14 T.C. 53 (1950)

To qualify as an exempt profit-sharing trust under Section 165(a) of the Internal Revenue Code, a plan must be a permanent, definite written program with a predetermined formula for determining and distributing profits, not a one-time lump sum payment.

Summary

The Lincoln Electric Company Employees' Profit-Sharing Trust sought exemption from federal income tax as a qualified profit-sharing trust under Section 165(a) of the Internal Revenue Code. The trust was funded by a one-time payment of $1,000,000 by the company. The Tax Court ruled against the trust, holding that it was not a true profit-sharing plan because it lacked a predetermined formula for determining profits to be shared and contemplated only a single contribution, rather than recurrent payments. The court emphasized the importance of adhering to the specific requirements of the statute and related regulations.

Facts

In December 1941, the Lincoln Electric Company established a trust for the benefit of 890 employees. The company paid $1,000,000 to the Cleveland Trust Co., as trustee. The trust was created pursuant to a resolution by the company's board of directors adopted on December 18, 1941. The payment of the $1,000,000 was not made according to any predetermined formula for determining the profits to be shared with employees. No provision was made for recurring contributions to the trust after the initial lump sum payment.

Procedural History

The Commissioner of Internal Revenue determined that the Lincoln Electric Company Employees' Profit-Sharing Trust was not exempt from taxation under Section 165(a) of the Internal Revenue Code for the years 1941, 1942, and 1943. The Tax Court considered the Commissioner's determination for the year 1944, as no changes in law or regulations occurred between 1943 and 1944. The trust petitioned the Tax Court for a redetermination of its tax liability, arguing that it qualified as an exempt trust or, alternatively, that the trust indenture created separate trusts for each beneficiary.

Issue(s)

1. Whether the Lincoln Electric Company Employees' Profit-Sharing Trust constituted an exempt profit-sharing trust under Section 165(a) of the Internal Revenue Code.
2. Alternatively, whether the trust indenture created separate trusts for each of the 890 beneficiaries.

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Holding

1. No, because the trust did not constitute a true profit-sharing plan under Section 165(a) of the Internal Revenue Code, as it lacked a predetermined formula for determining profits to be shared and only contemplated a single contribution.
2. No, because the trust instrument indicated an intention to create a single trust, considering its repeated use of the singular form when referring to the trust and the plural form when referring to the beneficiaries.

Court's Reasoning

The Tax Court emphasized that a taxpayer claiming exemption must bring themselves within the precise terms of the statutory provision granting the exemption. The court relied on Treasury Regulations 111, Section 29.165-1, which requires a profit-sharing plan to have "a definite predetermined formula for determining the profits to be shared and a definite predetermined formula for distributing the funds accumulated under the plan." The court found that the trust failed to meet these requirements because the $1,000,000 payment was a lump sum with no provision for recurrent contributions. The court stated that "The term 'plan' implies a permanent as distinguished from a temporary program." It deemed the regulation a reasonable interpretation of the expression "profit-sharing plan" and thus upheld the Commissioner's determination.

Regarding the alternative argument that the trust indenture created separate trusts for each beneficiary, the court held that the intent of the grantor, as determined from the entire trust instrument, was to create a single trust. The court noted the consistent use of the singular form in referring to the trust estate and the plural form in referring to the beneficiaries.

Practical Implications

This case clarifies the requirements for establishing an exempt profit-sharing trust under Section 165(a) of the Internal Revenue Code. It emphasizes that for a trust to qualify, it must be part of a permanent, definite written program with a predetermined formula for determining and distributing profits. This ruling prevents employers from making one-time, discretionary contributions to a trust and then claiming tax-exempt status, which could undermine the purpose of encouraging ongoing, systematic profit-sharing arrangements. Subsequent cases have cited this decision to reinforce the need for adherence to the regulatory requirements for qualified retirement plans. Legal practitioners must advise clients to establish plans with clear, predetermined formulas and consistent contributions to ensure compliance with tax laws.

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