17 T.C. 34 (1951)

Amounts paid at intervals as a gift, bequest, devise, or inheritance are included in the gross income of the recipient to the extent that they are paid out of income from property placed in trust.

Summary

The Tax Court addressed whether a prior tax refund barred the determination of a deficiency and whether amounts received from a testamentary trust were taxable as income. The court held that the refund did not bar the deficiency determination, as the notice of deficiency was timely. It also held that monthly payments from the trust, intended to be paid primarily from income, were taxable income to the recipient under Section 22(b)(3) of the Internal Revenue Code, as amended by the Revenue Act of 1942, regardless of the possibility that principal could be used.

Facts

Mildred Irene Lauffer (petitioner) received monthly payments of $250 from a testamentary trust established by her deceased husband. The trust directed the trustees to collect rents, issues, and profits from the residuary property and pay the petitioner $250 per month for life or until remarriage. If the income was insufficient, the trustees were authorized to use the principal to make up the deficit. The IRS determined a deficiency in Lauffer's 1947 income tax, arguing the trust payments were taxable income. A prior refund had been issued to Lauffer for the same tax year.

Procedural History

The Commissioner determined a deficiency in the petitioner's 1947 income tax. The petitioner appealed this determination to the Tax Court, arguing that the deficiency was barred by a prior refund and that the payments from the testamentary trust were not taxable income.

Issue(s)

1. Whether the respondent is barred from determining the deficiency in the petitioner's 1947 income tax because of a prior refund?

2. Whether the amounts received by the petitioner in 1947 from the testamentary trust were taxable as income to her?

Holding

1. No, because the notice of deficiency was mailed within the statutory limitation prescribed by section 275(a), I.R.C., and the allowance of the refund was not a final determination.

2. Yes, because the amounts were paid at intervals as a devise, bequest, or inheritance out of income of property placed in trust, and are therefore includible in gross income under Section 22(b)(3) of the I.R.C.

Court's Reasoning

Regarding the first issue, the court reasoned that the prior refund did not bar the deficiency determination because there was no closing agreement or valid compromise. Citing *Burnet v. Porter, 283 U.S. 230*, the court affirmed the IRS's right to reopen a case and redetermine the tax, absent specific agreements or statutory limitations. As the notice of deficiency was timely, the respondent's determination was not barred by the statute of limitations.

Regarding the second issue, the court distinguished *Burnet v. Whitehouse, 283 U.S. 148*, noting that the will in *Whitehouse* provided an annuity not related to income, unlike the trust here, where the testator intended payments to come first from income. More importantly, the court emphasized the significance of the amendment to Section 22(b)(3) of the I.R.C. by Section 111 of the Revenue Act of 1942. This amendment explicitly states that if payments of a gift, bequest, devise, or inheritance are made at intervals, they are considered income to the extent paid out of income. The court stated, "From what appears to be the plain intention of Congress in revising section 22 (b) (3), amounts paid at intervals as a gift, bequest, devise, or inheritance are not to be excluded from the gross income of the recipient to the extent that they are paid out of income." Because the amounts received were paid at intervals as a devise, bequest, or inheritance from trust income, they were includible in the taxpayer's gross income.

Practical Implications

Lauffer clarifies that amendments to the tax code can significantly alter the taxability of income from trusts and estates. It underscores the importance of analyzing the source of payments made at intervals from testamentary trusts or similar arrangements. Even if a will or trust document allows for the invasion of principal, if the payments are made from income, they are generally taxable to the recipient under current law. This decision emphasizes that post-1942, the focus is on the *source* of the payment, not solely the *potential* for the payment to come from principal. This case informs how estate planning attorneys should advise clients regarding the tax implications of creating trusts and how beneficiaries should report income received from trusts.

