7 T.C. 1428 (1946)

Income from an estate that is designated for distribution to trust beneficiaries is not deductible from the estate's income as income "to be distributed currently" if the estate is still in administration and the assets have not yet been transferred to the trust.

Summary

The First National Bank of Memphis, as executor of Hugh Smith's estate, sought to deduct income designated for a testamentary trust from the estate's taxable income. Smith's will directed the bank, as trustee, to distribute income to his wife, brother, and sister. However, the widow dissented from the will, acquiring statutory dower rights. The Tax Court denied the deduction, holding that because the estate was still in administration and the assets hadn't been transferred to the trust, the income wasn't "to be distributed currently" to the remaining beneficiaries under Section 162(b) of the Internal Revenue Code. The court also held that income from property the widow was entitled to by dissent was part of the estate's income until the property was formally assigned to her.

Facts

Hugh Smith died testate, naming the First National Bank of Memphis as both executor and trustee in his will.

The will directed the trustee to pay monthly sums to Smith's wife, brother, and sister from the net income of the estate.

Less than a month after the executor qualified, Smith's widow dissented from the will, electing to take her statutory dower and legal share of the estate instead.

The estate was still in administration during the tax year in question, 1941.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate's income tax for 1941.

The bank, as executor, filed a claim for a refund, arguing that the income was distributable to the beneficiaries.

The Chancery Court of Shelby County, Tennessee, issued a decree construing the will after the widow's dissent, stating the testator intended the income to accrue to the beneficiaries from the date of death.

The Tax Court reviewed the Commissioner's deficiency determination.

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Issue(s)

1. Whether the income of the estate, designated for distribution to the testamentary trust beneficiaries (excluding the widow), was deductible as income "to be distributed currently" under Section 162(b) of the Internal Revenue Code.
2. Whether the income from the property the widow was entitled to due to her dissent should be included in the estate's net income.

Holding

1. No, because the estate was still in administration, and the assets hadn't yet been transferred to the trust for distribution.
2. Yes, because the widow's interest in the property had not been formally assigned or set apart to her during the taxable year.

Court's Reasoning

The court reasoned that the Chancery Court decree didn't mandate current distribution during the taxable year, particularly since distribution was impossible after the year had ended. The Tax Court found that the state court decree merely stated that the income was to accrue to the beneficiaries from the date of death, not that it was currently distributable.

The court distinguished *Estate of Peter Anthony Bruner, 3 T.C. 1051*, noting that even when a will directs payments from the time of death, the income isn't deductible if the trust isn't yet established and assets haven't been transferred. Here, the assets were not yet transferred to the trustee.

The court cited *In re Smith's Estate v. Henslee, 64 F. Supp. 196*, a related case, where it was shown that no income or property had come into the hands of the bank as trustee.

Regarding the widow's share, the court emphasized that under Tennessee law, the widow had no vested legal title to the dower interest until it was formally assigned. Since there was no evidence of assignment, the income from that property remained part of the estate.

Practical Implications

This case clarifies that merely designating estate income for a trust does not make it deductible under Section 162(b) if the estate is still in administration. Executors must demonstrate that the income was actually "to be distributed currently," meaning the trust must be established, and assets must be in the process of transfer to the trust.

For tax planning purposes, estates should expedite the administration process and

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the transfer of assets to trusts to enable the deduction of distributed income. The timing of these transfers is critical. Further, until a widow's dower rights or statutory share are formally assigned under state law, the income from those assets remains taxable to the estate.

Attorneys should carefully examine state law regarding dower and statutory rights to determine when income from those assets shifts from the estate to the individual beneficiary for income tax purposes.

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