6 T.C. 1036 (1946)

A grantor is taxable on trust income when they retain substantial control over the trust, including the power to shift income among beneficiaries, but this control must be direct or equivalent to direct control, and the presence of adverse interests can negate such control.

Summary

Standish and Lotta Backus created trusts for their children. The Tax Court addressed whether the trust income was taxable to the grantors. A key issue was the degree of control the grantors retained over the trusts, both before and after the division of a combined trust into separate trusts. The court held that the grantors were taxable on the income of the combined trust due to their power to shift income among beneficiaries. However, after the trusts were divided and beneficiaries reached the age of majority, the grantors were not taxable due to the lack of control and the presence of adverse interests.

Facts

In 1924, Standish and Lotta Backus created a trust for their five children, initially structured as a single combined trust. The trust indenture allowed the trustee to distribute income among the beneficiaries at its discretion until the eldest child reached 30. In 1932, Lotta created five additional trusts, one for each child, naming herself and Standish as co-trustees. Standish alone held the power to modify or terminate these trusts, but only with the beneficiary's consent if they were over 21. The trust income was primarily from Burroughs Adding Machine Co. stock.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Backuses' income tax, arguing the trust income should be taxed to them as grantors. The Backuses petitioned the Tax Court, contesting the Commissioner's determination. The Tax Court addressed the taxability of the trust income under sections 22(a), 166, and 167 of the Internal Revenue Code.

Issue(s)

1. Whether the income from the combined trust (1924 trust before division) is taxable to the grantors under Section 22(a) due to the trustee's discretion to distribute income among beneficiaries.
2. Whether the income from the separate trusts (1924 trust after division) is taxable to the grantors after the division into five separate trusts.
3. Whether the income from the 1932 trusts is taxable to Lotta Backus, the grantor, due to Standish Backus's power to modify or terminate the trusts.

Holding

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1. Yes, because during the period of the combined trust, the trustee's power to shift income among beneficiaries equated to taxable enjoyment and ownership of the income by the grantors.
2. No, because after the division, the trustee could only distribute income from each separate trust to the named beneficiary, and this level of control was insufficient to tax the income to the grantors.
3. No, for the three trusts with beneficiaries over 21, because their consent was required for any modification or termination, creating adverse interests. No, for the two trusts with minor beneficiaries, because Standish's power could not be imputed to Lotta.

Court's Reasoning

The court relied on *Stockstrom v. Commissioner* in holding the grantors taxable on the combined trust income. The power to

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