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Income Tax--Tax Status of Trust Income Distributed as Prize (McDermott v. Commissioner of Internal Revenue, 150 F.2d 585 (App. D.C. 1945))

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tions threatening to obstruct war production and the production and distribution of essential civilian commodities.[3] These conditions created a public emergency which made action by the legislature imperative in order to protect the public safety, health, and general welfare of the people of the State of New York.

The court's conclusion that the Act was within the police power of the state also disposed of the plaintiff's contention that the statute violated the due process clause.[4]

J. M. Z.

INCOME TAX—TAX STATUS OF TRUST INCOME DISTRIBUTED AS PRIZE.—Malcolm McDermott, the recipient of the Ross Essay Prize awarded by the American Bar Association in 1939, petitioned the United States Court of Appeals, District of Columbia, to review a decision of the Tax Court, sustaining an income tax deficiency determined by the Commissioner of Internal Revenue on the income from the award.

Erskine M. Ross, a retired federal judge, left a will, one of the clauses of which provided that the sum of $100,000 be given to the American Bar Association to be safely invested by it, and the annual income to be offered and awarded as a prize for the best discussion of a subject to be suggested at the preceding annual meeting of the Association. The Superior Court of Los Angeles County, previous to the award of the prize to the petitioner, construed this clause to mean that in any given year the Association might spend less than the entire income for that year; that it might in any given year expend more than the entire current and accumulated income; and that it was empowered to pay the resulting deficiency, if any, from the income of the following year.

In 1939 an award of $3,000 was made to Professor McDermott for the best essay on the topic, "To What Extent Should the Decisions of Administrative Bodies Be Reviewable by the Courts."[1] The Tax Court held that as Professor McDermott was the ascertained income beneficiary of the trust for 1939, the award was part of his gross income and he was therefore taxable thereon. *Held,* reversed. *McDermott v. Commissioner of Internal Revenue,* 150 F. (2d) 585 (App. D. C. 1945).

The question presented on appeal to the United States Court of Appeals was whether such award was part of the petitioner's gross income within the meaning of Section 22(a) of the Internal Revenue Code which includes "gains, profits and income . . . from professions . . . or . . . from any source whatever," and there-

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[3] N. Y. Laws 1945, c. 3, § 1.

[4] U. S. CONST. AMEND. XIV, § 1; N. Y. CONST. Art. I, § 6.

[1] 25 A. B. A. J. 453.

fore taxable; or whether it was a "gift" within the meaning of Section 22(b)(3) and therefore excludable from gross income.

The court pointed out that in accordance with the construction of the Ross will by the Superior Court the trustees might make the award out of past, present or anticipated future income and that the record did not show whether the award to the petitioner was in fact made out of the current income, accumulated income, or from other funds. Therefore, as under the statute, only the *current income* of a trust fund is taxable to the beneficiary,[2] the $3,000 award was not part of the gross taxable income of the petitioner.

But even if it were shown that the award was made out of the current income of the trust it would not follow that the award was part of the petitioner's gross income for two reasons. First, under the ruling in the *Gavit* and *Beatty* cases,[3] relied upon by the respondent, only trust income which accrues to a beneficiary because it is trust income is taxable to the beneficiary for the same reason. A sum which is paid under the terms of a trust and which accrues whether or not the trust has any income is not taxable to the recipient merely because it is primarily payable and is in fact paid out of income.[4]

Second, the principle of the *Gavit* and *Beatty* cases, which dealt with payments for long periods of time to beneficiaries named in the original trusts, is not applicable to amounts payable only from income by an educational or charitable trust to a beneficiary not named in the trust instrument. The present award was not, as in the cases cited above, a continuous flow of trust income through the trustee as a conduit but rather a single gift, and such a gift is not income to the donee merely because it is expressly made out of the income of the trust.

The court considers at length the circumstances which require the conclusion that the award was a gift and not income within the meaning of the statute,[5] citing supporting cases,[6] and points out that the American Bar Association did not employ Professor McDermott; that it neither expected nor received profit from the contest or from the petitioner's participation in it; and finally that "requiring winners of scholarly awards to pay taxes on them would conflict with the wise and settled policy of encouraging scholarly work."

M. H. L.

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[2] INT. REV. CODE § 162(b), (c).

[3] Irwin v. Gavit, 268 U. S. 161, 69 L. ed. 897 (1925); Heiner v. Beatty, 17 F. (2d) 743 (1927), *aff'd* 276 U. S. 598, 72 L. ed. 723 (1928).

[4] Burnet v. Whitehouse, 283 U. S. 148, 75 L. ed. 916 (1931).

[5] INT. REV. CODE §§ 22(a)(b)(3), 101(6), 162(a).

[6] Helvering v. American Dental Co., 318 U. S. 322, 87 L. ed. 785 (1943); United States v. Merriam, 263 U. S. 179, 68 L. ed. 240 (1923).