5 T.C. 577 (1945)

Distributions from a testamentary trust are taxable to the beneficiary when the trustee's power to invade the trust's corpus is discretionary, not mandatory, and the distributions are made from the trust's income.

Summary

Franc Curry, a beneficiary of a testamentary trust established by her deceased husband, argued that $10,000 of the trust's annual distributions to her should be treated as a tax-exempt annuity. The Tax Court disagreed, holding that because the trustees had discretionary, not mandatory, authority to invade the trust corpus if the income fell below $10,000, the distributions were taxable income to Curry under sections 22(a) and 162(b) of the Revenue Act of 1938 and the Internal Revenue Code. The Court emphasized the importance of the will's language, contrasting "shall have the right" with imperative terms like "shall pay" to determine the testator's intent.

Facts

Harry J. Curry's will established a trust with his wife, Franc Curry, and The Northern Trust Company as trustees. The will directed that all net income from the trust be paid to Franc during her lifetime. However, payments to Harry's children were also stipulated if the net income exceeded $25,000 annually. A clause in the will stated that if the trust income fell below $10,000 in any year, the trustees "shall have the right to apply the principal" to ensure Franc received $10,000 for maintenance and support. During the tax years in question, the trust's total distributable net income was approximately $21,000, and, with minor exceptions, the income was distributed to Franc.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Franc Curry's income tax for the years 1938-1941. The Commissioner argued that the trust income distributed to Franc was taxable under section 162(b) of the Revenue Act of 1938 and the Internal Revenue Code, rejecting Franc's claim that a portion of the distribution constituted a tax-exempt annuity. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether distributions to the petitioner as the beneficiary of a testamentary trust were taxable income, or whether a portion of the distributions constituted a tax-exempt annuity under section 22(b)(3) of the Revenue Act of 1938 and the Internal Revenue Code because the trustee had the right to invade the trust corpus.

Holding

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No, because the will granted the trustees discretionary, not mandatory, authority to invade the trust corpus to ensure the beneficiary received $10,000 annually; therefore, the distributions constituted taxable income.

Court's Reasoning

The Tax Court reasoned that the testator's intent, as expressed in the will's language, was the determining factor. The Court distinguished between mandatory directions and discretionary powers granted to the trustees. The will stated that the trustees "shall have the right to apply the principal" if the income fell below $10,000. The Court contrasted this permissive language with the imperative language used elsewhere in the will, such as "shall pay" and "I direct." The Court concluded that the testator intended to grant the trustees a discretionary right to invade the corpus, not a mandatory duty. Because the distributions to Franc Curry were made from the trust's income, they were considered taxable income under sections 22(a) and 162(b) of the Revenue Act of 1938 and the Internal Revenue Code. The court distinguished *Carr v. United States Trust Co.*, noting that the language in that will imposed a mandatory obligation on the trustees. The Court also cited *Helvering v. Butterworth*, emphasizing that the distributions were taxable to the beneficiary when paid out of income.

Practical Implications

Curry v. Commissioner highlights the importance of precise language in testamentary documents, especially concerning trust provisions and potential invasion of the corpus. When drafting wills and trusts, attorneys must carefully consider whether the testator intends to create a mandatory obligation or a discretionary power for the trustees. The use of terms such as "shall" versus "shall have the right" can have significant tax consequences for the beneficiaries. This case informs how similar cases should be analyzed by focusing on the specific wording of the trust agreement to ascertain the grantor's intent. Furthermore, this case serves as precedent for determining when trust distributions should be treated as taxable income versus tax-exempt annuities, impacting estate planning strategies and tax compliance.

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