1 T.C. 1019 (1943)

In a community property state, a husband's control over community property, even when placed in trust for the benefit of his children, does not sufficiently alter the economic positions of the husband and wife to avoid the application of the Clifford doctrine, thus the trust income remains taxable to the community.

Summary

The Losh case addresses whether trust income is taxable to the grantors when the trust was funded with community property. The petitioners, husband and wife, created trusts for their children, funding them with interests from their community property partnership. The court held that the trust income was taxable to the petitioners. Applying the principles of *Helvering v. Clifford*, the court reasoned that the husband's continued control over the community property, even within the trust structure, meant that neither spouse had relinquished enough control to shift the tax burden. The court also addressed business expense deductions and accrual of disputed commissions.

Facts

Petitioners, husband and wife, resided in New Mexico, a community property state. They operated a business as a partnership. The wife had a substantial interest in the partnership, which was considered community property. The petitioners created trusts for their sons, transferring portions of their partnership interests to the trusts. The husband served as both trustee and managing partner, retaining significant control over the trust assets and income. The trust instrument allowed the trustee to use income for the sons' comfort, education, care, support, and welfare. Expenditures were, in fact, made for these purposes. The trusts were intended for a short period.

Procedural History

The Commissioner of Internal Revenue determined that the trust income was taxable to the petitioners. The petitioners appealed this determination to the Tax Court.

Issue(s)

1. Whether the income from trusts established with community property is taxable to the grantors when the husband, as trustee, retains substantial control over the trust assets and income.
2. Whether certain business expenses claimed by the partnership were properly deductible.
3. Whether commissions earned during the tax year, but disputed by debtors, should have been accrued as income.

Holding

1. Yes, because the husband's control over the community property, both before and after the creation of the trust, meant that the economic positions of the husband and wife were not significantly altered by the trust. Therefore the income remained taxable to the community under the principles of *Helvering v. Clifford*.
2. No, because the record showed that these expenses were not paid to public officials against public policy and that they were sufficiently related to current business.
3. No, because the doubt of collectibility was sufficiently great.

Court's Reasoning

The court relied on *Helvering v. Clifford*, which holds that a grantor is taxable on trust income if the grantor retains substantial control over the trust. The court noted that in community property states like New Mexico, the husband has significant control over community property. The court cited New Mexico statutes which state the husband is the agent of the community and given dominion and control over the community property. The court stated that when the wife permitted the husband to become trustee of the transferred community property she gave up no control or dominion that she had had previously. Therefore, the creation of the trust did not substantially change the economic relationship between the parties, and the trust income was taxable to the community. The court also determined that the business expenses were ordinary and necessary and that the commissions were not accruable due to doubt of collectibility.

Practical Implications

This case clarifies the application of the Clifford doctrine in community property states. It emphasizes that the degree of control retained by the grantor, especially within the context of community property laws, is crucial in determining whether trust income will be taxed to the grantor. Practitioners in community property states must carefully consider the extent of the grantor's control over trust assets, particularly when the grantor is the managing spouse in a community property regime. The case underscores that merely transferring property to a trust does not automatically shift the tax burden if the grantor retains substantial control. Subsequent cases have cited *Losh* in the context of grantor trust rules and the assignment of income doctrine.

