8 T.C. 213 (1947)

Trust income is taxable to the grantor when the grantor retains substantial control over the trust assets and the power to revoke the trust is held by a party lacking a substantial adverse interest.

Summary

Morris Joseloff created trusts for his daughters, retaining significant control over investments, directing the trustee to invest heavily in a family holding company, Sycamore Corporation, where he owned 73% of the stock. His wife had the power to revoke the trust. The Commissioner of Internal Revenue sought to tax the trust income to Joseloff. The Tax Court held that the trust income was taxable to Joseloff because he retained substantial control over the trust assets through investment powers and his wife's power of revocation was not considered an adverse interest.

Facts

Morris Joseloff created two trusts for his minor daughters in 1931, naming the First National Bank & Trust Co. as trustee. The trust agreement granted Joseloff the power to direct the trustee's investments. Joseloff directed the trustee to invest heavily in "debentures" of Sycamore Corporation, a personal holding company. Joseloff owned 73% of Sycamore's stock, his wife 18%, and the trusts for the children 9%. His wife, Lillian Joseloff, had the power to revoke the trusts before each daughter reached the age of 25, at which point the trust corpus would revert to Morris Joseloff.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Joseloff's income tax for 1938-1941, arguing that the trust income should be included in Joseloff's personal income. The cases were consolidated in the Tax Court.

Issue(s)

Whether the Commissioner properly included the income from the two trusts in the petitioner's income for the years 1938 to 1941, based on the petitioner's retained dominion and control over the trust property and the revocability of the trust by the settlor's wife, who allegedly lacked a substantial adverse interest.

Holding

Yes, because the grantor retained substantial control over the trust assets through his power to direct investments, effectively making himself both lender and borrower of the trust corpus, and because the power of revocation was held by a party, his wife, who lacked a substantial adverse interest.

Court’s Reasoning

The court relied on *Helvering v. Clifford, 309 U.S. 331*, stating that the settlor retained significant control over the trust. The court found that Joseloff, by directing the trustee to invest in Sycamore debentures, effectively borrowed from the trust. The court emphasized that Joseloff bypassed the trustee’s fiduciary duty to act in the beneficiary’s interest. This arrangement allowed him to use the trust assets for his economic benefit, blurring the lines between his personal finances and the trust assets.

Regarding the power of revocation, the court found that Lillian Joseloff’s interests were not substantially adverse to her husband’s. The court noted that her contingent remainder interest was too remote to be considered substantial, requiring her to outlive both daughters and their issue. The court noted the lack of adversity between Joseloff and his wife, pointing out that she deposited stock into the trusts which would ultimately benefit her husband if the trust was revoked. The court cited *Fulham v. Commissioner, 110 F.2d 916*, for the proposition that “realistic appraisal” is called for rather than a purely legalistic one when judging the adversary interest of a person holding the power of revocation in a family trust.

Practical Implications

This case highlights the importance of carefully structuring trusts to avoid grantor taxation. Grantors must relinquish sufficient control over trust assets to avoid being treated as the de facto owner. Furthermore, any power of revocation must be held by a party with a genuine, substantial adverse interest in the trust’s continuation. A remote contingent interest, particularly within a close family relationship, is unlikely to suffice. This ruling reinforces that family trusts are subject to close scrutiny, and courts will look beyond the formal structure to determine the true economic substance of the arrangement. Later cases have cited *Joseloff* for the proposition that retained powers can result in grantor trust status even when the grantor is not the trustee.