Mary Miller, 22 T.C. 293 (1954)

A lump-sum distribution from a qualified pension plan is considered a long-term capital gain if paid to an employee within one taxable year on account of the employee's separation from the service, even if the separation is due to a corporate reorganization or liquidation and the employee continues working for a successor employer.

Summary

This case concerns the tax treatment of a lump-sum distribution from a pension plan following a corporate reorganization. Mary Miller, the taxpayer, received a lump-sum distribution from her employer's pension plan after the company was liquidated and its assets and business were transferred to a successor corporation, where Miller continued her employment. The court addressed whether the distribution was made "on account of the employee's separation from the service" as required for capital gains treatment under Section 165(b) of the Internal Revenue Code of 1939. The Tax Court held that the distribution qualified for long-term capital gains treatment because Miller's employment with the original employer had been terminated, even though she continued to work for the new company, thus meeting the separation from service requirement.

Facts

The taxpayer, Mary Miller, was a participant in a tax-exempt pension plan of a company (Dellinger). On April 1, 1949, Dellinger was liquidated, and all its assets were transferred to a sole stockholder (Sperry). All of Dellinger's employees, including Miller, became employees of Sperry, which continued the business previously conducted by Dellinger. The pension plan was terminated. Following the liquidation and transfer, Miller received a lump-sum distribution from the pension plan. The issue was whether this distribution was taxable as ordinary income or as a long-term capital gain.

Procedural History

The case was heard in the United States Tax Court, which addressed the taxability of the lump-sum distribution. The Tax Court sided with the taxpayer. This decision was subsequently affirmed by the Court of Appeals for the Second Circuit.

Issue(s)

1. Whether the lump-sum distribution to Miller was made "on account of the employee's separation from the service" as required by Section 165(b) of the Internal Revenue Code of 1939, despite Miller continuing employment with a successor company.

Holding

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1. Yes, because the liquidation of Dellinger terminated Miller's employment with that company, and the distribution was made as a result, even though she continued working for Sperry, a different employer.

Court's Reasoning

The court relied on its prior decision in *Edward Joseph Glinske, Jr.,* 17 T.C. 562, holding that "separation from the service" means separation from the service of the employer. The court noted that the facts here were substantially similar to those in the Glinske case, where the employee was separated from the service of the original employer but continued working for a successor entity. The court rejected the argument that the distribution was made because of the plan's termination, emphasizing that Miller's rights arose due to her separation from the service of her original employer, Dellinger. The court pointed out that the mass termination of the employees' services occurred because of Dellinger's liquidation and that the pension board's decision about the distribution was made after the rights had been fixed. The court found no material difference between the facts in *Mary Miller* and those in *Glinske*. The court focused on the distinction between the original employer and the successor employer.

Practical Implications

This case is crucial in interpreting the tax treatment of pension distributions following corporate reorganizations, mergers, or liquidations. It establishes that a separation from service occurs when an employee's relationship with their employer is terminated, even if they subsequently work for a different company that takes over the business. This decision helps determine whether a lump-sum distribution from a qualified pension plan qualifies for favorable capital gains treatment. Lawyers must consider the precise nature of the separation from service and the entity involved when advising clients about the tax consequences of such distributions. It also demonstrates how courts prioritize the technical definitions in tax law (separation from the service of the employer) even where economic substance of the transaction might suggest another interpretation. Later cases involving similar facts will likely be decided similarly.

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