12 T.C. 1020 (1949)

An annuity payable at intervals from a testamentary trust, and actually paid out of the trust's income, is taxable to the beneficiary as income under Section 22(b)(3) of the Internal Revenue Code.

Summary

The Tax Court addressed whether annuity payments received by Raye E. Copeland from a testamentary trust were taxable income. The annuity was established in Joseph V. Horn's will to compensate Copeland, his secretary. The Commissioner of Internal Revenue argued that because the annuity was paid out of the trust's income, it was taxable under Section 22(b)(3) of the Internal Revenue Code. The Tax Court agreed with the Commissioner, holding that the payments, being derived from the trust's income and distributed at intervals, constituted taxable income to Copeland.

Facts

Joseph V. Horn died in 1941, leaving a will that included a codicil granting Raye E. Copeland, his secretary, an annuity of $1,500 per year, payable in quarterly installments. The purpose of the annuity was to allow her to leave her job at Horn & Hardart Baking Company. The will stipulated that she provide reasonable services to his executors and trustees without additional compensation. The trustees made the annuity payments to Copeland from the general income of the trust estate. Later, the payments were made from the income of government bonds purchased specifically to fund the annuity.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Copeland's income tax for the years 1944, 1945, and 1946, based on the inclusion of the annuity payments as taxable income. Copeland challenged this determination in the Tax Court.

Issue(s)

Whether the $1,500 received annually by the petitioner from the testamentary trust should be included in her gross income under Section 22(b)(3) of the Internal Revenue Code.

Holding

Yes, because the annuity payments were made at intervals and were paid entirely out of the income from the property held in the testamentary trust; therefore, the payments constitute a bequest of income from property and are taxable to the petitioner under Section 22(b)(3) of the Internal Revenue Code.

Court’s Reasoning

The Tax Court relied on Section 22(b)(3) of the Internal Revenue Code, which excludes the value of property acquired by gift, bequest, devise, or inheritance from gross income, but explicitly includes “the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income.” The Court highlighted the final sentence of the provision: “if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.” Because the annuity was to be paid at intervals, and was in fact paid out of the trust’s income, the court concluded that it fell squarely within the provision defining it as taxable income. The court cited *Alice M. Townsend, 12 T.C. 692* to support its reasoning regarding the legislative history and purpose of this provision.

Practical Implications

The *Copeland* case clarifies the tax treatment of annuities paid from testamentary trusts. It establishes that even if a bequest is framed as an annuity, if the payments are made from the income of the trust property and are distributed at intervals, they are considered income to the beneficiary and are subject to income tax. This ruling has implications for estate planning, requiring careful consideration of how bequests are structured to minimize tax liabilities for beneficiaries. It also emphasizes the importance of tracking the source of annuity payments from trusts to determine their taxability. Later cases would likely distinguish *Copeland* if the payments were made from the principal of the trust rather than from income, potentially leading to a different tax outcome.

