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TAXATION-FEDERAL INCOME TAX-CONSTITUTIONALITY OF THE CLIFFORD REGULATIONS

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TAXATION—FEDERAL INCOME TAX—CONSTITUTIONALITY OF THE CLIFFORD REGULATIONS—Taxpayer created a five year irrevocable trust on December 1, 1941 for the benefit of a charitable foundation. She retained a reversion in the corpus but disclaimed any right to income. She did not retain, directly or indirectly, any interim control over the corpus or income. On December 1, 1942 the term of the trust was extended to December 1, 1951. Taxpayer did not report the income of the trust in her return. The Commissioner assessed deficiencies for 1946 claiming that the trust was for a term of nine years and that under the new ten year rule,[1] the income of the trust was that of the taxpayer. The Tax Court rejected the Commissioner's contention and asserted that the ten year rule was not intended to apply to a charitable trust.[2] On appeal, *held,* affirmed. The court said, inter alia,[3] that the ten year rule raised a conclusive presumption that irrevocable trusts for less than ten years were within the grantor's control, whether in fact they were or not. It prevented rebuttal by the grantor and taxed him on the strength of the presumption (thus accomplishing that which even Congress could not do) and must of necessity be void. *Commissioner v. Clark,* (7th Cir. 1953) 202 F. (2d) 94.

[1] Treas. Reg. 111, §29.22(a)-21, T.D. 5488, 1946-1 Cum. Bul. 19, amended T.D. 5567, 1947-2 Cum. Bul. 9. "(c) *Reversionary interest after a relatively short term.*—Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment—(1) within 10 years commencing with the date of transfer. . . ."

[2] 17 T.C. 1357 (1952).

[3] The taxpayer argued (1) that application of the regulation to the instant situation would give it retroactive effect and, in any event, the trust was not merely for nine years, as asserted by the Commissioner, but was a ten year trust; (2) that the regulation was unconstitutional inasmuch as it deprived petitioner of property without due process, that is, without a hearing on the issues that existed between taxpayer and Commissioner; (3) that the regulation was unreasonable and arbitrary and therefore void. The court accepted all three of taxpayer's arguments and said that at the time the regulations went into effect, January 1, 1946, the trust involved was a ten year trust. As a result, even assuming the validity of the ten year rule, it would not be applicable in this case. See principal case at 98.

The Supreme Court in *Helvering v. Clifford,* in holding that the income from the trust was taxable to the grantor, emphasized the fact that its decision was motivated by the combination of factors there presented, namely: the short duration of the trust with a reversion in the grantor; the fact that the beneficiary was a member of an intimate family group; and the broad powers retained by the grantor-trustee over the trust res.[4] When the present Clifford Regulations were promulgated in 1946 it became apparent that the Treasury considered the presence of certain single incidents of ownership as determinative of the question of taxability of trust income under the *Clifford* doctrine. The regulations provided that trust income was taxable to the grantor present the retention of either (1) a reversionary interest effective after a relatively short time, or (2) a power to dispose of the beneficial enjoyment of corpus or income, or (3) a power of administrative control exercisable primarily for the grantor's benefit.[5] These regulations were attacked as running contrary to the admonition of the *Clifford* case that "no one fact is normally decisive," in that they singled out one factor after another and asserted that each factor standing by itself was sufficient to make the grantor taxable.[6] Per contra, it was urged that the Treasury, pursuant to Supreme Court invitation, had merely crystallized the concept of substantial ownership, which after all was the real basis of the *Clifford* decision.[7] However, it was not suggested that the regulations might be subject to attack on grounds that they created certain conclusive presumptions of fact.[8]

In the principal case neither the Tax Court nor the Seventh Circuit chose to apply the regulation. The Tax Court in effect ignored it by looking to prior case law[9] sustaining similar transactions and by concluding that the present situation was not within the reach of the *Clifford* doctrine.[10] The Seventh Circuit invalidated the ten year rule on two interrelated grounds. First, it was declared unconstitutional primarily on the basis of *Schlesinger v. Wisconsin*[11] and *Heiner*

[4] 309 U.S. 331 at 335, 336, 60 S.Ct. 554 (1940).

[5] Note 1 supra.

[6] Pavenstedt, "The Treasury Legislates: The Distortion of the Clifford Rule," 2 TAX L. REV. 7 (1946).

[7] Eisenstein, "The Clifford Regulations and the Heavenly City of Legislative Intention," 2 TAX L. REV. 327 (1947).

[8] Although admitting that the Clifford Regulations represented certain extensions of the doctrine, most writers welcomed them as a means of dispelling the great uncertainty that had existed in the area. See Guterman, "The New Clifford Regulations," 1 TAX L. REV. 379 (1946); Atlas, "The Clifford Regulations: Genesis of a Concept," 25 TEX. L. REV. 373 (1947); cf. Lynch, "The Treasury Interprets The Clifford Case," 15 FORD. L. REV. 161 (1946).

[9] Mary Louise Bok, 46 B.T.A. 678, affd. (3d Cir. 1942) 132 F. (2d) 365 (a three year charitable trust, extended at end of two years for an additional three years; no control reserved by the settlor); United States v. Pierce, (8th Cir. 1943) 137 F. (2d) 428 (charitable trust for nine years and nine months); Commissioner v. Chamberlain, (2d Cir. 1941) 121 F. (2d) 765.

[10] See dissenting opinion of Raum, J., in Tax Court decision, 17 T.C. 1357 at 1364 (1952). He felt that the majority had, in effect, declared the regulation invalid. See Estate of Louis Stockstrom, 7 T.C. 251 at 254 (1946) where the Tax Court refused to allow the regulations to override a previous line of case authority.

[11] 270 U.S. 230, 46 S.Ct. 260 (1925).

v. Donnan.[12] In both cases conclusive statutory presumptions dealing with gifts made within a certain period of the donor's death were struck down by the Supreme Court as arbitrary and therefore void under the Fourteenth and Fifth Amendments, respectively. Since the question in regard to conclusive presumptions is ultimately one of the reasonableness of the classification within the context of due process,[13] it may be argued contra to the principal case that the ten year rule is reasonable, such argument being based on the assumption that it is necessary to administer the tax laws successfully and to prevent the avoidance or evasion of taxes.[14] Yet these arguments were specifically rejected by the majority in both the *Schlesinger* and *Donnan* cases. Furthermore, even though these arguments may now be acceptable to the present Supreme Court in so far as gift or estate taxes are concerned,[15] it does not necessarily follow that they would be acceptable in the context of income taxes. In the former situation the primary question is *when* shall the tax be imposed—during the donor's life or at his death—while in the latter case the question is whether *any* tax shall be imposed on the grantor. In addition to the constitutional objection, the Seventh Circuit concluded that the ten year rule was contrary to congressional intent. This argument was predicated on the fact that Congress had granted to the Tax Court the exclusive right to determine facts[16] and that conclusive presumptions usurped the court's function in that regard.

Although the principal case involved only the ten year rule, the court's reasoning would apply to any of the conclusive presumptions contained in the Clifford Regulations. At the least both the Tax Court and Seventh Circuit decisions manifest a reluctance to depart from the "bundle of rights" approach of the *Clifford* case and accept the presence of single incidents of ownership as determinative of the taxability of trust income.

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[12] 285 U.S. 312, 52 S.Ct. 358 (1932).

[13] Knouff, "Death Taxes On Completed Transfers Inter Vivos," 36 MICH. L. REV. 1284 (1938).

[14] See dissent of Holmes, J., Schlesinger v. Wisconsin, supra note 11 at 241; Hoeper v. Tax Comm. of Wisconsin, 284 U.S. 206 at 218, 52 S.Ct. 120 (1931); dissent of Stone, J., Heiner v. Donnan, supra note 13 at 332.

[15] Note 13 supra; Helvering v. Bullard, 303 U.S. 297, 58 S.Ct. 565 (1938).

[16] See Hormel v. Helvering, 312 U.S. 552 at 560, 61 S.Ct. 719 (1941).