4 T.C. 88 (1944)

A grantor is taxable on trust income under Section 22(a) of the Internal Revenue Code where they retain dominion and control over the assets, even if the assets are nominally held in trust for another beneficiary.

Summary

Dorothy Sunderland transferred securities to a trust her husband had established for their children. The trust allowed the trustee to pay income to Sunderland during the children's minority, without requiring her to apply it specifically for their benefit. Sunderland commingled this income with her other funds. The Tax Court held that Sunderland was taxable on the income from the securities she transferred, despite the trust arrangement, because she retained practical control over the income under Section 22(a) of the Internal Revenue Code.

Facts

Edwin Sunderland created two trusts in 1934, one for each of his two children, naming his law partner, Walter Fletcher, as trustee. The trust indentures provided that income was to be paid to or applied to the use of the children. During the children's minority, the trustee could pay the income directly to Dorothy Sunderland (the children's mother and Edwin's wife), with no obligation to ensure the income was used for the children's benefit.
On three occasions between 1935 and 1938, Dorothy Sunderland transferred securities of her own to Fletcher, instructing him to hold them under the terms of her husband's trusts. In 1940, Fletcher paid all trust income, including that from Dorothy's securities, to Dorothy, who deposited it into her general bank account. Edwin reported the income from his securities on his tax return, while the income from Dorothy's securities was reported on the children's tax returns.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Dorothy Sunderland's 1940 income tax, arguing she was taxable on the income from the securities she transferred to the trusts. Sunderland petitioned the Tax Court for a redetermination. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether the income from securities transferred by Dorothy Sunderland to trusts established by her husband, where the trust allowed income to be paid to her without restriction, is taxable to her under Section 22(a) of the Internal Revenue Code.

Holding

Yes, because Dorothy Sunderland retained practical control and dominion over the income from the securities she transferred to the trusts, making it taxable to her under Section 22(a) of the Internal Revenue Code.

Court's Reasoning

The Tax Court reasoned that, despite the trust arrangement, Dorothy Sunderland effectively retained control over the income from her securities. The trust instrument allowed the trustee to pay the income to her without requiring any specific application for the children's benefit. She commingled the trust income with her other funds, making it impossible to trace expenditures to a specific source. The court relied on the principle established in *Corliss v. Bowers, 281 U.S. 376 (1930)*, that "income that is subject to a man's unfettered command may be taxed to him." The court distinguished this case from situations governed solely by Section 167 of the IRC, emphasizing the broader application of Section 22(a) when the grantor retains substantial control. Although the trust indentures executed by petitioner's husband controlled the disposition of the income, the basic question is whether or not such income in reality remained the income of petitioner. The court concluded that the provisions of the indentures were such that the income from petitioner's securities remained her income during the minority of each child, for all practical purposes.

Practical Implications

This case illustrates that the IRS and courts will look beyond the formal structure of a trust to determine who actually controls the trust income. The ability to use trust income without restriction, coupled with commingling of funds, can lead to the grantor being taxed on that income, even if the trust is nominally for the benefit of another. It underscores the importance of carefully structuring trusts to ensure a genuine transfer of control and benefit to avoid grantor taxation. This case is often cited in situations where the grantor attempts to retain too much control over trust assets or income. The dissent argued that the mother was charged with the duty to spend the income for the use of the children and that an arbitrary exercise of the power would be subject to judicial control.

