1 T.C. 449 (1943)

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In determining the distributable income of a trust under Section 162(b) of the Revenue Act of 1936, the terms of the trust instrument govern unless there is a clear rule of local law or a determination by a local court dictating otherwise, particularly regarding the allocation of carrying charges on unproductive property.

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Summary

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John and Ada Lewis, beneficiaries of an inter vivos trust in Pennsylvania, contested deficiencies in their income tax for 1936 and 1937. The trustees used trust income to pay carrying charges on unproductive real estate, reducing the net income distributed to the Lewises. The Commissioner argued these charges should have been paid from principal, increasing the distributable income taxable to the beneficiaries. The Tax Court held that absent a clear Pennsylvania law or local court ruling, the trust's terms, which allowed the trustees to deduct expenses from income, controlled the determination of distributable income. Therefore, the Commissioner's assessment was incorrect.

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Facts

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Anne H.R. Baker Lewis created an inter vivos trust in 1935, conveying stocks, bonds, mortgages, and real estate to trustees. The trust directed the trustees to pay all expenses from trust income and distribute the remaining net income to life beneficiaries, including John and Ada Lewis. The trust included several unproductive real estate properties that incurred losses due to taxes, expenses, and depreciation. In 1936 and 1937, the trustees paid the carrying charges on these unproductive properties out of the trust's income, thereby reducing the amount of income distributed to the beneficiaries.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the income tax of John and Ada Lewis for 1936 and 1937, arguing that the trust income distributable to them should not have been reduced by the operating losses on unproductive real estate. The Lewises petitioned the Tax Court for a redetermination of these deficiencies. The case proceeded to trial before the Tax Court.

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Issue(s)

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Whether the income from an inter vivos trust distributable to the petitioners should be reduced by a proportionate amount of the operating losses on certain unproductive real estate comprising part of the original corpus of said trust, upon the ground that such losses are chargeable to trust income rather than principal, for purposes of Section 162(b) of the Revenue Act of 1936.

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Holding

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No, because in the absence of a clear rule of local law in Pennsylvania or a determination by a local court, the terms of the trust govern the amount of currently distributable income for purposes of Section 162(b) of the Revenue Act of 1936, and the trust authorized the trustees to deduct expenses from income before distribution.

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Court’s Reasoning

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The Tax Court reasoned that Section 162(b) of the Revenue Act of 1936 allows a deduction for the amount of trust income to be distributed currently to beneficiaries. The court considered whether the amount of trust income

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