6 T.C. 1016 (1946)

A beneficiary who possesses the power to revoke a trust is treated as the owner of the trust corpus for tax purposes and is therefore taxable on the trust's income, even if that income is designated for charitable purposes or would otherwise be considered a gift.

Summary

Whitely created five trusts, funded by her husband, that provided her with $18,000 annually. She argued this was a non-taxable gift. Furthermore, she claimed income designated for charity was not taxable to her. The Tax Court held that because Whitely possessed the power to revoke the trusts entirely, she was effectively the owner of the trust assets. As such, she was taxable on all of the trust income, regardless of whether some of it was distributed as a purported gift to her or set aside for charitable purposes. The court emphasized that the power to revoke equated to ownership for tax purposes.

Facts

Whitely's husband created five trusts in 1937, each containing a provision to pay Whitely $300 per month ($18,000 annually in total). The trust instruments also granted Whitely the "full power and authority to cancel or revoke this trust at any time in whole or in part." The trusts also allocated some income to religious, charitable, and educational purposes. Whitely reported some of the trust income in her tax returns but excluded the $18,000 annual payments, claiming they were gifts, and the charitable contributions. The Commissioner assessed deficiencies, arguing that Whitely's power to revoke made her taxable on all trust income.

Procedural History

The Commissioner assessed deficiencies against Whitely for the tax years 1939, 1940, and 1941. Whitely petitioned the Tax Court for a redetermination, arguing that the $18,000 annual payments were non-taxable gifts and that the income set aside for charity was not taxable to her. The Tax Court ruled in favor of the Commissioner, holding that Whitely's power to revoke the trusts made her taxable on all of the trust income. Whitely appealed. The specific appellate outcome is not detailed in this document.

Issue(s)

1. Whether Whitely is taxable on the income of the five trusts created by her husband, given her power to revoke the trusts.
2. Whether the assessment of a deficiency for 1939 is barred by the statute of limitations.

Holding

1. No, because Whitely possessed the power to revoke the trusts, making her the equivalent of the owner of the trust corpora for tax purposes.
2. No, because the amount of unreported income taxable to Whitely exceeded 25% of the reported gross income, and the notice of deficiency was mailed to her within five years after her return was filed.

Court's Reasoning

The court reasoned that Whitely's power to revoke the trusts at any time gave her substantial dominion and control over the trust assets. It cited several cases, including *Richardson v. Commissioner*, *Ella E. Russell*, *Jergens v. Commissioner*, and *Mallinckrodt v. Nunan*, where beneficiaries with similar powers were deemed taxable on trust income. The court distinguished *Plimpton v. Commissioner*, where the beneficiary's control was limited by the discretion of other trustees. The court emphasized that the power to revoke, acting alone, equated to ownership for tax purposes. Specifically, the court stated that in cases like Whitely's, the taxpayer-beneficiary, "acting alone and without the concurrence of any one else, had the right to acquire either the corpus or income of the trust at any time." Because of this power, the court concluded that Whitely was taxable on all income, nullifying her claims of a non-taxable gift and charitable deductions. The court also held the statute of limitations did not bar assessment because the unreported income exceeded 25% of her gross income, invoking Section 275(c) of the I.R.C.

Practical Implications

This case reinforces the principle that the power to revoke a trust carries significant tax consequences. It establishes that a beneficiary with such power is treated as the owner of the trust assets for tax purposes, regardless of how the trust income is distributed. Attorneys drafting trust instruments must carefully consider the tax implications of granting beneficiaries the power to revoke. Granting this power can negate the intended tax benefits of establishing a trust, such as shielding income from the beneficiary's taxable income or facilitating charitable contributions. Later cases have cited *Whitely* to support the proposition that control over trust assets, even without direct ownership, can lead to tax liability. Taxpayers should be aware that the IRS scrutinizes trust arrangements where beneficiaries retain significant control, such as the power to revoke, and will likely treat them as the owners of the trust assets for tax purposes. The case also highlights the importance of accurate income reporting to avoid extending the statute of limitations.