS A "UNITRUST"?

A. *General Characteristics*

A unitrust is similar to the classical trust in that property is conveyed to a fiduciary for management and investment for the benefit of a beneficiary. Unlike the classical trust, however, the property in the trust is administered as a single fund, into which all receipts are added as they accrue. Periodically the fund is evaluated at its fair market value and a stipulated percentage of that value is set aside for "payouts" to the beneficiary at subsequent specified dates.[3] The conveyance might read as follows:

> To T in trust, for the benefit of B, to be administered as provided in sections (a) and (b) of this clause.
> (a) The trustee is directed to manage and invest the property conveyed herein as a single fund, with all receipts to be added to such fund as they accrue. Annually, on December 31, the fund is to be evaluated to determine its fair market value as of that date.
> (b) The trustee is directed to pay to B, in equal monthly installments, amounts equalling six per cent per annum of the fair market value of the fund as determined in section (a) of this clause.
> Upon the death of B, if any property shall remain in the fund, I direct the trustee to convey all such remaining property to R.

Of course, infinite variations on this simple theme are possible. For example, it would be advisable for the instrument to provide more detail in provisions over which litigation might subsequently arise, such as adding to the direction that all receipts be added to the fund, a description of receipts as "including, but not limited to, interest, cash dividends, stock dividends, stock splits, stock rights, rents, [etc.]." The conveyance as described is the basic vehicle, how-

life tenant to predominate, will reduce the need for costly accountings, and will free the trustee from restrictions on his investment policy. *Id.* at 215.

3. Mr. Lovell's suggested unitrust is somewhat broader than the example given here in that he envisages the unitrust as encompassing instruments directing distribution of a dollar amount, as well as the percentage amount described. *Id.* at 215. *But see* text accompanying note 36 *infra*.

ever, and further discussion in this note will be directed to this simplified model.

The novelty of the unitrust concept lies in its administration by the trustee. The unitrust permits unrestricted investment management by the trustee to the end of maximum benefit to all successive beneficiaries, it eliminates conflicts between income beneficiaries and remaindermen, it substantially avoids the need for costly accountings beyond statutory requirements, and it reduces income-principal allocation problems.

The unitrust concept is not without analogy in trust law (rather, various attributes of the unitrust are in common use in some of the more modern existing trusts, such as employees' pension fund trusts and commercial investment trusts (mutual funds)).[4] The unitrust simply combines many favorable aspects of more traditional trust forms, thereby eliminating or reducing many of the problems caused by failure of trust law to keep pace with current needs.

Mr. Lovell sees as one of the most advantageous characteristics of the unitrust the freedom of the trustee to pursue an investment policy calculated to produce the greatest growth, with maximum benefit to the life tenant.[5] The first of these goals can be achieved under the modern discretionary trust,[6] if the trust instrument specifically provides that the trustee is given complete discretion to invest for such maximum growth.[7] A completely growth-oriented investment policy, however, normally works to the detriment of the life tenant, whose interest is served by high income producing investments. The second

4. As Lovell points out, an employees' pension fund need not be administered with the interests of any life tenant in mind, thus permitting an investment policy oriented completely toward growth of the fund. Lovell, *supra* note 1, at 219. Moreover, the mutual fund has some of the mechanical characteristics of the proposed unitrust, especially if the fund is in the form of an investment trust. If such a fund is to qualify under subchapter M of the Internal Revenue Code ("regulated investment companies"), it must distribute at least 90% of its income anuually, such distribution to include capital gains on sales of appreciated securities, as well as dividends on stocks held in the fund. INT. REV. CODE of 1954, §§ 851-52. This distribution of capital gains under traditional trust concepts would amount to a distribution of corpus, under a stipulated percentage requirement.

These analogies to the unitrust are not, of course, directly in point, but they do indicate that the unitrust has characteristies which are sufficiently familiar to permit the trust industry and courts to handle them without undue confusion.

5. Lovell, *supra* note 1, at 215.

6. G. BOGERT, TRUSTS AND TRUSTEES § 228 (2d ed. 1965) [hereinafter cited as BOGERT]; RESTATEMENT (SECOND) OF TRUSTS § 155 (1959) [hereinafter cited as RESTATEMENT]; A. SCOTT, ABRIDGEMENT OF THE LAW OF TRUSTS § 128.3 (1960); MCLUCAS, *Discretionary Trusts—Guides for Exercise of Power to Distribute Income and Principal,* 97 TRUSTS & ESTATES 210 (1958).

7. Note, *Common Stocks in Trust,* 113 U. PA. L. REV. 228, 248 (1964). But note that the instrument must so provide before invasion of corpus will be permitted. 32 MO. L. REV. 280, 281 (1967).

goal, maximum benefit to the life tenant, can be achieved by investment in high-yield securities, but this reduces growth, to the detriment of the remainderman. An acceptable compromise can be reached by directing a growth-oriented investment policy, with additional directions to pay a specified amount to the life tenant, with periodic distributions to corpus where necessary.[8] The unitrust achieves this compromise by directing a stipulated percentage distribution, with the implication (which might be specified) that corpus is to be distributed to the extent that receipts do not equal required distributions. Thus, the unitrust has the advantages of a discretionary trust; but what of its disadvantages? The typical discretionary trust requires the trustee to make distributions in amounts which, in his complete discretion, are appropriate for the "needs," or "comfort," or "well being" of the beneficiary. Under traditional law, the trustee then has two opposing forces bearing upon the exercise of his discretion: he must attempt to fulfill the life tenant's perceived wants; but he must also preserve as much of the corpus as possible for ultimate distribution to the remainderman. Although this dilemma may be somewhat alleviated by stipulating that distributions to the life tenant must provide adequately for the "support" or "support and education" of the beneficiary,[9] whenever there is any discretion in determining the amount of the distribution there is a potential complaint from the life tenant or the remainderman (or both) that such discretion was improperly exercised. The trustee in a discretionary trust is thus caught between conflicting interests, in the exercise of either type of discretion granted him (discretion in investment or discretion in distribution). This problem is neatly solved in a unitrust by specific directions as to distributions but with complete freedom to manage for growth, since both life tenant and remainderman stand to gain most from an imaginative growth-oriented investment policy.[10]

8. Gelb v. Commissioner, 298 F.2d 544 (2d Cir. 1962); Barclay, *The Lot of the Income Beneficiary: Remedies,* 104 Trusts & Estates 277 (1965); Note, *Principal and Income Allocation of Stock Distributions—The Six Per Cent Rule,* 64 Mich. L. Rev. 856 (1966).

9. 2 A. Scott, Trusts § 128.4 (2d ed. 1956) [hereinafter cited as Scott]; Bogert § 229.

10. There have been other suggested trust forms which would permit maximization of investment freedom while maintaining reasonable fairness as between the life tenant and the remainderman. One such solution would allocate realized capital gains to income, but would permit the trustee to accumulate income during periods when the total "income" so allocated exceeded reasonable proportions. Note, *Common Stocks in Trust,* 113 U. Pa. L. Rev. 228, 248 (1964). Another suggestion would require distribution from corpus in the form of a "deficiency distribution" to the extent income from the corpus investment did not equal the current bond yield. Since the difference between the stock yield and the current bond yield would not be as great as the annual appreciation in value of the corpus-share of the stocks, the deficiency distributions would be less each succeeding year until they disappeared completely when the

Another difficulty concerning the trustee's discretion in traditional trusts involves allocation of receipts; that is, given the principal-income dichotomy, to which interest does the trustee attribute a particular receipt, such as a stock dividend? There have been several statutory attempts to solve this problem, including the Kentucky rule,[11] the Pennsylvania rule,[12] the Massachusetts rule,[13] the more recent "6% rule,"[14] the "underproductive test,"[15] and the "prudent man rule."[16] Of course, it has often been said,[17] and is so provided in

amount of income equalled the amount which the same original corpus would then be yielding at bond yield rates. This method is denominated "anticipatory apportionment." *Id.* at 252-55. This plan has been criticized in Barclay, *supra* note 8. Mr. Barclay, in turn, proposes a trust with invasion-of-corpus provisions, with additional provision for adjustment of stipulated (dollar) payments according to periodic comparisons with the cost of living index. *Id.* And finally, a "percentage trust" has been proposed, wherein the corpus could be invested in growth securities, with the trust instrument providing that the trustee should distribute to the life tenant amounts which fairly reflect the income on a fund of comparable size invested more for production of income. Clark, *Power to Invest Without Yield*, 100 TRUSTS & ESTATES 495 (1961); Wells, *Pity the Poor Income Beneficiary—How to Reconcile Growth and Yield?*, 103 TRUSTS & ESTATES 119 (1964).

11. All dividends, including stock dividends made from accrued earnings, are income. Note, 44 CORNELL L.Q. 284, 285 (1959).

12. This rule requires apportioning receipts between the life tenant and the remainderman so as to preserve the initial value of the trust asset. *See* Note, *supra* note 8, at 859; Cohan, *Accounting Considerations of Apportionment by Trustees of Receipts from Stock*, 36 TEMP. L.Q. 121 (1963); Niles, *Fosdick, Cunningham and Chaos—Ways Out of Apportionment Dilemma*, 98 TRUSTS & ESTATES 924 (1959).

13. The Massachusetts Rule allocates all stock dividends to corpus, unless the stock distributed is not that of the distributing corporation. This is now the majority rule, having been incorporated in REVISED UNIFORM PRINCIPAL AND INCOME ACT, which has been adopted in 25 states. *See also* RESTATEMENT § 236(b).

14. Stock dividends amounting to less than 6% of outstanding stock are treated as income. *See, e.g.*, N.J. STAT. ANN. § 3A:14A(a) (Supp. 1967) (similar rule, but uses 4% as determinative percentage); N.Y. ESTATES, POWERS AND TRUSTS LAW § 11-2.1(e)(2) (McKinney 1967); PA. STAT. ANN. tit. 20, § 3470.5 (Purdon 1964). This rule was considered for adoption by the Commissioners on Uniform State Laws, but was rejected in favor of the Massachusetts Rule. Bogert, *Uniform Principal and Income Act Revised*, 101 TRUSTS & ESTATES 787 (1962). *See also* ABA REAL PROPERTY, PROBATE AND TRUST LAW SECTION, *Uniform Revised Principal and Income Act* 18 (Aug. 6-7, 1962).

15. Section 12 of the REVISED UNIFORM PRINCIPAL AND INCOME ACT provides that if the yield on corpus property is less than 1% of its inventory value for more than a year, it shall be considered "underproductive," shall be sold, and the proceeds apportioned. *See also* Barclay, *The Lot of the Income Beneficiary*, 104 TRUSTS & ESTATES 144 (1965). It should also be noted that if the property in the corpus is underproductive, the marital deduction will be denied unless the surviving spouse has the power to require sale of such property for more beneficial investment. Treas. Reg. § 20.2056(b)-5(f)(4), (5) (1967).

16. Determination here rests on whether the receipt would be considered allocable to principal or income by men of "prudence, discretion, and intelligence in the management of their own affairs." DEL. CODE ANN. tit. 12, § 3526(a)(1) (Supp. 1966).

17. ABA REAL PROPERTY, PROBATE AND TRUST LAW SECTION, *Report of the Subcommittee on Trusts and Estates: Tax Burden Genesis of Beneficiary Conflicts* 192 (Aug. 11-13, 1963). *But see* Halbach, *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425, 1427 (1961).

most statutes,[18] that the settlor can eliminate this problem by directing how such receipts shall be allocated. But even a lengthy and carefully prepared itemization of possible receipts can be made obsolete by the invention of a new corporate distribution technique. The unitrust avoids this difficulty by directing that all receipts, of whatever form, be added to the fund, to be evaluated later in calculating the directed percentage distribution.[19]

Finally, the unitrust idea provides a method through which the life tenant's interest can keep pace with business growth and inflation by giving him a percentage participation in all such growth, whether represented by dividends or growth from reinvestment.[20] And, even more ideally, it provides a hedge against all but the most severe and long-lived depression by continuous bolstering of the fund through the infusion of all receipts.

B. *Limitations*

Although the unitrust concept can eliminate many of the problems which plague trust managers, there are some difficulties, both of traditional and modern origin, which it cannot solve. Lovell noted, for example, that the unitrust does not eliminate the need for judgment on the part of the trustee.[21] In fact, use of a unitrust probably requires even more investment judgment, since one of the major advantages of the idea is that it permits the trustee to exercise untrammelled investment discretion, to the end of maximum fund growth.

18. Ala. Code Ann. tit. 58, § 76 (1960); Ariz. Rev. Stat. Ann. § 14-1082 (1956); Cal. Civ. Code § 730.02 (Supp. 1967); Colo. Rev. Stat. Ann. § 57-4-2 (1964); Conn. Gen. Stat. Rev. § 45-111 (1959); Fla. Stat. Ann. § 690.03 (1944); Idaho Code Ann. § 68-1002(a)(1) (Supp. 1967); Ill. Ann. Stat. ch. 30, § 160 (Smith-Hurd Supp. 1967); Kan. Gen. Stat. Ann. § 58-902 (Supp. 1967); Ky. Rev. Stat. Ann. § 386.200 (3d ed. Baldwin 1963); Md. Ann. Code art. 75B, § 2(a)(1) (Supp. 1967); Mont. Rev. Codes Ann. § 62-1902 (1962); N.M. Stat. Ann. § 33-5-2 (Supp. 1967); N.Y. Estates, Powers and Trusts Law § 11-2.1(a)(1) (1967); N.C. Gen. Stat. § 37-2 (1966); Okla. Stat. Ann. tit. 60, § 175.26 (1963); Ore. Rev. Stat. § 129.020 (1963); Pa. Stat. Ann. tit. 20, § 3470.2 (Purdon 1964); S.C. Code Ann. § 67-504(a)(1) (Supp. 1967); Tenn. Code Ann. § 35-703 (Supp. 1967); Tex. Rev. Civ. Stat. art. 7425b-26 (Vernou 1960); Utah Code Ann. § 22-3-2 (1953); Vt. Stat. Ann. tit. 14, § 3302 (1959); Va. Code Ann. § 55-254 (1959); W. Va. Code Ann. § 36-6-2 (1966); Wis. Stat. Ann. § 231.40(2) (Supp. 1967); Wyo. Stat. Ann. §34-375(a)(i) (Supp. 1965).

19. Fees and expenses would be subtracted directly from the general fund, thus further eliminating the need for allocation of these items. This would probably alleviate the conflict of interests regarding the trustee-executor's decision as to whether to take an estate tax deduction for administration fees under § 2053 or an income tax deduction under § 642(g).

20. *See* Aronsteiu, *Toward Growth With Fair Return—Plea for Imagination in Solving Plight of Income Beneficiary,* 104 Trusts & Estates 788 (1965).

21. Lovell, *supra* note 1, at 217.

Lovell also suggested that the unitrust should not be used with a charitable reminder.[22] This would be true if it be assumed that the receipts of the unitrust will in some years be less than the stipulated percentage payout, so as to require an invasion of "corpus" in traditional trust terms. The problem is created by Treasury Department pronouncements that trusts which may distribute corpus are not deductible to the extent that corpus is not exempt from potential distributions. The Regulations provide that the estate tax charitable deduction will be limited to "that portion, if any, of the property or fund which is exempt from an exercise of the power [to distribute corpus]."[23] Closely analogous to this provision is Revenue Ruling 60-385,[24] which provides that where the trust contains shares of a regulated investment company, and if the governing instrument or local law permits or requires distribution of the capital gain portion of the company's dividends as income, no charitable deduction will be allowed, "since no known formula has been advanced for ascertaining the value of the charitable interest." The unitrust can avoid these pitfalls.

In *Northeastern Pennsylvania National Bank & Trust Co. v. United States*,[25] the Supreme Court held that it is possible to determine, for federal estate tax purposes, the amount of corpus needed to produce income in a stipulated dollar amount per month, by employment of projected rates of return. Assume that such projected rate is computed to be four per cent per annum. If the unitrust's stipulated payout percentage is five per cent, it is clear that payouts will include some "corpus" for each year that the projected rate of return is correct. However, it is also clear that the amount of corpus distribution can be calculated at the time of the establishment of the trust, since the payout percentage bears a direct relation both to the amount of the original fund and to the projected return rate. Therefore, under the Regulation described above, the portion of the "corpus" which is exempt from the direction to distribute "corpus" is ascertainable. And since it is ascertainable, it would seem that a rule analogous to Revenue Ruling 60-385 would not be applied. On this same principle, if the payout percentage were three per cent, it appears that payouts would never include "corpus," and the Regulation should present no problem at all. The same result would follow if the payout percentage equals the projected rate of return. Therefore, it appears that after *Northeastern Pennsylvania* the unitrust may be used with a

22. *Id.* at 218.
23. Treas. Reg. § 20.2055-2(b) (1966).
24. 1960-2 CUM. BULL. 77.
25. 387 U.S. 213 (1967).

charitable remainder. However, such use may be hazardous if it is desired to avoid litigation, since the Commissioner might be expected to question this reasoning.

The simple unitrust, as described in the sample above, will not by itself necessarily provide a complete hedge against inflation, since business conditions of the future cannot be predicted with great accuracy. Although a five per cent payout may seem ample today, it may not be adequate twenty years from now, due to unforeseen disparities between the cost of living and stock value appreciation.[26] Moreover, today's ample income may not be sufficient to meet, for example, unanticipated medical expenses. This problem can be remedied in any one of several ways, including an additional direction for supplemental payouts upon specific contingencies, and provision for periodic resetting of the payout percentage on the basis of some external standard, such as the cost of living index.[27]

Some state statutes require periodic accountings which include indications of the trustee's allocation of receipts as between corpus and income.[28] Of course, the very nature of the unitrust makes this particular aspect of the accounting superfluous, but the requirement could prove troublesome if imposed strictly on the trustee of the unitrust. Not only would such a requirement necessitate the keeping of books similar to those for a traditional trust, and thus cause additional and unnecessary expense to the trust, but it would also explicitly set forth the basis for the very conflict of interests between life tenant and remainderman which the unitrust is designed to eliminate. It is hoped that the corpus-income accounting requirement would not be imposed on the unitrustee, since the reason for such accountings is to enable the various beneficiaries to monitor the trustee's allocations and such watchfulness is irrelevant to the unitrust.

New York law provides that it is against public policy for a trust instrument to attempt to grant to a testamentary trustee the power to make a "binding and conclusive fixation of the value of any asset for purposes of distribution or allocation."[29] This provision is a potential stumbling block for the unitrust in New York, since an integral part of the unitrust concept is the periodic fair-market valua-

26. *See* Barclay, *supra* note 8, at 277; Halbach, *supra* note 17, at 1426.

27. Barclay, *supra* note 8, at 279.

28. CONN. GEN. STAT. REV. § 45-268 (Supp. 1965); DEL. CODE ANN. Chancery Rule 117 (1953) ("where applicable"); FLA. STAT. ANN. § 737.12 (1964); IND. ANN. STAT. §§ 31-701, -702 (Burns Supp. 1967); KAN. GEN. STAT. ANN. § 59-1602 (Supp. 1967), § 59-1606 (1964); MASS. ANN. LAWS ch. 206, § 2 (1955); MINN. STAT. ANN. § 501.34 (1947); NEB. REV. STAT. § 30-1801 (1964); NEV. REV. STAT. §§ 165.040 -.140 (1956); N.M. STAT. ANN. §§ 33-2-3, -13 (1953); WASH. REV. CODE ANN. § 30.30.030 (1961). *See also* UNIFORM TRUSTEES ACCOUNTING ACT § 3.

29. N.Y. ESTATES, POWERS AND TRUSTS LAW § 11-1.7(a)(2) (1967).

tion of the trust fund for determining subsequent payouts pursuant to the percentage stipulation. However, the purpose of the statute was to protect settlors and beneficiaries from instruments ingeniously drawn to limit the liability of institutional trustees for lack of due care,[30] so the statute does not necessarily preclude the unitrust. Since the unitrust concept does not attempt to eliminate the accountability of the trustee for lack of discretion, and since assent by the beneficiary would obviate the effect of this provision, the unitrust should be available to New York settlors.

Various problems which may arise with regard to income taxation of the unitrust will be discussed in Part IV below. Estate tax problems will be treated in Part III.

There remain two questions with regard to the unitrust—questions which cannot be answered with confidence at this time. First, will the courts accept the unitrust? It is different, and it has some characteristics which do not fit comfortably within the framework of existing trust law. However, these differences do not seem to require rejection of the concept and there appears no good reason that it should not be accepted with enthusiasm. Second, will trustees accept the idea? It may involve some litigation at first, but the advantages seem substantially to outweigh any such consideration. Absent some adverse turn in the courts or the Internal Revenue Service, trustees should welcome the unitrust.

III. The Unitrust and the Marital Deduction

A. *The "Estate Trust" as a Unitrust*

Lovell concluded that the unitrust as a marital deduction trust would be restricted to the form of an "estate trust."[31] Since an estate trust is not a "terminable interest" for federal estate tax purposes,[32] it is not subject to the restrictive provisions of section 2056(b)(5). Hence the fact that a trust instrument might provide for, or result in,

30. Book 13, N.Y. Deced. Est. Law 635-36 (Historical Note) (1949).

31. Lovell, *supra* note 1, at 218-19. The "estate trust" is one under which all beneficial interests are in the surviving spouse and her estate—the income is payable to the spouse for life, with payment of the corpus to her estate. Casner, *Estate Planning Under the Revenue Act of 1948—The Regulations*, 63 Harv. L. Rev. 99, 100 (1949).

32. The estate trust is not a terminable interest within the meaning of the estate tax provisions, because the interest of the surviving spouse in the property does not terminate upon her death or the occurrence of any other contingency. *See* Int. Rev. Code of 1954, § 2056(b)(1); Treas. Reg. §§ 20.2056(a)-2, (b)-1 (1966). If the trust were a terminable interest, Treasury Regulation § 2056(b)-5(a)(1) & (2) would require that the surviving spouse have a right to all the trust income for life, payable annually or more frequently. Since it is possible that in some years unitrust receipts would exceed the payout percentage, the unitrust would thus appear not to qualify for the marital deduction.

the accumulation of income would not disqualify the trust for the marital deduction;[33] that is, a unitrust in the form of an estate trust would qualify although the payout percentage did not equal or exceed the income percentage. Developments since the formulation of the unitrust idea, making the unitrust arguably appropriate for any marital deduction trust, will be discussed below with regard to the power of appointment trust. However, there are some potential difficulties concerning the "estate unitrust" under various state laws.

1. *"Payable to Beneficiary's Estate."*—Professor Casner has suggested that some state laws may not permit distribution to the estate of the life beneficiary.[34] An adverse ruling on this point could disqualify the estate trust for the marital deduction, since the surviving spouse's interest would become terminable, and the interest would pass to someone else upon termination.[35] To the extent that this analysis is correct for specific states, of course, the "estate unitrust" would be inappropriate as a marital deduction trust. However, this does not lessen the value of the unitrust itself, since the estate unitrust would fare no differently than would a traditional estate trust.

2. *Rules Against Accumulation.*—Since the unitrust payout percentage is static as fixed by the governing instrument, and since receipts fluctuate under the influence of many variables, it can be assumed that sometimes the annual payout will not completely consume the prior year's receipts.[36] Under more traditional trust accounting principles, this would amount to the addition of income to corpus, or the accumulation of income. While the accumulation of income for minors during their minority has generally been accepted,[37] many states traditionally forbade income accumulation for adults.[38] Today,

33. ABA REAL PROPERTY, PROBATE AND TRUST SECTION, *Report of the Subcommittee on Estate Planning and the Marital Deduction* 82, 93 (Aug. 11-13, 1963).

34. Casner, *supra* note 31, at 101-02.

35. *Id.* at 102. However, he predicts that the courts will generally follow the view already taken by some courts, that an estate may be the beneficiary of a gift. *Id.* This holding is implicit in Commissioner v. Ellis, 252 F.2d 109 (3d Cir. 1958).

36. Of course if the percentage is set high enough, payouts will always exceed receipts. This would result in continuous depletion of the fund to the point at which, for all practical purposes, the trust will become worthless. The discussion in this note assumes that the stipulated payout percentage will be set at about current expected income, or income-plus-growth, rates, so that the unitrust will continue as a viable income producer for the life of the life tenant. While this result is, of course, not necessary under the unitrust principle, most settlors establishing testamentary trusts for their wives would prohably reject the thought that at some not too distant date the trust would cease to produce and the widow would be without income. But see the discussion regarding the types of situations in which a unitrust should be used, in Part III, § B below.

37. ALA. CODE tit. 47, § 146 (1958); S.D. CODE § 51.0304 (Supp. 1960).

38. *See generally* Powell, *Changes in the New York Statutes on Perpetuities and Accumulations: A Report and a Proposal,* 58 COLUM. L. REV. 1196 (1958). South

however, most states permit all such accumulations, at least for periods not longer than the applicable rule against perpetuities,[39] and at least one state has provided that such period shall be measured by actual events, rather than mere possibilities.[40] Therefore rules against accumulations are not significant deterrents to the marital deduction unitrust. However, since income accumulation aspects of the unitrust are not universally acceptable, some caution is indicated.

3. *State Allocation Rules.*—Rules for allocations of receipts between income and corpus should not affect the unitrust. Both Uniform Principal and Income Acts defer to explicit allocation provisions in the governing instrument, and provide for allocation of stock splits and stock dividends to corpus only in the absence of such specific instructions.[41] The nature of specifications for treatment of receipts in the unitrust should eliminate any need to consider statutory allocation provisions in states which have adopted this version of the uniform acts.[42] This same argument should apply in states which employ

Dakota apparently still forbids such accumulations. The statutory direction against such accumulations was repealed in 1957, but the section permitting accumulations during minority still provides that accumulations must end when the beneficiaries reach majority. *See* S.D. CODE OF 1939. § 51.0307 (repealed 1957); S.D. CODE § 51.0304 (Supp. 1960).

39. SCOTT § 62.11, at 560. For statutory authorization for accumulations, see CAL. CIV. CODE § 724 (Supp. 1967); ILL. ANN. STAT. ch. 30, § 153 (Smith-Hurd Supp. 1967); MONT. REV. CODES ANN. § 67-412 (1947); NEV. REV. STAT. § 166.150 (Supp. 1965); WIS. STAT. ANN. § 230.37 (Supp. 1967). England now permits accumulations for 21 years from the date of the grant, plus the minority of any persons in being or *enventre as mere* at that date. Discussed in Battersby, *The Perpetuities and Accumulations Act, 1964,* 108 SOL. J. 627 (1964). Alabama limits trusts for accumulation to 10 years, except for minors. ALA. CODE tit. 47, § 146 (1958).

40. PA. STAT. ANN. tit. 20, § 301.6 (Purdon Supp. 1966). The New York statute appears to adopt this idea by providing that "[a]n accumulation directed to continue for a period extending beyond the expiration of such time terminates upon such expiration." N.Y. ESTATES, POWERS AND TRUSTS LAW § 9-2.1(b) (1967). This doctrine has been denominated "wait-and-see." Cohen, *The Rule Against Accumulations and "Wait and See,"* 33 TEMPLE L.Q. 34 (1959).

41. UNIFORM PRINCIPAL AND INCOME ACT §§ 2, 5 (1931 version); REVISED UNIFORM PRINCIPAL AND INCOME ACT §§ 2, 6.

42. ALA. CODE tit. 58, § 79 (1960); ARIZ. REV. STAT. ANN. § 14-1085(A) (1956); CAL. CIV. CODE § 730.06(a) (Supp. 1967); COLO. REV. STAT. ANN. § 57-4-5(1) (1964); CONN. GEN. STAT. REV. § 45-113(1) (1959); FLA. STAT. ANN. § 690.06(1) (1944); IDAHO CODE ANN. § 68-1006(a) (Supp. 1967); ILL. ANN. STAT. ch. 30, § 164(1) (Smith-Hurd Supp. 1967); KAN. GEN. STAT. ANN. § 58-905(1) (1964); KY. REV. STAT. 386.230(1) (3d ed. Baldwin 1963); MD. ANN. CODE art. 75B, § 6(a) (Supp. 1967); MONT. REV. CODES ANN. § 67-1905(1) (1962); N.M. STAT. ANN. § 33-5-5(1) (Supp. 1967); N.C. GEN. STAT. § 37-5(a) (1966); OKLA. STAT. ANN. tit. 60 § 175.29(A) (1963); ORE. REV. STAT. § 129.050(1) (1963); S.C. CODE ANN. § 67-509(a) (Supp. 1967); TENN. CODE ANN. § 35-706(1) (Supp. 1967); TEX. REV. CIV. STAT. ANN. art. 7425b-29(A) (Vernon 1960); UTAH CODE ANN. § 22-3-5(1) (1953); VT. STAT. ANN. tit. 14, § 3305(a) (1959); VA. CODE ANN. § 55-257(1) (1959); W. VA. CODE ANN. § 36-6-5(1) (1966); WIS. STAT. ANN. § 231.40(5)(a) (Supp. 1967); WYO. STAT. ANN. § 34-379(a) (Supp. 1965).

the "6% rule," since these states have adopted the basic form of the Uniform Principal and Income Acts, changing only the stock dividend allocation provisions to require allocation of small stock dividends to income.[43] Moreover, if a question arises as to whether the directions in the unitrust instrument are sufficiently explicit to avoid the statutory provisions, it can be argued that such alternative statutory allocation requirements are irrelevant to the unitrust, either because there are not two receptacles in the unitrust between which to allocate, or because the unitrust is itself an allocation device. However, it is remotely possible that the unitrust could be questioned in states with some form of the "6% rule." This possibility arises because allocation of stock dividends to income raises the ratio (and thus the percentage) between income and the amount which represents combined income and market value of assets in the traditional trust. If the percentage represented by this ratio is greater than the unitrust payout percentage, there is an accumulation of income in the unitrust. For example, assume that a traditional trust with corpus of one hundred dollars has dividend (cash) income of four dollars and receives a stock dividend valued at one dollar, which stock dividend qualifies under the local "6% rule." Assuming no capital appreciation, the total value of corpus plus income is 105 dollars. The income of five dollars (cash dividend plus stock dividend) represents nearly 4.8 per cent of the total value. But in a unitrust with the same receipts which directs payouts of four per cent, the unitrust beneficiary gets only $4.20. Thus, it could be argued that in the unitrust there has been an accumulation of 80 cents.

The argument above, although remote, is not without merit. The rule against accumulations is a rule of law, and thus applies regardless of the grantor's intent or direction.[44] Hence, where an accumulation for adults is void, or where an accumulation for the surviving spouse would be void due to statutory or instrument construction, the situation described above would result in an illegal accumulation. And, in the example, this would be true only because another state law alternatively allocated the stock dividend to income in the absence of a sufficiently specific direction.

The final state allocation rule to be considered, allocation of dividends paid by regulated investment companies (mutual funds), involves considerations similar to those set forth above concerning the "6% rule" and the rule of the Uniform Principal and Income Acts. In the absence of a controlling statute, courts have held that the

43. *See* N.J. STAT. ANN. § 3A:14A-2(A) (1953); N.Y. ESTATES, POWERS AND TRUSTS LAW § 11-2.1(a)(1)(A) (McKinney 1967); PA. STAT. ANN. tit. 20, § 3470.2 (Purdon 1964).

44. *See, e.g.,* PA. STAT. ANN. tit. 20, § 301.6 (Purdon Supp. 1966).

entire dividend is allocated to income, in spite of segregation of the distribution into capital gain dividends and dividends from income of the corporation.[45] However, the Revised Uniform Principal and Income Act explicitly splits the mutual fund dividend between corpus and income,[46] and the older uniform act does so by implication.[47] Here, as above, these rules should not present the unitrustee with any difficulties, but the rules should be kept in mind, especially in those states where statutes have not made such allocation subject to alteration by express provision in the trust instrument.

4. *Spendthrift Provisions.*—With a few well-recognized exceptions,[48] restraints on the voluntary or involuntary alienation of a beneficiary's interest in a trust are valid.[49] Except where spendthrift provisions are

45. *In re* Gardner's Trust, 266 Minn. 127, 123 N.W.2d 69, 79 (1963). The legal literature supports this view, either on the theory that gains on the sale of appreciated stock by the mutual fund are really more like income from the stock-in-trade of the corporation than like the sale of capital assets, Cohan & Dean, *Legal, Tax and Accounting Aspects of Fiduciary Apportionment of Stock Proceeds: The Non-Statutory Pennsylvania Rules,* 106 U. PA. L. REV. 157 (1957), or on the theory that if the capital gains portion of the dividend is allocated to corpus, the portion remaining for income is not enough to justify investment in such funds, because it favors the remainderman to the detriment of the life tenant. Bogert, *supra* note 14. In this regard, the Restatement provides that dividends of corporations engaged in the business of buying and selling land shall be considered income (not corpus). RESTATEMENT § 236, comment *x.* This seems directly analogous to the mutual fund situation.

46. REVISED UNIFORM PRINCIPAL AND INCOME ACT § 6. *See also* IDAHO CODE ANN. § 68-1006(c) (Supp. 1967); MD. CODE ANN. art. 75B, § 6(c) (1965); N.Y. ESTATES, POWERS AND TRUSTS LAW § 11-2.1(e)(7) (1967); S.C. CODE ANN. § 67-509(c) (Supp. 1967); WYO. STAT. ANN. § 34-379(c) (Supp. 1965).

47. UNIFORM PRINCIPAL AND INCOME ACT § 5 (1931 version). *See also* ALA. CODE tit. 58, § 79 (1960); ARIZ. REV. STAT. ANN. § 14-1085(c) (1956); CAL. CIV. CODE § 730.06(c) (Supp. 1967); COLO. REV. STAT. ANN. § 57-4-5(3) (1964); CONN. GEN. STATS. ANN. § 45-113(3) (1959); FLA. STAT. ANN. § 690.06(3) (1944); ILL. ANN. STAT. ch. 30, § 164(1) (Smith-Hurd Supp. 1967); KAN. GEN. STAT. ANN. § 58-905(3) (1964); KY. REV. STAT. ANN. § 386.230(3) (3d ed. Baldwin 1963); ME. REV. STAT. ANN. § 4054 (1964); MONT. REV. CODES ANN. § 67-1905(3) (1962); N.M. STAT. ANN. § 33-5-5(3) (Supp. 1967); N.C. GEN. STAT. § 37-5(c) (1966); OKLA. STAT. ANN. tit. 60, § 175.29(c) (1963); ORE. REV. STAT. § 129.050(3) (1963); PA. STAT. ANN. tit. 20, § 3470.5(3) (Purdon 1964); TENN. CODE ANN. § 35-706(3) (Supp. 1967); TEX. REV. CIV. STAT. art. 7425b-29(c) (Vernon 1960); UTAH. CODE ANN. § 22-3-5(3) (1953); VT. STAT. ANN. tit. 14, § 3305(c) (1959); VA. CODE ANN. § 55-257(3) (1959); W. VA. CODE ANN. § 36-6-5(3) (1966); WIS. STAT. ANN. § 231.40(5)(c) (Supp. 1967). A similar rule has been judicially adopted in Massachusetts. Tait v. Peck, 346 Mass. 521, 194 N.E.2d 707 (1963).

48. Spendthrift provisions are generally not effective if they are in favor of a settlor-beneficiary, RESTATEMENT § 156, nor are they effective against the beneficiary's wife or child for support or his wife for alimony, against creditors who supply the beneficiary with necessities, against creditors for services rendered to preserve or benefit the beneficiary's beneficial interest, or against a state or the United States to satisfy claims against the beneficiary (for taxes). RESTATEMENT OF TRUSTS § 157.

49. RESTATEMENT OF TRUSTS § 152. *But see* Sherrow v. Brookover, 174 Ohio St. 310, 189 N.E.2d 90 (1963) (adopts minority view and holds involuntary provisions ineffective in Ohio), 24 OHIO ST. L.J. 567 (1963).

held ineffective, the authorities almost unanimously agree that a beneficiary's income interest may be protected,[50] but there is less agreement as to whether restraints on the alienation of the beneficiary's interest in the corpus are valid. If the beneficiary is entitled to receive corpus at some *future* time, the weight of authority permits the restraint.[51] But if the corpus is presently payable to the beneficiary, or if he can withdraw principal on demand, the restraint ceases to be effective.[52] In addition to these rather general rules, some states have provided for limitations on the power to restrict alienation through spendthrift provisions, by limiting the value of corpus which is protected,[53] by limiting the amount or per cent of income not subject to involuntary alienation,[54] or by making excess income subject to claims of creditors.[55]

In a unitrust with an explicit spendthrift clause, in which the payout percentage is less than, or equal to, total receipts for the year, the payout could be equated entirely with income under a traditional trust, and thus would generally be protected.[56] However, there could be problems during years or in situations where the directed payout exceeds receipts. The payout would probably be protected to the extent that it did not exceed receipts, but the excess of payout over receipts for the year might well be subject to creditors' claims, at least on the payout dates.[57] Furthermore, in states which make excess income subject to claims, this unitrust could be particularly vulnerable, since the excess of payout over receipts could be considered surplus.[58] However, the trustee could certainly argue that many of

50. *See* 2 Scott § 152.5. Moreover, discretionary and support trusts cannot be reached by creditors of the beneficiary. Restatement of Trusts §§ 154, 155.

51. 2 Scott § 153, at 1075. *But see id.* at 1076.

52. Restatement § 153(2), & comment *c. But see* 2 Scott § 153, at 1172 (3d ed. 1967).

53. Va. Code Ann. § 55-19 (1959) ($200,000).

54. Ala. Code Ann. tit. 58, § 1 (1960) ($1800 per year); N.J. Stats. Ann. tit. 2A, § 17-50 (1952) ($18 per week); N.Y. Civ. Procedure Law & Rules § 5205(e)(1) (McKinney 1963) (90%); N.C. Gen. Stats. § 41-9 (1966) ($500 per year); Okla. Stats. Ann. tit. 60, § 175.25 (1963) ($5000 per year).

Dean Griswold has suggested a draft statute which would make all present and future income in excess of $5000 per annum subject to voluntary and involuntary alienation, regardless of contrary provisions in the instrument. In addition, if trust income exceeds $12 per week, creditors could attach up to 10% of such income. E. Griswold, Spendthrift Trusts § 565, at 648 (2d ed. 1947) (§ 2 of draft statute).

55. Cal. Civ. Code Ann. § 859 (West 1954); Conn. Gen. Stats. Ann. § 52-321 (1959); Mich. Stats. Ann. § 26.63 (1957); Minn. Stats. Ann. § 501.14 (1947); Mont. Rev. Codes Ann. § 86-106 (1947); N.Y. Estates, Powers and Trusts Law § 7-3.4 (McKinney 1967); N.D. Cent. Code § 59-03-10 (1960); S.D. Code of 1939, § 59.0306; Wis. Stats. Ann. § 231.13 (1957).

56. *But see* notes 53 & 54 *supra*, and accompanying text.

57. *See* note 52 *supra*, and accompanying text.

58. *See* note 55 *supra*, and accompanying text.

these provisions relating to income restrictions are not applicable to the unitrust, since the concept of "income" is alien to the unitrust. Receipts cannot be equated to income, because they become, immediately upon receipt, a sort of undivided part of the fund. However, since the fund is the amount to be managed by the trustee, the unitrust is arguably nothing but corpus, with periodic payments from corpus to the life tenant.[59] But this argument would be worthless in states which protect income, but subject the beneficiary's corpus interests to attachment.[60] Therefore, while a spendthrift unitrust should generally be valid, arguments for its validity must vary from state to state.

The remaining problem is whether the spendthrift unitrust will qualify for the marital deduction. As a general proposition, spendthrift provisions do not destroy the marital deduction,[61] but the marital deduction has been disallowed in states which place a good-faith restriction on an otherwise unlimited power of invasion by the spouse.[62] This reasoning would disqualify a unitrust which names remaindermen, since the unitrust by its nature does not permit complete exhaustion of the fund,[63] but it would not disqualify a spendthrift estate unitrust.

However, one further caution should be observed concerning spendthrift clauses and the estate unitrust. A recent case[64] held that

59. Although the part of this argument involving the non-income nature of receipts seems reasonable, it is suggested that the trustee tread lightly with the last analogy to a constant corpus, since this would make the unitrust similar in form to a discretionary trust. This is undesirable for marital deduction purposes. An argument to this effect by the Commissioner, however, could be countered with the contention that even if the unitrust is really nothing but corpus, it is not subject to attack as being discretionary, since the express payout percentage in the instrument leaves the unitrustee with no discretion in this matter.

60. *See* notes 51 & 52 *supra*, and accompanying text.

61. *See* Treas. Reg. § 20.2056(b)-5(f)(7) (1967). Note that this Regulation appears in the discussion involving power of appointment trusts. However, it has been cited to support the general proposition above. Morever, as will be discussed in the next section of this note, it is doubtful whether the words in this section of the Regulations which limit the approval of spendthrift clauses to power of appointment trusts, are still binding after Northeastern Pa. Nat'l Bank & Tr. Co. v. United States, 387 U.S. 213 (1967).

62. Piatt v. Gray, 321 F.2d 79 (6th Cir. 1963); Gelb v. Commissioner, 298 F.2d 544, 548 (2d Cir. 1962); Estate of May v. Commissioner, 283 F.2d 853 (2d Cir. 1960). However, the deduction was permitted even when the instrument provided for a gift over, where the surviving spouse was given an unlimited power of invasion, in Hoffman v. McGinnes, 277 F.2d 598 (3d Cir. 1960).

63. Technically the unitrust could never be completely depleted, since only a stipulated percentage of the fund is distributed, thus always leaving something in the fund for the next valuation date. Of course, the fund can easily become too small for effective management, or even for any realistic value to the beneficiary.

64. Utley v. Graves, 258 F. Supp. 959 (D.D.C. 1966), *rev'd sub nom.* American Sec. & Tr. Co. v. Utley, 382 F.2d 451 (D.C. Cir. 1967). *See* comments on this case in the District Court, in 67 COLUM. L. REV. 780 (1967); 55 GEO. L.J. 952 (1967).

spendthrift provisions were ineffective because by taking under the will, a widower had foregone his statutory share and thus had given a consideration for the trust. Since the general rule does not permit spendthrift trusts for the benefit of the settlor, the court found that by foregoing his statutory share, the widower had become a self-settlor, and thus was not protected by the spendthrift clause. Although this case was reversed on appeal, the reasoning could appear elsewhere to defeat any spendthrift clause in a marital deduction trust.[65]

B. *The Unitrust Under Section 2056(b)(5)*

In order for a "terminable interest" to qualify for the marital deduction, it must meet five requirements set forth in the Regulations.[66] When Lovell proposed the unitrust concept, it would not have qualified for the marital deduction as a power of appointment trust,[67] because it did not meet all these requirements. But after the *Northeastern Pennsylvania*[68] decision, the unitrust will qualify, under the following reasoning. The disqualifying characteristic of the unitrust under prior law was the possibility that payouts would be less, during some years, than "all the income" of the trust. If less than all the income were to be paid to the surviving spouse, it was required that the income paid represent a fractional or percentile share of all the income, or all the income from a fractional or percentile share of the corpus.[69] Since the payout percentage is based on a fund consisting of both corpus and receipts, rather than on a specific amount of corpus or of income, the Commissioner would have disallowed the marital deduction entirely because of its incalculability.[70] However, extension

65. *But see* RESTATEMENT § 156, comment *f*.

66. "(1) The surviving spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest. (2) The income payable to the surviving spouse must be payable annually or at more frequent intervals. (3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate. (4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events. (5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse." Treas. Reg. § 20.2056(b)-5(a) (1967). Only parts (1) and (3) present particular problems with respect to the unitrust.

67. *See* Lovell, *supra* note 1, at 218-19.

68. 387 U.S. 213 (1967).

69. Treas. Reg. § 20.2056(b)-5(c) (1967).

70. The reasoning here is similar to: Estate of May v. Commissioner, 283 F.2d 853 (2d Cir. 1960), regarding limits on the power of appointment; the related question of limits on powers to invade corpus, discussed and criticized in Howard & Lederer, *The Marital Deduction: Powers of Invasion and the "All Events" Requirement*, 40 ST. JOHN'S L. REV. 179 (1966); and the incalculability criterion of Rev. Rul. 60-385, 1960-2 CUM. BULL. 77, discussed in text accompanying note 24 *supra*.

of the definition of "specific portion" in *Northeastern Pennsylvania* to include stipulated amounts, from which can be calculated an appropriate deduction amount using projected earnings tables, permits use of the unitrust. Although the payout percentage is less than all the income, application of the percentage to the original corpus provides an amount from which the allowable marital deduction can be calculated with the projected earnings figures.[71] But note that if this projection procedure is pursued, the estate could lose part of the benefit of the marital deduction under pecuniary or fractional share marital deduction trusts. If the maximum marital deduction is first calculated and this amount set aside in trust, and then the computations above are applied, the allowable marital deduction will be only a "specific portion" of such maximum marital deduction. This problem can be eliminated by providing in the will that the deduction-maximizing computations and the income-projection calculations be used together to arrive at the final determination of the amount for funding the trust. Hence, the will should provide that the corpus of the trust, as determined pursuant to the deduction-maximizing computation, shall be increased by an amount such that the finally-determined income-projection figure will equal the maximum allowable marital deduction.

This discussion assumes that the marital deduction power of appointment unitrust provision will give the surviving spouse the appropriate power of appointment, which will not differ from that of a traditional trust. Therefore, one need only consider cautions suggested by prior litigation in this area.[72]

The considerations above have dealt with specific points of concern under the Regulations. In addition, the unitrust form has a characteristic which should recommend it to the Commissioner. A recurring point in the Regulations is that the surviving spouse must have the "requisite degree of beneficial enjoyment;" that is, the governing instrument must not evidence an intent to deprive the spouse of such beneficial enjoyment.[73] One of the most favorable aspects of the

71. Of course, if the payout percentage is set high enough so that it will always consume some corpus, or if an alternative clause stipulating that the spouse is always to be paid at least all the "income" as traditionally defined, there should be no difficulty in obtaining the deduction.

72. *See, e.g.*, Piatt v. Gray, 201 F. Supp. 401 (W.D. Ky. 1961), *aff'd*, 321 F.2d 79 (6th Cir. 1963), and the power of appointment aspects of the discussion in Gelb v. Commissioner, 298 F.2d 544 (2d Cir. 1962); Estate of May v. Commissioner, 283 F.2d 853 (2d Cir. 1960); Hoffman v. McGinnes, 277 F.2d 598 (3d Cir. 1960). *See also* Treas. Reg. § 20.2056(b)-5(g) (1967), especially subsec. (3), and -5(j); Dane, *Marital Deduction Questions—Three Current Tax Issues and Suggested Solutions*, 103 TRUSTS & ESTATES 112 (1964).

73. *See* Treas. Reg. § 20.2056(b)-5(f)(1), (3), (4), (5) (1967).

marital deduction unitrust is its indication that the surviving spouse is the prime object of the testator's bounty, with the implication that considerations after her welfare is assured amount, at most, to "what is left." However, since the unitrust permits the life tenant a full share of fund appreciation, it does not violate Regulation proscriptions against the holding of "unproductive" property, at least in the sense indicated by the Treasury Department.[74]

There are, however, two potential problems peculiar to the unitrust. First, since the nature of the unitrust requires valuation of the fund after the receipts have been added and appreciation has been realized, there is no provision for income during the first year of the trust. This would disqualify the unitrust as a marital deduction.[75] Therefore, it would be necessary to provide specifically in the marital deduction clause of the will that the first payout valuation will be made at the time of the original transfer of property to the unitrust, with monthly payouts of this amount prorated until the first regular valuation date. Second, if the trust is small, a larger payout percentage will be required to provide the spouse with a meaningful income. On the other hand, the larger the payout percentage, the more quickly will the fund be depleted below a worthwhile level from the standpoint of the unitrustee.[76] While this basic reasoning is theoretically applicable to any unitrust in which the payout percentage exceeds "income," a minor excess will present no practical restrictions, since the life expectancy of the surviving spouse will not be sufficient to overcome the effects of inflation and fund appreciation.

C. *When to Use the Unitrust*

1. *General Considerations–Size of the Fund.*–The basic considerations, from the settlor's standpoint, as to whether to use a unitrust are much the same as those for any other type of trust device. That is, the questions of whether to create a trust or make an outright gift, whether to employ a power of appointment or estate trust, whether to attach spendthrift provisions, or whether to grant the trustee full discretion in making additional corpus distributions, are not affected by unitrust considerations. However, the size of the conveyance in trust may affect the choice between unitrust and traditional trust.

74. *See* Treas. Reg. § 20.2056(b)-5(f)(4) (1967).

75. *See* Treas. Reg. § 20.2056(b)-4(a) (1967).

76. For example, assume a $100,000 unitrust with a 20% payout during a period of 5% annual appreciation and 5% annual receipts, and assume a full payout during the first year before effective management has begun; the fund will amount to less than $28,000 at the end of 10 years, giving the life tenant only $5,600 for the next year. This aspect of the unitrust will be examined in more detail in the next section of this note.

In each of the tables below, it is assumed that the trust is originally funded with 100,000 dollars, that each trust produces five per cent annual yield, and that the corpus appreciates at the rate of five per cent annually. Under these assumptions, a traditional trust paying out all income will produce as illustrated in Table I. Comparing these results with those of a unitrust with a payout percentage of five per cent in Table II, it is seen that payment to the beneficiary is initially greater under the unitrust. The difference between the trusts in payouts for successive years gradually diminishes until beneficial income from the traditional trust surpasses that from the unitrust (in year 21), and the corpus of the traditional trust grows more rapidly than does that of the unitrust.[77] However, when the unitrust percentage is reduced to four per cent, shown in Table III, the unitrust funds grows faster than does the traditional corpus example, and eventually surpasses the traditional trust both in corpus size (year 2) and in beneficial payments (year 24).

Table IV illustrates the effect of a ten per cent payout unitrust provision. Here, the payout percentage equals that of the combined receipts and appreciation, with the indicated progressive reduction of the fund, and consequently of the payouts. But note, as demonstrated in Table V, that when the payout percentage on the same trust is reduced to eight per cent, or less than the accrual percentage, both fund and payouts steadily increase. Hence the general rule for determination of unitrust payout percentage is as follows:

> When the payout percentage equals that of combined receipts and appreciation, the fund is gradually reduced. The greater the excess of payout percentage over combined receipts and appreciation, the more rapid is depletion of the fund and of subsequent payouts. Conversely, when the payout percentage is less than that of combined receipts and appreciation, the fund progressively increases. The greater the excess of accruals over payout percentage, the more rapid is the growth of both fund and payouts.

From these basic propositions, it is apparent that the payout percentage should be set below combined receipt and appreciation percentages.

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77. Unitrust payout is initially greater because the percentage factor is applied to a larger fund—a fund which contains income and appreciation. The excess represents payment of a share of the appreciation before such appreciation is reflected in the fund assets. This means that less of the appreeiation is actually attributed to the successive fund in the unitrust, resulting in the faster growth of the traditional corpus.

TABLE I—TRADITIONAL TRUST

Year	Corpus[78]	Income to Beneficiary
1	$100,000	$ 5,000
2	105,000	5,250
3	110,250	5,512
4	115,762	5,788
5	121,550	6,078
6	127,628	6,381
7	134,009	6,700
8	140,709	7,035
9	147,744	7,387
10	155,131	7,757
15	197,991	9,900
20	252,748	12,637
25	322,577	16,129

78. Here it is assumed that corpus appreciates at the rate of 5% annually, and that 5% net yield is realized annually on the fair market value of the fund at the beginning of each year.

TABLE II—UNITRUST

Year	Fund After Prior 5% Payout	Receipts (5% of Fund)	Appreciation (5% of Fund)	Fund for New Payout Valuation[79]	Next Year's Payout
1	$100,000	$5,000	$5,000	$110,000	$5,500
2	104,500	5,225	5,225	114,950	5,748
3	109,202	5,460	5,460	120,122	6,006
4	114,116	5,706	5,706	125,528	6,276
5	119,252	5,963	5,963	131,178	6,559
6	124,619	6,231	6,231	137,081	6,854
7	130,227	6,511	6,511	143,249	7,162
8	136,087	6,804	6,804	149,695	7,485
9	142,210	7,110	7,110	156,430	7,822
10	148,608	7,430	7,430	163,468	8,173
15	185,194	9,260	9,260	203,714	10,186
20	230,785	11,539	11,539	253,863	12,693
25	287,600	14,380	14,380	316,360	15,818

79. Here it is assumed that corpus appreciates at the rate of 5% annually, and that 5% net yield is realized annually on the fair market value of the fund at the beginning of each year.

TABLE III—FOUR PER CENT UNITRUST

Year	Fund After Prior 4% Payout	Fund for New Payout Valuation[80]	Next Year's Payout
1	$100,000	$110,000	$4,400
2	105,600	116,160	4,646
3	111,514	122,665	4,907
4	117,758	129,534	5,181
5	124,353	136,788	5,472
6	131,316	144,448	5,778
7	138,670	152,537	6,101
8	146,436	161,080	6,443
9	154,637	170,101	6,804
10	163,297	179,627	7,175
15	214,449	235,894	9,436
20	281,607	309,768	12,391
25	369,798	406,778	16,271

80. Here it is assumed that corpus appreciates at the rate of 5% annually, and that 5% net yield is realized annually on the fair market value of the fund at the beginning of each year.

TABLE IV—TEN PER CENT UNITRUST

Year	Fund After Prior 10% Payout	Fund for New Payout Valuation[81]	Next Year's Payout
1	$100,000	$110,000	$11,000
2	99,000	108,900	10,890
3	98,010	107,811	10,781
4	97,030	106,733	10,673
5	96,060	105,666	10,567
6	95,099	104,609	10,461
7	94,148	103,563	10,356
8	93,207	102,528	10,253
9	92,275	101,503	10,150
10	91,353	100,488	10,049
15	86,876	95,564	9,556
20	82,619	90,881	9,088
25	78,571	86,428	8,643

81. Here it is assumed that corpus appreciates at the rate of 5% annually, and that 5% net yield is realized annually on the fair market value of the fund at the beginning of each year.

TABLE V—EIGHT PER CENT

Year	Fund After Prior 8% Payout	Fund for New Payout Valuation[82]	Next Year's Payout
1	$100,000	$110,000	$8,800
2	101,200	111,320	8,906
3	102,414	112,655	9,012
4	103,643	114,007	9,121
5	104,886	115,375	9,230
6	106,145	116,759	9,341
7	107,418	118,160	9,453
8	108,707	119,578	9,566
9	110,012	121,013	9,681
10	111,332	122,465	9,797
15	118,174	129,991	10,399
20	125,437	137,981	11,038
25	133,147	146,462	11,719

82. Here it is assumed that corpus appreciates at the rate of 5% annually, and that 5% net yield is realized annually on the fair market value of the fund at the beginning of each year.

Annual payout amounts listed for various percentages in the last column of each unitrust table indicate that a unitrust funded with 100,000 dollars will provide only a modest income for the surviving spouse. If the figures in Table V are doubled, however, the income becomes more reasonable, and would probably suffice to maintain most widows.[83]

The larger unitrust provides the same relative advantages as does the smaller unitrust, but also permits more variation in form. For example, in very large estates where the widow would not need the entire payout of the maximum marital deduction unitrust, the settlor could project the approximate size of his estate and the approximate amount desired annually for the widow, calculate an appropriate payout percentage and initial fund for such amount, and thereby be able to determine the amount remaining for other beneficiaries, including charities.

2. *Funding the Unitrust—Types of Assets.*—Keeping in mind that any marital deduction trust must be funded only with assets included

83. For very rough approximations of results for multiples of $100,000, the statistics in the tables can be multiplied by similar factors. But it should be noted that the figures in these tables are for purposes of illustration only, and are no more precise than continuous and compounded rounding off to the nearest dollar will permit.

in the decedent's gross estate,[84] the unitrust may safely be funded with the same types of assets as traditional trusts. However, as indicated above,[85] the unitrustee and settlor need not be concerned with whether trust assets are "productive" in the traditional sense. Therefore the unitrust may be funded with, and the trustee may freely invest in, common stocks,[86] mutual funds,[87] and corporate bonds.[88] However, the nature of unitrust mechanics limits the trustee somewhat in his investment asset choices. Since each unitrust payout must consist partially of fund appreciation,[89] some assets must be liquidated annually to meet payout obligations. Hence, a significant portion of the unitrust assets must be readily marketable. Lovell suggests that this would largely preclude investment in mortgages, real estate, and tax-exempt bonds.[90] Except for this restriction, the unitrustee is limited only by the requirement of prudence in managing the fund.

3. *Relevance of the Spouse's Non-Trust Income.*—Non-trust income[91] of the surviving spouse often causes difficulties where the trust instrument provides for trustee discretion in distributing to the spouse "as her needs require," for her support, or for her "comfort and well being."[92] In such cases, the question of the testator's intent arises; that is, did the settlor intend that the trustee take the spouse's other income into account in determining her "requirements"? The unitrustee should meet none of these difficulties, since he has no discretion in payouts.

84. INT. REV. CODE of 1954, § 2056(a).

85. *See* text accompanying note 74 *supra*.

86. Standard & Poor's composite yield statistics for 500 corporate stocks during the past 3 years indicate that stock yield has slightly exceeded 3%:

1965	2.99%
1966	3.45%
1967	3.14%

Compiled from STANDARD & POOR'S TRADE & SECURITIES STATISTICS, CURRENT STATISTICS, Feb., 1968, at 31 (statistics dated Jan., 1968).

87. Mutual fund dividend yield in 1960 averaged 2.8% income and 2.3% in capital gain. BOGERT § 858. This total of 5.1% would benefit the life tenant under a unitrust, thus making mutual funds a reasonable investment.

88. Statistics compiled by Moody's Investors Service indicate that the average corporate bond yield has pushed well past 6%:

1965	4.64%
1966	5.34%
1967	5.82%
Jan., 1968	6.45%
Feb., 1968	6.40%

Compiled from MOODY'S BOND RECORD (Year End Edition), Mar. 8, 1968, at 135.

89. *See* note 77 *supra*.

90. Lovell, *supra* note 1, at 219.

91. "Non-trust income" here means income from sources other than the marital deduction unitrust, including income from other non-marital deduction trusts.

92. Halbach, *supra* note 17; McLucas, *Discretionary Trusts—Guides for Exercise of Power to Distribute Income and Principal*, 97 TRUSTS & ESTATES 210 (1958).

It has been suggested that the estate trust is useful when the surviving spouse has substantial income from independent sources, since income may be accumulated in the estate trust until needed.[93] Similarly, an estate unitrust, combined with additional discretionary distribution powers in the unitrustee, could be accommodated, for income tax purposes, to the spouse's outside income. In addition to this general consideration, or in the alternative, the payout percentage could be diminished to an appropriate level, even below the receipt percentage in an estate unitrust.[94]

IV. The Unitrust and Subchapter J

When considering the income tax aspects of the unitrust concept, it will be necessary to attempt to relate the terms "receipts," "fund," and "payouts" to more traditional trust concepts. For example, the term "receipts" is used in the trust concept partially to avoid the conflict of interest implications of the word "income." For purposes of subchapter J it is also important that "income" is not equated with "receipts." Distributable net income (DNI) is calculated on the basis of the trust's *taxable income*.[95] Hence the portion of "receipts" attributable to cash dividends, rents, and interest are obviously included in the trust's DNI.[96] However, section 643(a)(3) provides that capital gains are excluded in computing DNI to the extent that they are not distributed, and are allocated to corpus. Under the unitrust, each payout includes some distribution of the fund in excess of receipts, whenever the payout percentage is equal to or greater than the receipt percentage. Therefore it may be necessary to provide in the unitrust instrument that capital gains receipts shall be treated, for purposes of subchapter J, as allocable to "corpus" to the extent that they are not paid out pursuant to the percentage payout directions. Then there could be no question that the capital gains are to be included in DNI only to the extent that they are included in the payouts for the year.

Although payouts for any given year are calculated on the basis of the effect of the prior year's receipts on the fund, it must be remembered that this method of determining payouts is only a valuation device, and not a calculated distribution of the prior year's receipts. Stated differently, the payouts for 1969, as calculated on the last day

93. ABA Real Property, Probate and Trust Section, Report of the Subcommittee on Estate Planning and the Marital Deduction 82, 93 (Aug. 11-13, 1963).

94. For the effects of such adjustments, see tables above.

95. Int. Rev. Code of 1954, § 643(a).

96. Int. Rev. Code of 1954, § 61(a).

of 1968, will be paid from the receipts during 1969, not 1968. If the required payouts exceed 1969 liquid receipts, the unitrustee must either sell stock to meet the payments or distribute property of the value of the deficiency. If he sells stock and distributes cash, he has distributed capital gains, which then must be included in DNI. If the unitrustee makes up the deficiency by distributing shares of stock, it can be argued that he has distributed corpus, and DNI would be reduced.[97] Such treatment would, however, reduce the basis to the unitrust of shares remaining in the fund.[98] Moreover, this would not be a truly discretionary distribution, since it is made to discharge an obligation of the unitrust, so even a distribution of stock should be treated as a distribution of capital gains to the extent indicated.

Although the unitrust concept frees the trustee from conflict of interest problems of allocation presented by the traditional trust,[99] the unitrustee still must face certain aspects of allocation under subchapter J. Since a trust is treated for income tax purposes as a conduit, the trustee should "fragment" distributions to the beneficiary so that the beneficiary may properly calculate his income tax, taking full advantage of capital gain and tax-free provisions.

Assuming that the fair market value of the unitrust fund steadily appreciates from year to year, and that the unitrust instrument does not provide for discretionary distributions or invasions of corpus, the "throwback rule"[100] will not apply to the unitrust. So long as the payout percentage at least equals the receipt percentage, the unitrust will not accumulate "income," and there can thus be no "accumulation distribution,"[101] and if the payout percentage is less than the receipt percentage, payouts will not fully consume DNI for any year. For unitrusts providing for distributions in addition to the payout percentage amount, however, the throwback rule may apply to those unitrusts in which the payout percentage is less than the receipt percentage, as in the case of certain "estate unitrusts" and non-marital deduction unitrusts.

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97. *See* Note, *Taxation of Capital Gains Realized by Trusts,* 12 TAX L. REV. 99, 109 (1956).

98. INT. REV. CODE of 1954, § 1016. *See also* Barclay, *Lot of Income Beneficiaries: Remedies,* 104 TRUSTS & ESTATES 277, 278-79 (1965); Note, *Principal and Income Allocation of Stock Distributions—The Six Per Cent Rule,* 64 MICH. L. REV. 856, 869 (1966); Note, *Common Stocks in Trust,* 113 U. PA. L. REV. 228, 256 (1964). For the effects of expense allocation between corpus and distributions, see ABA REAL, PROPERTY, PROBATE & TRUST SECTION, REPORT OF THE SUBCOMMITTEE ON TRUSTS AND TRUSTS AND ESTATES: TAX GENESIS OF BENEFICIARY CONFLICT 192, 201 (Aug. 11-13, 1963).

99. *See* Part II *supra.*

100. INT. REV. CODE of 1954, §§ 666, 668.

101. INT. REV. CODE of 1954, § 665(b).

The employment of two unitrusts in the estate plan—one for the marital deduction and one for the rest of the residuary estate—may be useful in reducing taxes to the settlor's surviving family,[102] and would be particularly useful for smaller estates. For example, assume that two such unitrusts are created, one to take advantage of the marital deduction, and the other providing that the unitrustee is to make annual payouts of two per cent to each of the testator-settlor's three children or their issue. The widow's income from a similar payout percentage would be accumulated in the non-marital deduction trust[103] so long as her income from the marital deduction trust is sufficient for her needs. Now, in a smaller estate, the payout percentage for the marital deduction trust can be set at a high level (for example, ten per cent[104] or more), so that the marital deduction unitrust is progressively consumed. Then when the marital deduction trust no longer produces sufficient income for the widow, the non-marital deduction trustee may either make annual payments to supplement the widow's marital deduction trust income, or, under an unrestricted discretionary provision, could pay out her accumulated share or even her entire share of the non-marital deduction unitrust, this amount being added to the fund of the marital deduction unitrust, either pursuant to express direction in the unitrust instrument, or at the direction of the widow.[105]

The discussion in this section of the note has presupposed that the unitrust must be administered under existing tax laws and Regulations. However, some of the difficulties and uncertainties indicated above could be resolved by the Commissioner through minor adjustments to the existing Regulations. For example, DNI computation questions could be eliminated by creating a presumption that unitrust DNI equals the payout percentage as adjusted under section 643. In the alternative, the Regulations could gear unitrust DNI to the projected income percentage for the current year. It is assumed that the Commissioner, after the decision in *Northeastern Pennsylvania*,[106] will have to provide a percentage figure which may be applied to extrapolate the marital deduction amount from testamentary provisions for periodic payment of specific sums to the widow. The Regulations could provide that unitrust DNI equals the payout percentage

102. *See* Halbach, *supra* note 17, at 1425.

103. *See* INT. REV. CODE of 1954, § 663(c) ("separate share rule").

104. *See* Table IV above. But it is possible that if the payout percentage is set too high, the Commissioner will allege that the settlor has created a terminable interest.

105. If the widow herself arranges the addition to the marital deduction unitrust, however, she may lose the advantage of spendthrift provisions therein. *See* note 48 *supra*.

106. 387 U.S. 213 (1967).

amount, but only to the extent that it does not exceed the projected income percentage amount as adjusted for capital gains distributions in section 643. Such presumptions could be overcome in specific cases upon a showing by the trustee that a different computation would better achieve the purposes of the Code.

V. Conclusion

In determining whether to use the unitrust concept rather than a traditional trust, the settlor, his attorney, and his trustee must attempt to arrive at some sort of net benefit under one device or the other, as applied to the needs and desires of the particular settlor and his family. As has been shown throughout this note, there are many variables to be considered, and it is possible that the unitrust, or some types of unitrusts, will not be useful in some states, and in some individual situations. However, the unitrust generally has all the advantages and uses of the traditional trust, and a broad comparison of the two types of trusts indicates that the unitrust can be extremely useful in most estate plans. There are some drawbacks, one of the most significant of which is the fact that its novelty may initially give rise to some interpretive litigation, instigated by private parties, such as creditors of the beneficiary, or by the Commissioner of Internal Revenuc. But it must be noted that this risk of litigation is, at most, only a possibility, and as such must be weighed against the strong attributes of the unitrust concept, including the unitrustee's freedom to manage for maximum benefit to all beneficial parties, and the flexibility permitted by abandoning the restrictive concepts of income and corpus. Although the unitrust is not a panacea for all trust problems, and it does not completely revise current trust law, the unitrust concept should be eagerly accepted by the trust industry as a solution to many of the problems spawned by the failure of trust law to keep pace with changes in trust administration.

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