4 T.C. 1140 (1945)

A beneficiary with significant control over a trust, including the ability to direct income to others, may be taxed on that income under Section 22(a) of the Internal Revenue Code, regardless of whether the income is actually received.

Summary

Lena Stix created two trusts, naming her sons, Edgar and Lawrence, as trustees and "primary beneficiaries." The trustees had discretion to distribute income to the primary beneficiary's sons (the grantor's grandsons). The IRS assessed deficiencies against Edgar and Lawrence, arguing they should be taxed on the trust income distributed to their sons. The Tax Court upheld the IRS determination, finding that the beneficiaries' control over the trust income was equivalent to ownership, making it taxable to them even if distributed to others. The court relied heavily on the precedent set in *Mallinckrodt v. Commissioner*.

Facts

Lena Stix created two trusts in 1935, each funded with an undivided one-half interest in $200,000 of cash and securities. One trust named Lawrence Stix as the "primary beneficiary," and the other named Edgar Stix. Lawrence and Edgar served as co-trustees of both trusts. The trust instruments allowed the trustees, at their discretion, to distribute income and principal to the primary beneficiary or their sons (the grantor's grandsons). During the tax years in question (1938-1940), the trustees distributed all income from one trust to Edgar's son, Donald, and all income from the other trust to Lawrence's son, Edgar R. Stix, 2nd. Both grandsons reported the income on their individual tax returns.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Edgar and Lawrence Stix's income tax for the years 1938, 1939 and 1940. Edgar and Lawrence Stix petitioned the Tax Court for redetermination of the deficiencies. The Tax Court ruled in favor of the Commissioner, upholding the deficiencies.

Issue(s)

Whether the income from trusts, where the petitioners were designated as primary beneficiaries and trustees with broad discretionary powers, is taxable to the petitioners under Section 22(a), even though the income was actually paid to their children.

Holding

Yes, because the petitioners, as trustees and primary beneficiaries, possessed sufficient control over the trust income to be considered the equivalent of

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ownership, making the income taxable to them under Section 22(a), regardless of where it was distributed.

Court's Reasoning

The Tax Court relied heavily on the precedent set in *Mallinckrodt v. Commissioner*, which held that a beneficiary's power to receive trust income upon request is equivalent to ownership for tax purposes. The court reasoned that even though the Stix brothers did not directly receive the income, their power as trustees to direct its distribution to their sons demonstrated sufficient control. The Court noted that the trustees' discretion to pay the income to someone other than the primary beneficiary required the agreement of both trustees. Without that agreement, the income would necessarily go to the primary beneficiary. Therefore, each primary beneficiary had the power to obtain the current income of the trust if that suited his purpose.

The court dismissed arguments that the true purpose of the trusts was to benefit the grandsons, noting the trust terms favored the primary beneficiaries. The court also cited *Harrison v. Schaffner*, stating that the tax is concerned with "the actual command over the income which is taxed and the actual benefit for which the tax is paid." The court concluded that the petitioners' power to command the income and direct its payment to their sons meant they enjoyed the benefit of that income and were therefore liable for the tax.

Judge Harron dissented, arguing that the Lena Stix trusts were distinguishable from the *Mallinckrodt* trust because the trustees had discretion to distribute income to named beneficiaries other than the primary beneficiary. Harron believed the majority opinion essentially nullified the role of the trustees and treated the trusts as shams. She argued that the income should be taxed to those who actually received it under Section 162(b), rather than to the petitioners under Section 22(a).

Practical Implications

This case reinforces the principle that control over trust income, rather than actual receipt, can trigger tax liability. It highlights the importance of carefully drafting trust instruments to avoid granting beneficiaries excessive control that could lead to unintended tax consequences. Legal practitioners should consider this ruling when advising clients on estate planning and trust administration, especially when beneficiaries also serve as trustees and have discretionary powers over income distribution. This decision also underscores the IRS's ability to look beyond the form of a transaction to its substance, especially in cases involving family trusts. Later cases have cited *Stix* to support the proposition that a taxpayer cannot avoid income tax liability by assigning income to another when the taxpayer retains control over the income-producing property.

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