1 T.C. 992 (1943)

Where a trust's income is payable to a divorced wife for her support and the support/education of her children with the grantor, the grantor is only taxed on the income actually used for the children's support/education if state law doesn't require him to support his ex-wife.

Summary

Walter Ferris created a trust with income payable to his ex-wife, Alice, for her support and their children's. The Tax Court addressed whether Walter was taxable on the trust's entire income. The court held that Walter was only taxable on the income used for the minor child's support and education, as Connecticut law did not obligate him to support his divorced wife, and he had no control over the remaining funds. The court distinguished *Helvering v. Stuart*, emphasizing the ex-wife's adverse interest in the income.

Facts

- Walter and Alice were married and divorced twice.
- After their first remarriage in 1923, Walter created a trust, income payable to Alice for her and the children's support.
- In 1930, before their second divorce, Walter executed another trust indenture, conveying all his interest in the 1923 trust to a trustee.
- The trustee was directed to pay Walter a small annual sum, pay life insurance premiums for policies benefiting Alice, and pay the remaining income to Alice for her support and the children's.
- The trust stipulated Alice should use the income for support and save Walter harmless from any support obligation.
- In 1938, the trust income was $7,818.72, with $1,200 spent on their minor son's college education. Walter did not withdraw his entitled 20% of the income.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies against Walter and his current wife, Violet, including the entire trust income in Walter's gross income, claiming it discharged his legal obligations. Walter petitioned the Tax Court, challenging this assessment. Violet's case was consolidated but involved additional issues settled by stipulation.

Issue(s)

1. Whether Walter L. Ferris is taxable on the entire income of a trust of which he was the grantor, where the income was payable to his divorced wife for her support and the support and education of their children.

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Holding

1. No, Walter is not taxable on the entire trust income. He is only taxable on the portion of the income used for the support and education of his minor child because Connecticut law, at the time of the divorce, did not impose a continuing obligation for spousal support. Additionally, Walter did not have the ability to control the distribution of the income beyond what was used for the minor child.

Court's Reasoning

The Tax Court relied on the Ninth Circuit's decision in *Chandler v. Commissioner*, which held that under Connecticut law, a final divorce decree discharges a husband's duty to support his wife if it doesn't provide for alimony. Therefore, trust income used for the wife's support is not taxable to the husband. However, the court recognized a continuing obligation to support minor children. Walter was thus taxable on the $1,200 used for his son's education under Section 22(a) of the Revenue Act of 1938. The court distinguished *Helvering v. Stuart*, noting that in *Stuart*, the trustees had no adverse interest, whereas in this case, the ex-wife did have an adverse interest. The court stated:

"We can not escape the conclusion that under such circumstances it was the duty and privilege of the wife, as a practical matter, to determine how much of the income she would use for her own support and how much would be devoted to the minor child…During the tax year petitioner was not required to pay from his own funds debts incurred by or in behalf of the minor for his necessaries. So long as this situation prevailed petitioner had no right to any of the income or to direct that more of it be used for the child, and the wife had a right to retain what she did."

Practical Implications

This case clarifies the tax implications of trusts established in divorce settlements. It highlights that a grantor is not taxed on trust income paid to a divorced spouse unless there is a continuing legal obligation to support the spouse under state law, or unless the grantor maintains control over the trust's distributions. It emphasizes the importance of the trust's terms and the presence of an adverse interest. This case informs the drafting of trust instruments in divorce settlements to ensure the desired tax consequences are achieved. Later cases applying or distinguishing *Ferris* often focus on the degree of control the grantor retains over the trust and whether the trust discharges a legal obligation of the grantor.

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