THE TREASURY INTERPRETS THE CLIFFORD CASE

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The Clifford case,¹ a hardy perennial, is again in bloom. Analyzed, criticized or cited in more than two hundred decisions over a six-year period, it has already caused such confusion in the determination of whether income of certain trusts is taxable to the grantor or to the beneficiary, as to become the despair of both bench and bar.

In 1945, Roswell Magill proposed a resolution of the uncertainties by statutory amendments which would contemplate the following results:

1. If the income of the trust is in fact used to discharge the settlor's pecuniary obligations, the settlor shall be taxable on the income so used.
2. If the settlor retains the power to add or subtract beneficiaries, he shall be taxable on the income subject to such power.
3. The income of trusts having a term of five years or less (after which the corpus is to revert to the settlor) shall be taxed to the settlor.
4. The fact that the settlor, or an individual or institution of his choice is trustee, shall not render the settlor taxable upon the trust income.
5. The fact that the settlor retains the power to direct trust investments or to vote corporate stock held by the trustee shall not render him taxable on the trust income.²

The Clifford principle as stated by the Treasury is that a grantor of a trust is taxable under Sec. 22(a)³ if he has retained "a control of

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In this article the following abbreviated citations will be used: Decisions of the Board of Tax Appeals will be cited as B. T. A. Decisions of the Tax Court (formerly Board of Tax Appeals) will be cited as T. C. Memo. Op., Dkt. refers to docket number of a Memorandum Opinion of the Board of Tax Appeals or the Tax Court. Acquiescence of the Commissioner of Internal Revenue in a decision of the Board of Tax Appeals or the Tax Court will be cited as A. Non-acquiescence will be cited as N. A. Internal Revenue Bulletins will be cited as I. R. B. Cumulative Bulletins of the Internal Revenue Bureau will be cited as C. B. Internal Revenue Code will be cited as I. R. C. and Treasury Decisions will be cited as T. D.

3. I. R. C. Sec. 22(a) includes among "gross income" all "... gains, profits, and income
the trust so complete that he is still in practical effect the owner of its income.” Recognizing that the application of this principle “to varying and diversified factual situations” has led to considerable uncertainty, the Treasury has now set down specific norms by which in its judgment the doctrine is to be applied.4 While the purpose of Mr. Magill’s article was to analyze and evaluate the Clifford decision and the cases stemming from it, the primary purpose of this paper is to make an examination and appraisal of the Treasury’s interpretation of the decision with a view to indicating the extent to which it has judicial support.

It will be recalled that Clifford had set up a trust for his wife for a period of five years, following which the principal was to revert to him, and that if he died within that period the trust was to terminate and the principal to pass to his estate; that he had the right to pay over to his wife all or any part of the net income as he “in his ‘absolute discretion’ might determine”, but that any income not distributed to her became hers upon the trust’s termination, and that as sole trustee he had quite normal powers of administrative control—power to vote stocks held in trust, to sell, mortgage or pledge the trust assets, to make investments and to retain the assets in his own name. Noting three factors, the shortness of the trust term, the intimacy of the family relationship between the grantor-husband and the beneficiary-wife, and the control over the trust which the former retained, and stressing and amplifying the last two considerations, the Court held Clifford to be in substance the owner of the trust property, and, as such, taxable on its income.

By the decision, the Commissioner was invited to fare forth and attack with “all considerations and circumstances of the kind we have mentioned”, and the taxpayer was warned that he was defenseless if his only armor consisted of “niceties of the law of trusts or conveyances”, or “legal paraphernalia”. Just when all such considerations and circumstances added up to an effective weapon, and at what point legal rights deteriorated into legal paraphernalia was an intriguing problem left to future adjudication. The Court admonished that no one fact was normally decisive. That a melee of vexatious litigation would ensue should have surprised no one. There was no definite yardstick, no fixed standard. On the contrary, the Court noted the failure derived ... from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever ...” Sec. 22(a) of the Revenue Act of 1934, under which the Clifford case was decided, contained an identical provision.

of Congress to provide a "rule of thumb," and this was indeed a failure, presupposing that the judicial interpretation of Sec. 22(a) in relation to trust income accurately reflected Congressional intent. Later cases made reference to "the process of repeated adjudications" consequent upon "the absence of legislative rule," and to a solution of the difficulty "by statute or treasury regulation." Again, the wish was expressed that the Clifford case could be advanced from "the doctrinal state in which the matter has been left by the Supreme Court" to a field with "some definite monuments." Perhaps the most discouraging view of all was that taken by the Second Circuit when it characterized the decision as the "starting point of a fertile proliferation, out of which no definite doctrine has emerged, or in the nature of things could emerge."

Surely, these were broad hints to Congress and the Treasury to come forward with something specific. Hence, in the absence of Congressional action, the Treasury is to be commended for undertaking the task. It was an exacting one. An extremely narrow construction would adversely affect the public revenue, while an unduly broad construction would sow the seeds of still further litigation. As was stated by the Treasury's Assistant Tax Legislative Counsel prior to the publication of T. D. 5488, the "lines drawn should not represent minimum effects from the Commissioner's point of view, nor should the Bureau seek to grasp each last ounce of revenue." That the Treasury has achieved the middle-of-the-road desideratum not all will agree.

The three general factors which the Treasury considers determinative of the question of taxability of trust income to the grantor under the Clifford doctrine are retention of (1) reversionary interest effective after a relatively short term, (2) power to dispose of beneficial enjoyment of corpus or income, and (3) power of administrative control exercisable primarily for the grantor's benefit. Before discussing these three major items in detail, it may be observed that several considerations mentioned in the decided cases are not deemed by the Treasury

10. T. D. 5488 has no application to income from trusts received by divorced or legally separated persons. The tax accounting of such income is governed by I. R. C. Secs. 22(k) and 171.
to be relevant to the issue, for example, the grantor's purpose of minimizing taxes through the creation of a trust.\textsuperscript{11} Neither is the shortness of the trust term a factor, unless coupled with a reversionary interest in the grantor,\textsuperscript{12} nor the circumstance that the grantor is a trustee, unless certain powers are exercisable by him under stated conditions.

I

Reversionary Interest After Relatively Short Term

The Regulations provide that a grantor is taxable upon trust income if he has a reversionary interest in the corpus or income which becomes effective within 10 years of the date of the transfer to the trust. They also hold the grantor taxable if he has such interest which becomes effective within 15 years of such date and any one of three specified power of administration is exercisable solely by the grantor, the spouse living with the grantor, or both, whether or not as trustee. These powers are (1) power to vote or direct the voting of stock or other securities, (2) power directly or indirectly to control investments, and (3) power to reacquire trust corpus. Of these, the first two are not abnormal fiduciary powers. Hence, in a case in which the grantor or wife living with him is the sole trustee, or in which both are the sole trustees, he will normally be held taxable on the income if a reversionary interest exists and the trust is to last less than 15 years. Even in the event that there are additional trustees, it appears that the grantor will be held taxable if he has reserved the right to remove them.\textsuperscript{13} The provision with respect to a trust of less than 15 years' duration, unlike that with respect to one of less than 10 years' duration, has no application if the sole income beneficiaries are charities.

Short Term Trusts Lacking Family Beneficiary or Administrative Control Factors. One of the stated bases of the Clifford decision was "the fact that the wife was the beneficiary", and the Court, in developing this point, indulged in such phrases as "a temporary reallocation of

\textsuperscript{11} Avoidance of taxes was mentioned by the Court as one of the purposes of the Clifford trust, but, as pointed out in the Hyman case, there was no indication in the opinion that taxpayer's motive was considered by the Court to be a factor relevant to the result.

\textsuperscript{12} Cf. Helvering v. Fuller, 310 U. S. 69 (1940).

\textsuperscript{13} See Stockstrom et al., Trustees v. Commissioner, 151 F. (2d) 353 (C. C. A. 8th, 1945), aff'd 4 T. C. 5, in which the Court adopted the language of the Tax Court opinion as follows: "But she... reserved the right by amendment to the trust agreements to remove any of the trustees and to name herself as trustee. We think that this reserved power gave her as complete control over the action of the trustees and over the distribution of trust income as if she herself had been the sole trustee." See also Standish Backus Est., 6 T. C. —, No. 132 (May 19, 1946) A. 1946-17-12372.
income within an intimate family group", "the normal consequences of family solidarity", "household arrangements", the "intimacy of the familial relationship" of grantor and beneficiary, and income which "stays in the family group".

Another of the stated bases of the decision was Clifford's "retention of control over the corpus". This concept was reiterated by statements to the effect that Clifford's "control over investment remained", that his "control over the corpus was in all essential respects the same after the trust was created, as before", and that the "wide powers which he retained included for all practical purposes most of the control which he as an individual would have." Again, it was said that "the all-important factor might be retention by him of control over the principal. With that control in his hands he would keep direct command over all that he needed to remain in substantially the same financial situation as before."

Despite such rationalization, the Regulations flatly hold that, irrespective of the relationship of grantor to beneficiary, and irrespective of whether he has retained any control over the corpus, every grantor of a trust with a reversionary interest effective within 10 years is taxable on the income. There would seem to be little room for doubt that the scope of this provision is far beyond that of the Clifford opinion as rendered. It remains for consideration, however, as to whether it is outside the Clifford doctrine as subsequently extended by the courts.

In the Schaffner case, the Court said:

"Income which the donor gives away through the medium of a short term trust created for the benefit of the donee is nevertheless income taxable to the donor. Helvering v. Clifford, supra."

Is this statement a repudiation of the elaborate reasoning of the Clifford opinion? Should it be interpreted to mean that absent the factor of family beneficiary, and absent the factor of trust control, Clifford, nevertheless, would have been taxable on the trust income? It would appear that such is the Treasury view. It was forecast by Mr. De Wind when he stated:

"Logically, it must appear to make very little difference whether the beneficiaries are members of the family group or not, particularly in view of the Schaffner case."

The Schaffner case dealt, not with a short-term trust, but with a situation in which the donor assigned for a year a certain dollar amount

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14. 312 U. S. 579 (1941).
15. De Wind, op. cit. supra note 9, at 840.
of income from a trust. In holding the donor taxable, the Court reasoned that the gift of a part of the trust income “for the period of a day, a month or a year” involved no substantial disposition of the trust property and was no different from the “gift of income in a specified amount by the creation of a trust for a year”. This dictum would seem to indicate no more than a conviction that income from a trust of so short a duration as a year is, without consideration of any other factor, taxable to the grantor.

*Hormel v. Helvering*\(^{18}\) and *Helvering v. Richter*\(^{17}\) preceded the *Schaffner* case by two weeks. In neither was the question of liability under Sec. 22(a) specifically before the Court. Both related to short-term trusts with reversionary interests in the grantors. The *Hormel* case involved a 3-year trust of which the grantor and another were trustees. The grantor and his wife, as guardians of their son, were the beneficiaries, and were also vested with power to remove the co-trustee. The *Richter* case dealt with a trust to terminate at the end of 5 years, but which might have been terminated earlier upon consent of the wife who was the income beneficiary. In both cases the Court indicated that on the record the grantors were taxable under the *Clifford* rule. Of the *Richter* case, Mr. De Wind states that it “comes fairly close to saying that a short term is itself enough on which to predicate taxability”\(^{18}\) of the grantor. If, by “short term”, Mr. De Wind had in mind a 5-year term, it would seem that his view did not properly evaluate the circumstance that the wife of the grantor in the *Richter* case was the income beneficiary and hence that the *Clifford* case family-group factor was also present.\(^{19}\)

The Second Circuit now holds that if the trust-control element is present, the family-beneficiary factor is not essential to the taxability of the grantor under the *Clifford* doctrine. In *Commissioner v. Lamont*,\(^{20}\) the donor of a successively extended 1-year trust was held taxable on the income notwithstanding that charitable institutions as well as certain individuals not closely related to the grantor were beneficiaries. Largely influenced by the *Schaffner* decision, the Court rejected the theory of distinguishing the *Lamont* case from the *Clifford* case on the ground that in the former the beneficiaries were not members of the settlor’s

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16. 312 U. S. 552 (1941).
17. 312 U. S. 561 (1941).
19. It is possible that Mr. De Wind's view was predicated on the theory that the provision for the wife's consent to such termination might be disregarded and hence that the trust was terminable by the grantor at any time. See note 41, infra, and accompanying text.
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family group, and even went so far as to case some doubt on the correctness of its rule in the *Achelis* and *Chamberlain* cases, wherein the grantors were held not taxable on the income of 4-year and 5-year trusts, respectively, of each of which an educational organization was the income beneficiary. In the *Chamberlain* case, the Court had said that the trust there under consideration differed from both the *Clifford* and *Hormel* trusts.

"in that here no inter-family distribution of income was brought about to satisfy the natural desires of the donor in that respect and gain for him whatever intangible benefit might flow therefrom."

However, the Court distinguished the *Lamont* from the *Achelis* and *Chamberlain* cases by reference to the shorter term of the *Lamont* trust, and by the circumstances that the grantor controlled the corpus through a reservation of the right to substitute securities, and did in fact control distribution among beneficiaries.

Nor is the rationale of the *Lamont* decision entirely consistent with that of *Helvering v. Elias* wherein the Court said of the *Clifford* situation that

"the prime consideration is whether the income remains within the family."  

In *McKnight v. Commissioner*, the Eighth Circuit held taxable the grantor of a trust of less than 3 years' duration which had been set up for the benefit of his wife, notwithstanding that he had reserved no direct control. The trustee, however, was a close friend and business associate. The case was decided on the basis of the short-term and family-beneficiary factors, and the indirect control which the grantor retained through the trustee. The Court stated that under the *Clifford* doctrine "the effectiveness of the short term family trust . . . has been virtually destroyed". Obviously, if the grantor of a 3-year trust were taxable on the income merely by reason of the brevity of the trust's term, it were idle to discuss the family-beneficiary or indirect-control elements.

In *Commissioner v. Wilson*, the Seventh Circuit was concerned with a trust to continue for not more than two years for the benefit of a son.

24. *See also Commissioner v. Wooley*, 122 F. (2d) 167 (C. C. A. 2d, 1941), cert. denied, 314 U. S. 693 (1941), in which the family-beneficiary doctrine of the *Clifford* case was applied to a nephew who, the Court said, "must be regarded as 'in the family' even though he was not a member of the settlor's household."
25. 123 F. (2d) 240 (C. C. A. 8th, 1941).
Had it been the opinion of the Court that the grantor was taxable solely by reason of the 2-year term, it could readily have said so. Instead, it rested its conclusion upon the Clifford doctrine which "holds that the head of a family cannot affect his tax liability by allocating part of his income to his wife through the medium of a short term trust over the corpus of which he retains control."

In Helvering v. Bok, the Third Circuit, dealing with a 3-year trust, dismissed the theory that a short-term trust, without more, renders the income taxable to the donor, and distinguished the case under consideration from the Lamont case on the ground that in the latter "the settlor retained substantial control over investments since she could withdraw and substitute securities."

In Central National Bank of Cleveland, Exr. v. Commissioner, the Sixth Circuit also rejected "the view that the income of every short term trust should be taxed to the settlor, as far beyond the Clifford case, and those which followed it", noting:

"No case has been brought to our attention which expressly holds that a short term trust of itself requires taxation of income to the donor."

In Hyman et al v. Nunan, the Second Circuit dealt with a case in which the grantor conveyed property to herself and her husband as trustees for the benefit of her minor son, the trust to last for twelve years. She had the right to substitute any beneficiary except herself. By reason of the combination of the shortness of the term and the retention of beneficial control, the Court held her taxable. Referring to the Lamont case, the Court stated that it

"counted it the most important single factor that the settlor, although she retained no legal power to change beneficiaries, was in such a relation to the trustee that he would be almost certain to follow her wishes."

27. 132 F. (2d) 365 (C. C. A. 3d, 1942).
30. In Commissioner v. Jonas, 122 F. (2d) 169 (C. C. A. 2d, 1941), the Court had specifically stated that it had been "... referred to no decision taxing a settlor of a trust as the owner of the income where the allocation of the income to the trust beneficiaries has been for a period as long as ten years, where neither the settlor nor any member of his family has been a trustee, and where no management of or control over the investments ..." was retained. In Cory v. Commissioner, 126 F. (2d) 689 (C. C. A. 3d, 1942), cert. denied, 317 U. S. 642 (1942) the grantor of a 10-year trust, who had retained wide administrative powers, was held taxable on the income, and in Commissioner v. Berolzheimer, 116 F. (2d) 628 (C. C. A. 2d, 1940), the grantor of a less than 10-year trust who had retained administrative powers was also held taxable. See also, United States v. Pierce, 137 F. (2d) 428 (C. C. A. 8th, 1943).
In view of the circumstance that the Lamont trust was to last for only a year, this statement would seem to be proof positive that the Second Circuit, even though it does not regard the family-beneficiary factor as essential to a Clifford case, does not count the shortness of the trust term as of itself the determining factor.  

In Commissioner v. Tower, the Supreme Court reiterated the rule of the Schaffner case that it is "the command of the taxpayer over the income which is the concern of the tax laws", but the Court was applying that comment to a situation in which, in a husband-wife partnership, the "income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership", and again cited the Clifford case for the proposition that Sec. 22(a) "could not be frustrated by family group arrangements".  

Rabkin and Johnson say that there is some support in prior decisions for the Treasury Regulations holding taxable to the grantor income of a trust which reverts to him within ten years "whether or not other Clifford factors are present", and cite the Elias, Barbour and Price cases. However, in the Elias case, as has been seen, the family-beneficiary factor was present in that the income beneficiaries were the four children of the grantor and in the Barbour case the income was payable seven-tenths to the grantor's wife and children and three-tenths to her mother, while in the Price case the beneficiary was an adopted daughter, held by the Court to be "within an intimate family group". Thus, the family-beneficiary element was not lacking in any of the three cases.  

From the decided cases, it is reasonable to deduce that the grantor of a trust with reversionary interest effective after a short term may be

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31. In Helvering v. Achelis, 112 F. (2d) 929 (C. C. A. 2d, 1940), the same Court had said of the Clifford decision that it "... did not suggest that the settlor of a trust could not so completely sever himself from the income of property, for a period—even a short period—as to make it no longer his." It may be noted that in Amory S. Carhart, Memo. Op., Dkt. No. 6643 (June 20, 1946), the Tax Court held taxable the grantor of two trusts of less than nine and fourteen years duration, respectively, commenting: "When a grantor has retained the reversion, as he did here, but the term of the trust is comparatively short, the retention of administrative control by the grantor is not a requisite of its taxability." This statement, however, is merely dictum since in addition to the shortness of the trusts' terms there were present the family beneficiary and administrative control factors, and the decision rested on all of these.  

32. 326 U. S. 703 (1946).  

33. FEDERAL INCOME, GIFT AND ESTATE TAXATION (1944) 3416.  

34. 122 F. (2d) 171 (C. C. A. 2d, 1941), cert. denied, 314 U. S. 692 (1941).  


taxable on the income if the beneficiaries are within an intimate family group, even though there exist no powers of administrative control, and that he may also be taxable although there is present no factor of family beneficiary, but there does exist an important power of administrative control. Even in these cases the Treasury, in fixing as a short term any term within ten years, is skirting along the outside limits mentioned by the courts. But these deductions are a far cry from Regulations which hold taxable to the grantor the income of a trust of less than 10 years' duration in which there is a reversionary interest, but where there exists no factor of family beneficiary and no element of administrative control. Such provisions appear far to transcend the bounds of judicial sanction. In the Barbour case the Court observed that "to formulate a predictable rule for the taxation of grantors who set up trusts in their property for short terms and retain the reversion is far from easy." It would seem that the Treasury has somewhat oversimplified the task.

As long as the family-beneficiary factor of the Clifford case was recognized, it was logical, if a charity were the beneficiary of a short-term trust, to hold the grantor not taxable on the income. Such, in fact, was the distinction drawn in the charity-beneficiary cases, but once the family-beneficiary factor is discarded, as in the Regulations, it would appear that policy rather than logic dictates the basis for the exception whereunder, in the case of trusts of less than 15 years' duration, of which Sec. 23(o) organizations are the sole beneficiaries, the grantor is not taxable even if he reserves powers of administrative control.

**Attribution to One Spouse of Administrative Powers of Other.** In the case of trusts with reversionary interests in the grantor, and which have a duration of less than 15 years, the Regulations provide for the taxability of the grantor if certain administrative controls reside solely either in "the grantor, or spouse living with the grantor or both, whether or not exercisable as trustee". Is there any judicial sanction for attributing

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37. In the Chamberlain case, the Court found a substantial difference between that and the Clifford case "... where there was a family purpose trust ... ", and in the Pierce case, the Court observed that "... the trust here was not a mere temporary allocation of family income among the members of an intimate family group. ... ".

38. I. R. C. Sec. 23(o) describes the religious, charitable, educational, etc., organizations herein referred to generally as "charities," contributions to which are deductible for income tax purposes.

39. The Regulations provide for taxability of the grantor "... if the income is or may be payable to a beneficiary other than a donee described in section 23(o). ... " (Italics supplied.) Accordingly, if, as in the Lamont case, the trust income were to be distributed "... in the discretion of the trustees among specified charitable institutions and individuals ... ", the grantor would, under the Regulations, be taxable even though in fact the trustees distributed the income to corporations which qualified under Sec. 23(o).
to the husband the administrative powers of the wife with whom he lives?

In *Hormel v. Helvering*,\(^40\) the Court indicated that the power of the grantor and his wife to remove a co-trustee, and thus control the trust, was tantamount to such power in the grantor, and, borrowing a phrase from the *Clifford* case, said that to hold otherwise "would be to treat the wife as a complete stranger", and not to recognize "the normal consequences of family solidarity". To Mr. De Wind it "seems not impossible... that the *(Hormel)* decision may point to ultimate general disregard of a wife's powers of control on the basis of family solidarity.\(^41\)

In the *Barbour* case,\(^42\) the Court was dealing with a 6-year trust of which the grantor's attorneys were the trustees with wide investment powers, and, other *Clifford* case elements being present, observed that "the selection of the grantor or his wife as trustees would beyond a peradventure have resulted in his taxation", while in the *Elias* case\(^43\) the same Court, having before it a 6½-year trust, concluded that a settlor's lawyers are no more likely to be amenable to his wishes than a husband to his wife's." In *Altmaier v. Commissioner*,\(^44\) the wife was the co-beneficiary with children in trusts set up by the husband. The husband and wife acting jointly could terminate the trusts at any time. The Court held that the wife was not a person "having a substantial adverse interest", and that its conclusion flowed from the *Clifford* concept of "the normal consequences of family solidarity".

The contrary point of view was expressed by the Seventh Circuit in *Commissioner v. Katz et al.*,\(^45\) in which a wife had an interest in a trust, and the wife and husband had joint power to terminate it at any time. The Board held that the wife had a substantial adverse interest, and the Court affirmed. The Commissioner invoked the *Clifford* doctrine of the family economic unit, but the Court, while admitting that the contention "presents a close question", was not persuaded that the Board's findings should be upset.\(^46\)

The Tax Court leaves no room for doubt as to its views. In *Lillian M. Newman*,\(^47\) it said that

\(^40\) 312 U. S. 552 (1941).
\(^41\) De Wind, *op. cit.* supra note 9 at 837.
\(^42\) 122 F. (2d) 165 (C. C. A. 2d, 1941), *cert. denied*, 314 U. S. 691 (1941).
\(^44\) 116 F. (2d) 162 (C. C. A. 6th, 1940), *cert. denied*, 312 U. S. 706 (1941).
\(^45\) 139 F. (2d) 107 (C. C. A. 7th, 1943).
\(^46\) To the same effect, see *Commissioner v. Betts*, 123 F. (2d) 534 (C. C. A. 7th, 1941):

"It may be that because of family affection they (mother and wife of grantor) might consent to a revocation but that fact does not of itself destroy their quality of adverse holding."

\(^47\) 1 T. C. 921 (1943).

Our view was, and is, that the *Clifford* case does not mean that a person with an otherwise adverse interest will, solely by reason of marital relationship, act in accordance with the wishes of his or her spouse.”

It is unrealistic to assume that a wife, not adversely affected, would not observe the wishes of her husband with respect to the administration of a trust. Consequently, a husband should not be permitted to insulate himself against tax liability resulting from the existence of an administrative power by reason of the circumstance that the power resided not in him but in his wife. The courts have given wide scope to the *Clifford* concept of family solidarity, and have stressed the need of a “rule of thumb”. It does not seem likely that they would challenge so much of the Treasury Regulations; but it is equally unrealistic not to recognize an actual adverse interest wherever it exists, even in a family, and, therefore, when in fact a spouse of the grantor has such an interest, it would seem that the Treasury’s argument that a power in such spouse is tantamount to a power in the grantor, would generally fall upon deaf judicial ears.

**Power to Vote and Power to Control Investments.** If a grantor of a trust of less than 15 years' duration in which he has a reversionary interest has the power, even as trustee, to vote stock or to control investments, he is, under the Regulations, taxable on the income. Perhaps in the case of a short-term trust a presumption should not be recognized that powers possessed by the grantor-trustee are exercisable primarily for the benefit of the beneficiary. On the other hand, it would seem an unduly harsh rule, and one which has no judicial support, to preclude the grantor-trustee from showing that such powers were in fact so exercisable. The latter is the rule which the Treasury lays down. If such

48. *Cf.* Ward Wheelock, 7 T. C. 14, No. 14 (June 12, 1946) in which the Court, with four dissents, held dividend income not taxable to the grantor of a long-term trust which held shares of a family-owned corporation. The grantor's wife had the power in her individual capacity to designate who should vote the stock, and exercised this power in favor of the grantor during the taxable years. The majority refused to base ownership on "rightful expectations" or "undoubted assurance" of the husband as to the subservience of the wife. However, it should be noted that the beneficiaries were the children of grantor and his wife, and, as the Court pointed out, "... her interest in the welfare of her children ... may not be said to be less than his."
a grantor has no power other than to vote stock, or if he has no power other than to control investments, he is taxable. Each of these is a normal trust power.

In *Helvering v. Fuller*, the Court had before it a 10-year trust for the grantor's wife. The grantor retained exclusive voting power over stocks constituting the corpus of the trust which, plus the shares owned by the grantor, constituted more than a majority of the total voting stock. While the Court did not pass upon the applicability of the *Clifford* rule (the point not having been considered in the lower courts or briefed or argued in the Supreme Court), it took occasion to observe that the grantor "did retain considerable control over the trustee's shares" and that the trust agreement might have left him "with sufficient interest in or control over the trust as to make him the owner of the corpus for purposes of the federal income tax. *Helvering v. Clifford*, supra."

*Archibald G. Bush* involved trusts of less than 3 years' duration set up for the benefit of the grantor's wife and for that of his sister "for whose support he felt responsible". The corpus consisted of stock of a corporation of which the grantor was vice president, a member of the board of directors, and a substantial stockholder. The trustee had no power to change the corpus of the trust without the donor's consent. The Board held the donor taxable under the *Clifford* doctrine.

In *Williamson v. Commissioner*, the grantor was held taxable upon the income of a long-term trust for the benefit of his wife and child, where he had a substantial amount of control which included both the right to vote stock and the right to direct investments. The stock involved was that of a corporation of which he was president, and in which he owned a very substantial interest. Of this decision it was said in *Miller v. Commissioner* that "the Court of Appeals ... somewhat reluctantly,

49. Even though these powers were not specifically reserved, the result would be the same if, as in *Funsten v. Commissioner*, 148 F. (2d) 805 (C. C. A. 8th, 1945), the grantor reserved the right "to change or modify any of the administrative provisions" of the trust.

50. Under the Regulations, the power to control investments is broadly stated. It may be "by directing investments or reinvestments or by vetoing proposed investments or reinvestments". In Frank E. Wolcott, 42 B. T. A. 1151 (1940), A. 1941-1 C. B. 11 the Board distinguished between a grantor's right to direct investments by a corporate trustee and his right to disapprove suggested investments by such trustee, which latter was thought, under the circumstances, "a very reasonable reservation".

51. 310 U. S. 69 (1940).

52. 43 B. T. A. 535 (1941), aff'd 123 F. (2d) 242 (C. C. A. 8th, 1941).

53. 132 F. (2d) 489 (C. C. A. 7th, 1942)

it would seem, affirmed the decision of the Board" that the grantor was taxable.

In *Edison v. Commissioner*, the grantor as sole trustee of long-term trusts set up for the benefit of his son and daughter had "full and plenary powers of investment such as he would possess if he were the absolute owner of the 'trust estate' in his private individual capacity", powers "far beyond the scope of traditional fiduciary concept and function". As sole trustee, he also had power to vote the stock. The trust assets consisted almost wholly of stock of a company of which he was president, director and a large stockholder. The Tax Court ruled: "Control of the trust stock, together with that which he continued to hold individually, may well have been of supreme importance to his economic welfare", and the Circuit Court felt constrained to say that the Tax Court's appraisal of such powers in the light of the relationship of father-grantor and son and daughter beneficiaries, when added to the donor's general scheme of family economics, made a rational finding that under the *Clifford* doctrine the grantor was taxable on the trust income.

In *Kohnstamm v. Pedrick*, the Court said, in relation to a grantor's reservation of a right to vote trusteeed shares:

"One or two courts have considered it a revelant circumstance that the settlor—either as trustee, or having power over the trustee—was a high official in a company, a controlling number of whose shares were in the fund; but they have merely counted it as one of many factors which taken together kept the 'ownership' in the settlor, and we have no way of knowing how much it weighed in their conclusion."

*United States v. Pierce* involved a trust of less than 10 years' duration of which a charity was the beneficiary. The donor reserved the right to approve of investments of principal. In holding the grantor non-taxable on the income, the Court observed that the "right reserved by the settlor to approve the securities in which the trustee might invest the trust principal was retained to protect her right of reversion, and had nothing to do with the operation of the trust."

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56. 153 F. (2d) 506 (C. C. A. 2d, 1945). One of the factors in this case was the reserved right of the grantor-trustee to vote stock of a company in which he was otherwise interested. A similar power was present in *Cushman v. Commissioner*, 153 F. (2d) 510 (C. C. A. 2d, 1946). In neither case was the grantor held taxable on the income. However, both were long-term trusts. In both cases the Government has announced that it will not appeal. In *John Stuart*, 2 T. C. 1103 (1943), A. 1944 C. B. 27, which also involved a long-term trust, the investment-control factor was definitely rejected as a basis of taxation of the grantor.
57. 137 F. (2d) 428 (C. C. A. 8th, 1943).
Thus, in the Fuller case in which, through a reservation of a power to vote, the Court indicated that the grantor might have been taxable, and in the Bush, Williamson and Edison cases, in which the grantor was held taxable, the trust corpus consisted of stocks of corporations wherein the grantor, individually, had a substantial interest apart from the trust, and it may be added that the income beneficiaries were within an intimate family group. No useful purpose would be served by a discussion of the numerous cases in which there existed a power to vote, or a power to control investments, along with other administrative powers or powers over beneficial enjoyment, since there is no means of measuring the weight to be attached to each particular fagot in the "bundle of rights". If a reservation of a power to vote or to control investments results in a substantial economic benefit to the grantor, such power might, as in the Fuller case, when added to the brevity of the term and the grantor's reversionary interest therein, be sufficient to constitute practical ownership and thus render the grantor taxable; but this theory would require due appraisal of the facts and circumstances surrounding each of such cases—a difficulty which the Regulations solve by ignoring.

**Power to Reacquire Trust Corpus.** Another power, the presence of which renders taxable the grantor of a less than 15-year trust in which he has a reversionary interest, is the power to "reacquire the trust corpus by substituting other property, whether or not of an equivalent value." In the Lamont case, the grantor of a one-year trust was held taxable on the income thereof, having reserved "the power to withdraw any of the securities held in trust upon substituting others of equivalent value." Although, as already noted, the Court later stated in the Hyman case that the most important single factor in the Lamont case was a wholly different power, namely, the indirect power which the grantor reserved to shift beneficial interests, the Third Circuit, dealing with a 3-year trust, distinguished the Bok from the Lamont case by the circumstance that in the former there was no reserved power to withdraw and substitute securities, which power, the Court observed, "certainly shows continuous control by the settlor. Certainly such control is one of the important attributes of ownership."

Neither of these cases related to a close family-beneficiary. It would thus appear that in the case of a short-term trust with reversionary

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58. Among the most recent cases on this point are Lillian R. Chertoff et al., 6 T. C. 266 (1946); Verne Marshall, 1 T. C. 442 (1943) and Lorenz Iversen, 3 T. C. 756 (1944). See also Ellis H. Warren, 45 B. T. A. 379 (1941), aff'd 133 F. (2d) 312 (C. C. A. 6th, 1942); Followed in Leslie H. Green, 7 T. C. —, No. 34 (June 28, 1946).

59. 127 F. (2d) 875 (C. C. A. 2d, 1942).
interest in the grantor, there is considerable judicial support for the provision of the Regulations under which a grantor is held taxable who reserves the right to reacquire trust corpus through the substitution process; but whether the existence of such a power would be sufficient to tip the scales in favor of taxability in the case of any trust of less than 15 years' duration with reversionary interest in the grantor, still remains open to judicial determination. In a trust for the lives of beneficiaries the reservation of a right to withdraw the corpora upon substitution of securities of equal value was held not determinative of grantor’s taxability.\(^6\)

**Powers “Which May Reasonably be Expected” to Become Effective Within Specified Period.** The Regulations provide for the taxability of a grantor who has a reversionary interest in a trust, not only when such interest will, but also when it “may reasonably be expected” to, take effect in possession or enjoyment within a specified 10 or 15-year period, as the case may be; and further provides that the expiration of such period may result not only from the passage of time, but also from the happening of some specified event which is its “practical equivalent”.\(^6\) It would not seem to be essential to a short-term trust within the Clifford rule that the trust expire by the passage of years. The tax effects should be precisely the same if it were to terminate on the happening of an event which would be the practical equivalent of the specified term. However, the indefiniteness of the phrase, “may reasonably be expected”, leaves considerable play for administrative interpretation. The Regulations furnish two examples:

The first is that of a trust the reversionary interest in which becomes effective on the death of a person whose life expectancy was six years when the property was conveyed to the trust. The Regulations hold the grantor of such a trust taxable on its income. If the implication is that the Treasury will employ mortality tables to determine the period of a trust when measured by a life, then the income of every trust with reversionary interest in the grantor, which by its provisions is to terminate upon the death of a man, say, 60-62 years old when the trust was created, and whose life expectancy, therefore, was less than 15 years, would be taxable to the grantor if he retained any one of the three specified administrative powers. In the event that the

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\(^{61}\) The Regulations refer to “... the practical equivalent of the expiration of a period less than of equal to 10 or 15 years...”. By reason of the phrase, “or equal to”, the provision with respect to the term of a trust which expires through the happening of a specified event is made inconsistent with the provision with respect to the terms of trusts which expire by the passage of time “within 10 years” or “within 15 years”. 

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TREASURY INTERPRETS CLIFFORD CASE

Treasury so applied its Regulations, it is doubtful whether it could count on judicial support. At any rate, no case has come to the writer's attention which would sustain such a rule.

The second example is that of a trust which is to revert to the grantor or his estate "on the graduation from college or prior death of his son", who, when the transfer to the trust was made, was 18 years of age. Accepting the illustration at its face value, the happening of such an event might or might not be the practical equivalent of the expiration of a term of less than ten years, since "graduation from college or prior death" are not mutually exclusive occurrences.

The Regulations further state that if a reversionary interest is to become effective in the event that the grantor survives "any stated contingency which is of an insubstantial character", it will be treated as an interest which "may reasonably be expected" to take effect within 10 or 15 years, as the case may be, and here the illustration is that of a grantor of a 3-year trust to whom corpus is to be returned if he survives this brief period, otherwise to be paid to his wife. Again, the term, "stated contingency . . . of an insubstantial character", leaves an open field for departmental interpretation. The principle would seem to be sound. Its application by the Treasury may or may not be.

Finally, the Regulations provide that if the date when the reversionary interest becomes effective is deferred, such postponement is tantamount to the creation of a new trust to commence on the date when the postponement becomes effective, and to terminate on the date prescribed. Income which would not be taxed to the grantor for any period in the absence of a postponement is not taxed to him during such period by reason thereof. Both of these are logical and acceptable provisions.

II

Power to Dispose of Beneficial Enjoyment

Subject to specified exceptions, the Treasury lays down the general rule that income of a trust is taxable to the grantor if he has a power to dispose of the beneficial enjoyment of income or corpus. He is also taxable if another party not having a substantial adverse interest has such power, or if he and such other party have such power. For the purpose of the general rule, it appears that the spouse living with the grantor is not necessarily to be regarded as a person not having a substantial adverse interest. The power exists irrespective of the duration of the trust, whether or not there is a reversionary interest, whether the power is exercisable by revocation, alteration or otherwise, irrespective of the capacity in which the person possessing the power may
act, and without regard to whether its exercise is contingent upon a preceding giving of notice or limited to some future date.\textsuperscript{62} It is, however, provided that a broadly stated power to allocate receipts as between corpus and income is not deemed to be a power over beneficial enjoyment.

The general rule that a grantor of a trust may be taxable on the income if he has the power to shift at will the beneficial enjoyment of such income or of the corpus, even though he personally does not thereby benefit, is not now open to serious question. Such a power is so important an attribute of ownership that the grantor may, for tax purposes, fairly be regarded as the owner, and this view has substantial judicial support.\textsuperscript{63} To avoid practical nullification of the rule, it also appears to be sound to provide for the same result, whether the power resides in the grantor or in some other person not having a substantial adverse interest. The difficulty arises in making provision for appropriate exceptions.

The only instances in which, under the Regulations, the foregoing rule has no application are those as to which the taxation of income is governed by Sec. 167(c) (relating to discretionary payments of trust income for support or maintenance), and those embraced within any one of the five following exceptions:

\textbf{Exception 1. Power Exercisable by Will.} If the power to control the beneficial enjoyment of income or corpus is exercisable only by will, then the income of a trust is not taxable to the grantor unless under the power the grantor may appoint income accumulated for such disposition by the grantor, or income which may be so accumulated in the discretion of the grantor, or any person not having a substantial adverse interest in the disposition of such income, or both. The exception itself requires no comment. No case has been found wherein a grantor has been held taxable on the income of a long-term trust if the only retained

\textsuperscript{62} Consistent with the provisions relating to the taxation of the grantor on income of a trust the reversionary interest of which becomes effective within 10 years, or within 15 years if specified administrative controls exist, the Regulations with reference to taxation of grantors of trusts wherein there is a power to dispose of beneficial enjoyment contain detailed provisions with respect to the tax effects of such powers if such beneficial enjoyment becomes effective for a period commencing 10 or more years from the date of the transfer, or, if specified administrative powers are retained, 15 or more years from such date; and when the measure of the period after which the beneficial enjoyment becomes effective is not a term of years but the happening of an event, the provisions are consistent with those which relate to administrative control. Here again, therefore, mortality tables, objection to which has already been noted, may play a part.

power was that to appoint by will income not accumulated for such disposition by him, nor in the discretion of any person not having a substantial adverse interest. The exception to the exception, namely, a case in which a grantor is taxable for the reason that, although the only retained power is that to appoint by will, the income subject to the power has been accumulated for such purpose by him or in the discretion of a non-adverse party, has the support of the Board in *Reginald B. Parsons* 64 and *Stanley J. Klein.* 65 To the contrary is *Commissioner v. Bateman,* 66 in which the trust provided for the accumulation of 5% of the annual income, and the grantor reserved a power of appointment over such income. The Court held the grantor nontaxable, but the ruling was, in the language of the Court, "not without some misgivings". It would seem that such misgivings were not without foundation. It is difficult to find a reason why a grantor should not be taxed on income accumulated by him for disposition under his will.

**Exception 2. Power to Shift Beneficial Enjoyment Among Charities.**

If the power to control the beneficial enjoyment of the income or corpus consists only of a power to determine such enjoyment with respect to income or corpus irrevocably dedicated to organizations qualifying under Sec. 23(o), the income is not on that account taxable to the grantor. This rule is a recognition by the Treasury of the decision of the Eighth Circuit in the *Pierce case* 67 in which the grantor was held not taxable on the income of a trust which provided that such income should be paid to or for religious, charitable, benevolent and educational organizations and purposes, and which reserved to the grantor power to amend the trust terms.

"only to 'such extent and for such purposes as may hereafter appear reasonably necessary or advisable in order to fully carry out the religious, charitable and educational purposes' for which the trust was created."

As already indicated, 68 the logic of providing an exception with respect to any of these institutions would seem to flow from a premise which the Treasury denies.

**Exception 3. Power to Accumulate Income.** If the power to control the beneficial enjoyment of the income or corpus consists only of a power which enables the grantor or another person to distribute or apply income to or for a current income beneficiary, or to accumulate

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64. 44 B. T. A. 1142 (1941), A. 1941-2 C. B. 10.
65. 4 T. C. 1195 (1945), aff'd 154 F. (2d) 58 (C. C. A. 3d, 1946), cert. denied, June 10, 1946.
66. 127 F. (2d) 266 (C. C. A. 1st, 1942).
67. 137 F. (2d) 428 (C. C. A. 8th, 1943).
68. See note 39 *supra.*
such income for him, the grantor is not taxable provided that any accumulated income is ultimately payable (a) to the beneficiary from whom distribution or application is withheld, or, (b) if payable either upon termination of the trust or in conjunction with a distribution of corpus augmented by such accumulated income, is ultimately payable to the current income beneficiaries, in shares which have been irrevocably specified in the trust instrument. Accumulated income is considered so payable although it is provided that if any beneficiary does not survive the date of distribution, his share is to be paid to a designated alternate taker, other than the grantor or his estate. In that event, however, the share of such alternate taker must be irrevocably specified in the trust instrument and the distribution date must reasonably be expected to occur within the beneficiary’s lifetime.

In providing this exception the Treasury follows a group of decisions in which the courts refused to tax grantors who had reserved the right to accumulate income, where the power was so limited that the beneficiary from whom income was withheld would receive it on a date of distribution which might reasonably be expected to occur within his lifetime. Conversely, the Treasury also adopts the rule of another group of cases in which the grantor had been held taxable where the reserved power was so extensive that the beneficiary from whom distribution was withheld might never have received it. Although such cases would seem to present an array of judicial support for the Regulations, the grantor of a trust has in other instances escaped taxation despite the existence of so broad a reserved power to accumulate that the income might never reach the beneficiary from whom it was withheld.

69. Jones v. Norris, 122 F. (2d) 6 (C. C. A. 10th, 1941); David L. Loew, 7 T. C. —, No. 43 (July 12, 1946); Standish Backus Est. 6 T. C. —, No. 132 (May 19, 1946), A. 1946-17-12372 (as to separate trusts); W. L. Taylor, 6 T. C. 201, (1946), A. 1946-12-12326; Alma M. Myer, 6 T. C. 77 (1946), A. 1946-10-12306; J. M. Leonard et al., 4 T. C. 1271 (1945), A. 1945-16-12105; David Small, 3 T. C. 1142 (1944), A. 1944 C. B. 25; Lura Morgan, 2 T. C. 510 (1943), A. 1944 C. B. 20.

70. Sinopoulos v. Jones, 154 F. (2d) 648 (C. C. A. 10th, 1946); Edison v. Commissioner, 148 F. (2d) 810 (C. C. A. 8th, 1945), cert. denied, 326 U. S. 721 (1945); Funsten v. Commissioner, 148 F. (2d) 805 (C. C. A. 8th, 1945); Stockstrom v Commissioner, 148 F. (2d) 491 (C. C. A. 8th, 1945), cert. denied, 326 U. S. 719 (1945); Miller v. Commissioner, 147 F. (2d) 189 (C. C. A. 6th, 1945); Warren v. Commissioner, 133 F. (2d) 312 (C. C. A. 6th, 1942); Williamson v. Commissioner, 132 F. (2d) 489 (C. C. A. 7th, 1942); Standish Backus Est., 6 T. C. —, No. 132 (May 19, 1946), A. 1946-17-12372 (as to combined trust); Harold F. Jones et ux., 6 T. C. —, No. 54 (Mar. 11, 1946); Lillian R. Sheftoff et al., 6 T. C. 266 (1946); V. U. Young et al., 5 T. C. 1251 (1945); Anna Morgan et al., 5 T. C. 1689 (1945); Ben F. Hopkins, 5 T. C. 803 (1945); Alex McCutchen et ux., 4 T. C. 1242 (1945), A. 1945-22-12163, Lura Morgan, 2 T. C. 510 (1945), A. 1944 C. B. 20.

71. Commissioner v. Katz, 139 F. (2d) 107 (C. C. A. 7th, 1943); Phipps v. Commis-
In the cases holding taxable a grantor having the power to accumulate income, and in which the accumulations might never be distributed to the beneficiary from whom withheld, it must be observed that other controls over income or corpus were reserved. Under the Regulations, on the contrary, a non-excepted power to accumulate is of itself sufficient to require taxing the grantor. In the *Stuart* case,\(^7\) the Supreme Court voiced the opinion that the power to accumulate trust income is not alone sufficient to make the income taxable to the grantor. In that case the beneficiaries from whom income could be withheld might never have received the accumulations. Speaking of this power, the Court said: "So broad a basis would tax to a father the income of a simple trust with a disinterested trustee for the benefit of his adult child. No act of Congress manifests such an intention.\(^7\)

In the *Stockstrom* case,\(^7\) the Circuit Court, in affirming the Tax Court, said:

"Whether the control of corpus or the power to dispose of income in the present case was such as might create taxability against the petitioner on either ground separately, we need not pause to consider, for the Tax Court rested its decision, not upon one of the grounds singly, but upon the combination of the two grounds that existed in the situation.\(^7\)

Contrariwise, where the power of accumulation was accompanied only by such powers of management as were ordinary to a trustee, both the Circuit Court\(^7\) and the Tax Court\(^7\) have held the grantor not taxable.

The Regulations further exceed judicial sanction in providing that a non-excepted power of accumulation requires taxation of the grantor whether the power resides in the grantor or with any person not having a substantial adverse interest. In the cited cases in which the grantor was held taxable, the power resided in the grantor either in his individual or fiduciary capacity.\(^7\) Indeed, in the *McCutchin* case,\(^7\) in which

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sioner, 137 F. (2d) 141 (C. C. A. 2d, 1943); I. A. Wyant, 6 T. C. —, No. 72 (Mar. 25, 1946), A. 1946-12-12326; Donald S. Black, 5 T. C. 759 (1945); Alex McCutchin et seq., 4 T. C. 1242 (1945), A. 1945-22-12163; Robert S. Bradley, 1 T. C. 566 (1943), A. 1943 C. B. 3; Frederick Ayer, 45 B. T. A. 146 (1941), N A. 1943 C. B. 27.


73. 148 F. (2d) 491 (C. C. A. 8th, 1945), cert. denied, 326 U. S. 719 (1945).

74. See also Funsten v. Commissioner, 148 F. (2d) 805 (C. C. A. 8th, 1945); Ben F. Hopkins, 5 T. C. 803 (1945).


76. Donald S. Black, 5 T. C. 759 (1945).


78. 4 T. C. 1242 (1945).
the income of the trusts for the parents was taxed to the grantor, the power to accumulate was in a corporate trustee, and as a basis for finding the grantor taxable the Tax Court was at pains to indicate that the trustee was the *alter ego* of the settlor. In the *Black* case, in which the grantor was held nontaxable, although the accumulations might never be distributed to the beneficiary, the power of accumulation was in the grantor as trustee. In its opinion, the Tax Court said:

“If the petitioner had not become trustee of the trust here in question, we do not think that any contention could validly be made that he was taxable upon the income of the trust; for he retained no power to control the trustee.”

To similar effect is the *Bradley* case, in which the grantor was not taxed where the power of accumulation resided in the trustee, who during the taxable years involved, was, successively, the grantor’s law-year, broker and bookkeeper. Further support for the proposition illustrated by the *Black* and *Bradley* cases is found both in the *Hawkins* case, in which the Circuit Court pointed out that the settlor was not the trustee, and in the above quoted language of the Supreme Court in the *Stuart* case.

**EXCEPTION 4. Power to Pay Corpus to Income Beneficiary.** The fourth exception to the general rule that a power to control beneficial enjoyment of income or corpus renders the grantor taxable, relates to power to invade principal. If either the grantor or anyone else has the power to make payment of corpus to or for a current income beneficiary, such power does not render the grantor taxable, provided either that any such payment is chargeable against the proportionate share of corpus held for such income beneficiary, or that such power is limited by “some reasonably definite external standard.” If, therefore, there is but a single income beneficiary, or if there are several income beneficiaries and the principal held for each is divided into shares or held “as if such corpus constituted a separate trust”, it is not necessary that there be an external standard in order to relieve the grantor of tax liability. The standard to which the Regulations refer must be set forth in the trust instrument, consist of the needs and circumstances of the beneficiaries, and “be susceptible of enforcement by a court of equity.” Instances in which a reasonably definite external standard are held by the Treasury to be lacking are cases in which there may be paid out of principal “such amounts as the trustee shall determine wise and proper in the exercise of his honest discretion”, or “such amounts as

79. 5 T. C. 759 (1945).
80. 1 T. C. 566 (1943).
81. 152 F. (2d) 221 (C. C. A. 5th, 1945).
the trustee determines to be in the best interests of the beneficiaries”.

In ruling that a grantor is not taxable by reason of the circumstance that he has power to invade principal for payments to an income beneficiary, the Treasury is adopting the rule established by such cases as *Jones v. Norris*, in which the grantor of a long-term trust was held nontaxable on the income, although he had reserved the right during his lifetime to direct the trustee to make settlement either in full or in part with any one of the beneficiaries who had attained the age of twenty-one years. The trusts involved were separate trusts for each of the grantor’s children, and any payment of corpus directed under the reserved power was chargeable against the share held in trust for the payment of income to the beneficiary. The foregoing principle was recently followed in *I. A. Wyant* in which the grantor was held nontaxable as to the income of a trust for an adult son to whom he might make advances which would reduce the corpus held in trust for the payment of income to such son. The trust instrument under consideration in the *Hall* case is a practical illustration of a case which meets the external standard test. There the trustee was empowered

“to expend from the principal or income any sums reasonably necessary for the education and maintenance of the beneficiaries, and for the ‘purpose of defraying the expense of illness, emergency or other extreme misfortune.’”

In *Frederick Ayer* the trust instrument authorized the trustees, who were the grantor and his wife, to pay to their son, the income beneficiary, “so much of the principal as they deem necessary from time to time for his maintenance and support.” In *Commissioner v. Armour* the trustee was authorized to pay such part of the principal as might be necessary for the “support, maintenance and comfort” of the income beneficiary. Here, too, the grantor was held nontaxable. In these five cases, however, it appears that under the Regulations the grantor would have been nontaxable under the separate trust fund rule.

In providing for the nontaxability of the grantor of a trust in which there is a power to invade principal for payment to an income beneficiary for whom there is no separate trust fund, solely where the power is limited by a “reasonably definite external standard”, the Treasury

82. 122 F. (2d) 6 (C. C. A. 10th, 1941).
83. 6 T. C. —, No. 72 (Mar. 25, 1946); see also Kohnstamm v. Pedrick, 153 F. (2d) 506 (C. C. A. 2d, 1945); Standish Backus Est., 6 T. C. —, No. 132 (May 9, 1946), A. 1946-17-12372.
85. 45 B. T. A. 146 (1941), N. A. 1943 C. B. 27.
86. 125 F. (2d) 467 (C. C. A. 7th, 1942).
87. See also Suhr v. Commissioner, 126 F. (2d) 283 (C. C. A. 6th, 1942).
seems to have proceeded without specific judicial support. The requirements that the "external standard" be "reasonably definite" and "susceptible of enforcement by a court of equity" are scarcely to be classified as "precise guides". Where the power authorizes payment for "maintenance, education and support", it is clear that there is a "reasonably definite external standard"; where the power authorizes payment merely for "comfort" or "well being", it appears equally clear that such standard is lacking. But in many trusts there is coupled with the phrase, "maintenance, education and support", such additions as "comfort", "happiness" or "well being". In such instances it would appear that the reasonably definite external standard has been met. Accordingly, a clause in a trust instrument vesting a trustee with power to invade principal for an income beneficiary's "maintenance, education, support and comfort", to be exercised "as the trustee deems proper", or "in his discretion", would not seem to make the power so subjective as to fall short of a "reasonably definite external standard".  

EXCEPTION 5. Power to Apportion Income Within Class of Beneficiaries. The fifth and final exception to the general rule that a power to control beneficial enjoyment of income or corpus renders the grantor taxable is a case where there exists a power exercisable exclusively by a trustee other than the grantor, or spouse living with the grantor, to apportion income to or within a class of beneficiaries if (a) the exercise of the power is not subject to approval or consent of any person other than the trustee, and (b) the power is limited by "some reasonably definite external standard." The requirements of such standard are the same for this as for the immediately preceding exception.

The provision making the exception inapplicable if the power is exercised by a spouse living with the grantor appears inconsistent with the holding of the Second Circuit in the Phipps case in which the

88. The trust law on the subject is stated as follows: "... Thus where by the terms of the trust he is directed to pay so much of the income or principal of the trust estate to a beneficiary as is in the opinion of the trustee necessary for his support, or maintenance, or comfort, the court will control the trustee if he acts beyond the bounds of a reasonable judgment. ... It is true that the standard is not a fixed standard, but the trustee is guilty of an abuse of discretion if it appears to the court that he is paying less than a reasonable person could think necessary for the beneficiary's support. So also he may be guilty of an abuse of discretion where he pays the beneficiary more than could reasonably be thought necessary for his support." (Italics supplied.) 2 Scott, The Law of Trusts (1939) § 187.2.

89. The term "class of beneficiaries" is susceptible of various interpretations. In the law of wills and trusts, whether a gift is one to a class has been a frequently litigated question. Cf. I. R. C. Sec. 811 (f) relating to powers of appointment in which the excepted "class" is specifically defined.

grantor's spouse was co-trustee with a trust company and the trustees could, in their discretion, apportion income between the wife and the child of the grantor. Accepting the finding of the Tax Court that the corporate trustee was not independent, and that the situation must be considered as if the grantor and his wife were the two trustees, the Court nevertheless reversed the Tax Court and held that the grantor was not taxable. In the opinion of the Court, it could not be conclusively presumed that the wife, having a substantial adverse interest in the income, would exercise her fiduciary powers in accordance with the wishes of her husband.91

The proposition that a grantor is taxable on the income of a trust if the right to apportion income within a class of beneficiaries is reserved to himself in any capacity is in conflict with the decision of the Fifth Circuit in Hawkins v. Commissioner.92 In that case, the grantor reserved to himself, among other powers, the right to “alter or modify the provisions of distributions as herein set forth to the beneficiaries.” The Court held the grantor nontaxable, and the Government announced that it would not appeal. Supporting the Regulations is Laura H. Morgan,93 in which the grantor-trustee, who had reserved the power to appoint among her husband, nephews and nieces, was held taxable on the income.94

III

Power of Administrative Control Exercisable Primarily for Grantor's Benefit

The Regulations provide that, irrespective of the duration of a trust, the income thereof shall be taxable to the grantor if administrative control is exercisable “primarily for the benefit of the grantor rather than the beneficiaries of the trust.” If the power is exercisable by a person as trustee, the Regulations provide a presumption that it is exercisable primarily in the interests of the beneficiary, and this is subject to rebuttal “only by clear and convincing proof” that it is not

92. 152 F. (2d) 221 (C. C. A. 5th, 1945).
94. For cases in which the power to appoint existed along with other powers, and in which the grantor was held taxable, see Littel v. Commissioner, 154 F. (2d) 922 (C. C. A. 2d, 1946); Steckel v. Commissioner, 154 F. (2d) 4 (C. C. A. 6th, 1946); Funsten v. Commissioner, 148 F. (2d) 805 (C. C. A. 8th, 1945); George v. Commissioner, 143 F. (2d) 837 (C. C. A. 8th, 1944), cert. denied, 323 U. S. 778 (1944); Hyman v. Nunan, 143 F. (2d) 425 (C. C. A. 2d, 1944); Brown v. Commissioner, 131 F. (2d) 640 (C. C. A. 3d, 1942), cert. denied, 318 U. S. 767 (1943).
so exercisable. On the other hand, if the power is not exercisable by a person as trustee, there is a presumption that it is exercisable in a nonfiduciary capacity, which, however, may also be rebutted if it appears "from all the terms of the trust and the circumstances surrounding its creation and administration" that it is exercisable primarily in the interests of the beneficiaries.

In the Clifford case, the Court said that the answer to the question as to whether the grantor could be treated as the owner of the corpus must depend upon an analysis "of the terms of the trust and all the circumstances attendant on its creation and operation." (Italics supplied.) In the Regulations the Treasury refers to the existence of administrative control "under the terms of the trust or the circumstances attendant on its operation." (Italics supplied.) While it is true that the "express provisions of the declaration of trust . . . must give way before the realities of the situation," this provision suggests a fertile field of potential claims.

The administrative control to which reference was made in relation to short-term trusts, differs from that here under consideration in that here such control is that which is "exercisable primarily for the benefit of the grantor rather than the beneficiaries". The Regulations specify four situations, and it would seem that they not merely illustrate but comprise such administrative control.

Power to Sell for Less Than Full and Adequate Consideration. The first situation is that in which a power is exercisable by the grantor, or by any person lacking a substantial adverse interest in its exercise, or both, and enables the grantor or any person to deal with or dispose of the corpus or the income "for less than an adequate and full consideration in money or money's worth". The Regulations further provide that the mere fact that a trustee's power is described in broad language does not indicate that he is authorized to deal with or dispose of the trust estate for less than such consideration, but that, on the other hand, his authority might be indicated by the actual administration of the trust. Where, as in Christopher L. Ward, the trustee was required to sell any investments representing principal of the estate "at such price as may be directed by the Donor", and to exchange investments "for others as may be directed by the said Donor", the grantor would, under the Regulations, have such administrative control as to make him taxable on the trust income.

95. William J. Garland, 42 B. T. A. 324 (1940), A. 1941-1 C. B. 5.

96. The phrase, "an adequate and full consideration in money or money's worth" is that of I. R. C. Sec. 811 (i) relating to estate taxes, and I. R. C. Sec. 1002 relating to gift taxes.

Power to Borrow. The second situation is that in which a power is exercisable by (a) the grantor, (b) spouse living with the grantor, (c) both (whether or not as trustee in any instance), (d) any other person in a nonfiduciary capacity, (e) such person and either the grantor or spouse, or (f) such person and both the grantor and spouse, which enables the grantor to borrow trust funds. The Regulations cover both direct and indirect borrowings, and apply whether there is or is not adequate security or interest. It would seem that just as the Regulations provide that the mere fact that a trustee has the power described in broad language authorizing him to purchase and sell securities is not indicative of a power to sell for less than a full consideration, so, too, the Regulations should have provided that a power in a grantor-trustee to "Lend money with or without security", as in Alex McCutchin,98 is not indicative of a power to lend money to himself with or without security. In Morss v. United States99 the Court rejected the Government's contention that a power reserved in broad terms permitting the lending of trust funds to any person as the trustee-grantor might determine, allowed the grantor to benefit himself. The Court was of the opinion that such power was fiduciary and necessary for trust management.

Power to Borrow—Loan Repaid. The third situation is that in which a power exercisable by a trustee, other than the grantor or spouse living with the grantor, permits the grantor to borrow from the trust. Such a power, however, does not constitute administrative control exercisable primarily for the grantor's benefit if he, having borrowed from the trust, completely repays the loan, including interest, before the beginning of the taxable year. This provision, unlike the immediately preceding one, makes no reference to the adequacy of the interest.

Power to Vote, Power to Control Investments, and Power to Reacquire Trust Corpus. The fourth situation is that in which there exists any of the three administrative powers which, in relation to short-term trusts, have already been discussed. While the administrative powers in short-term trusts related to powers exercisable solely by the grantor or spouse living with the grantor, the powers here under consideration are those exercisable by "any person in a nonfiduciary capacity". This phrase would seem to include the grantor. In Ronald K. Evans,100 the Tax Court has recently held nontaxable a non-trustee grantor, who had retained the right to direct the investment of trust funds.101 The Court

98. 4 T. C 1242 (1945)
101. To same effect is David L. Loew, 7 T. C. —, No. 43 (July 12, 1946); see also
was convinced that the retained power was exercisable for the benefit of the beneficiaries.

The Treasury's omission to provide for a trust of which a charity is the beneficiary presents an anomaly. If a grantor constitutes himself sole trustee of a trust for the benefit of a charity, the trust to terminate within 15 years, and the grantor has the right as trustee to vote stock constituting corpus of the trust, he would not be taxable on the income; but if he appoints another as trustee and reserves the same right, and the trust is to last for 15 or more years, it would be presumed that he was exercising the power primarily for his own benefit, and, unless he could rebut the presumption, he would be taxable. Indeed, it is not clear that he would not be taxable in the latter event, even if the trust were for less than 15 years.

IV

Related Matters

Limitations of Regulations. Out of a superabundance of caution, the Regulations provide that the grantor of a trust who directs the payment of income in satisfaction of his own legal obligations continues to be taxable on the income. They also provide that the grantor may be taxable despite the limitations of the foregoing provisions if, by virtue of some other principle of law, the income is attributable to him, for example, on the theory that he had merely assigned income.

The Regulations further state that the foregoing provisions do not “affect the applicability of section 22(a) to the creator of a family partnership.” Indeed, such provisions do not in terms relate to the applicability of Sec. 22(a) to the income from an interest in any partnership, family or otherwise, held in trust. Therefore, the extent to which a grantor, who assigns a partnership interest to a trust, may retain administrative control without incurring tax liability on the trust income is a point on which the Treasury has not functioned. In Armstrong et al. v. Commissioner, the grantor, without retaining any reversionary interest, conveyed to himself as trustee for his children an interest in a family partnership. The trust was to terminate in not more than twelve years. The Tax Court held the grantor taxable under the Clifford doctrine. In reversing, the Circuit Court stated that the grantor

Ward Wheelock, 7 T. C. —, No. 14 (June 12, 1946), (grantor not taxable despite power in grantor's wife, in her individual capacity, to direct voting of stock); cf. M. Friedman, 7 T. C. —, No. 9 (June 10, 1946).
103. 143 F. (2d) 700 (C. C. A. 10th, 1944).
104. 1 T. C. 1008 (1943).
had no greater voice in the partnership management through the trust than he had independently. On the other hand, the Tax Court, in *S. Kenneth Alexander*, 105 has recently held taxable a grantor who had declared himself trustee of a trust set up for the benefit of his wife to which he had conveyed an interest in a family partnership. The trust was to terminate upon the death of the wife. The Court distinguished the *Armstrong* from the *Alexander* case on the ground that in the latter there was not only a reversionary interest, but the grantor had retained such complete control of the partnership business as to constitute dominion substantially equivalent to full ownership. In the light of the two Supreme Court decisions dealing with family partnerships, 106 handed down since the promulgation of T. D. 5488, it is doubtful whether a grantor under any circumstances may assign an interest in a family partnership to a trust of which there is a family beneficiary, without remaining taxable on the income. 107

It is provided that Sec. 22(a) "shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference" to the Regulations as amended by T. D. 5488, but in a separate ruling 108 it is provided that in cases not finally determined for such years it will be the Bureau policy, where no inconsistent claims prejudicial to the Government are asserted by trustees or beneficiaries, not to assert liability under the general provisions of Sec. 22(a) if the trust income would not be taxable to the grantor under the amendment to the Regulations.

*Trust Income Taxable to Persons Other Than Grantor.* The Regulations provide that where someone other than the grantor has a power, exercisable solely by himself, to possess corpus or income, he shall be taxable on the income; and even though such power were so modified that he himself could no longer receive the income or corpus, he still remains taxable if he continues to have powers such as would subject a grantor to tax on the income. But this provision has no application to a power over income if, under the Regulations, the grantor is otherwise taxable. It, too, affects in terms only taxable years beginning on and after January 1, 1946, but may be retroactively applied under Mim. 5968.

*Gift Tax Considerations.* It is not within the scope of this paper to discuss the gift tax implications of the *Clifford* decision or of the

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105. 6 T. C. —, No. 105 (Apr. 23, 1946).
107. See Lewis C. Benson, 6 T. C. —, No. 97 (Apr. 17, 1946).
Treasury Regulations. Since the grantor of a trust which is within the Clifford doctrine is "still in practical effect the owner of its income", it has been suggested that in periodically relinquishing his rights to such income he makes a taxable gift. However, just as it seems that a forgiveness of a debt might be a gift within the meaning of Sec. 22(b)(3), for the purpose of exempting the debtor from income taxes, but not a "gift" under Sec. 1000 for the purpose of imposing a gift tax on the grantor, so, too, it appears that a grantor may be deemed to have made a legally effective and complete gift of property within the meaning of Sec. 1000 and still remain the owner of the property for purposes of Sec. 22(a). As the Court observed in Helvering v. American Dental Co.: 

"'Gifts', however, is a generic word of broad connotation, taking coloration from the context of the particular statute in which it may appear."

Conclusion

T. D. 5488 serves a useful purpose. It is a definite studied statement by the Treasury of its current views as to the scope of the Clifford doctrine. It is, however, so far out of focus with judicial interpretation that further litigation with piecemeal adjudications is inevitable. As to the Tax Court and the various Circuit Courts, it seems likely that each will continue to apply the Clifford principle according to its own lights, whether or not in agreement with the Treasury. Indeed, presaging general opposition to the Treasury's position, the Tax Court has already held that the Regulations do not represent a correct interpretation of the statute, stating that:

"the mere change in . . . administrative construction of the Revenue Acts of Congress, will not result . . . in the overruling of a line of decisions of this Court which, to the present time, have the approval of the higher Courts."

Congress placed a definite practical restriction on the rule of the Stuart case. What T. D. 5488 patently demonstrates is the urgent need of similar action on the Clifford decision.

110. Louis Stockstrom Est., 7 T. C. —, No. 32 (June 27, 1946).
111. I. R. C. Sec. 167 (c), as added by Sec. 134, Revenue Act of 1943.