6 T.C. 438 (1946)

Whether a trust instrument creates a single trust or multiple trusts depends on the intent of the grantor as manifested in the language of the instrument and the actions of the parties involved.

Summary

The Tax Court addressed whether a trust instrument created one trust for three beneficiaries or three separate trusts. The trustees argued for three trusts, citing a state court decision and the grantor's intent to treat all children equally. The court held that the trust instrument created a single trust based on the language used, the initial actions of the trustees, and the lack of evidence demonstrating a clear intent to establish multiple trusts. The court also found that the state court decision was not binding because the proceeding appeared collusive, aimed at resolving a federal tax issue without a genuine adversarial process.

Facts

James S. Reid created a trust on December 18, 1935, naming his three children as beneficiaries. The trust instrument directed the trustees to distribute income and principal "one third each" to the children. The trustees initially administered the trust as a single entity, filing a single fiduciary income tax return for the years 1936-1938. Later, the trustees began segregating assets and income into three separate accounts on December 31, 1938, and filing separate tax returns. A state court decision was obtained, which construed the trust instrument as creating three separate trusts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the trust's income tax for 1941 and 1942, arguing that the trust should be treated as a single entity for tax purposes. The trustees petitioned the Tax Court, asserting that the trust instrument created three separate trusts and that the Tax Court was bound by the state court's judgment. The Tax Court disagreed, holding that the trust constituted a single entity.

Issue(s)

1. Whether the Tax Court is bound by the judgment of the Court of Common Pleas of Cuyahoga County, Ohio, which construed the trust instrument as creating three separate trusts.
2. Whether the trust instrument created one trust for three children or three separate trusts.

Holding

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1. No, because the proceeding in the Court of Common Pleas appeared collusive, aimed at resolving a federal tax controversy without a genuine adversarial process.
2. No, because the language of the trust instrument, the initial actions of the trustees, and the surrounding circumstances indicated that the grantor intended to create a single trust.

Court's Reasoning

The Tax Court first addressed the state court judgment, finding it not binding because the proceeding appeared collusive. The court noted that one of the objects of the proceeding was to resolve a controversy "between plaintiffs and the Treasury Department of the United States respecting the taxation of the income upon the funds held by plaintiffs." The court also emphasized the lack of adversarial elements in the state court proceeding, stating, "we are not convinced…that the proceeding was not collusive…that is, 'collusive in the sense that all the parties joined in a submission of the issues and sought a decision which would adversely affect the Government's right to additional income tax.'"

Turning to the trust instrument, the court emphasized that the language predominantly referred to "the trust" in the singular. While the instrument initially mentioned "trusts created hereunder," subsequent references consistently used the singular form, such as "the trust estate" and "the trust fund." The court also noted that the trustees initially treated the trust as a single entity for several years. The court stated, "The idea of three trusts appears quite clearly as an afterthought, rather than an intention expressed in the trust instrument, which intention is, of course, the criterion by which we must decide." The court dismissed the trustees' argument that three trusts were necessary to ensure equal treatment of the children, finding that the trustees' discretion in distributing income could address any potential inequities.

Practical Implications

The *Reid Trust* case provides guidance on determining whether a trust instrument creates a single trust or multiple trusts for tax purposes. It highlights the importance of examining the language of the trust instrument as a whole, giving weight to the consistency of language referring to the trust in the singular or plural. It also emphasizes the significance of the parties' initial actions in administering the trust, as this can be indicative of the grantor's original intent. Moreover, the case serves as a cautionary tale against collusive state court proceedings aimed at resolving federal tax issues, as such judgments are unlikely to be binding on federal courts. Later cases involving similar issues of single vs. multiple trusts often cite *Reid Trust* for its analysis of the grantor's intent and the weight given to the trust's language and administrative history.

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