30 T.C. 278 (1958)

Income set aside for charity by a trust is not deductible for tax purposes if the charitable beneficiary's right to the income is contingent and unascertained during the tax year in question.

Summary

The United States Tax Court held that a trust could not deduct income purportedly set aside for charitable purposes because the charitable beneficiary's right to the income was contingent upon the outcome of ongoing litigation regarding the validity of a power of appointment. The trustee of the John Walker Trust sought to deduct income under Section 162(a) of the 1939 Internal Revenue Code, arguing it was permanently set aside for charities. However, the court reasoned that until the Pennsylvania Supreme Court resolved the dispute over Henry Walker's exercise of a power of appointment in favor of charities, the charitable beneficiaries were unascertained, and the income was not "permanently set aside" as required for a charitable deduction. The court also rejected the argument for deduction under Sections 162(b) and (d)(3), finding the income was not "distributable" within the relevant timeframe.

Facts

John Walker established a trust in his will, granting his widow, Susan C. Walker, a life income interest. Upon Susan's death, a one-fourth share was to be held in further trust for his son, Henry P. Walker, if Henry survived Susan. John's will granted Henry a limited power of appointment over this one-fourth share, exercisable if Henry died without surviving issue, allowing him to appoint to his lineal descendants or educational/charitable institutions.

Henry P. Walker predeceased Susan C. Walker but exercised his power of appointment in his will, directing that the one-fourth share be held in trust to pay income to his sister for life, and the remaining two-thirds of the income to four qualified charities during his sister's lifetime, with the charities as ultimate remaindermen.

After Susan's death, John Walker's heirs contested the validity of Henry's appointment, claiming it was contingent on Henry surviving Susan. The Orphans' Court initially upheld Henry's appointment, but this decision was appealed and litigated through the Pennsylvania court system until the Pennsylvania Supreme Court ultimately validated Henry's appointment in January 1954.

The income from the disputed one-fourth share, earned in 1953, was accumulated by the trustee of John Walker's trust and was not distributed until July 1954, after the litigation concluded and the Orphans' Court approved distribution to the trustee under Henry's will.

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Procedural History

Orphans' Court of Allegheny County, Pennsylvania:

June 4, 1951: Suspended distribution of the disputed one-fourth share of the trust and income pending adjudication.

December 11, 1952: Auditing judge upheld Henry's power of appointment and decreed distribution to Henry's trustee.

April 13, 1953: Orphans' Court en banc reversed, decreeing distribution to John Walker's heirs.

Supreme Court of Pennsylvania:

January 4, 1954: Reversed the Orphans' Court en banc and reinstated the auditing judge's decree, validating Henry's appointment (*In re Walker's Estate*, 376 Pa. 16).

United States Tax Court:

May 14, 1958: Held that the John Walker Trust was not entitled to a charitable deduction for 1953 income.

Issue(s)

1. Whether the trustee of the John Walker Trust was entitled to a deduction under Section 162(a) of the Internal Revenue Code of 1939 for income permanently set aside for charitable purposes during the taxable year 1953, when the charitable beneficiaries' right to that income was contingent and subject to ongoing litigation.

2. Alternatively, whether the trustee was entitled to a deduction under Sections 162(b) or 162(d)(3) of the 1939 IRC, arguing the income became distributable to charities within 65 days of the close of the 1953 taxable year.

Holding

1. No, because during 1953, the distributee of the income was unascertained, and its interest was contingent upon the final decision of the Supreme Court of Pennsylvania. Therefore, the income was not "permanently set aside" for charitable purposes during that tax year as required by Section 162(a).

2. No, because the income was not actually distributed nor was it considered "distributable" to the beneficiaries within the first 65 days of the subsequent taxable year (1954). The trustee was not obligated nor authorized to distribute the income until after the Orphans' Court decree in July 1954.

Court's Reasoning

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Section 162(a) Deduction: The court emphasized that for a deduction under Section 162(a), the income must be "permanently set aside" pursuant to the terms of the will or deed creating the trust. While Henry's will directed income to charity, this was not directly from John Walker's will. More critically, during 1953, the charitable designation was contingent due to the legal challenge by John Walker's heirs. The court stated, **"The 'setting aside' necessary to qualify an amount for deduction must be accomplished by the will of the donor and is not accomplished by the act of a fiduciary independent of such testamentary provision."** The court found that John Walker's will did not irrevocably set aside income for charity; Henry's appointment was the source, and its validity was contested, making the charitable interest contingent in 1953.

Sections 162(b) and 162(d)(3) Deduction: The court rejected the alternative argument that the income was deductible as distributable to beneficiaries. For income to be considered "distributable," the beneficiary must have a present right to demand it. The court found that until the Pennsylvania Supreme Court's decision in 1954 and the subsequent Orphans' Court order in July 1954, the trustee of John Walker's trust was neither obligated nor authorized to distribute the 1953 income to Henry's trustee for the benefit of charities. The income distribution was contingent upon the resolution of the litigation and court approval, which occurred after 1953 and beyond the 65-day window for retroactive deductibility.

Practical Implications

Contingency and Charitable Deductions: *Walker v. Commissioner* establishes that for a trust or estate to claim a charitable set-aside deduction, the charitable beneficiary's interest must be definitively ascertained and not subject to significant contingencies during the tax year for which the deduction is claimed. Ongoing litigation that directly impacts the validity or identity of the charitable beneficiary creates such a contingency, preventing the income from being considered "permanently set aside."

Distributable Income and Timing: The case clarifies the meaning of "distributable income" in the context of trust and estate taxation. Income is not considered distributable merely because it might eventually be paid to a beneficiary. Instead, the beneficiary must have a present and legally enforceable right to demand the income from the fiduciary. Court orders and resolution of legal uncertainties are often necessary to establish this right to demand distribution.

Source of Charitable Designation: The decision highlights that the charitable set-aside must originate from the testamentary instrument of the original donor (John Walker in this case), not merely from a subsequent exercise of a power of appointment (Henry Walker's will), if the deduction is sought by the original donor's trust. While Henry's will effectively directed funds to charity, the deduction for John's trust was disallowed because, during the tax year, this charitable designation was not certain and direct from John's will due to the contingency.

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Precedent for Contingent Beneficiary Cases: *Walker v. Commissioner* is a key case in tax law concerning charitable deductions for trusts and estates, particularly when beneficiary designations are contingent or subject to legal disputes. It underscores the strict requirements for demonstrating that income is "permanently set aside" or "distributable" to charity for deductibility under federal tax law.

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