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TAXATION—FEDERAL INCOME TAX—TAXATION TO SETTLOR OF INCOME FROM TRUST ESTABLISHED TO DISCHARGE A LEGAL OBLIGATION—Shortly before the entering of a decree of absolute divorce in favor of his wife, a husband agreed to transfer securities in trust for the wife's benefit in lieu of alimony and all other claims. The divorce decree incorporated the trust agreement. On cer-

tiorari to the Circuit Court of Appeals for the Eighth Circuit,¹ which had sustained a tax against the settlor on the income of the trust estate on the ground that it discharged a legal obligation, the Supreme Court of the United States affirmed the judgment. After disposing of the argument that the trust was entirely voluntary since created prior to the divorce,² Chief Justice Hughes interpreted the provisions of the Revenue Act to allow the tax. Petitioner's contention that the beneficiary was the taxable person was *denied* on the basis of *Gould v. Gould*.³ *Douglas v. Willcuts*, (U. S. 1935) 56 S. Ct. 59.

The constitutional power of Congress to attribute to the settlor the income thus segregated and paid in discharge of his obligation to pay alimony was not challenged in this case, nor as the Court declared could it successfully be challenged.⁴ The question was purely one of statutory construction. The sections of the Revenue Act dealing with the taxation of trusts, fiduciaries and beneficiaries⁵ contain no express provision applicable to the use of the trust here involved. Petitioner's theory was that taxation of the settlor must be limited to the situations provided for by sections 166 and 167 of the act. By the former⁶ the settlor is taxed on the income of the trust when he has reserved the power, either alone or in conjunction with any person not a beneficiary of the trust, to revest title to any part of the corpus in himself. By section 167 the settlor is taxed when the trust

¹ (C. C. A. 8th, 1934) 73 F. (2d) 130, noted 33 MICH. L. REV. 634 (1935). Certiorari was first refused, 293 U. S. 626, 55 S. Ct. 346 (1935), but later granted, 295 U. S. 722, 55 S. Ct. 642 (1935), because of an asserted conflict with the Circuit Court of Appeals for the Seventh Circuit shown in *Schweitzer v. Commissioner of Internal Revenue*, (C. C. A. 7th, 1935) 75 F. (2d) 702.

² The Minnesota court, which granted the divorce, had power to make this provision in its decree. Minn. Stat. (Mason, 1927), §§ 8601-8604. It was not precluded by the prior stipulations of the parties. *Warren v. Warren*, 116 Minn. 458, 133 N. W. 1009 (1912). "The court made its own requirement. The decree required the petitioner to 'provide and create the trust fund.' . . . It was from this action of the court that the decree derived its force." 56 S. Ct. 59 at 62 (1935).

³ 245 U. S. 151, 38 S. Ct. 53 (1917), noted 16 MICH. L. REV. 201 (1918). "Amounts paid to a divorced wife under a decree for alimony are not regarded as income of the wife but as paid in discharge of the general obligation to support, which is made specific by the decree." 56 S. Ct. 59 at 62 (1935). The force of *Gould v. Gould*, however, which may have been based on the desire to avoid double taxation, would have been weakened had the Supreme Court refused to sustain the tax on the husband in the principal case.

⁴ 56 S. Ct. 59 at 62 (1935). This follows logically from the decision in *Burnet v. Wells*, 289 U. S. 670, 53 S. Ct. 761 (1933), noted 32 MICH. L. REV. 123 (1933). In that case the Court upheld the provision of the Revenue Act, referred to *infra*, taxing the settlor on the income of an irrevocable funded insurance trust set up for the benefit of his family.

⁵ Rev. Act 1928, §§ 161, 162, 48 Stat. L. 727, 728, 26 U. S. C., §§ 161, 162.

⁶ Rev. Acts of 1928 and later, § 166, 48 Stat. L. 729, 26 U. S. C., § 166. In the Revenue Acts of 1924 and 1926 this was § 219 (g). The section clearly does not apply in the principal case. "The bald fact that, after an irrevocable trust has served its purpose, the trust estate is to revert to the creator, does not, without more, make the income during the trust period that of the creator for tax or any purposes." *Willcuts v. Douglas*, (C. C. A. 8th, 1934) 73 F. (2d) 130 at 132.

income may be distributed or accumulated for future distribution to him, or used to pay premiums on policies of insurance on his life, by his own act or in conjunction with any person not a beneficiary.⁷ It would doubtless be an unjustifiable extension of the language of this section to apply it to the instant case, where the income of the trust could not in any strict sense be distributed to the settlor. While the benefit to the settlor in discharging his legal obligation is even more substantial than that conferred in the case where the income is devoted to maintaining insurance for his family, a situation expressly covered by the Revenue Act,⁸ yet this benefit is not within the letter of the statute.⁹ The Supreme Court put its decision on a broader basis than is indicated in the opinion of the lower court.¹⁰ The definition of gross income laid down in the Revenue Act,¹¹ "considered in the light of the evident intent of the Congress 'to use its power to the full extent,'" ¹² was held to cover the "constructive receipt" of income arising from the discharge of the settlor's obligation to pay alimony.¹³ The Court declared that the provisions of the Revenue Act relating to the taxing of fiduciaries and beneficiaries were never intended to apply to cases where the trust income in view of the nature of the trust remains attributable to the creator; and sections 166 and 167 cannot "be regarded as excluding instances not specified, where in contemplation of law the income remains in substance that of the grantor."¹⁴ This decision marks a milestone in the liberal construction of the Revenue Acts.¹⁵ It obviates the neces-

⁷ Rev. Act 1928, § 167, 48 Stat. L. 729, 26 U. S. C., § 167. In the Revenue Acts of 1924 and 1926 this was § 219 (h). For a discussion of changes of this and other sections in the Revenue Act of 1932, see Sutter and Owen, "Federal Taxation of Settlers of Trusts," 33 MICH. L. REV. 1169 at 1176 (1935).

⁸ Note 7, *supra*.

⁹ Commissioner of Internal Revenue v. Stokes, (C. C. A. 3rd, 1935) 79 F. (2d) 256; Schweitzer v. Commissioner of Internal Revenue, (C. C. A. 7th, 1935) 75 F. (2d) 702. The court attempted to distinguish Willcuts v. Douglas, (C. C. A. 8th, 1934) 73 F. (2d) 130, but the two cases are clearly in conflict. While admitting that a refusal to apply § 167 "will open the door for increased tax evasion," the court said that "in view of the Board's prior rulings in this respect it would seem that the door has been open for some time, and Congress has failed to close it." (C. C. A. 7th, 1935) 75 F. (2d) 702 at 706. See 48 HARV. L. REV. 815 (1935); 35 COL. L. REV. 461 (1935); 30 ILL. L. REV. 249 (1935).

¹⁰ (C. C. A. 8th, 1934) 73 F. (2d) 130.

¹¹ Rev. Act 1926, § 213, 26 U. S. C., § 22; Rev. Act 1928, § 22, 26 U. S. C., § 22.

¹² 56 S. Ct. 59 at 62 (1935), quoting *Irwin v. Gavit*, 268 U. S. 161 at 166, 45 S. Ct. 475 (1925); *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, 55 S. Ct. 50 (1934).

¹³ *United States v. Boston & M. R. R.*, 279 U. S. 732, 49 S. Ct. 505 (1929); *Old Colony Trust Co. v. Commissioner of Internal Revenue*, 279 U. S. 716, 49 S. Ct. 499 (1929); *Lansill v. Burnet*, (App. D. C. 1932) 58 F. (2d) 512. See on this point 33 MICH. L. REV. 634 at 636 (1935).

¹⁴ 56 S. Ct. 59 at 63 (1935).

¹⁵ "Grammatical interpretation is giving way to functional construction." Landis, "Statutes and the Sources of Law," HARVARD LEGAL ESSAYS 213 at 233 (1934). The decision in the principal case seems, however, to depart from the familiar doctrine that

sity of an amendment to provide for the taxation of settlors where trusts are employed to discharge legal obligations,¹⁶ an amendment which would otherwise be desirable to prevent the increasing use of the trust device for the purpose of escaping the higher surtax levels.

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taxing acts are to be construed in favor of the taxpayer. *United States v. Updike*, 281 U. S. 489 at 496, 50 S. Ct. 367 (1930).

¹⁶ Suggested in 30 ILL. L. REV. 249 at 253 (1935).