11 T.C. 352 (1948)

Trust income that is required to be distributed currently to a beneficiary is taxable to the beneficiary, regardless of whether it is actually distributed.

Summary

The Tax Court addressed whether trust income was taxable to the beneficiary, Joseph Blake Koepfli. The trust instrument directed that net income be distributed to beneficiaries no less frequently than quarterly. Koepfli argued the trustees had discretion to accumulate income. The court held the trust income was to be distributed currently and thus was taxable to Koepfli. It found the trust instrument lacked explicit language allowing accumulation, and the trustee's power to determine "net income available for distribution" pertained only to calculating net income, not discretionary distribution.

Facts

In 1931, Joseph O. Koepfli and Juliette B. Koepfli transferred 12,000 shares of National Biscuit Co. stock to a trust for the benefit of their children, Joseph Blake Koepfli (petitioner) and Hortense Koepfli Somervell. The trust instrument directed that the entire net income be paid to the beneficiaries in equal parts, no less frequently than quarterly if possible. A dispute arose with the IRS regarding whether the trust was mandatory or discretionary. Joseph Blake Koepfli, his mother, and his wife acted as trustees. Hortense Koepfli Somervell died in 1933 leaving Joseph Blake Koepfli the sole beneficiary.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Joseph Blake Koepfli's income tax liability for 1941. The Commissioner argued that Koepfli was either the real owner of the trust property or that the income was currently distributable to Koepfli. The Commissioner also sought an increased deficiency based on capital losses charged to the corpus. The Tax Court reviewed the case to determine Koepfli's tax liability.

Issue(s)

1. Whether the respondent properly determined that petitioner is the real owner of the trust property or whether the income of the trust was currently distributable to petitioner, and accordingly was it includible in the income of petitioner under sections 161 and 162(b) of the Internal Revenue Code?

2. Is petitioner taxable upon an amount equal to the capital losses sustained by the trust?

Holding

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1. No, the income was not includable because the trust income was to be distributed currently and, therefore, it is taxable to the petitioner under sections 161 and 162 (b) of the Internal Revenue Code.

2. No, because there is no evidence to sustain the respondent's prayer for increased deficiency on the ground that capital losses were charged to corpus and were not deductible from trust income taxable to the petitioner.

Court's Reasoning

The court focused on whether the trust income "is to be distributed currently." The trust instrument stated, "The entire net income received and derived from the trust properties and available for distribution hereunder shall be… paid and delivered… no less frequently than quarterly if possible…" Koepfli argued that the trustee had discretion to determine what constituted "net income available for distribution," making the distribution discretionary. The court rejected this argument, stating that the trustee's power was limited to determining the *amount* of net income, not whether it should be distributed. The court reasoned that the trust instrument lacked explicit language authorizing the accumulation of income, and the provision for quarterly distribution suggested an intent to distribute income currently. The court also dismissed Koepfli's testimony and an instrument executed by the settlor as self-serving and contradictory to the trust's express terms.

Regarding capital losses, the court found no evidence that these losses were charged to the corpus, which would have made them non-deductible by the beneficiary.

Practical Implications

This case illustrates the importance of clear and unambiguous language in trust instruments, particularly regarding the distribution of income. If a trust is intended to provide the trustee with discretion to accumulate income, that intention must be clearly stated. Otherwise, the default rule is that income required to be distributed currently is taxable to the beneficiary, regardless of actual distribution. The case also highlights the limitations on using extrinsic evidence, such as settlor testimony, to contradict the plain language of a trust instrument. Attorneys drafting trust documents must ensure that the language accurately reflects the settlor's intentions to avoid unintended tax consequences for the beneficiaries.

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