5 T.C. 856 (1945)

Income from a trust is taxable to the grantor if the grantor retains substantial dominion and control over the trust corpus and income, even if the trust is nominally for the benefit of others.

Summary

Morris Eisenberg and Herman Schaeffer created trusts for their minor children, transferring portions of their partnership interests into these trusts. They named themselves trustees, maintaining significant control over the trust assets and income. The Tax Court held that because the grantors retained substantial control, the income from the trusts was taxable to them personally under Section 22(a) of the Internal Revenue Code, as interpreted in *Helvering v. Clifford*. The court focused on the powers retained by the grantors as trustees, including restrictions on income distribution and the subjection of trust income to business risks.

Facts

Eisenberg and Schaeffer operated Bailey's Furniture Co. as a partnership. In 1940, they created separate irrevocable trusts for their children, transferring portions of their partnership interests to these trusts. Eisenberg and Schaeffer appointed themselves as trustees. The trust agreements stipulated that the beneficiaries would receive the trust funds at age 40, with provisions for earlier distribution at the trustee's discretion. The partnership agreement required unanimous consent for profit distribution, effectively allowing the grantors, in their individual and trustee capacities, to control income distribution.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Eisenberg and Schaeffer's income tax for 1940 and 1941, adding the trust income back to their personal income. Eisenberg and Schaeffer petitioned the Tax Court, contesting this determination. The Tax Court consolidated the cases. A state court later reformed the trust agreements, but the Tax Court based its decision on the original agreements in effect during the tax years in question.

Issue(s)

1. Whether the grantors retained sufficient dominion and control over the trust corpus and income such that the trust income should be taxed to them personally under Section 22(a) of the Internal Revenue Code.
2. Whether the trusts were validly made partners in Bailey's Furniture Co., such that the income attributable to the trust interests should be taxable to the trusts themselves.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because the grantors retained extensive administrative authority and control over the corpus and income of the trusts.
2. No, because the grantors, acting as trustees, maintained control over income distribution and subjected the trust income to the risks of the business, thus not creating a true partnership for tax purposes.

Court's Reasoning

The court relied on the principle established in *Helvering v. Clifford*, stating that income is taxable to the grantor when they retain substantial ownership through control over the trust. The court emphasized that Eisenberg and Schaeffer, as trustees, had significant control over the distribution of income, which could be withheld unless all partners (including themselves) agreed. The court found that the settlors' powers as trustees, coupled with their control over the partnership, allowed them to control the economic benefits of the trust property. The court distinguished this case from *Robert P. Scherer*, where the Commissioner had conceded that completed gifts had been made to the trusts. The court noted, "Taking the trust indentures and partnership agreement all together and having in mind their several provisions, we think the instant case falls within the ambit of *Losh v. Commissioner*, and *Rose Mary Hash, supra*, rather than *Robert P. Scherer, supra*, and we so hold." The court also disregarded the state court's reformation of the trust agreements, holding that the original agreements controlled the tax liability for the years in question.

Practical Implications

This case illustrates the importance of carefully structuring trusts to avoid grantor trust status. Attorneys should advise clients creating trusts to relinquish substantial control over the trust assets and income. Specifically, grantors should avoid acting as trustees, especially when the trust holds an interest in a business they control. The decision underscores that the IRS and courts will scrutinize the actual control retained by the grantor, not just the formal terms of the trust documents. Later cases applying this ruling emphasize that the grantor's continued involvement in managing the trust's assets and their beneficial enjoyment are key factors in determining taxability.

© 2025 SCOTUSreports.com. All rights reserved.