16 T.C. 244 (1951)

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An employer’s transfer of funds to an irrevocable trust for an employee’s benefit, as compensation for services, is taxable to the employee in the year the trust is established, even if the employee receives distributions from the trust in later years.

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Summary

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Brainard Steel Corporation established a trust in 1945 to compensate E.T. Sproull for past services, directing the trustee to pay him $10,500 in installments in 1946 and 1947. The IRS argued that the entire amount was taxable income to Sproull in 1945. The Tax Court agreed with the IRS, holding that the creation of the trust conferred an economic benefit on Sproull in 1945, making the full amount taxable in that year, even though he received the funds later. The court distinguished this situation from constructive receipt, focusing on the “cash equivalent” doctrine.

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Facts

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E.T. Sproull was a large stockholder and president of Brainard Steel Corporation. Due to financial difficulties in the 1929s, Sproull voluntarily decreased his compensation. In 1945, the corporation’s board of directors authorized the creation of a trust to compensate Sproull for past services and inadequate salary. On December 31, 1945, the corporation paid $10,500 to Union Savings and Trust Company as trustee. The trust agreement directed the trustee to pay Sproull $5,250 on December 26, 1946, and the balance on December 26, 1947. If Sproull died before receiving the funds, the amounts were to be paid to his estate. Sproull received the payments in 1946 and 1947 and reported them as income in those respective years.r

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Sproull’s 1945 income tax, including the $10,500 trust amount as taxable income in that year. Sproull challenged the Commissioner’s determination in the Tax Court.r

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Issue(s)

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Whether the amount of $10,500 transferred in trust for the petitioner in 1945 by the petitioner’s employer, but which was thereafter paid by the trustee to the petitioner in installments in 1946 and 1947 as required by the trust agreement, was properly included in the petitioner’s taxable income for 1945.r

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Holding

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Yes, because the employer irrevocably paid out the funds for the employee’s sole benefit, creating a vested beneficial interest in the employee in 1945; therefore, the full amount was taxable to the employee in 1945.r

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Court’s Reasoning

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The Tax Court reasoned that while the doctrine of constructive receipt might not directly apply because Sproull didn’t have immediate access to the funds in 1945, the “cash equivalent” doctrine did. The court cited Section 22(a) of the Internal Revenue Code, which broadly defines gross income as including compensation for personal service

