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THE CIRCUIT COURTS OF APPEALS EXAMINE THE *CLIFFORD* DOCTRINE

By RICHARD W. CASE*

On February 26, 1940, the Supreme Court of the United States decided the case of *Helvering v. Clifford.*[1] In the relatively short period of time which has elapsed since that decision was handed down, the doctrine of the *Clifford* case has been the subject of controversy in more than forty appeals to the various Circuit Courts of Appeals. Although the *Clifford* doctrine has provided a source for countless articles in leading law reviews and tax magazines,[2] it is believed that its frequent appearance in the Circuit Courts of Appeals justifies an analysis of their decisions.[3] This is very clearly demonstrated when it is considered that the Supreme Court has granted certiorari in

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[1] Helvering v. Clifford, 309 U. S. 331 (1940).

[2] Pavenstedt, *The Broadened Scope of Section 22 (a)* (1941) 51 Yale L. J. 213; Reidick, *The Problem of Personal Income Tax Avoidance* (1940) 7 Law and Cont. Prob. 243; Surrey, *The Supreme Court and The Federal Income Tax* (1941) 35 Ill. L. Rev. 779, 795; Warren, *Liability of Settlors of Irrevocable Short Term Trusts* (1940) 38 Mich. L. Rev. 885; Magill, *The Federal Income Tax on The Family* (1941) 20 Tex. L. Rev. 150, 156-158; Ray, *The Income Tax on Short Term and Revocable Trusts* (1940) 53 Harv. L. Rev. 1322; Jones, *Family Trusts and Federal Taxes* (1942) 9 U. of Chi. L. Rev. 427; Griswold, *A Summary of the Regulations Problem* (1941) 54 Harv. L. Rev., 398, 421-422; Altman, *Community Property in Peril* (1941) 19 Tax Mag. 262; Nash, *What Law Taxation* (1940) 9 Ford. L. Rev. 165; Tyre, *Federal Taxation of Irrevocable Trusts Reexamined* (1940) 18 Tax Mag. 216; Magill, *The Supreme Court on Federal Taxation,* 1939-40 (1940) 8 U. of Chi. L. Rev. 1; Nash, *Implications of Some Recent Developments in the Taxation of Trusts* (1940) 18 Tax Mag. 267; see also 6 MERTENS, LAW OF FEDERAL INCOME TAXATION (1942) Secs. 37.17, 371. See also Merrills, *Status of short term trusts and trusts where the control remains in the grantor under the Federal income tax* (1943) 28 Wash. U. L. Q. 99, published as this was being set in type.

[3] This fact was foreshadowed by Ray, *The Income Tax on Short Term and Revocable Trusts* (1940) 53 Harv. L. Rev. 1322, 1352-1353, where the author said:

> "An attempt to formulate by deduction rules as to the extent to which the grantor may exercise control over corpus without subjecting himself to tax makes evident the fact that these questions arising from the *Clifford* case are questions of degree and will not be answered until enough cases have been decided to prick out the line between situations in which the grantor is taxable and those in which he is not."

See also Nash, *Implications of Some Recent Developments in the Taxation of Trusts* (1940) 18 Tax Mag. 267, 331.

only five of the forty odd cases which have dealt with the doctrine before the Circuit Courts. It becomes obvious, therefore, that for the greater part, the boundaries and limits of the *Clifford* doctrine lie in the hands of the lower Federal Courts, and particularly in the hands of the Circuit Courts of Appeals.[4]

I

THE *CLIFFORD* CASE RE-EXAMINED

In *Helvering v. Clifford* the taxpayer created a trust, naming himself as trustee and his wife as beneficiary. The trust was to last for five years, or for a shorter time if either the grantor or his wife died. The indenture provided that upon termination, the settlor was to receive the trust corpus, and further provided that any accumulated income was to be paid to the beneficiary. During the life of the trust the trustee had full power to manage the property by voting the securities which constituted the *res*, to sell, exchange, or in any way encumber the corpus or accumulated income, and to invest any funds constituting "trust funds" by making unsecured loans, deposits in banks, or by buying securities without regard for their "speculative character" or their "rate of return". The settlor also retained the power to collect all income, to compromise any claims held by him as trustee, and to hold any property in the trust estate in any name, including his own as an individual.

The question presented was whether or not the income from the trust was taxable to the settlor. Basing its opinion on the broad sweep of Section 22(a) of the Internal

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[4] In so stating, the author is well aware of the abundance of authority dealing with the Clifford doctrine available in the reported decisions of The Tax Court of the United States (formerly the Board of Tax Appeals). These cases are omitted from the present article not because it is felt that they are any less important to the tax practitioner than the decisions of the Circuit Courts of Appeals, but because the length of this paper coupled with its attempt to present a general view of the problem necessitates the narrowing of its scope. For a similar reason, all future references to decisions of the District Courts of the United States will be confined to the footnotes. For an excellent analysis of some of the leading decisions of The Tax Court and the District Courts see Pavenstedt, *op. cit.* n. 2.

Revenue Code,[5] the Supreme Court held that the head of a family could not avoid tax liability by channelling a portion of his income to members of his immediate family by means of a short-term trust, over which he retained such a degree of control as to constitute him, for all practical purposes, the owner of the corpus.

Utilization of the trust device as a means of tax avoidance was by no means new before the *Clifford* case was decided.[6] A constant battle had been waged between Congress and the taxpayer with respect to Sections 166 and 167 of the Internal Revenue Code.[7] It was clear, however,

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[5] For purposes of discussion of the Clifford doctrine, Section 22 (a) is as follows:

> "Sec. 22 (a). *General Definition*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, . . . of whatever kind and in whatever form paid, or 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, rents, 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 . . ."

[6] For a more complete discussion of this point, see Warren, *Liability of Settlors of Irrevocable Short Term Trusts* (1940) 38 Mich. L. Rev. 885, in which the author states in part:

> "It is easily understood why the history of the taxation of trust income has been described as an unending struggle between taxpayers and the government. Taxpayers and their counsel are continually seeking devices which, while permitting escape from surtaxes, will yet allow the settlor maximum control over the trust property. The treasury department, on the other hand, in seeking to close all avenues of escape, believes it proper to tax settlors who retain control over and receive the benefits from trust property."

Also see Reidick, *The Problem of Personal Income Tax Avoidance* (1940) 7 Law and Cont. Prob. 243, 251; Warren, *The Reduction of Income Taxes Through the Use of Trusts* (1936) 34 Mich. L. Rev. 809; Buck, *Income Tax Evasion and Avoidance* (1936-37) 23 Va. L. Rev. 107, 265.

[7] SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

that these sections did not contain the necessary sweep to place the income of an irrevocable short-term trust in the settlor's return.[8] As a result, taxpayers in the high surtax bracket seized upon the apparently tax immuned device of a short-term trust as a means by which their income might be split between the settlor on the one hand and the beneficiary on the other. When such a device was utilized it was believed that surtaxes would be substantially reduced. To block this avenue of tax avoidance, the Supreme Court decided that a taxpayer retaining the economic benefits of property would remain taxable on the income derived therefrom, irrespective of the fact that he had tentatively parted with title thereto by means of a conveyance in trust to last for a limited time.

An analysis of the *Clifford* decision shows that in that case no one fact was regarded as decisive by the Court in reaching its final conclusion. Important factors which were considered included the length of the term of the trust, the control retained by the settlor over the corpus, the identity of beneficiaries, and the identity of the trustee. Although a court, in dealing with problems involving the *Clifford* doctrine, might treat one factor as controlling, such a treatment would not necessarily mean that error had been committed. On the other hand, errors are more likely to occur if the court utilizes one of the tests outlined by Mr. Justice Douglas in the *Clifford* case to the exclusion of all others. It is submitted, therefore, that the only true test which can be applied in such cases is whether or not the settlor, after the creation of the trust, has retained the economic benefits thereof in such a degree that he will

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(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

[8] Helvering v. Wood, 309 U. S. 344 (1940).

continue to realize economic gain from the corpus. It follows that the factors outlined in the *Clifford* decision are not complete tests in themselves, but are only aids in arriving at the ultimate decision, and should not, therefore, be considered as isolated criteria.

After the *Clifford* case had been decided, a controversy arose concerning the utility of such a nebulous kind of decision. On the one hand it was contended that the sweeping language used by Mr. Justice Douglas decided nothing for the future, and that in all fairness to the taxpayer the Court should have indicated how far it would go in extending the scope of Section 22(a).[9] These contentions were answered on the other hand with the argument that it was for Congress and not the courts to place exact limitations on the governmental taxing powers, and that so long as Section 22(a) was used to tax income to the settlor of a short-term trust, vagueness was a virtue and not a vice.[10] While it is undoubtedly true that cases involving the *Clifford* doctrine should not be dogmatically characterized, it is now possible to view with some clarity the limits of the doctrine, and the reasons for those limitations, thereby answering, in part, the controversy in question. As indicated above, this development has been made possible to a great extent by reason of the fact that numerous cases involving similar or related questions as found in *Helvering v. Clifford* have reached the Circuit Courts of Appeals within the past three years.

II

SHORT-TERM TRUSTS

The trusts which have been involved in cases before the Circuit Courts of Appeals construing the *Clifford* doctrine may, for the purpose of clarity, be broken down into three rough categories. The first group includes those trusts which can be styled "short-term" family trusts, and

[9] See Ray, *The Income Tax on Short Term and Revocable Trusts* (1940) 53 Harv. L. Rev. 1322, 1358, in which the author advocates the passage of appropriate legislation to cure the defect.

[10] Pavenstedt, *The Broadened Scope of Section 22 (a)* (1941) 51 Yale L. J. 213, 217-219.

which usually end after the expiration of six years or less. In the second class are found trusts which may be called "trusts of intermediate duration". These are instruments which create a relationship to last longer than the strictly short-term family trust described above, and yet are not trusts whose termination depends upon the death of either the settlor or a beneficiary. The third category are those trusts whose terms are measured by the life of a party in interest.

As a general proposition, all cases which involve strictly short-term family trusts have held that income therefrom should be taxed to the settlor. This rule has been adopted by statute in England,[11] and has now been made universal in this country by court decision.[12] At first blush, it would seem that such a rule is at complete variance with general proposition that no one factor should prove conclusive in applying the *Clifford* doctrine. An analysis of the reasons underlying the rule clearly demonstrates, however, that such is not the case.

A significant reason why income from a short-term family trust is taxed to the grantor lies in the fact that the terms of such trusts are for the most part subject to a close comparison with the terms of the trust in *Helvering v. Clifford*. In such cases, the *Clifford* decision is easy to follow and the rule of law therein set forth can be applied with little or no independent trail blazing on the part of the lower court.[13] As was said in *Commissioner v. Barbour*:[14]

[11] The English tax income of a trust to the settlor if it is to last but for six years unless the disposition was made for valuable and sufficient consideration. See the Finance Act, 1922, 12 & 13 Geo. V, C. 17, No. 20 (1) (b).

[12] The Treasury in hearings before the House Ways and Means Committee on the Revenue Act of 1934 made, among others, the recommendation that Section 166 be amended to tax the income of a short term trust to its grantor. The recommendation stated:

> "The income from short-term trusts and trusts which are revocable by the creator at the expiration of a short period after notice by him should be made taxable to the creator of the trust."

See Hearings before the House Ways and Means Committee, 73d Cong., 2d Sess., p. 151. Congress did not, however, incorporate such an amendment into the law.

[13] See Reuter v. United States, 34 F. Supp. 1014 (Ct. of Cls., 1940).

[14] Commissioner v. Barbour, 122 F. 2d 165 (C. C. A. 2d, 1941) Cert. den. 314 U. S. 691 (1941).

> "Accordingly the period of 6 years and 16 days (which is the longest period involved here) seems close enough to the five years in Helvering v. Clifford to bring the present case within its intention."[15]

A second reason why income from a short-term family trust is taxed to the settlor, and perhaps a more important reason from a theoretical standpoint than the first, is the fact that irrespective of the creation of such instruments, a very considerable degree of control over the corpus is retained by the settlor. Where property is conveyed to a trustee in trust for a beneficiary and trustee and beneficiary are both members of the settlor's intimate family group, and where the trust in question is to last for a relatively short period of time, the settlor has retained in deeds if not by words dominion and control over the corpus. He can be relatively sure that there will be no dissipation of the corpus by the trustee or beneficiary during the period of the trust, the reason being that the settlor has, for all practical purposes, dominion and control over the trustee and beneficiaries individually. This, coupled with the fact that the settlor will soon again be the absolute owner of the *res*, makes his degree of control complete. A summation of this factor was made by Judge Learned Hand in the following manner in the case of *Helvering v. Elias*:[16]

> "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 presumably for a long time, and the reversioner has a corresponding 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. For this reason it appears to us that it is only when

[15] *Supra*, n. 14, 166.

[16] Helvering v. Elias, 122 F. (2d) 171, 173 (C. C. A. 2d, 1941) Cert. den. 314 U. S. 692 (1941).

> the term is longer than six or seven years (as for example ten years, Commissioner v. Jonas, 2 Cir., 122 F. 2d 169) that the settlor's legal reservation of control becomes vital, certainly if the settlor and the trustee are not strangers."

In stressing the fact that a family trust naming the settlor's son as beneficiary was to last for only two years, the Circuit Court of Appeals of the Seventh Circuit had no trouble in following the *Clifford* doctrine and taxing the income therefrom to the settlor.[17] This decision was reached in face of the fact that for the two-year period, the settlor retained no expressed power to control the corpus. It has uniformly been held that the income from a family trust which is to last for only three years is taxable to the settlor. The *Clifford* doctrine has been followed in such cases where the beneficiaries were the settlor and his wife as guardian for his children,[18] the settlor's wife individually,[19] the settlor's brother, a widow of his deceased brother and his sister,[20] and the settlor's nephew.[21] In these decisions little weight was given to the fact that the trustees happened to be a business associate of the settlor[22] or the settlor in conjunction with a third party not a member of the intimate family group.[23]

Before the *Clifford* case was decided it was a common practice to make short-term family trusts expire at the end of five years. As indicated above, the Circuit Courts have had little trouble in taxing the income of these trusts to their grantors.[24] Unlike cases involving trusts which

[17] Commissioner v. Wilson, 125 F. (2d) 307 (C. C. A. 7th, 1942).

[18] Helvering v. Hormel, 111 F. (2d) 1 (C. C. A. 8th, 1940), Reversed: Hormel v. Helvering, 312 U. S. 552 (1941).

[19] McKnight v. Commissioner, 123 F. (2d) 240 (C. C. A. 8th, 1941).

[20] Bush v. Commissioner, 123 F. (2d) 242 (C. C. A. 8th, 1941); First National Bank of Chicago v. Commissioner, 110 F. (2d) 448 (C. C. A. 7th, 1940).

[21] Commissioner v. Woolley, 122 F. (2d) 167 (C. C. A. 2d, 1941) Cert. den. 314 U. S. 693 (1941).

[22] McKnight v. Commissioner, 123 F. (2d) 240 (C. C. A. 8th, 1941).

[23] Helvering v. Hormal, 111 F. (2d) 1 (C. C. A. 8th, 1940), Reversed: Hormel v. Helvering, 312 U. S. 552 (1941).

[24] Reuter v. Commissioner, 118 F. (2d) 698 (C. C. A. 5th, 1941); Commissioner v. Goulder, 123 F. (2d) 686 (C. C. A. 6th, 1941); Thomson v. Helvering, 114 F. (2d) 607 (C. C. A. 8th, 1940); Penn v. Commissioner, 109 F. (2d) 954 (C. C. A. 8th, 1940); Helvering v. Abraham, 115 F. (2d) 368 (C. C. A. 2d, 1940); also see *supra*, n. 13.

would terminate at the end of three years, however, the cases involving trusts which terminated at the end of five years usually vest a measure of expressed control in the settlor.[25] This added factor makes the result of these decisions inevitable.[26]

In dealing with the taxability of a short-term family trust, the Circuit Court of Appeals for the Fourth Circuit reached an interesting result in *Helvering v. Dunning.*[27] In that case the settlor created a family trust which was irrevocable for five years, but which could be terminated by the settlor at the end of this period by giving written notice to the trustee. If no such notice were given, the trust was to continue for another five years, but if the settlor died during any of the five-year periods, the trusts were to continue for twenty-one years after the death of the last beneficiary. The Court, passing the *Clifford* doctrine, rested its decision on the grounds that the settlor retained a vested right to revoke the trust which was subject to being divested, and that as a result, the trust fell squarely within the letter of Section 166 of the Internal Revenue Code. It is submitted, however, that the same result could have been reached on a sounder basis had the Court seen fit to rely on the *Clifford* rule.[28]

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[25] Commissioner v. Goulder, 123 F. (2d) 686 (C. C. A. 6th, 1941); Penn v. Commissioner, 109 F. (2d) 954 (C. C. A. 8th, 1940); Reuter v. United States, 34 F. Supp. 1014 (Ct. of Cls., 1940).

[26] See also Commissioner v. Ward, 119 F. (2d) 207 (C. C. A. 3rd, 1941), in which the Court remanded the case to the Board of Tax Appeals for a rehearing in the light of the Clifford case. There, the trust as originally framed was to last for five years, but was subsequently amended to last for six. A trust company was designated as trustee, and the beneficiaries were the settlor's wife and children. The donor had the power to approve or disapprove of any and all investments made by the trustee, and had the power to direct the trustee in making investments, etc. In Reuter v. United States, 34 F. Supp. 1014 (Ct. of Cls., 1940) a settlor was held taxable on the income of a trust which was to last five years, which named the settlor as trustee and his wife, father and mother as beneficiaries, and which vested broad and almost unlimited powers upon the trustee to deal with the trust property upon such terms and conditions as he deemed best. The Court stated that for all practical purposes the trust was identical with the one found in the Clifford case.

[27] Helvering v. Dunning, 118 F. (2d) 341 (C. C. A. 4th, 1941), Cert. den. 314 U. S. 631 (1941).

[28] Under the decided cases it would appear clear that the income from the trust in the Dunning case should be taxable to the settlor under Section 22 (a). It will be noticed that the trust was a "short-term family trust," and this factor coupled with the broad powers of administrative control retained by the settlor over the corpus should have been decisive.

Although dodged in one case,[29] the Circuit Courts have held that income from a family trust which was to last for six years was taxable to the settlor.[30] As indicated above, the Second Circuit gave little concern in such a case to the fact that the settlor had parted with his expressed control over the corpus,[31] and in a similar decision, the Sixth Circuit did not feel precluded from taxing the income to the settlor because he had named an independent trust company as trustee.[32] In *Commissioner v. Barbour,*[33] the settlor created two trusts, neither of which could last longer than six years, six months. The settlor's attorneys were named trustees, his mother, wife and children were named beneficiaries, and the settlor reserved no expressed power to determine investments or to revoke the trust. The Court, basing its opinion largely on the fact that the trusts were to last for only a limited time, held that the trust income was taxable to the grantor.[34]

No case has as yet been before the Circuit Courts which involved a short-term trust naming a member of the settlor's family as beneficiary, a completely independent third party as trustee, and which reserved no expressed control in the grantor.[34a] The tone of the later decisions, particularly the *Price* case, supra, indicates that the income from

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Judge Soper, in dissenting from the majority opinion, pointed out that with Section 22 (a) not considered, it could not be said that the income from the corpus should be taxed to the settlor under Section 166. Since the Supreme Court has indicated that Section 166 is to be narrowly construed (Helvering v. Wood, *supra*, n. 7) it is submitted that this reasoning was correct.

[29] Commissioner v. Richter, 114 F. (2d) 452 (C. C. A. 3rd, 1940); Remanded, Helvering v. Richter, 312 U. S. 561 (1941).

[30] Price v. Commissioner, 132 F. (2d) 95 (C. C. A. 6th, 1942). In reality, the trust was to last from May 26, 1932 until January 1, 1938.

[31] Helvering v. Elias, *supra*, n. 16.

[32] Price v. Commissioner, *supra*, n. 29. Emphasis was placed, however, on the degree of control retained by the settlor coupled with the duration of the trust.

[33] Commissioner v. Barbour, 122 F. (2d) 165 (C. C. A. 2d, 1941), Cert. den. 314 U. S. 691 (1941).

[34] *Supra*, n. 15.

[34a] The three cases which come closest to this point are the Ward case, *supra*, n. 26, the Price case, *supra*, n. 30, and the Barbour case, *supra*, n. 33. In both the Ward and Price cases, a trust company was named trustee, but in each case the settlor reserved broad powers of expressed control. In the Barbour case, no expressed control was retained by the settlor, but the trustee was the grantor's attorney who could not qualify as a "completely independent third party".

such a trust would be taxed to its settlor.[34b] It may well be, however, that such income would be taxable to the beneficiary, since it could not be said in such cases that the settlor had not made a bona fide gift nor that the settlor was none the poorer for the duration of the trust.

In dealing with short-term trusts which are not, strictly speaking, "family trusts", the courts have reached a somewhat different result.[35] In such cases, where the beneficiary is some party other than a member of the settlor's immediate family, decisions have generally held that it is necessary for the grantor to retain some degree of expressed control over the corpus before he will be taxed on the income therefrom. This result is natural, since in these cases it cannot be said that because of the short duration of the trust in question the settlor has in fact retained control over the *res*.

In *Helvering v. Bok*,[36] the settlor created a trust to last for three years. The beneficiaries named in the deed were a charitable corporation and certain designated individuals none of whom the settlor was under any obligation to support. In holding the *Clifford* doctrine inapplicable the Court said:

> "The case for the Commissioner, as the Board in its opinion points out, really comes down to the contention that the income of every short term trust shall be taxed to the settlor of the trust. To hold the income of this trust taxable to the settlor under the circum-

[34b] The Price case relied heavily on Commissioner v. Barbour, *supra*, n. 33 to reach its result. If the two cases are combined, it could fairly be said that the income from a trust naming an independent third party trustee and which reserved no expressed control in the settlor would be taxable to the settlor. This result is evident in the fact that in the Barbour case no expressed control was reserved, while in the Price case an independent bank was named trustee.

[35] The breakdown of short-term trusts into those instruments which are primarily for the benefit of the settlor's family and those which are not, has not been universally made. Hence it has been stated that the income from all short-term trusts should not be taxed to the settlor. See Tyre, *Federal Taxation of Irrevocable Trusts* (1940) 18 Tax Mag. 216, 222. The author there points out that the Clifford doctrine should not be applicable if the settlor has not reserved substantial control over the *res*. Since the decisions indicate, however, that the settlor retains control in fact due to the short term of a family trust, the statement must be taken to envision short-term trusts for the benefit of parties not members of the settlor's immediate family.

[36] Helvering v. Bok, 132 F. (2d) 365 (C. C. A. 3rd, 1942).

stances present would go far beyond Helvering v. Clifford, 1940, 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788, and the cases which have followed it. In the absence of legislation making such an extension we are not justified in going that far."[37]

In *Commissioner v. Chamberlain*,[38] the settlor conveyed certain property in trust naming as beneficiaries the trustees of Columbia University. Although the trust was to last for only four years, and although the settlor retained broad powers of administrative control, the Second Circuit held that the *Clifford* doctrine did not apply.[39] Previously, the same court, by way of dictum, had indicated that there was a valid distinction between a short-term trust naming a member of the settlor's family as beneficiary, and one of like duration which named an outsider as the *cestui que trust*.[40]

Apparently inconsistent with the theory advanced above are the cases of *Commissioner v. Lamont*[41] and *United States v. Anderson*.[42] In the first case, the Circuit Court for the Second Circuit held that income from a trust to last for one year was to be taxed to the settlor, even although the beneficiaries were persons other than members of the settlor's family. In the second decision, the Court of Appeals for the Sixth Circuit held that the income from a trust which was to last for six years should be taxed to the settlor, irrespective of the fact that the beneficiary was the First Baptist Church of Knoxville. On the one hand, the Court felt that a trust lasting for only one year reserved all economic benefit to the settlor,[43] and on the

[37] *Supra*, n. 36, 367.

[38] Commissioner v. Chamberlain, 121 F. (2d) 765 (C. C. A. 2d, 1941).

[39] *Supra*, n. 38, where the Court said at page 766:

> "We think the substantial difference between this case and Helvering v. Clifford, supra, where there was a family purpose trust or Helvering v. Horst, supra, where there was a family purpose gift, lies in the fact that here there is no such family flavor."

[40] See Helvering v. Achelis, 112 F. (2d) 929 (C. C. A. 2d, 1940).

[41] Commissioner v. Lamont, 127 F. (2d) 875 (C. C. A. 2d, 1942).

[42] United States v. Anderson, 132 F. (2d) 98 (C. C. A. 6th, 1942).

[43] In the Lamont case the settlor retained broad powers to control the corpus. This factor coupled with the fact that its term was for but one year is strongly persuasive of the fact that the grantor still retained the economic benefit of the *res* irrespective of its conveyance in trust. See *infra*, n. 108.

other, that the giving of income to a favorite religious organization would produce the same degree of personal satisfaction as a like donation to a member of one's family.[44]

III

TRUSTS OF INTERMEDIATE DURATION

Closely akin to short-term trusts which name persons other than the settlor's family as beneficiaries, are family trusts which, for the purposes of this paper, have been styled "trusts of intermediate duration".[45] In such cases, as in the case of short-term trusts which are not strictly speaking "family trusts", the question of whether or not the *Clifford* doctrine is applicable depends on the interplay of the length of the trust with the degree of control retained by the settlor. In cases involving trusts of intermediate duration, these factors are complementary, and usually the courts have applied the theory that the longer the term the more important the expressed power of control and vice versa.[46]

In dealing with the factor of "expressed control" care must be taken to distinguish between that type of control over matters which are purely administrative, and that type of control over matters which deal with the actual disbursement of trust funds. Administrative control includes, among others, the power to direct investments, to determine whether stock included in the trust corpus should be bought or sold, to vote such stock, to manage the properties constituting the corpus, and to do all acts necessary for the administration of the trust. Control over disbursements of trust funds, on the other hand, is that degree of control vested in the grantor which enables him

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[44] In the Anderson case, although the settlor retained substantial powers of management, he had nevertheless parted with the corpus for six years. Since the trust was not a "family trust", it is submitted that the Clifford doctrine should not apply. See Tyre, *op. cit.* n. 35.

[45] These trusts have been styled above as those instruments which will last longer than strictly short-term trusts, but whose termination is not dependent on the death of either the settlor, the beneficiary, or some party in interest.

[46] See Helvering v. Elias, 122 F. (2d) 171 (C. C. A. 2d, 1941), Cert. den. 314 U. S. 692 (1941).

to dictate after the creation of the trust who are to constitute the beneficiaries and how much income they are to receive.

The Circuit Courts have held that the income from trusts which were to last for 8 years and 8 months,[47] and 10 years[48] was taxable to the grantor, but at the same time have held that income from trusts lasting 10 years,[49] 20 years,[50] and 23 years[51] was not likewise taxable. In the first of these decisions the term of the trust was coupled with relatively broad powers of administrative control. The Court felt that the combination of these two factors was conclusive.

In both *Cory v. Commissioner*,[52] and *Commissioner v. Jonas*,[53] the Court was asked to tax to a settlor income from trusts which were to last for 10 years. It was found that in the first case the settlor had retained wide powers of administrative control, and therefore the settlor was held taxable.[54] In the second case, the settlor retained no power of control or management over the corpus and the Court held that he was not taxable on the income therefrom.[55] The Circuit Court of Appeals for the First Circuit inferred in a related case that its facts were not as strong as those found in the *Clifford* case but remanded the cause for further proceedings because the issues had not been

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[47] Commissioner v. Berolzheimer, 116 F. (2d) 628 (C. C. A. 2d, 1940).

[48] Cory v. Commissioner, 126 F. (2d) 689 (C. C. A. 3rd, 1942), Cent. den. 63 S. Ct. 34 (U. S., 1942).

[49] Commissioner v. Jonas, 122 F. (2d) 169 (C. C. A. 2d, 1941).

[50] Jones v. Norris, 122 F. (2d) 6 (C. C. A. 10th, 1941).

[51] Hogle v. Commissioner, 132 F. (2d) 66 (C. C. A. 10th, 1942).

[52] *Supra*, n. 48.

[53] *Supra*, n. 49.

[54] In the Cory case, the reason for the Court's decision can be summed up in the following quotation (p. 693):

> "Finally we come to the taxpayer's control over the trusteed property. Unlike the Clifford case the taxpayer here had no right to change the distributive provisions of the trust or the beneficial interests created thereby. Nevertheless, he could control the purse strings through his power to change, modify or alter any of the administrative provisions of the agreement. By this provision the settlor subtly reserved complete dominion over the trustee, since the trustee's appointment and powers are administrative."

[55] It is worthy of note that in both the Cory case and the Jonas case, the trustee was a third party, not a member of the settlor's immediate family. This leads irresistibly to the conclusion that the degree of control retained by the settlor was the factor that swung the scales in favor of taxability in the first case and tax immunity in the second.

framed with respect to Section 22(a) before the Board of Tax Appeals.[56] In that case the trust was bound to last for fifteen years, the settlor was one of four trustees, and although the trustees were given broad powers of management and control, no one of them acting alone could exercise such powers.

In *Jones v. Norris*[57] the settlor conveyed certain property to one of his confidential employees in trust for his children. The settlor reserved full power of control and management over the trust estate. In holding that the reservation of administrative control alone would not cause the settlor to be taxed on the income from a family trust which was to last for 20 years, the Court said:

> "We do not understand that the power of management, however unlimited, may operate to bring the grantor within the sweeping provisions of Section 22(a), if by such powers he cannot derive any economic benefit therefrom, except whatever advantages he may gain by virtue of the provisions in the Revenue Act, which permits the creation of trusts and imposes taxation under Section 161 et seq."[58]

An interesting question was presented in *Hogle v. Commissioner.*[59] There the settlor created a trust to last for twenty-three years. The instrument named a third party trustee and the settlor's children as beneficiaries. It set up as trust *res* a trading account in stocks, bonds, and real

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[56] Commissioner v. O'Keeffe, 118 F. (2d) 639 (C. C. A. 1st, 1941).

[57] *Supra*, n. 50.

[58] *Supra*, n. 50, 11. In this connection, it is interesting to note that although the settlor could not change any of the beneficiaries of the trust, he could under certain conditions direct the amount of net income payable to each. In this connection, the trust provided:

> "I further reserve the right during my lifetime, to order and direct my said Trustee to make settlement, either in full or in part, with any one of my said beneficiaries, after such one shall have reached the age of 21 years, or to order and direct that a certain part of the net income from any one, or more, of said estates, to be determined by me alone, shall be paid to the beneficiary thereof, . . ."

Although it might have been possible for the Court to construe such a provision as control of disbursements, it either ignored this fact or its attention was not called thereto. In any event, the decision clearly indicates that where such a power is retained solely for the protection of the beneficiaries, the control in question is control over management within the rule as stated above. But see Commissioner v. Buck, 120 F. (2nd) 775 (C. C. A. 2d, 1941).

[59] *Supra*, n. 51.

estate which was to be managed and operated under the direction of the taxpayer. Although the settlor thereby retained broad powers of administrative control over the *res*, there was no provision whereby he could share in the corpus or the income of the trust. The trust corpus was built up in two ways, namely, by the gain realized by the settlor in trading in stocks, bonds and real estate on behalf of the trust, and by the normal income received from the sale or investment of property which was already part of the trust corpus. The Court held that the income realized from the trading on margin by the taxpayer on behalf of the trust involved an exercise of his personal skill and judgment, was in substance his personal earnings, and was therefore taxable to him. The income derived as interest or capital gains resulting from an outright sale of the corpus, however, was taxed to the trust or the beneficiaries.[60] The Court also held that the same theory applied to a somewhat similar trust, which was to last for eighteen years, and which called for annual distributions to the beneficiaries.[61]

The opinions in the *Jones* case and the *Hogle* case are excellent illustrations of the effect of the retention by a settlor of mere administrative control over the corpus in a trust which is to last in the neighborhood of twenty years. Both cases stand for the proposition that by retaining administrative control alone, the taxpayer does not thereby subject himself to income tax liability. That both decisions reach the correct result is made clear when it is realized that in neither case did the settlor retain any economic benefit from the corpus, and therefore the true test of taxability to a grantor was absent.

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[60] This phase of the case drew a strong dissent from Judge Bratton in which he said (p. 77) :

> "By each of these trust instruments, petitioner gave to the trust estate the right to receive and enjoy the economic gain realized from his time and efforts devoted to its management. All of the taxable income of each trust should be taxed to the estate or the beneficiaries. None of it should be taxed against petitioner, except the income which accrued to the individual share of George H. Hogle in the Three Trust during his minority."

[61] *Supra*, n. 51, 72-74.

It is sometimes the case that a settlor will create a trust which has no definite termination date, but at the same time is not a trust of unlimited duration. Examples of such instruments are trusts established for the maintenance and support of the settlor's minor children,[62] trusts which can be terminated by the trustee,[63] or trusts which will terminate upon fulfillment of all conditions named therein.[64] Where a settlor has created a trust for the support of his minor children and reserved therein broad powers of administrative control, the courts generally hold that the income is taxable to him.[65] Such decisions are justified on the ground that by analyzing the interplay of control on duration the court can clearly see that the settlor has retained the economic benefits from the corpus.[66]

In *Richardson v. Commissioner*[67] a situation arose in which the *Clifford* doctrine was used to tax the income of a trust to the trustee. The corpus involved in that case consisted of a certain property which had recently been given to the settlor by the trustee. After the creation of the trust, the trustee was given the power to terminate the instrument at any time, and upon such termination the corpus was to go to him. In such a situation, the

[62] Whiteley v. Commissioner, 120 F. (2d) 782 (C. C. A. 3rd, 1941). Here the trust was irrevocable and provided for payment of the income to the donor when he should so demand during the minority of his children, said income to be used entirely for their support, maintenance, education and enjoyment. After the beneficiary attained the age of twenty-one, she was entitled to receive income and corpus "in such amounts and at such times as the Donor in writing orders such distribution or distributions to be made."

[63] Richardson v. Commissioner, 121 F. (2d) 1 (C. C. A. 2d, 1941), Cert. den. 314 U. S. 684 (1941).

[64] Jacobs v. Commissioner, 129 F. (2d) 99 (C. C. A. 5th, 1942).

[65] The Supreme Court has held that where a trust is established in discharge of the settlor's parental obligation to support his minor children, the income therefrom will be taxable to him. See Helvering v. Stokes, 296 U. S. 551 (1935); Helvering v. Coxey, 297 U. S. 694 (1936). And see Helvering v. Stuart, 63 S. Ct. 140 (1942), which held that in such cases the possibility of the use of income to relieve the grantor, pro tanto, of his parental obligation is sufficient to bring the entire income of such trusts within the rule of attribution laid down in Douglas v. Willcuts.

[66] In the Whiteley case the Court, in emphasizing the control retained by the settlor, said, 120 F. (2d) 785:

> "In this case the settlor of these trusts by its terms could have received its income and applied it to the support of his minor children. He did not choose to do so, but left it to accumulate for them. He controlled the use of the money and had the same non-material satisfaction as that of the taxpayer in the Horst case."

[67] *Supra*, n. 63.

Court had no trouble in applying the rule in the *Clifford* case, since all the economic benefits of the corpus remained at the command of the trustee.

IV

TRUSTS FOR LIFE

Where a trust is to last for the life of a party in interest, the question of whether or not the *Clifford* doctrine can apply usually depends on the degree of control the settlor has retained over the corpus.[68] In such cases, the distinction drawn above between purely administrative control and control over disbursements bulks large in importance. As a general rule it may be stated that if a trust is to last for the life of a party in interest and if the settlor retains merely administrative control over the corpus, income from the trust will not be taxable to the grantor. On the other hand, if the settlor in a similar trust reserves that degree of control over disbursements which would enable him to determine what portions of income will be paid to what beneficiaries, the *Clifford* doctrine will apply.[69] The reason for the rule is that in the first case the settlor has not retained the economic benefits from the corpus, while in the second case he still remains the substantial owner of the *res* even after his conveyance in trust.

In dealing with trusts which are to last for the life of an interested party, the Court should consider both Sections 166 and 167, and Section 22(a), thereby construing

[68] In dealing with instruments which are to last for the life of a party in interest it is necessary to adopt a realistic approach to the problem. It could not be said, for example, that a trust would come within this classification if its duration were dependent on the death of a beneficiary who was, at the date of its creation, ninety-five years old. In such cases the court should look through the form to the substance of the transaction, and find that the trust was, in reality, one of the short-term class. The author makes no attempt to draw the line in such unusual cases, but leaves this question to future judicial decisions.

[69] Interrelated with these two types of control is the nature of the corpus over which said control is retained. The distinction drawn above is clear where the corpus consists of stable investments, or securities in a large corporation. If the corpus is represented by stock in a wholly owned family corporation, however, absolute power of management by the settlor might in substance amount to control over actual disbursements. In such cases, a realistic approach should be adopted and the Clifford doctrine applied.

their interplay upon one another.[70] In one case[71] the Court was able to show that by virtue of retaining wide powers over disbursements, the settlor remained taxable on the trust income, even though the terms of the trust stated that it was to last for the life of the settlor.[72] In reaching its decision, the Court relied on both Sections 166 and 22(a).[73] In another case,[74] the Court indicated that although it was likely that the income of the trust was taxable to the settlor under Sec. 166, it would place its decision on Section 22(a) as construed by *Helvering v. Clifford,* inasmuch as it was clear that the *Clifford* doctrine was applicable and because the Court had refused to tax the settlor under Sections 219(g) and (h) when the trust had been before it on a previous occasion.[75]

An excellent case which demonstrates the fact that the retention of control over disbursements will be fatal to the settlor is *Commissioner v. Buck.*[76] In that case, the

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[70] Helvering v. Stuart, 63 S. Ct. 140 (1942). See Kraft v. Commissioner, 111 F. (2d) 370 (C. C. A. 3rd, 1940), Cert. den. 311 U. S. 671 (1940), where the court stated that certain trusts were within the literal provisions of Section 166 of the Revenue Act of 1934, but that the case might have been decided on the authority of the Clifford case. And see Welch v. Bradley, 130 F. (2d) 109 (C. C. A. 1st, 1942), Cert. den. 63 S. Ct. 257 (1942).

[71] Cox v. Commissioner, 110 F. (2d) 934 (C. C. A. 10th, 1940), Cert. den. 311 U. S. 667 (1940).

[72] For a somewhat similar decision see the late case of Downie v. Commissioner, — F. (2d) — (C. C. A. 6th, 1943). There the taxpayer created a trust which provided that the income should be collected until his death, at which time complete distribution would be made to the settlor's brother and sister. The instrument provided that should the settlor become disabled, both the principal and the income of the trust could be used for his support. Subject to the consent of one beneficiary, the settlor could revoke the trust, change the beneficiaries, or change their respective shares. The Court stated that the Clifford doctrine was clearly applicable and also that the trust income could be taxed to the settlor under Sec. 167.

[73] In this case the Court relied heavily on the fact that the two trustees of whom the grantor was one had the power in their discretion to control the amounts to be paid to the beneficiaries. Since the instrument stated that in all matters of discretion, the grantor's will should control, the Court stated that donor's powers were substantially equivalent to those of absolute owner of the corpus.

[74] White v. Higgins, 116 F. (2d) 312 (C. C. A. 1st, 1940).

[75] Sections 219(g) and (h) were the predecessors, in the Revenue Acts of 1924 and 1926, of Sections 166 and 167.

The Court indicated that its former ruling based on Sec. 166 was of shrunken importance, since after the instant case has been previously before it (Higgins v. White, 93 F. (2d) 357 (C. C. A. 1st, 1937)) that section had been amended to make grantors taxable not only where the power to revest is in the grantor as such, either alone or in conjunction with any person not having a substantial adverse interest, but also where such power is vested in any person not having a substantial adverse interest.

[76] Commissioner v. Buck, 120 F. (2d) 775 (C. C. A. 2nd, 1941).

taxpayer created a trust naming a bank as trustee and his wife and children as beneficiaries. The trust was to last during the life of settlor's wife, and for a period thereafter at which time the corpus was to be paid to the children. Coupled with broad administrative power, the settlor retained the power to alter or amend in any respect those trust provisions which related to the distribution of income or principal. However, this power could not be exercised in such a way that the trust could be revoked, or the corpus could revert to the settlor. In holding the *Clifford* doctrine applicable, the Court said:

> "During his life, he has entire control of the sale and investment of the corpus, in whole or in part, and the voting power of any stock now or later constituting that corpus. When to such control there is coupled the power, until his death, freely to sprinkle the income about among any beneficiaries he may select (as if he were playing a hose), it is impossible to conclude, in the light of the recent decisions of the Supreme Court, that the income is not taxable to him."[77]

After indicating that retention of control over disbursements was a sufficient indication of ownership as to justify taxing the income from a trust to its settlor,[78] the Third Circuit Court of Appeals applied the *Clifford* doctrine to a trust which was to last for the life of the grantor and which named the settlor's retired servant and a friend as beneficiaries.[79] That the settlor retained the power to control disbursements of the trust income was a decisive factor in making him liable for the tax.[80] The same result was reached in a similar case by the Court of Appeals for the Sixth Circuit.[81]

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[77] *Supra*, n. 76, 777.

[78] Commissioner v. Brown, 122 F. (2d) 800 (C. C. A. 3rd, 1942).

[79] Brown v. Commissioner, 131 F. (2d) 640 (C. C. A. 3rd, 1942), Cert. den. — S. Ct. — (U. S., 1943).

[80] In the Brown case, the Court stated 131 F. (2d) 641:

> "We think that a settlor who is a person of means and who can control the spending of a fund, which she has set up, in every respect except spending it for herself is sufficiently the 'owner' of the fund to make its income taxable to her under 22(a)."

[81] Warren v. Commissioner, 133 F. (2d) 312 (C. C. A. 6th, 1942).

Apparently in harmony with the general rule is *Williamson v. Commissioner*.[82] There the settlor created a trust which named the taxpayer, his wife, and their attorney as trustees, any two of which were given full power and authority to exercise all the powers of the trustees under the indenture. The trustees were directed to administer the trust property for the benefit of the settlor's wife and daughter as long as either were living, and were authorized "in their uncontrolled discretion" to apply the net income and so much of the corpus as they deemed necessary for the maintenance and welfare of the beneficiaries. The taxpayer retained the power to remove the other two trustees and appoint their successors, the power to vote the trusteed stock, the power to direct sales of trust property without limitation, and the power to preclude sales and investments by the trustees except upon his approval. On these facts, the Board of Tax Appeals held that the settlor was taxable under Section 22(a), and this decision was affirmed on appeal.

In the *Williamson*[83] case it is clear that the Court was called upon to apply the *Clifford* doctrine to a trust to last for the life of an interested party, and which reserved broad powers of administrative control in the settlor. The Court was also able to see, however, that the settlor in conjunction with his attorney could control the amount of trust income distributable to the beneficiaries.[84] This being true, the Court held that the taxpayer was liable under Section 167 as well as Section 22(a), and thereby relied on both sections of the Internal Revenue Code to sustain taxability.[85]

Family trusts are often created which are to last for the life of a party in interest, and which reserve broad

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[82] Williamson v. Commissioner, 132 F. (2d) 489 (C. C. A. 7th, 1942).

[83] *Supra*, n. 82.

[84] Clearly, therefore, the settlor retained control over distribution.

[85] The Court stated that any two of the three trustees were given full power to exercise all the power of the trustees under the trust instrument. Thus, the Court reasoned, the taxpayer and his lawyer were given an uncontrolled discretion to apply all of the net income they deemed sufficient for the support of the settlor's child. Since the settlor in his uncontrolled discretion could have distributed all of the income to the child, the Court held Section 167 applicable.

powers of administrative control with the grantor, but which do not reserve in the grantor control over the disposition of the income. In such cases, the trustee may be the settlor himself, or a third party who is directed to follow the advice of the grantor in such matters. In either event, the *Clifford* doctrine will not be applied, inasmuch as the settlor has parted with that degree of economic benefit that makes the income of the trust which he has created taxable to him.

Commissioner v. Branch[86] illustrates the application of the general rule. There the taxpayer created an irrevocable trust naming himself and two other parties as trustees, and naming his wife as life beneficiary with provisions for distribution of the corpus upon termination. The trust provided that as long as the settlor continued to act as trustee he alone should have full power to direct investments and otherwise manage the *res*. In refusing to tax the income of the trust to the settlor the Circuit Court of Appeals for the First Circuit said:

> "Helvering v. Clifford rests on its particular facts, as the court was careful to say. We do not understand that the case, as a general proposition, obliterates the separate legal personality of the wife for purposes of determining the gross income of the husband under Section 22(a). Where the grantor has stripped himself of all command over the income for an indefinite period, and in all probability, under the terms of the trust instrument, will never regain beneficial ownership of the corpus, there seems to be no statutory basis for treating the income as that of the grantor under Section 22(a) merely because he has made himself trustee with broad power in that capacity to manage the trust estate."[87]

The Court of Appeals for the Second Circuit used the *Branch* case as sole authority when it refused to apply the *Clifford* doctrine to a trust which named the settlor and wife as trustees and the settlor's wife as life beneficiary;

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[86] Commissioner v. Branch, 114 F. (2d) 985 (C. C. A. 1st, 1940).

[87] *Supra*, n. 86, 987.

and which in substance gave the grantor power to administer the trust in his uncontrolled discretion.[88] A similar conclusion was reached in *Commissioner v. Armour*[89] where an irrevocable trust named the settlor as trustee, the settlor's daughter as life beneficiary, and gave the settlor trustee the broad power to manage, control, sell, lease, invest and reinvest the trust *res*.[90]

Two cases which illustrate the extreme to which the Government has attempted to carry the *Clifford* doctrine are *Commissioner v. Betts*[91] and *Suhr v. Commissioner*.[92] In both cases the taxpayer created irrevocable trusts naming third parties as trustees and stating that the indentures were to last for the life of the beneficiary, with appropriate remainders over.[93] In each case the settlor retained expressed powers of control over investment, sale, and management of the trust corpus, but in neither case did these reservations make the rule in the *Clifford* case applicable.[94] In a somewhat similar case,[95] the Circuit Court for the First Circuit refused to apply the *Clifford* doctrine where an irrevocable trust was created to last for the duration

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[88] Helvering v. Palmer, 115 F. (2d) 368 (C. C. A. 2d, 1940).

[89] Commissioner v. Armour, 125 F. (2d) 467 (C. C. A. 7th, 1942).

[90] In Kent v. Rothensies, 35 F. Supp. 291 (D. C., E. D. Pa., 1940) (reversed on other grounds 120 F. (2d) 476) the taxpayer created a trust to last for the life of the beneficiary. The instrument named the settlor as one of two trustees, the said trustees being given unusual powers to deal with the trust property in connection with the grantor's business. The Court refused to tax the settlor on the income of the trust under Sec. 22(a) and distinguished the Clifford case on the grounds that there a short-term trust was in issue while here the trust was not to terminate until the death of the beneficiary. Cf. Schoellkopf v. McGowan, 43 F. Supp. 568 (D. C., W. D. N. Y., 1942).

[91] Commissioner v. Betts, 123 F. (2d) 534 (C. C. A. 7th, 1941).

[92] Suhr v. Commissioner, 126 F. (2d) 283 (C. C. A. 6th, 1942).

[93] In Commissioner v. Donahue, 128 F. (2d) 739 (C. C. A. 2d, 1942), the government contended that the Clifford case applied where the term of the trust was for the life of certain beneficiaries, none of whom were members of the taxpayer's household. The settlor had named a corporate trustee, but had stipulated that the trustee should accept such directions concerning the management of the trust *res* as the grantor should give in writing. The Clifford case was distinguished by the Board of Tax Appeals (44 B. T. A. 329) and this decision was affirmed.

[94] See also the dissenting opinion of Judge Biggs in Commissioner v. Park, 113 F. (2d) 352, 354 (C. C. A. 3rd, 1940), in which it was stated that the Clifford case should apply to preclude a taxpayer from taking as a deduction from gross income interest on a demand note given by the taxpayer to his wife.

[95] Commissioner v. Bateman, 127 F. (2d) 266 (C. C. A. 1st, 1942).

of the settlor's life with all powers of management and control vested in the trustee. However, in refusing to tax the settlor, the Court experienced some difficulty in applying the *Clifford* doctrine to the facts as presented.[96]

V

RECENT SUPREME COURT DECISIONS

Since the decision in *Helvering v. Clifford* there have been relatively few cases before the Supreme Court dealing with the taxability to a grantor of income derived from irrevocable family trusts. The Court has held, however, that such income cannot be properly taxed to the settlor under Section 166, even though the trust in question was to last but for a short span of years, and reserved broad powers of management and control in the grantor.[97] Moreover, after rendering its opinions in *Helvering v. Horst*[98] and *Helvering v. Eubank*,[99] the Court had no trouble in taxing the income of a testamentary trust to its *cestui que trust*,[100] although the facts showed that the taxpayer had irrevocably assigned a part of said income to her children for one year.[101]

In *Hormel v. Helvering*[102] the Supreme Court affirmed a decision of the Circuit Court of Appeals[103] which taxed to the settlor income from a trust to last for three years, which named as beneficiaries the taxpayer and his wife as guardian for their children, and which named the grantor and another as co-trustees. The Court recognized, however, that the taxpayer had not been given an opportunity to offer evidence before the Board of Tax Appeals

[96] In the Bateman case the Court said 127 F. (2d) 271:

> "Frankly we do not know how the Supreme Court would apply the general criteria of the Clifford case to the facts now before us. We have to make our decision with such light as is available to us."

[97] Helvering v. Wood, 309 U. S. 344 (1940).

[98] Helvering v. Horst, 311 U. S. 112 (1940).

[99] Helvering v. Eubank, 311 U. S. 122 (1940).

[100] Harrison v. Schaffner, 312 U. S. 579 (1941), reversing Schaffner v. Harrison, 113 F. (2d) 449 (C. C. A. 7th, 1940).

[101] For a full discussion of the Horst and Eubank cases and their interplay on Section 22(a) see Pavenstedt, *The Broadened Scope of Section 22(a)* (1940) 51 Yale L. J. 213, 239-248.

[102] Hormel v. Helvering, 312 U. S. 552 (1941).

[103] Helvering v. Hormel, 111 F. (2d) 1 (C. C. A. 8th, 1940).

on the question of the applicability of Section 22(a), and that a remote chance might exist to take the case out of the *Clifford* rule. The case was remanded, therefore, with direction to the Board to allow the grantor an opportunity to present any additional facts which would serve this purpose.

Closely akin to the *Hormel* case, supra, is *Helvering v. Richter*,[104] in which the Court followed its previous decision by remanding the cause to the Board of Tax Appeals for further proceedings in the light of the *Clifford* case. It is worthy to note, however, that in the *Schaffner*,[105] *Hormel*,[106] and *Richter*[107] cases, the Court indicated that short-term family assignments, whether they be in trust or otherwise, would not defeat the tax liability of the assignor, irrespective of the fact that the assignor retained

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[104] Helvering v. Richter, 312 U. S. 561 (1941). The Richter and Hormel cases laid to rest one procedural problem involved in the application of the Clifford doctrine, namely whether Section 22(a) could be relied upon for the first time on appeal to the Circuit Courts. There remains unanswered by the Supreme Court, however, the perplexing question of whether or not the ownership of trust income is a question of law or fact. The importance of this point lies in the fact that if the Court of Appeals adopts the view that ownership is a question of fact, it will not reverse the lower court even though it believes the government has failed to make its case come within the Clifford doctrine and vice versa. The converse of this is, of course, true, if the court adopts the view that the question of ownership of the income is a question of law.

The Circuit Courts have applied opposite theories with regard to this point. Both White v. Higgins, 116 F. (2d) 312, 321 (C. C. A. 1st, 1940) and Commissioner v. Wilson, 125 F. (2d) 307, 309 (C. C. A. 7th, 1942) hold that the ultimate question of ownership is one of law and open for determination on appeal. But in Commissioner v. Goulder, 123 F. (2d) 686, 689 (C. C. A. 6th, 1941) the Court stated that the Clifford case seemed to hold that whether or not initial facts have the legal effect of proving ownership of income is a question of fact, and that as a result the Appellate Court lacked "the power to decide the facts upon appeal, no matter how clearly the record may disclose them". In Commission v. Armour, 125 F. (2d) 467 (C. C. A. 7th, 1942) the Court said (p. 471):

> "The Board, with the Clifford case in mind, found here that the settlor did not reserve the economic enjoyment of the income of this trust estate and, just as the Supreme Court felt in the Clifford case, so we feel here that the Board having found as an ultimate fact that the settlor did not retain the economic enjoyment to such an extent as to render her subject to the tax upon the income, we should not, indeed may not, disturb the finding."

It is submitted that the ultimate question of ownership of income is either a question of law or a mixed question of law and fact, and in either event should be subject to review on appeal.

[105] *Supra*, n. 100.

[106] *Supra*, n. 102.

[107] *Supra*, n. 104.

little if any expressed control over the property thus conveyed.[108]

The most recent and far reaching construction by the Supreme Court of the rule in the *Clifford* case is *Helvering v. Stuart.*[109] In that case two separate trusts were created by John Stuart and R. Douglas Stuart of stock of a corporation of which they were respectively president and vice-president. In the John Stuart trust the life beneficiaries were the settlor's adult children, and the trustees were the grantor, his wife, and R. Douglas Stuart. In the R. Douglas Stuart trust the beneficiaries were the minor children of the settlor, the trustees were the settlor, his wife and John Stuart, and the trust was to continue until the youngest beneficiary reached the age of thirty.

Both trusts provided that the settlor should retain absolute control over the management of the corpus,[110] and that during the settlor's life the remaining trustees should have the power to alter the indenture in any way.[111] Be-

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[108] These cases are not absolute holdings on this point. However, the broad sweep of the language contained therein points with almost certainty to the conclusion that unless the taxpayer could show strong facts to the contrary, the income from the strictly short-term family trusts would be taxable to him. Such decisions are very closely akin to the doctrine of Lucas v. Earl, 281 U. S. 111 (1931). That case, and the decisions which have extended its scope, proceed upon the theory that "no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew." In the short-term family trust arrangement, not only the income but also the income producing property is conveyed for a short period of time. However, the substantive effect of a purely short term assignment in trust (for example, a trust to last for one year) is in reality the assignment of an item of income. See MAGILL, THE IMPACT OF FEDERAL TAXES (1943) Ch. 2, 49-57.

[109] Helvering v. Stuart, 63 S. Ct. 140 (U. S., 1942).

[110] In this connection the instrument provided:

> "Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn."

[111] In this connection the instrument provided:

> "Ninth. During the life of the Donor, the said [wife and brother of the donor], or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the

cause the Circuit Court of Appeals had found that under the law of Illinois the wife and brother as trustees had no authority to revest the property in the grantor, the Supreme Court held that Sections 166 and 167 were inapplicable.

The Government contended, however, that although Sections 166 and 167 did not apply, Section 22(a) was applicable and the income from the trusts should be taxed to the settlors. The Court stated that irrespective of the broad power of administrative control reserved by the settlor in the John Stuart trust, the facts on the present record did not justify taxing him under the *Clifford* doctrine because:

> "Economic gain realized or realizable by the taxpayer is necessary to produce taxable income under our statutory scheme."[112]

The Court stated, however, that when the case had been before the Board of Tax Appeals it had not been necessary for the Board to reach a conclusion based on Section 22(a). Thus there was no definite finding in the record as to the character of control reserved by the settlor. The case was therefore remanded for a determination of such facts.[113]

The importance of the *Stuart* case is readily demonstrated when it is realized that its facts presented an excellent opportunity for the extension of the *Clifford* doctrine by the Supreme Court. Under the *Stuart* decision, however, the Court impliedly recognized the rule that the retention by the grantor of only broad administrative control over the corpus would not make the income of a long-term family trust taxable to him. The Court adopted,

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beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect."

[112] *Supra*, n. 109, 148.

[113] In the R. Douglas Stuart trusts the court held that entire income was taxable to the settlor under Section 167, because, *supra*, n. 109, 149:

> "We are dealing with a trust for minors where the trustees, without any interest adverse to the grantor, have authority to devote so much of the net income as 'to them shall seem advisable' to the 'education, support and maintenance' of the minor."

therefore, the sound underlying theory of the previous decisions handed down by the various Circuit Courts of Appeals which had dealt with similar trusts.[114]

VI

CONCLUSION

1. Although represented as being a monster by some, the rule in the *Clifford* case is, in reality, a useful plug in one of the last methods of tax avoidance which utilized the trust device. Where a taxpayer seeks to reduce his surtaxes by channelling a part of his earnings by means of a short-term family trust to members of his immediate family, his scheme is doomed to failure. On the other hand, if a settlor creates a trust intending thereby actually to give the corpus or its benefits to a member of his family and not merely to part therewith for a short period of time, he will not remain taxable on the income.[115] The ultimate test is, therefore, that irrespective of his conveyance in trust, if the taxpayer has retained the economic benefits of the *res*, he will remain taxable on its income.

2. While it is dangerous dogmatically to classify cases involving the *Clifford* doctrine, it is possible, in the light of the abundant authority on the subject represented by the decisions of the Circuit Courts of Appeals, to state three general rules with respect thereto.

It may be stated as an initial proposition that where the Court is dealing with a strictly short-term family trust, (lasting for six years or less) it will generally tax the income therefrom to the settlor irrespective of the absence of expressed control over the corpus retained by the settlor. In such cases, it is felt that the implied control reserved by the settlor by reason of the fact that the trust

[114] The Stuart case received a careful examination in Williamson v. Commissioner, supra, n. 82. The Court there points out that the Stuart decision stands for the fact that although a trust is of long duration or that the trustees are persons other than the donor, the Clifford doctrine will yet apply. The important factor, in such cases, is the type of control reserved by the settlor.

[115] It is clear that where a settlor has created a trust but retains the power to change the beneficiaries at will, he has made no completed gift within the intendments of the Gift Tax Law. Estate of Sanford v. Commissioner, 308 U. S. 39 (1939).

is to last but a few years, and the ordinary control exercised by the settlor over the members of his family, make the result conclusive.

Where a trust is to last longer than a strictly short-term instrument, but termination of it is not dependent upon the life of an interested party, a different rule is applicable. In such cases, duration and control are complementary, the courts usually applying the theory that the longer the term, the more important the factor of control and vice versa. It is also important in dealing with such cases to clearly distinguish between control over management and control over actual disbursements. If the type of control is of the latter character, the settlor has, for all practical purposes, retained the economic benefits of the corpus, and will therefore remain taxable on its income.

If the term of a trust is measured by the life of an interested party, the settlor will not be taxable on its income, irrespective of the fact that he has retained broad powers of administrative control. Where, however, the settlor still retains the power to alter the beneficiaries and direct the amounts payable to each, the decisions indicate that he is taxable on the income from the trust.