Hackett v. Commissioner, 159 F.2d 121 (6th Cir. 1947)

An annuity contract purchased by an employer for an employee as compensation constitutes taxable income to the employee in the year the contract is received, measured by the contract's fair market value, even if the employee receives no annuity payments in that year.

Summary

Hackett, Wellman, and Nichols, officers of Nichols & Co., received annuity contracts from the company as additional compensation. The Commissioner determined that the cost of these contracts should be included in their gross income for the year they were received. The taxpayers argued that the value of the annuity contracts should be excluded from gross income under Section 22(b)(2) of the Internal Revenue Code. The Tax Court held that the receipt of the annuity contracts constituted taxable income in the year of receipt, rejecting the taxpayers' argument that future annuity payments would be fully taxable, thus precluding current taxation of the contract's value.

Facts

Nichols Co., a wool manufacturing company, purchased single premium annuity contracts for its officers (Hackett, Wellman, and Nichols) as additional compensation. The decision to purchase these annuities was made at a directors' meeting in August 1941. The annuity contracts provided the officers with income for life, with provisions for beneficiaries to receive payments if the total annuity payments did not equal the premium paid. The officers believed the value of the policies need not be returned as income in the year purchased but that the full amounts paid as annuities thereon should be so returned in each year received. The corporation deducted the cost of the annuity contracts as an expense on its income tax return.

Procedural History

The Commissioner assessed deficiencies against Hackett, Wellman, and Nichols for failing to include the cost of the annuity contracts in their gross income. The Tax Court upheld the Commissioner's determination. The Sixth Circuit Court of Appeals affirmed the Tax Court's decision.

Issue(s)

Whether the fair market value of annuity contracts, purchased by an employer for employees as compensation, is includible in the employees' gross income in the year the contracts are received, even if no annuity payments are received in that year.

Holding

Yes, because the annuity contracts were received as compensation for services rendered, and their fair market value is therefore includible in the employees' gross income in the year of receipt under Section 22(a) of the Internal Revenue Code.

Court's Reasoning

The court reasoned that the annuity contracts were received as compensation for services rendered. Section 22(a) of the Internal Revenue Code defines gross income as including "compensation for personal services…in whatever form paid." The court relied on the plain language of the statute and Section 19.22(a)-3 of Regulations 103, which states that "[i]f services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income." The court rejected the taxpayers' argument that Section 22(b)(2) of the Code, which addresses the taxability of annuity payments, excluded the value of the contracts from gross income. The court stated that Section 22(b)(2) applies only to amounts received as an annuity, and the taxpayers received no annuity payments in 1941. The Court cited *Renton K. Brodie* and *Oberwinder v. Commissioner* as precedent.

The court also rejected the argument that taxing the value of the contracts in the year of receipt and then taxing the full annuity payments in later years would constitute double taxation. Citing *William E. Freeman,* the court stated: "Payments under the annuity contracts may be reported properly under section 22(b)(2), and for that purpose [the cost of the annuity contracts] will represent their cost." In other words, the cost of the contract is considered the "aggregate premiums or consideration paid for such annuity" for purposes of calculating the exclusion under Section 22(b)(2) in future years.

Practical Implications

This case clarifies that non-cash compensation, such as annuity contracts, is taxable in the year of receipt based on its fair market value. Employers and employees must recognize the tax implications of such compensation arrangements. Later cases and IRS guidance confirm this principle. The cost of the annuity becomes the employee's investment in the contract, affecting the taxation of future annuity payments. This ruling impacts tax planning for executive compensation and employee benefits, emphasizing the need to consider the present value of deferred compensation when offered in the form of annuity contracts. It highlights that the taxation of the annuity itself occurs in the year of receipt, even if payouts are deferred.

