BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
DOUGLAS A. AND ROSEMARIE MACMILLAN)

Appearances:

For Appellants: Nathan Bessin, Certified Public Accountant

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 Douglas A. and Rosemarie Macmillan against proposed assessments of additional personal income tax in the amounts of $728.48, $887.72, $15167.88 and $301.35 for the years 1951, 1952, 1953 and 1954, respectively.

Douglas A. Macmillan is involved here primarily because he filed joint returns with his wife, Rosemarie; hereafter, the term "Appellant" will refer to Mrs. Macmillan, only.

During the years in question, Appellant had an interest in certain property which had been distributed in 1942 from the estate of her late husband, Alexander B. Macbeth. The distribution order of the superior court stated:

> To said Rosemarie Macbeth, to have and hold, lease, sell; assign, convey, mortgage, pledge, encumber, occupy, use and enjoy the whole or any part thereof for and during the term of her natural life in such manner as may in her judgment seem advisable or desirable for her comfort, maintenance or support, or for her benefit and welfare, without any hindrance on the part of any person or persons and without accounting therefor or giving any bond or other security to protect any rights of those in remainder, including the power to dispose of or consume the whole or any part of said property for the aforesaid purposes and excluding only the power of disposition thereof by Will or by Gift.

This order was substantially the same as the provisions of the decedent's will, except that after releasing Appellant from the duty of posting a bond, the will stated: "... wholly confiding

in my said beloved wife and believing that she will have due regard for the rights of such remaindermen and will not allow the property to go to waste." The will further provided that upon Appellant's death the remaining property was to pass, in trust, to certain of Mr. Macbeth's relatives.

During the years on appeal, capital gains were derived from transactions involving the property left by Mr. Macbeth, The Franchise Tax Board determined that these gains should have been reported on Appellant's individual returns. Inclusion of these additional amounts in Appellant's gross income resulted in the disallowance of $445.41 deducted for medical expenses paid in 1951, since medical deductions were limited to the amount by which such expenses exceeded five percent of the taxpayer's adjusted gross income. (Rev. & Tax. Code, § 17319.3.)

At the outset, we are guided by the broad principles laid down in Corliss v. Bowers, 281 U. S. 376 [74 L. Ed. 916], and Burnet v. Wells, 289 U. S. 670 [77 L. Ed. 1439]. In the former, the court said:

> But taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed - the actual benefit for which the tax is paid. (Corliss v. Bowers, supra at p. 378.)

The court in Burnet v. Wells, supra at page 678, stated:

> Liability does not have to rest upon the enjoyment by the taxpayer of all the privileges and benefits enjoyed by the most favored owner at a given time or place.... Government in casting about for proper subjects of taxation is not confined by the traditional classifaction of interests or estates. It may tax not only ownership, but any right or privilege that is a constituent of ownership.... Liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis.

The interest Alexander B. Macbeth created in his will for the benefit of his wife, Rosemarie, is regarded under California law as a life estate with power to consume. (Colburn v. Burlingame, 190 Cal. 697 [214 P. 226]; Hardy v. Mayhew, 158 Cal. 95 [110 P. 113].) Subject to the life tenant's power to consume, capital gains accrue to principal and belong to the remainderman. (Civil Code, § 730.05, derived from Stats. 1941, ch. 898, p. 2476.) Thus, we must decide whether, because of the life tenant's power to consume the capital gains which would otherwise accrue

to the remainderman, she should be taxed as the owner of such gains.

Mallinckrodt v. Nunan, 146 F. 2d 1, cert. denied, 324 U.S. 871 [89 L. Ed. 1426] held that where the beneficiary of a trust was entitled to all of the income therefrom "upon his [the beneficiary's] request," the beneficiary was taxable as the owner of all the trust income although it had actually not been distributed to him. Recognizing that he did not hold all of the incidents of ownership, the court concluded that the beneficiary held sufficient benefits to require this result. Other courts have reached similar results where it was found that the beneficiary or life tenant effectively had "unfettered command" over income. (Smith v. United States, 265 F. 2d 834; Spies v. United States, 84 F. Supp. 769, aff'd, 180 F. 2d 336.) Following the same theory, the court in Hirschmann v. United States, 202 F. Supp. 722, aff'd, 309 F. 2d 104, held a life tenant taxable on capital gains realized from the sale of portions of the principal of the life estate, where it was found that she was "given unfettered power to spend the entire corpus for her own benefit; ..." (Hirschmann v. United States, supra at p. 723.)

On the other hand, where it has been found that the instrument in question created a clear, enforceable standard which placed effective limits on the power to use or consume, the courts have refused to treat the beneficiary or life tenant as the owner of the income or property subject to such a power. (United States v. De Bonchamps, 278 F. 2d 127 ["needs, maintenance, and comfort"]; Funk v. Commissioner, 185 F. 2d 127 ["needs"]; Security First National Bank v. United States, 181 F. Supp. 911 ["support, comfort, health and service"]; Smither v. United States, 108 F. Supp. 772, aff'd, 205 F. 2d 518, ["support, maintenance, comfort and enjoyment"].) Typically, words such as "needs," "comfort," "support," and "maintenance" have been held to limit the power to consume to expenditures that would be necessary to maintain the beneficiary's accustomed station in life. (Funk v. Commissioner, supra; Smither v. United States, supra.)

Appellant argues that the power to consume granted to her is substantially the same as the powers granted the life tenants in United States v. De Bonchamps, supra, 278 F. 2d 127, and that she, Appellant, may only consume corpus for the purpose of maintaining her station in life. The life tenants in De Bonchamps, who had the power to consume for their "needs, maintenance and comfort" were found sufficiently restricted to prevent their taxation as owners. Appellant's power goes far beyond this. Her right to consume or dispose of the property is limited by the words "for her comfort, maintenance or support, or for her benefit and welfare." (Emphasis added.) We cannot ignore the words "benefit and welfare" or assume that they are merely cumulative and add nothing to the intended meaning. (Prob. Code, § 102.)

A power to consume property for one's "benefit" is broader than one for "support or maintenance" and has been said to include whatever may promote the donee's personal prosperity and happiness without limitation except that the power be exercised in good faith. That is, the donee must exercise the power for his own personal benefit and not to preserve the property for others, which would thereby change the beneficiaries from the remaindermen chosen by the testator to those of the donee's selection. (Colburn v. Burlingame, supra, 190 Cal. 697 [214 P. 226]; King v. Hawley, 113 Cal. App. 2d 534 [248 P. 2d 4911; see also Re Robinson, 101 Vt. 464 [144 A. 457], holding that under "benefit" a life tenant would not be restricted to his present scale of living nor need he first use up his own resources.)

Colburn v. Burlingame, supra, illustrates the type of expenditure which falls within the broad scope of the term "benefit." In that case the life tenant was given the right to use property "in such manner as may in her judgment seem 'best for her own individual benefit and support." The life tenant used the property to support herself and her second husband who had given up his employment shortly after their marriage. While the court recognized that there could be some expenditures that would be too remote'to the life tenant's benefit to be allowed, it said, at page 704:

> The defendant [life tenant), it appears, has remarried, and for a time lived with her husband in Chicago. Having ample means ... the not unnatural desire arises in her to remove to California, or at least live there during a part of the year. Should she leave her husband toiling and moiling in Chicago? . . . [I]f in her opinion her life is made pleasanter or more to her liking by the freedom of her husband from the irksome demands of business we perceive no reason why, under the wide discretion she enjoys as to what expenditures are for her benefit, the expense of their common life may not be included under this head.

In addition, the will gave Appellant the power to consume "for the aforesaid purposes [comfort, maintenance, support, benefit and welfare] and excluding only the power of disposition thereof by Will or by Gift." (Emphasis added.) The clear import of the latter phrase is that Mr. Macbeth intended to grant to Appellant the right to dispose of the estate for her "benefit" in its broadest possible sense, limited only in that she could not will or give it away. The language relieving her from hindrance from any person, from accounting for the property, or from giving security to protect the remainder, is additional proof of such intent.

While she does not have complete ownership, we think that the broad power to consume granted to Appellant effectively gives

her unlimited enjoyment of the estate property, exclusive of the right to give or will it away, As stated at the outset, taxation is more concerned with actual benefits than with refinements of title. (Corliss v. Bowers, supra, 281 U. S. 376 C74 L. Ed. 916].) In view of her substantial interest in the property and the capital gains which accrue thereto, we conclude that it is reasonable and just to deal with Appellant as if she were the owner thereof.

In view of the above holding, Respondent's action in disallowing certain of Appellant's medical expenses was also correct.

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, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Douglas A. and Rosemarie Macmillan against proposed assessments of additional personal income tax in the amounts of $728.48, $887.72, $167.88 and $301.35 for the years 1951, 1952, 1953 and 1954, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 5th day of November, 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, Secretary