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## Probate Law

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## PROBATE LAW

### I. SUPREME COURT HOLDS REVOCABLE INTER VIVOS TRUST INVALID AS ILLUSORY AND SUBJECT TO THE ELECTIVE SHARE OF A SURVIVING SPOUSE

In *Seifert v. Southern National Bank*<sup>1</sup> the South Carolina Supreme Court held that, when “a spouse seeks to avoid payment of the elective share by creating a trust over which he or she exercises substantial control, the trust may be declared invalid as illusory, and the trust assets will be included in the decedent’s estate for calculation of the elective share.”<sup>2</sup> The court’s broad language in striking the revocable inter vivos trust in this case created significant questions about the general validity of such trust. However, the South Carolina General Assembly responded to limit the *Seifert* holding to trusts designed to avoid a spouse’s elective share.<sup>3</sup>

Decedent, Harry Seifert, was married to Agnes Seifert for ten years. Prior to his death, Mr. Seifert created a revocable inter vivos trust in favor of his daughters from a previous marriage, but he retained the income benefits of the trust for his lifetime. At the time of Mr. Seifert’s death, the value of the trust was approximately \$800,000, and his gross estate, including the trust, totaled approximately \$1,200,000. Under the terms of the trust, upon Mr. Seifert’s death, \$150,000 was carved from the trust and placed into a separate trust for the benefit of the widow.<sup>4</sup>

Mrs. Seifert claimed that the revocable inter vivos trust was part of her husband’s estate, therefore subject to her statutory elective share.<sup>5</sup> Mr. Seifert’s daughters, the beneficiaries of the trust, sought to exclude

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1. 305 S.C. 353, 409 S.E.2d 337 (1991).

2. *Id.* at 357, 409 S.E.2d at 339 (footnote omitted).

3. *See infra* note 39 and accompanying text.

4. *Seifert*, 305 S.C. at 354-55, 409 S.E.2d at 338. This new trust was called the “Agnes T. Seifert Trust.” Mrs. Seifert received a life estate in the income of this trust, but could invade its principal only for medical reasons. Mr. Seifert’s daughters retained the remainder interest in the new trust. Under the decedent’s will, Mrs. Seifert also received a one-half life interest in the marital home, and the residue of the estate was transferred to the main trust. *Id.*

5. *Id.* South Carolina’s elective share statute provides: “[I]f a married person domiciled in this State dies, the surviving spouse has a right of election to take an elective share of one-third of the decedent’s probate estate, as computed under § 62-2-202.” S.C. CODE ANN. § 62-2-201(a) (Law. Co-op. Supp. 1991).

the trust assets from their father's estate pursuant to section 62-2-202 of the South Carolina Probate Code (SCPC).<sup>6</sup>

The supreme court, relying on *Moore v. Jones*<sup>7</sup> and *Newman v. Dore*,<sup>8</sup> found the trust invalid as illusory because the decedent retained extensive control over the trust during his life.<sup>9</sup> The court expressly rejected the respondents' interpretation of section 62-2-201 of the SCPC.<sup>10</sup> The respondents argued that the 1987 amendments to these sections indicated the legislature's intention to exclude trusts and other nonprobate assets from the estate by which the elective share is calculated.<sup>11</sup> However, the court stated that these sections did not specifically preclude the trust from being included in the decedent's estate.<sup>12</sup> The court further noted that very little difference exists between an illusory trust and an otherwise valid trust that fails; in either case, the trust assets revert to the settlor's estate and become subject to the elective share.<sup>13</sup>

6. S.C. CODE ANN. § 62-2-202 (Law. Co-op. Supp. 1991). This section defined the "probate estate" to include "the decedent's property passing under the decedent's will plus the decedent's property passing by intestacy, reduced by funeral and administration expenses and enforceable claims." *Id.* Prior to its amendment in 1987, section 62-2-202 provided: "Estate means the estate reduced by funeral and administration expenses and enforceable claims." S.C. CODE ANN. § 62-2-202 (Law. Co-op. 1987) (current version at S.C. CODE ANN. § 62-2-202 (Law. Co-op. Supp. 1991)). The reporter's comments to the prior section stated:

This section rejects the "augmented estate" concept promulgated by the drafters of the Uniform Probate Code as unnecessarily complex. The spouse's protection relates to all real and personal assets owned by the decedent at death but *does not take into account the use of various will substitutes which permit an owner to transfer ownership at his death without use of a will. Judicial doctrines identifying certain transfers to be "illusory" or to be in "fraud" of the spouse's share have evolved in some jurisdictions to offset the problems caused by will substitutes.*

*Id.* § 62-2-202 cmts. (emphasis added).

7. 261 S.E.2d 289 (N.C. Ct. App. 1980) (finding an otherwise valid trust ineffective only insofar as it impaired surviving spouse's statutory rights).

8. 9 N.E.2d 966 (N.Y. 1937) (applying illusory-transfer test whereby inter vivos trust is void if settlor failed to divest himself of ownership of property).

9. *Seifert*, 305 S.C. at 355-56, 409 S.E.2d at 338 (noting that the trust was completely revocable, that the trust agreement described the trustee's role as merely custodial, and that the terms of trust did not allow the trustee to sell, invest, or reinvest any of the assets during Mr. Seifert's lifetime, unless he gave written notice or was incompetent).

10. *Id.* at 356, 409 S.E.2d at 339.

11. *See supra* note 6.

12. *Seifert*, 305 S.C. at 356, 409 S.E.2d at 339.

13. *Id.*

The court also refused to accept the respondents' contention that the South Carolina General Assembly's rejection of the Uniform Probate Code's "augmented estate" option<sup>14</sup> implicitly prohibited the invalidation of the trust.<sup>15</sup> The court reasoned that the right to receive the elective share is substantial because section 62-2-204 of the SCPC requires any waiver of the elective share to be in writing.<sup>16</sup> Therefore, the legislature did not intend to allow that right to be circumvented in this manner.<sup>17</sup> The court concluded that, because nothing in the SCPC expressly prohibits the proceeds of an invalid or illusory trust from being included in the probate estate, the proceeds of the decedent's trust should be included in his estate and subject to the elective share.<sup>18</sup>

*Seifert* illustrates the underlying public policy conflict between the desire to protect a surviving spouse from disinheritance and the settlor's right to alienate freely his property during his lifetime.<sup>19</sup> Although the court held that the trust was illusory and subject to the elective share, the legislative history of the statute and the common law of South Carolina suggest that the trust was a valid nonprobate asset, not subject to the elective share. The breadth of the *Seifert* court's decision left unanswered many questions concerning the viability of revocable trusts.

In 1984 the South Carolina Supreme Court acknowledged that "[t]he right to deal with one's real property without the prior consent and cooperation of one's spouse is substantial and valuable."<sup>20</sup> The court held that the South Carolina common-law right of dower, which protected only widows from disinheritance, was unconstitutional under the Equal Protection Clause.<sup>21</sup> After this decision, wives in South Carolina had no protection from disinheritance until the elective share statute of the SCPC<sup>22</sup> became effective on July 1, 1987.<sup>23</sup>

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14. UNIF. PROB. CODE § 2-202, 8 U.L.A. 75 (1990); see also S.C. CODE ANN. § 62-2-202 cmts. (Law. Co-op. 1987) (current version at S.C. CODE ANN. § 62-2-202 (Law. Co-op. Supp. 1991)).

15. *Seifert*, 305 S.C. at 356, 409 S.E.2d at 339 (noting that the augmented estate "is an elaborate system of incorporating various non-probate assets into the estate").

16. *Id.* at 357, 409 S.E.2d at 339 (citing S.C. CODE ANN. § 62-2-204 (Law. Co-op. 1987)).

17. *Id.*

18. *Id.*

19. See *Moore v. Jones*, 261 S.E.2d 289, 292 (N.C. Ct. App. 1980) (discussing these competing policies).

20. *Boan v. Watson*, 281 S.C. 516, 519, 316 S.E.2d 401, 403 (1984).

21. *Id.* The Equal Protection Clause provides: "No State shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.

22. S.C. CODE ANN. § 62-2-201 (Law. Co-op. Supp. 1991).

As originally enacted, the SCPC included a broadly defined estate as the basis of calculating the elective share.<sup>24</sup> This broad definition of “estate” could have subjected nonprobate assets to the elective share despite the reporter’s comments to this section. The General Assembly amended sections 62-2-201 and 62-2-202 to provide that the elective share could be charged only against the “probate estate,” which the legislature defined as those assets passing by will or intestacy, less funeral and administration expenses and enforceable claims.<sup>25</sup> The court offered no explanation for these amendments to the SCPC, but summarily noted that the legislature’s rejection of the augmented estate concept did not “prohibit invalidation of [an] inter vivos trust.”<sup>26</sup> The only realistic explanation for the amendments and the rejection of the augmented estate concept is that the legislature intended to prohibit nonprobate assets, such as revocable inter vivos trusts, from inclusion in elective share calculations. The court’s failure to address the legislative intent of the amendments to the SCPC may render the amendments meaningless.<sup>27</sup>

Furthermore, the SCPC suggests that the trust should have been upheld as valid and not subject to the elective share. The judiciary must apply the terms of a statute according to their literal meaning when the terms are clear and unambiguous.<sup>28</sup> The language of the amended

23. S.C. CODE ANN. § 62-1-100(a) (Law. Co-op. Supp. 1991) (establishing July 1, 1987 as the effective date of the SCPC unless otherwise provided).

24. See S.C. CODE ANN. § 62-2-201(a) (Law. Co-op. 1987) (stating that “the surviving spouse has a right of election to take an elective share of one-third of the decedent’s estate, as computed under § 62-2-202”) (emphasis added) (superseded); S.C. CODE ANN. § 62-2-202 (Law. Co-op. 1987) (defining “estate” for purposes of § 62-2-201 as “the estate reduced by funeral and administration expenses and enforceable claims”) (superseded); S.C. CODE ANN. § 62-1-201(11) (Law. Co-op. 1987) (defining “estate” to include generally “the property of the decedent, trust, or other person whose affairs are subject to this Code as originally constituted and as it exists from time to time during administration”).

25. See *supra* note 6.

26. *Seifert v. Southern Nat’l Bank*, 305 S.C. 353, 357, 409 S.E.2d 337, 339 (1991).

27. Cf. *Crescent Mfg. Co. v. South Carolina Tax Comm’n*, 129 S.C. 480, 493-94, 124 S.E. 761, 765 (1924) (stating that “a statute must receive such construction as will make all of its parts harmonize with each other and render them consistent with its general scope and object”). Notably, the *Seifert* court held that “the trust assets will be included in the decedent’s estate,” instead of using the term “probate estate.” *Seifert*, 305 S.C. at 357, 409 S.E.2d at 339 (emphasis added).

28. *Crown Cork & Seal Co. v. South Carolina Tax Comm’n*, 302 S.C. 140, 394 S.E.2d 315 (1990); accord *South Carolina Dep’t of Highways & Pub. Transp. v. Dickinson*, 288 S.C. 189, 191, 341 S.E.2d 134, 136 (1986) (noting that the supreme court has “no right to legislate the provision from the statute or to modify its

statutes distinguishes probate assets from nonprobate assets; only probate assets, those passing by will or intestacy, are included in computing the elective share.<sup>29</sup> Moreover, the SCPC recognizes the validity of a revocable inter vivos trust,<sup>30</sup> and South Carolina case law has long upheld a revocable trust as a valid nonprobate transfer.<sup>31</sup> Because the assets of a valid revocable inter vivos trust are nonprobate assets, the SCPC unambiguously prohibits those assets from inclusion in elective share calculations.<sup>32</sup>

The *Seifert* court's holding brings the validity of all revocable trusts into question. The court held that a settlor's extensive control over a revocable trust renders the trust invalid, but failed to limit its sweeping language to actions involving elective share calculations.<sup>33</sup> This rationale ignores previous South Carolina decisions. In *Citizens & Southern National Bank v. Auman*<sup>34</sup> the court stated that "[c]ertainly, the creation of a revocable trust indicated that the donor intended to retain ultimate control of the estate."<sup>35</sup> The cases cited by the *Seifert* court in support of its finding that the revocable trust was illusory did not involve statutes that limited the elective share to probate assets.<sup>36</sup> Even those jurisdictions that have found revocable trusts illusory for elective share purposes have upheld such trusts for all other purposes.<sup>37</sup> The *Seifert* court

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application under the guise of judicial interpretation?") (quoting *Davis v. Doe*, 285 S.C. 538, 541, 331 S.E.2d 352, 354 (1985)).

29. See S.C. CODE ANN. §§ 62-2-201 and -202 (Law. Co-op. Supp. 1991).

30. S.C. CODE ANN. § 62-6-201(a) (Law. Co-op. 1987) (stating that a transfer effective as a contract, gift, or trust is valid, although deemed nontestamentary); S.C. CODE ANN. § 62-7-603(A)(3) (Law. Co-op. Supp. 1990) (implicitly upholding validity of revocable inter vivos trusts by preventing merger of legal and equitable titles to property held in trust, unless the legal and equitable titles are identical).

31. See *Citizens & S. Nat'l Bank v. Auman*, 259 S.C. 263, 191 S.E.2d 511 (1972) (construing terms of a revocable trust after donor's death); *Peoples Nat'l Bank v. Peden*, 229 S.C. 167, 92 S.E.2d 163 (1956) (acknowledging power to revoke trust when validly reserved by the trust document).

32. See S.C. CODE ANN. § 62-2-201(a) (Law. Co-op. Supp. 1991) (limiting the elective share to decedent's "probate estate"); S.C. CODE ANN. § 62-2-202 (Law. Co-op. Supp. 1991) (defining "probate estate").

33. *Seifert v. Southern Nat'l Bank*, 305 S.C. 353, 355-56, 409 S.E.2d 337, 338 (1991) (stating that "[i]n light of the evidence of Husband's extensive control over the trust, we find that the trust is illusory and, thus, invalid").

34. 259 S.C. 263, 191 S.E.2d 511 (1972).

35. *Id.* at 267, 191 S.E.2d at 514.

36. See *Newman v. Dore*, 9 N.E.2d 966, 967 (N.Y. 1937); *Moore v. Jones*, 261 S.E.2d 289, 291 (N.C. Ct. App. 1980).

37. See, e.g., *Moore*, 261 S.E.2d at 292.

ignored not only South Carolina case law and the legislative intent to uphold revocable trusts, but also the trend of the modern authorities.<sup>38</sup>

In response to *Seifert*, the South Carolina General Assembly amended the SCPC to ensure the general validity of revocable inter vivos trusts.<sup>39</sup> The legislature's corrective action should clarify the current legal relationship between revocable inter vivos trusts and the elective share and should restore predictability in the practice of estate planning. This welcomed response to *Seifert* protects settlors' alienation rights while protecting surviving spouses from disinheritance. Consequently, a court may now declare an otherwise valid revocable inter vivos trust illusory, but only for purposes of including trust assets in the testator's probate estate for calculating the elective share.

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38. See generally 1A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 57.2, at 140 (4th ed. 1987) (noting that the trend "is to uphold an inter vivos trust no matter how extensive may be the powers over the administration of the trust reserved by the settlor"). Additionally, the court's emphasis on excessive retention of control may lead to questions about the validity of other transfer instruments. Cf. *In re Estate of Francis*, 394 S.E.2d 150 (N.C. 1990) (refusing to extend surviving spouse's rights to joint bank accounts with right of survivorship).

39. Act of June 23, 1992, § 3, 1992 S.C. Acts 475 (to be codified at S.C. CODE ANN. § 62-7-112). This new section provides:

A revocable inter vivos trust may be created either by declaration of trust or by a transfer of property and is not rendered invalid because the trust creator retains substantial control over the trust including, but not limited to, (1) a right of revocation, (2) substantial beneficial interests in the trust, or (3) the power to control investments or reinvestments. Nothing herein, however, shall prevent a finding that a revocable inter vivos trust, enforceable for other purposes, is illusory for purposes of determining a spouse's elective share rights under Section 62-2-201 *et seq.* A finding that a revocable inter vivos trust is illusory and thus invalid for purposes of determining a spouse's elective share rights under Section 62-2-201 *et seq.* shall not render that revocable inter vivos trust invalid, but would allow inclusion of the trust assets as part of the probate estate of the trust creator only for the purpose of calculating the elective share and would make available the trust assets for satisfaction of the elective share only to the extent necessary under Section 62-2-207.