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Under what circumstances may the United States tax the income of a trust as though, in fact, the trust were actually a corporation? For an answer one must go to the books and attempt to reconcile not only literally dozens of conflicting decisions; but, also, to try to "square" them with the law itself. Because of the anomalous views in the several lesser Federal jurisdictions, the Supreme Court of the United States took up for review four cases[1] involving the above question and tried, in deciding them in 1935, to lay the attendant errors and misconceptions. Since then chaos in the lower courts has been complete.

Not overlooking the unflattering classification to which tradition and the ancient experience of mankind assigns one who rushes in where angels dare not tread, the writer, never-the-less, meekly ventures the suggestion that, perhaps, the situation above outlined results from failure to give effect to the applicable revenue statutes, (the expressed will of Congress in this behalf) and to a rule of law from which the Supreme Court has never departed.

In order to get perspective we must examine the first two Supreme Court decisions ever handed down on the right of the United States to tax trusts as corporations. We start, then, with the Supreme Court's opinion in a case decided in 1919[2] where a trust had been formed in connection with the dissolution of a corporation, so that the proceeds of the sale of certain properties might be distributed to beneficiaries within a period left to the discretion of the trustees. The Court noted that the beneficiaries had "no control over the fund,"[3] and from that the Bureau of Internal Revenue jumped to the conclusion that if the cestuis que trust *did* "have a voice in the conduct of the business of the trust, whether through a right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute."[4]

Thus was born the illegitimate[5] so called "control" test for determining the status of a trust for Federal tax purposes. That the test was based upon an invalid assumption, drawn from dictum and not upon the principle intended, is clear from the following excerpt from the decision:

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*Of the Denver Bar.

[1]Morrissey et al. v. Com. (1935) 296 US 344.
Swanson v. Com. (1935) 296 US 362.
Helvering v. Coleman-Gilbert Associates (1935) 296 US 369.
Helvering v. Coombs (1935) 296 US 365.

[2]Crocker v. Malley (1919) 249 US 223.

[3]Ibid 234.

[4]Treasury Regulations 45 and 62, Article 1504.

[5]Morrissey v. Com., supra, 350.

> "The function of the trustee is *not to manage the mills* but simply to collect the rents and income of such *property* as may be in their hands, with large discretion in the application of it, but with a recognition that the receipt holders are entitled to it. subject to the exercise of powers confided to the trustees. . . . The trust that has been described would not fall under any familiar conception of a joint-stock association whether formed under a statute or not."[6] (Emphasis supplied)

Differently stated, the income of the trust was *not* from carrying on of a going, day to day business. It was not from *operations* ("the trustees do not manage the mills"). The income was simply the fruits of property held in trust. Consequently, the trust under examination was held not to be taxable as an association or corporation.

Thus it seems plain that, in the very first case calling for determination of the taxable status of a trust in the Federal scheme, the "doing business test" was made controlling. This fact should be kept constantly in mind as we progress, because its significance has, apparently, been overlooked in many later decisions.

This question next came before the Supreme Court in four cases which were consolidated and decided in 1924.[7] One of these cases was a second *Crocker v. Malley* controversy, involving the same trust as in the first *Crocker* matter, but the trust was functioning differently than at first, the trust instrument having been appropriately modified to permit the trustees to exercise their new powers. Said the Court, in part:

> "Since the modification *the trustees have carried on the manufacturing business* in substantially the same manner as it was formerly conducted by the corporation. . . . We conclude, therefore, that . . . as petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors of a corporation *for the purpose of carrying on business enterprises*. the trusts are to be deemed associations . . ."[8] (Emphasis supplied)

Here again the test was "doing business." The trust was taxable as a corporation because it was carrying on "business enterprises." It was an *operating* economic entity. If it had merely held property and received and distributed income, as was its situation in the first case, the trust in the second Crocker case would not have been so taxed. Clearly the test is found in the answer to the question: What does the trust *do?* Does it *operate* a business? If it does, then, being an association of persons, closely akin to that contemplated by the word corporation, it may be taxed as a corporation.

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[6]Crocker v. Malley (1919) 249 US 223, 232, 233.
[7]Hecht v. Malley (1924) 265 US 144.
[8]Ibid, 149, 161.

Following the *Hecht* decision, the Bureau of Internal Revenue abandoned the socalled "control" test, and the lesser Federal courts, in attempting to interpret the new decision, got into such conflict that the Supreme Court felt compelled to cover the whole field in the *Morrissey* and companion cases decided in 1935, as noted above. It will serve no useful purpose here to review that conflict. The *Morrissey* opinion furnishes a new starting point.[9]

In the *Morrissey* case the trustees were empowered to and did, inter alia, actually subdivide 42 out of 150 acres of land into lots and sold the lots, mostly on the installment plan; they sold 3,016 beneficial interests, both "preferred" with a par value of $100 and "common" without par value, to 920 different persons and paid salesmen commissions on such sales; they constructed and operated a golf course for profit, sold the course to a corporation, rented it back and continued *operations*. The Supreme Court, held the trust taxable as a corporation and in the opinion said in part:

> ". . . we are of the opinion that the trust constituted an association. The trust was created for the development of a tract of land through the construction and *operation* of golf courses, club houses, etc., and the *conduct of incidental business*, with broad powers for the purchase, operation and sale of properties."[10] (Emphasis supplied)

So far so good. The Supreme Court has been absolutely consistent. It decided the *Morrissey* case and companion cases in 1935 on the same principle that it applied to the first *Crocker* matter in 1919 and to the second *Crocker* matter (one of the cases in *Hecht v. Malley*) in 1924. But, in the fullness of its treatment of the question in the 1935 decisions, the Court entered upon a sort of general discussion of the "resemblance" of certain trusts to associations, which are taxed like corporations. It said[11] that the word association implied associates; that the entering into a joint enterprise, as the cestuis que trust had in the *Morrissey* case, made them associates and that that fact, combined with (a) continuity of the trust throughout the period limited in the indenture, (b) centralized management, (c) continuity of the trust despite the death or withdrawal of members, (d) means for the transfer of shares of beneficial interest; and, (e) limitation of liability of beneficiaries, made the *Morrissey* trust so much like a corporation that it could be taxed as one. Most of the lesser Federal courts seem to have immediately concluded that these mere attributes of a corporation were controlling, regardless of whether or not a trust *operated* a business, and to have overlooked the other equally significant fact that the *Morrissey* trust

[9]Morrissey v. Com., and related cases, supra, p. 1.
[10]Morrissey v. Com., supra, 361.
[11]Morrissey v. Com., supra.

actually made its taxed income by carrying on a day to day business. Thus it came about that almost every "voluntary" trust, as distinguished from (a) a testamentary trust, or, (b) a liquidating trust, is taxed as a corporation. Cases are legion to sustain this, but the necessity for brevity here precludes citations.

On the other hand, in a few jurisdictions, what appears to be the correct view has been maintained. In those jurisdictions it is recognize that a trust must derive its income from the operation of a business, as distinguished from income from property held in trust, before the United States may tax that income as though earned by a corporation. In one of the best of this line of decisions it was said in part:

> "The word 'business' in its present connection connotes a commercial or industrial establishment or enterprise. *The distinction between it and 'property' must be kept clearly in mind in applying the taxing statute here.* Business in the sense in which it is here used means . . . the doing of the varied *commercial* acts and taking the requisite steps from which result conclusions and conditions. The mere receipt of income from leased property and its distribution to cestuis que trustant amounts to no more than *receiving the ordinary fruits that arise from the ownership of property and does not constitute doing business.*"[12] (Emphasis supplied)

In view of the revenue law on this question it seems odd that the distinction pointed out above has been so much overlooked. The statutes first enacted by Congress in 1928 have continued without change for approximately seventeen years and are as follows:[13]

> "SEC. 161. IMPOSITION OF TAX. (a) Application of tax. The taxes imposed by this title upon *individuals* shall apply to the income of estates or of any kind of property held in trust. . . ."[14] (Emphasis supplied)
>
> "SEC. 162. NET INCOME. The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an *individual* . . ."[15] (Emphasis supplied)

It seems plain enough that the view of the Sixth Circuit noted above[16] squares with the statute and the Supreme Court's rule.[17] Not only so, but in 1941 the Supreme Court itself, in passing upon these very sections, indicated, at least, that they are controlling. In over-

[12]Cleveland Trust Co. v. Com. (CCA 6, 1940) 115 Fed. 2d 481, 483. Cert. den. (1941) 312 US 704.
[13]Secs. 161 (a) and 162, Revenue Act of 1928.
[14]Internal Revenue Code.
[15]Ibid.
[16]Cleveland Trust Co. v. Com., supra.
[17]Morrissey v. Com. and companion cases, supra.

ruling the contention of the trustee that the trust there involved was doing business and referring to and citing Sections 161 (a) and 162, the Court said in part:

> ". . . In view of the expressed Congressional command, that the same method and basis of computation must be applied to trust income as to individual income, it is doubtful whether any administrative practice, no matter how clear or long existent, would warrant us in applying one concept of carrying on business in the case of an individual and another concept in the case of a trust."[18]

Such was the decision despite the fact that the trust under examination had a corpus consisting of stocks and bonds which the trustee from time to time sold and reinvested the proceeds in other securities with so much success that, despite large distributions of income, the corpus increased from approximately $7,600,000 in 1923 to about $10,000,000 in 1931.

Under what circumstances may a trust be taxed as though it were in fact a corporation? The plain answer seems to be as follows:

(1) Where the income is from the operation of a business; and,

(2) The trust resembles a corporation in the mode and form of its organization and operation.

In the absence of these circumstances it does not appear that either the applicable revenue law[19] or the Supreme Court's rule[20] would permit imposition of any tax upon a trust except that imposed upon individuals.

Personals

Maj. John A. Carroll, former district attorney, has been released from active duty. While on active duty he was a member of the allied military government in Africa, Italy and France, and upon returning to the United States was associate professor of military government at Stanford University.

Maj. Ira Rothgerber, Jr., while in Denver recently, told of meeting other Denver men over thirty cases of Coors beer in front of the Manila Hotel, now destroyed. Lt. Ranger Rogers of the coast guard was skipper of the FS boat which transported the beer to the point from which it was taken ashore. Lt. Col. Charles Cooper Young, judge advocate of the First Cavalry Division in Manila, is one of the men whom Maj. Rothgerber has seen in recent months.

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[18]City Bank Farmers Trust Co. v. Helvering (1941) 313 US 121, 126.
[19]Sections 161 (a) and 162, Int. Rev. Code.
[20]Morrissey v. Com. and companion cases, supra.