12 T.C. 675 (1949)

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When a trust distributes income comprised of both taxable and tax-exempt components, the distribution is deemed to consist of taxable and tax-exempt income in the same proportion as the trust's total income available for distribution.

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Summary

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The Burt Trusts case addresses how to allocate tax-exempt income when a trust makes distributions to beneficiaries. The trust was directed to pay fixed annual amounts to beneficiaries, drawing from principal if income was insufficient. In 1942 and 1943, the trust had both taxable and tax-exempt income exceeding the required payments, and the trustee deducted the full distribution amount. The Commissioner disallowed a portion of the deduction, equivalent to the percentage of tax-exempt income in the trust's total income. The Tax Court upheld the Commissioner's determination, ruling that distributions must be proportionally allocated between taxable and tax-exempt income, and the tax-exempt portion is not deductible by the trust.

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Facts

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Wellington R. Burt created a testamentary trust instructing the trustee to pay specific annual amounts to named beneficiaries for life. If the trust income was insufficient, the trustee was directed to use the principal to ensure full payment. In 1942 and 1943, the trust's income included both taxable income and tax-exempt interest from state, county, and city bonds. The trust's income available for distribution significantly exceeded the required annuity payments. The trustee distributed the required amounts to the surviving beneficiaries each year.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the trust's income tax for 1942 and 1943. The Commissioner disallowed a portion of the deductions claimed by the trustee for distributions to beneficiaries. The disallowance was based on the percentage of tax-exempt income in the trust's total income available for distribution. The Tax Court reviewed the Commissioner's determination.

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Issue(s)

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Whether the amounts distributed to trust beneficiaries, where the trust income comprises both taxable and tax-exempt income, should be treated as consisting of taxable and tax-exempt income proportionally to the trust's total income.

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Holding

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Yes, because distributions to beneficiaries are deemed to comprise taxable and tax-exempt income in the same proportions as the total trust income available for distribution, and the portion deemed tax-exempt is not deductible by the trust.

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Court's Reasoning

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The court reasoned that the distributions to beneficiaries, though required by the trust document, are still subject to the rules regarding taxable and tax-exempt income. Citing previous cases such as *J. Cornelius Rathborne, 37 B.T.A. 607*, affd., 103 F.2d 301, the court emphasized that distributions from a trust retain the character of the income from which they are derived. The court rejected the petitioner's argument that Section 162(d)(1) of the Internal Revenue Code provided a separate, independent deduction, finding instead that it merely classified certain payments as trust income. The court stated that Section 162(d)(1) "provides merely that amounts which can be paid, credited, or distributed out of other than income by a trustee 'shall be considered as income of the estate or trust which is paid,

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credited, or to be distributed.'" The legislative intent behind the enactment of subsection 162(d) was to "make uniform the tax incidence of distributions made by a trustee from trust income, regardless of whether the distributions were payable from income only or could be paid from either income or principal.

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