***Newman v. Commissioner, 4 T.C. 263 (1944)***

When a beneficiary sells stock received from a trust, the basis for determining gain or loss is the same as it would be in the hands of the grantor, not the fair market value at the time of distribution, even if the trust income was taxable to the grantor or the grantor retained power to alter beneficiaries.

**Summary**

The Tax Court addressed the proper basis for calculating loss on the sale of stock distributed from a trust to its beneficiary. The IRS argued that the beneficiary's basis should be the fair market value of the stock at the time of distribution, which was lower than the grantor's basis. The court held that the basis should be the same as the grantor's, as the stock was acquired through a transfer in trust, regardless of whether the trust income was taxable to the grantor or whether the grantor retained certain powers over the trust. This decision emphasizes that property acquired through a trust uses the grantor's basis for determining gain or loss upon sale by the beneficiary.

**Facts**

The father and mother of J. Kiefer Newman, Jr., created a trust in 1924, naming themselves as trustees. The trust assets included voting trust certificates for 5,000 shares of Polman Co. stock, with a basis of $23.99 per share for the grantors. The trust instrument allowed the trustees to withhold income or principal from any beneficiary and transfer it to other beneficiaries. The trustees distributed Polman Co. stock to the beneficiaries, including Newman. Newman later sold the stock and claimed losses on his income tax returns for 1938-1941. The fair market value of the stock at the time of distribution to Newman was equal to the selling price.

**Procedural History**

The Commissioner of Internal Revenue disallowed the losses claimed by Newman, arguing that the value of the stock at the time Newman acquired it was not greater than the selling price. Newman challenged the Commissioner's determination in the Tax Court.

**Issue(s)**

1. Whether the basis for determining loss on the sale of stock distributed from a trust to a beneficiary is the grantor's basis under Section 113(a)(3) of the Internal Revenue Code, or the fair market value at the time of distribution under Section 113(a)(2).

**Holding**

1. Yes, the basis is the grantor's basis, because the stock was acquired through a

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transfer in trust, and Section 113(a)(3) applies.

**Court's Reasoning**

The court relied on *Edward T. Bedford Trust, 42 B.T.A. 748, aff'd, 123 F.2d 819 (2d Cir. 1941)*, and *Commissioner v. Warren Webster Trust No. 1, 122 F.2d 915 (3d Cir. 1941)*, which established that property acquired through a trust is governed by Section 113(a)(3), regardless of whether it constitutes a gift. The court dismissed the argument that the grantor's potential tax liability on the trust income or the grantor's retained power to alter beneficiaries should change the result. It emphasized that income tax principles do not necessarily align with estate and gift tax principles. The court stated that the beneficiary's title had its "origin" in the trust, citing *Helvering v. Reynolds, 313 U.S. 428 (1941)*. The court concluded that the stock was transferred in trust and acquired by the petitioner through that transfer, making Section 113(a)(2) inapplicable. The court stated, "The property was clearly transferred in trust and as clearly acquired by petitioner by the transfer in and out of the trust… His title had its 'origin' in the trust."

**Practical Implications**

This case clarifies that the basis rules for property distributed from a trust are consistently applied, regardless of the specific terms of the trust or the grantor's relationship to it for income tax purposes. It confirms that the grantor's basis carries over to the beneficiary when property is transferred through a trust, impacting how capital gains or losses are calculated upon the beneficiary's subsequent sale of that property. This ruling provides clarity for tax planning involving trusts and ensures consistent treatment of trust beneficiaries in similar situations. It confirms the importance of looking at the origin of the transfer to determine the appropriate basis. Later cases applying this ruling would focus on determining whether a transfer actually occurred

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