5 T.C. 1380 (1945)

A beneficiary of a trust is taxable only on the portion of trust income they are entitled to receive for their support and maintenance, as determined by the trust instrument and relevant state law, and not on the entire income of the trust if their entitlement is limited.

Summary

Eva Townsend was the beneficiary of a trust established by her deceased husband's will, which directed trustees to pay her income as she deemed necessary for her support and her children's maintenance. The will also instructed trustees to apply surplus income to the testator's debts, and later, to distribute it equally among the children upon reaching majority. After the testator's debts were paid and the children reached adulthood, disagreements arose about the appropriate distributions. The Tax Court ruled that Townsend was taxable only on the income necessary for her support, and not on the entire trust income, based on a state court ruling defining her rights under the trust.

Facts

Robert T. Townsend died in 1928, leaving a will that created a trust for his wife, Eva, and their two children. The will stipulated that Eva should receive "such portion of the income as she deems necessary for her own support and for the maintenance, education and support of my children." Initially, the trust income was used to pay off Robert's debts. After the debts were settled and the children became adults, the trust income was divided, with Eva receiving one-half and each child one-quarter. In 1944, one of the children, Margaret, contested this arrangement, arguing that Eva was receiving far more than necessary for her support.

Procedural History

Margaret Townsend Reid challenged the income distribution in Pennsylvania Orphans' Court. The Orphans' Court determined that Eva was only entitled to income necessary for her support and deemed $30,000 annually as sufficient. Eva appealed, but the Orphans' Court affirmed its prior decision. The Commissioner of Internal Revenue then determined that Eva was taxable on the entire net income of the trust. Eva Townsend petitioned the Tax Court, contesting the Commissioner's determination.

Issue(s)

Whether the entire net income of a testamentary trust is taxable to the beneficiary (Eva Townsend), when the trust instrument entitles her only to the portion of income deemed necessary for her support, as determined by a state court.

Holding

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No, because the state court determined that Eva Townsend was only entitled to receive income necessary for her support, and therefore she is taxable only on that amount, not the entire net income of the trust.

Court's Reasoning

The Tax Court relied on the Orphans' Court decision, which interpreted Robert Townsend's will to mean that Eva was only entitled to income necessary for her support. The Tax Court acknowledged that the state court's decision was binding because it was a contested proceeding involving property rights, and no collusion was shown. The Tax Court distinguished this case from *Mallinckrodt v. Commissioner*, where the beneficiary had "unfettered command" over the trust income. In this case, Eva's control was limited by the

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