Arthur A. Morrissey et al., Trustees, v. Commissioner of Internal Revenue, 296 U.S. 344 (1935)

An entity organized as a trust can be classified and taxed as a corporation if its primary objective is to conduct business and share its gains, rather than merely to hold and conserve property.

Summary

The Supreme Court addressed whether a trust established to develop and sell real estate should be taxed as a corporation. The Court held that despite being organized as a trust, the entity possessed characteristics similar to a corporation, including centralized management, continuity, transferable interests, and limited liability. Because the trust's primary purpose was to operate a business for profit, rather than simply conserve assets, it was deemed an association taxable as a corporation under the Revenue Act.

Facts

Individuals transferred property to trustees under a trust agreement to develop and sell real estate, specifically lots in a tract near Los Angeles. The trustees had broad powers to manage the property, construct improvements, and conduct sales. Beneficial interests were represented by transferable shares. The trust operated for several years, engaging in substantial business activities, including developing and selling lots, constructing a golf course, and other related undertakings.

Procedural History

The Commissioner of Internal Revenue determined that the trust was an association taxable as a corporation and assessed deficiencies. The Board of Tax Appeals reversed the Commissioner's determination. The Ninth Circuit Court of Appeals reversed the Board, holding the trust taxable as a corporation. The Supreme Court granted certiorari to resolve conflicting interpretations of the Revenue Act.

Issue(s)

Whether the trust, established for the purpose of developing and selling real estate, constitutes an association taxable as a corporation under the Revenue Act of 1924.

Holding

Yes, because the trust was not simply holding and conserving property but was established and operated as a business enterprise with characteristics analogous to a corporation, making it an association taxable as such.

Court's Reasoning

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The Court examined the characteristics of the trust, comparing them to those of a corporation. It emphasized features such as centralized management (trustees acting like a board of directors), continuity of enterprise despite the death of beneficiaries, transferable shares similar to stock, and limitation of personal liability. The Court distinguished between traditional trusts designed to protect or conserve assets and "business trusts" created to conduct a business for profit. The Court stated, "'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business." The Court concluded that the trust's activities and organizational structure mirrored those of a corporation and, therefore, it should be taxed accordingly. The Court noted, "In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains."

Practical Implications

This decision provides a framework for distinguishing between trusts taxed as regular trusts and those taxed as corporations. It emphasizes that the IRS and courts will look beyond the formal structure of an entity to its actual operations and purpose to determine its tax classification. Attorneys structuring business entities must consider the Morrissey factors to avoid unintended corporate tax treatment for trusts. Later cases have further refined the application of these factors, but Morrissey remains the foundational case in this area. This case also impacts real estate ventures structured as trusts, requiring careful consideration of the level of business activity to avoid corporate taxation.

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