27 T.C. 426 (1956)

Undistributable capital gains earned by an irrevocable trust are not taxable to the grantor-life beneficiary when the grantor's retained powers are limited and do not amount to substantial ownership.

Summary

The United States Tax Court considered whether capital gains realized by an irrevocable trust were taxable to the grantor-life beneficiary. The court determined that the gains were not taxable to the grantor, Carolyn Solomon (now Manson), despite her retention of certain powers over the trust. These powers included a limited ability to invade the corpus, the power to alter the distribution among remaindermen, a contingent right to dispose of the corpus by will, and the right to become co-trustee. The court found that, considering the circumstances, these powers did not give Solomon such substantial ownership as to warrant taxing her on the undistributed capital gains. The decision emphasized the importance of analyzing the specific facts and circumstances surrounding a trust's creation and operation to determine the grantor's actual control and benefit.

Facts

Carolyn Solomon created an irrevocable trust in 1932, with her mother as trustee, funded by her interest in her father's estate. The trust provided that Carolyn would receive the net income for life, with the corpus passing to her descendants upon her death, or to her mother and/or as designated in her will if no descendants survived. In 1938, the trust was amended to include a provision allowing Carolyn to invade the principal if the income fell below certain levels. In 1943, Carolyn became a co-trustee. In 1950, the trust realized substantial capital gains, which were not distributed to Carolyn. The Commissioner of Internal Revenue determined that these capital gains were taxable to Carolyn based on her retained powers over the trust. These powers included: (1) the retention of the life interest to trust income; (2) the right to invade the corpus if the yearly income was ever less than $ 7,500 during her mother's lifetime or less than $ 15,000 after her mother's death; (3) the right to become co-trustee with her own attorney in the event of the resignation of the designated trustee who was her mother; (4) the power to provide, with the consent of herself and Ross, as co-trustees, that "the said trust estate be payable to the issue of the settlor, or any of them, her surviving in such shares and in such manner as she may from time to time determine"; and (5) the right of ultimate disposition after the death of Estelle "in any such manner as may be directed in the said settlor's last will and testament."

Procedural History

The Commissioner assessed a deficiency in Carolyn Solomon's income tax for 1950, claiming that she should be taxed on the capital gains realized by the trust. Solomon contested the assessment, leading to a case in the United States Tax Court. The Tax Court reviewed the facts, the trust instrument, and relevant legal precedents.

Issue(s)

Whether the capital gains realized by the Carolyn Solomon Trust in 1950 were taxable to Carolyn Solomon, the grantor and life beneficiary of the trust, in addition to the ordinary income of the trust distributable to her.

Holding

No, because the court found that the grantor did not retain such control over the trust's corpus as to be deemed the substantial owner for income tax purposes, despite the powers retained by her.

Court's Reasoning

The Tax Court applied the principle of *Helvering v. Clifford*, which considers whether the grantor retains such control over the trust that they should be treated as the owner for tax purposes. The court emphasized that the determination depends on "an analysis of the terms of the trust *and all of the circumstances attendant on its creation and operation*." The court distinguished the case from situations where trusts are created for tax avoidance or to provide familial benefits, highlighting that the creation of this trust was not for that purpose. The court also considered the limited nature of the retained powers. Specifically, the court addressed the invasion of corpus provision and found that since the income exceeded the invasion threshold, the power was "highly speculative." The court also found that the grantor's co-trustee status did not translate to control since the trust corpus consisted of marketable securities. In the court's view, the powers retained by the grantor did not blend with the normal concept of full ownership. The court quoted *Commissioner v. Bateman* stating that the answer to taxability "must depend on an analysis of the terms of the trust *and all of the circumstances attendant on its creation and operation*."

