5 T.C. 394 (1945)

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A life beneficiary of a trust is not taxable on trust income used by the trustee to pay interest on a federal estate tax deficiency assessed against the grantor’s estate when the trustee, acting within their discretion, charges the interest expense to trust income.

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Summary

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The Tax Court addressed whether a life beneficiary of a trust was taxable on trust income that the trustee used to pay interest on a federal estate tax deficiency. The grantor’s estate owed additional estate taxes, and the trustee, exercising their discretion under the trust agreement, used trust income to pay the interest on that deficiency. The court held that the beneficiary was not taxable on that portion of the trust income, emphasizing that the beneficiary did not receive the income and that the trustee’s action was within their discretionary powers and not an abuse thereof. The decision hinged on the interpretation of the trust agreement and the trustee’s authority under Ohio law.

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Facts

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Jeptha H. Wade, Jr., created a revocable trust, later amended to provide that after his death, the income from the trust would be paid to his wife, Elizabeth F. Wade (the petitioner), for life. The trust also granted the trustee discretionary powers, including the power to determine whether money or property should be treated as principal or income. Upon the grantor’s death, an additional federal estate tax was assessed against his estate. The trustee withdrew funds from the trust to pay both the tax deficiency and the accrued interest. The trustee charged the interest payment of $26,604.08 to the trust’s 1940 income.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Elizabeth Wade's income tax for 1940, including the $26,604.08 as distributable income from the trust. Wade challenged this determination in the Tax Court.

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Issue(s)

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Whether the Commissioner properly included in the petitioner's income, as distributable income of a trust of which she was the life beneficiary, a portion of the trust income for the taxable year which the trustee transferred to the executor of the grantor's estate to pay interest on an additional Federal estate tax determined to be due from the estate.

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Holding

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No, because the life beneficiary did not receive the income, and the trustee acted within its discretionary powers under the trust agreement and Ohio law when charging the interest expense to the trust's income.

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Court's Reasoning

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The court reasoned that the income beneficiary is required to report all the income properly distributable to them during the taxable year, citing Freuler v. Helvering, <span normalizedcite="291 U.S. 35“>291 U.S. 35. However, determining what income is distributable is governed by the trust agreement and local law. Here, the trust agreement authorized the trustee to determine whether payments were charged to principal or income, as it deemed

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