March 10, 1930.

OPINION No. 1554.

TAXATION; INCOME TAX; TAXABLE INCOME:

Income receivable by life beneficiaries from property devised and/or bequeathed in testamentary trust upon which the inheritance tax has been assessed, is subject to the territorial income tax.

SAME; EXEMPT REQUESTS OR INHERITANCES:

Income receivable by life beneficiaries from property devised and/or bequeathed in testamentary trust is not a bequest or inheritance within the contemplation of Section 1391, Revised Laws of Hawaii, 1925, exempting bequests or inheritances from taxation under the Territorial Income Tax Law.

Honorable E. S. Smith,
Treasurer, Territory of Hawaii,
Honolulu, Hawaii.

Sir:

The opinion of this Department has been requested by you and Mr. Glass, Income Tax Assessor, relative to the taxability under the Territorial Income Tax Law of income received by a life beneficiary under the will and/or testamentary trust of a deceased person where an inheritance tax is assessable upon the corpus of the property devised and/or bequeathed.

In oral conferences you set forth various cases arising in your Department involving the question above propounded. In general the facts involved in such cases are as follows:

A testator dies leaving a will disposing of property in trust to designated trustees upon certain trusts includ-

ing the payment of income to designated beneficiaries for life. An inheritance tax is assessed against the total net estate pursuant to Chapter 104, Revised Laws of Hawaii, 1925, as amended, and more particularly for the purposes of this discussion, pursuant to Section 1400 thereof, the pertinent part of which provides as follows:

"*Sec. 1400. lmposed when, rate.* All property which shall pass by will or by the intestate laws of the Territory, from any person who may die seized or possessed of the same while a resident of the Territory, or which, being within the Territory, shall pass, whether by the laws of the Territory, or otherwise, from any person who may so die while not a resident of the Territory, or which or any interest in or income from which, shall be transferred by deed, grant, sale or gift, made in contemplation of the death of the grantor, vendor, or bargainor, or intended to take effect in possession or enjoyment after such death, to any person or persons, or to any body politic or corporate, in trust or otherwise, or by reason whereof any person or body politic or corporate shall became beneficially entitled, in possession or expectancy, to any property, or to the income thereof, shall be and is subject to a tax hereinafte provided for * * *."

The value of the net estate is ascertained by capitalizing the income receivable by life beneficiaries and adding thereto the present value of the remaindermen's interest. It is the contention of the life beneficiaries that the payment of the inheritance tax excludes the liability to pay the territorial income tax upon income received by them throughout their lives. This contention is predicated upon Section 1391, Revised Laws of Hawaii, 1925, as amended, the pertinent part of which provides as follows:

"Provided, further, that in assessing the income of any person or corporation there shall not be included the amount received from any corporation as dividends upon the stock of such corporation if the tax of two per centum has been assessed upon the net profits of such corporation as required by this chapter, nor any bequest or inheritance otherwise taxed as such."

And that part of Section 1400, Revised Laws of Hawaii, 1925, providing as follows:

" * * * All property so passing for which such exemption of five thousand dollars ($5,000.00) can be maintained shall not be taxable as income under the provisions of any other law."

The amount of the inheritance tax is computed pursuant to the provisions of Section 1400 in cases of definite and certain ascertainment and where the amount is uncertain, including an estate, income, or interest for a term of years, or for life, or determinable upon any future or contingent descent, or a remainder, reversion or other expectancy, real or personal, the same is computed pursuant to the provisions of Section 1412. In the latter case, Section 1402 requires that the computation be based upon a determination of the value of the entire property or fund by which such estate, income or interest is supported, or of which it is a part.

In determining the propriety of the contention made by the life beneficiaries, it is desirable to inquire into the nature of the interest passing to a life beneficiary under a testamentary trust. Such an inquiry first presents the question whether the right to receive income is distinguishable from the actual income received, and in itself the subject of the bequest.

An examination of the authorities indicates that the *right* to receive income is property, and is to be distinguished from income accruing to the owner of the *right.* The corpus of the property left by a testate continues unimpaired by the gift of income therefrom, and if the *right* to receive that income for a certain period is bequeathed, the fund itself cannot be said to be the subject of the gift. Likewise, if, in computing the value of the corpus in determining the inheritance tax, the income is capitalized pursuant to the standards of mortality and the rate of five per cent per annum fixed by the statute. and such capitalized value is merged with the value of the remainder to reflect the present total value of the corpus for inheritance tax purposes, it does no violence to the statute to say that the income itself is not taxed.

It follows that income as such does not constitute a bequest within the contemplation of the statute. This view is in harmony with controlling authorities.

In the determinative case of *Irwin vs. Gavit,* 69 L. Ed. 897, 268 U. S. 161, 165-169, 45 S. Ct. 475 the Supreme Court of the United States construed similar provisions of the Federal Income Tax Act of 1913, c. 16, sec. 2, A Subds. 1 and 2, B.D. & E. (38 Stat. 114, 166 et seq.). The question there was whether certain sums received by one Gavit under the will of Anthony N. Brady were income and taxable as such. The will left the residue of the estate in trust, and a portion of the income therefrom was directed to be paid to Gavit during his life, subject to being cut off by certain prescribed conditions. The courts below had held that the gift to Gavit was a bequest and not taxable under that provision of subsection B of Section 2 of the Act, which prescribes that "the value of property acquired by gift, bequest, devise or descent" is not to be included in net income, but only the income derived from such property is subject to the tax. The Supreme Court says:

" • • • The language quoted leaves no doubt in our minds, that, if a fund were given to trustees fur A for life, with remainder over, the income received by the trustees and paid over to A would be income of A under the statute. It seems to us hardly less clear that even if there were a specific provision that A should have no interest in the corpus, the payments would be income none the less, within the meaning of the statute and the Constitution, and by popular speech. In the first case it is true that the bequest might be said to be of the corpus for life; in the second, it might be said to be of the income. But we think that the provision of the act that exempts bequests assumes the gift of a corpus, and contrasts it with the income arising from it, but was not intended to exempt income properly so-called simply because of a severance between it and the principal fund."

The *Gavit* case has been cited and followed in numerous cases including the following: *Heiner vs. Beatty,* 17 Fed. (2nd Ed.) 743; affirmed 72 L. Ed. 723, 276 U. S. 598 (affirmed on authority of *Irwin v. Gavit; Commissioner of Internal Revenue vs. Widener,* 33 Fed. (2nd Ed.), 833 (decided by the Circuit Court of Appeals, Third Circuit, June 20, 1929), and *White vs. Gilchrist,* 211 N. Y. S. 746.

In the cases cited *supra,* it was held in general under

statutory provisions similar to the ones in question here, that a beneficiary receiving income from property devised and/or bequeathed in trust, was subject to an income tax thereon, and that because income receivable by the beneficiary under a will was described as an annuity and/or income, and its capitalization value fixed for inheritance tax purposes, which was paid by the beneficiary, the same did not render the annual payments exempt from an income tax.

This view of the law is supported in this jurisdiction by the cases of *Estate of Castle,* 25 Haw., 108, affirmed 281 Fed., 609, and *Wilder vs. Hawaiian Trust,* 20 Haw., 589. In the *Castle* case it was held that where an estate is devised to trustees and such trustees are charged with the duty of paying out of such estate certain annuities, the annuities as such were not subject to the inheritance tax. And in the case of *Wilder vs. Hawaiian Trust,* the Supreme Court held that income accumulated by trustees under a testamentary trust was subject to the income tax when received personally by the life annuitants.

Applying these authorities to the instant case, it appears that the inheritance tax contemplated by the statute is only directed to the payment of a tax upon the transfer of the corpus of the property passing upon death, and that income in itself does not constitute a "bequest or inheritance" as those terms are used in the tax statutes. It further appears that the method of computation is directed to the ascertainment of the value of the corpus, and that although various interests therein, including the right to receive income for certain designated periods, may be included in the basis for measuring the total value of the corpus, the tax still remains a tax upon the transfer of the corpus, and this is so even though the tax may be theoretically apportioned in the assessment thereof among legatees of rights to receive income from the corpus.

It is contended by certain life beneficiaries that tax

laws should be construed favorably for the taxpayer. Mr. Justice Holmes, in delivering the opinion of the Supreme Court of the United States in *Irwin vs. Gavit*, supra, says in respect to such a contention:

"* * * It is raid that the tax law should be construed favorably for the taxpayers. But that is not a reason for creating a doubt, or for exaggerating one when it is no greater than we can bring ourselves to feel in this case."

Mr. Justice Holmes likewise answers the contention that the rule of contemporaneous construction is invokable, and that considerable weight should be given to the practical construction which for many years has been placed upon the statute by the assessors exempting such income. It is sufficient to say that such construction by officials is to be resorted to only in aid of the interpretation in ambiguous and doubtful cases. The case of *Irwin vs. Gavit, supra,* is controlling in the determination of the doubt, if any, existing in the case here.

You are advised for the reasons above stated that income and/or annuities paid to life beneficiaries from property subjected to the payment of the inheritance tax are not exempt from the income tax where the payment of such income and/or annuity does not impair the corpus.

Respect fully,

H. T. KAY,
First Deputy Attorney General.

APPROVED:
H. R. HEWITT,
Attorney General.