3 T.C. 482 (1944)

A grantor is taxable on trust income used to pay life insurance premiums only if the grantor contributed the income-producing property to the trust.

Summary

A husband and wife created a trust for their children. The wife contributed income-producing stock, while the husband contributed life insurance policies on his life. The trust used the income from the stock to pay the premiums on the life insurance policies. The Commissioner argued that the trust income should be taxed to either the husband or the wife. The Tax Court held that the income was not taxable to the husband because he did not contribute the income-producing property. However, the income was taxable to the wife because, under Tennessee law, parents are jointly responsible for the support of their children, and the trust income could have been used for that purpose.

Facts

Petitioners, W.C. Cartinhour and Kathleen Gager Cartinhour, were husband and wife. In 1935, they created an irrevocable trust for the benefit of their two children. Kathleen contributed 660 shares of stock in Provident Life & Accident Insurance Co. to the trust, which she had previously received as a gift from W.C. Cartinhour. W.C. Cartinhour contributed two life insurance policies on his own life to the trust. The trust agreement authorized the trustees to use the income from the trust to pay the premiums on the life insurance policies, although they were not required to do so. The trust also contained provisions for the support, education, and assistance of the beneficiaries and specified that the trust would terminate when each beneficiary reached 50 years of age.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for the years 1939 and 1940, arguing the trust income should be included in their gross income under Sections 22(a) and 167 of the Internal Revenue Code. The cases were consolidated in the Tax Court.

Issue(s)

1. Whether the income of the trust is taxable to W.C. Cartinhour under Section 22(a) of the Internal Revenue Code?
2. Whether the income of the trust is taxable to W.C. Cartinhour under Section 167 of the Internal Revenue Code?
3. Whether the income of the trust is taxable to Kathleen Gager Cartinhour under Section 167 of the Internal Revenue Code?

Holding

1. No, because W.C. Cartinhour did not retain sufficient control over the trust to be considered the substantial owner of the income-producing property.
2. No, because W.C. Cartinhour was not the grantor of the income-producing property in the trust.
3. Yes, because under Tennessee law, both parents are equally responsible for the support of their minor children, and the trust income could be used for that purpose.

Court's Reasoning

The court reasoned that W.C. Cartinhour could not be taxed under Section 22(a) because, although he had some powers as a trustee, he did not have the power to revoke the trust or take the corpus for himself. The court distinguished this case from others where the grantor retained substantial control over the trust. The court cited *Helvering v. Clifford*, 309 U.S. 331 (1940), noting the absence of powers that would equate to ownership. Regarding Section 167, the court stated that this section was intended to apply only when the grantor of the trust was also the insured party and had contributed the income-producing property. Since Kathleen, not W.C. Cartinhour, contributed the stock, Section 167 did not apply to him. Regarding Kathleen, the court relied on *Helvering v. Stuart*, 317 U.S. 154 (1942), which held that a grantor is taxable on trust income where it may be used to discharge their legal obligation to support their children. The court determined that Tennessee law imposed a joint and equal obligation on both parents for the support of their children, referencing *Rose Funeral Home, Inc. v. Julian*, 176 Tenn. 534 (1940). Therefore, Kathleen was taxable on the trust income.

Practical Implications

This case clarifies the circumstances under which trust income used to pay life insurance premiums is taxable to the grantor. It emphasizes the importance of determining who the actual grantor of the income-producing property is. The case also highlights that the legal obligation of parents to support their children can extend to mothers and can result in the taxation of trust income to the mother if that income could be used for support. This decision was influenced by the specific laws of Tennessee regarding parental support obligations. It is significant to note that Congress subsequently amended Section 167 to limit the circumstances under which trust income is taxable to the grantor due to potential use for child support, indicating a shift away from the broad interpretation applied in this case. Attorneys drafting trust agreements need to be aware of the grantor's state's specific laws regarding parental obligations. This case underscores the importance of careful trust drafting to avoid unintended tax consequences and understanding the interplay between state law and federal tax law.