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FEDERAL TAXATION OF NORTH CAROLINA
TRUSTS FOR UNBORN AND UNASCERTAINED
BENEFICIARIES

CHARLES L. B. LOWNDES*

Ordinarily a trust, even a gratuitous trust, is irrevocable unless a power of revocation has been reserved. The rigor of this rule is mitigated to some extent by the doctrine that a trust may be terminated by the action of all the beneficiaries where this does not violate a material purpose of the trust; or, even if such a purpose is violated, by the concurrent consent of the settlor and the beneficiaries. The termination of a trust by the action of the beneficiaries, or that of both beneficiaries and settlor, requires, however, not only that the interested parties be capable of giving a legally effective consent, but that they be in esse and ascertained. Where beneficiaries are not in being or are not ascertained and a power of revocation has not been explicitly reserved, there is virtually no way to terminate a trust.

In North Carolina, however, the legislature has made provision for this situation. Under Section 996 of the Code, where a trust is created for the benefit of the settlor or some other person in being and unborn or unascertained persons, the interest given to the unborn or unascertained beneficiaries may be revoked by the settlor alone, if the trust is gratuitous; or by the settlor and the person who furnished the consideration, if the trust was created for a consideration. Section 996 makes similar provision for conveyances of future interests in real estate to unborn persons apart from any trust.

Although the basic idea underlying Section 996 is sound, in the absence of clarification on the part of the legislature it may prove a source of unanticipated embarrassment to people who have created trusts under the North Carolina laws. It is possible that Section 996 may be construed to prevent the creation of an irrevocable trust for unborn or unascertained beneficiaries. This is a possibility pregnant

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1 Restatement, Trusts (1935) §330(2).
2 Restatement, Trusts (1935) §337.
3 Restatement, Trusts (1935) §338.
5 A court may, however, order the termination of the trust where an emergency has arisen which threatens the destruction of the trust property, unless the trust is terminated. Restatement, Trusts (1935) §336. Also, of course, where the execution of the trust was induced by fraud, duress, undue influence or mistake it may be rescinded, Restatement, Trusts (1935) §333, and if a power to revoke the trust was omitted by mistake the settlor can have the trust instrument reformed and revoke the trust. Restatement, Trusts (1935) §332.
with potentialities of heavy penalties under the federal estate, gift and income taxes.

The federal estate, gift and income taxes are closely connected. They have a good many related characteristics. An important conception common to all three is their treatment of revocable transactions. As Mr. Justice Holmes pointed out, modern federal taxes are "not so much concerned with the refinements of title as... with actual command over the property taxed—the actual benefit for which a tax is paid." Even though a person has parted with title to property, if he retains power to recall the transfer, the federal estate, gift and income taxes disregard the transaction and treat it as though it had never occurred. Thus, for example, a man is regarded as the continuing owner of property conveyed by way of a revocable trust, so that it is taxed to his estate under the federal estate tax upon his death, and the income from the property is taxed to him under the federal income tax during his life. By a parallel principle he will not be regarded as having made a taxable gift of the property under the federal gift tax, at least, until he relinquishes his right of revocation. The details of the definitions of a revocable trust differ for purposes of the federal estate, gift and income taxes. Under all three, however, it makes an important difference whether a trust is revocable or irrevocable. It is quite possible, moreover, that the definitions of a revocable trust under all three taxes are sufficiently broad to catch a trust within the scope of Section 996.

(1) THE FEDERAL ESTATE TAX

A concrete hypothesis may serve to focus the problem more clearly. Suppose that A conveys property to B in trust for C for life, with a remainder to C's unborn children. The trust is governed by North Carolina law. A intended that the trust should be irrevocable so he did not put in a provision reserving a power of revocation. To clarify the preliminary consideration of the problem, moreover, assume that A did not see any necessity for stipulating that the trust should be irrevocable, so there is no explicit provision concerning the revocation of the trust at all. It will be simpler to consider the effect of the federal estate, gift and income taxes separately, so the first question is whether at A's death the trust property will be taxed as part of his gross estate under the federal estate tax.

Assuming that the trust was not created in contemplation of death, the only provision under which it can be reached is that taxing revocable

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7 Int. Rev. Code §811(d) (1939).
trusts. The federal estate tax imposes a tax upon a trust where the settlor alone or "in conjunction with any other person" has at his death a power "to alter, amend, revoke, or terminate" the trust. There is a further provision that the tax shall apply "without regard to when or from what source the decedent acquired such power" or in what capacity the power is exercisable. This is a broad provision and it has been construed broadly. Thus, for example, the Supreme Court has held that the tax applies even though the trust in question can only be revoked by the settlor in conjunction with a person having a substantial adverse interest in the trust.

Upon a casual inspection of the provisions of the federal estate tax taxing revocable trusts it would appear that the trust in the hypothetical case is taxable to A's estate, at least to the extent of the value of the remainder in favor of the unborn children. Although A may not have intended to create a revocable trust, it is revocable under Section 996 of the North Carolina Code. This would be true even if the trust antedated the passage of the Code provision. Section 996 applies to trusts created before as well as after the passage of that section, and the retroactive aspect of this provision has been held constitutional. Even assuming that the trust were created for a consideration, so that it could only be revoked with the concurrence of the person furnishing the consideration, it would still be revocable under the federal estate tax, which defines a revocable trust as one which can be revoked by the settlor alone or the settlor in conjunction with any other person, including a person who has a substantial adverse interest in the trust.

It is possible, moreover, that not only the value of the remainder interest in the hypothetical trust will be taxed to A's estate, but that the entire trust, that is, the value of the property transferred in trust, will be so taxed. A can revoke the entire trust with the consent of the beneficiary in being, which means that he can revoke it without the consent of all those beneficially interested in it, and it is arguable that this makes the trust taxable to his estate in its entirety. Obviously there are two ways of looking at the trust. It may be viewed as a single trust which can be revoked with the consent of some, but not all, of the persons interested in it. From this angle it is a single revocable trust taxable in its entirety to A's estate. On the other hand, it is possible

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to regard the trust as really in substance two trusts: an irrevocable trust for the beneficiary in being, which is not taxable to A's estate, and a revocable trust for the unborn beneficiaries, which is taxable to A's estate. From this point of view only the value of the remainder would be included in the grantor's gross estate for purposes of the federal estate tax.\textsuperscript{16} The second point of view is strengthened if we start from the premise that what A did in the hypothetical case was to create an irrevocable trust. Then Section 996 fastened upon the trust and made the remainder revocable. It did not, however, touch the interest of the beneficiary in being, with the result that there is still an irrevocable trust for the beneficiary in being, but a revocable trust of the remainder. This is less persuasive when one considers the countervailing argument in favor of the first view. Suppose that in a state which has no statute similar to Section 996 A conveys property in trust for C for life, remainder to C's unborn children. A explicitly reserves a power to revoke the trust with the consent of C. The entire trust, not merely the value of the remainder, is taxed to A's estate under the federal estate tax.\textsuperscript{17} Yet in this situation A has actually given up more during his life than in the case of a trust revocable because of Section 996. During his life A deprived himself of power to recall C's interest without C's consent. He also has deprived himself of the power to recall the interest of the unborn children without C's consent. Where the trust is revocable because of Section 996, however, the settlor has only given up the power to recall the interest of the life beneficiary without the life beneficiary's consent. He has power to revoke the interest of the remainderman without the life beneficiary's concurrence. In the latter situation, he has actually parted with less than in the former. It would seem to follow, therefore, that he should not be taxed upon less at his death. The conclusion, of course, is that from the point of view of the federal estate tax there is no difference between the two trusts and a trust revocable only because of Section 996 is taxable in its entirety to the settlor's estate. There appears to be no authority precisely in point. Although it is impossible to make any accurate forecast of what will happen, it should be borne in mind that if a trust is revocable under Section 996 there is a substantial chance that not only the value of the revocable remainder but that of the irrevocable estate for the beneficiary in being will be taxed as part of the grantor's gross estate under the federal estate tax.\textsuperscript{18}

\textsuperscript{16} Cf. the dissenting opinion of L. Hand, J., in Commissioner v. City Bank Farmers Trust Co., 74 F. (2d) 242, 246, 247 (C. C. A. 2d, 1934).

\textsuperscript{17} Supra note 15.

\textsuperscript{18} It has been held, however, that where there is a transfer to a trust under which the transferor has no power to revoke the interest of the life beneficiary, but can revoke the interests of the remaindermen, there is a taxable gift only to the extent of the life interest. Emery May Holden Norweb, 41 B. T. A. 179 (1940). That is, the trust for purposes of the federal gift tax is irrevocable as
There is a bare possibility that A's estate may not be taxable in the hypothetical case even upon the remainder of the unborn children. It is not, however, much more than a bare possibility. In *Helvering v. Helmholz*, the Supreme Court decided that a trust was not taxable under the federal estate tax merely because of a provision by which it could be revoked with the consent of all the parties interested in the trust. *Helvering v. Helmholz* has been variously interpreted. According to a recent writer the Court held that a formal reservation of a power of revocation will not make a trust taxable under the federal estate tax "when the reservation of such right adds nothing to the power given under local law." If this interpretation is sound, it would follow that a trust which is revocable because of some rule of law rather than a formal reservation in the trust instrument is not a revocable trust under the federal estate tax, and that a trust which is revocable solely because of Section 996 is not taxable.

It is exceedingly doubtful, however, whether *Helvering v. Helmholz* stands for any such broad proposition. The lower federal courts have held that the question of whether a trust is revocable under the federal gift and estate taxes is not affected by whether the power to revoke originates in a formal reservation of the trust instrument or some rule of the local law. *Commissioner v. Allen*, for example, involved the federal gift tax. A minor created a trust two days before the 1932 gift tax was passed. Under the applicable New Jersey law this gift was voidable during the donor's minority. The Commissioner contended that there was a taxable gift upon the theory that the gift was not made when the trust was created before the enactment of the gift tax, but when the donor reached majority and lost her power to disaffirm after the tax had been passed. The Circuit Court of Appeals for the Third Circuit, in sustaining the Commissioner's contention, said that for purposes of the federal gift tax there is no distinction "between a settlor's power to revoke when imposed by law and a settlor's like power when reserved by his trust indenture." The same result has been reached under the federal estate tax. Under the law of Louisiana a gift by one spouse to the other is revocable although no power of revocation is

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\(396\) U. S. 93, 80 L. ed. 76, 56 S. Ct. 68 (1935).
\(20\) \textit{Shockey, Federal Taxation for the Lawyer} (1941) 76.
\(21\) 108 F. (2d) 961 (C. C. A. 3d, 1939).
\(22\) \textit{Id.} at 965.
formally reserved. The Board of Tax Appeals and the Circuit Court of Appeals have held recently that such gifts are taxable to the estate of a deceased spouse as revocable transfers. Both tribunals declared upon the authority of Commissioner v. Allen that a transfer revocable because of a formal reservation of a power to revoke and one which is revocable because of a rule of law stand upon the same footing. Helvering v. Helmholz was distinguished upon the ground that the Supreme Court held that the trust in the Helmholz case was not taxable because the power to terminate it was conferred in explicit terms upon the beneficiaries of the trust and the settlor acquired this power by virtue of the accidental circumstance that she was a beneficiary, rather than in her capacity of settlor. This distinction is of dubious authenticity. That does not mean, however, that the doctrine enunciated by the Allen, Keiffer, and Howard cases is necessarily erroneous. In fact the conclusion reached in those cases to the effect that there is no distinction for federal tax purposes between a trust revocable because of a formal reservation of a power of revocation and because of some rule of the local law seems eminently sound and sensible.

Although the circumstances that the settlor acquired her power to revoke the trust in the Helmholz case as a beneficiary may have been a makeweight in the decision, a careful reading of the case will disclose that the principal ground upon which the Court relied was the fact that the power of revocation reserved by the trust instrument was merely a power to revoke with the consent of all those interested in the trust. This interpretation of the case makes it necessary to face squarely the question which Commissioner v. Allen and the decisions following that case sidestepped. Does Helvering v. Helmholz stand for the broad proposition that a power to revoke a trust which is based upon a rule of the local law rather than a formal reservation in the trust instrument will not make the trust taxable under the federal estate tax? One of the best ways to define the implications of a decision is to examine their practical operation. A rule that a trust shall not be treated as revocable unless the right to revocation originates in a formal reserva-

23 LA. CIV. CODE (Dart, 1932) art. 1749.
24 Estate of Felicie Gumbel Keiffer, 44 B. T. A. No. 198 (1941).
27 296 U. S. 93, 80 L. ed. 76, 56 S. Ct. 68 (1935).
29 Estate of Felicie Gumbel Keiffer, 44 B. T. A. No. 198 (1941).
33 Estate of Felicie Gumbel Keiffer, 44 B. T. A. No. 198 (1941); Howard v. United States, 40 F. Supp. 697 (E. D. La. 1941).
tion in the trust instrument would lead to absurd results. For example, if a husband were to make a gift to his wife in North Carolina and provide that this should be revocable, he would clearly be taxable upon this gift under the federal estate tax. But a man in Louisiana could make exactly the same sort of gift and escape any liability under that statute.\textsuperscript{34} It is true that there are some situations where liability for federal taxes is determined by conflicting rules of local law. This occurs for instance in the taxation of community income under the federal income tax.\textsuperscript{35} It also occurs in connection with the taxation of income from an alimony trust, where the federal income tax liability of the husband who creates such a trust depends upon whether it is possible under the local state law to completely discharge any future liability to the wife by the creation of the trust.\textsuperscript{36} In the cases where liability for federal taxes is contingent upon local law, however, the local law actually makes a difference in the taxpayer’s rights and liabilities. Husbands and wives in community property states have different rights with respect to each other’s earnings than spouses in other states. An alimony trust which completely discharges any future obligation of the settlor to his divorced wife is a legally distinct thing from a trust which does not discharge this obligation. Although it may be questionable whether these legal differences are sufficiently substantial to justify distinct federal tax treatment,\textsuperscript{37} the fact remains that there are differences. There is not even a legal difference, however, between a trust which can be revoked because of the formal reservation of an explicit power of revocation and one which can be revoked because of some quirk of local state law. Both powers derive their ultimate sanction from rules of law—either a rule which recognizes the validity of a formal reservation of a power of revocation, or a rule making a trust revocable directly. There is no distinction here upon which to base a different federal tax treatment.

Conceding that practical considerations preclude construing \textit{Helvering v. Helmholz}\textsuperscript{38} as a broad mandate to the effect that a trust will not

\textsuperscript{34} \textit{Ibid.} By Section 2280 of the \textit{California Civil Code} (Deering, 1937) it is provided, "Unless expressly made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee." If the proper interpretation of \textit{Helvering v. Helmholz}, 296 U. S. 93, 80 L. ed. 76, 56 S. Ct. 68 (1935) were that a trust revocable because of a rule of law is not a revocable trust under the federal estate tax, trusts could be created in California which would not be subject to the federal estate tax, although similar trusts in other states would be subject to quite different federal tax treatment. It seems doubtful, to say the least, whether \textit{Helvering v. Helmholz} will be construed to require any such footless discrimination.


\textsuperscript{36} \textit{Helvering v. Fuller}, 310 U. S. 69, 84 L. ed. 1082, 60 S. Ct. 784 (1940).

\textsuperscript{37} See Lowndes, \textit{Taxation of Community Income and Alimony} (1942) 20 \textit{Taxes} 3.

\textsuperscript{38} 296 U. S. 93, 80 L. ed. 76, 56 S. Ct. 68 (1935).
be treated as a revocable trust for purposes of the federal estate tax merely because it is revocable because of some local rule of law, the question remains, what does the decision stand for? The chances are that it stands for just what the Court decided in the case—that a trust which can only be revoked with the consent of the interested parties is not a revocable trust within the purview of the federal estate tax. This is, of course, eminently sensible. Such a trust is no more revocable than any absolute gift which can be recalled with the connivance of the donee. It is true that in Helvering v. Helmholz the power of revocation which the settlor had formally reserved happened to concur with what the Court took to be the rule of the local law where no power to revoke was reserved. Although the Court commented upon this fact, it seems to have been an accidental circumstance, rather than a determining factor in the decision. Trying to view Helvering v. Helmholz not so much through the eyes of the Court which decided it, as through those of later courts who may be called upon to interpret it, a fair construction of the case seems to be that a trust will not be revocable for estate tax purposes where it can only be revoked by the consent of all those interested in the trust.

From this point of view Helvering v. Helmholz affords no obstacle to the taxation of a trust for unborn or unascertained beneficiaries which is revocable under Section 996 of the North Carolina Code, since the obvious purpose of that section is to admit of revocation of the trust without the consent of those beneficiaries. Although the distinction of the Helmholz case by the lower federal tribunals in the cases which repudiated any difference for federal tax purposes between a trust revocable because of a formal reservation in the trust instrument and one revocable by rule of law is quite dubious, the conclusions reached in those cases appear entirely sound. A trust which is revocable because of Section 996 of the North Carolina Code seems to be taxable under the federal estate tax.

It is, of course, also possible to contend that the 1936 amendment to the provisions of the federal estate tax taxing revocable trusts expressly abolished any distinction between a trust revocable because of the formal reservation of a power of revocation and one revocable because of a rule of law which may have been suggested by Helvering v. Helmholz. This amendment, which was passed after that decision, provides that a trust shall be deemed revocable where there is a power to revoke "without regard to when or from what source the decedent acquired" the power and without regard to the capacity in which it is "exercisable." Although the literal reach of the language is broad

enough to embrace a trust revocable because of a rule of law, it is
doubtful whether it is properly applicable to such a situation. The
legislative history of the amendment discloses that it was not passed to
deal with the problem of a trust revocable by a rule of law, but to
nullify the effect of the Supreme Court's decision in *White v. Poor*\(^\text{40}\)
where it was held that a trust which the settlor could revoke in her
capacity as a trustee rather than in her role of a settlor was not taxable
under the federal estate tax. From a practical point of view, the diffi-
culty with applying the 1936 amendment to trusts revocable by rule of
law is that the amendment is purely prospective and this, therefore,
affords a basis for arguing that such a trust created prior to the enact-
ment of the amendment is not taxable. When this argument was made
in *Estate of Keiffer*,\(^\text{41}\) the Board disposed of it by saying that to the
extent that it applies to trusts revocable by rule of law it is simply
declaratory of the pre-existing law.

The discussion up to this point has been premised upon a trust for
unborn or unascertained beneficiaries where the trust instrument did
d not expressly provide that the trust should be irrevocable. Such a trust
is clearly revocable under Section 996 of the North Carolina Code and
it would appear to be taxable under the federal estate tax. Suppose,
however, that a trust for unborn or unascertained beneficiaries contains
an explicit provision to the effect that it shall be irrevocable. What
effect will this have upon liability under the federal estate tax? The
answer to this question hinges upon whether it is possible to create an
irrevocable trust for unborn or unascertained beneficiaries in North
Carolina in view of Section 996. Upon this point there appears to be
no controlling authority. The competing considerations which will have
to be weighed in this connection are, however, fairly clear.

If the purpose of Section 996 is simply to confer upon the creator of
a trust for unborn or unascertained beneficiaries a personal privilege of
revoking the trust and involves no particular question of policy, it
would seem that this privilege could be waived by the creator of such
a trust and that an irrevocable trust for unborn or unascertained bene-
ficiaries could be created, despite Section 996, by an explicit provision
to that effect. It might be difficult to find such a waiver in the case
of a trust created prior to the enactment of Section 996 since a person
cannot usually waive a right which he does not know about and it would
appear even harder to find a waiver of a right which did not even exist.
If, moreover, no explicit provision for irrevocability were inserted in a
trust for unborn or unascertained beneficiaries at the time the trust was
created, there might be some difficulty, if an attempt to waive the privi-

\(^{40}\) 296 U. S. 98, 80 L. ed. 80, 56 S. Ct. 66 (1935).
\(^{41}\) 44 B. T. A. No. 198 (1941).
lege of revocation were made later, to find consideration to sustain the waiver, assuming this to be necessary. However, if Section 996 merely confers a personal privilege which can be waived, this certainly clarifies the tax problems raised by that section.

One of the grave difficulties with Section 996 as it stands at present, however, is that it is very doubtful whether it expresses a personal privilege which can be waived or a public policy of the state which it would be illegal to try to waive. It is interesting, although not unduly significant, to observe in this connection that an eminent authority on trusts, in writing in praise of the North Carolina statute, apparently regards it as expressive of the public policy of the state against tying up property irrevocably in favor of persons who may never be born or ascertained.42 Apparently the only North Carolina case which has raised this problem is Cutter v. American Trust Co.43 In that case the lower court held that a provision that a trust should be irrevocable did not prevent modification of the trust under Section 996. Unfortunately for our present purposes, however, the appellate court upheld the modification of the trust upon another ground and expressly refused to consider the effect of Section 996.

It may or may not be significant that, although Section 996 says that the settlor of a trust for unborn or unascertained beneficiaries may revoke their interests, which looks a little like the language of privilege, no distinction is made with respect to trusts which are explicitly provided to be irrevocable. As far as the literal reach of the language of the section is concerned it covers all trusts for unborn and unascertained beneficiaries regardless of what explicit provisions are made about revocation. It might be argued, moreover, that if the statute were intended merely to confer a personal privilege upon the settlors of such trusts to revoke them rather than to express the public policy of the state, the legislature took a curious way of achieving this result. Prior to the statute the grantor of a trust for unborn or unascertained beneficiaries had the privilege of making their interests revocable by an explicit provision to this effect. If Section 996 was simply designed to reverse the ordinary presumption that a trust which fails to stipulate explicitly for revocation is irrevocable, why did the legislature stop with trusts for unborn and unascertained beneficiaries? Why, moreover, did not the legislature express itself in these terms instead of laying down a flat rule that all trusts for unborn and unascertained beneficiaries should be revocable?

It is at least arguable that Section 996 makes it impossible to create an irrevocable trust for unborn or unascertained beneficiaries in North

42 3 Scott, TRUSTS (1939) 8340.
43 213 N. C. 686, 197 S. E. 542 (1938).
North Carolina. If this is true it has serious implications in connection with the federal estate tax. It may also have an important bearing upon liability for the federal income and gift taxes. Before taking up the question of what remedial legislation should be enacted in connection with Section 996 it will be well to consider these taxes.

(2) The Federal Income Tax

A trust within the purview of Section 996 should not ordinarily present any serious problem in connection with the federal income tax. Normally the trustee will be directed to pay the income from the trust to the settlor, or to some other beneficiary in being, during the life of the settlor or that of the beneficiary in being, and to distribute the trust property to the unborn or unascertained beneficiaries, who presumably will be born or ascertained by this time, at the death of the income beneficiary. If the income from the trust is paid to the settlor, it will be taxed to him.\(^4\) If it is paid to another beneficiary in being it will be taxed to this beneficiary\(^5\) save for a rare situation where because of some intimate tie-up between the beneficiary and the settlor the beneficiary is not regarded as having a substantial adverse interest in the trust,\(^6\) or the income from the trust is used to discharge an obligation of the settlor.\(^7\) In other words, even though there is a trust for unborn or unascertained beneficiaries, Section 996 will not create any difficulties in connection with the federal income tax, if these beneficiaries have no interest in the income from the trust.\(^8\)

Conceivably, however, the unborn or unascertained beneficiaries may have an interest in the income of a trust. Thus, suppose for example, that \(A\) conveys property to \(B\) in trust to pay one half of the income to \(C\) during \(C\)'s life and to accumulate the residue of the income for \(C\)'s unborn children. Assuming further that the trust was gratuitous and that there is no provision in the trust instrument making it irrevocable, the interest of the unborn beneficiaries is clearly within \(A\)'s unfettered power to recall under Section 996. How will the income from the trust be taxed under the federal income tax?

The income which is distributable to \(C\) is, of course, taxable to \(C\). The rest of the income, however, would appear to be taxable to \(A\).\(^8\) It is true that the federal income tax defines a revocable trust differently than the federal estate tax. A trust is not revocable under the federal

\(4\) "Int. Rev. Code §162(b) (1939)." 
\(5\) "Ibid."
\(6\) Fulham v. Commissioner, 110 F. (2d) 916 (C. C. A. 1st, 1940).
\(7\) Douglas v. Willcuts, 296 U. S. 1, 80 L. ed. 3, 56 S. Ct. 59 (1935).
\(8\) If there are capital gains, however, which are added to corpus, rather than distributed currently as income, it might be argued that these are taxable to the settlor of the trust because of his power to revoke the remainder.
\(8\) "Int. Rev. Code §166 (1939)."
income tax if the settlor cannot revoke it without the concurrence of a person having a substantial adverse interest in the trust.\textsuperscript{49} If, however, part of the trust may be recalled without such consent, the income from this portion of the trust is taxable to the settlor.\textsuperscript{50} In the hypothetical case $A$ cannot revoke the entire trust without $C$'s consent. He may, however, revoke the interest of the unborn beneficiaries without anyone's consent. He is, therefore, apparently taxable upon the income which is to be accumulated for these beneficiaries.

There is, moreover, another ground upon which $A$ appears to be taxable in this case. Under the federal income tax, income from a trust which may be accumulated for or distributed to the settlor of the trust in the discretion of the settlor alone, or the settlor and a person who has no substantial adverse interest in the trust, or a person lacking such an interest alone, is taxable to the settlor.\textsuperscript{51} Inasmuch as $A$ may revoke the interest of the unborn beneficiaries under Section 996 and possess himself not only of their remainder interest in the principal of the trust but the accumulated income as well, it would seem that the income is taxable to him as income distributable to him in his discretion. Even if the trustee in the hypothetical case were not directed to accumulate half of the income from the trust for the unborn beneficiaries, but was merely authorized to do so, it would seem that this part of the income would be taxable to the settlor, $A$, as income which could be accumulated for him in the discretion of the trustee, a person lacking a substantial adverse interest in the trust.\textsuperscript{52}

The extent to which these results would be different if the trust in the hypothetical case had been created for a consideration is not entirely clear. If the person furnishing the consideration were also a beneficiary of the trust, presumably none of the income from the trust would be taxed to the settlor, because he would not be able to revoke any part of the trust nor reach any of the accumulated income without the concurrence of a person having a substantial adverse interest in the trust. If, however, the person furnishing the consideration were not a beneficiary under the trust, then whether or not the income to be accumulated under the trust would be taxable to the settlor would depend upon whether the person furnishing the consideration could fairly be said to have a substantial adverse interest in the trust.\textsuperscript{53}

\textsuperscript{49} Ibid.
\textsuperscript{50} Ibid.
\textsuperscript{51} \textit{Int. Rev. Code} §167 (1939).
\textsuperscript{52} Reinecke v. Smith, 289 U. S. 172, 77 L. ed. 1109, 53 S. Ct. 570 (1933).
\textsuperscript{53} It has been held that where a trust is created for a child, a parent who has the duty of supporting the child has a "substantial adverse interest" in the trust, although the parent was not named directly as a beneficiary of the trust. Raoul H. Fleischman, 40 B. T. A. 672 (1939); Freda R. Caspersen, 40 B. T. A. 759 (1939).
The conclusion that income which is to be accumulated for unborn or unascertained beneficiaries under a North Carolina trust is taxable to the settlor because of Section 996 of the North Carolina Code is, of course, posited upon the proposition that the federal income tax makes no distinction between a trust which is revocable because of a formal reservation of a power of revocation and one revocable because of a rule of law. It has been held with seeming reason that this distinction is not material as far as the federal gift and estate taxes are concerned. There is no manifest reason why it should make any particular difference in connection with the federal income tax.

It is possible that an irrevocable trust for unborn or unascertained beneficiaries may be created in North Carolina despite Section 996 by an explicit provision for irrevocability. If this is true, and it is by no means clear that it is, then income accumulated for such beneficiaries under an irrevocable trust for their benefit should be taxable to the trustee rather than to the settlor of the trust. The problem here, of course, is that discussed earlier of whether Section 996 expresses a personal privilege which the settlor of a trust for unborn or unascertained beneficiaries may waive, or an inflexible rule of public policy. There is no advantage to be gained by repeating the earlier discussion of this point.

(3) The Federal Gift Tax

A taxable gift is not made under the federal gift tax when a revocable trust is created. The taxable transfer takes place only upon the relinquishment of the power of revocation. Applied to a North Carolina trust for unborn or unascertained beneficiaries this means that where such a trust is created by way of a gift there may be considerable difficulty in determining when liability for the federal gift tax accrues.

Going back to the case with which this discussion started, suppose that A gratuitously conveys property to B in trust for C for life, remainder to C’s unborn children. The trust instrument is silent as to whether the trust is revocable or irrevocable. A cannot revoke C’s life estate. To this extent it would seem that he has made a taxable gift. Under Section 996 of the North Carolina Code, however, A may divest the unborn beneficiaries of their remainder interests. It would appear,
therefore, that there will be no taxable gift of the remainder until the interest of the remaindermen vests and becomes irrevocable.\footnote{Ibid.}

A possible argument might be made to the effect that $A$ made a taxable gift of the entire trust property at the time he created the trust. Unlike the federal estate and income taxes the federal gift tax contains no explicit definition of a revocable trust. It is not clear whether a trust which can only be revoked with the consent of a substantial adverse interest is to be treated as a revocable trust under the gift tax as it is under the estate tax, or as an irrevocable trust as it is under the income tax. The present position of the Regulations\footnote{Regs. 79, Art. 3 (1936) as amended by T. D. 5010 (1940).} is that such a trust is an irrevocable trust, which means, of course, that a taxable gift occurs when the trust is created. Assuming in the hypothetical case that $C$'s interest in the trust is both substantial and adverse, it might be argued that this is a trust which can only be revoked with the consent of a substantial adverse interest and that a gift of the property embraced in the trust occurs when it is created.

It seems reasonably clear, however, that when the Regulations say that a trust which can only be revoked by the concurrence of a person having a substantial adverse interest is an irrevocable trust, they have in mind a situation where no portion of the trust can be revoked without such concurrence. If, for example, the interest of the unborn beneficiaries could not be recalled without $C$'s consent in the hypothetical case, then for gift tax purposes the entire trust would be irrevocable and its creation taxable under the gift tax. Where, however, part of a trust can be revoked without anyone's consent, which is the situation with respect to the interest of the unborn beneficiaries in the hypothetical case, it would seem that to this extent there is a revocable transfer which is not taxable as a gift under the federal gift tax.\footnote{Emery May Holden Norweb, 41 B. T. A. 179 (1940).}

These conclusions are premised, of course, upon the assumption that for gift tax purposes there is no distinction between a trust revocable by rule of law and one revocable because of a formal reservation of a power of revocation.\footnote{Commissioner v. Allen, 108 F. (2d) 961 (C. C. A. 3d, 1939).} The discussion has also proceeded upon the assumption of a hypothetical situation where there was no express provision for irrevocability. If by explicit provision a trust for unborn or unascertained beneficiaries can be made irrevocable despite Section 996, a taxable gift for purposes of the federal gift tax will occur when such a trust is created. If, however, as seems not at all unlikely, Section 996 expresses a principle of public policy which cannot be waived, the trust
will remain revocable despite explicit provision against revocation and
there will be no taxable gift when it is created.\textsuperscript{63}

\textbf{CONCLUSION}

Section 996 of the North Carolina Code constitutes a serious tax
hazard for persons who have created or who are about to create trusts
for unborn or unascertained beneficiaries under the laws of North Caro-
lina. If the proper construction of that section is that it confers merely
a personal privilege of revoking such trusts, which may be waived by an
explicit provision against revocation, it is, of course, possible to create
irrevocable trusts for unborn and unascertained beneficiaries in North
Carolina just like it is in other states. By careful planning North
Carolinians may undertake such trusts without encountering any heavier
federal tax burdens than citizens of other states. If, however, Section
996 expresses a rule of public policy which makes it impossible to
create an irrevocable trust for unborn or unascertained beneficiaries,
it does a serious injustice to people who wish to create such trusts under
the laws of this state. Either they must resign themselves to heavy
federal tax burdens or they must go abroad and seek to bring their
transactions under the more favorable laws of some other jurisdiction.

It is clear that the desirable construction of Section 996 in view of
the federal tax situation is that it creates a personal privilege rather
than that it expresses an inflexible rule of public policy. It is not at
all clear, however, whether this is a permissible construction under the
broad language of that section or the one which will finally be adopted
by the North Carolina courts. Even though Section 996 may eventually
be construed as conferring merely a defeasible privilege, until this ques-
tion is finally settled there will be a period of acute uncertainty during
which the conscientious lawyer can do little more than advise his clients
who wish to create a trust for unborn or unascertained beneficiaries to
try to create them under the law of some other state. He may even
feel obliged to counsel the revocation of such trusts which have already
been created in North Carolina and their reconstitution under the laws
of some other jurisdiction.

Trusts in North Carolina should not be subjected to these hazards.
Section 996 should be amended to provide that it shall not apply to a
trust which is explicitly declared to be irrevocable. Of course, even this
amendment will not fully meet the unfortunate situation which Section
996 has created. It will take care of future cases, but it will not meet
the very legitimate necessities of trusts created before the amendment is
passed. A good many trusts for unborn and unascertained beneficiaries

\textsuperscript{63} Supra p. 287.
have been created in North Carolina with an explicit provision against revocation in the confident expectation that the settlors would be relieved from any future tax liability.

These cases can be partly cared for by providing a simple statutory procedure by which the settlor of a trust for unborn or unascertained beneficiaries may release his power of revoking the trust. Even this, however, will not take care of the cases where due to the death or other incapacity of the settlor this is no longer possible. Conceivably such situations might be met by amending the statute to provide that a trust for unborn or unascertained beneficiaries, which was explicitly declared to be irrevocable, shall be irrevocable, regardless of whether the trust was created before or after the passage of the amendment.

This is a just solution, but a nice question may arise as to its constitutionality. Of course, there will be no problem if the North Carolina Supreme Court construes the statute in its present form as creating a mere privilege of revocation which may be waived by explicit provision against revocation. Assuming, however, that the Court construes the statute as stating a rule of policy which cannot be waived, then the question will arise as to whether the retroactive operation of the amendment does not unconstitutionally deprive the settlor of a trust for unborn or unascertained beneficiaries of a vested right. It is true that in Stanback v. Citizens National Bank of Raleigh it was held that Section 996 applied to trusts for unborn and unascertained beneficiaries created before as well as after the passage of that statute. The retroactive operation of Section 996 was, moreover, held to be constitutional. If Section 996 may be applied retroactively to convert an irrevocable trust for unborn or unascertained beneficiaries into a revocable trust, it might seem to follow that the proposed amendment could be applied retroactively to convert a revocable trust into an irrevocable trust. This does not, however, follow from the reasoning in the Stanback case. The Court there said that an irrevocable trust for unborn or unascertained beneficiaries could be converted into a revocable trust because the contingent expectancies of the beneficiaries were not protected by the constitution. There is a strong intimation that vested rights could not be treated in the same way. Unless it is possible to say that the power of revocation conferred upon the settlor of a trust for unborn or unascertained beneficiaries is not a vested right protected by the constitution, the retroactive operation of the proposed amendment would appear to be clearly unconstitutional.

64 197 N. C. 292, 148 S. E. 313 (1929).