Fidelity Trust Co., Trustee v. Commissioner, 29 T.C. 57 (1957)

A trustee can only deduct income "permanently set aside" for charity under the 1939 Internal Revenue Code if the governing instrument specifically directs the setting aside of income for charitable purposes.

Summary

Fidelity Trust Company, as trustee of the John Walker estate, sought to deduct income from a trust that was ultimately destined for charitable institutions, based on a power of appointment granted to John Walker's son, Henry. The Commissioner of Internal Revenue disallowed the deduction, arguing the will did not explicitly set aside income for charity. The Tax Court sided with the Commissioner, holding that the deduction was not allowed because John Walker's will did not itself mandate the setting aside of income for charity. The court emphasized that the income was not permanently set aside by the will, but rather it was the son's later exercise of the power of appointment which directed the funds for charitable purposes.

Facts

John Walker's will created a trust for his wife, Susan, and then for his son, Henry, with a provision allowing Henry to appoint a portion of the trust to charitable or educational institutions. Henry exercised this power of appointment to benefit various charities. The trust income in question was generated in 1953. Litigation ensued regarding the validity of Henry's exercise of the power of appointment, resolving in favor of the charitable beneficiaries in 1954. The trustee, Fidelity Trust, did not distribute the income until after the court decisions.

Procedural History

Fidelity Trust filed a fiduciary income tax return for 1953, claiming a deduction for income inuring to charity. The IRS disallowed the deduction, leading to a deficiency assessment. Fidelity Trust petitioned the Tax Court to challenge the IRS's determination.

Issue(s)

1. Whether the trustee could deduct the trust income under section 162(a) of the Internal Revenue Code of 1939 as income "permanently set aside" for charity.

2. Whether the trust income was deductible under section 162(b) and (d)(3) of the Internal Revenue Code of 1939 because the Supreme Court of Pennsylvania's decision made the income payable to the charities.

Holding

1. No, because the will did not specifically require the setting aside of income for

charity.

2. No, because the income was not distributable within 65 days of the taxable year.

Court’s Reasoning

The court analyzed the requirements for the charitable deduction under Section 162(a) of the 1939 Internal Revenue Code, which permitted a deduction for income “permanently set aside” for charitable purposes. The court found that the income in question was not permanently set aside under the terms of John Walker’s will. The power of appointment granted to Henry meant that John did not specifically designate the income for charitable purposes. The court emphasized that the ‘setting aside’ necessary for the deduction must be accomplished by the will of the donor. Here, the will gave the power to designate to the son, Henry. The court distinguished that the setting aside was a result of Henry’s will, not John’s.

The court also addressed the alternative argument under section 162(b), which allowed a deduction for income distributable to beneficiaries. The court determined that the income was not distributable within the taxable year, as it was not actually distributed until July 1954, and that the income only became distributable after the final decision of the Supreme Court of Pennsylvania.

The court noted the long-standing congressional policy to encourage charitable contributions but asserted that the taxpayer must still meet the specific requirements of the statute to claim a deduction. The fact that the income was ultimately designated for charity was not enough; the key was the language in John Walker’s will.

Practical Implications

This case underscores the importance of precise language in wills and trust documents when establishing charitable deductions. It highlights that the instrument creating the trust must specifically direct the setting aside of income for charitable purposes to qualify for the deduction. The fiduciary’s actions alone, without clear instructions in the governing document, are insufficient.

Practitioners should carefully draft testamentary instruments to ensure that any charitable contributions are clearly and unambiguously provided for, specifying how income or principal is to be used. Failing this, a deduction will not be allowed, regardless of the eventual use of the funds. This case has been cited in other cases regarding trust and estate taxation, emphasizing the need for strict compliance with statutory requirements for charitable deductions. In the estate context, if a testator wants a charitable deduction, the will must provide the charitable distribution.