12 T.C. 817 (1949)

A grantor is not taxable on trust income merely because they retain certain powers over the trust, especially when those powers are limited and subject to fiduciary duties, and the trust has a legitimate business purpose.

Summary

Eight individuals, members of the Chandler family, created a trust, transferring stock in two companies, Times-Mirror Co. and Chandis Securities Co. The trust directed income to be paid to the grantors for life, then to their spouses, issue, and heirs. The grantors reserved a power of appointment. The IRS argued that taxable stock dividends received by the trust should be taxed to the grantors because the trust was invalid or because of grantor trust rules under sections 22(a), 166, or 167. The Tax Court held the trust was valid under California law and that the grantor trust rules did not apply, as the grantors did not retain enough control to justify taxing the trust income to them.

Facts

In 1935, eight individuals (primarily the Chandler family) transferred stock into Chandler Trust No. 2. Marian Otis Chandler, the matriarch, transferred shares of Chandis Securities Co. Her seven children each transferred shares of Times-Mirror Co. and Chandis. The trust instrument vested legal and equitable title in the trustees, stating the beneficiaries only had the right to enforce the trust. Net income was to be distributed to the trustors. Each trustor reserved the power to appoint their share of income and principal after death. The trust was set to terminate upon the death of the last survivor of 21 named individuals. A key purpose of the trust was to ensure Norman Chandler would succeed to the presidency of Times-Mirror Co.

Procedural History

The IRS determined that the stock dividends received by the trust were taxable to the grantors (petitioners). The petitioners contested this determination in Tax Court. The Tax Court consolidated the cases and ruled in favor of the petitioners, finding the trust valid and the stock dividends taxable to the trust, not the grantors.

Issue(s)

Whether taxable stock dividends received by the Chandler Trust No. 2 are taxable to the trust or to the grantors, given the powers retained by the grantors and the purpose of the trust.

Holding

No, the taxable stock dividends are not taxable to the grantors because the trust was a valid trust under California law, the grantors did not retain enough control to be treated as owners under section 22(a), and sections 166 and 167 do not apply because the trust was not revocable and income was not held for the benefit of the grantors.

Court's Reasoning

The Tax Court determined the trust was valid under California law, citing *Bixby v. California Trust Co.* and *Gray v. Union Trust Co.*, which held that trusts with contingent remainders to heirs cannot be terminated without the consent of all beneficiaries, including those whose identities are not yet ascertainable. The court emphasized that the power of appointment reserved by the trustors did not prevent the vesting of remainders in their heirs. The court found that the limitations on the trustors' right to amend the trust prohibited them from indirectly terminating the trust to exclude other beneficiaries.

The court distinguished *Helvering v. Clifford*, noting that the grantors here relinquished significant control over the assets. They could not vote the stock individually, receive dividends directly, or unilaterally alter the trust. The court noted that while the grantors as a group had certain powers, these were fiduciary powers to be exercised for the benefit of all beneficiaries. The primary purpose of the trust was family control of the Times stock, a legitimate business purpose, not tax avoidance. The court specifically noted, "*This was a business, and not a tax avoidance, purpose. The receipt by the trustor beneficiaries of substantially the same cash income from the trust as they would have received had the property not been conveyed in trust also refutes the respondent's suggestion that the trust was created for tax avoidance purposes.*"

The court held that sections 166 and 167 did not apply because the trust was not revocable, and the stock dividends were not held for the benefit of the grantors but became part of the trust corpus to be distributed at termination.

Practical Implications

Goodan illustrates the importance of the specific powers retained by a grantor when determining whether trust income should be taxed to the grantor. It shows that retaining some powers, especially when coupled with fiduciary duties and a valid business purpose, does not automatically trigger grantor trust rules. When drafting trusts, consider the balance between retaining control and achieving desired tax outcomes. Later cases distinguish *Goodan* based on the degree of control retained and the presence of a business purpose beyond tax avoidance. The decision reinforces that legitimate business purposes can shield trusts from being disregarded for tax purposes, even when family members are involved as trustees and beneficiaries. Practitioners should carefully document any such business purposes.