***3 T.C. 128 (1944)***

A grantor is taxable on the income of a trust if they retain substantial control over the trust, including the power to direct income distribution and manage investments, even without a reversionary interest, particularly when the trust is funded with the grantor's future earnings.

**Summary**

Eugene Mesta created several trusts for his children, funded by royalty income from his agreement with Mesta Machine Co. He retained significant control over these trusts, including the power to direct income distribution, control investments, and even terminate the trusts. The Tax Court held that Mesta was taxable on the income of these trusts under Section 22(a) of the Internal Revenue Code, applying the principles of *Helvering v. Clifford*. The court reasoned that Mesta's retained powers and the integration of the trust income with his personal earnings demonstrated that he effectively remained the owner of the income.

**Facts**

Eugene Mesta, president and a large stockholder of Mesta Machine Co., entered into a royalty agreement with the company. He then created five trusts for his children, assigning his royalty income to the trusts. Mesta retained significant powers over the trusts, including the right to direct the trustee to use principal or income to satisfy his liabilities, control income distributions, control investments, and terminate the trusts. The trust income was used, in some instances, to make "Christmas gifts" to Mesta and for his business ventures.

**Procedural History**

The Commissioner of Internal Revenue determined that Mesta was taxable on the income of the trusts. Mesta petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination.

**Issue(s)**

Whether the grantor is taxable on the income of five children's trusts under Section 22(a) of the Internal Revenue Code, given his reserved interest in and powers over the principal and income of the trusts.

**Holding**

Yes, because the grantor retained substantial control over the trusts, including the power to direct income distribution, control investments, and terminate the trusts, indicating that he effectively remained the owner of the income. Additionally, the trusts were funded with the grantor's future earnings, further supporting the conclusion that the income was taxable to him.

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## Court’s Reasoning

The Tax Court relied on the principle established in *Helvering v. Clifford*, which holds that a grantor is taxable on trust income if they retain substantial control over the trust. The court emphasized the cumulative effect of Mesta’s retained powers, including his ability to direct income distribution, control investments, and terminate the trusts. The court also noted the close family relationship between Mesta and the beneficiaries, and that the trust income ultimately found its way back to Mesta. Furthermore, the court emphasized that the trusts were created by assigning the source of Mesta’s earnings (the royalty agreement), raising questions under the principles of *Helvering v. Horst* and similar cases regarding the assignment of income. The court stated, “*Regardless of petitioner’s motives, the result of his acts in creating the trusts was to reduce his income taxes by spreading large amounts of income, which would otherwise have been taxable to him, among the members of his immediate family and their fiduciaries.*“

## Practical Implications

This case reinforces the principle that a grantor’s retained control over a trust can lead to taxation of the trust income, even without a reversionary interest. It highlights the importance of carefully considering the scope of the grantor’s powers when drafting trust agreements. Attorneys should advise clients that retaining significant control over income distribution, investment decisions, or the power to terminate the trust can result in the grantor being treated as the owner of the trust income for tax purposes. The case also serves as a reminder that funding a trust with future earnings, as opposed to accumulated wealth, increases the risk of the grantor being taxed on the income. Later cases have cited *Mesta* for the proposition that the grantor’s actual control over the trust property, and not merely the form of the trust agreement, is the governing factor in determining taxability.

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