St. John's Law Review

Volume 7, May 1933, Number 2 Article 29

The Gift Tax as Applied to Revocable Trusts

Alfred Hecker

remedial tax measures unwise, the state legislature itself should undo the harm without the assumed paternalistic intervention of the Supreme Court.

WILLIAM H. SHAPIRO.*

THE GIFT TAX AS APPLIED TO REVOCABLE TRUSTS.—Congress, in 1924, included among the provisions of the revenue act of that year, a tax upon gifts.[1] "For the calendar year 1924 and each calendar year thereafter * * * a tax * * * is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly * * *."[2] This levy was included to supplement the estate and income taxes, which had been frequently avoided by the making of large gifts.[3] The gift tax being a new venture in the field of taxation, Congress did not expressly state its intention in regard to all the situations that might arise. It was not known until the case of *Burnet* v. *Guggenheim*,[4] whether Congress intended to include as a gift *inter vivos* the delivery of the revocable deed of trust or whether the intent was to tax such gift upon the extinguishment of the power of revocation.

In the *Guggenheim* case[5] it appeared that in June, 1917, the defendant executed two deeds of trust for the benefit of each of his two children. The trusts were to continue for ten years. At the end of the ten-year period, the principal and accumulated income were to go to the beneficiaries if living. In the event of their death, other dispositions were made. The settlor also reserved to himself powers of control in respect to the trust property and its investment and administration. In particular, there was an unrestricted power to modify, alter or revoke the trusts except as to

---

* B.S.S., LL.B., J.S.D. (St. John's Law School, 1932), Tax Editor ST. JOHN'S LAW REVIEW, 1931-1932, Member of the New York Bar.

[1] REV. ACT OF 1924, 43 Stat. 253, 313, c. 234, §§319, 320, 26 U. S. C., §§1131, 1132; see (1930) 28 MICH. L. REV. 778. This section was repealed by the Revenue Act of 1926 and later incorporated into the Revenue Act of 1932. GLEASON AND OTIS, INHERITANCE TAXATION (4th ed.) 182, "The federal gift tax is a new departure in taxation—never before in the history of English-speaking people has such a tax been levied, and yet it is a natural outgrowth of the effort of Congress and the state legislatures to reach the corpus of all estates undiminished by any act of the decedent during his lifetime." Bromley v. McCaughn, 280 U. S. 124, 50 Sup. Ct. 46 (1929); (1930) 4 ST. JOHN'S L. REV. 314.

[2] *Ibid.*

[3] Hunter, *Gifts in Contemplation of Death*, 7 NAT. TAX ASS'N BULLETIN 146; Note (1930) 5 ST. JOHN'S L. REV. 147.

[4] 287 U. S. —, 53 Sup. Ct. 369 (1933).

[5] *Ibid.*

incomes, received or accrued. The power of administration was transferred by the settlor to others, and the power to modify, alter or revoke was eliminated and thereby surrendered in July, 1925. Prior to the cancellation of the power and subsequent to the execution of the deeds, the Revenue Act of 1914 was put into effect. The majority, Mr. Justice Cardozo writing the opinion, reversed the decision of the lower court,[6] and held that the gift became taxable when the power reserved by the settlor, to revest in himself title to the corpus, had expired.

It was urged by the taxpayer in that case,[7] that title to the property had passed prior to the enactment of the statute [8] in question and hence it must have been the intent of Congress to tax the transfer at that time. Although it is true that a revocable trust passes title immediately,[9] a discussion of the leading decisions[10] will lead to the conclusion that taxation is not so much concerned with the inchoate title as it is with the shifting of the *entire* economic benefits and control over the property taxed.

In the case of *Bullen* v. *Wisconsin*,[11] the Court held that a trust conveyed with the power of revocation reserved by the settlor

---

[6] Burnet v. Guggenheim, 58 F. (2d) 188, 192 (1932), "To impose this tax, we must say to the petitioner that the property was still his while he had the power to revoke, but when he gave up that power, he transferred the corpus by way of gift. This we cannot do. Nor may we say that the income of the property was still his while he held the power to revoke and when the income went to the beneficiary it was a transfer of income by way of gift. When he relinquished the power of revocation, he did not make the gift; that was made when he created the trust of 1917."

[7] *Supra* note 4.

[8] *Supra* note 1.

[9] Jones v. Clifton, 101 U. S. 229 (1879), "The powers of revocation and appointment to other uses reserved to the husband in the deeds in question do not impair their validity or their efficiency in transferring the estate to the wife, to be held by her until such revocation or appointment be made." Stone v. Hacket, 12 Gray 227 (Mass. 1858); National Newark & Essex Banking Co. v. Rosahl, 97 N. J. Eq. 74, 128 Atl. 586 (1925); Van Cott v. Prentice, 104 N. Y. 45, 54, 10 N. E. 257, 261 (1887), "The existence of that [power of revocation and control] inevitably leaves in the settlor an absolute control, since at any moment he may end the trust and resume possession of the fund as his own. The trustee is directed to hold the fund and invest and reinvest and pay over as ordered, but is to do all this subject to the settlor's absolute control. This cannot mean that the trustee is to have no title and the trust no effective existence, and the property remain the settlor's, but that the trust and the title, good and effectual while it stands, is, nevertheless, to continue and exist only at the will and pleasure of the settlor." Schreyer v. Schreyer, 101 App. Div. 456, 91 N. Y. Supp. 1065 (1905), *aff'd*, 182 N. Y. 555, 75 N. E. 1134 (1905); see (1929) 42 HARV. L. REV. 958.

[10] Bullen v. Wisconsin, 240 U. S. 625, 36 Sup. Ct. 473 (1916); Saltonstall v. Saltonstall, 276 U. S. 260, 48 Sup. Ct. 225 (1928); Chase National Bank v. United States, 278 U. S. 327, 49 Sup. Ct. 126 (1929); Reinecke v. Northern Trust Co., 278 U. S. 339, 49 Sup. Ct. 123 (1929); Corliss v. Bowers, 281 U. S 376, 50 Sup. Ct. 336 (1930); Tyler v. United States, 281 U. S. 497, 50 Sup. Ct. 356 (1930); see Note (1931) 29 MICH. L. REV. 796; (1928) 41 HARV. L. REV. 916.

[11] *Ibid.*

may be subject to an inheritance tax in the state of his domicile, without violating the Constitution. Mr. Justice Holmes, who delivered the opinion of the Court, said:[12]

> "The power to tax is not limited in the same way as the power to affect the transfer of property. If this fund had passed by intestate succession, it would be recognized that by the traditions of our law the property is regarded as a *universitas* the succession to the *persona* of the deceased."

Again in the case of *Reinecke* v. *The Northern Trust Company*,[13] the Court held that a transfer in trust subject to a power of revocation in the transferror alone, terminable at his death, is not complete until his death and hence a transfer tax applied to it, as in Revenue Act of 1921, 3422, is not retroactive where his death follows the date of the taxing statute, though the creation of the trust preceded that date.

In the later case of *Tyler* v. *United States*,[14] Mr. Justice Sutherland pointedly said:[15]

> "The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fictions, whether that power has been properly exercised in the present instance must be determined by the actual results brought about by the death, rather than by a consideration of the artificial rules which limit the title, rights and powers of tenants by the entirety at common law."

The decision of the Court in the *Guggenheim* case[16] may also be upheld by the case of *Saltonstall* v. *Saltonstall*,[17] wherein the Court passed upon the constitutionality of a state statute taxing property which passed under a trust instrument created before the date of its enactment, but where the power of appointment was reserved. The defendant in the latter case[18] contended that the statute deprived him of property without due process because he was taxed on an interest he had already received before the enactment of the Act, also that he had vested interests or remainders

[12] Bullen v. Wisconsin, *supra* note 10, at 361, 36 Sup. Ct. at 474.
[13] *Supra* note 10; (1930) 5 St. John's L. Rev. 137
[14] *Supra* note 10.
[15] Tyler v. United States, *supra* note 10, 281 U. S. at 503, 50 Sup. Ct. at 503.
[16] *Supra* note 4.
[17] *Supra* note 10. This case upheld the so-called Massachusetts rule, on the validity of a succession tax in such a case; that so long as the transfer is subject to be defeated prior to the donor's death, no technical distinctions should be taken between vested and contingent remainders but the transaction should be deemed to take effect as of the time when there took place a final shifting of the economic benefits and burdens of property.
[18] *Ibid.*

subject only to being divested by the exercise of the reserved power which never happened; that as the remainders vested before the enactment of the taxing statutes it cannot constitutionally be applied to them. The Court held that the act did not deprive the beneficiaries of property without due process of law, since, so long as the privilege of succession had not been fully exercised, it could be reached by tax. In the words of Mr. Justice Stone,[19]

> "The present tax is not laid on the donor but on the beneficiary; the gift taxed is not one long since contemplated, but one which never passed to the beneficiaries beyond recall until the death of the donor; and the value of the gift at that operative moment, rather than at some later date, is the basis of the tax.
>
> "So long as the privilege of succession has not been fully exercised it may be reached by tax."

Finally, in the case of *Corliss* v. *Bowers*,[20] Mr. Justice Holmes said:[21]

> "But taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid. If a man directed his bank to pay over income as received to a servant or friend, until further orders, no one would doubt that he could be taxed upon the amounts paid. It is answered that in that case he would have a title whereas here he did not. But from the point of view of taxation there would be no difference. The title would merely mean a right to stop payment before it took place."

It is submitted that the holding of the majority of the court in the *Guggenheim* case[22] is correct, not only in purview of the present gift tax,[23] wherein Congress expressly stated that its intent was to have the tax apply at "the relinquishment or termination of such

---

[19] Saltonstall v. Saltonstall, *supra* note 10, 48 U. S. at 271, 276 Sup. Ct. at 227.

[20] *Supra* note 10.

[21] Corliss v. Bowers, *supra* note 10, 281 U. S. at 378, 50 Sup. Ct. at 336.

[22] *Supra* note 4.

[23] REVENUE ACT OF 1932, c. 209, 47 Stat. 169, 245, §501 (c) 26 U. S. C. A., §1136a (c): "The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or the income therefrom, but the relinquishment or termination of such power (other than the donor's death) shall be considered to be a transfer by the donor by gift of the property subject to such power, and any payment of the income therefrom to a beneficiary other than the donor shall be considered to be a transfer by the donor of such income by gift."

power," or upon the application of the doctrine of *stare decesis*,[24] but also from the standpoint of its practicability. It could not have been the intent of Congress to lay the tax at once, while the deed was still subject to the power of revocation, for such a gift might never have become consummate. If the grantor of a revocable trust deed would exercise his power of revocation, he would be burdened by a tax upon the transfer of the entire principal, when actually only a gift of the income had been made. Since it is the rule that in the construction of a taxing act doubt is to be resolved in favor of the greatest number of taxpayers effected by it,[25] the contention of the taxpayer, in the case under discussion,[26] cannot be upheld.

ALFRED HECKER.

LEGISLATION TO PREVENT CORPORATE EVASION OF TAXES.—As long as the Government's main source of revenue is derived from taxation just so long will the attempts of man to defeat it continue. Nor is the legislature unmindful of this as is evidenced by the preponderance of conditions, exceptions, limitations and modifications that constitute nearly every such statute.

Perhaps the outstanding embodiment of this is noticed in the Revenue Act of 1932, Section 104, dealing with surtax on personal income. The main objective of this act is to prevent the utilization of the corporate entity theory to lessen materially or defeat the amount due as a tax on personal income. That there is a considerable advantage to be gained by permitting one's income to accumulate in the coffers of a corporation can readily be perceived when we recall that the Government demands a levy of only thirteen per cent on the income of a corporation no matter how large it may be, but requests the private individual to pay over as much as fifty-five per cent. Further, the corporation is not taxable at all if the source of its income is derived from dividends of other corporations.[1] Is it surprising, then, that this situation will result

---

[24] *Supra* note 10.

[25] American Net and Twine Co. v. Worthington, 141 U. S. 468 (1891); Benzger v. United States, 192 U. S. 38 (1904); Gould v. Gould, 245 U. S. 151, 153, 38 Sup. Ct. 53, 54 (1917), "in the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen"; United States v. Merriam, 263 U. S. 179, 44 Sup. Ct. 69 (1923); Tyler v. United States, *supra* note 10, 281 U. S. at 503, 50 Sup. Ct. at 503, "Taxation, as it many times has been said, is eminently practical * * *." See also Note (1931) 6 ST. JOHN'S L. REV. 172 and cases cited therein.

[26] *Supra* note 4.

[1] REVENUE ACT of 1932, §23.