TERRITORY OF HAWAII

DEPARTMENT OF THE ATTORNEY GENERAL

HONOLULU

45

January 31, 1942

OPINION NO. 1797

TAXATION: INCOME TAX:

Trust income which is to be either distributed to the grantor or accumulated, is not taxable to the grantor insofar as it is accumulated, merely because of the possibility of distribution of the accumulations to the grantor in the discretion of the trustees in the event of an emergency.

Honorable William Borthwick
Tax Commissioner
Territory of Hawaii
Honolulu, Hawaii

Dear Sir:

You have requested our opinion as to whether or not income is taxable to the grantor of a trust, for net income tax purposes, in the following situation:

The trust was created in 1933 and is irrevocable. The trustees named in the trust instrument are the grantor's mother and a trust company. There is no provision for the grantor to replace either trustee. The income is distributable to the grantor but any surplus income over the amount deemed by the Trustees "adequate and appropriate, considering the character, individuality and station in life of Settlor", may

be accumulated and added to the corpus of the trust estate. Upon the death of the grantor her mother, if she survive her, will receive the entire income. Upon the death of both the grantor and her mother the trust will terminate, and the corpus will be distributed as set forth. There is no possibility of reverter of the corpus or accumulation of income to the grantor or her heirs or devisees, except under the following clause:

> "* * * In the event of any emergency or extraordinary situation, of which the Trustees shall be the sole judges, in which Settlor requires funds in addition to the income from the trust estate, said Trustees may for such purpose sell part of the corpus of said trust estate and pay the net proceeds of such part thereof as may be required to or for the benefit of the Settlor."

Section 2037, R.L. 1938, provides that increase of a trust which may be either distributed or accumulated shall be taxed to the beneficiaries in the amount distributed and to the trust in the amount accumulated, with two exceptions, one of which concerns revocable trusts and is in no way involved, the other exception being as follows:

> "Income for benefit of grantor. There any part of the income of a trust, in the discretion of the grantor of the trust, either alone or in conjunction with any other person not having a substantial adverse interest in the disposition of the income in question, may be distributed to the grantor or may be held or accumulated for future distribution to him, such part of the income of the trust shall be included in computing the net income of the grantor;"
>
> Sec. 2 37, par. C, R.L. 1935.

This provision differs substantially from Section 167 of the Internal Revenue Code, which is its nearest counterpart in the federal act. Under the local act the only possibility of taxing the accumulated income would be on the ground that it was accumulated for future distribution to the grantor. The right to have the accumulated income distributed depends, however, upon the occurrence of an "emergency or extraordinary situation." Under similar clauses the Board of Tax Appeals has held that the income was not "accumulated for future distribution to the grantor." Katherine Boyd Morehead, 42 B.T.A. 851; Frances S. Willson, 44 B.T.A. 383. Similarly, the Board of Tax Appeals holds that a mere possibility of reverter of the accumulated income, as part of the corpus, in the event the named beneficiary or beneficiaries do not survive the grantor, is not enough to make out a case of income "accumulated for future distribution to the grantor." William H. Boeing,

37 B.T.A. 178; J.S. Pyeatt, 39 B.T.A. 774; Genevieve F. Moore, 39 B.T.A. 808; Henry Martyn Baker, 43 B.T.A. 1029; John P. Wilson, 49 B.T.A. 1260. On the other hand, Kapalan v. Commissioner, 66F. (2d) 401 (C.C.A.1st) holds that where the accumulated income may in the future be distributed to the grantor that is sufficient, but in that case the grantor had the discretion to distribute the accumulations to himself if he survived his wife. The case is contrary to the posiibility of reverter cases in the Board of Tax Appeals, and while it has been distinguished by the Board of Tax Appeals (39 B.T.A.781) on the ground of Helvering v. St. Louis Union Trust Co., 296 U.S. 29, and Becker v. St. Louis Union Trust Co., 296 U.S. 48, those Supreme Court cases have now been overruled. Helvering v. Hallock, 309 U.S. 106. The obstacle in the way of distribution of the accumulations to the grantor in the present case, however, is not merely the happening of a specified event (which under the Kaplan case might be considered an immaterial obstacle) but, further, the discretion of the trustees must be exercised in her favor. That discretion is not controlled by the grantor, within the intent of the local statute, and the accumulations cannot be said to be "for future distribution to the grantor."

Respectfully,

Rhoda V. Lewis
Deputy Attorney General

Approved:

Attorney General