1 T.C. 566 (1943)

A grantor is not taxable on trust income under Sections 166 or 167 of the Revenue Act when the power to revoke or amend the trust is held by trustees other than the grantor, and any benefit to the grantor requires the consent of a beneficiary with a substantial adverse interest.

Summary

Robert Bradley created trusts for his daughters, granting the trustees (including his lawyer, broker, and bookkeeper) the power to alter or revoke the trusts, but not to benefit Bradley without a beneficiary's consent. The IRS argued that Bradley was taxable on the trust income under sections 22(a), 166, or 167 of the Revenue Acts of 1934 and 1936. The Tax Court held that the trust income was not taxable to Bradley because the beneficiaries had substantial adverse interests and the trustees operated independently. This case clarifies the importance of adverse interests and trustee independence in determining grantor trust status.

Facts

Robert S. Bradley created three identical trusts in 1923, one for each of his three daughters. The trusts provided income to the daughters for life, then to their issue. Ultimately, the trust corpora were to go to Bradley's grandchildren. The trustees could distribute or withhold income, adding retained income to the principal after six months. The trustees had broad powers of investment and management. Initially, Bradley was a trustee, but he later resigned. The trust instruments allowed the trustees to revoke or amend the trusts, but not to benefit Bradley without the consent of a primary beneficiary or someone with a substantial interest.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Bradley's income taxes for 1935 and 1936, arguing that the trust income was taxable to him. The Commissioner later amended their answer, seeking to increase the deficiencies. The Tax Court reviewed the case to determine whether the trust income was taxable to the grantor.

Issue(s)

1. Whether the income from trusts created by the petitioner for his daughters is includible in his gross income under Sections 166 or 167 of the Revenue Acts of 1934 and 1936, given the trustees' power to alter or revoke the trusts?

2. Whether the income from the trusts is includible in the petitioner's gross income under Section 22(a) of the Revenue Acts of 1934 and 1936, based on whether the petitioner remained the substantial owner of the trust corpora?

Holding

1. No, because the trustees, other than the grantor, had the power to revoke or amend the trusts, and any benefit to the grantor required the consent of beneficiaries with substantial adverse interests.

2. No, because the grantor had relinquished substantial ownership and control over the trust corpora, and the trustees operated independently.

Court's Reasoning

The court reasoned that Sections 166 and 167 did not apply because the beneficiaries had a "substantial interest in the income of the trusts, and consequently the corpora thereof, which was adverse to that of petitioner." The court emphasized that Bradley's primary purpose was to provide for his children. The court distinguished this case from others where the grantor retained significant control. The court also noted that even contingent beneficiaries could have adverse interests. Regarding Section 22(a), the court distinguished this case from *Helvering v. Clifford*, noting that the trusts were to continue for the lives of the beneficiaries, Bradley could not benefit without adverse parties' consent, and he retained no control over the trust corpora. The court stated: "Where the grantor has stripped himself of all command over the income for an indefinite period, and in all probability, under the terms of the trust instrument, will never regain beneficial ownership of the corpus, there seems to be no statutory basis for treating the income as that of the grantor under Section 22 (a) merely because he has made himself trustee with broad power in that capacity to manage the trust estate."

Practical Implications

Bradley v. Commissioner provides guidance on structuring trusts to avoid grantor trust status. It highlights the importance of ensuring that beneficiaries have a genuine adverse interest, preventing the grantor from easily reclaiming trust assets or income. It also demonstrates that the independence of the trustees is key. The case emphasizes that the grantor's relinquishment of control, the duration of the trust, and the presence of adverse interests are critical factors in determining whether the grantor should be taxed on the trust's income. Later cases cite Bradley for its analysis of adverse interests and its distinction from the *Clifford* doctrine, providing a framework for analyzing the substance of trust arrangements.

