Russell v. Commissioner, 5 T.C. 974 (1945)

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A grantor is taxable on trust income used to discharge the grantor's legal obligations, even if done through a discretionary power granted to the trustees, when the trustees lack an adverse interest.

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Summary

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The Tax Court held that income from a trust created by Clifton B. Russell was taxable to him to the extent it was used to discharge his pre-existing debts. Russell had transferred stock to a trust, some of which was encumbered by his personal debt. The trust agreement allowed the trustees to discharge debts against trust property. The trustees used trust income to pay off Russell's debt, indirectly benefiting him. The court found that because the trustees had no adverse interest to Russell, the trust income used to pay his debts was taxable to him under Section 167 of the Internal Revenue Code. The court also addressed the issue of constructive receipt of bonus income, finding that a portion of a bonus allocated to Russell but used to set up an annuity trust in a subsequent year was not constructively received in the year the bonus was declared.

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Facts

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– Clifton B. Russell created a trust in 1939, naming his mother and daughter as beneficiaries.r
– He transferred 400 shares of Emery & Conant Co. stock to the trust; 50 shares were unencumbered, while 350 shares were subject to a $25,000 debt, Russell's personal obligation.r
– The trust indenture granted the trustees broad powers, including the authority to discharge indebtedness against trust property and to make loans using trust assets.r
– In 1940, the trustees paid off the $25,000 loan. They borrowed $20,000 from Russell and used $5,000 of undistributed trust income from 1939.r
– Subsequently, the trustees repaid the $20,000 loan to Russell using trust income.r
– In 1941, Emery & Conant Co. credited $25,000 to "Allan C. Emery as Trustee for

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Clifton B. Russell" as part of a bonus, but this amount was not actually received by Russell that year.r

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Procedural History

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– The Commissioner of Internal Revenue determined deficiencies in Russell's income tax for 1940 and 1941.r
– Russell petitioned the Tax Court for a redetermination of these deficiencies.r
– The Commissioner moved for an increased deficiency for 1941.r

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Issue(s)

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1. Whether income from the trust was taxable to Russell to the extent it was used to discharge his personal indebtedness.r
2. Whether Russell constructively received $25,000 in 1941 when Emery & Conant Co. credited that amount to a trust account for his benefit, but the trust was not established and the funds not transferred until 1942.r

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Holding

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1. Yes, because the trust agreement granted the trustees, who had no adverse interest to Russell, the discretion to use trust income to discharge indebtedness against trust property, and they exercised that discretion to pay off Russell's debt.r
2. No, because Russell, on the cash basis, neither actually nor constructively received the $25,000 in 1941, as the trust was not established and the funds were not transferred until 1942.r

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Court’s Reasoning

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– The court relied on Section 167(a)(2) of the Internal Revenue Code, which taxes to the grantor any part of the trust income that

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