32 T.C. 538 (1959)

Trust income is taxable to the grantor if the income is held or accumulated for future distribution to the grantor, even if the distribution is contingent upon future events, such as the grantor surviving another person.

Summary

The Estate of Edward Wadewitz challenged the Commissioner's determination that trust income should be included in the grantor's gross income under Section 167(a)(1) of the Internal Revenue Code of 1939, arguing that income accumulated in Trust #1 was not for future distribution to the grantor because it was contingent on the grantor surviving her husband. The Tax Court ruled in favor of the Commissioner, holding that the income was subject to tax because the grantor was named as a beneficiary to receive distributions, even though those distributions were contingent. The court also addressed the taxability of capital gains in Trust #2, holding that the capital gains were currently distributable and taxable to the grantor since she could demand their distribution to meet the trust's required payments to her.

Facts

Edward and Nettie Wadewitz created two trusts. In Trust #1, Edward assigned life insurance policies to the trustees, and Nettie assigned corporate stock. The trustees were to use the trust income to pay premiums on the policies, and any remaining income was added to the corpus. After Edward's death, the trustees were to pay Nettie $800 per month for life. Trust #2 required the trustees to pay Nettie $1,000 per month from principal and income, along with payments to other beneficiaries. During the tax years in question, the income from Trust #1 was used to pay insurance premiums, and the balance was added to the corpus. Trust #2 had both ordinary income and capital gains. The Commissioner determined deficiencies in the Wadewitzes' income taxes, arguing that the income of Trust #1 was includible in Nettie's income under Section 167(a)(1), and that Nettie's share of Trust #2's capital gains were currently distributable.

Procedural History

The case was brought before the United States Tax Court. The Tax Court issued a decision in favor of the Commissioner of Internal Revenue.

Issue(s)

1. Whether the income of E. H. Wadewitz Trust #1 was held or accumulated for future distribution to the grantor, Nettie Wadewitz, causing it to be includible in her individual income under section 167(a)(1) of the Internal Revenue Code of 1939.
2. Whether certain long-term capital gains derived by E. H. Wadewitz Trust #2

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qualify as trust income currently distributable to beneficiaries, so that petitioner Nettie is taxable with her proportionate share under section 162(b) and (d)(1).

Holding

1. Yes, because the income of Trust #1 was held or accumulated for future distribution to Nettie, despite the condition that she survive Edward to receive it.
2. Yes, because Nettie's proportionate shares of the ordinary income and capital gains of the trust were currently distributable and taxable to her under section 162(b) of the 1939 Code.

Court's Reasoning

The court focused on the interpretation of Section 167(a)(1), which states that trust income is taxable to the grantor if it is "held or accumulated for future distribution to the grantor." The court rejected the petitioners' argument that the income was not for future distribution because Nettie's receipt was conditional on her surviving Edward. The court cited *Kent v. Rothensies* and stated that the statute does not require unconditional distribution, and it is enough that the grantor is named as a beneficiary to whom, if living, the accumulated income will be distributed. The court noted: "In effect, both the taxpayer and the district court would read Section 167 as though it provided that the trust income is taxable to the grantor if it 'is unconditionally held or accumulated for future distribution to the grantor.'" The court held that the focus is whether the grantor will potentially benefit from the accumulation. Regarding Trust #2, the court found that the capital gains were currently distributable to Nettie because the trust income was insufficient to meet the required monthly payments to her. Thus, she could have demanded the distribution of principal, including capital gains, to cover the shortfall.

Practical Implications

This case is crucial for analyzing the tax treatment of trust income, particularly where the grantor's benefit is contingent. It clarifies that the "held or accumulated for future distribution" standard in Section 167(a)(1) is broad and covers situations where the grantor is named as a potential beneficiary, even if the conditions are not met. Therefore, attorneys should carefully examine the trust instrument to determine if the grantor is a potential beneficiary, and the facts of the case to determine how trust income and capital gains will be distributed. The case also highlights that if trust distributions are required, the trustee's power to allocate receipts between principal and income is not absolute, and the capital gains can be deemed "currently distributable" where the trust's current income is insufficient to meet these requirements. Moreover, it emphasizes the importance of looking at what could be done under the trust instrument. *Wadewitz* has been cited in many subsequent cases, with courts often using it as a framework to examine tax liability

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when the income and capital gains may go to the grantor, even if there are contingencies.

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