Lincoln Electric Co. Employees' Profit-Sharing Trust v. Commissioner, 14 T.C. 598 (1950)

For a trust to qualify as a tax-exempt profit-sharing plan under Section 165(a) of the Internal Revenue Code, it must be part of a permanent, definite written program with a predetermined formula for contributions and distributions, not merely a single, lump-sum contribution.

Summary

Lincoln Electric Co. established a trust in 1941 for its employees with a one-time contribution of $1 million, intending it to be a profit-sharing plan. The trust sought tax-exempt status under Section 165(a) of the Internal Revenue Code. The Tax Court denied the exemption, holding that the trust did not qualify as a profit-sharing plan because it lacked a predetermined formula for profit sharing and was not considered a permanent program due to the single contribution. The court emphasized that Treasury Regulations require a definite program with recurrent contributions for a plan to be considered a tax-exempt profit-sharing plan.

Facts

In December 1941, Lincoln Electric Co. established a trust for approximately 890 employees and contributed $1 million. The trust was intended to distribute funds to beneficiaries after ten years, with proportions predetermined based on past compensation. The trust document outlined beneficiary shares and limited amendments or revocations. The company did not commit to further contributions, and the plan lacked a formula for future profit sharing. The Commissioner of Internal Revenue determined the trust was not tax-exempt.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency in the trust's income tax for 1944, arguing it was not a tax-exempt profit-sharing trust. The Tax Court reviewed the Commissioner's determination. The Tax Court upheld the Commissioner's decision, finding the trust did not meet the requirements for exemption under Section 165(a) of the Internal Revenue Code.

Issue(s)

1. Whether the Lincoln Electric Co. Employees' Profit-Sharing Trust qualifies as a tax-exempt trust under Section 165(a) of the Internal Revenue Code as part of a "profit-sharing plan."
2. Whether the trust indenture created a single trust or multiple separate trusts for each beneficiary.

Holding

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1. No, because the trust did not form part of a “profit-sharing plan” as defined by Treasury Regulations, which require a definite program with a formula for determining profits and recurrent contributions, not just a single contribution.
2. The trust indenture created a single trust, not multiple trusts, based on the language and intent of the trust document.

Court’s Reasoning

The Tax Court relied heavily on Treasury Regulations 111, Section 29.165-1, which interprets Section 165(a). The regulations define a profit-sharing plan as a “plan established and maintained by an employer to provide for the participation in his profits…based on 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 the Lincoln Electric plan deficient because it involved a single, lump-sum contribution without a formula for future profit contributions. The court quoted the regulation stating, “The term ‘plan’ implies a permanent as distinguished from a temporary program.” The court reasoned that while the statute itself doesn’t explicitly define “plan,” the Treasury Regulation provides a reasonable interpretation, entitled to deference. The court stated, “So far as we can see, the above regulation is reasonable and a fair interpretation of the expression ‘profit-sharing plan.'” Regarding the multiple trust argument, the court examined the trust instrument’s language, noting the consistent use of singular terms like “the Trust Estate” and “the Trust,” indicating an intent to create a single trust.

Practical Implications

This case clarifies the requirements for establishing tax-exempt profit-sharing trusts, emphasizing the necessity of a “permanent” plan with a predetermined formula for profit contributions and distributions, as interpreted by Treasury Regulations. It highlights that a one-time contribution, without a commitment to ongoing profit sharing, is unlikely to qualify as a tax-exempt profit-sharing plan. Legal practitioners advising on employee benefit plans must ensure plans are structured with recurrent contributions and clear formulas to meet the IRS’s definition of a “profit-sharing plan” under Section 165(a) and related regulations. This case is frequently cited when determining whether a plan meets the “permanency” and “definite formula” requirements for tax exemption. Later cases have distinguished this ruling by focusing on plans with established formulas, even if contributions fluctuate with profits, reinforcing the need for a clear, ongoing profit-sharing commitment.

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