David Small, 3 T.C. 1142 (1944)

A settlor of a long-term trust can be taxed on the trust's income if the settlor retains substantial control over both the trust corpus and the distribution of income, even if the settlor is not a beneficiary.

Summary

This case addresses whether the income from several long-term trusts should be taxed to the settlor, who also served as trustee. The settlor established trusts for his children and grandchildren, granting himself broad administrative powers over the trust corpus and significant discretion over income distribution. The Tax Court held that, despite the long-term nature of the trusts, the settlor's retained control made him taxable on the trust income under the principles established in Helvering v. Clifford.

Facts

The petitioner, David Small, created multiple long-term trusts for the benefit of his three children and seven grandchildren. Small served as the trustee for all the trusts. The trust instruments granted Small broad administrative powers over the trust corpus. He had the discretion to distribute income to the beneficiaries, or to accumulate it within the trust. Small had considerable wealth and income beyond the trust assets, suggesting the trusts were primarily for family income allocation.

Procedural History

The Commissioner of Internal Revenue determined that the income from the trusts was taxable to the settlor, David Small. Small petitioned the Tax Court for a redetermination of the deficiency. The Tax Court reviewed the trust documents and the facts surrounding the creation and administration of the trusts.

Issue(s)

Whether the settlor of long-term trusts, who retains broad administrative powers over the trust corpus and significant discretion over income distribution to beneficiaries, is taxable on the income of those trusts.

Holding

Yes, because the settlor retained substantial control over both the trust corpus and the distribution of income, making the trust income taxable to him under the doctrine of *Helvering v. Clifford*.

Court's Reasoning

The Tax Court emphasized that while the length of the trust term is a factor, it is not

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the sole determinant of taxability. The court acknowledged the petitioner's argument that long-term trusts should only result in settlor taxation when the settlor derives an economic benefit, such as through retained voting rights of stock in a company they control or the power to change beneficiaries. However, the court stated, "the decision of such a case requires a nice balancing of the power and rights granted to the trustee and beneficiary and those retained by the donor, to the end of determining where lies the real right of ownership of the income."

The court found that Small's powers over income distribution, combined with his broad administrative powers, warranted taxing the trust income to him. The court highlighted the fact that he had the discretion to distribute income to his children or grandchildren, or to accumulate it within the trust, stating, "he was not required to distribute any part of the income to any of the beneficiaries during his lifetime." This control over the "purse strings" for his immediate family, combined with his administrative powers, led the court to conclude that the principles of *Helvering v. Clifford* applied.

The court reasoned that even though the trusts were long-term, the settlor's retained control allowed him to continue enjoying the "direct satisfactions of pater familias" and "indirect satisfactions" from the consumption of income by his family. These factors indicated that the settlor effectively remained the owner of the income for tax purposes.

Practical Implications

The *David Small* case reinforces the principle that the grantor of a trust can be taxed on the trust's income if they retain too much control, even in long-term trusts. It demonstrates that broad administrative powers combined with discretionary control over income distribution can trigger grantor trust rules. Attorneys drafting trust documents must carefully balance the grantor's desired level of control with the goal of shifting income taxation to the beneficiaries. Later cases have cited *Small* to emphasize the importance of examining the totality of the circumstances, including the powers retained by the grantor, the relationship between the grantor and the beneficiaries, and the economic realities of the trust arrangement. This case serves as a caution against grantors acting as trustees with extensive discretionary powers, especially when the beneficiaries are family members.

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