TAXATION-TRUST INCOME-TAXABILITY TO PERSON OTHER THAN SETTLOR ON BASIS OF "UNFETTERED COMMAND"

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TAXATION—Trust Income—Taxability to Person Other Than Settlor on Basis of “Unfettered Command”—Petitioner's father, who owned the entire capital stock of a manufacturing corporation, bequeathed a controlling interest therein to his wife and son, in equal shares. The widow transferred her shares in trust to a corporate trustee, the evident purpose being to vest in the son, petitioner here, the power to control the corporation. According to the terms of the trust the income was to be accumulated and added to the corpus for the joint lives of the settlor and petitioner, and after death of settlor to be disposed of according to the directions of petitioner. The shares were to be retained and voting control maintained in the family after petitioner's death, but this clause he later changed to provide for distribution at his death. Overriding all these provisions were the following powers given to the petitioner: (1) absolute power to modify or amend, including power to change beneficiaries and appoint to himself; (2) power to withdraw any part or all of the corpus, or revoke the trust and appropriate the trust property to himself; (3) control over all dealings in the stock by the trustee, and over the voting of the stock by the trustee; (4) power to remove the trustee. At no time during the existence of the trust had any of the income or principal been distributed to any person, and the income tax had been paid by the trustee on a fiduciary return. The Tax Court sustained the commissioner's contention that the income was taxable to petitioner under section 22(a) of the Internal Revenue Code, the theory being that his powers over the trust property amounted to ownership of the income.¹ The facts that the purpose of the settlor had been to preserve management of the family corporation rather than to bestow economic benefits on petitioner,

and that the latter had exercised none of his powers over the income, were not significant. On appeal, held, affirmed. *Bunting v. Commissioner of Internal Revenue*, (C.C.A. 6th, 1947) 164 F. (2d) 443.

In the general furor created by the *Clifford* case and the later developments of the doctrine therein enunciated, the line of circuit court decisions upon which the principal case was based has gone relatively unnoticed except by the commissioner, who codified their result as an addendum to his well-known "Clifford Regulations." Although these cases are not direct descendants of *Clifford*, they are causally dependent upon that decision, the causal factor being the willingness of the Supreme Court, evidenced therein, to extend its "real-ownership-equals-taxability" formula into the trust field, stepping lightly around sections 161 and 162. The *Clifford* decision was stated entirely in terms of powers retained by the settlor, but the language did not limit its implications to this situation, and the reaction of the Second Circuit Court of Appeals was that the same reasoning should make the income of a trust taxable to any other person who was given powers over the trust similar to those retained by Clifford. The other circuit courts which have followed the lead of the Second Circuit in similar situations have also relied on their inability to see any valid distinction between *Clifford* and the case at hand, and in addition have reached back farther for their authority to two potent ideas expressed by Justice Holmes.

In *Corliss v. Bowers,* where the question was whether the income of a revocable trust could constitutionally be taxed to the grantor, he said: "The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not."

And in *Irwin v. Gavit* he nursed from an unpromising beginning in *Eisner v. Macomber* an idea which attained its full fruition in the *Clifford* case, namely, that in enacting the provision of the revenue law, which is now section 22(a), Congress intended to use its power to the full extent. The resultant of the fusion of these two ideas is that the income tax law, by judicial construction, now has its incidence on trust income initially through the medium of section 22(a), and it is only when neither the grantor nor any other person can be called the "owner" of the income under these doctrines that the sections of Super-


3 These cases, all of which tax trust income to a person other than the settlor on the basis of section 22(a), are cited in 1948 P.H. Fed. Tax Serv., ¶ 15347. The first of its kind was the Richardson case, (C.C.A. 2d, 1941) 121 F. (2d) 1.

4 Treas. Reg. 111, § 29.22(a)-22, added by T.D. 5488, Dec. 29, 1945. This section was not made applicable to the taxable years concerned in the principal case, and did not figure in the litigation.

5 Richardson v. Comm., (C.C.A. 2d, 1941) 121 F. (2d) 1 at 3, cert. den., 314 U.S. 684, 62 S.Ct. 188 (1941). "We cannot suppose that a court which held the income of a trust subject to taxation against the grantor, where there were serious difficulties in reaching such a result, would hesitate to treat the income in a case like the present as that of the donee of the power."


7 268 U.S. 161, 45 S.Ct. 475 (1925).

8 252 U.S. 189 at 203, 40 S.Ct. 189 (1920).
plement E come into play. One of the attorneys for the taxpayer in the Jergens case attacks the circuit court opinion in that case, and this whole line of authority, on the ground that the Supreme Court cases relied upon are all cases in which the party with the power had actually exercised dominion over the income by directing it into one channel or another, and that the principle cannot be extended to the donee of a power who has not exercised any such control. It is unlikely that this argument will have any notable success in view of the history of unexercised powers in the estate tax field. In fact, the rule of these cases is apparently quite firmly entrenched, the Supreme Court having denied certiorari in all instances when application was made. A subject of contention which must still be settled is the question of how much power over what a person other than the grantor must possess in order to qualify as the owner of the income. The criterion advanced by the commissioner is that such person may be taxed if he possesses a power exercisable solely by himself to vest either the income or the corpus in himself, but the Tax Court has divided on the question of whether power over income is sufficient without power over corpus.

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9 "But the contention that section 161(a) (4) can apply here overlooks the principle that when the income of a trust must be regarded as that of the beneficiary under section 22(a), no subsection of 161(a) can have any applicability." Tax Court majority in Eleanor M. Funk, 7 T.C. 890 at 900 (1946). The Clifford Regulations also contain an internal priority, that is, by § 29.22(a)-22 the beneficiary is not taxed even though he has the power to vest the income or corpus in himself if the grantor himself is taxable under the criteria of § 29.22(a)-21.

10 (C.C.A. 5th, 1943) 136 F. (2d) 497, supra, note 1.


12 TREAS. REG. III, § 29.22(a)-22.

13 Eleanor M. Funk, 7 T.C. 890 (1946).