Luman v. Commissioner, 86 T. C. 860 (1986)

Income from a trust is taxable to the grantor if the grantor retains the power to distribute income to themselves or their spouse, and expenses for creating a trust for personal reasons are not deductible.

Summary

The Luman case involved the tax treatment of income from a family trust and the deductibility of costs associated with its creation. The court held that the trust's income was taxable to the grantors, Robert and Doris Luman, under the grantor trust rules of the Internal Revenue Code, as they retained the power to distribute trust income to themselves. Additionally, the court ruled that the $20,000 paid to Educational Scientific Publishers for trust creation was not deductible under IRC sections 212 or 165, as it was a personal expense. The decision underscores the importance of the grantor trust rules and the limitations on deducting personal expenses related to trust creation.

Facts

Robert and Doris Luman, Wyoming residents, operated a ranch and sought to keep it within the family. They rejected an attorney's proposal due to high fees and later established a family trust using forms from Educational Scientific Publishers (ESP). The trust was created to ensure the ranch remained in the family and to facilitate an orderly transfer of assets to their children. The Lumans transferred most of their property to the trust, including the ranch and securities. They paid ESP $20,000 for assistance in setting up the trust. The trust's income was reported and distributed to the beneficial interest holders, including the Lumans. The Commissioner determined deficiencies in the Lumans' income taxes, asserting that the trust's income was taxable to them and that the $20,000 payment was not deductible.

Procedural History

The Commissioner issued a notice of deficiency to the Lumans for the tax years 1974, 1975, and 1976, asserting that the trust income was taxable to them and disallowing the deduction for the $20,000 payment to ESP. The Lumans petitioned the Tax Court for a redetermination of the deficiencies and the disallowed deduction.

Issue(s)

1. Whether the income generated by the trust property is taxable to the Lumans individually or to the trust they created.
2. Whether the Lumans are entitled to deduct the $20,000 paid to ESP under IRC section 212 or 165.
3. Whether the Lumans are liable for additions to tax under IRC section 6653(a) for negligence.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because the trust income is taxable to the Lumans under the grantor trust provisions of IRC sections 671 and 677, as they retained the power to distribute income to themselves without the consent of an adverse party.
2. No, because the $20,000 payment to ESP was a nondeductible personal expense under IRC section 262, not deductible under sections 212 or 165.
3. Yes, because the Lumans failed to prove that the additions to tax for negligence under IRC section 6653(a) were not applicable.

Court's Reasoning

The court applied the grantor trust rules under IRC sections 671 through 677, focusing on section 677, which treats the grantor as the owner of the trust if they retain the power to distribute income to themselves or their spouse. The Lumans, as trustees, had the power to distribute income to each other without the consent of their daughter, who was also a trustee. The court found that the Lumans were not adverse parties regarding distributions to each other, citing the Tax Reform Act of 1969 and case law such as Vercio v. Commissioner. Regarding the $20,000 payment, the court determined it was a personal expense for creating the trust, not deductible under IRC section 212(2) as it was not for managing or conserving income-producing property. The court also rejected the claim for a deduction under section 165 as a theft loss, due to lack of evidence of theft under Wyoming law. The court sustained the additions to tax for negligence under section 6653(a), as the Lumans failed to carry their burden of proof.

Practical Implications

This decision reaffirms the application of the grantor trust rules, emphasizing that retained powers over income distribution can result in the trust's income being taxable to the grantor. Practitioners must carefully structure trusts to avoid unintended tax consequences. The case also clarifies that expenses related to creating trusts for personal reasons are not deductible, highlighting the need to distinguish between personal and business expenses. This ruling has influenced subsequent cases involving trust taxation and deductions, such as Schulz v. Commissioner and Epp v. Commissioner. Attorneys should advise clients on the tax implications of trust creation and the limitations on deducting associated costs.

© 2025 SCOTUSreports.com. All rights reserved.