1 T.C. 275 (1942)

An employer’s purchase of annuity contracts for employees, as part of a compensation plan, constitutes taxable income to the employees in the year the contracts are purchased, even if the employees have no control over the form of the compensation and the contracts are non-assignable and have no cash surrender value.

Summary

The Procter & Gamble Co. established a five-year plan for additional remuneration to certain executives and employees. In 1938, instead of paying cash bonuses, the company’s president directed the purchase of retirement annuity contracts for the petitioners. The petitioners had no option to receive cash instead. The Tax Court held that the amounts used to purchase the annuity contracts were additional compensation to the employees and thus taxable income under Section 22(a) of the Revenue Act of 1938, distinguishing the case from situations involving pension trusts.

Facts

The Procter & Gamble Co. adopted a plan in 1934 to provide additional compensation to executives and employees based on a percentage of the company’s net profit. The plan stipulated that the president would determine recipients and amounts each year. In 1938, the company purchased special single premium retirement annuity contracts for the petitioners instead of paying cash bonuses. These contracts were non-assignable and had no cash surrender value. The company considered this a way to secure the future of its important employees. The employees completed applications for the annuity contracts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners’ income taxes for 1938, including the cost of the annuity contracts in their income. The petitioners contested this inclusion in the Tax Court.

Issue(s)

Whether the amounts paid by Procter & Gamble to purchase annuity contracts for its employees, where the employees had no option to receive cash and the contracts were non-assignable and had no cash surrender value, constitute taxable income to the employees in the year the contracts were purchased under Section 22(a) of the Revenue Act of 1938.

Holding

Yes, because the amounts expended by the company for the annuity contracts were

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for the petitioners' benefit and represented additional compensation, thereby falling within the broad definition of gross income under Section 22(a) of the Revenue Act of 1938.

Court's Reasoning

The court reasoned that although the petitioners did not constructively receive the cash (as they had no option to receive it), the amounts used to purchase the annuity contracts were intended as extra compensation. The court relied on Section 22(a) of the Revenue Act of 1938, which defines gross income as including "gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid." The court distinguished this case from *Raymond J. Moore, 45 B.T.A. 1073*, because that case involved a pension trust, whereas here, the company directly purchased annuity contracts for the employees without establishing a formal trust. The court cited *George Mathew Adams, 18 B.T.A. 381*, and other cases holding that insurance premiums paid by an employer on policies for employees are taxable income to the employees, even if they don't have free use or disposition of the funds. The court acknowledged prior administrative rulings that treated annuity contracts differently, but found the statute's language controlling.

Practical Implications

This case establishes that employer-provided benefits, even those with restrictions on access or transferability, can be considered taxable income to the employee if they are provided as compensation for services. It highlights the importance of Section 22(a) (and its successors in later tax codes) as a broad catch-all for defining taxable income. This ruling informs how courts analyze compensation packages, emphasizing that the *form* of payment is less important than its *purpose* as remuneration. Subsequent cases and IRS guidance have further refined the tax treatment of employee benefits, but the core principle remains: benefits provided in lieu of salary are generally taxable as income.

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