

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA



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

Appearances;

For Appellant: William C. 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 protest of Rosaline C. Merritt to a proposed assessment of additional personal income tax in the amount of \$1,452.68 for the year 1941.

The assessment 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 15, 1931. Three individuals, including Appellant's husband, Hulett C. Merritt, were named in the trust instrument to act as trustees, and Mr. Merritt was designated the primary beneficiary. Other provisions of the instrument were substantially the same as those in the trust instrument involved in the Appeal of Hulett C. Merritt, decided this day, including one (not considered in that Appeal) vesting the trustees "with absolute and uncontrolled discretion and power to determine what shall constitute principal of the trust estate or the gross income therefrom, or the income available for distribution under the terms of this Trust." Mrs. Merritt's trust differed, however, in that the corpus was subject to her testamentary power of disposition, the net income was payable to Mr. Merritt and upon his death to Appellant, and the provision for invasion of the corpus was for the support and benefit of Mr. Merritt rather than Appellant.

The Commissioner has presented the same arguments in this case as in the Appeal of Hulett C. Merritt, except that he has omitted the first ground set forth therein inasmuch as he does not contend here that any part of the trust income could have been used in satisfaction of any legal obligation on Appellant's part to support anyone.

The second of the Commissioner's grounds in support of his action in Mr. Merritt's case, i.e., that the income might have

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been accumulated for Appellant's benefit, is based on Section 12(h)(1) of the Personal Income Tax Act (now Section 18172(a) of the Revenue and Taxation Code), providing that trust income which "is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be held or accumulated for future distribution to the grantor ... " is taxable to the trustor. In this regard, the Commissioner relies upon the provisions of the trust instrument authorizing the trustees to determine income and principal and upon the language thereof entitling Mr. Merritt to the trust income on the prior death of Appellant,

We do not agree that the provisions mentioned support the Commissioner's contention. As we construe them, those relating to the determination of income and principal merely permit an allocation of trust receipts; and those to the payment of income to Mr. Merritt after Appellant's death, to income then currently distributable. None in any way refers to the accumulation of income or the distribution of income accumulated. All net income, as a matter of fact, is required to be paid out as earned under other provisions of the trust, and nowhere in the trust is there any provision for its accumulation.

The Commissioner's next-mentioned basis for his action herein, i.e., title to the corpus may revest in Appellant prior to the death of the last beneficiary, relates to Section 12(g) of the Personal Income Tax Act (now Section 18171 of the Revenue and Taxation Code), providing that where title to any part of the corpus of a trust "may revest 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 revesting is not contingent upon the death of all the beneficiaries," the income is taxable to the trustor. Argument in this connection centers around the provision in the trust instrument under which Appellant reserves what is obviously a testamentary power of disposition over the trust corpus, the Commissioner contending that this contemplates that "at some time prior to the death of the grantor, title must revest in the grantor to give effect to that power of testamentary disposition." We are unable to agree in this view of the matter, however, inasmuch as the transfer in trust was expressly made irrevocable, and since the trust instrument further specifically provided that the trust is to terminate only at the death of the survivor of Mr. and Mrs. Merritt. A contention similar to the Commissioner's with reference to a factual situation: analagous to that here involved was disposed of in favor of the taxpayer in Commissioner of Internal Revenue v. Bateman, 127 Fed. 2d 266, the law there involved being Section 166 of the Federal Internal Revenue Code, upon which Section 12(g) of the Personal Income Tax Act was modeled. If anything, the facts there were even more strongly in favor of the taxing authorities than they are in the case at hand, since there, unlike the situation here, there was specific provision for the accumulation of a certain percentage of the trust income during the life of the trust, such income going, along with the corpus, to such person as the trustor might appoint by will or deed.

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The Commissioner's fourth ground for taxing the trust income to Appellant i.e., her alleged retention of such control over the trust corpus as to have resulted in her remaining in substance the owner of the trust property, relates to Helvering v. Clifford, 309 U.S. 331, wherein the Court held that the usual technical niceties of the law of trusts will be ignored to the extent of treating a trustor of a family trust as the owner in his individual capacity for the purpose of Section 22(a) of the Internal Revenue Code, if he has never in fact relinquished his dominion over the trust principal. The Court there held that the trustor involved, who was also the trustee remained the owner of the trust principal for income tax purposes because (1) the trust, being for five years, was of short duration, (2) the corpus would revert to the trustor in 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.

We fail to see anything in the overall picture here presented indicating any character of control retained by Appellant over the corpus of a kind justifying the application of the Clifford Rule. Contrary to the Commissioner's argument on the subject, Appellant's mere testamentary power of appointment over the corpus does not have that effect. Commissioner of Internal Revenue v. Bateman, supra.

Ø 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 protest of Rosaline C. Merritt to a proposed assessment of additional personal income tax in the amount of \$1,452.68 for the year 1941 be and the same is hereby reversed,

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

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

ATTEST: Dixwell I., Pierce, Secretary