Fall 9-1-1949

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THE FAMILY LAND TRUST TREATED AS
AN ASSOCIATION
FOR FEDERAL INCOME TAXATION

Carter Glass, III*

Introduction

Owners of undivided interests in real property are frequently confronted with a very realistic and practical business problem brought about by the complexity of liquidating their interests without an economic loss and of obtaining an advantageous investment return on the property during the process of liquidation. Where partition is not feasible due to the size or nature of the property, current market conditions, or the multitudinous and widespread ownership of the undivided interests, the owners must resort to some form of legal entity to hold, develop and ultimately dispose of the property. In addition to the business impracticalities of a joint liquidation of such property, the owners are faced with legal complications attributable to the numbers of owners, the different rules of real property in the various jurisdictions in which the property may be located, and the necessity of court action in instances where infants are involved. Quite often the value of the real property lies in its availability for business or industrial leases, or in underlying oil, gas and various minerals. In such instances, the owners may find that parties previously interested in leasing business sites or purchasing oil and mineral rights are quite cool to the proposition when they become aware of the prospect of paying rental or royalties to numerous owners in proportion to their ownership interests, especially if some of the owners are infants.¹

Of course, individuals who go into the market and jointly purchase real property for investment purposes must be assumed to approach the transaction with open eyes and with some notice of the future difficulties, though this is not always true.² On the other hand, there is another class of co-owners who have the property thrust upon them and are placed in the position of co-owners of realty with no volition on their part. This class is composed of beneficiaries of inter vivos trusts, heirs of decedents who die intestate, and devisees under wills and

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¹Member of the Lynchburg, Virginia Bar.

²This was precisely the difficulty which faced the heirs to coal land in Hugh MacRae Land Trust, 1 T. C. 899 (1943).

testamentary trusts. With the increasing prevalence of the trust as a means of disposing of property by will and the tendency to tie up the property for a period of time commensurate with the rule against perpetuities, the day of distribution of the trust corpus often arrives with remainder beneficiaries numbering in the dozens, owning varying undivided interests largely dependent upon the generations they are removed from the testator's bounty.3

Whatever the source from which the ownership sprang, the basic nature of the problem is the same, and similar methods have been employed in an attempt to minimize the burdens of co-ownership.4 However, since there is a tendency to feel more sympathy for those that are placed in a questionable legal position not of their own making than there is for the unwary who reach such a position on their own, this article is confined to a consideration of co-ownership by inheritance, and the so-called family land trust.

In seeking a legal entity which is capable of liquidating such real property, the first considerations are flexibility, simplicity and all the legal attributes necessary to accomplish the desired end. At first glance the corporate form appears to be the obvious solution, and it quite possibly might be were it not for the impact of federal income taxation. The corporation provides title in one source, centralized management, security of the enterprise from termination or interruption by death of the co-owners, transferability of ownership interests without affecting continuity, the introduction of new capital if needed in the liquidation process, and limitation of personal liability of the co-owners. This ideal scheme, however, must be viewed with an eye toward the tax aspects, and when so viewed is found wanting. Not only is the corporation subject to the federal income tax of 38% of its net taxable income5 in addition to the individual income tax on the dividends in the hands of its stockholders, but also it may be classed as a personal holding company and be required to pay an additional surtax,6 or be required to pay an additional surtax because of an un-

3For example see Hugh MacRae Land Trust, 1 T. C. 899 (1943) where the beneficiaries were 36 in number and were composed of kinships ranging from children to great-grandchildren.


6I. R. C. § 500.
reasonable accumulation of surplus not distributed to its stockholders. Furthermore, of no minor importance is the effect of state income, franchise, capital stock and a multitude of license taxes imposed upon corporations, and these, together with various state and federal regulatory measures, cannot be overlooked in selecting the corporate form.

Many family groups desiring to liquidate inherited realty have immediately rejected the idea of incorporation in favor of a partnership or agency. True, most of the danger of increased taxation is avoided but the legal shortcomings of such arrangements are immediately apparent. Title and centralized management are vested in one source but the life of the enterprise is only co-extensive with the death of the first co-owner. Except for an agency or power of attorney agreement, coupled with an interest, no agreement of this nature offers certainty that an interfamilial argument will not render the scheme a nullity through the withdrawal of one or more of the participants. Such a plan will suffer from the difficulties of selling and assigning interests, the inability of easily bringing in new capital, and the danger of absolute liability of each co-owner. The death of any party requires the execution of new agreements, and, if infants or incompetents are involved, requires appropriate court action and the introduction of guardians, committees and personal representatives into the scheme.

The entity most frequently resorted to has been the trust, and, when appropriately framed, it has been the most adequate. If sufficiently broad powers are given the trustee, all of the advantages of the corporation are preserved, such as flexibility, centralization, continuity, uninterrupted existence, facility of transferring interests and introduction of new capital, and limited liability both as to the beneficiaries and the trustees. In addition, the trust furnishes a testamentary scheme for the ultimate disposition of the income and principal to descendants of the original co-owners. But, here again, the impact of federal taxation can materially reduce the effectiveness of the transaction, where the trust instrument is not carefully framed and its powers are very broad. The ordinary trust is taxed at the same rates applicable to individuals, but the most flexible type of trust, especially the business or Massachusetts trust, has most of the legal characteristics of a corporation and is likely to be taxed as such.

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7 I. R. C. § 102.
8 There is the additional possibility that taxation will not be minimized and the partnership or agency entity might be taxed as a corporation. See Wabash Oil and Gas Ass'n v. Commissioner, 160 F. (2d) 658 (C. C. A. 1st, 1947).
9 I. R. C. § 161 (a).
The Internal Revenue Code provides that "The term 'corporation' includes associations, joint-stock companies, and insurance companies" and the Treasury Regulations define the word "association" to include certain types of trusts, and require that they be so taxed. While it is believed that the statute was aimed by Congress at the business type of trusts, the regulations and the decisions have extended the scope of "association" far beyond this point, until today many of the conventional or "pure" trusts, including some family land trusts, are taxed as associations. Therefore, it is imperative that a careful appraisal be made of the case material before the trust entity is chosen as the medium for the liquidation of real property acquired by co-owners from an ancestor.

Development of the Law

The Supreme Court of the United States was first called upon in *Crocker v. Malley* to construe the word "association" to include certain types of trusts within the contemplation of federal revenue acts. Under an enactment of 1913, Congress imposed a tax on dividends received by a taxable corporation from stock which it held in another corporation. The stockholders of a Massachusetts corporation liquidated the enterprise and transferred the corporate property to a Massachusetts type of business trust, organized to obtain this result. The property consisted of the fee simple ownership in real estate under lease and all of the stock of another corporation, a manufacturing concern. The stockholders in turn became beneficiaries of the trust, their respective interests being represented by transferable trust receipts. The Court overruled the Commissioner of Internal Revenue and held that the trust was not a "corporation, joint-stock company or association" in the terminology of the statute and did not have to pay a tax on the dividends it received from the manufacturing corporation. In reaching its conclusion, the Court found that the purpose of the act was to discourage holding companies and concentration of power and wealth, and that Congress was not concerned with the trust situation, however analogous to a corporation it might be. Its determination on the facts was based upon the degree of control which was exercised over...
the legal entity by the owners, and it decided that beneficiaries of trusts are "... not partners in any sense, and when they have no joint action or interest and no control over the fund" they cannot be classed as an association.

Following this case, the Commissioner adopted a series of regulations and rulings to the end that a trust would be treated as an association for federal income taxation where the beneficiaries retained a voice in the conduct of the business of the trust or control over the trustees, whether through the right to elect trustees periodically or otherwise. These regulations and the cases decided in accordance therewith thereby adopted the "control test." In instances where the beneficiaries exercised substantial control, the trust was taxed as an association. Where the control was insubstantial or incidental to the exercise of other legitimate trust powers, the trust was taxable at individual rates.

The "control test" was destined to have short existence, as the Supreme Court was again asked to construe the word "association" as applied to trusts in Hecht v. Malley. Congress had imposed an excise tax for the privilege of doing business, based upon capital stock value, upon "... every corporation, joint-stock company or association." Three Massachusetts business trusts had been held taxable as associations by the Commissioner and the three appeals to the Supreme Court had been consolidated for hearing. One trust had been organized by members of the Hecht family and its corpus was composed of real estate inherited by them as tenants in common. The trust instrument provided for full and complete powers of management in the trustees to accomplish the business purpose and for transferable certificates of ownership evidencing the beneficial shares. The other two trusts were typical business trusts formed to operate businesses with capital obtained by selling trust shares. The Court decided that all three trusts were taxable as associations, not because of any degree of control exercised by the beneficiaries, but due to the quasi-corporation nature of their organization; "... as the petitioners are

24 249 U. S. 223, 234 (1918).
26 For typical cases see: E. A. Landreth and Co., 15 B. T. A. 655 (1929); Wilkins & Lange, 15 B. T. A. 1183 (1929).
27 265 U. S. 144 (1923).
not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations."

Notwithstanding the apparent repudiation of the "control test" by the Court in the Hecht case, after this decision the Commissioner adopted new regulations containing two alternatives, providing in brief that a trust would be treated as an association either where the beneficiaries retained positive control over the trust or where the trust was an association together of trustees in a similar manner to directors of a corporation for the purpose of carrying on business enterprise. The commission was sustained in this action by the lower court decisions and the two alternative tests of "control" and "business purpose" became firmly implanted in the law.

The Supreme Court expressed no further opinion in this matter for twelve years, during which interim the lower court decisions showed a complete lack of harmony in applying the tests to given factual situations. However, in 1935 the Court handed down a new doctrinal concept and basic principles of determination in Morrissey v. Commissioner and applied these principles to three divergent factual cases in Swanson v. Commissioner, Helvering v. Combs, and Helvering v. Coleman-Gilbert Associates. All four of these cases involved the determination of whether a trust was an association for purposes of federal income taxation under the definition: "The term 'corporation' includes associations, joint-stock companies and insurance companies."

The Morrissey case was concerned with a real estate trust formed by two individuals for the purpose of developing, renting and selling a golf club and adjoining residential property and for investing the proceeds. The trust instrument gave broad business powers to the trustees who were not subject to control by the beneficiaries. In addition, it provided for transferable shares, both common and preferred, which

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19265 U. S. 144, 161 (1923).
22296 U. S. 344 (1935).
25296 U. S. 369 (1935).
were to be sold to the general public, limited liability of beneficiaries and trustees, continuity on the death of any party, and a fixed trust life of 25 years terminable by the trustees. The Court found the trust was taxable as an association because it was organized for business in a manner analogous to a corporation and in fact operated as a business. It emphasized certain characteristics of the trust as the determining factor: The trustees operated a business in accordance with broad trust powers; transferable shares were issued rather than normal trust beneficial interests; the trust instrument provided for centralized control, continuity and limited liability. The Court minimized the fact that none other than the original property was acquired by the trustees, in the light of the business purposes of the trust.

As a matter of policy, the Morrissey case discussed in quite some detail the basic differences between an ordinary "pure" trust and a business trust taxable at corporate rates. In the ordinary trust, the object is to hold and conserve particular property, with incidental powers; "But the nature and purpose of the cooperative undertaking will differentiate it from an ordinary trust." Thus, the business trust is a joint enterprise, the object of which is to provide a medium for the conduct of business and the sharing of its gains. From a practical approach, the Court pointed out that corporate characteristics are important but made clear that it is resemblance not identity which is controlling. The Court considered the following elements as indicating a corporation rather than a trust, none of which alone was considered decisive or indispensable:

1. Statutory or common law form of corporation utilized.
2. A body of persons united for a common enterprise.
3. Use of particular corporate methods, forms or terminology.
4. Trustees functioning in the same manner as officers and directors, with broad powers.
5. A trust instrument similar to a corporate charter or by-laws.
6. Control by the beneficiaries or meetings and elections of their representatives.
7. Facility of transferring beneficial interests and transferability by negotiation rather than assignment by deed.
8. Formal evidence of ownership—i.e., trust certificates.
9. Continuity of control, uninterrupted by death of beneficiaries.
10. Title in the trustees.

296 U. S. 344, 357 (1935).
11. Centralized management.
12. Self-perpetuation of the trustees or perpetuation by the beneficiaries.
13. Large numbers of participants, and facility for the introduction of new capital.
14. Limitation of liability of the participants or of the trustees.

In the Swanson case two joint owners of an apartment building transferred the building in trust, apparently to facilitate renting of the building. The trust instrument gave broad powers to the trustees to lease, manage, improve, sell and invest and provided for assignable trust receipts, limited liability of the beneficiaries and the trustees, continuity unaffected by death of any party, and limitation of the life of the trust to an ascertainable date or within the trustees' discretion. In operation, the trustees never exercised their broad powers but acted through a firm of real estate agents of which the settlors were owners, in accordance with a clause in the trust instrument. No formal corporate forms or procedures were employed but a few trust receipts were actually sold and transferred upon a written registry of beneficiaries. The Court held that the trust was taxable as an association on the basis of the Morrissey case. It was not impressed by the fact that the number of beneficiaries was limited, that no additional property was ever acquired, that the trust had a limited life span, and that the trust never performed in a formal sense like a corporation, because these facts did not alter the basic nature and purpose of the undertaking as a common business enterprise.

In the Combs case, an owner of oil land transferred the property in trust for the purpose of financing, leasing and drilling an oil well. The trust instrument created transferable trust receipts which were sold and issued to thirteen beneficiaries. The trustees were given broad powers co-extensive with the purpose of developing the oil well and were protected through limited liability. As it turned out, the trust was of short duration as the trustees first leased and then sold the oil interests and the trust ceased in accordance with its terms. During its short existence the trust employed no corporate forms or methods. The Court found the trust taxable as an association by analogy and stated: "Entering into a joint undertaking they avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain to corporate organization."28 The Court empha-

28 296 U. S. 365, 368 (1935).
sized that the trust was akin to a corporation in that it provided centralized management, continuity, limited liability and transferability of beneficial interests. It deprecated the importance of the lack of control in the beneficiaries, the absence of particular forms of corporate procedure, and the fact that only one oil well was contemplated or actually involved.

The *Coleman-Gilbert* case interjects a new element of basic policy into the picture with relation to the binding effect of the trust instrument insofar as it establishes the purpose of the trust. Here, five individuals were co-owners of twenty rental apartment houses. They transferred the property in trust (to themselves as trustees), making themselves beneficiaries, and giving the trustees broad powers to deal with the property, including the power to reinvest proceeds and to withhold or distribute income. The instrument provided for the issuance of transferable beneficial shares, limited liability of trustees and beneficiaries, perpetuation of the trustees as a continuing body and a life span of fifteen years unless the property was sold sooner and the proceeds distributed. The evidence showed that the individuals as trustees operated the property through an office staff in essentially the same manner as they had done prior to the execution of the trust agreement. Oral testimony was introduced to the effect that the individuals as co-owners had experienced difficulty in operating the property and had seized upon the trust form as an advantageous method of liquidating the property at an appropriate time and on a favorable market.

The Court decided, under the doctrine of the *Morrissey* case, that the trust was taxable as an association as its purpose was to operate a business as evidenced by the broad powers given to the trustees in the instrument and their actual business activities in accordance therewith. The co-owners, in the language of the Court, "...formed a combination to conduct the business of holding, improving and selling real estate, with provision for management through representatives, with continuity which was not to be disturbed by death or changes in ownership of beneficial interests and with limited liability." The Court found additional support for its position in the fact that the co-owners conducted the business in much the same fashion after the trust was formed as before, and this fact indicated that the purpose was broader than an effort to avoid partition. As in previous cases, the Court again minimized the importance of the lack of formal legal con-

\[^{296}\text{U. S. 369, 374 (1935).}\]
trol in the beneficiaries and the absence of corporate methods and pro-

procedure. In addition, the Court was little concerned with the small

number of participants in the enterprise, stressing the fact that closed
corporations are frequently formed with as few as one stockholder; nor
was the Court concerned with the fact that the enterprise was confined
to the management and improvement of real estate, for it pointed out
that investment in real property can be a business as well as the invest-
ment in tangible or intangible personality.

Much of that which is given is pure dicta and was used as argu-

ment by the Court to bolster its conclusion already reached in the
light of the broad language used in the trust instrument. The Court
was apparently not convinced by the oral testimony of the co-owners
that the trust was formed to avoid partition and to liquidate the prop-
erty, and felt that the parties were bound by the terms of the instru-
ment and could not introduce contradictory testimony. From the ex-
tensive powers given to the trustees, the formal composition of the
trust and the methods of operation set forth in the trust instrument,
the Court found that the purpose of the endeavor was to operate a
business. In the ruling that “The parties are not at liberty to say that
their purpose was other or narrower than that which they formally
set forth in the instrument under which their activities were con-
ducted,” the Court laid down a policy which has a tendency to re-
strict the employment of traditional stereotyped forms of trust instru-
ments, wherein numerous powers are given to the trustees with no
expectation that they will ever be needed or exercised.

In only one other case has the Supreme Court considered the cor-

porate taxability of the trust. In *Lewis & Co. v. Commissioner* the
taxpayer met with success for the first time since the *Crocker* case. The
taxpayer owned a large tract of residential property, which, in order
to facilitate sale, had to be improved, subdivided and sold off in lots.
He executed contemporaneously a trust agreement and an agency con-
tract. The land was transferred in trust (for the benefit of the settlor
and the real estate agent) and the trustee was given limited power to
execute contracts and conveyances of individual lots at the direction
of a real estate agent and to make collection of payments after the
initial payments. The instrument specified transferable certificates of

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30It was on this last point that the Circuit Court based its opinion sustaining
the taxpayer. 76 F. (2d) 191 (C. C. A. 4th, 1934).
31296 U. S. 369, 374 (1935).
32501 U. S. 385 (1936).
ownership but none were ever issued. The agency contract constituted the real estate agent an exclusive agency to improve, subdivide and negotiate sales of lots and to accept the initial payments. The Court held that the trust was not analogous to an association and distinguished the Morrissey case on the basis that this was an ordinary or "pure" trust for a limited purpose, and stated: "There is simply the common relation of principal and agent, coupled with the collateral incidents of an ordinary trust."3 The Court found the following elements common to traditional trusts and to the particular trust under consideration:

1. Designation of particular property in trust with no power to increase the holding.
2. Limitation of the powers of the trustee to the end desired.
3. Limitation of the purpose of the trust to accomplish specific results, and not to operate a business.
4. Definitely named persons as beneficiaries rather than indefinite body of certificate holders.
5. The duties of the trustee are essentially ministerial with only those incidental powers necessary to accomplish the limited and specific purpose.
6. No association of individuals but rather an enterprise created by one individual for the benefit of himself or others.

The Court very strongly emphasized that the trust had been formed by a single individual and not by two or more persons, and that consequently there was no association, joint-enterprise, or combination and no planning of a common effort. If it be true as it appears from the opinion that the Court was influenced by this factor, this represents a departure from the Coleman-Gilbert case where the Court stressed that the number of participants was immaterial. Furthermore, the Court apparently backed down somewhat from the proposition in the Coleman-Gilbert case to the effect that the trust instrument is controlling on the purpose of the trust, in pointing out that while this trust instrument provided for the issuance of transferable certificates of ownership, none in fact were issued. Surely, the provision in the trust for transferable certificates contemplates a shifting body of beneficiaries and the introduction of new capital, and thus indicates an original purpose broader than a "pure" trust, regardless of subsequent developments. In view of the above, it is the opinion of the

3501 U. S. 385, 389 (1936).
writer that the Lewis & Co. case has at least by implication toned down the effect of the Coleman-Gilbert case on these points.

The doctrinal concepts and language of the foregoing cases form the basis of the present Treasury Regulation and determine the federal government's policy with regard to taxing of trusts as associations. In a regulation dealing with the nature of an association, the Commissioner defines an "association" as an organization characteristic of a corporation in its broadest sense regardless of the technical legal nature of the organization and of the form of the instrument creating it. In a second regulation, the Commissioner points out the essential differences between a "pure" trust and one taxable as an association. This latter regulation provides that the nature and purpose of the undertaking, as gathered from the instrument itself, differentiates the two types of trusts, without regard to the actual manner of operation, the degree of control in the beneficiaries, or the size of the undertaking. The employment of particular corporate forms or methods is an important consideration in finding a business purpose but is in no sense essential. If title is transferred to a trustee as a medium to conduct business with a view toward income or profit, as a substitute for a corporation and in order to obtain corporate advantages without its disadvantages, the entity is treated as an association. On the other hand, an ordinary trust, whether created by an outsider or the beneficiaries themselves, formed to protect or conserve property, without any undertaking not strictly necessary to reach this end, will retain its identity as a trust.

Elements to Consider

As previously pointed out, the Coleman-Gilbert case laid down a rule that the trust instrument determined the purpose of the trust, without any reference to the actual manner of operation, and the Lewis & Co. case cast some doubt upon this proposition. A perusal of the lower Court decisions clearly indicates that confusion exists as to the extent the terms of the instrument are controlling. The rule was rejected by the Sixth Circuit in the case of Commissioner v. Gibbs-Preyer Trusts Nos. 1 & 2, where two family land trusts were formed by heirs of a decedent. The trust indenture gave the trustees broad powers of a business nature, including the power to sell, rent or reinvest. The beneficiaries retained control over the trustees, and provision

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35Reg. 111, ¶ 29.3797-3.
36117 F. (2d) 619 (C. C. A. 6th, 1941).
was made for negotiable trust receipts (later changed by an amendment), some of which were actually transferred. The evidence showed that the trustees' activities were, in fact, limited, in conformity to an oral understanding, to the holding of legal title, the payment of taxes and maintenance and insurance costs, and the signing of leases at the direction of the beneficiaries.

The Court decided that the trust was not taxable as an association because it did not operate as a business despite the opportunity to do so under the terms of the trust: "The crucial test in determining whether a trust is an association taxable as a corporation, must be found in what the trustees actually do and not in the existence of long unused powers." It felt that Congress did not intend to apply corporate tax rates in every instance where persons associated themselves together for the purpose of engaging in business for profit. Congress intended, according to the Court, to balance the corporate and "pure" trust similarities, and only where the business trust was constituted after the method and form of a corporation, with its economic advantages, was it to be considered an "association." The Court's position was somewhat weakened by the fact that it stressed the lack of technical corporate procedures and the absence of limited liability with regard to the trust under consideration. Nevertheless, its basic principle is sound and receives support from other lower Court decisions, in one of which the Commissioner acquiesced.

On the contrary, a numerical majority of the decisions have followed the Coleman-Gilbert case on this point and have based their determination that the trust was taxable as an association on the existence of broad powers in the trust instrument, irrespective of the fact that the trust was organized for a more limited purpose and the broad powers were never exercised. Typical of these cases is Sherman v. Commissioner, where thirteen heirs of a decedent as joint owners

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Footnotes:


of a single piece of rental property, transferred the property in trust in order to avoid partition and the consequent economic loss. Broad powers were given to the trustees, transferable beneficial interests were employed, and the trust was terminable only by consent of the beneficiaries. In actual practice, the trustees limited their activities to leasing the property, collecting rents, paying the carrying charges and distributing the income of the beneficiaries. The Court held that the trust was taxable at corporate rates, as it was organized for "doing business."

In reaching its conclusion, the Court relied on the Morrissey case and stated: "The purpose of the trust is found in the instrument which created it. The parties are not at liberty to say that it had a different or narrower purpose."40 The Court felt that the purpose so found was not restricted by the fact that the activities of the trustees "...were confined to the collection and distribution of rents, payment of taxes, bookkeeping and other incidental duties."41 It is interesting to note that this decision was rendered by the same Circuit Court, the Sixth, that rendered the opinion in the Gibbs-Preyer case, without overruling or distinguishing the previous case. Whether the Court disbelieved the taxpayer's testimony as to the actual purpose of the trust, or was changing its position on this point is speculative. In either event its end result finds adequate support and offers a danger signal to framers of trust instruments.42 An interesting additional possibility is given in Frederick Pitzman et al, Trustees,43 to the effect that broad powers are proper where they are restricted in the trust instrument to accomplish a limited and specific purpose. However, no other case has been found on this point and the decision should be regarded with caution.

Assuming for the moment that no objection is made as to the scope of the purpose and powers of the trust as contained in the trust instrument, the logical problem is then one of the nature of the limited trust purposes which are acceptable to the Courts as indicative of a

4386 B. T. A. 81 (1937).
"pure" or traditional type of trust. The Coleman-Gilbert case indicates, in a rather left handed way, that if the trust is formed for the purpose of liquidating property, in order to avoid the necessity of partition, it will not be taxed as an association. This proposition is sustained by a number of cases, outstanding among them being Girard Trust Co., Trustee. Here, nine heirs owning undivided interests in undeveloped residential land, transferred it in trust in order to effect a liquidation of the property. The court found that the enterprise was a "pure" trust because it was created as the most convenient and practical method of disposing of the property. It considered the practical aspects of the situation in emphasizing that subdivision was the only feasible method of handling the property, as the estate was too large for the market to be promptly liquidated, and to have deeds executed by all interested individuals would be too cumbersome. The Court rejected the contention of the Commissioner that the profit motive changed the situation and turned the trust into a business enterprise.

While the Court in the Girard Trust case was not concerned with the lengthy period of liquidation, other cases have reached a different conclusion. In Joseph C. Grew the Court, in holding the trust taxable as an association, was greatly impressed by the fact that the trust had not been liquidated in the 33 years since its creation. Probably the correct approach is that found in Frederick Pitzman et al, Trustees where the court emphasized that the land had to be disposed of slowly due to its utility only for industrial sites, and stated that the nature of the property must be balanced against the period of liquidation in determining whether the actual purpose of the trust is liquidation or operation of a business.

Most family land trusts have been formed to liquidate the property, but quite frequently they have an additional purpose, or a sole pur-

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45 B. T. A. 81 (1937).
pose, of conserving and protecting the property for the benefit of future generations. As previously shown, this object is approved by the regulations and draws additional support from the cases. In *Myers v. Commissioner*, four brothers jointly inherited a single parcel of real estate from their father. They found it impossible to liquidate the property and were afraid that the death of any one of them and the consequent introduction of minor children into the picture would, in the long run, result in a loss to the family. Therefore, they transferred the property in trust for a term of twenty years in order to conserve the property until their minor children became of age. Even though the powers given to the trustee were broad, the Court held that the trust was not taxable at corporate rates because it had been organized for conservation rather than business.

In *Estate of Cortlandt Parker* the Court held to the contrary in a rather strained opinion. Eight children and grandchildren of the decedent inherited an undivided interest in real and personal property. In order to preserve the property it was transferred in trust for the joint lives of the settlors. The trust instrument gave broad powers to the trustee and specifically provided that beneficial interests could be assigned only by deed. The trustees leased part of the property, sold off some lots, bought adjoining property as a protective measure, and invested proceeds in stocks and bonds. The Court held that the trust was a business both in purpose and in operation as "Its avowed purpose was to hold the properties of the estate for income production." In interpreting the *Morrissey* case, the Court decided that the "... fact that petitioner may have been organized principally for the purpose of conserving the assets of decedent's estate would not necessarily relieve it from tax liability as an association. Such a trust might still have all the essential characteristics of an association as defined by the Courts." The liquidation or conservation of property are rather broad purposes in themselves and it necessarily follows that more limited purposes do not carry the stigma of "association." Thus, the cases have ap-
proven various objects to be attained where the trust powers have been restricted to this end: The renting and distribution of rents on behalf of a cumbersome group of co-owners;\(^51\) the leasing and disposing of coal rights in order to avoid the difficulties of negotiating separate and multiple leases;\(^52\) the foreclosing of numerous defaulted mortgages and selling the jointly owned assets;\(^53\) the financing of real estate loans as a substitute for mortgages;\(^54\) and the lending of money and extension of credit.\(^56\) However, care must be taken in drafting the trust instrument in order that this limited end will be apparent to the Court.\(^58\)

It has been previously pointed out that the operation of a business is not generally considered a legitimate end of a "pure" trust. At the same time, the cases sustain the proposition that incidental powers may be given to the trustee to enable him to attain the limited and specific result desired.\(^57\) At least one case has gone much further and has put its stamp of approval upon a trust that actually operated a business. In *Commissioner v. Guitar Trust Estate*\(^58\) real and personal property, including a going business, was transferred in trust. The Court based its opinion upon the "control" test and held that since the beneficiaries had no legal right to control the trustees and did not in fact exercise any control, the trust was not taxable as an association. The Court minimized the broad powers in the trustees which enabled them to operate the business, on the ground that power to operate a going business was a normal trust provision.

The *Guitar* case was decided prior to the *Morrissey* case and must be considered in the light of subsequent developments. While the "control" test is no longer applied and some decisions have repudiated


\(^{52}\) Hugh MacRae Land Trust, 1 T. C. 899 (1943).

\(^{53}\) Broadway-Brompton Buildings Liquidation Trust, 34 B. T. A. 1089 (1936).

\(^{54}\) Cleveland Trust Co. v. Commissioner, 115 F. (2d) 481 (C. C. A. 6th, 1940), cert. den. 312 U. S. 704 (1941).

\(^{55}\) Commissioner v. McCormick, 68 F. (2d) 623 (C. C. A. 7th, 1934).

\(^{56}\) In Hill v. Reynolds, 75 F. Supp. 408 (D. C. Minn. 1948) the trust was formed to comply with the Hepburn Act, 49 U. S. C. A. Sec. 1 et seq., but the Court felt that this was not apparent from the instrument; and in National Metropolitan Bank v. Commissioner, 145 F. (2d) 649 (C. C. A. 4th, 1944) the Court denied that the trust was organized for charitable purposes.


\(^{58}\) 72 F. (2d) 544 (C. C. A. 5th, 1934).
the *Guitar case*, it is to be noted that the Court did not confine its conclusion to the "control" test but in addition emphasized the lack of resemblance between the trust and a corporation and the probable underlying restrictive purpose of liquidation, specifically approved in *Blair v. Wilson Syndicate Trust* and later decisions. In *Guitar Trust Estate* the Court refused to reverse the previous ruling as to the trust, for later income tax years, simply because the beneficiaries had failed to withdraw their distributable shares of the trust income and this accumulation had been reinvested. However, the Court seemed largely concerned with fair play: "We are satisfied that an orderly and equal administration of the revenue-collecting function requires that the determination of this case be controlled by... previous decisions.

It is somewhat difficult to determine what elements or characteristics of a trust are important in weighing its likeness to a "pure" trust and to a corporation because many of the cases are inconsistent and others minimize certain elements in order to strengthen their conclusion already reached. Nevertheless, at least one or more cases have emphasized the following facts as indicative of a "pure" trust: The limitation of the property held to the original property with no power to reinvest proceeds; confining the property to real estate; no provision for, or issuance of, transferable beneficial shares; no exemption from personal liability on the part of the beneficiaries or trustees; an association together of heirs of decedents rather than strangers; a short definite trust existence; no technical corporate...
procedures provided for or employed;\textsuperscript{70} the limited scope of the trustees actual activities;\textsuperscript{71} and the limited number of beneficial owners.\textsuperscript{72} On the other side of the ledger, cases have stressed the following elements as analogous to a corporation and decided that the trust under consideration was taxable as an association: The large amount of property involved and right to increase the holding;\textsuperscript{73} the right to issue transferable shares and bring in new capital;\textsuperscript{74} the large number of participants in the enterprise;\textsuperscript{75} the exemption from personal liability;\textsuperscript{76} the conduct of the enterprise in essentially the same manner after the trust was formed;\textsuperscript{77} and the lengthy duration of the trust, even after the original property is sold or exchanged.\textsuperscript{78}

\textit{Conclusion}

It is the opinion of the writer that the trust form is the most flexible and adaptable legal entity to accomplish the liquidation of jointly owned family property and to conserve the property during the period of liquidation. However, the danger of federal income taxation requires careful planning and execution of the trust. Prior to drafting the trust instrument, consideration must be given to the cases and allied material in order to ascertain whether the trust as contemplated will accomplish tax minimization.\textsuperscript{79} The draftsman must realize that it will be necessary to sacrifice many of the broad powers ordinari-

\textsuperscript{70}Myers v. Commissioner, 89 F. (2d) 86 (C. C. A. 7th, 1937); Gardiner v. U. S., 49 F. (2d) 992 (C. C. A. 1st, 1931).


\textsuperscript{73}Willis v. Commissioner, 58 F. (2d) 121 (C. C. A. 9th, 1932); Joseph C. Grew, para. 48,153 P-H Memo. T. C. (1948).

\textsuperscript{74}Morrisey v. Commissioner, 296 U. S. 344 (1935).


\textsuperscript{76}National Metropolitan Bank v. Commissioner, 145 F. (2d) 649 (C. C. A. 4th, 1944). See also the lower Court's opinion, National Metropolitan Bank, para. 43, 497 P-H Memo. T. C. (1949).


\textsuperscript{78}Sears v. Hassett, 111 F. (2d) 961 (C. C. A. 1st, 1940).

\textsuperscript{79}Thought should also be given as to whether one or several trusts are needed. However, in this connection the danger that several trusts together might be taxed as an association should not be overlooked. See: McKean v. Scofield, 108 F. (2d) 764 (C. C. A. 5th, 1940); Magoon Trust Estate, para. 42,406 P-H Memo. T. C. (1948).
ly given to the trustee. This omission is not likely to be serious and should not affect the efficient operation of the trust. For, after all, the purpose of the trust must be narrow, with only such powers placed in the trustees as are indispensable to its ultimate end. It should be borne in mind that the Court will likely look first to the scope of the trust instrument in order to ascertain whether the entity is a "pure" trust or an "association."

As an aid to the trust draftsman, but with no attempt to predict the vagaries of Court decision, it is suggested that an instrument drawn in accordance with the following pattern would achieve recognition as a "pure" trust:

1. The purpose of the trust must be set forth in the trust instrument. It should be specific and narrow, and not vague or broad. If consistent with the ultimate aim, elect between liquidation and conservation, or in other words, selling and renting, and do not attempt to accomplish both.

2. The powers given to the trustee should be restricted to those which are strictly necessary to attain the desired end. Eliminate traditional or stereotyped powers such as "to deal with the property as an individual." The trustee in no event should have the power to reinvest proceeds from the sale of property, to use income received in rental to invest in other property, to exercise discretion as to the distribution of income, or to operate a going business.

3. The instrument should not provide for any forms or procedures analogous to the corporation, such as certificates of ownership or trust receipts, control over the trust by the beneficiaries, exemption from personal liability, suing or being sued as an entity, or perpetuation of the trustees. The supervision of the trust should be left to the appropriate state Courts.

4. The trust's life should be restricted to a definite, short period, and, if feasible, its corpus composed of a limited amount of one class of property—i.e., a single tract of real property, with the property specifically enumerated in the trust instrument, together with a provision prohibiting the acquisition of additional property. In addition, the beneficiaries should be named and, if at all possible, limited in number.

The criterion of success is simplicity in the composition of the trust and a minimum of actual activity on the part of the trustee. Any attempt to obtain all of the advantages of the corporation will result in achieving as well its most obvious disadvantage, multiple taxation.
Washington and Lee Law Review

Member of Southern Law Review Conference

Volume VI 1949 Number 2

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