

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of )  
HULETT C. MERRITT )

Appearances:

For Appellant; William J. Cusack, Attorney at Law

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

O P I N I O N

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code (formerly Section 19 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner on the protests of Hulett C. Merritt to proposed assessments of additional personal income tax in the amounts of \$240.31 and \$5,932.06 for the years 1940 and 1941, respectively.

The assessments resulted from the inclusion by the Commissioner in the gross income of Appellant of the income of an irrevocable trust created by Appellant on December 31, 1928. Three individuals, none of whom was apparently related to Appellant, were named to act as trustees, and the primary beneficiary was Appellant's wife, Rosaline C. Merritt, although originally and until sometime before 1940, Appellant's grandchildren were also beneficiaries.

In the "Witnesseth" clause of the instrument declaring the trust was this language,:

"That the Trustor in consideration of the sum of One Dollar (\$1.00) and his love and affection for his wife and grandchildren, and of his desire to provide and secure for them, beyond peradventure, proper maintenance, education and support..,"

The trust instrument provided that the trust was to continue for the lives of Appellant and his wife, and that "it shall terminate at the death of the final survivor of said parties, in which event and at which time the property herein described shall be subject to the testamentary disposition of the Kill made by said Trustor..."

During the taxable years here in question, the entire trust income was payable to Mrs. Merritt for life "for her

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"personal use and enjoyment." Upon her death the income was to be paid to Appellant, if he survived, for the balance of his lifetime.

There was also incorporated in the trust instrument the following provision for the invasion of the trust corpus:

"If, in the absolute and uncontrolled discretion of said Trustees, the net income from the trust estate shall not be sufficient to provide for the reasonable needs and comforts of the said Rosaline C. Merritt, wife of the Trustor, during any period or periods of her illness or other want or necessity, said Trustees may, and they are hereby authorized and empowered, but they shall in no event be required to do so, and as often as they shall deem necessary, pay to or use, apply or spend for the use and benefit of the said Rosaline C. Merritt, such portions of the principal of the trust estate, up to and including the whole thereof, as said Trustees, in their absolute discretion may determine to be adequate to provide for the said Rosaline C. Merritt during such period or periods."

Another provision contained a declaration by the trustees (each of whom joined with Appellant in the creation of the trust) that they would hold the trust property and distribute its income "honestly and impartially, and free and clear from interference by either the Trustor or any beneficiary hereunder..." There was also a provision regarding the substitution of trustees on the death or resignation of those originally named, Appellant himself, however, apparently retained no right to serve as such, nor did he reserve any power whatever to remove a trustee,

During the taxable years under consideration the trustees retained a portion of the trust income to reimburse the trust for capital losses suffered in prior years, this being done, Appellant asserts, pursuant to a trust provision authorizing the trustees to determine principal and income. The balance of the income was distributed to Mrs. Merritt. None of the trust income, however, was used or applied towards her support, Appellant's own personal funds having been used for such purpose.

The Commissioner contends that his action in this matter can be supported on any one or all of several grounds, these being:

- (1) The trust income could have been used for the support of Appellant's wife.
- (2) The income could have been accumulated for the Appellant's benefit.
- (3) Title to the corpus might have reverted in Appellant "prior to the death of the last beneficiary."

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- (4) Appellant retained such rights over the trust as to have remained in substance the owner of the trust property and its income.

In connection with the third of these grounds, the Commissioner refers to a portion of Section 12(g) of the Personal Income Tax Act, now in Section 18171 of the Revenue and Taxation Code, providing that where title to any part of the corpus of a trust "may revert in the grantor without the consent of any person having a substantial adverse interest in any part of the corpus or the income therefrom, and the reversioning is not contingent upon the death of all the beneficiaries," the income is taxable to the trustor. We believe that for all practical purposes a reversioning of title in Appellant to some or all of the corpus of the trust here involved would occur on the exercise by the trustees of their power to invade the corpus, since the trustees have no substantial adverse interest therein (Georgia B. Lonsdale, 42 B.T.A. 847) and on their exercise of the power Appellant would thereby be relieved in the amount of the property affected from the necessity of using personal funds in providing for Mrs. Merritt's support, an invasion being authorized solely for support purposes. Wenger v. Commissioner of Internal Revenue, 127 Fed. 2d 523, cert den. 317 U.S. 646; John Koehrer, T. C. Memo. Op., Dkt. No. 2579; Emilie J. Heine, T. C. Memo. Op., Dkt. No. 3639. As indicated in these cases, which involved a provision in the Federal Law (Section 166, Internal Revenue Code) similar to Section 12 (g) of the Personal Income Tax Act, it is unimportant in a situation of this kind that title does not revert directly in the trustor if in fact the property can be used for the trustor's benefit. Nor, according to the same authorities, does it matter that an invasion has not actually occurred. What is important is the possibility that the corpus may be invaded to the trustor's advantage, as, for example, by relieving him of his legal obligation to support his wife or minor children, to the extent, at least, of the amount of property involved.

Appellant has cited Suhr v. Commissioner of Internal Revenue, 126 Fed. 2d 283, in opposing the Franchise Tax Commissioner herein. While that case might be construed to militate against our view of the matter: in holding that trust income is not taxable under Section 166 of the Internal Revenue Code where there has been no invasion of corpus, we believe that it must be deemed to have been overruled in that respect by the later decision of the United States Supreme Court in Helvering v. Stuart, 317 U.S. 154, which sets forth the general underlying principle on which we rely. See Emilie J. Heine, supra.

In view of the foregoing we consider it unnecessary to pass upon any of the other grounds on which the Commissioner rests his action herein.

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O R D E R

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

IT 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 protests of Yulett C. Merritt to proposed assessments of additional personal income tax in the amounts of \$240.31 and \$5,932.06 for the years 1940 and 1941, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 5th day of January, 1949, by the State Board of Equalization.

Wm. G. Bonclli, Chairman  
J.H. Quinn, Member  
J. L. Seawell, Member  
G. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary