2 T.C. 1157 (1943)

A trust beneficiary is liable for taxes on the income they are entitled to receive from a trust, even if they consent to receive a smaller amount, when their consent is required for the trustees to distribute a lesser amount.

Summary

Cecelia Frank was the beneficiary of a trust established by her husband, receiving 50% of the net income unless she consented to receive less. As a trustee, she had the power to vary the income distribution with her own consent. In 1939, she only received $11,000, less than 50% of the net income. The Commissioner of Internal Revenue argued she was taxable on the full 50%. The Tax Court agreed, holding that because Cecelia had the power to control the distribution of income, she was taxable on the amount she was entitled to receive, not just the amount she actually received. This decision emphasizes the importance of control over trust income when determining tax liability.

Facts

Robert Frank created a trust, naming his wife, Cecelia Frank, and others as trustees. The trust instrument stipulated that Cecelia was to receive 50% of the net income, subject to a provision allowing the trustees to alter the distribution with her consent. During 1939, the trustees distributed only $11,000 to Cecelia, an amount less than 50% of the trust's net income. The net income of the trust was $18,750.20, making Cecelia's share $9,375.10 before accounting for other distributions made to other beneficiaries.

Procedural History

The Commissioner of Internal Revenue determined that Cecelia Frank should have reported 50% of the trust's net income as her gross income, resulting in a tax deficiency. Cecelia Frank petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether Cecelia Frank is taxable on 50% of the net income of the Robert J. Frank trust for 1939, as stipulated in the trust agreement, or only on the $11,000 she actually received, when she had the power to consent to variations in the distribution?

Holding

Yes, because Cecelia Frank had the power to control the distribution of the trust income; therefore, she is taxable on the 50% of the net income she was entitled to receive, regardless of the amount she actually received.

Court's Reasoning

The Tax Court emphasized that this case did not involve a discretionary trust where the trustee had sole discretion over distributions. Instead, the trust required the trustees to pay 50% of the net income to Cecelia unless she consented to receive less. Because Cecelia's consent was necessary for any deviation from the 50% distribution, she effectively controlled the income stream. The court cited *Freuler v. Helvering*, stating that "the test of taxability of the beneficiary is not receipt of income, but the present right to receive it." Because Cecelia had the right to receive 50% of the income, and her consent was required to alter that, she was taxed on the full 50%. The Court also referenced *Lelia W. Stokes, 28 B. T. A. 1245*, where a beneficiary was taxable on income subject to her command, even if she directed it to others. The ability to control the distribution, even if not directly receiving the funds, triggered tax liability.

Practical Implications

This case clarifies that a beneficiary's power to control trust distributions can trigger tax liability, even if they don't directly receive the full amount. When drafting trust agreements, it is crucial to consider the tax implications of granting beneficiaries control over income distribution. The *Frank* case emphasizes that tax liability follows the right to receive income, not just the actual receipt. Later cases have cited *Frank* to support the principle that control over income, even without direct receipt, can result in tax obligations for trust beneficiaries. Legal practitioners should advise clients establishing trusts to carefully consider the degree of control given to beneficiaries over income streams to avoid unintended tax consequences.

