24 T.C. 907 (1955)

The power of a trust grantor to replace the trustee without cause, coupled with the trustee's power to control the distribution of income and corpus, results in the trust income being taxable to the grantor under the *Clifford* doctrine.

Summary

The United States Tax Court held that Warren H. Corning was liable for the income tax on a trust's income because he retained the power to substitute trustees without cause, which effectively gave him control over the trustee's discretion in allocating income and corpus among the beneficiaries. The court reasoned that this power, even when held indirectly through the ability to replace the trustee, allowed Corning to retain a degree of control that triggered the application of the *Clifford* doctrine. This doctrine attributes the trust's income to the grantor when they retain substantial control over the trust assets or income distribution, as if the grantor still owned the assets.

Facts

Warren H. Corning established a trust in 1929 for the benefit of his family. The trust instrument originally allowed Corning to receive the income. He reserved the power to substitute trustees at any time and without cause. The original trustee, and later the City Bank Farmers Trust Company, had the discretion to allocate income and corpus among family members. Corning's father had the power to amend or revoke the trust before his death in 1946, at which point the power to amend or revoke the trust passed to the trustee. In 1946, the trustee amended the trust to accumulate all income until 1962 and relinquished the power to pay over income until 1962. The Commissioner of Internal Revenue determined deficiencies in Corning's income tax, arguing that he retained such control over the trust that its income should be taxable to him.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Corning's income tax for the years 1946-1950, based on the argument that the trust income was taxable to him. The case was brought before the United States Tax Court. The Tax Court considered the facts, the relevant tax laws, and previous court decisions before issuing its judgment.

Issue(s)

1. Whether Warren H. Corning's power to substitute trustees without cause should result in the powers of the trustee being attributed to him?

2. Whether the trust's amendments in 1946, which stipulated accumulation of income, limited Corning's power to designate ultimate beneficiaries, and if not,

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whether the income should be taxed to him?

Holding

1. Yes, because the court found that Corning's power to substitute trustees without cause allowed him to control the trustee's discretionary power in the allocation of income and corpus, effectively making him in control of the trust.

2. Yes, because the 1946 amendments did not limit Corning's control over the ultimate beneficiaries of the accumulated income.

Court's Reasoning

The court applied the *Clifford* doctrine, which is designed to prevent taxpayers from avoiding tax liability by establishing trusts where the grantor retains significant control over the trust's income or assets. The court reasoned that Corning's power to replace the trustee, even with a corporate trustee, gave him effective control over the trust's administration. The court referenced its previous decision in *Stockstrom*, which held that the power to substitute trustees without cause and the trustee's discretion over income distribution meant the grantor had complete control. The court distinguished *Central Nat. Bank*, which held that power to substitute trustees in Cleveland, Ohio, did not give the grantor control. It noted that while a corporate trustee might resist a grantor's investment advice, the allocation of income among family members was an area where the grantor's wishes would likely be followed. The court concluded that, in practice, Corning controlled the allocation of income and corpus, despite the fact that the trustee technically held the powers. The court also noted that even the amendments, requiring accumulation of income, did not deprive Corning of the ability to determine the eventual beneficiaries of the income.

Practical Implications

This case is a clear warning that the grantor's power to substitute a trustee without cause, when coupled with the trustee's discretionary power over income or corpus distribution, can trigger application of the *Clifford* doctrine. Attorneys advising clients on setting up trusts need to carefully consider the implications of granting the grantor the power to remove and replace trustees. It underscores that courts will look beyond the formal structure of the trust to the economic realities of control. This case is frequently cited in tax law concerning trusts and the grantor's control over the trust property and income. It remains important for analyzing cases where a grantor attempts to maintain control over a trust while claiming the trust income should not be attributed to them for tax purposes.

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