7 T.C. 98 (1946)

A grantor is not taxable on trust income if the grantor's retained powers do not amount to substantial ownership or control over the trust, even if the grantor is the key employee of a corporation whose stock forms the trust's corpus.

Summary

Ward Wheelock created irrevocable trusts for his children, funding them with stock in his advertising agency, Ward Wheelock Co. The Commissioner argued that Wheelock should be taxed on the trust income because he retained substantial control over the company. The Tax Court disagreed, holding that Wheelock's limited retained powers, such as his wife's power to designate who votes the stock during her lifetime, did not amount to the kind of control necessary to tax the trust income to him. The court emphasized that Wheelock's power was contingent on his wife's actions and that she had an independent fiduciary duty to the children.

Facts

Ward Wheelock created three irrevocable trusts for his minor children, naming his wife and a trust company as trustees. He funded each trust with 48 shares of Ward Wheelock Co. stock. Later, his wife added 24 shares of her stock to each trust. The trust income was to be accumulated until each child reached 25, then paid out until age 35, at which point the trust would terminate. The trust instrument stipulated that the Wheelock Co. stock could not be sold without the written consent of either Ward or his wife, Margot. During Margot's lifetime, she had the power to designate who would vote the stock. Wheelock served as the president of Ward Wheelock Co., an advertising agency whose success depended largely on his personal efforts.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against Wheelock, arguing that the trust income should be taxed to him. Wheelock petitioned the Tax Court for a redetermination, contesting the Commissioner's assessment.

Issue(s)

Whether the dividends paid to the trusts from Ward Wheelock Co. stock are taxable to Ward Wheelock as the grantor of the trusts under Section 22(a) of the Internal Revenue Code, given the provisions of the trust agreement and Wheelock's position within the company.

Holding

No, because the grantor did not retain sufficient control over the trust or the trust income to justify taxing the income to him under Section 22(a).

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Court’s Reasoning

The court distinguished this case from *Helvering v. Clifford*, noting that Wheelock did not retain broad powers over the trust corpus or income. The court emphasized that during the tax years in question, Wheelock had no power over the trust stock; his wife had the exclusive right to designate the proxy for voting the stock, and her consent alone was sufficient for the sale of the stock. The court rejected the Commissioner’s argument that Wheelock’s control over the company was tantamount to control over the trust income, stating that taxation must be based on more than speculation about what Wheelock *might* do. The court also pointed out that the presence of an independent co-trustee (Girard Trust Co.) further limited Wheelock’s influence. The dissenting opinion argued that Wheelock’s control over the corporation effectively controlled the flow of dividends to the trusts and that the family’s solidarity made it likely his wife would follow his wishes. The dissent likened Wheelock’s control to that in *Corliss v. Bowers*, where the power to direct income was enough for taxation.

Practical Implications

Wheelock clarifies that merely being a key employee or founder of a company whose stock is placed in trust does not automatically result in the grantor being taxed on the trust income. The grantor must retain specific, enforceable powers over the trust itself. This case underscores the importance of carefully drafting trust instruments to avoid retaining excessive control. The decision suggests that having independent co-trustees and giving beneficiaries significant rights can help insulate the grantor from tax liability. Later cases have distinguished *Wheelock* by emphasizing that retained voting rights or managerial control over the corporation can lead to grantor trust treatment. The case demonstrates the tension between formal trust provisions and the practical realities of family-owned businesses, requiring courts to assess the substance of control rather than just the legal form.

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