5 T.C. 1049 (1945)

A grantor is taxable on the income of a trust to the extent of the property they contributed to the trust, especially if the income is used for the support of their legal dependents, regardless of whether it's actually used for that purpose.

Summary

Frank E. Joseph created a trust, transferring assets inherited from his deceased wife and his son's inheritance from her, naming the Irving Trust Co. as trustee. The trust instrument stipulated that all income be paid to Joseph for his son's support, maintenance, and education. The Tax Court held that Joseph was taxable on the portion of the trust income attributable to the assets he personally contributed to the trust, as he retained control and benefit, but not on the portion attributable to his son's assets. This decision clarifies the application of grantor trust rules under Section 167 of the Internal Revenue Code, especially when trust income is designated for a dependent's support.

Facts

Adele Unterberg Joseph died intestate, leaving her husband, Frank E. Joseph, and their son, Frank E. Joseph, Jr., as her heirs. Joseph created a trust with Irving Trust Co., transferring assets inherited from Adele, including assets belonging to his son. The trust stipulated that all income be paid to Joseph for the support, maintenance, and education of his son.
During the tax years in question, all trust income was paid to Joseph, who then returned it to the trustee to augment the trust principal. Joseph argued that he should not be taxed on the trust income because it was not directly used for his son's support.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Joseph's income tax, arguing that he was taxable on all trust income under Sections 22(a) and 167 of the Internal Revenue Code. Joseph petitioned the Tax Court for a redetermination. The Tax Court reviewed the case to determine the extent to which Joseph was taxable on the trust income.

Issue(s)

1. Whether Joseph, as the grantor of the trust, is taxable on the entire income of the trust under Section 167 of the Internal Revenue Code because the income was designated for the support, maintenance, and education of his minor son.
2. To what extent is the grantor considered to be the owner of a trust when it contains both his assets and the assets of another person (his son in this case)?

Holding

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1. Yes, Joseph is taxable on the portion of the trust income allocable to the trust principal contributed by him, because he retained control and benefit over that portion of the trust.
2. The court held that Joseph was the grantor of the 1930 trust only to the extent of property owned by him that was transferred to the trust. He was not the grantor of the trust to the extent of his son's property conveyed to the trustee; the son is taxable on that income, because a grantor is only taxed on the assets they put into the trust.

Court's Reasoning

The court relied on *Helvering v. Stuart, 317 U.S. 154* (1942), which held that a grantor is taxable on trust income that could be used for the support of minor children, regardless of whether it was actually used for that purpose. The court reasoned that because Joseph had the right to receive the trust income for his son's support, he was taxable on that income to the extent he contributed assets to the trust.
The court distinguished between the assets Joseph contributed and those belonging to his son. It held that Joseph was only the grantor to the extent of his own property transferred to the trust. The court cited cases such as *Allison L. S. Stern, 40 B.T.A. 757*, to support this distinction.
The court rejected Joseph's argument that he should not be taxed because the income was not directly used for his son's support, stating that the availability of the income for that purpose was sufficient to trigger tax liability under Section 167. The court stated that the relevant inquiry is who put the assets into the trust and if the grantor benefitted from the trust, quoting *Hopkins v. Commissioner (C. C. A., 6th Cir.), 144 Fed. (2d) 683*.

Practical Implications

This case clarifies that grantors of trusts are taxable on the income derived from assets they contribute to the trust, especially if the income can be used for the support of their dependents. It emphasizes that the mere designation of trust income for a dependent's support is sufficient to trigger tax liability, regardless of actual use.
Attorneys should advise clients creating trusts for their children to carefully consider the source of the assets contributed to the trust, as this will determine who is taxed on the income. The case serves as a reminder that Section 167 aims to tax those who retain control and benefit from trust assets, and careful planning is needed to avoid unintended tax consequences.

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