Harold G. Perkins et al., 8 T.C. 1051 (1947)

A trust established by a company to purchase annuity contracts solely for the benefit of its officer-stockholders, without a broad pension plan for other employees, does not qualify as a tax-exempt employees' trust under Section 165 of the Internal Revenue Code; therefore, the annuity premiums paid by the company constitute taxable income to the officer-stockholders.

Summary

The Tax Court held that annuity premiums paid by Optical Co. on behalf of its two officer-stockholders, Perkins and Everett, were taxable income to them. The court reasoned that the trusts established to hold the annuity contracts did not qualify as tax-exempt employees' trusts under Section 165 of the Internal Revenue Code because they were a device to provide additional compensation to the officers rather than a bona fide pension plan for employees generally. The absence of a broad-based pension plan and the limited number of beneficiaries (only two officer-stockholders) were key factors in the court's decision.

Facts

Optical Co. created two trusts for the benefit of Harold Perkins and Charles Everett, who were stockholders and principal officers of the company. The company paid premiums on annuity contracts held by the trusts. Optical Co. had approximately 350 employees but never had a written pension plan for all employees. Perkins and Everett were the only employees who received such benefits. The trust agreements primarily served to hold the annuity policies until maturity, acting as a conduit for payments from the insurance company to the beneficiaries. Subsequent to the creation of the trusts, Optical Co. deferred payments of premiums while paying cash bonuses to Perkins and Everett.

Procedural History

The Commissioner of Internal Revenue determined that the annuity premiums paid by Optical Co. constituted taxable income to Perkins and Everett. Perkins and Everett petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the trusts created by the Optical Co. for Perkins and Everett qualify as tax-exempt employees' trusts under Section 165 of the Internal Revenue Code.
2. Whether the amounts paid by Optical Co. as premiums on the annuity contracts constitute taxable income to Perkins and Everett under Section 22(a) of the Internal Revenue Code.

Holding

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1. No, because the trusts were not established as part of a bona fide pension plan for the benefit of employees generally.
2. Yes, because the payments represented additional compensation to Perkins and Everett, taxable to them under Section 22(a).

Court’s Reasoning

The court reasoned that the trusts did not qualify as tax-exempt under Section 165 because they were a device to defer taxes on additional compensation to the officer-stockholders. The court emphasized that Section 165 was intended to encourage genuine profit-sharing and pension plans for employees. The Optical Co. never had a general pension plan for its employees, and the trusts benefited only the two officer-stockholders. The court distinguished *Raymond J. Moore, 45 B. T. A. 1073*, and *Phillips H. Lord, 1 T. C. 286*, noting that those cases involved definite written programs for a substantial number of employees. The court found the trustee’s duties were merely ministerial, acting as a conduit for payments. The court stated, “To liberally construe section 165 under this factual situation would be to countenance and encourage a subterfuge.” The court also pointed out the factual similarity to *Renton E. Brodie, 1 T. C. 275*, where annuity premiums were considered taxable income when paid directly to employees.

Practical Implications

This case clarifies that establishing trusts for the exclusive benefit of a small number of highly compensated employees, particularly officer-stockholders, will not qualify as a tax-exempt employee trust under Section 165. Employers seeking to create qualified pension plans must demonstrate a genuine intent to provide retirement benefits to a significant portion of their workforce, not just a select few. The case highlights the importance of a comprehensive and non-discriminatory pension plan to achieve tax-exempt status. Later cases have cited *Perkins* as an example of a situation where a plan was deemed to be a disguised form of compensation for key executives, thus solidifying the principle that the substance of a plan, rather than its form, will determine its tax status.

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