*14 T.C. 792 (1950)*

A grantor is not taxed on trust income when they do not retain sufficient control over the trust, and income is not realized until the taxpayer has dominion and control, free from substantial restrictions.

**Summary**

L.M. and Pearl Fischer created trusts for their children, transferring oil and gas lease interests. The Tax Court addressed whether the trust income was taxable to the Fischers, if the transfer of leases was a sale or joint venture, the term of the capital gain, the worthlessness of the leases, and when a check for services was taxable. The court held the trust income was not taxable to the Fischers, the lease transfer was a sale resulting in long-term capital gain, the leases were not worthless in 1943, and the check was taxable in 1943, not 1942.

**Facts**

L.M. Fischer acquired oil and gas leases (Walters and Teachout leases) and contracted with Graham to drill wells. To provide for their children, the Fischers created four irrevocable trusts, each child benefiting from two trusts funded with a one-fourth interest in the leases. L.M. Fischer, as trustee, had broad powers but couldn't use funds for the children's support. Later, Fischer acquired the Banquette leases. He sold a one-fourth interest to Agua Dulce Co. Agua Dulce had the option of taking the interest or a refund. Separately, Fischer received a check for legal services late on December 31, 1942, but agreed to hold it at the client's request and deposited it in February 1943.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the Fischers' 1943 income tax and adjusted their 1942 tax due to the Current Tax Payment Act of 1943. The Fischers petitioned the Tax Court, contesting the inclusion of trust income, the nature of the lease transfer, the timing of income from the check, and the deductibility of the lease investment.

**Issue(s)**

1. Whether the income from the four trusts is includible in the Fischers' gross community income under Section 22(a) of the Internal Revenue Code.

2. Whether Fischer's receipt of $15,000 from Agua Dulce Co. for an interest in oil and gas leases constituted a sale or a joint venture.

3. Whether any gain realized from the transfer was a long-term or short-term capital gain.

 

4. Whether the Fischers' investment in certain oil and gas leases became worthless by December 31, 1943.

5. Whether a check for legal services received on December 31, 1942, but deposited in 1943, constituted taxable income for 1942.

## Holding

1. No, because the Fischers did not retain sufficient control over the trusts to warrant taxing the trust income to them.

2. It was a sale, because the Fischers presented no persuasive facts or reasons supporting a joint venture.

3. Long-term, because the sale occurred on December 31, 1943, when the formal conveyance was made.

4. No, because the Fischers' subsequent actions indicated the leases still had value.

5. No, because the check was subject to a substantial restriction when received.

## Court's Reasoning

The court reasoned that the Fischers did not retain enough control to be taxed on the trust income. The trustee's discretion was limited, and the funds couldn't be used for the children's support. The court found the $15,000 payment to be a sale because the Fischers initially treated the transaction as a sale and presented no facts supporting a joint venture. The court determined the sale occurred upon formal conveyance, making the gain long-term. Despite advice that the leases were worthless, the Fischers' continued investment indicated they believed the leases still had value. The court stated, "Rather, it speaks more loudly than petitioner's words of protest of a persisting value in the leases as gas and oil property." Finally, the check was not income in 1942 because of the agreement to hold it; income isn't realized until the taxpayer has "dominion and control, free from any substantial restriction."

## Practical Implications

This case clarifies the importance of the grantor's retained control in trust arrangements regarding income tax liability. It underscores that simply being a trustee doesn't automatically equate to taxable ownership of trust income. The case also highlights that a key factor in determining when income is taxable is whether the taxpayer has unfettered control over the funds. For determining capital gains, the exact date of the transfer of ownership matters, not preliminary agreements. The court also emphasizes that taxpayer actions, like subsequent investments, can contradict claims of worthlessness. This informs how taxpayers should document and consistently treat financial transactions for tax purposes and how the IRS may interpret those actions.

 