18 T.C. 713 (1952)

A trust can be recognized as a legitimate partner in a business partnership for tax purposes, and the trust's distributive share of partnership income is not automatically attributable to the settlor, even if the settlor retains some control over the business.

Summary

Edward D. Sultan formed a partnership with a trust he created for his son. The IRS challenged the validity of the partnership, arguing the trust was not a bona fide partner and that the trust's income should be taxed to Sultan. The Tax Court held that the trust was a valid partner because the parties intended to join together to conduct business, the trust had independent trustees who actively managed its interests, and Sultan did not retain such control as to render the trust a sham. The court distinguished this case from Helvering v. Clifford, finding the trust was long-term with an independent trustee and no reversion to the settlor.

Facts

Edward D. Sultan, who had been operating a business as a sole proprietorship, formed a trust for the benefit of his son in 1941. The trust was to last until the son reached age 30 (17 years). The trust agreement named independent trustees, including a corporate trustee. Subsequently, Sultan entered into a partnership agreement with the trust, making the trust a "special partner." The corporate trustee actively managed the trust's interests, insisting on distributions of partnership earnings. The trust invested the distributed funds. The trust instrument prohibited any distribution of property or income to the settlor, Edward D. Sultan.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Edward D. Sultan's income tax, arguing that the income reported by the trust should be taxed to Sultan. Sultan petitioned the Tax Court for a redetermination of the deficiencies.

Issue(s)

1. Whether the trust created by Edward D. Sultan should be recognized as a bona fide partner in the Edward D. Sultan Co. partnership for income tax purposes.
2. Whether the principles of Helvering v. Clifford, 309 U.S. 331, require the trust income to be taxed to the settlor, Edward D. Sultan.

Holding

1. Yes, the trust should be recognized as a bona fide partner because the parties truly intended to carry on the business together and share in the profits, and there was a substantial economic change in which Sultan gave up an interest

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in the business.
2. No, the Clifford case does not apply because the trust was long-term, had independent trustees, and no possibility of reversion to the settlor.

Court's Reasoning

The court relied on Commissioner v. Culbertson, 337 U.S. 733, stating that the key question is whether the partners truly intended to join together to carry on the business. The court found such intent existed here, noting the written partnership agreement, the trust's status as a "special partner" (akin to a limited partner), and the fact that profits no longer belonged solely to Sultan. The court distinguished cases where the settlor was also the trustee and retained significant control, citing Theodore D. Stern, 15 T.C. 521, which found a valid partnership even when the settlor retained control. The court emphasized the independent corporate trustee's active management of the trust's interests. The court stated, "A substantial economic change took place in which the petitioner gave up, and the beneficiaries indirectly acquired an interest in, the business. There was real intent to carry on the business as partners. The distributive shares of partnership income belonging to the trust did not benefit the petitioner." The court distinguished Helvering v. Clifford, pointing out the long term of the trust, the independent trustees, and the lack of any reversionary interest in Sultan.

Practical Implications

This case illustrates that a trust can be a valid partner in a business, even if the settlor retains some control. The key is whether the parties genuinely intended to form a partnership and whether the trust has independent economic significance. Attorneys advising clients on forming family partnerships with trusts should ensure that the trust has independent trustees who actively manage its interests, that the trust instrument prohibits benefits to the settlor, and that the partnership agreement clearly defines the rights and responsibilities of all partners. Later cases may distinguish Sultan if the settlor retains excessive control or if the trust serves no legitimate business purpose other than tax avoidance. This case also highlights the importance of documenting the intent to form a genuine partnership.

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