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# THE NORTH CAROLINA GIFT OF SECURITIES TO MINORS LAW—ITS FEDERAL TAX IMPLICATIONS

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In 1955, North Carolina, along with seven other states, followed the suggestion of the New York Stock Exchange in adopting a statute simplifying the procedure for making gifts of securities to minors.<sup>1</sup> The North Carolina enactment, styled the "Gift of Securities to Minors Law"<sup>2</sup> unquestionably provides a useful vehicle for transferring certain types of securities. In addition, it presents interesting possibilities for the minimization of Federal taxes through shifting of income within a family group.

In general, the new law provides that a valid transfer of registered securities may be made to a minor simply by registering them in the name of any adult member of the minor's "family,"<sup>3</sup> or in the name of any guardian of the minor, followed by the words "as custodian, for \_\_\_\_\_ (name of minor)."<sup>4</sup> Securities in bearer form may be transferred by delivery to any adult member of the minor's family (other than the donor) to any guardian of the minor, accompanied by a deed of gift duly acknowledged, in substantially the form set forth in the statute.<sup>5</sup> A very liberal definition of the term "security" permits the application of the new provisions to most categories of intangible personal property.<sup>6</sup>

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<sup>1</sup> Almost identical statutes were adopted by Georgia, California, Colorado, North Carolina, New Jersey, Connecticut, Ohio and Wisconsin. P-H 1955 Fed. Tax Serv., ¶ 34,302, 34,360.

<sup>2</sup> N. C. GEN. STAT. § 33-68 to N. C. GEN. STAT. § 33-74 (Supp. 1955).

<sup>3</sup> The term "family" includes the minor's parents, grandparents, brothers, sisters, uncles and aunts, whether of the whole blood or the half blood, or by or through legal adoption. N. C. GEN. STAT. § 33-69 (d) (Supp. 1955).

<sup>4</sup> N. C. GEN. STAT. § 33-70 (1) (a) (Supp. 1955).

<sup>5</sup> N. C. GEN. STAT. § 33-70 (1) (b) (Supp. 1955).

<sup>6</sup> N. C. GEN. STAT. § 33-69 (a) (Supp. 1955): "The term 'securities' or 'security' shall include any note, stock certificate, stock, treasury stock, bond, debenture, whiskey warehouse receipt, evidence of indebtedness, transferable certificate of interest or participation, certificate of interest in a profit-sharing agreement, any instrument representing any interest or right in or under any oil, gas or mining lease, fee or title, or rights or interests in land from which petroleum or minerals are, or are intended to be produced, certificate of interest in an oil, gas or mining lease, collateral trust certificate, any transferable share, investment contract, or beneficial interest in or title to property or profits or any contract or agreement in the promotion of a plan or scheme whereby one party undertakes to purchase the increase or production of the other party from the article or thing sold under the plan or scheme, or whereby one party is to receive the profits arising

G. S. 33-70 (2) provides that a gift made in the prescribed manner shall be irrevocable and shall convey to the minor indefeasibly vested legal title to the securities, and that a guardian shall have no rights with respect to such securities unless the guardian is also the custodian.<sup>7</sup>

The custodian is required to collect the income from the securities held by him and to apply all or part of such income and all or part of the principal, as he deems advisable, for the support, maintenance, education and benefit of the minor.<sup>8</sup> "To the extent that property held by the custodian and the income thereof is not so expended, it shall be delivered or paid over to the minor upon the minor's attaining the age of twenty-one years, and in the event that the minor dies before attaining the age of twenty-one years it shall thereupon be delivered or paid over to the estate of the minor."<sup>9</sup>

By far the most important provisions of the new law appear in G. S. 33-71, relating to the rights, powers and duties of the custodian. The custodian has authority to sell, exchange, convert or otherwise dispose of any and all of the securities held by him in such manner and at such time or times, for such prices and upon such terms as he may deem advisable. He has the power "in his sole and absolute discretion to retain any and all securities delivered to him within the meaning and under the authority of this Section without reference to the Statutes relating to permissible investments by fiduciaries."<sup>10</sup> He is required to "invest the minor's property in such securities as would be acquired by prudent men of discretion and intelligence who are seeking a reasonable income and the preservation of their capital without reference to the Statutes relating to permissible investments by fiduciaries. . . ."<sup>11</sup>

from the increase or production of the article or thing sold under the plan or scheme, or any other instrument commonly known as security."

In application, however, the new law is not quite so comprehensive as the definition of a "security" would suggest. Mechanics are provided only for the transfer of securities in "registered form" or in "bearer form." The usual promissory note payable to a named promisee or his order is not in "bearer form" nor is it considered to be in "registered form" unless "its terms specify that its transfer may be registered upon books maintained for that purpose by or on behalf of an issuer." N. C. GEN. STAT. § 33-69 (b) (Supp. 1955). It is doubtful that a brokerage account containing, for example, corporate stocks would qualify as a "security." A conservative approach would dictate transfer of the securities held in such an account rather than of the account itself.

<sup>7</sup> There is a slight ambiguity in this section which arises from the language of the draftsman that the minor shall have title "to the securities thus delivered." N. C. GEN. STAT. § 33-70 (1) (a) (Supp. 1955), which prescribes the manner of making gifts of securities in *registered* form does not require delivery.

<sup>8</sup> N. C. GEN. STAT. § 33-71 (1) (a) (Supp. 1955).

<sup>9</sup> *Ibid.*

<sup>10</sup> N. C. GEN. STAT. § 33-71 (1) (b) (Supp. 1955). Query whether, in the traditional "hard case" a court may not feel constrained to superimpose some standard of conduct, perhaps a prudent man rule? In any event, liability on the part of the custodian would arise in cases of his "bad faith or intentional wrongdoing." N. C. GEN. STAT. § 33-71 (3) (Supp. 1955).

<sup>11</sup> N. C. GEN. STAT. § 33-71 (1) (b) (Supp. 1955).

He may vote any securities held by him. In short, he enjoys the rights and powers bestowed upon trustees under many liberal trust agreements.

His clerical duties are not burdensome. Accounting is required only upon petition to the superior court by the minor after attaining age twenty-one, a parent or legal representative of the minor, or a successor custodian. He cannot be required to account more than one year after delivery to the minor after he has attained age twenty-one, or to the estate of the minor.<sup>12</sup>

A custodian who is not compensated for acting as such is not required to give bond for the faithful performance of his duties and "shall not be liable for any losses to the property held by him except such as are the result of his bad faith or intentional wrongdoing or result from his investing the minor's property in a manner other than as prescribed in G. S. 33-71 (1) (b)."<sup>13</sup>

The protective provisions for brokers, transfer agents and issuers are exceedingly broad, stating, *inter alia*, that "no issuer of securities, transfer agent, registrar or bank or other person acting on the instructions of any person purporting to be a custodian or donor shall be responsible for determining whether any person has been duly designated as a custodian under this Article, . . ."<sup>14</sup>

Its sponsorship by the New York Stock Exchange<sup>15</sup> indicates that the new law is a product of the incompatibility of the needs of commerce and the laws heretofore governing the property of minors. As in the case of many enactments prompted by commercial expediency, there may be those who will find the common law somewhat unyielding. Among them may be the custodian who finds in the literal words of the statute authority to retain any security transferred to him, and the broker, who, also relying on the literal expressions of the statute, accepts the instructions of one who unconvincingly purports to be a custodian.

#### FEDERAL GIFT AND ESTATE TAX

A problem which has often perplexed practitioners seeking to arrange transfers for the benefit of minors is the fear that the annual exclusion provided under the federal gift tax laws may be lost by virtue of a gift being held a transfer of a "future interest."<sup>16</sup> Section 2503 (c)

<sup>12</sup> N. C. GEN. STAT. § 33-73 (Supp. 1955).

<sup>13</sup> N. C. GEN. STAT. § 33-71 (3) (Supp. 1955). It is not clear whether a "retention" of property transferred to a custodian is considered an "investment" by the custodian in connection with his liability for unauthorized investments.

<sup>14</sup> N. C. GEN. STAT. § 33-71 (1) (d) (Supp. 1955).

<sup>15</sup> See note 1 *supra*.

<sup>16</sup> See Caplin, *How to Treat Gifts to Minors*, Proc. NYU 13TH ANN. INST. ON FED. TAXATION 193 (1955); Diamond, *Tops and Dolls or Gifts to Minors*, 30 TAXES 987 (1952). Section 2503(b), 1954 Code, provides for a recurring annual exclusion of the first \$3000 of gifts to one person, "in the case of gifts (other

of the 1954 Code, which provides that certain transfers for the benefit of minors shall *not* be considered gifts of future interests, is clearly applicable to gifts under the Gift of Securities to Minors Law, thereby qualifying such gifts for the annual exclusion.<sup>17</sup>

There would appear to be no occasion for the inclusion of property transferred under the Gift of Securities to Minors Law in the taxable estate of either the donor or the custodian, except in the event of a "transfer in contemplation of death" by the donor within the three-year period ending with his death.<sup>18</sup>

#### FEDERAL INCOME TAX

If a father were to establish a trust for his minor child, providing that the income could be used for the support of the minor child, or accumulated in the trustee's discretion, there could be no doubt that at least that portion of the income actually used for support would be taxable to the father.<sup>19</sup> Moreover, should the father reserve certain "administrative powers" such as the power to direct in a non-fiduciary capacity the voting of stock of a corporation in which the holdings of the grantor and the trust are significant from the standpoint of voting control, all the income of the trust would be taxable to him under Section 675(4), 1954 Code.

It is quite clear that, in enacting the Gift of Securities to Minors Law, the General Assembly has, in effect, provided fathers with a ready-made trust instrument adequate for many purposes. The custodian has ample powers of administration over the securities he holds, as well as full authority to apply the principal and income for the benefit of the minor, or to accumulate income, in his discretion.

Is it possible that by making use of a custodianship under the new than gifts of future interests in property) . . ." In effect, the amount becomes \$6000 in the case of a gift by a husband or wife whose spouse consents under Section 2513.

<sup>17</sup> Section 2503(c), 1954 Code: "TRANSFER FOR THE BENEFIT OF MINOR.—No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and the income therefrom—

(1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and

(2) will to the extent not so expended—

(A) pass to the donee on his attaining the age of 21 years, and

(B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514 (c)."

Moreover, it is not at all unlikely that the Treasury Department would hold a transfer under the new law a gift of a present interest in line with the principles stated in Revenue Ruling 54-400, 1954-2 Cum. Bull. 319 (1954), which liberalized previous official opinion on the subject.

<sup>18</sup> Section 2035, 1954 Code. Estate tax provisions not considered applicable are Sections 2031, 2033, 2034, and 2036-2044, 1954 Code.

<sup>19</sup> Section 677, 1954 Code.

law, the father can avoid the income tax he would otherwise have to pay if he were the grantor of a trust designed to perform the same functions? Obviously, a conclusive answer cannot be given. No case has yet considered the status of a statutory custodian. Yet, a consideration of the cases involving outright transfers, guardians and brokerage accounts on the one hand, and the *rationale* of the decisions in the trust cases, on the other, casts considerable light on the problem. The roles of application of income for support of minor children and of control in the donor or grantor merit particular attention.

There are a significant number of cases holding that, *where a trust is not utilized*, income from property transferred to a minor will be taxed to the minor and not to the donor, even though the donor retains a large measure of control over the property transferred. Thus in *A. N. McQuown*<sup>20</sup> a father transferred undivided interests in road building machinery to each of his three children. Thereafter, the father, as agent for the children, rented the machinery to himself and other contractors, exercising control over the rental equipment and collecting the income for the benefit of the children. The Tax Court held the income to be that of the children and not of the father. "The appointment of petitioner, a donor, to manage the equipment was not fatal."<sup>21</sup> Similarly, income from cattle, grazing and wheat land owned by a minor has been held to be taxable to the minor rather than his donor-father despite "managerial control" by the father while his son was away at school.<sup>22</sup>

Where the minor's property is held by his guardian (even though the father has often been both donor and guardian) the courts have been unanimous in applying the dictum of the United States Supreme Court in *Freuler v. Helvering*<sup>23</sup> that "the whole of a minor's income received by his guardian is taxable to the minor irrespective of its accumulation in the guardian's hands, distribution to the minor or payment for his support or education."<sup>24</sup>

The Tax Court has considered a number of cases involving gifts of securities to minors by means of transfers to a brokerage account managed by an adult. Perhaps the high-water mark was *Emil Frank*<sup>25</sup> in which the petitioner and his wife made gifts of securities to brokerage accounts managed by the petitioner for the benefit of their three daughters, all of whom were minors. Substantial amounts of the income were applied to their support, maintenance and education. Nevertheless, the

<sup>20</sup> P-H 1953 T. C. Memo. Dec., § 53,204 (1953).

<sup>21</sup> *Id.* at 606-53.

<sup>22</sup> *Alexander v. Commissioner*, 190 F. 2d 753 (5th Cir. 1951).

<sup>23</sup> 291 U.S. 35 (1934).

<sup>24</sup> *R. E. Martin*, P-H 1944 T. C. Memo. Dec., § 44,013 (1944); *H. C. Priester*, 33 B. T. A. 230 (1935), *nonacq.* XIV-2 Cum. Bull. 39. See *Van Wart v. Commissioner*, 295 U. S. 112 (1935).

<sup>25</sup> 27 B. T. A. 1158 (1933).

Tax Court held that the income was attributable to the separate property of the minors, and was not taxable to their father. In *Edward H. Heller*<sup>26</sup> a father managed brokerage accounts for his minor children. The accounts contained securities transferred by the father and others, but none of the income was applied for support. Although the father had designated himself "trustee" in opening the accounts, the entire income of the accounts was held to be taxable to the minors and not to the father, as a trustee or individually. To like effect are *Reginald Fincke*,<sup>27</sup> *Herbert L. Dillon*<sup>28</sup> and *Prudence Miller Trust*.<sup>29</sup>

Although the *Emil Frank* line of authority has been neither overruled nor limited by holdings in subsequent cases, dictum in *Daniel J. Fry*,<sup>30</sup> holding a purported transfer to minors not to be a completed gift, hinted that the Tax Court might no longer find them persuasive. "Petitioner places some reliance upon a group of cases in which it was held that a parent was not required to include in his gross income the profit resulting from operating brokerage accounts in the name of his minor child or children. *Emil Frank*, 27 BTA 1158; *Herbert L. Dillon*, 32 BTA 1254; *H. C. Priester*, 33 BTA 230. See, however, *Harry F. Canelo*, 41 BTA 713 (appeal, C. C. A., 9th Cir., dismissed) where the duties incumbent upon a parent under such circumstances are discussed at length. All of the cases were decided prior to the Clifford, Griffiths, Eubank, and Horst cases cited at the beginning of this opinion. Whether they have lost any of their value as precedents need not now be decided."<sup>31</sup> It should be noted that *Edward H. Heller* adverted to the Clifford decision, but did not consider it applicable.<sup>32</sup> Five years after the appearance of the *Daniel J. Fry* dictum, the Tax Court distinguished, but did not suggest disapproval of its decision in *Emil Frank*.<sup>33</sup>

The dictum was ignored when, in 1954, the Tax Court decided *Clay H. Brock*,<sup>34</sup> an interesting example of family benevolence in which the petitioner, an adroit trader in commodities, established separate trading accounts with a broker in the names of two minor daughters, two brothers, two sisters, and two nephews. He made deposits in each ac-

<sup>26</sup> 41 B. T. A. 1020 (1940).

<sup>27</sup> 39 B. T. A. 510 (1939).

<sup>28</sup> 32 B. T. A. 1254 (1935).

<sup>29</sup> 7 T. C. 1245 (1946), *acq.* 1947-1 Cum. Bull. 3, involving a transfer by a grandfather to his son and daughter-in-law as tenants in common, accompanied by a letter stating that the securities were being given to his grandchildren.

<sup>30</sup> 4 T. C. 1045 (1945).

<sup>31</sup> 4 T. C. 1045, 1052. The cases referred to in the quotation are: *Helvering v. Clifford*, 309 U. S. 331 (1940); *Griffiths v. Commissioner*, 308 U. S. 355 (1939); *Helvering v. Eubank*, 311 U. S. 122 (1940); *Helvering v. Horst*, 311 U. S. 112 (1940).

<sup>32</sup> 41 B. T. A. 1020 (1940).

<sup>33</sup> *Ludwig Bendix*, 14 T. C. 681 (1950).

<sup>34</sup> 22 T. C. 284 (1954).

count under an agreement with the account owner that profits would be used first to repay to the donor the amount of the deposit, but that thereafter gains and losses would be shared equally. The entire income of the accounts prior to repayment of the deposits was held taxable to the donor on the ground that the income was attributable to his "labor" and capital. However, it was held that after the advances had been repaid, one-half the profits retained in each account were property of the account owner and the donor was taxable only to the extent of the remaining half. Thus, although the donor had full trading control, and two of the accounts were established for his minor children, he escaped taxation on all income which, under the agreements, was payable to account owners. There was no finding on the application of income for support. The Tax Court cited no authority for holding half the income taxable to account owners rather than the donor.

As previously pointed out, the grantor of a trust used to support his minor children would be taxable under Section 677, 1954 Code, or, if he retained the proscribed administrative powers, under Section 675 (4). These sections, however, apply only to grantors of *trusts*. Since the Internal Revenue Service as well as the courts recognize clearly the distinction between a trust and a common-law custodianship,<sup>35</sup> is the Commissioner left without statutory basis for holding income taxable to a donor-custodian?

Strangely enough, although most of the cases holding the grantor of a support trust taxable on its income cite Section 167 of the 1939 Code and corresponding sections of prior law which are substantially similar to Section 677 of the 1954 Code,<sup>36</sup> the fountainhead for the proposition,

<sup>35</sup> Rev. Rul. 55-469, 1955 Int. Rev. Bull. No. 30 at 34 (1955); Prudence Miller Trust, 7 T. C. 1245 (1946), *acq.* 1947-1 Cum. Bull. 3 (1947).

<sup>36</sup> Section 677, 1954 Code: "INCOME FOR BENEFIT OF GRANTOR."

(a) General Rule.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be—

(1) distributed to the grantor;

(2) held or accumulated for future distribution to the grantor; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for a purpose specified in section 170 (c) (relating to definition of charitable contributions)). This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

(b) Obligations of Support.—Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In

*Douglas v. Willcuts*,<sup>37</sup> relied on the statutory definition of "gross income." Although *Douglas v. Willcuts* has been cited as holding that Section 167 of the 1939 Code requires that a grantor be taxed with the income of a trust which discharges his legal obligations,<sup>38</sup> a careful reading of the opinion of the Supreme Court indicates that its decision rested solely on the application of the term "gross income."<sup>39</sup> Thus, it does not suffice to say that Sections 677 and 675(4) cannot apply to a custodianship. The father must also escape what the Supreme Court has termed the "sweeping scope"<sup>40</sup> of the statutory definition of "gross income."<sup>41</sup>

Those who felt that Congress had properly laid to rest the *Clifford*<sup>42</sup> doctrine when it provided in Section 671 of the 1954 Code that a grantor could not be taxed "solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title" except in accordance with the specific statutory rules contained in Sections 671-678, may well witness its resurrection. Although the Commissioner can no longer make use of the statutory definition of gross income in taxing grantors of trusts, the donor in a custodianship presumably remains fair game. Surely the Commissioner could find comfort in many of the hundreds of decisions handed down during the fourteen year tenure of the *Clifford* doctrine.<sup>43</sup>

Too much has been written of the *Clifford* puzzle to justify a further summary of decisions. However, a consideration of a few of the cases is essential to any attempt to project the probable course of judicial thought relating to the taxation of a donor-custodian. It has been cor-

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cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661 (a) and shall be taxed to the grantor under section 662."

<sup>37</sup> 296 U. S. 1 (1935).

<sup>38</sup> *Commissioner v. Mortin*, 108 F. 2d 1005 (7th Cir. 1940).

<sup>39</sup> The Court held the grantor taxable under Section 213 of the Revenue Act of 1926, 44 STAT. 9, and Section 22 of the Revenue Act of 1928, 45 STAT. 791, both of which were statutory definitions of gross income, and forerunners of Section 22(a) of the 1939 Code and the corresponding Section 61 of the 1954 Code, note 41 *infra*.

<sup>40</sup> *General American Investors Company, Inc. v. Commissioner*, 348 U. S. 434 (1955).

<sup>41</sup> Under the 1954 Code, the definition of gross income appears in Section 61, which provides that "except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: . . ."

<sup>42</sup> *Helvering v. Clifford*, 309 U. S. 331 (1940), holding the grantor of a trust taxable under Section 22(a) of the 1939 Code.

<sup>43</sup> Many authorities are of the opinion that at least one decision is available to support almost any proposition under the *Clifford* doctrine and that therefore *Clifford* decisions hold little precedent value. Greenberger, *Changes in the Income Taxation of Clifford Type Trusts*, PROC. NYU 13TH ANN. INST. ON FED. TAXATION, 165, 166 (1955); Eisenstein, *The Clifford Regulations and the Heavenly City of Legislative Intention*, 2 TAX L. REV. 327, 332 (1947).

rectly stated that the *Clifford* case turned on four factors: (1) the length of the term of the trust, (2) the identity of the trustee, (3) the identity of the beneficiaries, and (4) control.<sup>44</sup> In *Clifford* itself the fact that the grantor retained a reversion after a relatively short-term trust was found to be most persuasive. In cases involving no reversionary interest in the grantor, the Tax Court has held that control over investments alone does not bring the grantor of a trust for his children within the *Clifford* rule.<sup>45</sup> A donor under the Gift of Securities to Minors Law has no reversion, since the securities held by the custodian are transferred outright to the beneficiary at age twenty-one, or to his estate in the event of death during minority.<sup>46</sup> In the absence of a reversion, is it possible that the element of control alone is sufficient to result in taxation of the donor?

Since in most instances where the North Carolina Gift of Securities to Minors Law is utilized, tax appeals would be heard by the Court of Appeals of the Fourth Circuit, the decisions of that Court are of particular interest. In *Hash v. Commissioner*<sup>47</sup> a husband and wife each owned a one-half interest in a partnership which operated a furniture store and a finance company. The husband transferred one-half of his interest in trust for one of his daughters, and the wife made a similar transfer for the benefit of the other daughter. The trustees of the husband's trust were the wife and their attorney, while the husband and the attorney acted as trustees under the wife's trust. The trustees, the husband and the wife entered into a partnership agreement. The Fourth Circuit, relying on the fact that control of the business remained in the husband and wife, held the income to be taxable to the respective grantors. There was no mention in the opinion of the length of the trust, or of the father's duty to support. However, from the opinion of the Tax Court below<sup>48</sup> it is clear that the grantor had no reversion, and that none of the income of either trust was applied for support of the children. The dissent by District Judge Coleman, sitting in the absence of Chief Judge Parker, emphasizes that the case turns solely on the issue of control over the property held in trust: "To uphold the Tax Court in the present cases would be tantamount to saying that a parent cannot, without continuing to pay income taxes as

<sup>44</sup> Pavenstedt, *The Broadened Scope of Section 22 (a); The Evolution of the Clifford Doctrine*, 51 YALE L. J. 213.

<sup>45</sup> B. H. Klein, 14 T. C. 687 (1950); Glenn S. Allen, Sr., P-H 1944 T. C. Memo. Dec., ¶ 44,014 (1944).

<sup>46</sup> N. C. GEN. STAT. § 33-71 (1) (a) (Supp. 1955). A parent or other relative who makes such a transfer may have a valuable expectancy nevertheless in view of the inability of the minor to dispose of his property by will. N. C. GEN. STAT. § 31-1 (Supp. 1955).

<sup>47</sup> 152 F. 2d 722 (4th Cir. 1945), cert. denied; 328 U. S. 848, rehearing denied 328 U. S. 879 (1946).

<sup>48</sup> Rose Mary Hash, 4 T. C. 878 (1945).

though the property were still in fact his own, give property, by a deed of trust no matter how absolute, to a child so long as the parent himself is one of the trustees, if—even though in the exercise of honest, business judgment the trustees feel that they can thereby best preserve and increase the child's trust estate—they invest the trust corpus in a business in which the father himself is interested and has invested his own money because he considers it a sound investment."<sup>49</sup>

The Fourth Circuit continued to emphasize control as a decisive factor in *Stanback v. Robertson*.<sup>50</sup> Fred and Thomas Stanback were partners in Stanback Company, a partnership which manufactured Stanback Headache Powders and other products and held real estate and securities. In 1937, the investment assets were transferred to a corporation. The operating business continued under a new partnership agreement. Each brother established separate trusts for his wife and minor children with a bank and the other brother as trustees. To each of these trusts, each brother transferred shares of stock in the corporation and a six percent interest in the partnership. Under the new partnership agreement, the brothers were general partners and the trustees limited partners. By reason of the control of the *partnership* (rather than the trust) the Court held the income from the *partnership* taxable to the grantors. Apparently the Commissioner had not contended that the income from the corporation was taxable to the grantors, although a similar measure of control would seem to be present. It is interesting to note that the Tax Court had considered the same trusts for two previous taxable years and had held the grantors not taxable in a decision from which the government did not take an appeal.<sup>51</sup>

A recent Fourth Circuit decision resting primarily on the presence of the control factor is *Wheeling Dollar Savings & Trust Co. v. Yoke*.<sup>52</sup> There the grantor created five substantially identical trusts, with himself as trustee, for the benefit, respectively, of four nephews and a sister, none of whom were owed a duty of support. The grantor retained broad powers of management and control, could add income to principal or invade principal. The corpus of each trust would eventually be distributed to the beneficiary unless the beneficiary died during the grantor's lifetime, in which case the trust estate would revert to the grantor. The district court held the income of the trusts taxable to the grantor. The Fourth Circuit agreed. "The significant factors in the pending case in support of the District Court's decision are that Wolf had no need for the income from the trusts, that the beneficiaries were

<sup>49</sup> 152 F. 2d 722, 725 (4th Cir. 1945).

<sup>50</sup> 183 F. 2d 889 (4th Cir. 1950).

<sup>51</sup> Wachovia Bank and Trust Company and Fred J. Stanback, Trustees, P-H 1944 T. C. Memo. Dec., § 44,217 (1944).

<sup>52</sup> 204 F. 2d 410 (4th Cir. 1953), *cert. denied* 346 U. S. 898 (1953).

his closest relations, that he named himself as trustee and endowed himself in this capacity with full power of control and management, including the right to sell the property at any price he might determine, the right to reinvest the proceeds in any property he might think desirable, the right to rent the property for terms of any duration, and the right to borrow money and secure the loan by mortgage of the property; in other words, as he expressed it in the trust instrument, the right to manage, control and distribute the trust estate for the benefit of the beneficiaries as if the property were absolutely owned by him."<sup>53</sup> Although the Court's decision was bolstered by the presence of a reversion in the grantor, unquestionably it considered the control factor as most convincing.

It can be concluded from the foregoing cases that, at least in the Fourth Circuit, a grantor who reserves to himself, as trustee or otherwise, a substantial measure of control over the corpus of the trust runs a strong risk of taxation. Yet a father who makes an outright transfer of machinery<sup>54</sup> or land<sup>55</sup> to his child, or a transfer of property to himself as guardian for his child,<sup>56</sup> or a valid transfer of securities to a brokerage account for his child<sup>57</sup> has usually avoided income tax despite retention of control.<sup>58</sup>

Into which category of cases does the custodianship logically fall? Factually, the custodian is quite similar to the managing parent in the brokerage account cases.<sup>59</sup> If those decisions are followed, the income of a custodianship seems clearly taxable to the minor and to no one else.

Even if the brokerage account cases have lost some of their former persuasion, it is suggested that the custodian's resemblance to a guardian, rather than to a trustee, should result in taxation to the minor. Basically, a grantor-trustee may prescribe his own ability to control the property transferred, whereas a donor-custodian cannot. A custodian's authority flows from legislative grant. Presumably, the legislature can narrow the control of the custodian by subsequent enactment. Consequently, although the custodian may today have a considerable measure of control over the securities he holds, tomorrow he may be governed

<sup>53</sup> 204 F. 2d 410, 413 (4th Cir. 1953).

<sup>54</sup> A. N. McQuown P-H 1953 T. C. Memo. Dec., ¶ 53,204 (1953).

<sup>55</sup> Alexander v. Commissioner, 190 F.2d 753 (5th Cir. 1951).

<sup>56</sup> R. E. Martin, P-H 1944 T. C. Memo. Dec., § 44,013 (1954); H. C. Priester, 33 B. T. A. 230 (1935), *nonacq.*, XIV-2 Cum. Bull. 39.

<sup>57</sup> Clay H. Brock, 22 T. C. 284 (1954); Edward H. Heller, 41 B. T. A. 1020 (1940); Reginald Fincke, 39 B. T. A. 510 (1939); Herbert L. Dillon, 32 B. T. A. 1254 (1935); Emil Frank, 27 B. T. A. 1158 (1933).

<sup>58</sup> A number of family income-shifting cases have failed because of a finding that no bona fide completed gift was made. See, e.g., Hilda M. Royce, 18 T. C. 761 (1952); Ludwig Bendix, 14 T. C. 681 (1950); Ralph R. Anderson, 5 T. C. 443 (1945); Weil v. Commissioner, 82 F. 2d 561 (5th Cir. 1936).

<sup>59</sup> Note 57 *supra*.

by the same rules that now apply to guardians. Further, since a donor-guardian can apply income for the support of his minor children without subjecting himself to taxation in his individual capacity, it seems that a donor-custodian, also a creature of the legislature, should be subject to a like rule.

Nevertheless, a conservative view must recognize the possibility that the courts will hold that the coexistence of the ability to apply income for support of dependents and legislatively granted control available *in a particular year* require taxation of income to a donor-custodian in that year, at least, under the statutory definition of gross income. Although the *Clifford*<sup>60</sup> and *Douglas v. Willcuts*<sup>61</sup> doctrines have thus far been limited to cases involving trusts, there is no assurance that the future will not see their application to other types of transfers. It can scarcely be contended that the present Supreme Court is of a mind to restrict the meaning of "gross income." In a single day in 1955, the Court decided that both "insider profits" under the Securities Exchange Act of 1934<sup>62</sup> and recoveries of treble damages under the Federal anti-trust laws were within the scope of Section 22(a) of the 1939 Code.<sup>63</sup>

Unquestionably, the current uncertainty as to income tax consequences will result in the deferring of many transfers that would otherwise take place under the new law until the matter has been clarified by ruling or decision. Nevertheless, it seems probable that a good many parents will calculate the tax risk and will make gifts to their children of income-producing securities, perhaps hedging their position to some extent by naming a relative of the minor other than themselves as custodian. A taxpayer who calculates the risk may find, in his own case, that the figures are attractive. If the transfer is recognized for income tax purposes, the income is shifted to the normally lower tax bracket of the minor. Moreover, the child will continue to qualify as a dependent regardless of the amount of income he receives so long as he is under age 19, or over that age but still a "student."<sup>64</sup> If the income of custodianship is taxed to the donor, he merely pays the tax he would have been obligated to pay, plus interest. A sound middle ground is available to a parent who desires to make a transfer for the benefit of his child, not anticipating that the income will be made available for support and maintenance prior to majority. Under Section 677 (b),

<sup>60</sup> *Helvering v. Clifford*, 309 U. S. 331 (1940).

<sup>61</sup> *Douglas v. Willcuts*, 296 U. S. 1 (1935).

<sup>62</sup> 48 STAT. 881 (1934), 15 U. S. C. § 78A (1952).

<sup>63</sup> *General American Investors Co., Inc. v. Commissioner*, 348 U. S. 434 (1955); *Commissioner v. Glenshaw Glass Company*, 348 U. S. 426 (1955).

<sup>64</sup> Section 151 (e) (1) (B), 1954 Code. Under the 1939 Code, Section 25 (b) (1) (D), exemption for a dependent was lost if his gross income for the taxable year reached \$600 or more.

1954 Code, if the transfer is made in trust, income will not be taxable to the grantor merely because such income may be applied for the support or maintenance of a beneficiary whom the grantor is legally obligated to support, except to the extent that such income is so applied. If, on the other hand, a parent with similar motives makes a transfer to a custodian, and is held to be taxable on the income of the custodianship by virtue of ability to apply income for support, presumably *all* of the income of the custodianship would be taxable to the donor, even though none had actually been applied to discharge of his obligation, under the doctrine of *Helvering v. Stuart*.<sup>65</sup>

In at least one situation involving transfers for the support of minors, a custodianship would appear to be currently preferable to a trust, despite the unsettled state of tax law. Prior to the adoption of the 1954 Code, a favorite arrangement saw a grandparent transferring property to his son as trustee for the support and maintenance of the grandchildren. It is quite probable that the son in such a situation is now subject to taxation on that portion of the income of the trust actually applied to the support of his minor children. Such would appear to result from the application of Section 678(c) of the 1954 Code, which it has been suggested, may have crept into the Code by reason of a misconception of prior case law.<sup>66</sup>

#### CONCLUSION

Whatever the ultimate result may be with respect to income taxation, the North Carolina Gift of Securities to Minors Law unquestionably provides a much-needed degree of convenience in handling the property of minors. If, in addition, a valid shifting of taxable income results, the General Assembly will have indeed earned the plaudits of countless Tar Heel fathers.

<sup>65</sup> 317 W.S. 154 (1942), holding that a grantor is taxable on all trust income which may be applied for the support of his minor children, although none is in fact so applied.

<sup>66</sup> Winton, *Taxation of Nongrants under Trusts for Support of Their Dependents*, 33 TAXES 804, 812 (1955). "It is by no means clear that if Congress had understood the pre-existing law, it would have adopted subdivision (c) of Section 678. It is even less clear that Congress would have changed the pre-existing law and made nongrants taxable if its attention had been clearly drawn to the problem."