Morris Trusts v. Commissioner, 51 T. C. 20 (1968)

Multiple trusts created primarily for tax avoidance may still be recognized as separate taxable entities if they are independently administered and maintained.

Summary

In Morris Trusts v. Commissioner, the court addressed whether multiple trusts created for tax avoidance purposes could be treated as separate taxable entities under the Internal Revenue Code. E. S. and Etty Morris established 10 trust instruments, each creating two trusts for their son and daughter-in-law, totaling 20 trusts. These trusts were intended to accumulate income and eventually distribute it to their grandchildren. The Commissioner argued that these trusts should be consolidated into one or two trusts due to their tax avoidance purpose. However, the court found that each trust was separately administered, with distinct investments and separate tax filings, and thus qualified as separate taxable entities under Section 641 of the Internal Revenue Code. This decision underscores the importance of independent administration in recognizing multiple trusts for tax purposes, despite their tax avoidance origins.

Facts

In 1953, E. S. and Etty Morris executed 10 irrevocable trust declarations, each dividing the trust estate into two equal shares for their son, Barney R. Morris, and daughter-in-law, Estelle Morris. Each trust was to accumulate income for the lives of the primary beneficiaries and then distribute to their issue upon their deaths. The trusts differed only in the periods of income accumulation and termination. Each trust received initial cash contributions and loans from E. S. Morris. The trusts acquired separate investments, maintained separate bank accounts, and filed separate tax returns. They were involved in real estate investments, including property in the Johnson Ranch, which was later sold at a profit. The trusts continued to operate independently, investing in various assets like trust deed notes and land contracts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies against the trusts for the fiscal years ending August 31, 1961 through 1965, asserting that the trusts should be treated as one or two trusts rather than 20. The trusts filed petitions in the U. S. Tax Court. After the petitions and answers were filed, the Commissioner amended the answers to argue that all 20 trusts should be considered a single trust for tax purposes. The Tax Court ultimately ruled in favor of the trusts, finding them to be separate taxable entities under Section 641 of the Internal Revenue Code.

Issue(s)

1. Whether each of the 10 declarations of trust executed by E. S. and Etty Morris on

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September 11, 1953, created one or two trusts for Federal income tax purposes.
2. Whether the trusts created by the 10 declarations of trust should be taxed as one or two trusts as respondent contends, or as 10 or 20 trusts as petitioner contends, or as some other number.

Holding

1. Yes, because each declaration of trust explicitly directed the creation of two separate trusts, one for each primary beneficiary, and these were administered separately with distinct investments and tax filings.
2. Yes, because despite being created primarily for tax avoidance, the trusts operated as separate viable entities with independent administration and should be recognized as 20 separate taxable entities under Section 641 of the Internal Revenue Code.

Court’s Reasoning

The court relied on the language of the trust instruments, which clearly intended to create two separate trusts per declaration. The trusts were administered separately, with each trust acquiring and managing its own investments, maintaining separate bank accounts, and filing separate tax returns. The court applied Section 641(b) of the Internal Revenue Code, which treats trusts as separate taxable entities. Despite acknowledging the tax avoidance motive, the court emphasized that Congress had not legislated against multiple trusts, and previous judicial decisions recognized trusts created for tax avoidance as valid if they were independently administered. The court rejected the Commissioner’s argument that tax avoidance alone should invalidate the trusts, noting that the trusts’ independent operation and the legislative history did not support such a broad application of the tax avoidance doctrine. The court distinguished cases like Boyce and Sence, where multiple trusts were consolidated due to lack of independent administration, from the present case where the trusts were meticulously maintained as separate entities. Judge Raum dissented, arguing that the trusts were a sham due to their tax avoidance purpose and should be treated as one or two trusts.

Practical Implications

This decision has significant implications for the use of multiple trusts in estate and tax planning. It establishes that trusts created primarily for tax avoidance can still be recognized as separate taxable entities if they are independently administered. Practitioners should ensure that multiple trusts are distinctly managed, with separate investments and tax filings, to maintain their status as separate entities. This case may encourage the use of multiple trusts to spread income and minimize taxes, although it also highlights the need for careful administration to avoid consolidation by the IRS. Subsequent cases have applied this ruling to similar situations, emphasizing the importance of independent operation and administration. Businesses and families planning estate distributions should

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consider this decision when structuring trusts to achieve tax benefits, while also being mindful of potential scrutiny from tax authorities.

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