T.C. Memo. 1955-175

A trust can be recognized as a legitimate partner in a business partnership for tax purposes if the trustee exercises genuine control over the trust's assets and participates actively in the business, demonstrating a bona fide intent to join the partnership.

Summary

Louis-White Motors sought a redetermination of tax deficiencies assessed by the Commissioner, who argued that a family trust established by the petitioner was not a legitimate partner in the business. The Tax Court disagreed, holding that the trust was a valid partner because the trustee had full control over the trust, actively participated in the business, and brought valuable resources to the partnership. The court emphasized the trustee's independent actions and the absence of control by the grantor, distinguishing this case from situations where trusts are merely used to reallocate income within a family.

Facts

The petitioner, Louis-White Motors, formed a partnership with a trust he created. The trust agreement granted the trustee, Harry W. Parkin, full management and control over the trust assets. The trust was explicitly prohibited from using its assets for the benefit of the petitioner or his family. Parkin, a business acquaintance of the petitioner, actively participated in the partnership, securing credit, suggesting business expansions, and obtaining agency contracts that increased the partnership's volume. Parkin often opposed the petitioner on business matters, demonstrating his independent authority.

Procedural History

The Commissioner determined deficiencies, asserting that all partnership income should be taxed to the petitioner because the trust was not a real partner. Louis-White Motors petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court reviewed the trust agreement and the conduct of the parties to determine the validity of the partnership.

Issue(s)

1. Whether the petitioner, as grantor of the trust, retained sufficient control over the trust corpus and income to negate the existence of a valid partnership.
2. Whether the trust, with Harry W. Parkin as trustee, was a legitimate partner with the petitioner in the operation of Louis-White Motors for tax purposes.

Holding

1. No, because the trust agreement vested full control in the trustee, and the

facts showed the trustee exercised that control independently, without subservience to the grantor.
2. Yes, because the trustee actively participated in the business, brought valuable resources to the partnership, and demonstrated a genuine intent to join together in the enterprise.

Court's Reasoning

The court emphasized that the trust agreement granted the trustee complete control and management powers. The trustee's active participation in the partnership, securing credit and business contacts, and opposing the petitioner's wishes, demonstrated that he was not merely a figurehead. The court distinguished this case from *Herman Feldman, 14 T. C. 17 (1950)*, where the trust was deemed not a true partner. Here, the trustee made significant contributions and participated in policy-making, indicating a genuine intent to operate as a bona fide partner. The court cited *Commissioner v. Culbertson, 337 U. S. 733 (1949)*, stating they inevitably reached the conclusion that "the petitioner and the trustee in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." The court also noted that trusts can be recognized as partners, referencing several previous cases including *Theodore D. Stern, 15 T. C. 521 (1950)* and *Isaac W. Frank Trust of 1927, 44 B. T. A. 934 (1941)*, and federal appellate court decisions.

Practical Implications

This case clarifies the requirements for a trust to be recognized as a legitimate partner in a business for tax purposes. It emphasizes the importance of the trustee's independence and active participation. To establish a valid partnership involving a trust, the trustee must have genuine control over the trust assets, actively contribute to the business's operations, and not merely act as an agent of the grantor. This ruling is crucial for tax planning involving family businesses and trusts, providing guidance on structuring partnerships to withstand IRS scrutiny. Later cases have cited this decision when evaluating the legitimacy of partnerships involving trusts, focusing on the trustee's actual conduct and control, and distinguishing situations where the trust is simply a tool for income shifting.