6 T.C. 266 (1946)

The grantor of a trust may be taxed on the trust's income if they retain substantial control over the trust property, even if they are acting as a trustee, especially when the beneficiaries are minors and the grantor retains broad powers over investments and distributions.

Summary

George and Lillian Chertoff created separate but similar trusts for their children, naming themselves as trustees and contributing shares of their company's stock. The Tax Court held that the income from these trusts was taxable to the Chertoffs, the grantors, under the principles of *Helvering v. Clifford*. The court reasoned that the Chertoffs retained substantial control over the trust assets and the business operated by the husband, benefiting economically from the arrangement while the children's access to the funds was restricted. The broad powers granted to the trustees, combined with their positions as natural guardians of the minor beneficiaries, led the court to conclude that the Chertoffs remained the substantive owners of the trust property for tax purposes.

Facts

George Chertoff owned a controlling interest in Synthetic Products Co. In 1937, he created trusts for each of his three minor children, Garry, Arlyne, and Gertrude, transferring 150 shares of the company's stock to each trust. George and his wife, Lillian, were named as trustees. The trust instruments granted the trustees broad discretion over investments and distributions. In 1940, Lillian also created similar trusts for the children, contributing 75 shares of stock each. The trusts' income was primarily from dividends and later, partnership profits, but no distributions were made to the beneficiaries.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in George and Lillian Chertoff's income taxes for the years 1937, 1940, and 1941, arguing that the income from the trusts should be included in their taxable income. The Chertoffs petitioned the Tax Court for redetermination. The Tax Court upheld the Commissioner's determination, finding the trust income taxable to the grantors.

Issue(s)

Whether the income of the trusts created by George and Lillian Chertoff is taxable to them under Section 22(a) of the Internal Revenue Code, as interpreted in *Helvering v. Clifford*, given their retained control over the trust assets and their positions as trustees and natural guardians of the beneficiaries.

Holding

Yes, because the Chertoffs retained substantial control and economic benefit from the trust assets, making them the substantive owners for tax purposes, thus the income is taxable to them.

Court's Reasoning

The Tax Court relied heavily on the principle established in *Helvering v. Clifford*, which taxes trust income to the grantor if they retain substantial incidents of ownership. The court emphasized several factors: the Chertoffs' control over the Synthetic Products Co., their broad discretion as trustees, the fact that the beneficiaries were minors, and the accumulation of trust income rather than its distribution. The court noted that the trustees' power to distribute principal to themselves as guardians of the beneficiaries further blurred the lines between ownership and trusteeship. The court stated, "It thus appears that petitioners have retained control of the business and the use of the trust estates therein through the power as trustees to control investments… We think that for all practical purposes these petitioners continued to remain the substantive owners of the property constituting the corpus of these trusts." The court concluded that, considering all the circumstances, the Chertoffs' economic position had not materially changed after the creation of the trusts.

Practical Implications

This case highlights the importance of genuinely relinquishing control over trust assets when seeking to shift income tax liability. It serves as a cautionary tale for grantors who act as trustees, especially when dealing with minor beneficiaries. The case reinforces the IRS's scrutiny of family trusts where the grantor retains significant managerial powers or economic benefits. Later cases applying *Chertoff* and *Clifford* often examine the grantor's powers, the independence of the trustee, and the extent to which the trust serves a legitimate purpose beyond tax avoidance. Properly drafted trusts with independent trustees and clear distribution guidelines are more likely to withstand IRS scrutiny.