Benson v. Commissioner, 76 T. C. 1040 (1981)

When a trust grantor borrows unsecured funds from the trust without repaying before the taxable year, the grantor is treated as the owner of the entire trust.

Summary

In Benson v. Commissioner, Larry Benson, the grantor of a trust, borrowed unsecured funds from the trust without repaying before the start of the taxable years 1974 and 1975. The IRS argued that Benson should be treated as owning the entire trust under IRC section 675(3). The Tax Court agreed, holding that Benson's borrowing of all trust income, which was derived from the entire trust corpus, indicated significant control over the trust, justifying treating him as the owner of the entire trust for tax purposes. This decision underscores the importance of the grantor trust rules in attributing trust income to the grantor based on retained control over the trust assets.

Facts

Larry and June Benson established the L. William Benson Short Term Irrevocable Trust in 1972, with June as trustee. The trust's sole asset was a property leased to Benson's Maytag, Inc. , generating rental income. From 1973 to 1974, Larry Benson borrowed unsecured funds from the trust, totaling $47,715 by January 1, 1975, without repayment before the start of the taxable years 1974 and 1975. The loans were used to finance personal expenses, and the trust reported no taxable income during these years due to distribution deductions taken but not actually distributed to the beneficiaries.

Procedural History

The IRS issued a notice of deficiency to the Bensons, treating Larry Benson as the owner of the entire trust under IRC section 675(3) and attributing the trust's income to him for 1974 and 1975. The Bensons petitioned the Tax Court for redetermination, arguing that only a fraction of the trust should be attributed to Larry based on the ratio of borrowed funds to the trust's value. The Tax Court upheld the IRS's determination, ruling that Larry Benson's borrowing of all trust income evidenced control over the entire trust.

Issue(s)

1. Whether a trust grantor who borrows unsecured funds from a trust without repaying before the beginning of the taxable year is treated as owning the entire trust under IRC section 675(3).

Holding

1. Yes, because the grantor's borrowing of all trust income, derived from the entire

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trust corpus, indicates significant dominion and control over the entire trust, justifying treating the grantor as the owner of the entire trust for tax purposes.

Court’s Reasoning

The Tax Court’s decision was based on the interpretation of IRC section 675(3), which treats a grantor as the owner of any portion of a trust from which the grantor borrows without adequate security or interest. The court emphasized that “portion” in this context refers to the part of the trust in respect of which the borrowing occurs, not merely the amount borrowed. Since Benson borrowed all the trust’s income, which was derived from the entire trust corpus, the court found that this borrowing evidenced control over the entire trust. The court rejected the Bensons’ argument for a fractional approach, stating that such an interpretation would undermine the purpose of the grantor trust rules, which aim to tax grantors on trust items over which they retain substantial control. The court also noted that the flexible meaning of “portion” allows for its adaptation to various trust scenarios, ensuring that grantors are taxed on trust assets they control.

Practical Implications

This decision has significant implications for trust planning and tax compliance. It underscores the need for grantors to be cautious when borrowing from trusts they have established, as such actions can lead to the entire trust being attributed to them for tax purposes. Practitioners should advise clients to ensure that any loans from trusts are secured and repaid before the start of the taxable year to avoid unintended tax consequences. The ruling also highlights the IRS’s focus on the substance of grantor control over trusts, rather than merely the form of trust agreements. Subsequent cases have followed this precedent, reinforcing the principle that borrowing from a trust can result in the grantor being treated as the owner of the entire trust if it evidences control over the trust’s assets.

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