



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
H. M. EICHELBERGER)

Appearances:

For Appellant: Sidney R. Reed

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; William Acton, Assistant Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1935, as amended) from the action of the Franchise Tax Commissioner, overruling the protests of H. M. Eichelberger, to his proposed assessment of additional tax of \$88.82 for the taxable year 1937.

The determinative question presented here is whether or not income from an irrevocable trust created by Appellant for the benefit of his adult, competent children, is taxable to him as grantor. He reported net income of \$8,870.19 for the income year 1937 and paid the tax thereon. The Commissioner claimed that he was in receipt of additional taxable income of \$8,142.00 being the net income of the trust for the year in question.

None of the relevant facts is in dispute.

The trust agreement expressly made irrevocable, provided that the trust estate be held for a five year period by the grantor, as trustee, and by a stranger as successor trustee, in the event of his death. All of the income was to be paid to his adult children for the duration of the trust, and on its termination, the entire principal was to be delivered to them in equal shares. The trustor alienated himself from every vestige of enjoyment of the trust property, except (1) the slight possibility of reversion in the event of the death intestate of both of the beneficiaries, leaving no issue, before the termination of the trust; and (2) the right to receive reasonable fees for his services as trustee.

The Commissioner relies on the case of Helvering v. Clifford 309 U. S. 311, and concedes that, if applicable, it is decisive. In that case a husband declared himself the trustee of a short term, irrevocable trust for the benefit of his wife. It was admittedly created to give her security and economic independence, rather than to relieve him from liability for family or household expenses, but was subject to termination on the death of either, with reversion to him in the event of her death.

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The **trustor** reserved absolute discretion as to the part of the net income to be paid to the beneficiary and retained wide powers of control over trust operations, in the capacity of trustee.

The Court held (with a strong dissenting opinion) that the trust arrangement was only a temporary reallocation of income within the intimate family group, without any substantial change in the grantor's financial condition by reason of his control over the **corpus**. The "benefits flowing to him indirectly through the wife" were stressed as a factor in the aggregate of legal rights retained.

The answer to the question of whether or not a grantor shall be treated for tax purposes as the owner of the trust corpus depends on an analysis of the terms of the trust and all the circumstances attendant on its creation and operations, and where the grantor is trustee and the beneficiaries are members of the family group, close scrutiny of the arrangement is admittedly necessary. It cannot be said, however, that either the retention of control over trust management through the acceptance of trusteeship or the short duration of the trust are conclusive factors in determining taxability.

Analysis of the Clifford case shows that it involves three principal elements; a short term trust; broad control of the trust corpus by the **trustor**; and a beneficiary, who is a member of the grantor's intimate family group, presumably amenable to his wishes, but to whom he owed a legal obligation of support. The principal of that case has had wide application in the short time since its enunciation, but it cannot be construed to mean that one presently owning property and vested with the right to receive income therefrom is forever thereafter subject to tax on such income under a transfer in trust for the benefit of adult children to whom he owes no obligation of support. By logical distinction that principle is not governing in the instant case.

There is authority for the view that the duration of the trust is of great weight, and may be decisive when viewed with other factors which make up the aggregate of benefits to the **trustor**, but the length of term of the trust is in itself not conclusive. The use of irrevocable trusts as a refuge from surtaxes prompted the Treasury Department to request Congress for legislation expressly taxing the income from short term trusts to the grantor. Congress did not accept the Treasury's recommendation and the accomplishment of such purpose under California law by amendment to Section 12 of the Personal Income Tax Act, through the guise of judicial construction, is inappropriate.

The intimacy of relation between the grantor and trustee, or beneficiary, goes to increase the control of the grantor, and if such **control** is untrammled, the income of the trust should be taxed to him. Actual control, however, must be distinguished from legal control. The Appellant, herein, as trustee, had only those broad powers of control and management that are customarily accorded trustees of trust agreements of conventional form. He did not have absolute ownership, nor the same degree of command or control with which the trustee in the Clifford case was vested. He retained

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neither the power to revoke, re-vest, or revert either the corpus or the income. In the Clifford case the grantor reserved the right, in his sole discretion, of determining the amount of net income to be paid to his wife during the entire term of the trust, and he may have provided for its accumulation for such period, with the possibility of reversion to him of the entire principal and unexpended income, **Only by** the remote contingency of the beneficiaries and their children predeceasing him, intestate, could Appellant benefit from the trust. A reversionary interest in the grantor is not the "power to re-vest," the corpus,

U.S. v. First National Bank, 74 Fed. (2d) 360

Corning v. Commissioner, 104 Fed. (2d) 329

Downs v. Commissioner, 36 BTA 1129

Of particular significance is the amendment of **Section 12(g)** of the Personal Income Tax Act by the 1939 session of the Legislature, permitting taxation on the basis of a possibility of reversion rather than through the existence of a "power to re-vest" which was lacking in the instant case. The amended section, departing from parallel federal provisions, provided for taxability "Where the title of the trust may at any time re-vest in the grantor. .." (**emphasis added**). In the instant case the **trustor** could in no manner regain ownership of the trust corpus by **his own** act, or through the automatic operation of the trust agreement.

In all of the cases relied on by the Commissioner in his brief there was an element of economic advantage to the **trustor** in that the trusts were created for the benefit of a wife or minor children, to whom the **trustor** had a legal obligation of support. In the instant **case** the beneficiaries were competent, adult children to whom the **trustor** owed no such legal obligation. There was no economic benefit to him, except the right to receive fees of reasonable amount for his services as trustee. The trust was created for the purpose of protecting the gift from possible loss through inexperience of the **beneficiaries, respectively** twenty-six and twenty-eight years of age in the year 1937. In assuming the responsibilities of trustee, Appellant may have suffered a burden rather than an advantage. His powers were restricted to the investment, sale, exchange of **hypothecation** of the trust estate and diminution thereof through gross mismanagement would have constituted actionable misfeasance. His control of the trust corpus was not, in essential respects, the same after the creation of the trust as it was when he held both legal and equitable title.

The Federal government, the victorious party in the Clifford case, has reviewed the instant case, holding that the income of the trust was not taxable to Appellant. We must give much weight to such holding under the case of Innes v. McColgan, 47 Cal. App. (2d) 781, as the applicable **sections of** the Personal Income Tax Act closely follow related provisions of the Federal Income Tax Law.

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O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protests of H. M. Eichelberger, to the proposed additional assessment of \$88,82 for the taxable year 1937, pursuant to Chapter 329, Statutes of 1935 as amended, be, and the same is hereby reversed. Said ruling is hereby set aside and the said Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 15th day of July, 1943,
by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary