18 T.C. 715 (1952)

A trust can be a valid partner in a family partnership for income tax purposes if the parties genuinely intend to conduct a business together, and the trust possesses sufficient attributes of ownership in the partnership.

Summary

Edward D. Sultan created a trust for his minor son, funded with a 42% interest in his business, which then became a special partner in a partnership with Sultan and others. The Tax Court addressed whether the trust's share of partnership income was taxable to Sultan. The court held that the trust was a bona fide partner because the parties intended to conduct the business together, and the trust, managed by independent trustees, received and managed its share of the profits. The court also found that Sultan retained insufficient control over the trust to warrant taxing the trust's income to him under the principles of *Helvering v. Clifford*.

Facts

Edward D. Sultan, a wholesale jeweler, created the Edward D. Sultan Trust, naming his brother, Ernest, and Bishop Trust Company as trustees. The trust was funded with $42,000 intended to purchase a 42% interest in a new partnership, Edward D. Sultan Co. The trust was irrevocable, and neither the corpus nor the income could revert to Sultan. On August 30, 1941, Sultan formed a special partnership under the name of Edward D. Sultan Co. The general partners were Edward D. Sultan, Ernest W. Sultan, Marie Hilda Cohen, and Gabriel L. Sultan. The trustees of the Edward D. Sultan trust were a special partner. The initial capital of the partnership was $100,000. Sultan transferred his business assets to the partnership in exchange for a 46% partnership interest and demand notes.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Edward and Olga Sultan's income taxes, arguing that the trust's distributive share of partnership income should be taxed to Edward. The Sultans petitioned the Tax Court for review.

Issue(s)

1. Whether the Edward D. Sultan Trust should be recognized as a bona fide partner in Edward D. Sultan Co. for income tax purposes.
2. Whether the trust income is taxable to the settlor, Edward D. Sultan, under the doctrine of *Helvering v. Clifford*, 309 U.S. 331 (1940).

Holding

1. Yes, because the parties intended to join together to conduct the business, and the trust possessed sufficient attributes of ownership.

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2. No, because Sultan did not retain sufficient control over the trust, and the trust terms prevented any reversion of corpus or income to Sultan.

Court's Reasoning

The Tax Court relied on *Commissioner v. Culbertson*, which stated that a family partnership is valid for income tax purposes if the partners truly intend to conduct a business together and share in profits or losses. The court found that the evidence showed such intent. The court emphasized that the corporate trustee was independent and actively managed the trust's interest, including insisting on distributions of the trust's share of partnership earnings. The court distinguished the case from others where settlors retained significant control. Quoting the case, "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." As for the *Clifford* issue, the court distinguished the facts, noting the trust's long term, the independent trustees, and the lack of any reversionary interest to Sultan. The court concluded that the trust was a valid partner and its income shouldn't be taxed to the Sultans.

Practical Implications

Sultan clarifies the requirements for a trust to be recognized as a partner in a family partnership for tax purposes. It emphasizes the importance of demonstrating a genuine intent to conduct a business together and ensuring that the trust has sufficient control over its partnership interest. The presence of independent trustees who actively manage the trust's investment is a key factor supporting the validity of the partnership. The case also reinforces that the *Clifford* doctrine will not apply if the settlor does not retain substantial control over the trust, and there is no possibility of the trust assets reverting to the settlor. This case continues to be relevant in structuring family business arrangements to achieve legitimate tax planning goals while complying with partnership and trust principles.

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