

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
TITLE INSURANCE AND TRUST CO., TRUSTEE)

Appearances:

For Appellant: John I. Bolen

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Title Insurance and Trust Co., Trustee, against a proposed assessment of additional personal income tax in the amount of \$755.99 for the year 1955.

On December 22, 1953, Appellant entered into a trust agreement under which it received from P. L. McNutt an undivided 50 percent interest in a limited partnership, known as McNutt & Sons, to be held in trust for Mr. McNutt's two sons. The agreement provided, in part:

SECTION TWO

For the purposes of bookkeeping, accounting and distribution, the Trustee shall immediately divide the Trust estate into two equal shares, one for the primary benefit of each of the Trustor's said children, namely -

LEE KENT McNUTT and
JAMES CRAIG McNUTT

Upon each occasion hereinafter during the continuance of this trust that a lawful child is born to or legally adopted by the Trustor, the trust estate shall be so divided and redivided so as to provide an equal share for each such child as an additional equal beneficiary of this trust to participate on the same basis of each of Trustor's above named children.

Appeal of Title Insurance and Trust Co., Trustee

Provided, however, for the purposes of administration, with respect to management and investments, Trustee need make no physical division but it may maintain said trust estate as a unit for such purposes.

Other pertinent provisions were that the income from the shares of the beneficiaries was to be accumulated and added to principal until they, respectively, reached age twenty-one, and thereafter the current income was distributable to each in his respective proportion until termination of the trust. The trust was to terminate in all events on February 28, 1965, the day after James Craig McNutt's twenty-first birthday. Upon the death of one of the **trustor's** children, his share of the principal and **any** undistributed income was to pass, by right of representation, to the surviving issue of such child and absent such issue, it was to be divided equally among the remaining shares, to be distributed or held in trust as though it originally formed a part of such shares. The trust specifically made irrevocable and unamendable.

Throughout the instrument, all references to the trust, or trust. **property** or estate were singular and not plural.

An action was filed in the Los Angeles County Superior Court, under date of January 25, 1956, to reform the above described trust instrument. Judgment was entered on November 5, 1956, ordering that:

... that certain "DECLARATION OF TRUST" executed on the 22nd day of December, 1953, by plaintiff Preston L. McNutt, . . . and in which defendant Title Insurance and Trust Company, a corporation, was named trustee, be and the same hereby is reformed so as to read as follows: ...

Thereafter followed a revised agreement providing for two separate trusts, Trust A for Lee Kent McNutt and Trust B for James Craig McNutt. These trusts followed the same general pattern as the earlier instrument with regard to the disposition of principal and income; however, the provision for children later born to or adopted by the **trustor** was omitted. The revised trust declaration was dated December 22, 1953.

On the theory that the original agreement created two separate trusts, Appellant filed two income tax returns for the year 1955, each reporting one-half of the income from the property held in trust. The Franchise Tax Board determined that but a single trust had been created and on October 15, 1959, it mailed the instant proposed assessment based on the combined income reported in Appellant's two returns.

Appeal of Title Insurance and Trust Co., Trustee

Appellant states that Mr. McNutt intended to create separate trusts, one for each of his children, under the original agreement. The testimony of the trustor, P. L. McNutt, and of Samuel A. Greenburg, the attorney employed by McNutt to set up the arrangement, support this statement. -While the cardinal principle in the construction of a declaration of trust is the intention of the trustor, the test is not what he intended to say but what he intended by what he did say. (Title Insurance & Trust Co. v. Duffill, 191 Cal. 629, 642 [218 P. 14]; Huntington National Bank v. Commissioner, 90 F. 2d 876, 878; Langford Investment Co. v. Commissioner, 77 F. 2d 468, 470.) As stated in Title Insurance & Trust Co. v. Duffill, supra, at p. 642:

The only intention this court is authorized to declare is such as may be deduced from an interpretation of the instrument which was drawn and executed by the parties to express their intention ... [citation omitted], which must be gathered from the general purpose and scope of the agreement.

Thus, it is the trustor's intention, as expressed in the instrument, that is controlling.

The relevant provisions of the instrument here under discussion are essentially the same as those found in the Appeal of Citizens National Trust and Savings Bank of Los Angeles, Trustee, Cal. St. Bd. of Equal., Dec. 16, 1959, 2 CCH Cal. Tax Cas. Par. 201-443, 3 P-H State & Local Tax Serv. Cal. Par. 58163, and the Appeal of Samuel Greenberg, Trustee, Cal. St. Bd. of Equal., Aug. 7, 1963, CCH Cal. Tax Rep. Par. 202-260, P-H State & Local Tax Serv. Cal. Par. _____. In each of those cases we held that but one trust was created. 'Factors which lead us to the same conclusion here are that the instrument consistently referred to the trust as one (Hale v. Dominion National Bank, 186 F. 2d 374, cert. denied, 342 U. S. 821 [96 L. Ed. 621]), each beneficiary had a contingent right to receive, in trust, the shares of the others and the entire trust was to terminate at one time. (McHarg v. Fitzpatrick, 210 F. 2d 792; Fort Worth National Bank v. United States, 137 F. Supp. 71.)

Appellant argues that the trust agreement was reformed to express with greater certainty the trustor's original intent and that the judgment adopting the reformed instrument retroactively nullified the original declaration and substituted the new agreement as of its date, December 22, 1953. It is urged that the court's order had the effect of a nunc pro tunc order establishing separate trusts on that date.

The general rule is that as between the parties to an instrument a reformation relates back to the date of the reformed instrument; however, even where the decree was specifically made

Appeal of Title Insurance and Trust Co., Trustee

nunc pro tunc, the reformation has not been accorded retroactive recognition for tax purposes. (Sinopoulo v. Jones, 154 F. 2d 648, 650.) Reformation is not binding upon third parties who have acquired some legal rights which would be destroyed or injured by giving the remedy retroactive effect. (M. T. Straight's Trust v. Commissioner, 245 F. 2d 327, 329, affirming 24 T.C. 69.) Therefore, as to third parties who have acquired rights under the instrument, the reformation is effective only from the date thereof. (Sinopoulo v. Jones, supra.)

On April 15, 1956, the tax for the year 1955 became due and payable and the State of California acquired a vested right therein. (Allen v. Franchise Tax Board, 39 Cal. 2d 109 [245 P. 2d 297].) Appellant asserts that the state's right to the tax for 1955 did not vest on April 15, 1956, by virtue of the fact that the action to reform the trust instrument had been filed prior to that date. It urges that the rights of the state were suspended until a decision in superior court was reached. Appellant has offered no authority in support of this novel theory, which apparently would permit a taxpayer to suspend the date on which the state's tax becomes due and payable by the mere filing of a complaint. In our opinion the judgment entered November 5, 1956, reforming the declaration of trust, had no effect upon Appellant's tax liability for the year 1955. We conclude that Respondent's action in combining the reported income of the trust and treating it as one was proper.

ORDER

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, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Title Insurance and Trust Co., Trustee, against a proposed assessment of additional personal income tax in the amount of \$755.99 for the year 1955, be and the same is hereby sustained.

Done at Pasadena, California, this 21st day of October, 1963, by the State Board of Equalization.

John W. Lynch, Chairman
Geo. R. Reilly, Member
Paul R. Leake, Member
Richard Nevins, Member
 , Member

ATTEST: H. F. Freeman, Executive Secretary