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form upon the same class of property, including franchises, within the territorial limits of the authority levying the tax.[34] The taxes levied under the Use Tax Act, therefore appear to be arbitrary, non-uniform, illegal, and in contravention of and prohibited by the North Dakota Constitution.

LEGISLATIVE INTENT

The question of the intent of the legislature as to how the use tax should operate remains open. The Attorney General of Iowa, which state North Dakota apparently patterned its sales and Use Tax Acts after, in one of his opinions said that the use tax is imposed as a complement to the sales tax and is intended to require the buyer of goods purchased outside the state to pay an amount *equal* to the sales tax that he would have paid had he purchased the goods within the state.[35] The Supreme Court of Iowa has held that the use tax law is supplementary to the sales tax law and serves, not only to produce revenue, but also to protect dealers within the state by placing them on tax *equality* with out-of-state vendors whose sales are not subject to sales tax.[36]

It is submitted that the legislature be urged to pass appropriate legislation, during the next general assembly, to remedy our use tax law.

ODELL ASTRUP.

INCOME TAX SAVING VIA THE SHORT TERM TRUST

The short-term intervivos trust has become of increasing importance to counteract the present day graduated income tax.[1] The trust is doubly advantageous when it can accomplish its ultimate goals in the form of gifts to one whom the grantor is morally obligated to support, and at the same time split the taxpayer's income into two or more separately taxable entities.[2] For example an out-

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34. N. D. Const. art XI, § 176.
35. Iowa Op. Att'y Gen. at 536 (1938).
36. Peoples Gas and Elec. Co. v. State Tax Comm'n, 238 Iowa 1369, 28 N.W.2d 799 (1947). See Nelson v. Sears Roebuck & Co., 312 U. S. 359 (1941). A New York Corporation, with retail establishments in Iowa, was required by Iowa statute to collect a tax on orders placed by residents of Iowa at the corporation's office outside the state. The Iowa statute was upheld, the court saying ". . . The use tax and sales tax are complementary. Sales made wholly within Iowa carry the same burden as those mail order sales. A tax or other burden does not discriminate against interstate commerce where equality is its theme."

1. General references include: Murphy, *Clifford-Type Trusts and the 1954 Code*, 29 N.Y.S. Bull. 55 (1957); Alexander, *A Case Method Restatement of the New Clifford Regulations*, 3 Tax L. Rev. 189 (1947).
2. But one must use care. See Paster v. Commissioner, 245 F.2d 381 (8th Cir. 1957) (A trust transaction within a family group is subjected to special scrutiny so that what is in reality one economic unit may not be broken up into two or more units); Edison v. Commissioner, 148 F.2d 810 (8th Cir. 1945) (The grantor is taxable if he retains in economic substance what he previously enjoyed).

right gift may be undesirable because one's beneficiaries are minors or are otherwise incapable of managing a substantial investment.[3]

Many taxpayers have not utilized the advantages of the trust device in that they feel they cannot afford to give up their property permanently because of oncoming old age, and resulting reduced earning power. This group is the moderately wealthy whose income ranges from $10,000 to $75,000 per year, or a tax rate from 25% to 70%.[4] This class of people is not so concerned with estate plans which avoid estate taxes as they wish to avoid present income taxes. They desire a temporary situation which will return the trust corpus to them after a certain period of time.

Who pays the income tax on the trust income is determined upon the concept of ownership as first defined by *Helvering v. Clifford*,[5] which treated the grantor as owner of the trust for tax purposes if: he had control over the corpus or income of the trust; or, there was an intimate family relationship between the grantor and the beneficiaries; or, the term of the trust was short.[6] Today the Clifford principles, with many refinements, are codified and these sections of the Code are the sole basis for determining the grantor's ownership and corresponding taxability.[7]

Section 673 of the Internal Revenue Code is specifically concerned with reversionary intervivos trusts. The section and the regulations state: 1) Income of the trust is not taxable to the grantor unless the reversion of either the income or the corpus may take place within ten years;[8] 2) The grantor of the trust is not taxed if the reversion takes place at the death of the trust beneficiaries even if at the creation of the trust their life expectancy is less than ten years;[9] 3) If the life of the trust is based upon an event other than

3. Wolder, *Making Gifts in Trust for the Members of One's Family*, 35 Taxes 273 (1957).

4. See Int. Rev. Code of 1954, §§ 1, 2, for income tax tables.

5. 309 U. S. 331 (1940).

6. *Ibid.* See Pavenstedt, *The Treasury Legislates: The Distortion of the Clifford Rule*, 2 Tax L. Rev. 7, 10 n. 19 (1946) (But clarification in subsequent decisions makes it clear that the last one supplements the other two). See also Howard Phipps, 47 B.T.A. 357, 364 (1942, *rev'd*, 137 F.2d 141 (2d Cir. 1943).

7. Int. Rev. Code of 1954, §§ 671-678, specifically Subtitle A, Chapter 1, Subchapter J, Subpart E. The "Clifford Regulations", promulgated in 1946, were the first attempt to set a standard for the courts, U. S. Treas. Reg. 111, § 29.22 (a)-21 (1945), T. D. 5488, 1946-1 Cum. Bull. 19, as amended, T. D. 5567, 1947-2 Cum. Bull. 9 [now U. S. Treas. Reg. 118, § 39.22 (a)-21].

8. Int. Rev. Code of 1954, § 673 (a), U. S. Treas. Reg. § 1.673 (a) (1956), T. D. 6217, 1956-2 Cum. Bull. 434. See Int. Rev. Code of 1954, § 673 (b) (For charitable trusts the minimum life of the trust need be only two years.). Charitable trusts are most beneficial to people in the larger income brackets. For a good example of the uses and advantages of charitable trusts see Tomson and Jaffe, *The Short-Term Trust and Charitable Contributions*, 35 Taxes 350 (1957).

9. Int. Rev. Code of 1954, § 673 (c), U. S. Treas. Reg. § 1.673 (a)-1 (b) (1956), T. D. 6217, 1956-2 Cum. Bull. 435.

the death of the beneficiaries or a term of years, the trust income is not taxed to the grantor unless that event may reasonably occur within ten years.[10]

For example, take a hypothetical person of the moderately wealthy class of taxpayer. His name is John Taxpayer. He is currently earning $40,000 per year from farming operations and sundry investments. His assets consist of land and securities valued at $250,000. He is 45, married, and has two sons: a student in premedicine who is 21 years old and another son age 10. His mother is 70 and relies upon John for support. John wishes to put some money away for his younger son's college education. He finds that his mother needs $2,000 per year to maintain her comfortably. His older boy, who is getting married, will need about $3,000 per year to continue school.

What should John Taxpayer be advised to do? None of these "expenses" are deductible for tax purposes;[11] but John may, in effect, deduct them through the media of three reversionary trusts. These trusts are outlined as follows: 1) Create an intervivos irrevocable trust, the income of which is to be distributed currently to his mother for life, the corpus to revert to John, the grantor, at her death. The income from this trust is not attributed to the grantor because the reversion depends upon the life of the trust beneficiary, the mother.[12] Under this trust the mother will still receive $2,000 per year but the grantor's gross income will be reduced by $2,000. 2) Create an irrevocable ten year trust, the income to be distributed to his married son and then revert back to the grantor, John. The income of this trust also is not taxable to the grantor because there is no reversion within ten years.[13] Here too the grantor's income will be reduced in an amount equal to the trust income. 3) Create an irrevocable eleven year trust for the benefit of his minor child, the income to be accumulated for him until he reaches the age of 21 at which time it will be distributed to him and the corpus will be returned to the grantor. The in-

10. Int. Rev. Code of 1954, § 673 (a), U. S. Treas. Reg. § 1.673 (a)-1 (c)c (1956), T. D. 6217, 1956-2 Cum. Bull. 435. (If the life of the trust is based upon a contingency, that contingency is considered for determining the happening within ten years). See Edna B. Elias, 41 B.T.A. 1109 (1940) (Corpus to revert to the grantor only if she survived both her husband and child beneficiaries); Phebe Warren McKean Downs, 36 B.T.A. 1129 (1937) (Reversion only if beneficiary daughter should die or remarry). Neither case treated the grantor as the owner of the corpus for tax purposes.

11. See Int. Rev. Code of 1954, §§ 151, 152, 214.

12. See Int. Rev. Code of 1954, § 673 (c). This holding has been recognized for some time; in this regard see G.C.M. 17, 741, 1937-1 Cum. Bull. 157.

13. Int. Rev. Code of 1954, § 673 (a). A trust which will last for ten years or until the death of the beneficiary, whichever occurs first, would also be an effective transfer and often more desirable; in this regard see U. S. Treas. Reg. § 1.673 (a)-1 (c) (1956), T. D. 6217, 1956-2 Cum. Bull. 435.

come from this trust is not taxable to the grantor either. A grantor of a trust may provide that the income of such trust accumulate so long as the income is ultimately payable to the designated beneficiaries.[14] When creating a trust for the benefit of a minor, one must be careful to use the trust income only for purposes which the grantor is not legally obligated to perform.[15] The grantor here is under no legal obligation once his son becomes 21. Comparing John's present tax status with his trust program we find:

Before (Joint Return)		With 3 Intervivos Trusts	
Taxable Income	$40,000	Taxable Income	$34,000
Tax Payable	14,500	Tax Payable	11,400[16]
Dependant's Needs	6,000	Dependant's Needs	0
Net Income	$19,500	Net Income	$22,600

Tax saving per year $3,000

Gift tax on the trust corpus must also be considered. Though the purview of this note does not include a consideration of gift taxes, such taxes must be considered by the grantor of short-term intervivos trust. Suffice it so say that in the example posed the value of the corpus will not exceed the exemptions and deductions provided for by the gift tax law.[17]

The trust program just presented is not taxable to the grantor as a reversionary interest. To completely escape having the income attributed to him,[18] the grantor must not retain certain powers of administration,[19] powers to change the beneficial enjoyment,[20]

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14. Int. Rev. Code of 1954, § 174 (b) (7) (B).

15. Int. Rev. Code of 1954, § 677 (b) (If the grantor has a legal obligation to the beneficiaries, the grantor is treated as the owner of the trust for tax purposes to the extent that such trust income is so distributed). See also Henry G. Miller, P-H 1952 T. C. Mem. Dec. ¶ 52208 (Income not applied to the support of dependent held not taxable to the grantor); Mairs v. Reynolds, 120 F.2d 857 (8th Cir. 1941) (Income for the present education of minor children taxable to the grantor); Raoul H. Fleichmann, 40 B.T.A. 672 (1936) (Maintenance for one's minor son is a legal obligation). See also, *e. g.*, Robert S. Bradly, 1 T. C. 566 (1943) (Trust for the benefit of adult daughters ,not taxable to the grantor); Rev. Rul. 54-516, 1954-2 Cum. Bull. 54 (Trust income accumulated for children held not to be a legal obligation).

16. Of course, the mother and eldest son will be taxed upon the trust income they receive; the trustee will pay the tax on the accumulated income of that trust. The total amount of this tax is far less than if all of the income is attributed to the grantor. See generally Int. Rev. Code of 1954, Subtitle A, Chapter 1, Subchapter J, Subparts A, B, C, D.

17. For gift taxes see Int. Rev. Code of 1954, Subtitle B, Chapter 12. The value of the gift is determined by taking the value of the corpus at the time of transfer less the reversionary interest.

18. The trust must pass each of the tests separately, and failure to pass any one of them will result in the grantor being taxed for the trust income.

19. Int. Rev. Code of 1954, § 675. See, *e. g.*, Warren H. Corning, 24 T. C. 907 (1955), *aff'd mem.*, 239 F.2d 646 (6th Cir. 1956) (The power of the trustee was imputed to the grantor who could substitute grantees); Louis J. Reizenstein, 22 T. C. 843 (1954) (Grantor taxable when the grantor's wife, who was trustee, was inexperienced in business matters); Rev. Rul. 54-9, 1954-1 Cum. Bull. 20 (Where the grantor retained

powers to revoke,[21] all of which are too detailed for the scope of this article but are well defined in the Internal Revenue Code and the recent treasury regulations.[22] By giving these powers to independent trustees the grantor may escape most of these restrictions:[23] Thus a prearranged plan so that the trustees are not actually independent,[24] or an unreasonable power of removal by the grantor have been held to be non-adverse.[25] The test for determining independent or adverse trustees is a substantive one.[26] But the grantor is not taxed simply because he is a co-trustee,[27] or the grantor received only non-material satisfaction.[28] The grantor may be a trustee if 50% of the trustees are adverse parties to the grantor.[29] Thus the grantor and a Trust Co. together may be co-trustees, or the grantor's wife may be co-trustee, but not the grantor and his wife together as sole trustees.[30]

The short-term trust can be as advantageous in saving income tax as an estate plan is in saving estate tax. As always, the trust

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the right to lease back the property from the trustee, held the trust income was taxable to the grantor).

20. Int. Rev. Code of 1954, § 674. See, *e. g.*, Edward E. Bardly, 27 B.T.A. 280 (1932) (If nothing prevents the grantor from making himself a beneficiary he is taxable); Rev. Rul. 54-41, 1954-1 Cum. Bull. 22 (Grantor taxable when he had the sole discretion to determine the needs of the beneficiaries and distribute such needs).

21. Int. Rev. Code of 1954, § 676. Often retention of a power to revoke may be more advantageous than a reversion. The regulations covering both reversions and power to revoke are similar; thus a power to revoke only after ten years does not make the donor the substantial owner. By retaining a power to revoke the grantor may make a gift of the corpus to the beneficiary simply by releasing the power.

22. Int. Rev. Code of 1954, §§ 671-678. See Ingle v. McGowan, 189 F.2d 785 (2d Cir. 1951) (Actual command of property is taxed rather than the refinements of title control); Brown v. Commissioner, 131 F.2d 640 (3rd Cir. 1942), *cert. denied*, 318 U. S. 767 (1943) (The factors of trust ownership are not the niceties of title but the controls retained by the settlor).

23. U. S. Treas. Reg. § 1.672 (c)-1 (1956), T. D. 6217, 1956-2 Cum. Bull. 433 (Where any related or subordinate parties are not independent or adverse, their acts are treated as the grantor's acts. Thus, *e. g.*, the grantor's wife, if living with the grantor, the grantor's mother, father, brother, sister, employees, are related or subordinate to the grantor.). See also Rev. Rul. 58-19, 1958-1 Cum. Bull. — (Half-brother and sister subordinate to the grantor).

24. See Rev. Rul. 54-9, 1954-1 Cum. Bull. 20.

25. Warren H. Corning, 24 T. C. 907 (1955), *aff'd mem.* 239 F.2d 646 (6th Cir. 1956) (Right to substitute trustees reserved); Bush v. Commissioner, 133 F.2d 1005 (2d Cir. 1943) (Where the trustee was the taxpayer's attorney and financial advisor, not independent); Commissioner v. Lamont, 127 F.2d 875 (2d Cir. 1942) (Trustee who was taxpayer's attorney and financial advisor not independent).

26. Int. Rev. Code of 1954, § 672 (a) (An adverse party is defined as one having a substantial beneficial interest adversely affected by the exercise of the trustee's powers). See, *e. g.*, Commissioner v. Betts, 123 F.2d 534 (7th Cir. 1941) (Beneficiaries have a substantial interest); U. S. Treas. Reg. § 1.672 (a) (1956), T. D. 6217, 1956-2 Cum. Bull. 432 (Remainderman and a donee of a general power of appointment have substantial interests).

27. See, *e. g.*, Sidney Nathan, P-H 1952 T. C. Mem. Dec. ¶ 43232.

28. See Helvering v. Stuart, 317 U. S. 154 (1942); Robert S. Bradley, 1 T. C. 566 (1943) (Satisfaction of seeing his children provided for).

29. Int. Rev. Code of 1954 § 672. See Sidney Nathan, P-H 1952 T. C. Mem. Dec. ¶ 43232.

30. See Int. Rev. Code of 1954, § 672 (c). The development of trust departments by many banks today provide easy access to competent independent trustees for these intervivos transfers as well as testamentary trusts.

plan must be correlated with the taxpayer's individual desires; unfortunately the desire for tax saving and the reluctance to divest control of one's property are often conflicting goals. The complex Code provisions plus the unawareness of the opportunities for tax avoidance must also be overcome. These drawbacks are not insurmountable, however, and once successfully met, full use of the short-term trust and its tax advantages will follow.

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