BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal Of)
)
AGNES PATTEN PARMA)

Appearances:

For Appellant: Harold A. Parma, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J'. Arditto, Franchise 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 protest of Agnes Patten Parma to a proposed assessment of additional personal income tax in the amount of $7,010.66 for the year 1937.

Although several questions were originally presented herein for decision, only one - the taxability to the Appellant of the income from certain trusts - requires any discussion. The contention urged by the Appellant that the proposed assessment was barred under the three-year limitation period provided by Section 19 of the Act in 1937 was rejected in Mudd v. McColgan, 30 Cal. 2d 463, upholding the applicability of the four-year period substituted through the amendment of that Section by Chapter 915, Statutes of 1939. The issues relating to the deductibility of certain amounts as bad debts and business expenses have been settled by stipulation, it having been agreed by the Appellant and the Commissioner that the former shall be allowed a deduction under Item 18 (Other Deductions) on her return for 1937 in the amount of $52,402.55.

The trust question arose out of the inclusion by the Commissioner in Appellant's personal income of the income from three irrevocable trusts established by Appellant on or about June 17, 1935, one for the benefit of each of her three adopted children, namely, Laura Louise Pocock, Thomas Fatten Wilder and Jean Wilder, their ages then being approximately 20 years, 17 years and 17 years, respectively. Appellant named herself the sole trustee of each trust and contributed her separately-owned corporate securities to the principal of each.

As amended on December 29, 1936, the declaration of trust for Laura Louise Pocock vests in the trustee various broad powers of management and control, including the, power to sell, lease, invest, lend or otherwise dispose of trust property "in such manner nnd upon such terms and conditions as to her may seem best" and as though she "were the sole and absolute owner thereof. .." Having disposed of eny particular trust property, the trustee can acquire other property of the same general type or kind, and is absolved from responsibility for any act or failure to act in that connection" so long es she acts in good faith and for what she believes to be for the best interest of the trust estate." There is also included a general provision holding the trustee harmless from liability for any act or omission, "except for willful misconduct or gross negligence in the execution" of the trust.

The trust declaration further provides that all the net trust income shall be paid'to the beneficiary until she reaches the age of 30 years, upon which she is to receive the principal and cny income accumulated thereon. In the event of her death before the age of 30, distribution of the corpus and any accumulated income is to be made to Laura Louise's surviving issue, free and clear of the trust; or if there be no issue, then to various others according to stated contingencies. Under no circumstances, however, can the property revert to Appellant or her estate. Should the net income from the trust be insufficient to provide "for the reasonable needs and comforts" of Laura Louise "during any period or periods of illness or other want or necessity," the trustee, "in her absolute, sole and uncontrolled discretion," is empowered to pay out or use for Laura Louise's benefit such portion of the trust principal as Appellant "may determine to be adequate to provide for such beneficiary during such period or periods." It is also provided in the trust declaration that tha trustee, "in her sole and uncontrolled discretion, anything to the contrary herein notwithstanding," cm extend the term of the trust beyond the date on which the beneficiary reaches the age of 30 years, but in no event beyond the lifetime of the last survivor of the "said Laura Louise Pocock, Joan Wilder and Thomas Patten Wilder."

The trusts for the benefit of Thomas Patten Wilder and Jean Wilder, also as mended December 29, 1936, are substantially the same as the one for Laura Louise Pocock. There is one difference, however, in that the declarations for the former trusts contain a provision to the effect that the net income thereof shall be accumulated by the trustee and "fall into and become a part of the corpus" of the trust until the beneficiary reaches the age of 21.

Laura Louise Pocock reached the age of majority and was married before the year 1937, the taxable period here involved. Thomas Patten Wider and Jean Wilder were approximately 19 years of age during that year.

It is the Commissioner's position thnt the so-called Clifford Doctrine (based on the decision in Helvering v. Clifford, 309 U.S. 331) compels the taxation of the 1937 trust income to Appellant personally on the ground that she never ceased to be the owner of the trust properties. In this regard, the Commissioner directs our attention to the facts that Appellant is both trustor and trustee of each trust, that each beneficiary is a member "of the intimate family circle;" and that Appellant has, as trustee, broad powers of control over the trust properties.

The United States Supreme Court held in the Clifford case that the technical niceties of the law of trusts will be ignored to the point of treating a trustor-trustee of a family trust as the owner of the corpus in his individual capacity for the purposes of Section 22(a) of the Federal Internal Revenue Code, if it appears that despite the creation of the trust he has not in fact relinquished his economic dominion and control over the trust principal. Section 22(a), which is substantially the same as Section 7(a) of the California Personal Income Tax Act (now Section 17101 of the California Revenue and Taxation Code), provides that "gross income" includes "gains, profits, and income ... growing out of the ownership or use of or Interest in . . property . . . "It was found in the Clifford case that the trustor-trustee there involved remained in substance the owner of the corpus because (1) the trust being for five years, was of short duration; (2) the corpus would revert to the trustor on the termination of the trust; (3) the trustor's dependent wife was the beneficiary; and (4) broad powers of management and control were vested in the trustor in his capacity as trustee. The court stated

> ". . . .We have at best a temporary reallocation of income within an intimate family group. Since the income remains in the family and since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position." 309 U.S. at 335.

The Court went on to say 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 standards or &ides suppiied by statute or appropriate regulations, answer to that question must depend on an analysis of the terms of the trust and all the circumstances attendant on its creation and operation." 309 U.S. at 334.

In the light of the reasoning of Helvering v. Clifford, considered along with the holdings of cases which have since been decided, we are unable to subscribe to the Commissioner's view that the facts of the instant case bring it within the scope of the rule therein expounded, There are several significant differences between this and the Clifford case. In the first place, here we have trusts whose terms are of considerably longer duration, approximately 9 1/2 years as to one 'beneficiary and 13 years as to the other two, with discretion in the trustor to extend each such term through the lifetime of the last survivor among the beneficiaries; in the Clifford case the term was only for 5 years. Here, there is no possibility whatever of a reversion of the corpus of any trust to the trustor upon the expiration of the term; in the Clifford case there was an express provision for such reverter. Here, as to one trust, that for Laura Louise Pocock, the beneficiary was a married adult during the taxable year involved and presumably not dependent upon Appellant for support; in the Clifford case, the trustor was legally liable for the beneficiary's support. All these distinctions point towards the inapplicability of the Clifford Rule, United States v. Morss, 159 Fed. 2d 142. Commissioner v. Branch, 114 Fed. 2d 985; John Stuart, 2 T.C. 1103.

As for the broad powers of management and control vested in Appellant as trustee, it appears that they are of a kind usually given a trustee so that he may function to the advantage and 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 then. in a bona fide manner on behalf of the beneficiary. Hall v. Commissioner, 150 Fed. 2d 304; Nossaman, Trust Administration and Taxation, Vol. 2, Sec. 666, pp. 149-150. Consequently, thoir mere specification in the trust instruments, as here, will not alone support a finding of retained control for the trustor's personal benefit, Jones v. Norris, 122 Fed. 2d 6; Armstrong v. Commissioner 143 Fed. 2d 700.

The provision of each trust declaration giving Appellant the right' to extend the term of the trust, while relevant and to some extent indicative of control, does not in our opinion justify a finding to that effect in the absence of other circumstances at least equally indicative. Miller v. Commissioner, 147 Fed. 2d 189. Furthermore, we find it difficult to give any weight to this factor for the added reason that in any exercise of the right, no apparent economic benefit could possibly accrue to Appellant.

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, pursuent to Section 18595 of the Revenue and Taxation Code, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of Agnes Fatten Parma to a proposed assessment of additional personal income tax in the amount of $7,010.66 for the year 1937 be and the same is hereby modified; the action of the Commissioner in including in the gross income of said Agnes Patten Parma income from certain trusts in the amount of $15,772.96 is hereby reversed;

the action of the Commissioner in reducing to $38,679.98 the deduction in the amount of $100,331.53 claimed by said Agnes Patten Parma under Item 18 (Other Deductions) in her return of income for 1937 is hereby revised to the end that a deduction shall be allowed under said item in the amount of $52,402.55; in all other respects the action of the Commissioner is hereby sustained.

Done at Sacramento, California, this 15th day of December, 1948, by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary