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TAXATION OF TRUSTS: WHEN DOES A TRUST TERMINATE FOR FEDERAL INCOME TAX PURPOSES?

BY ROLF A. HANNING*

With the increased popularity of financial planning by means of a trust, taxation problems become more complex and more important to lawyers in this area. Dealing with a vital facet of trust taxation, the author thoroughly explores the history of the principles of termination of trusts for taxation purposes, citing relevant regulations and tax decisions. He concludes that a trust terminates at the earlier of these two events: 1) The time when the trust assets have actually been distributed or 2) The expiration of a reasonable period for distribution.

"A trust does not automatically terminate upon the happening of the event by which the duration of the trust is measured."[1]

INTRODUCTION

THIS article attempts to shed some light on the question: When does a trust terminate for federal income tax purposes? Before proceeding further, however, it is appropriate to answer yet another question: Why is it important to know exactly when a trust terminates for tax purposes?

Subchapter J of the *Internal Revenue Code of* 1954 imposes an income tax on trusts.[2] It also provides that trusts have income,[3] deductions,[4] and exemptions.[5] It can therefore be concluded that trusts are taxable entities. This article will not treat in detail the various income tax problems incident to the termination of a trust, since these problems have been the subject of comprehensive analysis by various competent authors.[6] Let it suffice here to merely point

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[1] Treas. Reg. § 1.641(b)-3(b) (1956).

[2] INT. REV. CODE of 1954, § 641.

[3] *Id.* § 641.

[4] *Id.* § 642.

[5] *Id.* § 642(b).

[6] Comm. on Modification, Revocation and Termination of Trusts, *Termination of Trusts: Trustee's Problems in Winding Up,* 1 REAL PROP., PROB. & TRUST J. 514 (1966); Glassmoyer, *Termination Problems of Estates and Trusts: Capital Gains: Carryover of Tax Benefits Upon Distribution,* N.Y.U. 17TH ANN. INST. ON FED. TAX. 1227 (1959); Littenberg, *Techniques for Controlling Income Tax Consequences of Estates and Trusts,* 45 TAXES 206 (1967); Lowell, *Carryover of Unused Losses and Excess Deductions to Beneficiaries on Termination of Trusts and Estates,* 48 A.B.A.J. 1087 (1962); Rea, *The Fiduciary's Final Return,* 21 J. TAXATION 350 (1964); Somers, *Some Income Tax Problems Incident to the Termination of a Trust,* 14 TAX L. REV. 85 (1958); Tomlinson, *Tax Carryovers on Termination of Trusts and Estates,* N.Y.U. 20TH ANN. INST. ON FED. TAX. 267 (1962).

out some of the more important reasons for being concerned with the termination date of a trust.

The first reason is that the trust instrument itself does not necessarily control the exact termination date for tax purposes. Assume, for instance, a trust with income to the grantor's wife for her life, and upon her death the corpus to go to the grantor's children. As will be explained, such a trust will not necessarily terminate for tax purposes exactly on the date of the life income beneficiary's death. Thus, the question of the termination date is neither simple nor clear cut.

Secondly, since it is a taxable entity, a trust can be an income splitting device resulting in tax savings. This could be true of a trust which is accumulating income, for under the proper circumstances, the trust, and not the ultimate beneficiary would be taxed on the income accumulated by the trust.[7] This income splitting benefit will come to an end when the trust terminates as a taxable entity. It is also possible for a "simple" trust,[8] which has been distributing all its current income and has been paying little or no taxes,[9] to become a "complex" trust[10] and therefore an income splitting device during the termination process. Assume again a trust with all income to be currently distributed to the grantor's wife for her life, and upon her death the corpus to go to the grantor's children. Such a trust would operate as a pure conduit in regard to ordinary income during the life of the income beneficiary who would be taxed on the income of the trust.[11] Upon her death, however, there might be a change in the nature of the trust. If state law or the trust instrument required the trustee to accumulate the income accruing after the death of the life income beneficiary, and to pay this income out in one sum together with the principal, there would be created a complex income accumulating trust and income splitting device. It would come into being upon the happening of the trust duration measuring event, the death of the life income beneficiary, and would continue to exist until the trust terminated for income tax purposes,[12] which might not happen for some time. Thus, the question of when the income splitting benefit terminates is not only important for complex trusts; it may also be important in cases of simple trusts which turn into complex income accumulating trusts during the termination process.

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[7] INT. REV. CODE of 1954, §§ 641-43, 661-63.

[8] *See* INT. REV. CODE of 1954, § 651(a) and Treas. Reg. § 1.651(a)-1 (1956) for a definition of a "simple" trust.

[9] Because of the deduction allowed by INT. REV. CODE of 1954, § 651.

[10] Trusts which accumulate income or distribute corpus are called "complex." Treas. Reg. § 1.661(a)-1 (1956).

[11] INT. REV. CODE of 1954, § 652.

[12] Treas. Reg. §§ 1.641(b)-3(c), 1.651(a)-2 (1956).

The allocation of deductions is a major reason for concern over an accurate determination of how long the trust continues to exist for tax purposes. If, *upon termination,* a trust has an unused net operating loss carryover or excess deductions for its last taxable year, such carryovers or excess deductions are allowed as deductions to the beneficiaries who succeed to the property of the trust.[13] Since the excess deductions are only allowable to the beneficiaries in the year of termination,[14] it is vital that the trustee be certain of the exact time of termination for tax purposes, so that the winding up of the trust can be planned and accomplished with maximum benefit from deductions. Thus, the question of when a trust terminates can substantially affect the tax liabilities of the various beneficiaries. For this reason, it is understandable that the question has been repeatedly treated in periodical legal literature.[15]

I. LEGISLATIVE, STATUTORY, AND QUASI-STATUTORY PRONOUNCEMENTS

Trusts were taxable well before 1954.[16] However, the question of when a trust terminates for tax purposes was not addressed in the *Internal Revenue Code of* 1939, not even in section 161, the predecessor of the present section 641 which imposes the tax on trusts under the 1954 *Code.* Although the regulations under the 1939 *Code* addressed the duration of estates for tax purposes,[17] they did not define the termination of trusts.[18]

Congress gave the question of trust termination some thought before enacting the 1954 *Code.* The reports of the House Ways and Means Committee and the Senate Finance Committee of H.R. 8300, which became the 1954 *Code,* contain the following statement:

> The determination of whether a trust has terminated so that the provisions of this subchapter no longer apply depends on whether the property held in trust has been distributed to the persons entitled to succeed to the property upon termination of the trust rather than upon the technicality of whether or not the trustee has rendered his final accounting.[19]

The 1954 *Code* itself, however, does not expressly address the question of when trusts terminate for tax purposes. The question is

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[13] INT. REV. CODE of 1954, § 642(h).

[14] Treas. Reg. 1.642(h)-2(a) (1956).

[15] Camilli, *When Estates and Trusts Terminate,* 99 TRUSTS & ESTATES 370 (1960); Glassmoyer, *supra* note 6; Lowell, *supra* note 6; Somers, *supra* note 6.

[16] INT. REV. CODE of 1939, § 161.

[17] Treas. Reg. 118, § 39.162-1(g) (1956).

[18] *Id.* §§ 39.161-1 — 39.163-1 (1956).

[19] H.R. REP. No. 1337, 83d Cong., 2d Sess. A191-92 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 340 (1954).

not answered in section 641 which imposes the tax on trusts, nor is trust termination among the definitions of section 643. No enlightening reference to trust termination is to be found in all of subchapter J.[20] However, the regulations under the 1954 *Code,* unlike those under the *Code* of 1939, address the question of trust termination in some detail.[21]

According to the regulation, "reasonable" time is permitted for administration,[22] and winding up cannot be "unduly postponed,"[23] nor can distribution of corpus be "unreasonably delayed."[24] This all amounts to one general qualification exempting cases of unreasonable delay *in distribution* from the general rule that a trust terminates when the property has been distributed. While the regulation also mentions administration and winding up in these qualifying sentences, it can be shown that it is really only the delay in distribution which counts.

The winding up of a trust has two aspects. The trustee takes some steps to assure his discharge from further liability. This is the aspect of accounting which, *by itself,* does not control termination for tax purposes. All the other steps of winding up are somehow related to the second aspect — distribution of the corpus — and affect the time at which distribution is accomplished. This aspect may include management tasks and tax or other litigation to preserve

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[20] INT. REV. CODE of 1954, §§ 641-692.

[21] Treas. Reg. § 1.641(b)-3(b) (1956) provides:

> Generally, the determination of whether a trust has terminated depends upon whether the property held in trust has been distributed to the persons entitled to succeed to the property upon termination of the trust rather than upon the technicality of whether or not the trustee has rendered his final accounting. A trust does not automatically terminate upon the happening of the event by which the duration of the trust is measured. A reasonable time is permitted after such event for the trustee to perform the duties necessary to complete the administration of the trust. Thus, if under the terms of the governing instrument, the trust is to terminate upon the death of the life beneficiary and the corpus is to be distributed to the remainderman, the trust continues after the death of the life beneficiary for a period reasonably necessary to a proper winding up of the affairs of the trust. However, the winding up of a trust cannot be unduly postponed and if the distribution of the trust corpus is unreasonably delayed, the trust is considered terminated for Federal income tax purposes after the expiration of a reasonable period for the trustee to complete the administration of the trust. Further, a trust will be considered as terminated when all the assets have been distributed except for a reasonable amount which is set aside in good faith for the payment of unascertained or contingent liabilities and expenses (not including a claim by a beneficiary in the capacity of beneficiary).

The above provision was promulgated by the Treasury in 1956 together with some rules concerning the duration of estates under the heading "§ 1.641(b)-3 Termination of estates and trusts." The provision quoted above concerning the time that a trust terminates has remained unchanged since its promulgation in 1956.

[22] Treas. Reg. § 1.641(b)-3(a) (1956).

[23] *Id.*

[24] *Id.* § 1.641(b)-3(b) (1956).

the property so that it can later be distributed. It may entail sales or other transactions to make the corpus suitable for dividing among the various remaindermen. A trustee may have to perform certain tasks in preparation for distribution, and all fall within the headings of winding up and administration. But if there are any problems in this second aspect, they all manifest themselves eventually by a delay in distribution of the corpus to the remainderman. The various administrative actions and omissions of the trustee constitute the causes for the manifestation — delay in distribution. From a pragmatic viewpoint, it is also apparent that it must be a delay in distribution which takes a case out of the general rule, not a delay in "administration" or "winding up." Once the property has been distributed to the remaindermen, they are taxable on the income from the property which they now own. This is really all the Treasury is concerned about.

Another way to arrive at the exact meaning of the first qualification to the general rule is to examine the regulation text by itself. The first sentence of section 1.641(b)-3(b) states the general rule that a trust terminates for tax purposes when the corpus has been distributed. The second sentence merely states what is obvious from the general rule — that a trust does not automatically terminate for tax purposes upon the happening of the measuring event, such as the death of the life beneficiary. The trust cannot automatically terminate at that time, since the general rule provides that the trust does not terminate until the property has been distributed. The third and fourth sentences grant a reasonable time for administration and winding up. Not until the fifth sentence is there any qualifying language which indicates when a case is to be exempted from the general rule. The qualifying statement is: "if the *distribution* of the trust corpus is unreasonably delayed, the trust is considered terminated for Federal income tax purposes . . . ."[25] Thus, the first qualification to the general rule, that a trust terminates when the corpus has been distributed, is that an unreasonable delay *in distribution* will take the case out of the general rule. This qualification does not appear in the committee reports. However, a subsequent analysis of case law will show that the Treasury was justified in making this qualification, which is merely a restatement of a qualification adopted by the courts when they interpreted the basic rule.

The second qualification adopted by the Treasury is found in the last sentence of the regulation paragraph on trust termination. It provides that a trust will be considered terminated for tax purposes

[25] *Id.* (emphasis added).

even though some assets have not been distributed, provided the assets retained by the trustee are only a reasonable amount set aside in good faith for payment of unascertained or contingent liabilities and expenses, not counting claims by beneficiaries.[26] This can be explained as a clarification of what constitutes trust property or corpus for purposes of trust termination — in other words, it is a clarification of the basic rule. If so viewed, this qualification simply takes amounts equalling unascertained liabilities and expenses out of the category of corpus or trust property as used in the basic rule. Another explanation of this qualification is that it is a definition of substantially complete distribution, under the theory that substance rather than form controls tax consequences. Regardless of which view is preferred, the Treasury would be justified in adding such a clarification or definition without departing from the confines of legislative intent.

Summary of Statutory Law

The sum total of legislative, statutory, and quasi-statutory pronouncements on the question of trust termination consists of the committee reports and one Treasury Regulation paragraph. The committee reports state the basic rule that a trust terminates for tax purposes when its property has been distributed. The regulation repeats the basic rule and makes two exceptions:

(1) Unreasonable delay in distributing the trust property will cause the trust to be treated as terminated after expiration of a reasonable period for distribution.

(2) Distribution is considered completed for trust termination purposes even though the trust still retains a reasonable amount of assets set aside in good faith to meet unascertained or contingent claims and expenses, not counting claims by beneficiaries as such.

II. Case Law

Eighteen cases were found directly in point on the question of when a trust terminates for tax purposes, excluding appeals and two cases in point but representing a theory later universally rejected. Since the periodical legal literature does not anywhere provide a comprehensive listing of all trust termination decisions, and the major reference works cite only selected cases,[27] it seems appropriate to provide a chronological listing of all decisions which were based

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[26] *Id.*

[27] *See* 3 P-H 1969 Fed. Taxes § 28,025; 3 CCH 1969 Stand. Fed. Tax Rep. § 3605.71; 6 J. Mertens, Jr., Law of Federal Income Taxation § 36.22 (1968).

on the precise question of when a trust terminates for tax purposes.[28]

In the following discussion, the term "measuring event" will be used repeatedly. It means the "event" in the second sentence of the regulation paragraph on trust termination: "A trust does not automatically terminate upon the happening of the *event* by which the duration of the trust is measured."[29] The measuring event is the time at which the trust instrument calls for the trust to terminate. For example, if a trust is for 10 years, the measuring event is the expiration date of the 10 year period. If the trust is for the life of an income beneficiary, the measuring event is his death. If the trust is to endure until the remainderman attains a certain age, the measuring event is the appropriate birthday. There are trusts with indefinite measuring events, such as a trust until the surviving spouse dies or remarries. Some trusts have provisions for flexibility in the measuring event. An example would be a trust for 10 years and for so long thereafter as the trustees agree, but no longer than the life of X. In terms of tax impact, the measuring event triggers the termination process, but does not actually terminate the trust for tax purposes. The reasonable time allowed for distribution is measured from the happening of the measuring event.

Before proceeding with the analysis of case law, it is necessary to explain what is meant here by a "decision in point" on the question of termination of trusts. There must have been, first, a valid trust for tax purposes.[30] Secondly, the decision must have hinged on the question of when or whether the trust terminated for tax purposes. It is not necessary that the court actually stated the termination question, as long as it was necessary for the court to consider the

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[28] O.D. 806, 4 CUM. BULL. 223 (1921); George M. Studebaker, 2 B.T.A. 1020 (1925); Minneapolis Trust Co., 13 B.T.A. 1069 (1928); Francis Francis, 15 B.T.A. 1332 (1929) (the ruling of this case was expressly rejected in *Della M. Coachman*, 16 T.C. 1432 (1951), after having been universally disregarded since 1939); Florence H. Fitch, 29 B.T.A. 1299 (1934) (since this decision relied upon *Francis*, it should be considered rejected along with *Francis* insofar as it pertains to termination of trusts); Russel v. Bowers, 27 F. Supp. 13 (S.D.N.Y. 1939); Willard C. Lipe, 41 B.T.A. 107 (1940), *aff'd* Commissioner v. First Trust & Deposit Co., 118 F.2d 449 (2d Cir. 1941); George S. Fiske, 45 B.T.A. 135 (1941), *aff'd* Commissioner v. Davis, 132 F.2d 644 (1st Cir. 1943); Leonard Marx, 47 B.T.A. 204 (1942); Trust of Bingham, 2 T.C. 853 (1943), *rev'd* Commissioner v. Kenan, 145 F.2d 568 (2d Cir. 1944), *rev'd* Trust of Bingham v. Commissioner, 325 U.S. 305 (1945); Edith M. Bryant, 14 T.C. 127 (1950), *aff'd* Bryant v. Commissioner, 185 F.2d 517 (4th Cir. 1950); Della M. Coachman, 16 T.C. 1432 (1951); Anstes Agnew, 16 T.C. 1466 (1951); Charles F. Neave, 17 T.C. 1237 (1952); Gamble v. United States, 116 F. Supp. 694 (E.D. Mo. 1953); Rev. Rul. 55-287, 1955-1 CUM. BULL. 130; Rev. Rul. 55-159, 1955-1 CUM. BULL. 391; Swoboda v. United States, 156 F. Supp. 17 (E.D. Pa. 1957), *aff'd* 258 F.2d 848 (3d Cir. 1958); Green v. United States, 6 Am. Fed. Tax R.2d 5647 (N.D. Tex. 1960); Lawrence O. Weston, 24 P-H TAX CT. REP. & MEM. DEC. 1439 (1965).

[29] Treas. Reg. § 1.641(b)-3(b) (1956) (emphasis added).

[30] 6 J. MERTENS, JR., LAW OF FEDERAL INCOME TAXATION §§ 35.21 — .27 (1968) contains a detailed discussion of what constitutes a valid trust for tax purposes.

question of whether or not the trust terminated for tax purposes to arrive at its decision.

A. *Cases Not in Point*

There are three cases which tend to confuse the issue because they have been cited or discussed in the context of trust termination, but are really not in point. In *Norton v. United States*[31] the remainderman took the corpus subject to a tax liability, and wanted to deduct interest accrued *prior* to the measuring event and termination. The argument concerned his right to the deduction. The time of termination was not an issue. The case of *J. B. Drew*[32] involved a question of the right to deduct trust expenses. The trustee agreed with the remainderman not to collect the corpus commission upon termination if the remainderman would pay the commission later. The remainderman unsuccessfully tried to deduct the commission on her personal tax return when she paid it in a later year. There was never any question of when the trust terminated for tax purposes. *Samuel v. Commissioner*[33] involved a grantor trust where the grantor-cotrustee-beneficiary attempted to amend the trust to make his interest in the income resemble an annuity. The grantor had to pay tax on the trust income, and there was no question of termination of a trust for tax purposes.

B. *Cases No Longer Followed*

There is one 1929 Board of Tax Appeals (B.T.A.) case, later rejected, which squarely treated a trust terminated as a tax entity upon the happening of the measuring event. In *Francis Francis*[34] the measuring event was the death of the life tenant. During the winding up process, the trustee sold some corpus stock at a capital loss. The remainderman claimed this loss as a deduction. The B.T.A. allowed the deduction to the remainderman, thus effectively treating the trust as terminated for tax purposes upon the happening of the measuring event. The rationale was that under local law the remainderman became at once entitled to the assets of the trust upon the happening of the measuring event, despite the trustee's nominal power to sell the corpus and distribute the proceeds. In 1951, the *Francis* decision was expressly rejected by the Tax Court, the successor to the B.T.A., in *Della M. Coachman.*[35] By that time, the

[31] 144 F. Supp. 425 (W.D. La. 1956), *aff'd* 250 F.2d 902 (5th Cir. 1958).
[32] 30 T.C. 335 (1958).
[33] 306 F.2d 682 (1st Cir. 1962), *aff'd* Archbishop Samuel Trust, 36 T.C. 641 (1961).
[34] 15 B.T.A. 1332 (1929).
[35] 16 T.C. 1432 (1951).

Francis theory had already been ignored in six cases decided between 1939 and 1950.[36]

In 1934, however, the B.T.A. still considered the *Francis* theory valid. In *Florence H. Fitch*,[37] the B.T.A. relied upon *Francis* as an alternate ground for its decision. Therefore, so much of *Fitch* as pertains to termination of trusts can be considered rejected along with *Francis*.

C. *The Measuring Event as a Control for Tax Purposes*

The fact that the trust does not automatically terminate for tax purposes upon the happening of the event by which the duration of the trust is measured does not mean that the measuring event can be totally disregarded for tax purposes. Taxpayers cannot simply treat the trust as terminated for tax purposes before the measuring event. Nor can the trust continue indefinitely once the measuring event occurs.

In *Minneapolis Trust Co. v. Commissioner*[38] the grantor created an irrevocable trust in 1911. In 1919, and before the measuring event, the grantor, trustees, and beneficiaries agreed to revoke the old trust, and to create a new one instead. The old trust was held to have continued for tax purposes. In *George M. Studebaker*[39] and *Weston v. Commissioner*,[40] the trusts were to continue as long as the trustees — who were also beneficiaries — agreed. In both cases the trusts owned businesses which sustained losses while being operated by the trusts. The trustees-beneficiaries tried, after the fact, to treat the trusts as terminated and to claim the losses as their own deductions. In the absence of any disagreement about continuing, both trusts were held to have continued as taxable entities.

The other side of the coin is illustrated by *Green v. United States*.[41] In addition to major provisions for the settlor's son, the trust instrument called for small periodic payments to certain servants. After the measuring event, and after distribution of the corpus, the remainderman attempted to treat the trust as continuing with respect to the servants. This was not allowed, and it was held that the trust did not continue for tax purposes after such distribution of the corpus.

In summary, the measuring event is a condition precedent — a necessity — to termination of an existing trust for tax purposes; and

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[36] *See* Edith M. Bryant, 14 T.C. 127 (1950); Trust of Bingham, 2 T.C. 853 (1943); Leonard Marx, 47 B.T.A. 204 (1942); George S. Fiske, 45 B.T.A. 135 (1941); Willard C. Lipe, 41 B.T.A. 107 (1940); Russel v. Bowers, 27 F. Supp. 13 (S.D.N.Y. 1939).

[37] 29 B.T.A. 1299 (1934).

[38] 13 B.T.A. 1069 (1928).

[39] 2 B.T.A. 1020 (1925).

[40] 24 T.C.M. 1439 (1965).

[41] 6 Am. Fed. Tax R.2d 5647 (N.D. Tex. 1960).

ultimate termination for tax purposes is an automatic, if only eventual consequence of the happening of the measuring event.

D. *Distribution as a Control for Tax Purposes*

While the measuring event controls whether or not there can be a termination, or must be a termination, it does not control the precise time of termination. This time is controlled by the distribution of trust corpus.

In *Anstes v. Agnew,*[42] the Tax Court denied the remainderman a deduction on her income tax return for a commission paid to the trustee out of the trust at the time of distribution, thus treating the trust as the proper taxpayer for deducting a commission paid during distribution. This means that a trust does not terminate for tax purposes until the assets have been distributed. One of the reasons for holding that the trust in *George M. Studebaker*[43] was still a taxable entity was that two $10,000 legacies had not been distributed by the trust. The fact that no assets had ever been distributed and that the title to trust property was still in the trustee was relied upon in *Weston v. Commissioner*[44] for finding that the trust had not terminated. The holdings in *Della M. Coachman*[45] and *Charles F. Neave*[46] were that trusts continue for tax purposes while the trustee still has duties to perform. In both cases, the only remaining substantive duty was distribution of corpus at a time when the trusts were held to be taxable entities.

An applicable Revenue ruling simply states that a trust continues for tax purposes during the period allowed the trustee under state law to distribute the assets.[47] The reference to local law is probably attributable to *Coachman* which relied in part on New York law to the effect that where a trustee is required to distribute the corpus, he is allowed a reasonable period to do so, and the corpus remains trust property during that period.[48] *Coachman* was then cited with approval in *Agnew* and *Neave* both of which preceeded the Revenue statement concerning local law. The impact of state trust law will be discussed further under "Reasonable Period for Distribution."

A further Revenue ruling concerns a trust which distributed installment obligations upon termination.[49] If the trust has been reporting its capital gain on the installment basis, the distribution can

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[42] 16 T.C. 1466 (1951).
[43] 2 B.T.A. 1020 (1925).
[44] 24 T.C.M. 1439 (1965).
[45] 16 T.C. 1432 (1951).
[46] 17 T.C. 1237 (1952).
[47] Rev. Rul. 55-287, 1955-1 CUM. BULL. 130.
[48] 16 T.C. 1432, 1434-35 (1951).
[49] Rev. Rul. 55-159, 1955-1 CUM. BULL. 391.

be held to have been a disposition which accelerated capital gains to the trust. This theory is only possible if the trust is a taxable entity *during* distribution, and not only until distribution begins.

If distribution of trust property is to be the yardstick for determining when a trust terminates for tax purposes, it is not only necessary that trusts be held to endure at least until the assets have been distributed, it is also necessary that trusts be considered terminated as soon as distribution is or should have been completed. The necessary decision for this second element was provided in *Leonard Marx*.[50] There, a trust was held terminated for tax purposes when a reasonable time for distribution had elapsed, even though distribution had not been made. This would seem to imply that trusts are considered terminated at the time actual distribution is completed, if done within a reasonable time. This case also helps establish the point that trusts may terminate for tax purposes as to only part of their corpus under the same rules applicable to the termination of the entire trust.

There are, then, two types of decisions. One holds that a trust continues until assets have been distributed. The other provides that trusts will not continue beyond the date when distribution should have been accomplished. Between the two, they limit the possibilities of the termination time for tax purposes. In precise terms, the cases hold that a trust terminates at the earlier of the following two events:

(1) The time when the trust assets have actually been distributed.

(2) The expiration of a reasonable period for distribution.

If the possibility of unreasonable delay is ignored for the moment, a general rule can be stated: The determination of whether a trust has terminated depends upon whether the property held in trust has been distributed to the persons entitled to succeed to the property upon termination of the trust.[51]

Under the discussion of statutory and quasi-statutory law, it was asserted that distribution of corpus is the only true yardstick as to termination of trusts for tax purposes, and that all other aspects of winding up or administration are only relevant to the question of whether a delay in distribution is reasonable — but these aspects do not determine the time of termination by themselves. So far, the analysis of case law has only considered decisions which support this

[50] 47 B.T.A. 204 (1942).

[51] This rule was developed by the courts between 1925 and 1952, as can be seen from the dates in notes 38 through 48. The rule was then enunciated in the Committee Reports in 1954, followed in two revenue rulings in 1955, and incorporated in the Treasury Regulation in 1956. *See* H.R. REP. No. 1337, 83d Cong., 2d Sess. A-191-92 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 340 (1954); Treas. Reg. § 1.641(b)-3(b) (1956).

proposition.[52] It is now necessary to reconcile with these distribution cases all other decisions in point.

E. *The Sales Aspect*

There are three cases[53] in which the trustees sold the trust property at a loss during the winding up process, but prior to distribution of assets to the remaindermen. In each case, the remaindermen tried to deduct the capital losses incurred by the trust on their personal income tax returns. In each case the remaindermen were denied this deduction, and the trusts were held to be the tax entities to the deduction. These decisions stand for the proposition that a trust endures for tax purposes *at least* until the sale of the trust property. They do not hold that trusts terminate after the trust property has been sold. Because of the precise tax question involved, it was not necessary to decide whether the trusts continued for tax purposes beyond the date of sale. In one of the three cases, *Swoboda v. United States,*[54] the district court expressly limited its holding by stating that the trust did not terminate until *at least* the day of sale. Since in all three cases the sale occurred before distribution, and since in all three cases the court held that the trust was in existence at the time of the sale but did not decide how long after the sale the trust would continue, these sales cases are not in conflict with the proposition that trusts terminate after the trust property has been distributed. The district court in *Russell v. Bowers,*[55] and both the district court and the Third Circuit in *Swoboda,* also relied upon applicable state trust law in reaching their decisions.

F. *The Accounting Aspect*

In *Edith M. Bryant,*[56] the Tax Court held that a final accounting rendered while the trust still holds property does not terminate the trust for tax purposes. This 1950 holding decisively eliminated accounting as the ultimate yardstick for defining the tax termination date of a trust, and is reflected in both the 1954 Committee Reports[57] and the 1956 Treasury Regulation.[58] The rule in no way conflicts with the proposition that distribution controls the termination time.

While it does not, by itself, control the time of termination, the aspect of accounting can have a profound effect upon distribution

[52] Florence H. Fitch, 29 B.T.A. 1299 (1934); Francis Francis, 15 B.T.A. 1332 (1929).

[53] Swoboda v. United States, 156 F. Supp. 17 (E.D. Pa. 1957), *aff'd* 258 F.2d 848 (3rd Cir. 1958); Gamble v. United States, 116 F. Supp. 694 (E.D. Mo. 1953); Russel v. Bowers, 27 F. Supp. 13 (S.D.N.Y. 1939).

[54] 156 F. Supp. 17 (E.D. Pa. 1957), *aff'd* 258 F.2d 848 (3d Cir. 1958).

[55] 27 F. Supp. 13 (S.D.N.Y. 1939).

[56] 14 T.C. 127 (1950), *aff'd* 185 F.2d 517 (4th Cir. 1950).

[57] H.R. REP. and S. REP., *supra* note 18.

[58] Treas. Reg. § 1.641(b)-3(b) (1956).

which, in turn, controls the time of termination. The Second Circuit recognized this in *Commissioner v. First Trust & Deposit Co.*[59] where it was held that it may not be unreasonable for a trustee to await the protection of a decree upon his accounting before making distribution, and that the trust continues for tax purposes during this wait. Thus, the aspect of accounting has a definite function in the law of termination of trusts for tax purposes: The need for an accounting may be relevant to the question of whether a delay in distribution was reasonable.

G. *The Duty or Purpose Aspect*

The courts have made statements to the effect that a trust continues for tax purposes while the trustee still has duties to perform, and in three of the "duty" cases the duty involved was the distribution of trust property. These three cases, *Coachman, Studebaker,* and *Neave* can, therefore, be classified as holding that a trust continues for tax purposes until distribution has been made.

In *Willard C. Lipe,*[60] the B.T.A. was confronted with an inter vivos trust which was to last until the death of both the grantor and his spouse. The trust instrument, however, placed a duty upon the trustee to pay the state and federal death taxes of the grantor. It took several years after the measuring event, and before distribution was effected, to finally determine and pay the grantor's federal and state death taxes. The B.T.A. treated the trust as continuing for tax purposes during this long period, and the Second Circuit affirmed, accepting the proposition that since one of the purposes of the trust was to pay the death taxes, the duration of the trust as a tax entity could properly be extended. The courts did not hold the trust to continue beyond the distribution date. The decisions, therefore, are not in conflict with the proposition that termination for tax purposes is controlled by distribution.

There are no cases which hold that a trust continues while the trustee still has *any* duty to perform — at least not as a broad proposition. The cases discussed above concern *major* duties of trustees in administration of a trust. In *Lipe,* the duty was to pay taxes for which the trustees would have been liable in part as the recipient of life insurance proceeds. Thus, *Lipe* can be explained as a case where tax problems delayed distribution and the delay was found to be reasonable.

H. *General Winding Up Aspect*

The discussion of case law has covered all but three of the pertinent decisions on the question of trust termination for tax pur-

[59] 118 F.2d 449 (2d Cir. 1941), *aff'g* Willard C. Lipe, 41 B.T.A. 107 (1940).
[60] 41 B.T.A. 107 (1940), *aff'd* 118 F.2d 449 (2d Cir. 1941).

poses. The first of the remaining three cases is a 1921 Treasury Office decision.[61] The trust provided for distribution of trust property one year after the life beneficiary's death. The decision treated the trust as a taxable entity for a period following the anniversary of the death.

In *George S. Fiske,*[62] it was held that the trust did not terminate for tax purposes the moment that the income beneficiary died, but that the trust was allowed a reasonable time to wind up.

The United States Supreme Court, in *Trust of Bingham v. Commissioner,*[63] held winding up expenses to be deductible by the trust. This theory necessarily requires the trust to endure as a taxable entity at least until the winding up expenses are incurred. It should be noted that the winding up, in this case as in most, consisted of distribution of corpus.

Thus, the winding up decisions hold that a trust does not automatically terminate upon the happening of the measuring event.

I. *Distribution of Trust Assets: The Determinant of Trust Termination Time*

In summary, the case law points to the conclusion that it is the time of distribution of the trust corpus which controls the exact time when a trust terminates for tax purposes. There are several cases which precisely so hold. None of the remaining cases in point, and not expressly rejected, conflict with the aforementioned rule: a trust terminates for tax purposes at the earlier of the following two events:

(1) The time when the trust assets have actually been distributed.

(2) The expiration of a reasonable period for distribution.

It now remains to be shown how administration and winding up aspects other than distribution affect, under the case law, the definition of a reasonable period for distribution.

J. *Reasonable Period for Distribution*

The case law on trust termination sheds very little light on what is a reasonable period for distribution. However, the qualifying rule that the actual distribution will not control the date of termination if there has been unreasonable delay in distribution was clearly stated as early as 1942 in *Leonard Marx.*[64] *Marx* also held that the reasonableness of the delay is a question of fact.[65] There are three other cases in which the courts expressly found no unreasonable delay;[66]

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[61] O.D. 806, 4 CUM. BULL. 223 (1921).

[62] 45 B.T.A. 135 (1941), *aff'd* 132 F.2d 644 (1st Cir. 1943).

[63] 325 U.S. 365 (1945), *rev'g* 145 F.2d 568 (2d Cir. 1944, *rev'g* 2 T.C. 853 (1943).

[64] 47 B.T.A. 204 (1942).

[65] *Id.* at 211.

[66] Charles F. Neave, 17 T.C. 1237 (1952); Della M. Coachman, 16 T.C. 1432 (1951); Edith M. Bryant, 14 T.C. 127 (1950), *aff'd* 185 F.2d 517 (4th Cir. 1950).

although this holding could be implied in any case which holds a trust not terminated. The cases with express reference to no unreasonable delay are of little help in establishing precisely what time is reasonable, because they were not close cases. The delays involved in the three cases were of only five (*Edith M. Bryant*),[67] six (*Charles F. Neave*),[68] and nine (*Della M. Coachman*)[69] months duration counting from the measuring event. All three involved an accounting, and in the case of the nine months delay, the trustee had to distribute to 50 remaindermen.

On the other hand, the delay in *Marx* was so obviously unreasonable as to be of little help in deciding other close cases. The trustee delayed for four years the distribution of part of the corpus to a beneficiary as to whom the measuring event — age 30 — had occurred.[70] The court found that the corpus could have easily been divided and distribution made. Thus, there is no express definition of a reasonable period for distribution in the case law on trusts. It is possible, however, to draw some conclusions concerning which factors are relevant to the question of reasonable delay.

1. Time

Time, by itself, does not appear to control the question of reasonableness of a delay in distribution. One trust was permitted to continue for tax purposes for at least six years after the measuring event.[71]

2. Accounting

It has been expressly held that a trustee may, under some circumstances, reasonably delay distribution until he is protected by a court decree upon his accounting.[72] The circumstances involved risky trust property in the form of mortgages and high tax liabilities. The delay was at least six years. There are three other cases involving an accounting and an express holding of no unreasonable delay; but the delays were comparatively short, all less than nine months from the measuring event.[73]

3. Taxes

It has also been held that trust termination may be delayed until

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[67] 14 T.C. 127 (1950), *aff'd* 185 F.2d 517 (4th Cir. 1950).

[68] 17 T.C. 1237 (1952).

[69] 16 T.C. 1432 (1951).

[70] Leonard Marx, 47 B.T.A. 204, 207 (1942).

[71] Willard C. Lipe, 41 B.T.A. 107 (1940), *aff'd* 118 F.2d 449 (2d Cir. 1941).

[72] Commissioner v. First Trust & Deposit Co., 118 F.2d 449, 452 (2d Cir. 1941).

[73] Charles F. Neave, 17 T.C. 1237 (1952); Della M. Coachman, 16 T.C. 1432 (1951); Edith M. Bryant, 14 T.C. 127 (1950), *aff'd* 185 F.2d 517 (4th Cir. 1950).

taxes are determined and paid, if the payment of taxes is one of the trust's purposes.[74]

4. Ascertaining Amount of Distribution

A trustee may have to wait until the end of a calendar or fiscal year before he can determine each beneficiary's ratable share of income. This was held to be a good reason for delaying distribution.[75] Under the same theory, a delay caused by any other bona fide problems in ascertaining distributive shares would seem to be sufficient excuse for delay.

5. Sales

The three decisions that trusts continue at least until the trust property has been sold[76] indicate that the need to make a sale of trust property, in order to be able to distribute the corpus in the manner prescribed, is sufficient to delay distribution. These cases, however, shed no light on how long the required sale may be postponed. In one case, the sale itself was the measuring event.[77] The other two decisions involved short periods of less than one year between the measuring event and the sale.

6. Dividing Corpus

The need to divide the corpus so that it could be distributed to some 50 remaindermen was a definite factor in holding a nine months delay in distribution to be reasonable;[78] but the fact that the corpus could have easily been divided was a definite factor in holding delay in another case unreasonable.[79] Since division of corpus is so directly related to the ultimate distribution, any bona fide problems in division should be sufficient excuse for a delay. However, one requirement would seem to be that a division was necessary.

7. Local Law

There are a few references in the trust termination decisions to the applicability of local law to the question of when a trust terminates for tax purposes.[80] None of these cases involved a determina-

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[74] Commissioner v. First Trust & Deposit Co., 118 F.2d 449, 452 (2d Cir. 1941).

[75] Edith M. Bryant, 14 T.C. 127 (1950).

[76] Swoboda v. United Sttaes, 156 F. Supp. 17 (E.D. Pa. 1957), *aff'd* 258 F.2d 848 (3rd Cir. 1958); Gamble v. United States, 116 F. Supp. 694 (E.D. Mo. 1953); Russel v. Bowers, 27 F. Supp. 13 (S.D.N.Y. 1939).

[77] Gamble v. United States, 116 F. Supp. 694 (E.D. Mo. 1953).

[78] Della M. Coachman, 16 T.C. 1432 (1951).

[79] Leonard Marx, 47 B.T.A. 204 (1942).

[80] Swoboda v. United States, 156 F. Supp. 17 (E.D. Pa. 1957), *aff'd* 258 F.2d 848 (3d Cir. 1958); Della M. Coachman, 16 T.C. 1432 (1951); George S. Fiske, 45 B.T.A. 135 (1941); Russel v. Bowers, 27 F. Supp. 13 (S.D.N.Y. 1939); Rev. Rul. 55-287, 1955-1 CUM. BULL. 130.

tion that there was an unreasonable delay for tax purposes when local law permitted the delay. Thus, state trust law and federal tax law have not yet come into direct conflict in the area of trust termination.

8. Individual Circumstances

The fact that there is no defined period after which a delay in distribution is presumed to be unreasonable, and the decision that reasonableness is a question of fact[81] result in each case being considered on its own merits, depending upon the particular circumstances surrounding the case. All the factors outlined above influence the decision as to reasonableness of delay, but none of the factors control absolutely by themselves. Furthermore, this list of factors is by no means complete. There simply have not been enough decisions to date. It is clear, however, that the question of reasonable delay is influenced by factors from both aspects of trust administration. Some pertinent factors stem from the aspects concerned with distributing the corpus to the remaindermen. Examples are sales, dividing corpus, and ascertaining the amount of distribution. Other factors stem from the aspect of administration concerned with obtaining a discharge for the trustee. Examples are accounting and taxes which may involve a personal liability on the part of the fiduciary.

9. Estate Termination Law

There is a certain temptation to apply estate termination law, across the board, to trust termination questions. Estates and trusts are treated together in the same subchapter of the *Code*.[82] They both involve the termination of a taxable entity whose affairs must be wound up. These similarities would tend to make estate termination law applicable to trusts. There are also, however, some very striking differences between estates and trusts which should result in some estate termination decisions not being applicable to trusts. One major difference is that all people die, but few do so voluntarily. While only very few people create trusts, those created are nearly all premeditated, intentional, and voluntary. Also, hardly anyone ever dies purely for tax reasons, while many trusts are motivated, at least in part, by tax considerations. Too, the task of administering an estate is frequently imposed upon the fiduciary with little or no prior warning. The trustee, on the other hand, usually has much more opportunity for preplanning the winding up. These differences should be kept in mind when drawing parallels between estate and trust termination.

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[81] Leonard Marx, 47 B.T.A. 204 (1942).

[82] INT. REV. CODE of 1954, Subchapter J, § 641.

It is not intended here to analyze estate termination case law in detail. The subject has been quite adequately treated by various authors.[83]

CONCLUSION

The *Internal Revenue Code* of 1954 does not define the time at which a trust terminates for tax purposes.

The Committee Reports on H.R. 8300, the Treasury Regulations, and the case law lead to the conclusion that a trust terminates at the earlier of the following two events:

(1) The time when the trust assets have actually been distributed.

(2) The expiration of a reasonable period for distribution.

Whether a delay in distribution is reasonable is a question of fact, and depends upon the circumstances of each individual case. No single factor controls the question of reasonableness and all aspects of trust administration are relevant — aspects related to distributing corpus, as well as aspects related to protecting the trustee from further liability.

The Treasury Regulations further provide that a trust will be considered terminated for tax purposes even though some assets have not been distributed, provided that the assets retained by the trustee are only a reasonable amount set aside in good faith for payment of unascertained or contingent liabilities and expenses, not counting claims by beneficiaries in the capacity of beneficiary.

[83] *Supra* notes 6 and 15. *See also* Bailey, *To Continue or Not to Continue as an Estate,* N.Y.U. 23d ANN. INST. ON FED TAX. 1143 (1965) for a categorization of the factors which influence the question of whether a delay in estate termination is reasonable.