2 T.C. 298 (1943)

A grantor who retains substantial control over a trust, including the power to change beneficiaries, may be taxed on the trust's income under Section 22(a) of the Internal Revenue Code, and distributions of that income can constitute taxable gifts.

Summary

Chas. F. Roeser created a trust naming his minor children as beneficiaries and himself as trustee, retaining broad powers to manage the trust and change beneficiaries. The Tax Court held that Roeser's retained control made the trust income taxable to him and his wife (on a community property basis) under Section 22(a). Further, the distributions of trust income to the children were deemed taxable gifts from Roeser and his wife, but they were entitled to statutory exclusions. The court also imposed penalties for failure to file gift tax returns.

Facts

Chas. F. Roeser, a Texas resident, established a trust on August 30, 1938, with 20,000 shares of Roeser & Pendleton, Inc. stock as the corpus. He named himself trustee, granting himself extensive powers to manage the trust assets, including selling stock, voting rights, and reinvesting. The trust was to terminate upon the death of the survivor of Roeser and his wife, Maxine. Their two minor daughters were named primary beneficiaries, receiving income distributions. Roeser retained the right to change beneficiaries, modify the trust (within limits), and appoint a successor trustee.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies in Roeser's income and gift taxes for 1938, 1939, and 1940. Roeser and his wife petitioned the Tax Court for a redetermination of these deficiencies. The cases were consolidated.

Issue(s)

1. Whether the income from the trust created by Chas. F. Roeser is taxable to him and his wife for the years 1938 and 1939.
2. Whether the distributions of trust income to the Roeser children constitute taxable gifts for the years 1938, 1939, and 1940, and if so, whether they are gifts of present or future interests.
3. Whether a 25% penalty should be added for failure to file gift tax returns.
4. Whether taxing the trust income to the petitioners or imposing gift taxes on the distributions violates the Fifth Amendment.

Holding

1. Yes, because Roeser retained substantial control over the trust, making him

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the effective owner for tax purposes under Section 22(a).
2. Yes, the distributions are taxable gifts because the children's right to receive income stemmed from Roeser's direction, not a pre-existing beneficial interest, but the petitioners are entitled to statutory exclusions.
3. Yes, because the petitioners failed to file gift tax returns for years with net taxable gifts, and no reasonable cause for the failure was shown.
4. No, because the tax treatment is consistent with established legal principles regarding control over property and the nature of gifts.

Court's Reasoning

The court relied heavily on *Helvering v. Clifford*, noting that the extent of the grantor's control is the dominant factor in determining ownership for tax purposes. Roeser retained significant control, including the power to vote stock, change beneficiaries, and manage investments as if he owned them outright. The court stated, "It is clear beyond peradventure that the donor continued to enjoy every incident of control over this stock which had been his prior to the creation of the trust." Although the trust was intended to be long-term, the court emphasized that the length of the term is only one factor in determining taxability. The distributions of trust income were deemed gifts because the children had no guaranteed right to the income until Roeser directed it to them. The court cited *Commissioner v. Warner*, noting that until distribution, Roeser had the power to name other distributees. Because the petitioners failed to file gift tax returns when required, the penalty was mandatory, as "The question of reasonable cause arises only in the case of delinquent returns, not where taxpayer has filed no return whatever."

Practical Implications

Roeser v. Commissioner highlights the importance of relinquishing control when establishing a trust to avoid grantor trust status and potential gift tax liabilities. This case reinforces that retaining powers such as the ability to change beneficiaries or control investments can result in the trust's income being taxed to the grantor, even if the income is distributed to others. It emphasizes the need to carefully structure trusts to ensure that gifts are complete and that appropriate tax returns are filed. Later cases cite *Roeser* to emphasize that retained powers result in the grantor effectively remaining the owner of the assets for tax purposes, particularly if a donor continues to enjoy every incident of control over the assets in the trust. It also illustrates how the Tax Court determines whether a gift is a present interest or a future interest, and that a gift to a minor is a present interest if the minor has the immediate use of the funds.

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