4-1-1953

Taxation -- Constitutionality of Clifford Regulations

Martin E. Kestenbaum

limitations.[11] It may be used as a shield to prevent recovery, but not as a sword to accomplish recovery.[12]

In liberally construing the Federal Torts Claim Act the court in the noted case has maintained that the United States, by bringing such an action, submitted itself "to the jurisdiction of the Court for the determination of all issues that might arise from the accident. . . ."[13] Since Congress has expressly provided for a two year limitation period, it appears that the court is going beyond the authority created by Congress under the veil of "liberal interpretation". However, the primary concern of limitation statutes is one of fairness to a defendant.[14] He should not be called upon to defend a "stale" claim after the evidence has disappeared. In the instant case, the reason for the rule is not present. Therefore, the conclusion appears sound.

Alan R. Lorber.

TAXATION — CONSTITUTIONALITY OF CLIFFORD REGULATIONS

Petitioner contended that, by authority of one of the *Clifford Regulations,* the income of a charitable inter-vivos trust was taxable to the respondent-grantor who had retained a reversionary interest in the corpus, alleged by petitioner to take effect within ten years from the date of transfer of the corpus. *Held,* the trust was of ten years duration. However, a regulation which creates a *conclusive* presumption that the income is the settlor's, based solely on the trust duration without regard to who actually derives the economic benefits, is void as it is arbitrary, unreasonable and violative of the Fifth Amendment. *Commissioner of Internal Revenue v. Clark,* 21 U.S.L. WEEK 2421 (7th Cir. March 3, 1933).

Under the Treasury Department's *Clifford Regulations,*[1] when the grantor of a living trust retains a reversionary interest, to take effect within ten years of the date of transfer, the income received by the beneficiary is taxable to the grantor, even though by the terms of the instrument he divests himself of all control over the income, and even though it be used for general charitable trust purposes.[2] The theory is that by virtue of the short duration of the trust term, the grantor does not part with all of the

11. E.g., Bull v. United States, 295 U.S. 247 (1934); Beekner v. Kaufman, 145 Fla. 152, 198 So. 794 (1940); Payne v. Nicholson, 100 Fla. 1459, 131 So. 324 (1930).
12. Sullivan v. Hoover, 6 F.R.D. 513 (D.D.C. 1947).
13. United States v. Capital Transit Co., 108 F. Supp. 348, 350 (D.D.C. 1952).
14. Note, 63 HARV. L. REV. 1177 (1950).

1. U. S. Treas. Reg. 111, § 29.22(a)—21(c)(1), as added by T.D. 5488, Dec. 29, 1945, amended by T.D. 5567, June 30, 1947.
2. In the instant case there were no controls retained by the grantor and the transfer was irrevocable for the stated term.

economic benefits of the property,[3] but rather, employs a convenient method of income tax avoidance.[4]

The fact that the brevity of the term is related to the retention of controls by the grantor has been recognized for some time by the courts.[5] However, in the leading case on the subject, *Helvering v. Clifford*,[6] it was held that no single element is normally decisive, but rather the length of the trust term should be considered in conjunction with other factors such as the administrative controls retained and the power to determine beneficial enjoyment.[7] The *Clifford Regulations* are the Treasury's announced attempt to establish a set of precise rules taken from the broad principles of the *Clifford* case.[8] But in practical application, they are more than a mere codification of the *Clifford* criteria because the regulation treats each of the factors as an independent ground for taxability;[9] whereas under the interim[10] case law, short term trusts were largely held not taxable to the grantor if no other strings were attached.[11]

The peculiar aspect of the holding in the instant case stems from the

---

3. INT. REV. CODE, § 22(a), generally defines gross income to include ". . . gains or profits and income derived from any source whatever."; INT. REV. CODE, §§ 166, 167 (provide for the taxability of trust income to the settlor under various conditions).

4. Under § 162(a) of the INT. REV. CODE, a trust is granted an unlimited deduction for any part of its gross income which is used for charitable purposes authorized by § 23(o) of the Code. This provision permits an individual to exceed the present twenty per cent limitation on charitable deductions by transferring the income bearing corpus in trust. See Guterman, *Federal Income Taxation of Inter-Vivos Trusts*, NEW YORK UNIVERSITY NINTH ANNUAL INSTITUTE ON FEDERAL TAXATION, 205 (1951). However, the grantor's motive in attempting to enlarge the charitable deduction is irrelevant in determining whether the income is taxable to the grantor. Helvering v. Achelis, 112 F.2d 929 (2nd Cir. 1940).

5. Learned Hand, J., in Helvering v. Elias, 122 F.2d 171 (2nd Cir. 1941), *cert. den.*, 314 U.S. 692 (1941) (six and one-half year trust resulted in taxability of income to grantor): "There is good reason for such a correlation, because the shorter the term the more complete is the settlor's real power of management and control regardless of legal reservations. A trustee who must manage a fund throughout the life of the beneficiary may well refuse to be guided by the counsels of the reversioner; the income is to be the beneficiary's for a long time, and the reversioner has a correspondingly smaller stake. But a trustee who will have to account to his beneficiary for only five or six years and then to the reversioner, is in a very different position; if he is reasonable, he will heed the reversioner, treat his interest as paramount and be guided by his judgment. Legal powers of management add very little to such a reversioner's actual control over the fund while the trust lasts."

6. 309 U.S. 331 (1940) (income of five year trust held taxable to grantor, based on shortness of term, family nature of the trust and wide administrative controls retained).

7. *Id.* at 336.

8. Ervin, *Clifford Doctrine—Beneficial Enjoyment*, 90 TRUSTS AND ESTATES 603 (1951).

9. See KENNEDY, FEDERAL INCOME TAXATION OF TRUSTS AND ESTATES (1948), § 6.22, 6.23 and Cum. Supp. pp. 78-79 (1953); Guterman, *The New Clifford Regulations*, 1 TAX. L. REV. 379, 384 (1946); Pavenstedt, *The Treasury Legislates: The Distortion of the Clifford Rule*, 2 TAX L. REV. 7, 9 (1946).

10. Cases decided subsequent to the Clifford Case (Feb. 26, 1940) and prior to the promulgation of the Clifford Regulations (Dec. 20, 1945).

11. United States v. Pierce, 137 F.2d 428 (8th Cir. 1943) (charitable trust of slightly less than ten years held not taxable to grantor), the court stating on p. 432: "The term of the trust was not so short, taken alone or in connection with other circumstances in the case, as to *compel the inference* (emphasis added) that the settlor had

portion of the same regulation which prescribes the method of computing the length of the trust term.[12] Any postponement is considered a new transfer in trust, beginning with the postponement date and ending with the new termination date. In the instant case, the taxpayer originally created a five year trust in 1941 with reversion date in 1946. Then in 1942, the termination date was postponed until 1951. Thus, although the aggregate length was ten years, the length for tax purposes was computed at nine years by the Commissioner.[13] The Tax Court[14] accepted the nine year computation[15] but held for the taxpayer on other grounds.[16]

Therefore, what appears at first to be mere dictum in the principal case amounts, in the writer's opinion, to a square holding that the regulation is unconstitutional—on the reasoning that the court could not call the instrument a ten year trust, in derogation of the regulation,[17] without in effect declaring it to be invalid. The court has ample authority behind its conviction that a *conclusive* presumption of beneficial ownership, under circumstances similar to these, is unconstitutional[18] and that due process requires that the taxpayer have an opportunity to meet the burden of proof. This seems especially true where variable, rather than fixed, factors enter into the determination of who is the substantial owner of income for tax purposes. If a regulatory line can reasonably be drawn between substantial and non-substantial ownership determined solely by a term of years, then apparently it remains for the Treasury or Congress to convince the courts of that fact by acceptable regulation or statute.

Martin E. Kestenbaum

---

not parted with the beneficial ownership of the trust principal."; Helvering v. Bok, 132 F.2d 365 (3rd Cir. 1942) (six year charitable trust held not taxable to grantor because no powers of control were reserved); Cory v. Commissioner, 126 F.2d 689 (3rd Cir. 1941), *cert. den.* 317 U.S. 642 (1942) (court refused to be "hampered by the calendar" even in a short term trust); Commissioner v. Chamberlain, 121 F.2d 765 (2d Cir. 1941) (four year trust not taxable to settlor because of absence of family purpose). *But* cf., Commissioner v. Buck, 120 F.2d 775 (2d Cir. 1941) (shortness of term held sufficient ground for taxing grantor since he was soon to reacquire complete dominion).

12. U. S. Treas. Reg. 111, § 29.22(a)—21 (c)(1), as added by T.D. 5488, Dec. 29, 1945, amended by T.D. 5567, June 30, 1947.

13. The Commissioner sought to assess the grantor for income of 1946, the year the regulation took effect.

14. Clark v. Commissioner, 17 T.C. 1357 (1952).

15. The question before the court was whether the settlor should be taxed on the charitable trust income "solely because the duration of the trust is nine instead of 10 years. . . ." Clark v. Commissioner, 17 T.C. 1357, 1361 (1952).

16. "We do not think *Helvering v. Clifford, supra,* or section 29.22(a)—21 of Regulations 111 were intended to or do apply to the income of a trust such as we have here." Clark v. Commissioner, 17 T.C. 1357, 1363 (1952).

17. U. S. Treas. Reg. 111, §§ 29.22(a)—21(c)(2) (paragraph starting "Any postponement . . . ." and example following).

18. Heiner v. Donnan, 285 U.S. 312 (1932) (congressional act which created a conclusive presumption that gifts made within two years of death were made in contemplation of death, held violative of Fifth Amendment); Schlesinger v. Wisconsin, 270 U.S. 230 (1926) (conclusive presumption that gifts made within six years of death were made in contemplation of death for state inheritance tax purposes held violative of Fourteenth Amendment).