***Tobin v. Commissioner*, 11 T.C. 928 (1948)**

The income from reciprocal trusts is taxable to the grantors, and the determination of whether the grantor retains sufficient control over a trust to be taxed on its income under Section 22(a) depends on the specific facts of each case.

Summary

Edgar and Margaret Tobin created several trusts, some reciprocal and some not. The Commissioner argued that the income from all trusts was taxable to the Tobins as community income under Section 22(a) of the Internal Revenue Code, and that the income from four of the trusts was also taxable under Section 167(a)(2). The Tax Court held that the income from the reciprocal trusts was taxable to the Tobins, but the income from the other trusts was not, because the grantors did not retain sufficient control to be considered the owners for tax purposes under Section 22(a). The court also addressed deductions for farm expenses and storage costs.

Facts

Edgar G. Tobin and Margaret Batts Tobin, a married couple in Texas, created eight trusts in 1935. Four of these trusts (Edgar Tobin Trust, Margaret Batts Tobin Trust, Ethel Murphy Tobin Trust, and Harriet Fiquet Batts Trust) were reciprocal, meaning each spouse created a trust benefiting the other. The other four trusts (Ethel M. Tobin and Katharine Tobin Trust, the Katharine Tobin Trust No. 1, the Robert Batts Tobin Trust No. 1, and the Robert Batts Tobin Trust No. 2) were created for the benefit of their children and grandchildren. A bank was named as trustee for all trusts, and an advisory committee was appointed to assist the trustee. The Tobins also operated a farm.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Tobins' income tax for the years 1940-1943, arguing that the income from all eight trusts was taxable to them as community income. The Tobins petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court addressed the taxability of the trust income, as well as deductions claimed for farm expenses and equipment storage.

Issue(s)

1. Whether the income from the reciprocal trusts is taxable to the petitioners as community income under Section 167(a)(2) of the Internal Revenue Code.
2. Whether the income from the remaining four trusts is taxable to the petitioners as community income under Section 22(a) of the Internal Revenue Code (the Clifford doctrine).
3. Whether petitioners are entitled to deduct certain amounts as farm expenses.
4. Whether petitioners are entitled to deduct from their community income for

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the taxable year 1943 an amount of $1,840 claimed as storage and care of certain equipment during that year.
5. Whether petitioners are entitled to a credit against the deficiencies for the tax paid by the trustees of certain trusts for the years 1940 to 1943, inclusive.

Holding

1. Yes, because the trusts were reciprocal, and the grantors were essentially retaining control over the income for their own benefit.
2. No, because the grantors did not retain sufficient control over the trusts to be considered the owners for tax purposes under Section 22(a).
3. No, because the evidence did not show that the farm was operated for profit.
4. Yes, in part, because the portion of the storage expense paid to the Robert Batts Tobin Trust No. 1 (whose income was not taxable to the petitioners) is deductible as an ordinary and necessary business expense.
5. No, because the petitioners are not entitled to a credit for taxes paid by the trusts whose income is taxable to them.

Court's Reasoning

The court reasoned that the Ethel Murphy Tobin Trust and the Harriet Fiquet Batts Trust were reciprocal. Because Margaret Batts Tobin was effectively the grantor of the Ethel Murphy Tobin Trust, and Edgar Tobin was effectively the grantor of the Harriet Fiquet Batts Trust, the income was taxable to them under Section 167(a)(2), which states that income that "may, in the discretion of the grantor or of any person not having a substantial adverse interest…be distributed to the grantor" is taxable to the grantor. Similarly, the Edgar Tobin Trust and the Margaret Batts Tobin Trust were also reciprocal and their income was taxable to the grantors.

Regarding the remaining four trusts, the court considered the Clifford doctrine (Helvering v. Clifford, 309 U.S. 331), which holds that a grantor may be treated as the owner of a trust for tax purposes if they retain substantial control over the trust. The court found that these trusts were not short-term, the grantors could not reclaim the property, and the powers of management were vested in an advisory committee, not solely in the grantors. The court stated, "the analysis narrows down to whether the fact that the grantor of each trust was also one of the three members of the respective advisory committees is a sufficiently strong factor to compel us to find that the grantor continued to be the owner for the purposes of section 22 (a). We do not think such a finding would be a true finding of the ultimate fact, and so we do not so find." The court emphasized that any power the grantor had as a member of the advisory committee was to be exercised in a fiduciary capacity.

As for farm expenses, the court found insufficient evidence to prove that the farm was operated for profit, as required by Section 23(a)(1)(A) of the Internal Revenue Code. Regarding the storage expenses, the court allowed a deduction for the portion paid to the Robert Batts Tobin Trust No. 1, since the income of that trust was not

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taxable to the petitioners. Finally, the court denied the credit for taxes paid by the trusts, citing Leslie H. Green, 7 T.C. 263 (1946).

Practical Implications

This case illustrates the importance of avoiding reciprocal trust arrangements when attempting to shift income to lower tax brackets. It also underscores the fact-intensive nature of the Clifford doctrine, with courts examining the specific terms of the trust and the circumstances surrounding its creation to determine whether the grantor has retained sufficient control to be taxed on the trust's income. The decision emphasizes that serving on an advisory committee in a fiduciary capacity does not automatically equate to retaining taxable control over the trust. This case helps to define the boundaries of permissible grantor control over trusts without triggering grantor trust rules. Subsequent cases have further refined the application of the Clifford doctrine and clarified the types of powers that will cause a grantor to be treated as the owner of a trust for income tax purposes.

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