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Income Taxation--Clifford Trusts--Unrestricted Control Retained by Settlor-Trustee

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Todd v. Manufacturers Light & Heat Co., 90 W. Va. 40, 110 S.E. 446 (1922).

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INCOME TAXATION—CLIFFORD TRUSTS—UNRESTRICTED CONTROL RETAINED BY SETTLOR-TRUSTEE.—The settlor created trusts for his nephews and sister for the period of his life or that of the cestui. If the settlor predeceased the cestui, the trust estate would become the property of the latter; otherwise, it would revert to the settlor. The cestuis, although not members of the settlor's immediate family, not dependent upon him for support, and residing at points distant from the settlor's domicile, were his closest relatives. The settlor named himself trustee with complete control and management of the trust estate, including the right to sell the property at any price he might determine and reinvest the proceeds in any property he might think desirable, the right to borrow money and mortgage any or all of the trust estate as security, and even the right to repay any sum so borrowed from the trust estate. Furthermore, he retained the right to withhold the income from the beneficiaries and add it to the trust estate. A deficiency having been assessed against and paid by the settlor's executor for the trust income, the executor sued unsuccessfully in the district court to recover the sum so paid. *Held*, affirmed. The settlor retained so much of the bundle of rights that makes up ownership of the trust property that he continued to be the owner of the property, and the income from the trust property was taxable to him. *Wheeling Dollar Savings & Trust Co. v. Yoke*, 204 F.2d 410 (4th Cir. 1953).

INT. REV. CODE § 22 (a), the general definition of "gross income" includes all "gains, profits, and income derived . . . from professions, . . . or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, . . . or gains or profits and income derived from any source whatever." The famous case of *Helvering v. Clifford*, 309 U.S. 331 (1940), held that a settlor, who created a five-year trust, with himself as trustee and his wife as cestui, retaining substantial power and control over the trust res, and absolute discretion as to the distribution of income during the five-year term, although, upon termination of the trust, all accumulated income was to go to the wife, and the trust res to the settlor as remainderman, was taxable on the income under INT. REV. CODE § 22 (a). In determining the tax consequences to the settlor, the court concluded: ". . . the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for purposes of §22 (a)." Since the *Clifford* case rests on three elements—short term, beneficiary a member of the immediate family, and broad powers in the settlor, and since INT. REV. CODE §22 (a) does not determine *who* is the taxpayer, but merely defines, in broad general terms, *what* is income, there has been perplexity as to the scope of application of the *Clifford* doctrine.

The court in the principal case stressed primarily the retention of control over the corpora by the settlor. Other cases have given greater relative emphasis to the length of the term of the trusts. *E. g., Commissioner v. Buck,* 120 F.2d 775, 778 (2d Cir. 1941) [". . . the control factor is sufficiently present when the trust is of short duration, as in the *Clifford* case (because the grantor will soon reacquire complete dominion), even if there are no express reservations of control."]

Commissioner v. Barbour, 122 F.2d 165, 166 (2d Cir. 1941), mentioned the short term and the family relationship. Holding the settlor taxable on the income of a six-year trust, the court said: ". . . the income of trusts which are not substantially longer than the one in *Helvering v. Clifford* are to be taxed against the settlor if he retains the reversion and the income of the property originally in his hands remains 'within an intimate family group.'" In *Commissioner v. Branch,* 114 F.2d 985, 987 (1st Cir. 1940), decided after the *Clifford* case, the settlor trustee had powers of control and management comparable to the principal case but the court held the settlor not taxable, even though the same family relationship element as in the *Clifford* case was present. The court distinguished the *Clifford* case on the length of the trust, and stated: ". . . there seems to be no statutory basis for treating the income as that of the grantor under Section 22 (a) merely because he has made himself trustee with broad power in that capacity to manage the trust estate."

The *Branch* case differed from the principal case, in that the settlor in the *Branch* case was to pay the net income to the cestui quarterly, while in the principal case, the settlor reserved the power to accumulate the income and invest it in trust property. This might render the *Clifford* doctrine more applicable in the principal case than in the *Branch* case. Conversely, to the extent that the intimate family relationship is in the *Clifford* doctrine, it was more evident in *Commissioner v. Branch* than in the principal case.

Jones v. Norris, 122 F.2d 6 (10th Cir. 1941) like the *Branch* case, holds that the power to manage trust property, however unlimited, may not, in itself, operate to bring the grantor within provisions of INT. REV. CODE § 22 (a). However, in it, as in the *Branch* case, distribution of the trust income to the cestui was required and that was not true in the principal case. Had the trust instrument in the principal case required such distribution of the income to the cestui, that might have sufficed to change its tax consequences.

The problem is currently dealt with in U. S. Treas. Reg. 118, § 39.22 (a)-21, promulgated in an attempt to resolve the difficulties in the application of the *Clifford* doctrine by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under INT. REV. CODE § 22 (a). The regulation was not applicable to the trusts in the principal case which terminated before its adoption.

Its provision, U. S. Treas. Reg. 118, § 39.22 (a)-21 (e) (i), for taxability of the settlor on trust income where he retains power to "exchange or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate and full consideration in money or moneys worth", a power retained in the principal case, would probably indicate a result in line with that which was reached in the principal case.

J. L. A.

INSURANCE—SUBROGATION—WAIVER.—*P*'s automobile was damaged as a result of *X*'s negligence. The vehicle was insured by *D* company. *P* and *A*, an adjuster of *D*, agreed that *P* should sue *X* and that *D* would remain liable for the difference between the recovery against *X* and the damage incurred. A judgment was recovered in a justice's court for nearly the whole amount sought, but to avoid further litigation a compromise figure of half the