***First National Bank of Chicago, Trustee v. Commissioner*, 25 T.C. 488 (1955)**

A trustee can be held liable as a transferee for a donor's unpaid income taxes if the donor, who provided the trust's corpus, was insolvent at the time of the transfer, even if the trustee was unaware of the tax liability.

Summary

The Tax Court addressed whether a bank, acting as trustee for two separate trusts, was liable as a transferee for the unpaid income taxes of Joe Louis Barrow (Joe Louis), the actual donor of the trust assets. The court found that Louis was the true donor, not his ex-wife, Marva, who was listed as such in the trust documents. Crucially, the court determined that Louis was insolvent at the time of the trust transfers. Because Louis was the actual donor and was insolvent, the court held the trustee liable for the unpaid taxes to the extent of the value of assets received. The case highlights the significance of identifying the true donor and assessing their solvency in tax disputes involving trusts.

Facts

Joe Louis, a famous boxer, and his ex-wife, Marva, entered into a settlement agreement and manager's contract during their first divorce. The agreement stipulated that Marva would receive a portion of Louis's earnings and was obligated to establish a trust for their daughter, Jacqueline, with a portion of those earnings. Later, two irrevocable trusts were created, one for Jacqueline and another for their son, Joe Louis Jr., with the First National Bank of Chicago as trustee. Marva was listed as the donor in both trust agreements, though the funds originated from Louis. The IRS determined that Louis was the actual donor and assessed transferee liability against the trustee for Louis's unpaid income taxes, alleging that he was insolvent at the time of the transfers. Louis had significant debt and tax liabilities, and his assets were limited. The trustee argued that Marva was the donor and that they were not aware of Louis's tax liabilities.

Procedural History

The Commissioner of Internal Revenue determined transferee liabilities against the First National Bank of Chicago, as trustee, for Joe Louis's unpaid income taxes. The trustee contested this determination in the Tax Court, arguing that Marva was the donor and that the statute of limitations had expired. The Tax Court consolidated the cases and addressed the factual and legal issues presented.

Issue(s)

1. Whether the trustee was liable as a transferee of Joe Louis's assets for his delinquent income taxes, considering Louis's status as the actual donor.

2. Whether the assessments of transferee liabilities were barred by the statute of

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limitations.

3. Whether Marva was the actual donor of the trusts and, thus, liable for gift taxes and penalties.

Holding

1. Yes, the trustee was liable as a transferee for Louis's unpaid income taxes because Louis was the actual donor and was insolvent at the time of the transfers.

2. No, the assessments were not time-barred because the statute of limitations had not expired, and proper waivers had been executed.

3. No, Marva was not the actual donor and therefore was not liable for gift taxes or penalties.

Court's Reasoning

The court first determined that Louis, not Marva, was the actual donor of the trust assets. The funds used to establish the trusts came from Louis's earnings, even though Marva was initially in possession of the funds as per their agreements. The court focused on the source of the funds, finding that Marva was merely acting as Louis's agent in establishing the trusts. Regarding transferee liability, the court applied Section 311 of the Internal Revenue Code of 1939. The court stated, "The transferee is retroactively liable for transferor's taxes in the year of transfer and prior years, and penalties and interest in connection therewith, to the extent of the assets received by him even though transferor's tax liability was unknown at the time of the transfer." The court then found that Louis was insolvent at the time of the transfers, making the trustee liable to the extent of the trust assets. The court also addressed the statute of limitations, finding that the waivers of the statute executed by or on behalf of Louis were valid and prevented the assessments from being time-barred. The court emphasized that it was the actual donor's insolvency at the time of the transfer that triggered the transferee liability.

Practical Implications

This case clarifies the factors used to determine whether a trustee is liable for a donor's unpaid taxes. The court's emphasis on identifying the real source of funds, determining the donor's solvency, and the validity of waivers is critical. Attorneys must thoroughly investigate the source of funds used to establish trusts. They must be able to provide evidence to demonstrate the true donor and their financial condition at the time of the transfer, especially concerning their solvency. The case also highlights the importance of ensuring that proper tax consents or waivers are executed and that tax returns are filed appropriately. The case emphasizes that a trustee's knowledge of the donor's tax liabilities is not required for transferee liability, if the statutory conditions are met.

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