Ullman v. Commissioner, 17 T.C. 135 (1951)

A trustee's discretionary power to distribute trust income is a trust power, not a donee power, unless the trustee has unfettered command over the income; however, if the trustee directs income to an ineligible beneficiary, it is treated as if the income was distributed to the trustee and then given to the ineligible party, thus impacting the tax consequences.

Summary

Ruth W. Ullman was the trustee of two trusts created by her parents. The trusts gave her discretionary power to distribute income to her lineal descendants or ancestors, including herself. The Tax Court addressed whether the trust income was taxable to Ullman. The court held that the income from one trust was taxable to Ullman because she directed it to an ineligible beneficiary, effectively using it for her own benefit. The court also addressed the tax implications of Ullman's right to withdraw $25,000 annually from the trust corpus.

Facts

Benjamin Weitzenkorn and Daisy R. Weitzenkorn created trusts naming their daughter, Ruth W. Ullman, as trustee. Article II of each trust granted Ullman the absolute and uncontrolled discretion to distribute income to her lineal descendants or ancestors, a group defined to include Ullman herself "in any event." The Benjamin Weitzenkorn trust prohibited distributions to Benjamin or anyone he was legally obligated to support. Ullman, as trustee, directed income from the Benjamin Weitzenkorn trust to her mother, Daisy, and income from the Daisy R. Weitzenkorn trust to her father, Benjamin. Ullman also had the right to withdraw $25,000 annually from each trust's corpus.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Ullman's income tax for 1943, based on the trust income. Ullman petitioned the Tax Court for a redetermination. The Tax Court reviewed the case.

Issue(s)

1. Whether the income covered by Article II of the trusts created by petitioner's father and mother was taxable to her.

2. Whether Ullman's right to take $25,000 annually from the trust corpus subjected her to tax on the income attributable to that portion of the corpus.

3. Whether the petitioner is subject to the penalty proposed by the respondent for failure to file a timely return for 1943.

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Holding

1. Yes, as to the income from the Benjamin Weitzenkorn trust; no, as to the Daisy R. Weitzenkorn trust because Ullman directed the income from the Benjamin Weitzenkorn trust to an ineligible beneficiary, her mother, and effectively used it for her own benefit. Income from the Daisy R. Weitzenkorn trust was properly distributed to Benjamin Weitzenkorn.

2. Yes, in part, because Ullman's unqualified right to take and use trust corpus gives her such command over the trust property as to make the income therefrom her income, but only to the extent it exceeds the income she already reported from Article I of the trust.

3. No, because the petitioner's return was timely filed.

Court's Reasoning

Regarding the Article II income, the court reasoned that Ullman's power was a trust power, not a donee power, meaning she had to exercise it for the benefit of the beneficiaries. However, because Daisy Weitzenkorn was ineligible to receive income from the Benjamin Weitzenkorn trust (due to Benjamin's legal obligation to support her), Ullman's direction of income to her was considered an application of the income to Ullman's own use. The court stated, "The only way such action can be harmonized with the specific words of the trust instrument is to say that as trustee she distributed the income to herself and then gave it to her mother." Therefore, the Article II income from the Benjamin Weitzenkorn trust was taxable to Ullman. Regarding the $25,000 withdrawal right, the court held that this was a donee power, giving Ullman sufficient control over that portion of the corpus to make the income taxable to her. However, this was limited to the portion of income not already reported under Article I. As to the penalty, the court found that Ullman's testimony and customary practice of timely filing returns, combined with the lack of evidence from the Commissioner, supported a finding that the return was timely filed.

Practical Implications

This case clarifies the tax implications of discretionary trust powers held by trustees who are also beneficiaries. It highlights that while a trustee can be a beneficiary, directing income to an ineligible beneficiary can be construed as using the income for the trustee's own benefit, triggering income tax liability. The case also confirms that an unqualified right to withdraw from trust corpus can create a taxable interest in the income generated by that portion of the corpus. Practitioners must carefully consider the eligibility of beneficiaries and the extent of control granted to trustees to advise clients on potential tax consequences. This case emphasizes the importance of following the trust document's specific terms when distributing funds. Later cases may distinguish Ullman by focusing on the specific language of the trust document and the presence of specific standards for distribution.

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