1 T.C. 911 (1943)

A grantor is taxable on trust income under Section 22(a) of the Internal Revenue Code when they retain substantial control over the trust, including the power to alter beneficiaries and reclaim the corpus.

Summary

Florence Hyman created a trust for her son, naming herself and her husband as trustees. The trust accumulated income until the son turned 21, then paid income to him until age 30, at which point the corpus reverted to Hyman. Hyman reserved the right to change beneficiaries. The IRS assessed deficiencies, arguing the trust income and certain assigned dividends were taxable to Hyman, and the dividend assignment constituted a gift. The Tax Court agreed, holding Hyman retained too much control over the trust and the dividend assignment was an attempt to shift income without relinquishing ownership of the underlying stock.

Facts

On November 9, 1939, Florence Hyman created a trust with herself and her husband as trustees for the benefit of their son, John Arthur Hyman. The trust held 1,000 shares of Climax Molybdenum Company stock. Income was accumulated until John turned 21, then paid to him until he turned 30, at which point the corpus and accumulated income reverted to Florence. Florence retained the power to designate beneficiaries other than herself. On December 6, 1939, Florence assigned to her husband the right to receive dividends declared on 10,000 shares of Climax Molybdenum stock between that date and December 31, 1939. Dividends of $13,000 were subsequently paid to her husband.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Hyman’s 1939 income and gift taxes. Hyman petitioned the Tax Court for redetermination, contesting the inclusion of trust income and assigned dividends in her taxable income, as well as the gift tax assessment on the dividend assignment. The Tax Court consolidated the proceedings.

Issue(s)

1. Whether the income from the trust created by Hyman for her son is taxable to Hyman under Section 22(a) of the Internal Revenue Code, given her retained powers over the trust.
2. Whether dividends assigned by Hyman to her husband but declared and paid while she still owned the underlying stock are taxable to Hyman.
3. Whether the assignment of the right to receive dividends constituted a taxable gift, and if so, what was the value of the gift.

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Holding

1. Yes, because Hyman retained substantial control over the trust, including the power to designate beneficiaries and reclaim the corpus.
2. Yes, because Hyman remained the owner of the stock when the dividends were declared and paid, and the assignment was merely an attempt to assign income from property she still owned.
3. Yes, the assignment was a completed gift, and the value of the gift was the amount of the dividends actually declared and paid during the effective period of the assignment.

Court's Reasoning

The court relied on *Helvering v. Clifford, 309 U.S. 331 (1940)*, and *Commissioner v. Buck, 120 F.2d 775 (2d Cir. 1941)*, finding that Hyman's retained powers made her the virtual owner of the trust corpus for tax purposes. Key factors included the intimate family group, Hyman's considerable separate estate, the short term of the trust, the reversion of the corpus to Hyman, and her power to designate beneficiaries. As the court stated, the settlor reserved "the right to designate any beneficiary or beneficiaries, other than herself, to receive the income and/or principal in place and stead of the beneficiaries named herein." Regarding the dividend assignment, the court applied *Helvering v. Horst, 311 U.S. 112 (1940)*, noting that Hyman retained ownership of the income-producing property (the stock). The court quoted *Harrison v. Schaffner, 312 U.S. 579 (1941)*, stating, "Taxation is a practical matter and those practical considerations which support the treatment of the disposition of one's income by way of gift as a realization of the income to the donor are the same whether the income be from a trust *or from shares of stock* or bonds which he owns." The court determined the gift tax value based on the dividends actually paid, finding this the best evidence of the value of the transferred right.

Practical Implications

Hyman v. Commissioner illustrates the principle that grantors cannot avoid tax liability by creating trusts or assigning income if they retain substantial control over the underlying assets. This case reinforces the importance of relinquishing control to avoid grantor trust status and potential income tax liabilities. The case highlights that the IRS and courts will look beyond the form of a transaction to its substance, particularly in family contexts. Furthermore, it sets a precedent for valuing gifts of income rights based on actual income received, rather than speculative future income. This case is relevant for tax attorneys advising clients on trust design and income assignment strategies, particularly when family members are involved.

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