48-SBE-032

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ERLE P. HALLIBURTON

Appearances:

For Appellant: Francis J. McEntee, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Milton A. Huot, Assistant Tas 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 Erle P. Halliburton to proposed assessments of' additional personal income tax in the amounts of $2,285.56, $2,736.93 and $3,188.11 for the years 1939, 1940 and 1941, respectively.

The assessments result from the inclusion in Appellant's personal income of the income from five irrevocable trusts created by Appellant on January 12, 1937, one for the benefit of each of his five children, Erle F. Halliburton, Jr., Zola Catherine Halliburton, Vida Jessie Halliburton, Ruth Lou Halliburton and David John Halliburton, their ages on the date mentioned being 20 years, 18 years and 5 months, 15 years and 7 months, 12 years, and 10 years and 6 months, respectively. Each trust was committed to the sole trusteeship of Appellant, and the corpus of each consisted of cash contributed by Appellant from his separate property, although on or about December 24, 1937, stock in a closed corporation was substituted therefor. The Commissioner states that the corporation "was apparently controlled" by Appellant, but no evidence has been submitted as to the nature and extent of any such control,

Except for the names of the beneficiaries, each trust instrument contains substantially the same provisions. In each is a declaration that the trust created is to enable the beneficiary to enjoy a certain degree of independence not otherwise possible. Each vests the trustee with various broad powers of management and control, including the power to sell, lease, invest or otherwise dispose of trust property "according to his sole judgment and discretion and without being limited as to any investment, to securities, or other property as may be permitted by law for the investment of trust funds." With respect to bonds, shares of stock and other securities, it is

provided that the trustee "shall have all the rights, powers and privileges of an owner , .. asmay be deemed by the said Trustee expedient for the protection of the interests of the trust estate. .." Then after a listing of several specific powers, the instrument states: "The foregoing enumerated powers and discretions are not to be construed as a limitation upon the general powers or discretions of the Trustee, but the Trustee shall have full power, discretion and authority in all respects generally to handle, manage, operate and dispose of the whole or any portion of the trust estate under the terms of this trust in such manner and upon such terms and conditions as an owner might do, as may be permitted by law, oras said Trustee may deem most advisable for 'the purposes of this Trust," The trustee is also authorized to apportion expenditures between principal and income according to his discretion, any rule to the contrary notwithstanding, his decision thereon being made conclusive, and ha is expressly exonerated from any liability resulting from any depreciation or loss of trust property occurring from any sale, exchange, investment or other disposition thereof, unless the loss is caused by his gross negligence.

Each trust provides that during the minority of the beneficiary the trust income is to be accumulated and become' part of the trust corpus. Thereafter, until the termination Of the trust and just so long as the beneficiary is able to and does maintain and support himself or herself through his or her own efforts, the trustee, in his sole discretion, may pay the beneficiary such portion of the net income as to the trustee may seem reasonable in order that the beneficiary may enjoy certain of the advantages of life consistent with his or her status as a child of the trustor and which he or she might not otherwise be able to enjoy through his or her own efforts, Any income not distributed during majority is to become part of tile corpus. The trust is to terminate when the beneficiary reaches the age of 30, upon which the corpus and all accumulated income is to be turned over to the beneficiary. Should the beneficiary die before 30, the property is to go to one, some, or all of the other children of Appellant or to their issue or heirs, according to specified contingencies.

Each trust ihstrument also includes this language: "Anything herein to the contrary notwithstanding, the Trustee may, in his sole discretion, at any time, and from time to time, pay from the income and/or principal of the trust estate such amount or amounts up to and including the whole thereof, as may be necessary, in case of illness, want, or emergency affecting /name of beneficiary7 to provide for the reasonable support, care, and, during his minority, education consistent withthe station in life, financial means and other circumstances of the said beneficiary," No distributions of any kind have been made to any beneficiary pursuant to this provision during his or her minority.

Erle P. Halliburton, Jr,, the eldest beneficiary, became 21 years of age prior to 1939. Zola Catherine Halliburton reached her majority on August 14, 1939; and Vida Jessie Ealliburton was married on April 2.6, 1941, which was prior to her attaining the age of 21. The other two beneficiaries-, Ruth Lou and David John

Halliburton, were unemancipated minors throughout the three taxable years here involved.

It appears that the Franchise Tax Commissioner considered the trust income taxable to Appellant for the following reasons: (1) as to the income received during the minority of a beneficiary or, in the case of Vida Jessie, prior to her marriage, on the ground that such income could have been used by Appellant in discharge of his legal obligation to support the beneficiary; that bringing the situation withinthe principle laid down in Helvering v. Stuart, 317 U. S. 154, and Borroughs v. McColgan, 21 Cal. 2d 481; and (2) irrespective of whether the income was received during the minority of the beneficiary or not, because Appellant retained such complete dominion and control over each trust as to remain in practical effect the owner of its income, thereby subjecting himself to the impact of the decision in Helvering v. Clifford, 309 U. S. 331.

The United States Supreme Court in Helvering v. Stuart and the California Supreme Court in Borroughs v. McColgan held that if there is any possibility that the income of a trust can be used to meet the parental obligation of the trustor to support his mino: children, such income will be taxed to the trustor notwithstanding that none of it is actually used for such purpose. See also Rollins v. Helvering, 92 Fed. 2d 390, cert. den. 302 U.S. 763. In the Stuart case; the statutory basis for the decision was a provision in Section 167 of the Federal Internal Revenue Code taxing trust income to the trustor if such income "may, in the discretion of the grantor or of any person not having a substontia. adverse interest in the disposition of such part of the income, be distributed to the grantor." The statutory ground in the Borroughs case was identical language in Section 12(h) of the Personal Income Tax Act, now in Section 18172 of the Revenue and Taxation Code. It may be noted that in 1943, the year following the decision in the Stuart case, Congress amended Section 167 of the Internal Revenue Code to provide that income which may be applied or distributed for the support or maintenance of a beneficiary whom the trustor is legally obligated to support, is not taxable to the grantor except to the extent that the income is so applied or distributed. The amendment was made effective with respect to taxable years commencing after December 31, 1942, with a provision making it retroactive to prior years on the filing of certain consents with the Commissioner of Internal Revenue. The California law was similarly amended in $945 by the addition of Section 18173.1 to the Revenue and Taxation Code, but, unlike the Federal, the amendment is not retroactive and applies only to taxable years commencing after December 31, 1944 (Stats. 1945, Chap. 645, Sec. 123). Since the taxable years here involved are 1939, 1940 and 1941, we are not concerned with the amendment but, must look rather to the principles of the Stuart and Borroughs cases.

The provisions of each of the trust instruments at hand giving the trustee the right to pay out such income or principal as he may in his discretion consider necessary in case of any "illness, want,

or emergency" affecting the beneficiary to provide for his "reasonable support, careand, during his minority, education consistent with the station in life, financial means and other circumstcnces of the said beneficiary" is, in our opinion, sufficiently analogous to the education, support and maintenance provision of the trust in the Stuart case to require the application of the rule of that and the Borroughs cases. Clearly, it was possible for the Appellant, as trusted, to use trust income for the support or care of his children during their minority. It follows, accordingly, that the Commissioner correctly determined that the income of each trust was taxable to Appellant for the period of the minority of each beneficiary, or, in the case of Vida Jessie Halliburton for the period prior to her marriage.

In regard to the second of the Commissioner's reasons for the levy of the assessments at issue, i.e., the alleged retention of a type of control over the trusts which assertedly is the equivalent of ownership, thereby making the case one governor? by Helvering Clifford, the Commissioner apparently places prime reliance upon the provisions of the trust giving Appellant the discretion to pay out income to the beneficiary or to withhold and accumulate it. Before considering this specifically, it is well to note that the rule of the Clifford case is to the effect tha t the usual concepts of the law of trusts will beignored to the extent of treating a trustor-trustee of a family trust as the owner in his individual capacity of the corpus for the purposes of Section 22(a) of the Internal Revenue Code, if it appears that despite the creation of the trust, he has never in fact relinquishe his economic dominion and control over the trust principal. Section 22(z), which is substantially the same as Section 7(a) 'of the Personal Income Tax Act, provides that "gross income" includes "gains, profits, and income.. .growing out of the ownership or use of or interest in.... . property. . ." The court in the Clifford case found that the trustor-trustee there involved remained in substance the owner of the property because (1) tho trust, being for fivs years, was of short duration, (2) the corpus would revert to the trustor on the termination of the trust, (3) the trustor's wife was the beneficiary, and (4) broad powers of management and control over the corpus were vested in the trustor in his capacity as trustee, It wcs careful to point cut, however "that no one fact is normally decisive but that all considerations and circumstances of the kind we have mentioned are relevant to the question of ownership and are appropriate foundations for findings on that issue." 309 U.S. at 336. Furthermore, after noting that the issue as to the taxation of trust income to the trustor under Section 22(a) of the Internal Revenue Code is whether the trustor "may still be treated as the owner of the corpus," the Court stated "In absence of more precise stnndords or guides supplied by statute or appropriatc regulations, the answer to that question must depend on an analysis of the terms of the trust and all the circumstcnces attendant on its creation and operation." 309 U.S. at 334.

There is authority to the effect that a Clifford case situation may be present if the trustor-trustee reserves control

of such breadth over the disposition of the trust income that a beneficiary may never receive any benefit therefrom. This may occur. for example, where the income may be shifted from one beneficiary to another (Commissioner v. Buck, 120 Fed. 2d 775; Stockstrom v. Commissioner, 151 Fed. 2d 353; Ferdinand A. Bower, 10 T. C. 37), or be held by the trustor-trustee either for his own lifetime or that of the beneficiary. Miller v. Commissioner, 147 Fed. 2d 189; Stockstrom v. Commissioner, Fed. 2d 491, cert. den. 326 U.S. 719; Edison v. Commissioner, 148 Fed. 2d 810, cert. den. 326 U.S. 721. Where, however, none of these factors is found and the beneficiary from whom the income can be withheld will nevertheless receive it on a date which might reasonably be expected to occur within his lifetime, the case is exactly the contrary, and the mere discretion to distribute or accumulate and withhold will not alone afford a basis for taxing the trust income to the trustor. Jones v. Norris, 122 Fed. 2d 6; Ball v. Commissioner, 150 Fed. 2d 304; United States v. Morss, 159 Fed. 2d 1.42,

We believe that the case at hand falls within this last mentioned rule. Appellant's retained discretion is not one which he can employ to the economic advantage of either himself or anyone other than the named beneficiaries (except to the limited extent that the trust income may be used for a minor beneficiary, thus bringing into play the Stuart-Borroughs rule). Appellant cannot shift the enjoyment of the income to any other person nor can he withhold the income from a beneficiary for a fixed period measured either by his own life or the beneficiary's, Each trust is to terminate as to the beneficiary thereof when he or she reaches his or her 30th birthday, an age which each beneficiary may reasonably be expected to attain, the youngest being 10½ and the eldest 20 years of age when the trusts were executed. At that tirne the trust principal, along with any undistributed income, will be distributed to him or her.

The Commissioner also indicates that the Clifford Doctrine is applicable because the trusteed stock has been issued by a corporation in apparent control of Appellant, There is no evidence, however, as to the extent and nature of such control. Furthermore, although voting control, like a retained discretion to distribute or withhold income, is a clearly relevant circumstance in the determinntion of whether a given factual situation is within the purview of the Clifford-case, it alone does not compel a conclusion that trust income is taxable to the trustor personally. Cushman v. Commissioner, 153 Fed. 2d 510; United States v. Morss, supra.

It appears to us that the other powers vested in Appellant, as trustee, bythe trust instruments are the kind customarily given a trustee to enable him to function for the best interests of his trust; and, in the absence of evidence of a course of action to the contrary, it can only be assumed that he will use them solely on behalf of the trust. Hall v. Commissioner, 150 Fed. 2d 304. Consequently, their mere specification in the instruments will not, aside from anything else, support a finding

of retained control for the trustor's personal benefit. Jones 700 Norris, 122 Fed. 2d 6; Armstrong v. Commissioner, 143 Fed. 2d

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 Erle P. Halliburton to proposed assessments of additional personal income tax in tile amounts of $2,285.56, $2,736.93, and $3,188.11 for the years 1939, 1.940 and 1941, respectively, be and the same is hereby modified; the Commissioner is hereby directed to exclude from the gross income of said Erle P. Halliburton the income of certain trusts in the amounts of $22,950, $26,887.50 and $27,101.50 for the years 1939, 1940 nnd 1941, respectively; except to the extent of the income of each trust during, the period of the minority of the beneficiary thereof, or; in the case of the trust for the benefit of Vida Jessie Halliburton, for the period prior to her marriage; in all other respects the action of the Commissioner is hereby sustained,

Done at Sacramento, Californiu, this 16th day of December, 1948, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
J. I-i. Quinn, Member
J. L, Seawell, Member
Geo. R. Reilly, Member
Thomas H. Kuchel , Member

ATTEST: Dixwell L. Fierce, Secretary