McEwen v. Commissioner, 6 T.C. 1018 (1946)

An employee is liable for income tax on compensation paid by their employer to a trust established for the employee's benefit, even if the employee does not directly receive the funds.

Summary

McEwen, a minority shareholder and valuable officer of May McEwen Kaiser Co., arranged for a portion of his compensation to be paid to a trust for his benefit. The Commissioner of Internal Revenue included the amount paid to the trust in McEwen's taxable income. McEwen argued that he never received or constructively received the funds and that he waived his right to the compensation for a valid business purpose. The Tax Court held that the payment to the trust constituted an economic benefit conferred on the employee as compensation and was therefore taxable income under Section 22(a) of the Internal Revenue Code.

Facts

- McEwen owned a controlling interest in McEwen Knitting Co.
- After a merger, he became a minority shareholder in May McEwen Kaiser Co.
- McEwen entered into a three-year employment contract with the company on November 27, 1941.
- As part of the agreement, 5% of the company's net earnings above $450,000 were transferred to a trust (Security National Bank of Greensboro) for McEwen's benefit.
- In 1941, $43,934.62 was paid by the company to the trustee as part of McEwen's compensation.
- The trust agreement stipulated that no part of the trust estate could revert to the company.
- McEwen himself suggested the contract and trust arrangement to the company's officers.

Procedural History

The Commissioner of Internal Revenue determined that the $43,934.62 paid to the trust was taxable income to McEwen. McEwen petitioned the Tax Court for a redetermination. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether compensation paid by an employer to a trust for the benefit of an employee is considered taxable income to the employee, even if the employee does not directly receive the funds.

Holding

Yes, because the payment to the trust constituted an economic benefit conferred on the employee as compensation and was therefore taxable income under Section 22(a) of the Internal Revenue Code.

Court's Reasoning

The court reasoned that the employment contract did not actually change the rate of compensation due to McEwen. The court emphasized that the company intended the payment to the trustee bank as compensation for services rendered by McEwen. Citing *Commissioner v. Smith, 324 U.S. 177*, the court stated that "Section 22(a) of the Revenue Act is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected." The court noted that McEwen himself suggested the trust arrangement, thus his failure to personally receive the amount was due to his own volition. The court likened the situation to other cases where the taxpayer received an economic benefit, such as the employer paying the employee's income taxes (*Old Colony Trust Co. v. Commissioner, 279 U.S. 716*) or the taxpayer assigning interest coupons to his son (*Helvering v. Horst, 311 U.S. 112*). The court distinguished *Adolph Zukor, 33 B.T.A. 324*, where the trustee held funds with a contingency that the employee may forfeit the distribution.

Practical Implications

This case reinforces the principle that an employee cannot avoid income tax by directing their compensation to a third party, such as a trust. The key question is whether the employee received an economic benefit from the payment. This ruling has broad implications for executive compensation planning and other arrangements where compensation is paid to a third party on behalf of an employee. Attorneys must advise clients that such payments are likely to be treated as taxable income to the employee. Later cases have applied this ruling to various forms of deferred compensation and employee benefit arrangements.

