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Life Tenant as Trustee of Corpus for Capital Gain Purposes?—Remedial Section 641(c) a Solution

It is a well-established principle of law that taxes on capital gain are paid by the cestui or trustee of the capital asset.¹ There are three factual situations present in the taxation of such gain. First, if the property is owned in fee, the owner is required to file a return and to pay the tax on the capital gain.² Secondly, if the equitable title is broken into several estates—for instance, life estate with remainder over—and an express or implied trust established, the trustee is required to file a return for all capital gain received.³ The third factual situation is illustrated in the recent case of *United States v. De Bonchamps*,⁴ in which a life estate containing broad powers to consume the corpus for support, comfort and maintenance was devised with remainder following. No trust, express or implied, resulted from the devise. Thereupon the life tenant sold portions of the estate and realized a capital gain. The vexing problem created by the nature of the devise was whether the life tenant should be taxed as owner or as trustee of the corpus for the capital gain realized. The answer to this problem was not and still is not included in the present Internal Revenue Code. In a split decision the court chose to tax the life holder as trustee of the estate. The dissenting opinion reasoned that the life tenant should not be taxed as *either* owner *or* fiduciary.⁵

Before further investigation of the *De Bonchamps* and other similar cases can be attempted, a brief review of judicial history concerning three important areas should be made. First, the history of the courts concerning code expansion; second, the courts' past attitude towards treating a life tenant as trustee; finally, the fundamental duties of a trustee.

I. JUDICIAL EXPANSION OF TAXING POWER GENERALLY

The inherent power of Congress to use its taxing power to the fullest is evidenced by certain broadly worded sections of the Internal Revenue Code.⁶ The courts, too, have often fostered this attitude in holding a taxpayer liable "in accordance with the legislative design

1. Int. Rev. Code of 1954, §§ 1201, 1202.

2. *Ibid.*

3. *Hallowell v. Commissioner*, 160 F.2d 536 (3rd Cir. 1947).

4. 278 F.2d 127 (9th Cir. 1960).

5. *Id.* at 135.

6. Int. Rev. Code of 1954, §§ 61 (a), 261, 262.

to reach all gain constitutionally taxable unless specifically excluded. . . .”

This far-reaching phrase has been used by the courts to include as income within Section 61 (a) of the Internal Revenue Code of 1954⁸ insider profits,⁹ punitive damages,¹⁰ money received in settlement of a law suit,¹¹ retirement payments,¹² alimony,¹³ tips,¹⁴ room and board furnished by employer,¹⁵ windfall gain resulting from currency devaluation,¹⁶ and prizes won by contestants.¹⁷ In these decisions, the courts have repeatedly referred specifically to the all-inclusive phrase found within this section, that gross income includes all “income from whatever source derived.”¹⁸

The reasoning in *United States v. Glenshaw Glass Co.*,¹⁹ a case in which punitive damages were included as income, is illustrative of the courts’ propensity to liberally interpret the broadly worded sections of the code in favor of the government. Prior to the final determination of this case, the Tax Court chose not to include these damages as income. In the interim, the 1954 Code was enacted omitting any reference to the taxability of such gain. At first glance, this appeared to be an affirmation of the Tax Court’s holding; but paradoxically, the higher court found these punitive damages taxable, reasoning that Congress showed no intention to carve out such an exception.²⁰

On the other hand, there are numerous cases holding that the Internal Revenue Code should not be expanded by mere implication, these cases stating that the literal meaning of the words employed should not be expanded beyond their clear import.²¹ This school of thought

7. *General American Investors Co. v. Commissioner*, 348 U.S. 434, 436 (1955).

8. The Section reads: Gross Income Defined

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

9. *General American Investors Co. v. Commissioner*, 348 U.S. 434 (1955).

10. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

11. *Ibid.*

12. *Fisher v. Commissioner*, 59 F.2d 192 (2d Cir. 1932).

13. *Baker v. Commissioner*, 205 F.2d 369 (2d Cir. 1953).

14. *Nazzareno D. Cesanelli*, 8 T.C. 776 (1947).

15. *Olin O. Ellis*, 6 T.C. 138 (1947).

16. *Willard Helburn, Inc. v. Commissioner*, 214 F.2d 815 (1st Cir. 1954).

17. *Turner v. Commissioner*, P-H Tax Ct. Mem. ¶54,142 (1954).

18. Int. Rev. Code of 1954, § 61 (a).

19. 348 U.S. 426 (1955).

20. *Ibid.*

21. E.g., *Crooks v. Harrelson*, 282 U.S. 55 (1930); *United States v. Merriam*, 263 U.S. 179 (1923); *United States v. Field*, 225 U.S. 257 (1921). Prior to these cases was *Smietanka v. First Trust & Sav. Bank*, 257 U.S. 602 (1922) which stated the general intent of Congress was to read into the Code only language which could be reasonably construed to effect it.

reasons that all doubts as to the construction of a code provision should be construed in favor of the taxpayer,²² emphasizing that courts should not legislate.²³ In the case of *Helvering v. Clifford*,²⁴ the dissent by Mr. Justice Roberts stated:

No such dictum as that Congress has in the income tax law attempted to exercise its power to the fullest extent will justify the extension of a plain provision to an object of taxation not embraced within it. If the contrary were true, the courts might supply whatever they considered a deficiency in the sweep of a taxing act. I [Roberts] cannot construe the court's opinion as attempting less.²⁵

This statement reflects the fear that many courts possess of the propriety of reading implications into the statute in order to supply a tax shortcoming. More important, they have been afraid of the courts' usurpation of legislative powers.²⁶ The result is that these courts leave such remedies with Congress by simply absolving the taxpayer from liability. In the extreme, there is at least one court that has gone even further by excluding a taxpayer clearly within the letter of the law when the court felt that taxation would not be within the spirit of the law.²⁷

Although the decisions are not uniform, the overwhelming trend in the past few decades has been towards expansion.²⁸ It would be prohibitive for Congress to attempt to codify and exhaust all possible taxable events; therefore, Congress has given a considerable amount of discretion to the courts. Furthermore, there have been times when strict construction of the Code has clearly created greater absurdities than a liberal interpretation. With this in mind, the second consideration will be investigated.

II. TREATMENT OF LIFE TENANT AS TRUSTEE GENERALLY

The vexing problem of treating a life tenant as trustee has been the subject of extensive litigation.²⁹ The *De Bonchamps* case deals

22. *United States v. Merriam*, supra note 21; *United States v. Field*, supra note 21; *Gould v. Gould*, 245 U.S. 151 (1917); *Treat v. White*, 181 U.S. 264 (1901).

23. *Smietanka v. First Trust & Sav. Bank*, 257 U.S. 602 (1922).

24. 309 U.S. 331 (1940).

25. *Id.* at 342.

26. E.g., *Crooks v. Harrelson*, 282 U.S. 55, 60 (1930); *United States v. Merriam*, 263 U.S. 179 (1923); *United States v. Field*, 255 U.S. 257 (1921).

27. *Treat v. White*, 181 U.S. 264 (1901).

28. *White v. United States*, 305 U.S. 281 (1938).

29. E.g., *King v. Hawley*, 113 Cal. App. 534, 248 P.2d 491 (1952); *Skellenger v. England*, 81 Cal. App. 176, 253 Pac. 191 (1927); *Bienvenu v. First Nat'l Bank*, 17 S.E.2d 257 (Ga. 1941).

directly with this problem of regarding the life tenant as trustee for tax purposes. The authorities are in accord in not classifying a life tenant as a trustee in the *true legal sense*.³⁰ The creation of a technical trustee requires express or implied language in the devise or grant.³¹

Courts that have treated the life holder as trustee have done so by expressly stating that since the duties of the life tenant are similar to those of a trustee, he holds an interest *in the nature of a trust* or as *quasi-trustee*,³² and therefore, should do nothing to prejudice, destroy or defeat the remainderman's interest.³³ These decisions can be summarized by the reasoning in *Bienvenu v. First Nat'l Bank*,³⁴ which stated: "Because of the duty resting on the life tenant to *preserve* and protect the estate in remainder, the relation of the life tenant to the remainderman has been recognized by this court to be *to a certain extent* a fiduciary one and termed an implied or quasitrusteeship."³⁵

Contrariwise, there are numerous cases holding that a normal life tenant should *not* be deemed a trustee or quasi-trustee.³⁶ The courts foster the idea that no trust or form thereof should be created except when it clearly appears that such was the intent of the grantor.³⁷ The courts state that if the trust is not provided for in the devise, the subsequent decree of distribution should not have the effect of creating such an interest.³⁸ This point is well-taken since the legal life interest is recognized in law as being distinct from that of the equitable interest, assuming the grantor does not state his intent to combine the two. Moreover, the two interests are taxed separately in the eyes of the law.³⁹

30. *Hart v. Commissioner*, 54 F.2d 848 (1st Cir. 1932); *Estate of Larson*, 261 Wis. 206, 52 N.W.2d 141 (1952); 1 *Bogert, Trusts and Trustees* § 27, at 217 (1951); *Restatement (Second), Trusts* § 54 (1939).

31. E.g., *Estate of King*, 144 Wash. 281, 275 Pac. 82 (1929). See *Restatement (Second), Trusts* §§ 23, 54 (1959).

32. E.g., *Hart v. Commissioner*, 54 F.2d 848 (1st Cir. 1932); *Ferguson v. Forstmann*, 25 F.2d 47 (3d Cir. 1928); *King v. Hawley*, 113 Cal. App. 534, 248 P.2d 491 (1952); *Hardy v. Mayhew*, 158 Cal. 95, 110 Pac. 113 (1910).

33. *Edwards v. Puckett*, 196 Tenn. 560, 268 S.W.2d 582 (1954); *Morrow v. Person*, 195 Tenn. 370, 259 S.W.2d 665 (1953). But cf., *Attebury v. Prentice*, 158 Neb. 795, 65 N.W.2d 138 (1954).

34. 17 S.E.2d 257 (Ga. 1941).

35. *Id.* at 260. (Emphasis added).

36. E.g., *Mary M. Shea*, 31 B.T.A. 513 (1934); *Skellenger v. England*, 81 Cal. App. 176, 253 Pac. 191 (1927); *Bogle v. N.C.R.R.*, 51 N.C. 408 (1859); *Welsh's Estate*, 239 Pa. 616, 86 Atl. 1091 (1913). See also *Restatement, Property* § 204 comment (a) (1936).

37. *Estate of King*, 144 Wash. 281, 275 Pac. 82 (1929).

38. *Ibid.*

39. 6 *Merten, Law of Federal Income Taxation* § 36.01 (Zimvet ed. 1957).

The impropriety of treating a life tenant as trustee or quasi-trustee was recognized more than a century ago by a North Carolina court which said that the whole estate is divided into two sectors, life tenant and remainderman, each holding legal title to his respective part for his own use.⁴⁰ There is no separation of the legal from the beneficial estate in respect to either part; therefore, it is untenable to say that the life holder maintains the legal estate for the benefit of another.⁴¹ The renowned writers on the subject are in accord with this view.⁴² Exemplary of this is a comment in the Restatement of Property.

The relationship between the persons having respectively the present and future interests in a thing other than land cannot be defined accurately by analogizing it either to the trustee-beneficiary relation or to the relation between persons having like present and future interests in the land. The fact that each has legal ownership of an interest for his own use makes the trustee beneficiary analogy sometimes inapt.⁴³

One solution to the problem is to require the life holder to file a bond, thereby creating a debtor-creditor relationship between life tenant and remainderman.⁴⁴ However, the life tenant with the power to consume the corpus generally is not required to file a bond since he is not required to preserve the corpus.⁴⁵ In *Kirkpatrick's Estate*,⁴⁶ a will provided for the residue of the estate to go to the spouse for life, according her full possession and control. In the devise, a waiver of the statute requiring a bond to be filed was stipulated. Although no bond was filed, the court held that the relationship between the life tenant and the remainderman was that of debtor and creditor.⁴⁷ The creation of such a relationship precludes the courts from applying the trustee label to the life holder, for a debtor is not a fiduciary.

*Powell's Estate*⁴⁸ promulgated the rule for jurisdictions that do not require bonds to be filed by ordinary life holders. There the wife was given the entire estate for life with power to expend as much as she needed, including principal, for her support. The Court held that a

40. *Bogle v. N.C.R.R.*, 51 N.C. 408, 419 (1859).

41. *Id.* at 409, 420.

42. Restatement, Property, op. cit. supra note 36; 1 Bogert, supra note 30 at 218.

43. Restatement, Property, op.cit. supra note 36.

44. *In re Hays' Estate*, 358 Pa. 38, 55 A.2d 763 (1947); *Kirkpatrick's Estate*, 284 Pa. 583, 131 Atl. 361 (1925).

45. *In re Sanford's Estate*, 83 N.Y.S.2d 782 (1948); *In re Hays' Estate*, supra note 44. *Contra*, *Vaughn v. Vaughn*, 238 Miss. 342, 118 So. 2d 620 (1960).

46. 284 Pa. 583, 131 Atl. 361 (1925).

47. *Ibid.*

48. 340 Pa. 401, 17 A.2d 391 (1941).

debtor-creditor relationship was created although no bond was required by law or the devise. There was no fiduciary relationship and the rights of the respective parties were in no way altered.⁴⁹ Although the power to consume was granted in the devise, the rule applies also, according to the opinion, even to life holders without power to consume.⁵⁰

III. GENERAL DUTIES OF A TRUSTEE

The only justification in equating a life holder with a quasi-trustee arises from the fact that both interests at least impliedly have similar duties towards the remainderman.⁵¹

The primary duty of the trustee is "to administer the trust *solely* in the interest of the beneficiaries."⁵² A trustee is a person who undertakes to act in the interest of others. Any violation of this duty of loyalty⁵³ will subject the trustee to legal reprisals,⁵⁴ his relationship to these beneficiaries being purely one of a fiduciary nature.⁵⁵ A trustee commits a breach of this duty when he uses the trust res for his own benefit,⁵⁶ or when he occupies the land for his own purpose.⁵⁷ Accordingly, the trustee is accountable for any gain derived or liable for any loss sustained.⁵⁸ Thus, any use of the trust res by the trustee adverse to that of the beneficiary is a breach of the trustee's fiduciary duty of loyalty.

The second major duty of a trustee is the obligation to protect and *preserve* the trust corpus.⁵⁹ The power to expend the trust funds is limited to those expenditures made for the repair and maintenance of the res.⁶⁰ In an ordinary life estate, that is, one in which there is no power to consume the corpus, this duty is present even though not expressly stated. Included within this duty is the obligation to prevent waste, an inherent obligation in the trustee's "duty to preserve."⁶¹

49. *Ibid.* See also, *In re Hays' Estate*, 358 Pa. 38, 55 A.2d 763 (1947).

50. *Powell's Estate*, 340 Pa. 401, 17 A.2d 391 (1941).

51. *Graham v. Bryant*, 211 Ga. 856, 89 S.E.2d 640 (1955); *Burnett v. Quell*, 202 S.W.2d 97 (Ct. App. Mo. 1947); *In re Stein's Will*, 91 N.Y.S.2d 158 (1949). See also, *King v. Hawley*, 113 Cal. App. 534, 248 P.2d 491 (1952).

52. 2 Scott, *Trusts* § 170 (2d ed. 1956). (Emphasis added).

53. *Ibid.*

54. *Id.* at § 170.2.

55. *Id.* at 1193.

56. *Id.* at § 170.17.

57. *Ibid.*

58. *Id.* at § 170.25. See also, *Restatement, Trusts* § 170, comment 1 (1959).

59. 2 Scott, *op. cit. supra* note 52, §§ 176, 188.1. See also, e.g., *Williams v. Morrison*, 242 Iowa 1054, 48 N.W.2d 666 (1951); *Windscheffel v. Wright*, 187 Kan. 678, 360 P.2d 178 (1961).

60. 2 Scott, *op. cit. supra* note 52, § 176.

61. *Bliss v. Security-First Nat'l Bank*, 81 Cal. App. 2d 50, 183 P.2d 312 (1947);

If acts of waste are committed the trustee and the cestui respectively are held liable for losses sustained.

In the *De Bonchamps* case, the duties of protection, preservation and loyalty, and the task of administering the estate solely for another, which are duties inherent in the trustee and "normal" life tenant situations, are non-existent. This is because of the power granted the life tenant to consume the corpus for his need and support. Prior to the *De Bonchamps* case, *Randall v. Estes*⁶² held that where the testatrix devised the estate to her husband for life with power to sell, encumber or dispose of the entire estate for his support, comfort and maintenance, with remainder over, the life tenant was not a trustee or quasi-trustee for the remainderman. The court further stated that the life tenant is regarded a quasi-trustee to preserve and protect the estate *only* when the remainderman has a clear vested *indefeasible* interest in the property.⁶³ In *In re Barnes' Estate*,⁶⁴ the life owner was given full power to consume the corpus and attempted to give away the estate. The court held the life tenant a quasi-trustee only insofar as he is prohibited from recklessly squandering the estate.⁶⁵

The numerous courts that have regarded the life tenant as quasi-trustee invariably have done so under circumstances where no power to consume existed. This is justified since such a tenant possessed the duty to preserve the corpus.⁶⁶

Thus it is clear that a governing factor in the courts' categorization of a life tenant as quasi-trustee rests with his duty of loyalty to protect and preserve the estate for the remainderman.⁶⁷ Consequently, having the duties of a trustee, the life tenant has been treated as a trustee by the courts. Clearly then, by the life tenant's acquisition of the power to consume the estate for his own support, comfort and

Conner v. Bowdoin, 80 Ga. App. 807, 57 S.E.2d 334 (1950); *In re Buder*, 358 Mo. 796, 217 S.W.2d 563 (1949).

62. 218 S.W.2d 338 (Ct. Civ. App. Tex. 1949).

63. *Ibid.* See *Bienvenu v. First Nat'l Bank*, 17 S.E.2d 257 (Ga. 1941).

64. 108 N.E.2d 88 (Ohio 1950).

65. *Id.* at 98. See also, *Johnson v. Johnson*, 51 Ohio St. 446, 38 N.E. 61 (1894); 2 *Perry, Trusts* § 540 (7th ed. 1929). But cf., *Attebury v. Prentice*, 158 Neb. 795, 65 N.W.2d 138 (1956).

66. *Hart v. Commissioner*, 54 F.2d 848 (1st Cir. 1932); *Ferguson v. Forstmann*, 25 F.2d 47 (3d Cir. 1928); *Gaskill v. United States*, 188 F. Supp. 507 (N.D. Tex. 1960); *King v. Hawley*, 113 Cal. App. 534, 248 P.2d 491 (1952); *Hardy v. Mayhew*, 158 Cal. 95, 110 Pac. 113 (1910); *Windscheffel v. Wright*, 187 Kan. 678, 360 P.2d 178 (1961); *Morrow v. Person*, 195 Tenn. 370, 259 S.W.2d 665 (1953).

67. *Gaskill v. United States*, *supra* note 66; *Warmore v. Gilbert*, 51 Ga. 260, 106 S.E.2d 269 (1921); *Windscheffel v. Wright*, *supra* note 66; *Morrow v. Person*, *supra* note 66.

maintenance, the above duties vanish, leaving no justification for regarding the life holder as quasi-trustee. With this thought in mind, an investigation of other cases follows.

IV. TAXATION OF THE LIFE TENANT

Aside from the *De Bonchamps* case, there have been few decisions faced with the problem raised herein, that is, "Is the life tenant with broad powers to consume the corpus to be taxed as owner or as trustee for the capital gain derived?"

In *United States v. Cooke*,⁶⁸ a life tenant was given the power to use and consume the corpus (shares of stock) with remainder following. The life holder was held not taxable as owner since "she [was] not in any way the owner of the shares,"⁶⁹ nor the resulting capital gain. Likewise, the life tenant was not taxable as trustee of the corpus under Section 161 (a) of the Internal Revenue Code of 1939.⁷⁰ The decision rested on the interpretation of the term *trustee* found within the Code section, and as defined by Treasury Regulations.⁷¹ The court found it to pertain only to the *ordinary* trust which requires the conservation of the corpus under the customary rules of chancery.⁷² As a result, the life tenant, not having the property for the purposes of preservation, was not taxed. The dissenting opinion in the *Cooke* case urged that the life tenant should be taxed as owner of

68. 228 F.2d 667 (9th Cir. 1955).

69. *Id.* at 670.

70. The section reads:

Imposition of Tax

- (a) Application of tax—The taxes imposed by this chapter on individuals shall apply to the taxable income of estates or of any kind of property held in trust, including—
- (1) income accumulated in the trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;
 - (2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct; . . .
 - (4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated. . . .

71. Treasury Regulation 118, § 39.3797-3. The definition of the term *trust* as used in the Internal Revenue Code reads:

The term trust as used in the Internal Revenue Code, refers to an *ordinary trust*, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of *protecting* or *conserving* it as customarily required under ordinary rules applied in chancery and probate courts. (Emphasis added).

72. *Ibid.*

the corpus, reasoning that the life tenant had the absolute right of disposition of the income which was subject to her unfettered command. Courts have, at times, held a taxpayer liable as owner when technically he was not. They have concluded that "taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed"⁷³ or that "liability may rest upon the enjoyment by the taxpayer of privileges . . . so substantial . . . as to make it reasonable and just to deal with him as if he were the owner. . . ."⁷⁴ Aside from the *Cooke* dissent, the courts are in accord in not holding this class of taxpayer as owner of the corpus.⁷⁵

These courts have concluded that the power of the life tenant to use and consume the corpus was not equivalent to a power to vest in themselves the corpus of their respective estates.⁷⁶ Powers normally inherent in ownership are lacking; that is, this type life tenant has no power of appointment, nor to give the corpus away, nor to make testamentary disposition of the corpus.⁷⁷ Furthermore, reapportionment of the beneficiaries' shares and outright substitution of parties is prohibited.⁷⁸

Moreover, the power to consume is expressly limited to those powers stated within the devise, and is, in essence, the power of the life tenant to determine for himself his own personal mode of living. Any interest in the corpus is thereby limited to effectuate such purpose. Finally, this is not a situation where the failure of the life tenant to consume part of the estate can be regarded as a gift to the remaindermen, as would be true with ownership.⁷⁹

Prior to the *De Bonchamps* decision, *Weil v. United States*⁸⁰ was decided in the Court of Claims. On facts similar to the *Cooke* case, the court held the taxpayer liable for capital gains as fiduciary, while

73. *Harrison v. Schaffner*, 312 U.S. 579, 580 (1940); *Burnet v. Wells*, 289 U.S. 670, 678-79 (1933); *Corliss v. Bowers*, 281 U.S. 376 (1930); *Hulbert v. Commissioner*, 227 F.2d 399 (7th Cir. 1955); *Davis v. United States*, 226 F.2d 331 (6th Cir. 1955); *Flato v. Commissioner*, 195 F.2d 580 (5th Cir. 1952); *Farkus v. Commissioner*, 170 F.2d 201 (5th Cir. 1948); *Home Furniture Co., v. Commissioner*, 168 F.2d 312 (4th Cir. 1948); *Hallowell v. Commissioner*, 160 F.2d 536 (3d Cir. 1947); *Sewell v. United States*, 73 F. Supp. 957 (Ct.Cl. 1947).

74. *Burnet v. Wells*, supra note 73. See also, Int. Rev. Code of 1954, § 678.

75. In instances where the life owner is accorded *full power* over the income he is deemed owner of the income and taxed thereon. For examples see footnotes 73 & 74 above.

76. *United States v. De Bonchamps*, 278 F.2d 127 (9th Cir. 1960); *United States v. Cooke*, 228 F.2d 667 (9th Cir. 1955); *Weil v. United States*, 180 F. Supp. 407 (Ct.Cl. 1960), cert. denied, 364 U.S. 822 (1960).

77. *United States v. De Bonchamps*, supra note 76 at 130.

78. *Ibid.*

79. *Ibid.*

80. 180 F. Supp. 407 (Ct.Cl. 1960), cert. denied, 364 U.S. 822 (1960).

at the same time affirming the *Cooke* majority opinion in not regarding the life holder as owner.⁸¹ Again the interpretation of the term trustee played the predominant role in the court's decision. That tribunal found the interpretation in the *Cooke* case too narrow, and expanded it to include relationships "clothed with the characteristics of a trust."⁸² Apparently the court either ignored or placed very little weight on the fact that the life tenant with power to consume was entrusted with *no* duty to protect or preserve the corpus. Instead, the Court of Claims equated the life tenant and trustee, stating that neither was able to appropriate the principal, and as an end result held the taxpayer liable as trustee for the capital gain within Section 641 of the Internal Revenue Code of 1954.⁸³

In agreement with the *Weil* case is *Security-First Nat'l Bank v. United States*,⁸⁴ where the testator devised a life estate to his spouse with power to sell, dispose of and consume so much of the corpus as needed for her support, comfort and maintenance with remainder thereafter. Unlike the *Cooke* case, the devise expressly held the tenant liable for waste. The Court distinguished the *Cooke* decision on the basis of the waste provision stating that the devise in the earlier case granted broader powers which extended beyond the reach of a suit for waste.⁸⁵ This distinction is not well taken since both cases dealt with capital gain realized through the sale of securities. Waste is a technical term referring only to a *freehold* estate and is, therefore, inapplicable to personalty.⁸⁶ Consequently, the holding of the case cannot honestly be given weight as authority contra to the *Cooke* case.

The Ninth Circuit was so influenced by the decision in the *Weil* case that in the *De Bonchamps* case it reversed its previous position by choosing to follow the *Weil* decision rather than their own *Cooke* opinion. In finding the life tenant responsible for the tax on capital gains the court admitted that:

[U]ndue emphasis and significance were read into the regulation's reference to the customary requirements of protection and conservation. In searching for the meaning of the distinction which this regulation makes [between ordinary trusts and other types of trusts], we should be guided by the fact that this is a tax measure. The distinction intended then should be meaningful and purposeful in a tax context.⁸⁷

81. *Ibid.*

82. *Id.* at 411.

83. Int. Rev. Code of 1954, § 641.

84. 181 F. Supp. 911 (S.D. Cal. 1960).

85. *Id.* at 915-16.

86. *Caprito v. United States*, 217 F.2d 783 (5th Cir. 1954); *Graffell v. Honey-suckle*, 112 Wash. 64, 191 P.2d 858 (1948).

87. *United States v. De Bonchamps*, 278 F.2d 127, 132 (9th Cir. 1960).

The tribunal remarked strongly that an active trust is feasible without the inclusion of the normal duties and responsibilities given a trustee, adding that to ignore such a proposition would exclude property otherwise perfectly taxable.⁸⁸

The Court interpreted the Treasury's definition of the term trustee as an attempt to distinguish the business trust from the ordinary trust. This reasoning was founded upon the fact that the definition was promulgated at a time when the problem of separating business associations from trusts was dominant, a time almost two decades after the term first appeared in the code.⁸⁹ In the final analysis, the word *ordinary*, in the definition of the term trustee, was used to describe the purpose of the arrangement and not preservation. The *Cooke* case was thereby overruled.

The dissenting opinion in the *De Bonchamps* case was concerned with the life tenant as trustee of the corpus, and agreed with the majority in not regarding the life holder as owner.⁹⁰ In addition to affirming the reasoning in the *Cooke* case, the dissent based its opinion on a proposed legislative act entitled *Trust and Partnership Income Tax Revision of 1960*.⁹¹ The purpose of the bill was to amend the very section of the code so often relied upon by the government, namely, Section 641 of the Internal Revenue Code of 1954.

In essence the proposed bill⁹² taxes income attributable to the prop-

88. *Ibid.*

89. *Ibid.*

90. *Id.* at 133.

91. H.R. 9662, 86th Cong., 2d Sess. (1960). The Bill was withdrawn due to judicial determination, S.Rep. No. 1616, 86th Cong., 2d Sess. 6 (1960).

92. The bill read:

TITLE I—ESTATES AND TRUSTS

(Bill Sec. 101)

SEC. 101 IMPOSITION OF TAX-AMENDMENTS OF SECTION 641.

(Bill Sec. 101 (a))

(a) Application of Tax.—Section 641 is amended by adding at the end thereof the following new subsection:

‘(c) Legal Life Estates and Other Terminable Legal Interests.—If—

‘(1) any person owns a legal interest in property which may terminate on the lapse of time, on the occurrence of an event or contingency, or on failure of an event or contingency to occur, and

‘(2) at any time during any calendar year there is *gross income attributable to such property*—

“(A) which (but for this subsection) would not be currently includible in the gross income of any person because such person is not then ascertainable or for any other reason, but

“(B) which would be currently includible in the gross income of a trust with respect to such property if

erty (capital gain) of a life tenant by deeming a trust to exist with life tenant as fiduciary for the purpose of taxing such gain, which, but for the new law, would not be taxable unless such a trust existed.⁹³ The dissent thought the majority position untenable during the pendency of the proposed bill. Moreover, the proposed amendment was in line with past Congressional policy to accord separate treatment to legal life tenants and trustees.⁹⁴

The most recent case in point was *Robinson v. United States*,⁹⁵ decided in a Georgia Federal District Court. The facts of the case were substantially the same as the *De Bonchamps* case with the exception that the life tenant here was required "to hold the proceeds of the sale subject to the remaining interest in the property."⁹⁶ This additional factor made this case stronger in light of the government's contention. Accordingly, the Court followed the authority pronounced by the *Weil* and *De Bonchamps* decisions and taxed the life tenant as quasi-trustee of the corpus.⁹⁷ The lower court adhered to the doctrine of *stare decisis* with open reluctance, stating: "While this Court is following the above cited cases [*Weil, De Bonchamps, Security-First Nat'l Bank*] it does so with a great deal of hesitancy, for there are certain considerations that weigh heavily upon the side of a contrary view."⁹⁸

The reason for the hesitancy was due primarily to the pendency of a Congressional Resolution⁹⁹ that would clarify the statute under consideration.¹⁰⁰ Secondly, the court viewed its feelings by raising theories which cast doubt upon and might logically be more sound than its holding.¹⁰¹ One such theory was apportionment. The Court stated the sale of such property by the life tenant could have been that of two separate legal estates—life estate and remainder. As a result, the capital gain could be apportioned.¹⁰² The second theory of the court

such a trust existed (determined without regard to subpart E),

then, for purposes of this subchapter and subtitle F, a trust shall be deemed to exist for such calendar year with respect to all gross income described in paragraph (2) attributable to such property, and the person (or persons) described in paragraph (1) shall be deemed to be a fiduciary of such trust. (Emphasis added.)

93. Shortform explanation of the Congressional Bill cited in footnote 92.

94. *United States v. De Bonchamps*, 278 F.2d 127, 134 (9th Cir. 1960).

95. 192 F. Supp. 253 (N.D. Ga. 1961).

96. *Id.* at 253.

97. *Id.* at 254.

98. *Ibid.*

99. H.R. 9662, 86th Cong., 2d Sess. (1960). See note 92 *supra* for text.

100. Int. Rev. Code of 1939, § 161. (Section 641 of the Int. Rev. Code of 1954).

101. *Robinson v. United States*, 192 F. Supp. 253, 254-55 (N.D. Ga. 1961).

102. *Id.* at 254.

concerned the requirement of notice to necessary parties in matters pertaining to the estate. In a true trustee situation, the fiduciary is the only necessary party. However, the Court remarked that it could logically be argued that the life tenant be required to give legal notice to the remainderman prior to the sale of the corpus.¹⁰³ In so doing the trust aspect is virtually eliminated. The Court was not required to make rulings on these self-interposed theories since they were not made issues by the opposing parties.

The Court eliminated plaintiff's theory of postponement¹⁰⁴ and found the life holder liable for the tax on capital gain. They reasoned that the tax would be paid by the life tenant from the proceeds of the sale and would come out of the increment earned by the corpus. Furthermore payment of the capital gains tax from the corpus would result in an automatic adjustment between life tenant and remainderman.¹⁰⁵

V. REMEDIAL LEGISLATION NEEDED

The courts in the *Weil, De Bonchamps* and *Robinson* cases had no legal justification in reaching their separate but like conclusions. They were correct in not holding the life tenant as owner of the corpus, although historically incorrect in regarding respective life tenants as trustees. Practically speaking, the life tenant should be taxed for the capital gains earned since he has benefitted or will benefit from such gain. Furthermore, to disregard collection of this tax would be contrary to the intent of Congress. Taxing the remainderman for such gain is not feasible because of the problem that would arise if his interest be contingent. In addition, postponement is clearly not the policy of Congress.¹⁰⁶ The only proper solution to the problem rests with Congress itself. Congress, with its power to lay and collect taxes, has the prerogative to choose either alternative they deem proper. Congress could treat the life tenant with broad powers to consume the corpus for his support as owner or as trustee of the estate.

In selecting the manner in which to tax these life tenants, it is the duty of Congress to ascertain and carry out the devisor's or grantor's intent in creating such estates. In this regard, the trust label is better suited. The choice made of granting (or devising) a life estate with power to consume rather than granting a fee obviates the grantor's (or devisor's) intent to afford the life tenant almost complete power

103. *Id.* at 255.

104. *Ibid.*

105. *Ibid.*

106. Note, Federal Income Tax—Life Tenant not Liable for Capital Gains, 1956 U. Ill. L. F. 294. See also, *Robinson v. United States*, 192 F. Supp. 253 (N D. Ga. 1961).

of disposition, while at the same time enabling the grantor (or devisor) to retain control over the disposition of the remainder. An anomaly is created. Although this is an insufficient rationale to justifiably enable the courts to deem the tenant a trustee, it sheds enough light on the intent of the grantor to allow Congress to select this manner of taxation over that of ownership.

Moreover, the implications following taxation as trustee are less severe and damaging than those in which the life tenant is taxed as owner. By taxing the life tenant personally as owner, he will consume a greater portion of the corpus to reimburse himself for any taxes paid. The end result is forced consumption leaving only a semblance of the estate for the remainderman. This is contrary to the grantor's intent. Such consumption would not occur if the tenant were taxed as trustee, because he would not be taxed personally for the gain.

The problem of selecting how to tax the life tenant is, in essence, one of choosing the tax bracket to place the tenant within and is dependent upon the attitude of Congress. Although the standard fifty per cent deduction is allowable for capital gain in each case when there is a net long term profit, the tax will be less if computed on a trust basis.¹⁰⁷ This is because the income derived from capital gain in the trust situation is treated separately from personal income for tax purposes.

For example, assume a life tenant with broad powers to consume earns \$10,001 per year as personal net income. Further assume a \$10,000 net long term capital gain through the sale of part of the corpus. Only \$5,000 of this gain is attributable to income for taxation due to the standard deduction (not to be confused with the 10 per cent standard deduction). If taxed as owner, the \$5,000 must be added to the \$10,001 already earned. When so taxed, the tax for the total \$15,001 is \$4,730.47 yielding the taxpayer only \$10,270.53 net income.¹⁰⁸ Taxed as trustee, his personal tax on the \$10,001 is \$2,640.38 yielding \$7,360.62 and the tax on the \$5,000 capital gain is \$1,100 yielding \$3,900 for a grand total of \$11,260.62 net income.¹⁰⁹ As shown, the taxpayer has benefitted greatly by being taxed as trustee. Choosing the bracket is, therefore, a matter for Congress to decide in light of the other considerations above mentioned.

In view of the legal findings made herein, it appears necessary for Congress to enact remedial legislation on the problem of taxing this type of life tenant. Without such action the courts will, more than

107. Int. Rev. Code of 1954, § 1202. See also, § 642.

108. Int. Rev. Code of 1954, § 1(a).

109. Ibid.

likely, continue to follow the *Weil*, *De Bonchamps* and *Robinson* decisions. Congress, in so legislating, should consider the legal history of the matter, as well as the intent of the parties, the implications involved and the nature of their past attitude in levying taxes in selecting the proper alternative.