2 T.C. 510 (1943)

A grantor is not taxed on trust income if they have irrevocably transferred ownership and control of the trust assets, even when the beneficiary is their spouse, unless the grantor retains significant dominion and control, such as the power to designate beneficiaries.

Summary

Lura H. Morgan created five trusts, four for the benefit of her husband and one where she retained the power to designate beneficiaries among her husband, nieces, and nephews. The Tax Court held that the income from the first four trusts was not taxable to Morgan because she had relinquished control and ownership of the assets. However, the income from the fifth trust was taxable to her because she retained the power to alter the beneficiaries, thus maintaining significant control over the trust assets. The court emphasized the importance of determining the real owner of the property for tax purposes.

Facts

Lura H. Morgan created four trusts (A, B, C, and D) in 1937, naming herself trustee and her husband as the beneficiary. The income of each trust was to be accumulated and paid to her husband, along with the corpus, on specific dates in the future (1948-1951). In 1938, she created a fifth trust (E), also with herself as trustee and her husband as the primary beneficiary, but reserved the right to designate other beneficiaries (nieces and nephews) if she deemed her husband not in need. The purpose of the trusts was to provide a retirement fund for her husband. Morgan and her husband also owned a significant amount of stock in Block & Kuhl Co., the company her husband presided over.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies against Lura H. Morgan for the years 1938, 1939, and 1940, including the income from the five trusts in her taxable income. Morgan challenged the Commissioner's determination in the Tax Court.

Issue(s)

1. Whether the income from trusts A, B, C, and D should be taxed to the grantor, Lura H. Morgan, under Section 22(a) or 167 of the Internal Revenue Code, given that the income was to be accumulated and paid to her husband at the end of the trust terms?

2. Whether the income from trust E should be taxed to the grantor, Lura H. Morgan, given that she reserved the power to appoint the corpus and income at the end of the trust period among her husband, nieces, and nephews?

Holding

1. No, because Lura H. Morgan irrevocably divested herself of control and ownership of trusts A, B, C, and D, with no possibility of the income or corpus reverting to her benefit.

2. Yes, because Lura H. Morgan retained a significant power to designate beneficiaries in trust E, which is akin to retaining ownership.

Court's Reasoning

Regarding trusts A, B, C, and D, the court distinguished the case from *Helvering v. Clifford*, emphasizing that Morgan had genuinely relinquished ownership and control over the trust assets. The court stated, "Petitioner has given hers away, definitely and irrevocably, and never again may use either the income or the corpus for her own benefit." The court found that the administrative powers she retained were not the equivalent of full ownership. The court also noted that the trusts were not structured to fulfill any legal obligations of the grantor. As to Trust E, the court followed *Commissioner v. Buck*, noting that the power to designate beneficiaries among a class of individuals constituted a sufficient retention of control to justify taxing the income to the grantor. "While petitioner had somewhat limited her power of disposition, she could appoint the income and corpus among her husband and nieces and nephews. In our view, the case with respect to trust E is sufficiently like *Commissioner v. Buck*… as to call for the same conclusion."

Practical Implications

This case clarifies the application of grantor trust rules, emphasizing that the key factor is whether the grantor has truly relinquished dominion and control over the trust assets. A grantor can establish a valid trust for the benefit of a spouse without necessarily being taxed on the trust income, provided the grantor does not retain significant powers, such as the power to alter the beneficiaries. This decision highlights the importance of carefully drafting trust instruments to ensure that the grantor's intent to relinquish control is clear and unambiguous. It serves as a reminder that the substance of the transaction, rather than mere legal title, determines who is taxed on the income. Later cases have cited Morgan to illustrate when administrative powers are so substantial that they equate to ownership for tax purposes.

