BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ESTATE OF WILLIAM GARLAND (DECEASED))
TRUST S-1755)

Appearances:.

For Appellant;. George G. Witter, Attorney at Law

For Respondent:. W. M. Walsh, Assistant Franchise Tax Commissioner; Burl D. Lack, Franchise Tax Counsel

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This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code (formerly Section 19of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner oh the protest of the Estate of William Garland (Deceased) Trust S-1755 to a proposed assessment of additional personal income tax in the amount of $1,785.50 for the year 1940.

William Garland died leaving a will creating a testamentary trust for the primary benefit of his Grandchildren, a bank and the testator's two sons being named as trustees. The wili provided that the net income of the trust estate (after payment of two annuities) should be used, applied and devoted in equal shares to the benefit of the testator's grandchildren, then living or thereafter born during the life of the trust. The-will provided as follows in this connection:

> "My said trustees shall devote such portion of the share of income pertaining to each grandchild to the education, maintenance and support of such grandchild as said trustees may determine, having in view the circumstances of the grandchild and of its parents; and the surplus income pertaining to such grandchild shall be invested in the manner herein-above provided by said trustees until the grandchild arrives at legal age, at which time said accumulations and the investment thereof shall be paid over and delivered by said trustees to the grandchild for whose benefit such accumulation had been made, if he or she be then living.
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> "As , from time to time, other grandchildren my be born and thereby the number of my grandchildren may be increased, thenceforward the number of shares into which the net income of the trust estate shall be divided shall be likewise increased, but not so

"that any newly born grandchild shall be entitled to share in past accumulations of income made for the benefit of another grandchild, unless in the case of the death of such other grandchild as hereinafter provided.

. . . . . .

"In the event of the death of any grandchild during his or her minority, any accumulations of income, made for such grandchild and to which he or sho would have been entitled at his or her majority, shall forthwith pass, and shall be paid and transferred by my said trustees, to the then living issue of such deceased grandchild on the principle of representation, but if there be no such living issue then to my then living grandchildren and the issue of any deceased grandchild, in equal shares, such issue of a deceased grandchild to take among them the share to which the parent would have been entitled on the principle of representation."

The trust was to continue until each of the grandchildren living at the time of the testator's death had attained the age of 35 years or had died before attaining that age. At that time the principal of the trust estate and any undistributed net income then in the hands of the trustees were to be paid in equal shares to the then living grandchildron and descendants of any deceased grandchild, such descendants to take the deceased parent's share among them on the principle of representation.

In performing their functions under the will, the trustees set up a subsidiary trust for each minor grandchild, and every year deposited in each such trust any portion of the beneficiary's yearly share of the net income of the main trust which was not used or paid out for the beneficiary's education, maintenance and support. Each subsidiary trust was maintained apart from the main trust and each of the other subsidiary trusts, separate investments were made of the amounts deposited ineach trust, all accumulations from the investments of a particular trust were placed in that trust, and everything in a subsidiary trust was delivered to its beneficiary when he or she became of age. An annual fiduciary income tax return was filed for each. subsidiary trust, showingastaxable income the amounts doposited in the trust during the gear for which the return was made. An annual fiduciary return was also filed for the main trust, and in this a deduction was taken for the amounts paid into and disclosed in the returns of the subsidiary trusts. In claiming the deduction, the trustees relied upon Section 12(d)(2) Of the Personal Income Tax Act (now Section 18133 of the Revenue and Taxation Code), the former reading in part as follows in 1940:

"There shall be allowed as an additional de-deduction in computing the net income of the estate or trust the amount of the income of the estate or

> "trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries. .. but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not."

The trustees believed that they were within the scope of this provision on the ground that the testator contemplated not only a main trust but also a subsidiary trust for each minor grandchild consisting of the unused portion of the income of the main trust to be set aside for a grandchild during minority; and that the deposit of income in such a subsidiary trust constituted a distribution of income to a beneficiary. The Commissioner, however, was of the opinion that the testator intended to create only one trust with several beneficiaries, that any income not actually distributed or made available to any minor grandchild remained a part of such trust, and that no deduction could be taken by the trustees as to any such income not so distributed or made available.

It was, of course, within the power of the testator to create one or several trusts. The difference of opinion between the Appellant and the Commissioner as to the number of trusts created by the will must be resolved by ascertaining the intention of the testator in this regard through a construction of that document. Mertens' Law of Federal Income Taxation states as follows in this connection:

> "More than one trust may be established by the same instrument. Itis a matter essentially of intention. .. .The intention of the settlors, as disclosed by the provisions of the instrument, is largely controlling in the construction of the indenture, and the construction placed thereon by the trustee is persuasive. The practical interpretation put upon the will by the trustees and the treatment of the property as one trust are often considered quite persuasive in determining whether more than one trust is created." Vol. 6, Sec. 36.18, p. 188.

Looking at the language of the instrument here involved, we find, first, a direction that the net income of the residuary estate, after the payment of two annuities, "shall be used, applied and devoted" equally to the benefit of the testator's grandchildren. We find, too, that if the allocable share of any grandchild during his or her minority is more than enough to take care of his or her needs, the surplus is to be accumulated and invested for the grandchild until he or she reaches the age of majority, at which time he or she is to be entitled to receive everything thus accumulated and invested. Any after-born grandchild is also to share equally in the income of the residuary estate, but he is not entitled to any portion of any income accumulated prior to his birth, except in the event of the death without issue of a previously born grandchild.

We believe that the provisions mentioned show an intent

that the net income of the residuary estate shall be separated from the residue proper; that such income shall be divided into as many parts as there are grandchildren; that the portion allocable to each shall be considered separate and distinct from that attributable to any of the others; and that any such portion. which is unused during the minority of a grandchild, together with any accumulations thereof, shall be held for his or her benefit only.

The testator, in our opinion, expressed a desire for a high degree of separateness as respects the handling and investment of the annual shares of the net income of his residuary estate and the income derived from the investment of those shares. The amounts held in trust for the respective grandchildren might, and in fact did, differ by reason of variations in the amounts accumulated for them, the time of their birth (i.e., before or after the death of the testator), and the income from the investment of the funds accumulated for each of them. While it could hot be said that the testator's purposes could hot be carried out, through a single trust, it cannot be denied that the use of a main and the subsidiary trusts greatly facilitated the administration of the trust provisions of the will and it is entirely reasonable to believe that the testator was aware that such would be the case.

Confronted with a situation similar to that which we have here, theCourt in Lynchburg Trust & Savings Bank v. Commissioner of Internal Revenue, 68 Fed. 2d 356, cert. den. 292 U.S. 640, held that the unused income accumulated for the two beneficiaries therein involved was "held for their individual benefit in two separate trusts apart from the corpus of the main trust;" and that, therefore, the allocation of income to any one of those trusts permitted the taking of a deduction in the fiduciary return of the main trust under a provision of the Federal income tax law similar to that in the law with whichwe are presently concerned. This decision is, in our opinion, controlling here.

In support of his view, the Commissioner makes some point of the fact that the word "trusts" is used in but three places in the decedent's will, whereas the singular "trust" is used approximately thirty-one times. While this may be persuasive, it is by no means controlling (Charles B. Van Dusen, Trustees, 33 B.T.A. 662; Huntington Nat. Bank v. Commissioner of Internal Revenue, 90 Fed.. 2d 876), particularly as here, in the face of a preponderance of other evidence pointing to the contrary. Furthermore, as mentioned above in the quotation from Mertens' Law of Federal Income Taxation the Trustees' interpretation of the will as one providing for several trusts is also persuasive as to the intent of the testator. Houston Land & Trust Co., Trustee, 33 B.T.A.73.

The Commissioner has attempted to distinguish the instant matter from the Lynchburg case on the ground that in the latter the bencficiaries had a vested interest in the income accumulated for them, whereas here the interests were contingent until the

beneficiaries reached the age of majority. We fail for several reasons to see how such a distinction can be sustained. In the first place, the accumulations here are of income actually payable to persons in being - people, indeed, to whom all the income accumulated might originally have been distributed by the trustees had that been necessary. Therefore, apropos is Section 694 of the Civil Code, providing that a future interest (an interest entitling the owner of property to its possession at some future date) is vested "when there is a person in being who would have a right, defeasible or indefeasible, to the immediate possession of the property, upon the ceasing of the intermediate or precedent interest." In the second place, the law favors the vesting of interests in property, and, whenever possible, on interest will be construed as vested rather than contingent. In re DeVries, 17 Cal. App. 164. Hence, if there is any doubt here as to the nature of the interests of the grandchildren in the accumulated income, they should be considered as vested. But we do not believe that any such doubt exists and are of the opinion that the accumulations were vested in andbelonged absolutely to. the beneficiaries, subject to delayed possession and enjoyment or to possible divestment should they not survive until the age of majority.

The Commissioner also relies upon Urquhart v. Commissioner, 125 Fed. 2d 701, involving a factual situation somewhat similar to the cne here. That case, however, is distinguishable in that there the income accumulated was to be held by the trustors as part of the principal of the trust estate, whereas here the accumulated income was to be separated from the trust corpus.

O R D E R

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

I T IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of the Estate of William Garland (Deceased) Trust S-1755 to a proposed assessment of additional Personal income tcx in the amount of $1,785.50 for the year 1940 be and the same is hereby reversed?

Done at Sacramento, California, this 6th dog of January, 1949, by the State 3ocrd of Equalization.

Wm. G. Bonelli, Chairman
J. I!. Quinn, Member
J. L. Seawell, Member
G. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary