14 T.C. 687 (1950)

A trust established for the benefit of children is considered valid for tax purposes if the grantor, acting as trustee, retains no power that could inure to his individual benefit and the trust income is permanently severed from the grantor's personal income.

Summary

B.H. Klein purchased real estate with his own funds, deeding it to himself as trustee for his two minor daughters. The trust agreement granted Klein broad powers to manage the property for the beneficiaries' benefit, terminating when the younger daughter turned 21, at which point the assets would vest in the children. The key issue was whether the income generated from the property was taxable to Klein personally. The Tax Court held that the income was not taxable to Klein, emphasizing that he acted solely as trustee, could not personally benefit from the trust, and the income was permanently allocated to the beneficiaries.

Facts

B.H. Klein purchased property using his personal funds and directed the seller to deed the property to "B. H. Klein as Trustee" for his two minor daughters, Babs and Burke. The deed granted Klein, as trustee, broad powers to manage the property, including leasing, improving, selling, or exchanging it for the benefit of his daughters. The trust was set to terminate when Burke, the younger daughter, reached 21, at which point the trust corpus would vest in both daughters. Klein later used personal funds to pay off an existing mortgage on the property and subsequently mortgaged the property, as trustee, to construct a building that was then leased to a tenant. Rents were paid directly to the mortgagee, and no income was used for the children's upkeep or Klein's personal benefit.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Klein's income tax for 1941 and 1943, arguing that the income from the trust should be included in Klein's personal income. Klein challenged this determination in the United States Tax Court.

Issue(s)

Whether the income from a trust, where the grantor is also the trustee with broad management powers and the beneficiaries are his children, is taxable to the grantor under Section 22(a) of the Internal Revenue Code.

Holding

No, because the grantor acted solely as trustee for the benefit of the children, retaining no powers for personal benefit, and the trust income was permanently severed from the grantor's personal income.

Court's Reasoning

The Tax Court found that a valid trust existed under Alabama law, despite Klein not signing the initial deed as trustee, because his subsequent actions, such as leasing and mortgaging the property as trustee, sufficiently demonstrated his intent to establish a trust. The court distinguished this case from *Helvering v. Clifford*, 309 U.S. 331 (1940), noting that the trust was for a long period (until the younger child reached 21), was irrevocable, and Klein retained no power to amend the terms or modify the beneficiaries' shares. The court emphasized that all powers granted to Klein were in his capacity as trustee and for the benefit of his children. The court noted, "All power given was in petitioner 'as such trustee' and 'for the use and benefit' of Babs Klein and Burke Hart Klein. He had no individual status or power of control and his discretion, as trustee, was under the jurisdiction and power of the courts of equity. Nothing that he could do could inure to his individual benefit, or did so." Because the income was used to pay off the mortgage and none of it was used for the children's support or Klein's personal benefit, the court concluded that the trust income should not be taxed to Klein.

Practical Implications

This case clarifies the circumstances under which a grantor can act as trustee for family members without the trust income being attributed to the grantor for tax purposes. It emphasizes that the grantor must act solely in a fiduciary capacity, without retaining powers that could benefit them personally. This case highlights the importance of establishing clear, irrevocable trusts with long durations to avoid the application of the *Clifford* doctrine. Later cases have cited *Klein v. Commissioner* to support the validity of family trusts where the grantor's control is limited to their role as trustee and the trust income is genuinely allocated to the beneficiaries.