10 T.C. 1110 (1948)

A prior judgment does not bar relitigation of tax liability in a subsequent year if there has been a significant change in the legal climate, as exemplified by a new controlling precedent from the Supreme Court.

Summary

Maud Bush received income from a trust established during her divorce. An earlier Board of Tax Appeals case held this income was not taxable to her. The Commissioner now seeks to tax her on the trust income for later years. The Tax Court addresses whether the prior decision is res judicata (prevents relitigation). Citing Commissioner v. Sunnen, the court holds that because of a change in the controlling legal principles, the prior decision is not res judicata. Following the Second Circuit's reasoning in a related case, the court finds Maud Bush taxable on the trust income for the years in question because the trust was effectively funded with her assets.

Facts

Irving T. Bush created an irrevocable trust in 1923 for his then-wife, Maud, and his daughters from a prior marriage.
In 1930, during divorce proceedings, Maud wanted a separate trust with a different trustee.
An agreement allocated securities from the 1923 trust to a new trust for Maud's benefit. Irving guaranteed a $60,000 annual income from the new trust.
The divorce court adopted the agreement as a settlement in lieu of alimony.

Procedural History

1935: The Board of Tax Appeals held that the trust income was not taxable to Maud for 1931.
1943: The Second Circuit Court of Appeals held that the trust income was not taxable to Irving Bush for 1933, 1934, and 1935, reversing the Board's decision.
The Commissioner now seeks to tax Maud on the trust income for 1938, 1939, and 1940. Maud argues res judicata based on the 1935 decision.

Issue(s)

Whether the prior Board of Tax Appeals decision regarding Maud Bush's tax liability for 1931 is res judicata and bars the Commissioner from taxing her on the trust income for 1938, 1939, and 1940.

Holding

No, because the Supreme Court's decision in *Commissioner v. Sunnen* significantly changed the legal landscape regarding res judicata in tax cases, allowing the

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Commissioner to relitigate the issue of Maud Bush's tax liability for subsequent years. The Tax Court determined that it was "free to litigate" the connection between the 1923 trust and the 1930 trust — a point not at issue in the earlier case.

Court's Reasoning

The court relied heavily on *Commissioner v. Sunnen*, which narrowed the application of res judicata in tax cases. The court reasoned that the prior decision only applied to the specific tax year at issue (1931). The critical point was that the factual and legal context had changed with the *Sunnen* decision. The court adopted the Second Circuit's view from *Irving T. Bush v. Commissioner*, which determined that the 1930 trust was effectively a continuation of the 1923 trust, funded with Maud's assets. Therefore, the income was taxable to her as the beneficiary of an ordinary trust. The court quoted the Second Circuit: "the new agreement was, so far as Maud is concerned, but a continuation of the old one; * * * it was set up with her own property, and we think that the husband's guarantee of the trust income did not therefore make such income his."

Practical Implications

This case illustrates that res judicata is not a foolproof defense in tax litigation. A change in controlling legal precedent can allow the IRS to relitigate tax liabilities in subsequent years, even if the underlying facts are similar. The case emphasizes the importance of analyzing the source of the funds used to create a trust when determining tax liability for trust income. It also shows how circuit court decisions can influence the Tax Court's reasoning, even when the circuit court decision is from a related, but distinct, case. Attorneys should consider the evolution of relevant case law when advising clients on the potential for relitigation of tax issues. This case is significant in demonstrating the limits of res judicata in the context of federal tax law.

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