16 T.C. 1041 (1951)

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The grantor of a trust is taxable on trust income that is used to pay life insurance premiums on the grantor’s life or is distributable to the grantor, regardless of whether it is actually distributed.

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Summary

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Margaret Vreeland created a trust in 1931, funding it with real properties and securities. The trust agreement directed the trustees to manage the properties, pay expenses, including mortgage interest, and then use the remaining income to pay life insurance premiums on Vreeland’s life, her personal obligations, and up to $6,000 per year for her support. The Tax Court held that under Section 167 of the Internal Revenue Code, the trust income used to pay life insurance premiums and that which was available for distribution to Vreeland was taxable to her, even if not actually distributed. Further, a net operating loss suffered by the trust in a prior year could not be carried over to reduce the income taxable to the grantor in subsequent years.

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Facts

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Margaret Vreeland (formerly Curtis) owned various real estate interests and securities, some outright and some as life estates. By 1931, the real estate was encumbered by mortgages securing Vreeland’s personal debts, and the properties were in disrepair. To consolidate her finances, Vreeland borrowed $35,000 and, on May 13, 1931, transferred her real estate interests, securities, and the borrowed funds to a trust. The trust agreement directed the trustees to manage the properties, pay off existing debts and mortgages, pay insurance premiums on a $35,000 life insurance policy on Vreeland’s life, and pay Vreeland up to $6,000 per year for her support and maintenance.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the income tax liabilities of Margaret and George Vreeland (her husband, with whom she filed jointly in 1942) for 1942 and 1943, based on the inclusion of the trust's income in Margaret Vreeland's taxable income. The Vreelands petitioned the Tax Court for redetermination of the deficiencies. The Tax Court consolidated the cases.

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Issue(s)

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1. Whether the income of the trust created by Margaret Vreeland is includible in her net income under Section 167(a) of the Internal Revenue Code?

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2. If the trust income is so includible, whether the trust suffered a net operating loss in 1941 that reduces the income of the trust which is includible in the income of Margaret Vreeland during 1942 and 1943?

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Holding

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1. Yes, because the trust agreement directed the trustees to use the income to pay life insurance premiums on Vreeland's life and allowed for the distribution of income to Vreeland, making the income taxable to her under Section 167(a).

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2. No, because a net operating loss suffered by the trust is a loss of the trust, a separate entity, and does not reduce the income of the trust distributable to the grantor.

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Court's Reasoning

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The court relied on Section 167(a) of the Internal Revenue Code, which states that the grantor of a trust is taxable on trust income if it is or may be accumulated for future distribution to the grantor, may be distributed to the grantor, or is or may be applied to the payment of premiums on life insurance policies on the grantor's life. The court found that the trust agreement clearly directed the trustees to use the income to pay life insurance premiums on Vreeland's life, making that portion of the income taxable to her under Section 167(a)(3). The court also noted that the remaining income of the trust could have been distributed to Vreeland for her support and maintenance, or to pay her outstanding debts, thus making it taxable to her under Section 167(a)(2). The court emphasized that taxability under Section 167(a)(2) depends on whether the income *might* have been distributed to the grantor, not whether it was actually distributed. Regarding the net operating loss, the court explained that the trust remains a separate taxable entity under Section 167. A net operating loss is a loss of the trust, chargeable against the corpus in the year of the loss, and does not reduce the income distributable to the grantor in later years. The court stated,

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