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by Austin Bramwell and Leah Socash

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In this article, Bramwell and Socash argue that the spousal unity rule under section 672(e), which attributes even an ex-spouse's trust income back to the grantor ex-spouse, is unconstitutional under the due process clause limitations announced in *Moore* and that grantors have a constitutional right not to be taxed on their ex-spouses' trust income.

Unsurprisingly, Congress has long chosen to tax a married grantor on trust income, so long as the grantor's spouse is included in the class of beneficiaries.[1] The grantor of a trust, Congress apparently reasoned, does not truly surrender access to income if the grantor can continue to benefit from it indirectly through a spouse.[2] In addition — and this time rather surprisingly — Congress has chosen to tax the grantor on trust income so long as even a *former* spouse remains in the class of beneficiaries.[3] In other words, if one spouse creates a trust for the other, and the spouses later divorce, acrimoniously or otherwise, the grantor remains obligated to report and pay tax on income paid over to or held for the benefit of the ex-spouse.[4]

Absurd as it sounds, the attribution of one ex-spouse's trust income to the other ex-spouse follows from a literal reading of section 672(e). Enacted in 1986,[5] that section, known as the spousal unity rule, provides that "a grantor shall be treated as holding any power or interest held by . . . any individual who *was* the spouse of the grantor *at the time of the creation of such power or interest*" (emphasis added).[6] In other words, the grantor is deemed to have personally retained any power or interest that in fact belongs to a spouse or an ex-spouse, provided that the power or interest came into existence when the grantor and the spouse or ex-spouse were married. As the grantor is generally treated as the owner of any trust of which the grantor himself is a beneficiary,[7] the effect of the spousal unity rule is to cause virtually any trust for a spouse or ex-spouse,[8] if created while the spouses were married, to be taxed to the grantor. That the spouses later divorce makes no difference.

Few individuals contemplating divorce welcome the prospect of paying tax on an ex-spouse's income. Unfortunately, the prospect arises all too frequently. Wealthy individuals, in

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[1] A spouse's interests in income were added as a grantor trust trigger by the Tax Reform Act of 1969, section 332(a)(1). An exception to spousal attribution applies if distributions or accumulations of income for the spouse can only be made with the consent of an adverse person. *See* section 677(a) of the IRC of 1986, as amended (generally treating the grantor as the owner of any trust whose income may be distributed or accumulated for a spouse).

[2] H.R. Rep. No. 91-413 at 97 (part 1), 91st Cong., 1st Sess. (1969), 1969-3 C.B. 261.

[3] Section 672(e).

[4] A distribution from a grantor trust to a beneficiary is treated as a tax-free gift to the beneficiary under section 102(a). Rev. Rul. 69-70, 1969-1 C.B. 182 (providing that an individual beneficiary is not taxable on the income distributed to him from a trust in which the income is taxed to the grantor).

[5] TRA 1986, section 1401(a). The text of section 672(e) was modified two years later by the Technical and Miscellaneous Revenue Act of 1988, section 1014(a)(1).

[6] Section 672(e)(1).

[7] Section 677(a)(1)-(2).

[8] In principle, grantor trust status can be defeated if income can only be distributed or accumulated with the consent of an adverse person. Section 677(a). That condition is rarely satisfied in practice.

their estate tax planning, often create irrevocable trusts in which a spouse has a beneficial interest (perhaps along with others, such as the grantor's descendants). They do so for the very reason that Congress anticipated when it chose, for income tax purposes, to treat the grantor as the owner of a trust for the benefit of a spouse: By naming a spouse as a beneficiary, a grantor can make an irrevocable transfer of property yet retain enjoyment indirectly through the spouse. For estate tax purposes — in contrast to the income tax rules — the inclusion of the spouse as a beneficiary does not cause trust property to be included in the grantor's gross estate.[9] Thus, by creating an irrevocable trust for the benefit of a spouse, the grantor can pass on wealth, including post-gift appreciation, outside of the grantor's estate yet still benefit indirectly from the trust. In short, irrevocable trusts for the benefit of spouses — in recent years, dubbed spousal lifetime access trusts or SLATs — enable grantors both to have their estate tax planning cake and eat it too.

A SLAT can work as planned and even succeed brilliantly, so long as the spouses remain happily married. But if the marriage sours, SLAT planning can turn disastrous. Under the spousal unity rule, divorce does not terminate the attribution of the beneficiary spouse's interests back to the grantor spouse.[10] Thus, if the beneficiary spouse continues to be eligible for distributions, the grantor continues to be taxed on the income. Moreover, the grantor doesn't need to have retained any control or influence over the trust for the spousal unity rule to apply. The trustee, for example, could invest the entire portfolio in high-income, tax-inefficient investments, and the grantor can do nothing to stop it or avoid the resulting income tax attribution.

Fortunately, there is a remedy. Congress undoubtedly has broad powers to attribute income — including from a trust — back to the grantor,[11] but those powers are not unlimited. On the contrary, as the Supreme Court reaffirmed last year in *Moore*,[12] the Fifth Amendment's due process clause proscribes arbitrary attributions. Exactly what attributions are arbitrary remains unclear. But if any attribution is arbitrary, it is surely the attribution of one ex-spouse's trust income to the other. In our view, grantors of trusts for the benefit of former spouses have a constitutional right not to be taxed on the trust income merely because of the ex-spouse's access to trust income. This article explains why.

Constitutional Limits on Attribution: The Doctrine After *Moore*

Moore was not supposed to be a case about attribution. According to the taxpayers' petition for certiorari, the question presented was "whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states."[13] But though it agreed to take up the case, the Supreme Court declined to answer the question (or, as the dissenting justices wrote,[14] it simply changed the subject). The Court instead focused on the plain reality that the income at issue in *Moore* was in fact realized, if not by the individual taxpayers, then by the foreign corporation of which they were shareholders. Thus, reasoned the majority, the question was not whether Congress could tax unrealized income but rather whether it could attribute income realized by the corporation to its shareholders.

The answer to the latter question was yes. The Court held that Congress does indeed have broad power to attribute income from a corporation to its shareholders, including the taxpayers in *Moore*. Thus, in attributing a corporation's income to the

[9] *Cf.* Rev. Rul. 70-155, 1970-1 C.B. 189 (acknowledging that property transferred during the taxpayer's lifetime is not pulled back into the transferor's gross estate at death merely because the donee spouse permits the transferor to use the property as the spouse's guest); *Estate of Gutchess v. Commissioner*, 46 T.C. 554 (1966), *acq.* 1967-2 C.B. 2.

[10] As discussed in the text, historically the spousal unity rule's application to ex-spouses was largely mitigated by section 682. That section, before its repeal by the Tax Cuts and Jobs Act in 2017, section 11051(b)(1)(C), caused income paid, credited, or required to be distributed to an ex-spouse to be taxed to the ex-spouse (and not to the grantor), despite any attribution to the grantor under the grantor trust rules.

[11] *See, e.g.*, *Burnet v. Wells*, 289 U.S. 670, at 678-679 (1933).

[12] *Moore v. United States*, 602 U.S. 572 (2024).

[13] Petition for Writ of Certiorari at i, *Moore*, 602 U.S. 572.

[14] *Moore*, 602 U.S. at 621 (Thomas, J., dissenting).

taxpayers, Congress had not imposed a direct tax on the corporate shares — which, under Article I's apportionment clause,[15] would require apportionment among the states based on population. Rather, the tax was an indirect tax on realized corporate income, which merely requires that the tax be uniform throughout the United States. Whether a tax on unrealized income must be apportioned was left for another day.

In sidestepping the realization question, the majority reaffirmed that there are at least some limitations on Congress's attribution power. In particular, the Court cautioned that the Fifth Amendment's due process clause "proscribes arbitrary attributions."[16] But after laying down that principle, the majority did not elaborate on exactly what attributions would count as arbitrary. The majority's opinion, as Justice Amy Coney Barrett observed in her concurrence, provides no more than a preview of some future analysis.[17]

And as a preview, *Moore* does offer at least some insight into what the Court views as arbitrary. At least three sources of guidance can be gleaned from the majority's opinion. First and most obviously, *Moore* announces, as a "clear rule" established by "this Court's precedents," that Congress may attribute the undistributed income of a business entity to its owners, at least when the entity has not itself been taxed on the same income.[18]

Second, *Moore* indicates, albeit somewhat obliquely,[19] that *Wells*[20] supplies the test for determining whether an attribution is arbitrary. Importantly for estate planners, *Wells* happens to address whether income realized by an irrevocable trust could be attributed back to the grantor.[21] Thus, while the meaning of arbitrariness may be unclear in many contexts, the Supreme Court has provided direct guidance on the extent to which trust income may be attributed back to the grantor.

Finally, in deciding *Moore* for the government, the Court gave "great weight" to Congress's "long settled and established practice" of attributing corporate income to its shareholders.[22] Closely related to the Court's deference to Congress was the Court's admitted reluctance to trigger a "fiscal calamity" by rendering large swaths of the IRC unconstitutional.[23] After *Moore*, a congressional practice of attributing income in a particular way supports the conclusion that attribution is constitutional.

In summary, *Moore* affirms a general principle, namely, that the Fifth Amendment's due process clause prohibits Congress from arbitrarily attributing income from one person to another. It further holds that Congress does not act arbitrarily when it attributes an entity's income to its shareholders or partners (provided, at least, that Congress has not also taxed the entity on that income). As for other situations, *Moore* adopts *Wells* as the test for determining whether an attribution is permitted. Finally, the Court advises that it will give great weight to a long-settled and established practice of attribution. That, in short, is the attribution doctrine to be applied after *Moore*.

Additional Limits on Attribution

Moore leaves much unanswered. The majority opinion provides no examples of an arbitrary attribution, beyond, perhaps, a hypothetical attribution of corporate income to shareholders when Congress had already taxed the income.[24] The Court leaves uncertain whether *Wells* should be extended, qualified, or modified in any way. In her concurrence, Barrett also raises the intriguing possibility that the 16th Amendment independently imposes a limit — conceivably, a more stringent limit than the one imposed by the Fifth Amendment — on Congress's attribution authority.

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[15] U.S. Constitution Art. I.

[16] *Moore*, 602 U.S. at 599.

[17] *Id.* at 618 (Barrett, J., concurring).

[18] *Id.* at 586. Conversely, the Court strongly indicates, without so holding, that it would be unconstitutional to tax both the entity and its shareholders on the same income.

[19] *See* text at *infra* notes 35-48.

[20] *Wells*, 289 U.S. 670.

[21] *See infra* note 39 et passim.

[22] *Moore*, 602 U.S. at 592.

[23] *Id.* at 597.

[24] *Id.* at 599. Even then, the Court declines to say definitively that the attribution would be unconstitutional. *Id.* at 584, n.2.

Barrett's concurrence helpfully pointed to two possible sources of further guidance. First, she cited *Hoeper*,[25] a case that involved the taxation of married couples in which the Court held that a tax statute had impermissibly attributed income from one taxpayer to another. Second, Barrett pointed future courts to the factors suggested by the government for determining whether an attribution of income is arbitrary. At oral argument, Justice Neil Gorsuch asked the government what factors the Court should consider in determining arbitrariness.[26] The government responded with a list of three, which Barrett recited in her concurrence and for which she added helpful citations.

The government's suggested arbitrariness factors are:

- whether the taxpayer has sufficient power and control over the income that it is reasonable to treat him as the recipient of the income for tax purposes;[27]
- whether the taxpayer receives a special privilege or benefit from the entity that earns the income;[28] and
- whether the entity is foreign and thus outside the reach of an accumulated earnings tax.[29]

For better or worse, the majority chose not to adopt any of those factors in its own attribution analysis. Still, Barrett advised that the factors may prove useful to courts determining the constitutional limits of attribution.[30]

Applying *Moore* to Postdivorce SLATs

To attempt a complete theory of how courts will, or should, analyze whether an attribution of income passes constitutional muster would take some hubris. While the justices favorably cited the government's advocacy at oral argument, the majority stopped short of adopting, as Barrett was apparently willing to do, the government's suggested arbitrariness factors. The limits of Congress's attribution powers thus remain largely a mystery.

Fortunately, we do not need a comprehensive understanding of those limits to evaluate the constitutionality of the spousal unity rule. In *Moore*, after all, the Court was able to dispose of the taxpayer's argument without defining the contours of the arbitrariness limit. All the Court needed was a long-settled congressional practice, together with a series of cases upholding that practice. That history made it possible for the Court to reach the narrow holding that taxpayers can be taxed on their shares of corporate income.

Similarly, a court faced with a constitutional challenge to the spousal unity rule, as applied to a postdivorce SLAT, could decide the challenge on relatively narrow grounds. The courts merely need to follow prior cases on the attribution of income from one individual or trust to another individual, just as the Supreme Court in *Moore* claimed to follow a series of cases upholding attribution from entity to shareholder. The difference is that in *Moore*, congressional practice and case law supported attribution of income from a corporation to shareholders. In the case of the spousal unity rule, congressional practice and case law imply that attribution of income to the ex-spouse grantor is unconstitutional.[31]

We now apply the Court's attribution framework, preliminary as it may be, to the postdivorce SLAT. We consider whether Congress's power to attribute corporate income to shareholders has any relevance to the spousal unity rule, we apply the *Wells* test, and we consider whether Congress has a long-standing practice of taxing the grantor on an ex-spouse's trust income. Finally, we consider the two further sources of guidance identified by Barrett. As we will see, all elements of the Court's attribution doctrine point to the same conclusion: The

[25] *Hoeper v. Tax Commission of Wisconsin*, 284 U.S. 206 (1931).

[26] Transcript of Oral Arguments at 118-123, *Moore*, 602 U.S. 572 (2024) (No. 22-800).

[27] *Moore*, 602 U.S. at 619 (Barrett, J., concurring); *Commissioner v. Sunnen*, 333 U.S. 591, 604 (1948).

[28] *Moore*, 602 U.S. at 619 (Barrett, J., concurring); *Wells*, 289 U.S. at 679.

[29] *Moore*, 602 U.S. at 619 (Barrett, J., concurring); *cf. Ivan Allen Co. v. United States*, 422 U.S. 617, 624 (1975).

[30] *Moore*, 602 U.S. at 619 (Barrett, J., concurring).

[31] Indeed, a challenge to the spousal unity rule would be easier to decide than the challenge in *Moore*. As three justices complained in *Moore*, the majority tendentiously read a series of prior cases as blessing the practice of attributing income from a corporation to its shareholders. *Moore*, 602 U.S. at 604, 613-617 (Barrett, J., concurring); *id.* at 645-648 (Thomas, J., dissenting). By contrast, prior cases on attribution from a trust or an individual to another individual are clearly on point.

spousal unity rule is unconstitutional as applied to trusts for ex-spouses postdivorce.

Business Entities and Trusts: An Incongruity

Moore unmistakably adopts, as a clear rule supposedly emerging from precedent, that Congress may choose to tax either an entity directly or the entity's owners on their shares of the income.[32] Equally unmistakably, that "clear rule" is inapplicable if a business entity is not involved. Given the pains that the majority takes to emphasize the narrowness of its holding, any analogy from a corporation or partnership, which has shareholders or partners, to another form of entity that has no equity owners must fail. A trust, for example — unless it is recharacterized as an association[33] — lacks equity owners. Thus, it is not possible for Congress to enjoy a constitutional election, similar to the one identified in *Moore*, to tax either the entity or its owners.

If an analogy is to be drawn at all — and again, we think it would be inappropriate to do so — it would suggest that Congress needs special justification to tax the grantor on trust income. *Moore*, after all, holds that Congress may choose whether to tax the entity or its equity owners. A trust, meanwhile, does have beneficial owners — the beneficiaries eligible for or entitled to distributions under the terms of the trust. Similar to the shareholders of a corporation, beneficiaries are owed fiduciary duties and ultimately must receive the trust's income and capital. Applied to the trust context, therefore, *Moore* suggests that Congress may tax either the trust as an entity or its beneficiaries, but not necessarily both.[34] Any attempt to tax someone other than the trust or its beneficiaries, such as the grantor, therefore requires justification other than the one that *Moore* identifies. That justification can be found in some cases, as the discussion below explains, but it does not rise to the status of the "clear rule" announced in *Moore*.

The *Wells* Test of Arbitrariness

When asked at oral argument how far Congress may go in attributing income from one taxpayer to another, the government answered that "the test" is found in *Wells*.[35] *Wells*, explained the government, "looked at the taxpayer's relationship to the underlying income."[36] The majority opinion later repeated the government's answer with verbatim approval: Limits on attribution may be based, according to the majority, on the "taxpayer's relationship to the underlying income."[37] As support, the Court cited the government's account of *Wells* at oral argument, together with two pages of the *Wells* decision.[38] Without fanfare, in other words, the Court instructed future courts to apply *Wells* when determining whether an attribution decision is unconstitutional.

As it happens, the question in *Wells* was whether Congress could tax the grantor on trust income. To this day, it furnishes the constitutional foundation of what are now known as the grantor trust rules — that is, rules that in some cases deem the grantor to be the owner of a trust for income tax purposes.[39] A half-century after *Wells*, section 672(e) was added to the code as one of those rules.[40] The constitutionality of section 672(e) has not yet been tested. That said, it is unlikely to survive a *Wells* analysis.

In *Wells*, the taxpayer created five separate irrevocable trusts for the benefit of his children, relatives, and his soon-to-be wife.[41] Each trust directed that the income of the trust be used to pay, or be accumulated to pay, for premiums on

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[32] *Moore*, 602 U.S. at 586-587.

[33] *See* reg. section 301.7701-1(a)-(b) (distinguishing between ordinary trusts and business trusts); *see, e.g.*, Rev. Rul. 64-220, 1964-2 C.B. 335 (reclassifying a trust as an association).

[34] In the foundational case of *Irwin v. Gavit*, 268 U.S. 161 (1925), the revenue statute did not authorize a tax to be imposed on the trust estate. *See Irwin v. Gavit*, 295 F. 84, 88 (2d Cir. 1923) (saying that "there is nothing in the act" which made the trust estate taxable on its income). The Court brushed aside the lower courts' misgiving about taxing the beneficiaries, thereby suggesting, perhaps, that Congress may indeed choose either to tax the trust or the beneficiaries, just as *Moore* held a century later that Congress may choose to tax either the corporation or the shareholders. Since then, in a variety of contexts, Congress has chosen to tax beneficiaries on trust income. *See* sections 651, 661, 678(a); *cf.* sections 958(a)(2) and 1298(a)(3) (attributing ownership of controlled foreign corporations and passive foreign investment companies to trust beneficiaries).

[35] Transcript of Oral Arguments, *supra* note 26, at 66-67, 96-97.

[36] *Id.*

[37] *Moore*, 602 U.S. at 590, n.4.

[38] *Id.*

[39] Sections 671-679.

[40] *See* section 672(e).

[41] *Wells*, 289 U.S. at 673-674.

life insurance policies.[42] The government attempted to assess tax on the grantor based on the then revenue act, which provided that the grantor of a trust must report and pay tax on any income of a trust that is or may be paid toward the premiums of life insurance on the grantor's life.[43]

The grantor contested the alleged deficiency on the grounds that the statute unconstitutionally attributed income to him that he did not own or control. In response, the Court declared that maintenance of life insurance is a "pressing social duty" and "a common item in the family budget."[44] Thus, by setting aside a fund in trust to hold life insurance, the taxpayer had effectively directed that trust income be used for his own benefit, in the sense that income paid to keep a life insurance policy in force discharges a moral obligation of the grantor. The satisfaction of that moral obligation was enough for Congress to treat income paid to maintain life insurance as belonging to the grantor.[45]

In upholding Congress's attribution decision, *Wells* made clear that the judiciary would rarely question Congress's judgment. In the one passage in *Wells* that was cited by the majority in *Moore*[46] the Court said:

> A margin must be allowed for the play of legislative judgment. To overcome this statute [that is, the provision of the Revenue Act of 1924 whose constitutionality was at issue in *Wells*] the taxpayer must show that in attributing to him the ownership of the income of the trusts, or something fairly to be dealt with as equivalent to ownership, the lawmakers have done a wholly arbitrary thing, have found equivalence where there was none nor anything approaching it, and laid a burden unrelated to privilege or benefit.[47] [Internal citations omitted.]

Congress, put simply, must go out of its way to violate the Fifth Amendment when attributing one person's income to another.[48]

For all the play of legislative judgment that *Wells* allows, it does draw a line. As the dissent pointed out, if nothing more than a nonbinding moral obligation to provide for others justifies attribution of trust income, then a very wide range of trusts could be treated as owned by the grantor.[49] In response, *Wells* contrasts a trust holding life insurance with a trust "where the income of a fund, though payable to wife or kin, may be expended by the beneficiaries without restraint, may be given away or squandered, the founder of the trust doing nothing to impose his will upon the use."[50] In the latter case, courts reviewing an attribution decision should consider both the "relation between the parties" and the "tendency of the transfer to give relief" from moral obligations, that is, obligations "recognized as binding by normal men and women."[51] When it comes to a trust whose income is used to pay premiums on life insurance, however, a discharge of the grantor's moral obligations can be assumed. *Wells*, in short, relies on a commonsense sociology about what "normal men and women" consider to be obligatory. Given the commonly accepted obligation to provide for dependents after death, a grantor personally benefits from the payment of life insurance premiums, even if a grantor has no legal duty to maintain life insurance.

But a commonsense sociology like the one that justified attribution in *Wells* leads to a very different result in the case of a trust held for the benefit of an ex-spouse after divorce. Few would assert that one spouse, if not legally bound to do so (under a marital or property settlement agreement, for example), has a moral obligation to provide a fund for the other that continues after divorce. To the contrary, divorce is an adversarial

[42] *Id.*

[43] *Id.* at 674.

[44] *Id.* at 681.

[45] *Id.* at 682.

[46] *See Moore*, 602 U.S. at 590, n.4.

[47] *Wells*, 289 U.S. at 678-679.

[48] *Wells* also says that "liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Wells*, 289 U.S. at 678. That statement suggests that Congress's attribution powers are not so broad after all, as they must be objectively reasonable and based on the actual enjoyment of "substantial and important" privileges and benefits.

[49] *Wells*, 289 U.S. at 683-684 (Sutherland, J., dissenting).

[50] *Id.* at 682.

[51] *Id.*

process that is time-consuming, expensive, and frequently acrimonious. The default moral framework that normal men and women apply to divorce, if anything, is that spouses are entitled to get as much as and give as little to the other as possible.

Unlike in *Wells*, in a divorce situation, there is no privilege or benefit that the grantor retains from an irrevocable trust that continues for the benefit of the other ex-spouse. If anything, the postdivorce SLAT is likely a source of regret. By making a complete disposition of the SLAT property and not retaining any right to revoke or control the trust, the grantor has effectively given away assets to the ex-spouse that typically are not subject to division at divorce.[52] The grantor who creates a SLAT ends up potentially giving more than is legally required. By also imposing the burden of ongoing taxes on trust income, the spousal unity rule adds tax insult to self-inflicted injury.

Thus, the *Wells* test, forgiving as it is, cannot save the spousal unity rule. Commonsense sociology suggests that a grantor is positively harmed, in the eyes of "normal men and women," by the postdivorce continuation of income tax on an irrevocable trust for an ex-spouse. The relationship between ex-spouses is literally adversarial, yet a SLAT ends up benefiting one party while the other gets nothing in return. In the words of *Wells*, section 672(e) manages to find equivalence to ownership where none exists.

Congressional Practice of Attribution

Under *Moore*, the Court will give great weight to a long-settled and established congressional practice of attributing income from one person to another. But no such practice supports the spousal unity rule. To be sure, section 672(e) — that is, the spousal unity rule — was first enacted nearly 40 years ago, as part of the Tax Reform Act of 1986. Not until recently, however, did it actually threaten to cause the grantor to be treated as the owner of a trust for the benefit of an ex-spouse.

On the contrary, until its repeal by the Tax Cuts and Jobs Act, section 682 overrode the effect of the grantor trust rules altogether after a married couple divorced. That section, sensibly enough, provided that any income paid, credited, or required to be distributed to the grantor's spouse or former spouse, after divorce or legal separation, was included in the gross income of the spouse or former spouse but not in the gross income of the grantor. Thus, the literal application of section 672(e) to an interest held by a former spouse had no effect in practice, because section 682 reversed the effects of income attribution. The predecessor of section 682 was enacted in 1942.[53] For three quarters of a century, at least, Congress expressly protected the grantor from being taxed on an ex-spouse's trust income.

Given that long-standing policy, it is no surprise that section 672(e) was drafted somewhat imperfectly, without any worry that it might someday cause grantors to be treated as the owners of trusts for the benefit of their former spouses. Nothing in the legislative history indicates that the spousal unity rule was ever intended to apply to interests held by ex-spouses. On the contrary, according to the Joint Committee on Taxation's general explanation of TRA 1986,[54] the purpose of section 672(e) was to prevent income shifting through a strategy then known as the spousal remainder trust — a trust for the benefit of children, with remainder to spouse. The spousal remainder trust strategy only worked if the grantor and the spouse remained happily married, for otherwise the corpus could not effectively return to the grantor. Thus, if anything, the legislative history indicates that Congress did not intend for the rule to apply after divorce.

Two years later, in the Technical and Miscellaneous Revenue Act of 1988, Congress revised the spousal unity rule in a manner that confirms it had no intent to tax one ex-spouse on

[52] *See, e.g.*, *Hofmann v. Hofmann*, 63 N.Y.S.3d 243 (N.Y. App. Div. 1st Dep't 2017) (holding that the assets of an irrevocable trust created by the parties during the marriage "were not marital property subject to equitable division"); *Markowitz v. Markowitz*, 45 N.Y.S.3d 203 (N.Y. App. Div. 2d Dep't 2017) ("While marital assets placed in a trust may be subject to equitable division . . . the trust here is irrevocable, and neither party is a trustee with the power to transfer control of the trust assets."); *cf. Wortman v. Wortman*, 783 N.Y.S.2d 631 (N.Y. App. Div. 2d Dep't 2004) (holding that life insurance policies held in an irrevocable trust created by the husband were subject to equitable division because the wife, as trustee, could transfer the policies back to the husband).

[53] Section 171 of the Internal Revenue Code of 1939, added as part of the Revenue Act of 1942, P.L. 77-753, section 120.

[54] JCT, "General Explanation of the Tax Reform Act of 1986," JCS-10-87, at 1248 (May 4, 1987).

the other ex-spouse's trust income. Congress restricted the reach of section 672(e) by adding that "an individual legally separated from his spouse under a decree of divorce or separate maintenance shall not be considered married."[55] In other words, if spouses are divorced or merely separated *before* a trust is created, then the spousal unity rule does not apply.[56] Unfortunately, Congress failed to revise the language implying that if divorce or separation occurs *after* a power or interest is created, then the spousal unity rule continues to apply. Congress presumably thought it unnecessary to do so, given the section 682 override of the grantor trust rules. In any event, the 1988 revisions to section 672(e) show that Congress did not wish to attribute income from a former or even soon-to-be-former spouse back to the grantor.[57]

Thirty years later, the TCJA repealed section 682. Congress's decision to repeal section 682, however, does not indicate an intention to automatically attribute an ex-spouse's trust income back to the grantor. For one thing, the section 682 repeal was an afterthought. Congress's primary target was not section 682 but section 215, which, before its repeal by the TCJA, allowed a deduction for alimony payments. As the legislative history confirms, Congress wanted to eliminate the ability of divorcing spouses, through structuring payments to each other in a particular way, to shift income from the monied to the nonmonied spouse.[58] No mention is even made of the reasons for simultaneously repealing section 682. Presumably, repeal of section 682 was meant as a conforming change, given that it was designed to shift income to the beneficiary spouse, just as section 215, together with the inclusion of alimony in the payee spouse's income,[59] had done.

In any event, the very premise of section 682, before its repeal, was that an ex-spouse would normally be taxed on the income of a trust created by the other ex-spouse. As the regulations under section 682 have said since they were issued in 1956, income of a trust for the benefit of an ex-spouse is generally taxable to the beneficiary.[60] Only if the income happens to discharge the grantor's alimony obligations, or the grantor has retained some other grantor trust string, would income under the grantor trust rules be attributed to the grantor. Section 682 achieved uniformity of treatment by overriding the effect of the grantor trust rules and providing that the ex-spouse is taxed on income, regardless of whether the grantor's alimony obligations are discharged or not. By repealing section 682, Congress may well have expected that it was ratifying the very default treatment that section 682 assumed, namely, that the grantor is generally not taxed on income held for the benefit of an ex-spouse.

Unfortunately, as we have seen, the inartful drafting of section 672(e) defeats that expectation by treating an interest held by an ex-spouse as an interest held by the grantor, at least if the statute is read literally. The Supreme Court has said that statutes must be given their ordinary plain-meaning effect, regardless of the underlying policy.[61] But the question under *Moore* is not the meaning of the statute but whether Congress has adopted a long-settled practice. The repeal of section 682 does not mean that Congress has adopted a new practice, much less one that is long settled. It merely exposed a technical glitch in the spousal unity rule.

[55] Section 672(e)(2); P.L. 100-647, section 1014(a)(1).

[56] In addition, the 1988 act tweaked section 672(e) to (1) eliminate a prior requirement that spouses be living together at the time of an interest's creation for the spousal unity rule to apply and (2) add that the rule is triggered by an interest held by an individual who later becomes the grantor's spouse.

[57] In addition to restricting the spousal unity rule when spouses are already divorced or separated, the 1988 act added provisions confirming that sections 674(c) and 675(3) apply "for periods during which an individual is the spouse of the grantor (within the meaning of section 672(e))." The parenthetical cross-reference apparently refers to the rule that separated spouses are not considered married. Thus, the revisions to sections 674(c) and 675(3) imply that Congress did not think that the spousal unity rule would apply after separation or divorce.

[58] H.R. Rep. No. 115-409 at 179-180 (Nov. 13, 2017).

[59] *See* section 71, which the TCJA repealed along with section 215.

[60] Reg. section 1.682(a)-1(a)(3) ("Section 682(a) is designed to produce uniformity as between cases in which, without section 682(a), the income of a so-called alimony trust would be taxable to the husband because of his continuing obligation to support his wife or former wife, and *other cases in which the income of a so-called alimony trust is taxable to the wife or former wife because of the termination of the husband's obligation*" (emphasis added).).

[61] *See, e.g.*, *Gitlitz v. Commissioner*, 531 U.S. 206, 220 (2001) ("Because the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern."); *see generally Varian Medical Systems Inc. v. Commissioner*, 163 T.C. 76, 101 (2024) ("General policy concerns (i.e., those that fall short of an absurd result) and speculation about congressional intent cannot override clear statutory text.").

Indeed, a literal application of the statutory unity rule would contradict Congress's long-standing and settled practices. Congress has consistently sought to prevent the tax system from interfering with either the marital unit or with the process of its dissolution. For example, section 2516 permits transfers to be made under a marital settlement agreement without risk of gift tax; similarly, section 1041 prevents gain recognition on transfers of property incident to divorce. The code also facilitates the division of tax-deferred retirement accounts between spouses.[62] Divorce is vexing enough as it is; Congress has tried to not make it worse by imposing adverse tax consequences.

Yet the spousal unity rule, to the extent enforced, creates the mother of all postdivorce tax headaches. It literally requires the grantor to pay taxes on an ex-spouse's trust income for the rest of their joint lifetimes, despite the grantor having no say over how much income will be recognized and when. It thereby artificially gives the beneficiary spouse leverage over the grantor spouse, both in settlement negotiations and in their ongoing dealings.[63] Even if the beneficiary spouse agrees in a divorce settlement to reimburse the grantor spouse for taxes, the result is still a lifelong, tax-driven entanglement, with the beneficiary spouse having to pay amounts over to the grantor spouse and the grantor spouse having to collect from the beneficiary spouse.[64]

It is unclear whether Treasury and the IRS intend to enforce section 672(e) after a couple divorce. In Notice 2018-37, 2018-18 IRB 521, the government asked for comments on whether "guidance is needed regarding the application of sections 672(e)(1)(A), 674(d), and 677 following a divorce or separation in light of the repeal of former section 682." But the language of section 672(e) is quite clear. By suggesting guidance is needed anyway, Treasury and the IRS are effectively expressing doubt about whether the section should be enforced at all. That the executive branch implicitly questions whether section 672(e) should be interpreted to mean what it says is itself a sign that its meaning was unintended.

In summary, today there is no settled and established practice of taxing the grantor on an ex-spouse's trust income. Indeed, the settled and established practice had been the opposite. Historically, Congress went out of its way, through section 682, to tax the beneficiary on the income, regardless of the extent to which the grantor controlled or personally benefited from the trust. The relatively recent repeal of that rule creates an unfortunate implication for trusts for ex-spouses, but that alone does not establish a practice. Instead, the spousal unity rule violently upsets Congress's long-standing policy of keeping the tax system as far away from the divorce process as possible. If anything, congressional practice militates against the spousal unity rule.

Lack of Fiscal Calamity

The *Moore* majority proclaimed its relief that the Constitution does not require the "fiscal calamity" that a holding for the taxpayers might have precipitated. No doubt the Court's reluctance to intervene radically in the tax system motivated its decision to defer to Congress's long-standing practice. Fortunately, striking down the spousal unity rule would not cause any kind of crisis, fiscal or otherwise. For one thing, it's unclear if the spousal unity rule is even being enforced. For another, the class of affected taxpayers — postdivorce trusts for ex-spouses and their grantors and beneficiaries — is minuscule compared with those potentially affected by a decision, such as the one that the Court avoided in *Moore*, that would cast doubt on whether Congress may tax unrealized sums.

Moreover, striking down section 672(e) as unconstitutional, as applied to ex-spouses, would not cause any loss of revenue at all. If courts hold that Congress may not attribute trust income to the grantor merely because an ex-spouse is a beneficiary, the result would not be an inability to collect tax on trust income. Rather, with the income no longer attributed to the grantor, the IRS could simply collect the income from the trust or

[62] *See* sections 401(a)(13)(B), 414(p).

[63] Given that leverage, the spousal unity rule possibly causes an unconstitutional taking by one spouse from another. *Cf. Kelo v. City of New London*, 545 U.S. 469, 477 (2005) ("The sovereign may not take the property of A for the sole purpose of transferring it to another private party B, even though A is paid just compensation.").

[64] So egregiously does the spousal unity rule interfere with the freedom of divorcing spouses that perhaps it even violates the Constitution's fundamental rights guarantees. *See id*.

its beneficiaries under the general rules of trust taxation set forth in sections 651-662.[65] (Indeed, given that trusts are subject to tax at the highest rates at much lower thresholds, it may be that a limitation on the spousal unity rule would increase revenue collections.[66]) By contrast, if the Court had implied in *Moore* that income cannot always be attributed from an entity to its owners, the Court would have impaired collections from owners before Congress could find a way to impose a tax at the entity level. No similar revenue gap would be opened by holding the spousal unity rule unconstitutional.

Application of *Hoeper*

So far, in assessing the constitutionality of the spousal unity rule, we have applied the *Moore* majority's framework. But as Barrett observed in her concurrence, there is more to be said about the limitations on Congress's attribution power. As it happens, there is a Supreme Court case — *Hoeper*[67] — that is all but decisive on the question of whether Congress may tax one ex-spouse on the other ex-spouse's income, as section 672(e), by its literal terms, would do. In *Hoeper*, Wisconsin had enacted a statute that taxed each spouse on the combined income of the married couple.[68] Under the statute, spouses could file separate or joint returns, but in either case had to report and pay tax on the combined average income of the spouses. In other words, a portion of one spouse's income was automatically attributed to the other. The Court struck down Wisconsin's attribution scheme under the 14th Amendment's due process clause.[69] "That which is not in fact the taxpayer's income," the Court held, "cannot be made such by calling it income."[70]

Hoeper remains good law. To be sure, it has from time to time been distinguished, but never in a closely analogous case.[71] In *Leininger*,[72] for example, a husband attempted to reduce his tax liability by purporting to assign his interest in a partnership to his wife. The Court, applying the by-now familiar anticipatory assignment of income doctrine announced in *Earl*,[73] held that the income was nonetheless taxable in substance to the husband.[74] *Hoeper* was not an obstacle to the result in *Leininger*, because in *Hoeper*, unlike in *Leininger*, each spouse's income was truly separate. Later cases upholding the so-called marriage penalty against constitutional attack have likewise distinguished *Hoeper*[75] on the straightforward grounds that the federal system, by permitting married couples to elect whether to file jointly or separately, does not, in fact, attribute one spouse's income to the other.

Any doubt concerning *Hoeper*'s viability derives from its arguably unrealistic view of the marital unit. As Justice Oliver Wendell Holmes Jr., joined by Justices Louis Brandeis and Harlan Stone, claimed in dissent in *Hoeper*, spouses usually do get the benefit of their combined incomes. (Perhaps ironically, the more conservative or libertarian justices in the *Hoeper* majority had more enlightened views on women than Holmes, who would treat the wife's property as belonging to the husband, as in common law.) *Hoeper* arguably disregards the practical reality that married couples often function as a single

[65] Reg. section 1.671-3 (generally providing that the portion of a trust not attributed to the grantor or another person under the grantor trust rules of subpart E of Part I of subchapter J is governed by provisions A through D).

[66] Section 1(e), (j)(2)(E).

[67] *Hoeper*, 284 U.S. 206.

[68] *Id.* at 213.

[69] *Id.* at 215. The limitations imposed by the 14th Amendment on state taxation are the same as those imposed on the federal government by the Fifth Amendment. *Heiner v. Donnan*, 285 U.S. 312, 326 (1932).

[70] *Hoeper*, 284 U.S. at 215.

[71] Before *Hoeper*, the Court upheld Congress's practice of attributing gains on property transferred by gift from the donor to the donee. *Taft v. Bowers*, 278 U.S. 470 (1929). The attribution decision in *Taft* is easily distinguished from the attribution decision in *Hoeper*, given that the donee of property receives the entire benefit of the proceeds from disposition of the donated property. *See Taft*, 278 U.S. at 482 ("When [taxpayer] sold the stock, she actually got the original sum invested, plus the entire appreciation and out of the latter only was she called on to pay the tax demanded."). Indeed, if Congress chose, there is little doubt that Congress could treat 100 percent of a gift as gross income, regardless of the donor's basis. *Cf.* section 102(a) (generally excluding by statute gifts and inheritances from gross income).

[72] *Burnet v. Leininger*, 285 U.S. 136 (1932).

[73] *Lucas v. Earl*, 281 U.S. 111 (1930).

[74] *Leininger*, 285 U.S. at 141-143.

[75] *Johnson v. United States*, 422 F. Supp. 958 (N.D. Ind. 1976), *aff'd per curiam sub nom. Barter v. United States*, 550 F.2d 1239 (7th Cir. 1977), *cert. denied*, 434 U.S. 1012 (1978); *Mapes v. United States*, 576 F.2d 896 (Ct. Cl. 1978), *cert. denied*, 439 U.S. 1046 (1978); *Druker v. Commissioner*, 697 F.2d 46 (2d Cir. 1982).

economic unit, as Justice William O. Douglas later wrote in his concurring opinion in *Wiener*.[76] Even *Hoeper*'s critics, however, assume that taxpayers must benefit from the income in question to be taxed on it. No judge, not even in dissent, has questioned the fundamental *Hoeper* principle that the government lacks the bare power to treat one person's income as belonging to someone else.

If, under *Hoeper*, it is unconstitutional to tax one spouse on the other spouse's income, then *a fortiori* it is unconstitutional to tax one former spouse on another former spouse's income. To treat a married couple as a single economic unit, as Holmes would have done in *Hoeper*, is one thing. It is quite another to treat ex-spouses the same way when the very purpose of divorce is separation. Both the *Hoeper* majority and *Hoeper*'s dissenters and later critics must agree that a statute attributing income from one former spouse to another violates due process protections.

Yet that is exactly what Congress has done in enacting the spousal unity rule. To be sure, the rule only applies to a former spouse's income from a trust and not to income from other sources. But the relatively narrow application of the spousal unity rule does not save it. If property is transferred outright from one former spouse to another, then income from that property could not be attributed, under *Hoeper*, back to the transferee former spouse. That the property is instead transferred in trust for the spouse should make no difference. In neither case does the transferor spouse derive any benefit from the income after the divorce has taken place.

Remaining Factors for Determining Arbitrariness

The final source of authority for determining arbitrariness is the factors that the government identified in *Moore*. As Barrett wrote in her concurrence, there are three: whether the taxpayer has power and control over the income, whether the taxpayer derives a privilege or benefit from the income, and whether the income accumulates offshore. Two of those factors are inapplicable to the validity of the spousal unity rule. To start with the last, the spousal unity rule applies regardless of whether a trust is foreign or domestic or earns income offshore. The need to prevent tax avoidance or tax deferral through foreign structures therefore provides no justification for the spousal unity rule.[77]

As for control, the spousal unity rule causes attribution of income even if the grantor retains no power or control over trust income. To be sure, the grantor of a trust necessarily exercises some form of control *ab initio* by declaring what the terms of the trust will be. But the theory that the mere creation of a trust is sufficient to justify ongoing attribution of income back to the grantor proves too much. If correct, then income from any property transferred by gift in any form, whether in trust or otherwise and regardless of the identity of the beneficiaries, could be attributed back to the donor, given that the donor has the initial power to set the terms of the gift. Not surprisingly, the Supreme Court has not taken that extreme approach. On the contrary, *Wells* only permits Congress to tax the income of a trust based on a retained privilege or benefit. If the mere power to create a trust were sufficient to justify attribution, then the retained benefit analysis would be unnecessary.

That leaves but one factor: whether the taxpayer receives a privilege or benefit from the income. That factor derives from *Wells*, as previously discussed. Unlike the grantor in *Wells*, who benefits from having a trust maintain life insurance for his dependents, a divorced grantor does not benefit from having property held in trust for an ex-spouse outside of what is required as part of a divorce settlement. The divorced

[76] *Fernandez v. Wiener*, 326 U.S. 340, 365 (1945). *Hoeper* perhaps casts some doubt on the validity of grantor trust rules that treat the grantor as the owner of income that can be distributed or accumulated for a spouse. *See* section 677. Those rules, however, can be reconciled with *Hoeper*. In *Hoeper*, the taxpayer was not responsible for his wife's sources of income, which she owned independently of any steps taken by the taxpayer. A trust for the benefit of a spouse, by contrast, is created voluntarily. Thus, in contrast to the *Hoeper* situation, Congress is at least arguably justified in assuming that the grantor retains a privilege or benefit in the form of the spouse's beneficial interest in the income.

[77] Offshore accumulations are instead addressed in the trust area through two regimes. The first is in section 679, which generally treats any foreign trust with U.S. beneficiaries as a grantor trust that is subject to current taxation. Section 679 is a current taxation regime conceptually similar to the subpart F regime that applies to controlled foreign corporations. The second is in sections 665-668, which impose a throwback tax on U.S. beneficiaries who receive distributions of accumulated income from foreign non-grantor trusts. Sections 665-668 are conceptually similar to the passive foreign investment company regime (which is modeled on those very sections).

grantor is, if anything, positively harmed by having put assets out of reach of the marital estate. Thus, the factor cuts against the validity of attribution of an ex-spouse's interest back to the grantor.

Conclusion

Clients contemplating divorce hope at least to have the reassurance of expert advice. All too often, in tax matters, what they get instead is a doomsday prophecy. If they attempted to transfer wealth in a tax-efficient manner by including a spouse in the class of trust beneficiaries, they are routinely advised that even after divorce, they will need to pay taxes on their ex-spouses' trust income. Only through painful and expensive negotiation and restructuring can they find a way out of the predicament.

In our view, that advice is misguided and the source of much needless anguish.[78] A grantor has a clear constitutional right not to be taxed on trust income merely because an ex-spouse is included in the class of beneficiaries. To be sure, it is always prudent to implement additional strategies to defeat the spousal unity rule.[79] But if the IRS is ever brave enough to enforce the spousal unity rule at all after spouses divorce, the grantor should prevail. SLAT grantors should have nothing to fear. ■

[78] Indeed, the advice is positively harmful to clients. As one of the authors warned in an earlier article, if a grantor has a constitutional right to not be taxed on trust income, then the grantor who nonetheless chooses to pay income tax on trust income makes a transfer by gift of the amount of tax paid. The advice that a postdivorce SLAT is automatically a grantor trust, in other words, inadvertently subjects the grantor to gift tax risk. *See* Austin Bramwell and Raquel Begleiter, "Will *Moore* Be the End of Estate Tax Planning?" *Tax Notes Federal*, May 6, 2024, p. 1033. At a minimum, advisers who insist that the grantor report and pay tax on SLAT income, postdivorce, should also advise the grantor to consider disclosing the payment of income taxes on a gift tax return. *See* reg. section 301.6501(c)-1(f)(4).

[79] The simplest plan is to draft the SLAT so the spouse's interests terminate upon divorce. Many instruments don't contain those provisions since happily married couples typically prefer to be represented by one attorney, who is reluctant to draft a trust in a manner adverse to one of the joint clients. Alternatively, a grantor can take advantage of the fact that the spousal unity rule does not apply to interests or powers that are created after spouses divorce or are separated. In other words, if a new trust is created after divorce or separation, the spousal unity rule has no effect. That should be the case even if a trust created before divorce is merged into or paid over to the new trust. In that case, the grantor's status as the grantor carries over under reg. section 1.671-2(e)(5). But just because the identity of the grantor carries over to the new trust does not mean that the ex-spouse's newly created interests and powers are deemed to have been created before the divorce occurred; on the contrary, section 672(e) looks only to when powers or interests are created, not when the grantor's identity is established. Because the Supreme Court forbids courts from construing a statute in a manner contrary to its plain meaning, neither the IRS nor the courts are likely to adopt a construction of section 672(e) that artificially achieves the strange result of taxing the grantor on an ex-spouse's income.