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TAXATION — FEDERAL INCOME TAX — DISCHARGE OF LEGAL OBLIGATION BY CREATION OF TRUST FOR ALIMONY AS BASIS FOR TAXATION OF SETTLOR — A trust estate was created by a husband in accordance with a divorce decree, the income therefrom being paid to the wife in lieu of alimony. Provision was made for reversion of the estate on death of the wife and for payment of surplus income to the husband during the duration of the trust. *Held*, that the benefit arising from the discharge of a legal obligation constituted sufficient basis for taxing the trust income to the settlor. *Willcuts v. Douglas*, (C. C. A. 8th, 1934) 73 F. (2d) 130.

For purposes of the federal income tax, trust estates are expressly recognized as taxable entities, and the trustee or the beneficiary is designated as the taxpayer on income from such estates.[1] But there seem to be two general classes of cases

[1] Revenue Act 1934, secs. 161 (b), 142; U. S. C. tit. 26, secs. 5161 (b), 5142.

wherein the settlor is taxed on the trust income. First, the settlor may be taxed because of a retention of ownership or control of the *res* and its income, as in cases in which the right of revocation is reserved. This situation is expressly covered by the federal revenue acts,[2] with increasing thoroughness in recent years.[3] In the second class the settlor may be taxed even though he has parted with all control because in a sense he continues to receive benefits from the use of the trust corpus. Although partly treated in the revenue acts,[4] the boundaries of this field are almost as uncertain as the elusive concept of taxable income; but the instant case would seem to fall well within them. The payment of alimony was a legal obligation of the husband, as had previously been his obligation to support his wife. Ordinarily, payments from his regular taxable income would be used for this purpose, and no deduction from the tax return would be allowed.[5] It is clear that the settlor is directly benefitted by this allocation of the trust income. While from one point of view this may be a negative income as to him, there is no reason why it should not be taxed. A change in ownership should not conceal the fact that an actual benefit has accrued to the settlor.[6] The

[2] The present revenue act taxes the settlor on the income of the trust if he can regain the *res* or income. Revenue Act 1934, secs. 166, 167; U. S. C. tit. 26, secs. 5166, 5167.

The constitutionality of similar although not so extensive provisions in the 1924 act was sustained in Corliss v. Bowers, 281 U. S. 376, 50 Sup. Ct. 336 (1930), where the settlor had retained an unconditional power of revocation. The same result should follow where the power of revocation only allows the settlor to use the income. See Kaplan v. Commissioner, 26 B. T. A. 379 (1932). The court in the principal case did not rest its decision on the provision for reversion, nor on the surplus income provision, but called these without more unimportant.

[3] Possible loopholes in sec. 166 of the Revenue Act of 1928 are closed in sec. 166 of the acts of 1932 and 1934, preventing evasion of taxation by the settlor where his power of revocation, although substantial, must be exercised in conjunction with third parties. In Reinecke v. Smith, 289 U. S. 172, 53 Sup. Ct. 570 (1933), the settlor was taxed although his right to revoke depended upon consent of others.

[4] See Revenue Act 1934, sec. 167 (a) (3), U. S. C. tit. 26, sec. 5167 (a) (3), the insurance trust provision referred to in note 9, infra. A similar provision existed in revenue acts of earlier years.

[5] Alimony, allowances paid under a separation agreement, amounts paid as damages for breach of promise to marry, have been ruled personal expenses. Reg. 65, art. 291; Reg. 62, art. 291; Reg. 45, art. 291; Treasury Bull. 24-20-1003, Cumulative Bull. 2, p. 157. No deduction is permitted in regard to personal, living or family expenses, doubtless on the theory that these are covered by the arbitrary personal exemption allowed. Revenue Act 1934, sec. 24 (a) (1); U. S. C. tit. 26, sec. 5024 (a) (1). In Gould v. Gould, 245 U. S. 151 at 154, 38 Sup. Ct. 53 (1917), the court points out that "the net income of the divorced husband subject to taxation was not decreased by payment of alimony under the court's order."

[6] In the following cases the discharge of legal obligations constituted taxable income: United States v. Boston & Maine R. R., 279 U. S. 732, 49 Sup. Ct. 505 (1929), holding that the payment of lessor's income tax by lessee was *pro tanto* income to the former since it was equivalent to a receipt by him. Old Colony Trust Co. v. Commissioner of Internal Revenue, 279 U. S. 716, 49 Sup. Ct. 499 (1929), where employer paid income tax levied on employee. In Lansill v. Burnet, (App. D. C. 1932) 58 F. (2d) 512, an assignment of trust income was made in payment for services ren-

case should not be "decided by attenuated subtleties," but should turn "on the import and reasonable construction of the taxing act."[7] Since the revenue act aims at the taxation of income, the creator of a trust who receives the substance of enjoyment of its income should be taxed thereon. The decision in the instant case, while clarifying a somewhat uncertain situation,[8] was rendered logically inevitable by recent cases in which the Supreme Court of the United States has shown itself alert to prevent evasion of the federal income tax by use of the trust device. That Court has gone far, notably in *Burnet v. Wells*,[9] in discounting

dered and the assignor was taxed thereon. See Crile v. Commissioner, 26 B. T. A. 1020 (1932); U. S. Trust Co. v. Commissioner, 27 B. T. A. 1260 (1933). Hill v. Commissioner of Internal Revenue, (C. C. A. 1st, 1930) 38 F. (2d) 165; Benedict v. Price, (D. C. E. D. N. Y. 1929) 38 F. (2d) 309; Hilmer v. Commissioner, 27 B. T. A. 1165 (1933), where payments of profits by surviving partners to estate of a deceased partner pursuant to a contract obligation to purchase his interest were held taxable to the surviving partners.

But in a recent case where a legal obligation was not discharged, the Board ruled that the trust income was not taxable to the settlor. Brooks v. Commissioner, 31 B. T. A., No. 14 (promulgated Aug. 10, 1934), noted 34 COL. L. REV. 1375 (1934). The facts were identical with the principal case except that the trust was set up in anticipation of divorce and was not incorporated in the divorce decree or expressly stated to be in lieu of alimony. As in Lynch v. Commissioner, 23 B. T. A. 435 (1931), the Board stressed the voluntary nature of the payments; but some words in the opinion seem contrary to the principal case. See Wollman v. Commissioner, 31 B. T. A., No. 8 (promulgated Aug. 8, 1934), where income from a trust set up by a husband as an allowance for his wife was taxed to the settlor. Because of the large control exercised by the husband and the obvious intent to escape the income tax, the Board altogether disregarded the trust.

Of course Congress cannot tax one person on the income of another, or "measure the tax on one person's property or income by reference to the property or income of another." Hoeper v. Tax Commission of Wisconsin, 284 U. S. 206 at 215, 52 Sup. Ct. 120 at 122 (1931).

[7] Lucas v. Earl, 281 U. S. 111, 50 Sup. Ct. 241 (1930).

[8] In Treas. Bull. 45-21-1910, O. D. 1092, C. B. 5, p. 190, the Treasury Department had overruled a previous office decision that the entire income from the trust fund must be included in the husband's return (Office Decision 399, Treas. Bull. 6-20-730, C. B. 2, p. 156) and ruled that the income was taxable to the wife instead. Gould v. Gould, 245 U. S. 151, 38 Sup. Ct. 53 (1917), noted 16 MICH. L. REV. 201 (1918), reversing that ruling, held that alimony was not income taxable to the wife, but did not consider whether the settlor could be taxed. Then the department returned to the rule that the income is taxable to the husband as the real beneficiary. I. T. 2628, I. R. B. XI-22, 3, revoking O. D. 1092, C. B. 5, p. 190, and reinstating O. D. 399, C. B. 2, p. 156.

In Welch v. Commissioner, 12 B. T. A. 800 (1928), and Turner v. Commissioner, 28 B. T. A. 91 (1933), income from trusts set up in accordance with separation agreements was treated as taxable to the settlors, but the Board regarded the trusts only as security for the performance of the agreements, and not as irrevocably vested. These decisions might thus fall into the first class mentioned supra in the text. See Van Brunt v. Commissioner, 11 B. T. A. 406 (1928).

[9] 289 U. S. 670, 53 Sup. Ct. 761 (1933), noted 32 MICH. L. REV. 123 (1933). There the settlor of irrevocable trusts for the payment of premiums of his life insurance policies in favor of irrevocably-named beneficiaries was held taxable thereon under the

refinements of title based on traditional concepts which in effect contravene the essence of the revenue acts, and has held trust income taxable to the settlor where the benefit to him was much less tangible and substantial than in the principal case.[10]

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revenue act. In upholding the constitutionality of this provision of the act, the Court said that since insurance for dependents is a usual family expense, income applied for this purpose constitutes a taxable benefit to the settlor. This benefit is not as indisputable as the discharge of a legal obligation, although expressly covered by the statute. A similar case arising under sec. 219 (h) of the Revenue Acts of 1924 and 1926 was Du Pont v. Commissioner of Internal Revenue, (C. C. A. 3rd, 1933) 63 F. (2d) 44, aff'd in 289 U. S. 685, 53 Sup. Ct. 766 (1933). See Surrey, "Assignments of Income and related Devices: Choice of the Taxable Person," 33 COL. L. REV. 791 (1933).

[10] Mr. Justice Sutherland, dissenting in Burnet v. Wells, would doubtless find no difficulty in the principal case. "The distinction to be observed is between the devotion of income to payments which the settlor is bound to make, and to those which he is free to make or not make, as he may see fit. In the former case the payments have the substantial elements of income to the settlor." 289 U. S. 670 at 684, 53 Sup. Ct. 761 at 766 (1933).