8 T.C. 1351 (1947)

A taxpayer who assigns trust income for a fixed period while retaining the underlying equitable interest in the trust corpus remains taxable on that income.

Summary

Leonard Farkas, a life income beneficiary of a testamentary trust, created an inter vivos trust for his siblings' benefit, assigning his share of the testamentary trust income for a maximum of ten years. The Tax Court held that Farkas remained taxable on the income paid to the inter vivos trust. The court reasoned that Farkas retained a substantial interest in the trust property because the assignment was temporary. This decision distinguished itself from cases involving complete, lifetime assignments of trust interests and aligned with the principle that the power to dispose of income equates to ownership for tax purposes.

Facts

- Sam Farkas's will created a testamentary trust, with income payable to his eight children (including Leonard) for life.
- The will stipulated that any child attempting to divest their interest would forfeit it.
- In 1943, Leonard Farkas created an inter vivos trust, naming his brother Mack as trustee.
- Leonard assigned his testamentary trust income to the inter vivos trust for up to ten years, to benefit his siblings.
- The inter vivos trust's income was designated to aid siblings with education, sickness, or financial difficulties, at Mack's discretion.
- Leonard continued to hold the life interest in the testamentary trust.

Procedural History

- The Commissioner of Internal Revenue determined a deficiency in Leonard Farkas's income tax, asserting that the assigned trust income was taxable to him.
- Farkas challenged the deficiency in Tax Court.
- The Tax Court ruled in favor of the Commissioner.

Issue(s)

1. Whether the income from a testamentary trust, assigned to an inter vivos trust for a term of years, is taxable to the assignor (Leonard Farkas) or the inter vivos trust.

Holding

1. Yes, because the assignor retained a substantial interest in the underlying

trust property due to the limited duration of the assignment; thus, the income is taxable to the assignor.

Court's Reasoning

The Tax Court distinguished this case from *Blair v. Commissioner, 300 U.S. 5 (1937)*, where a lifetime assignment of trust income was deemed a transfer of an equitable interest in the trust corpus, shifting the tax burden to the assignee. The Court relied on *Harrison v. Schaffner, 312 U.S. 579 (1941)*, which held that a temporary assignment of trust income does not constitute a substantial disposition of the trust property. The court stated:

"We perceive no difference, so far as the construction and application of the Revenue Act is concerned, between a gift of income in a specified amount by the creation of a trust for a year, see *Hormel v. Helvering, 312 U.S. 552*, and the assignment by the beneficiary of a trust already created of a like amount from its income for a year."

The court emphasized that Farkas retained the right to the income upon the termination of the ten-year period, indicating a continued substantial interest in the trust. The court also noted that the assignment served as a means to make gifts to family members while avoiding income tax liability.

Judge Arundell dissented, arguing that a ten-year assignment was a substantial disposition of the trust interest and that the case was analogous to *Blair*. He also noted the independent trustee and lack of control retained by Farkas.

Practical Implications

- This case clarifies the distinction between assigning trust income for life (a transfer of an equitable interest) and assigning it for a fixed term (not a sufficient transfer to shift tax liability).
- Attorneys must advise clients that assigning trust income for a limited period, even a relatively long one like ten years, will not shift the income tax burden to the assignee.
- Tax planning strategies involving trusts must consider the duration of income assignments to determine whether the assignor retains enough control or interest to be taxed on the income.
- This decision reinforces the principle that the power to control the disposition of income is equivalent to ownership for tax purposes, even if the income is paid directly to another party.
- Later cases have cited *Farkas* to differentiate assignments of income-producing property from assignments of income from property where the assignor retains a substantial interest.

