28 T.C. 40 (1957)

Retirement payments received by state employees under a state retirement law, based on incapacity due to illness rather than performance of duties, qualify as health insurance benefits excludable from gross income under Section 22(b)(5) of the Internal Revenue Code.

Summary

The United States Tax Court considered whether retirement payments received by J. Wesley and Violette J. Sibole from the California State Employees' Retirement Law were exempt from federal income tax under Section 22(b)(5) of the Internal Revenue Code of 1939. The Siboles retired due to medical incapacity. The court followed the Supreme Court's precedent in *Haynes v. United States*, holding that payments received under a state retirement plan due to illness were considered health insurance benefits. Because the Siboles' retirement payments were based on health-related incapacity, they were excludable from gross income.

Facts

J. Wesley and Violette J. Sibole, husband and wife, received retirement payments under the California State Employees' Retirement Law. Both Siboles retired due to physical incapacity. Wesley retired in 1946 after 37 years of employment, and Violette retired in 1945 after 34 years. The retirement law permitted retirement for employees with 10 years of service who were incapacitated, regardless of the cause. Medical examinations confirmed the Siboles' incapacities. The payments were not directly linked to their performance of duties, nor were they workmen's compensation. The Siboles did not include these payments in their federal income tax returns, leading the Commissioner to determine deficiencies in their income tax.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Siboles' income tax for 1948 and 1949. The Siboles contested the deficiencies in the United States Tax Court, arguing the retirement payments were exempt from taxation under Section 22(b)(5). The Tax Court adopted the stipulated facts and rendered a decision in favor of the petitioners.

Issue(s)

1. Whether retirement payments received under the California State Employees' Retirement Law, based on physical incapacity due to illness, are excludable from gross income under Section 22(b)(5) as health insurance?

Holding

1. Yes, because the Tax Court followed the precedent in *Haynes v. United States*,

concluding that the retirement payments, based on incapacity, were health insurance and therefore excludable from gross income.

Court's Reasoning

The court based its decision primarily on the Supreme Court's ruling in *Haynes v. United States*. In *Haynes*, the Supreme Court held that payments received under a comprehensive plan for sickness disability benefits qualified as "health insurance" under Section 22(b)(5), even without a direct employee contribution or a dedicated fund. The Tax Court reasoned that the retirement payments received by the Siboles were analogous to the benefits in *Haynes*. The court considered that the California law provided for retirement due to illness, as determined by medical opinion. Despite the absence of a requirement that the incapacity arise from the employee's duties, the court held that payments for such incapacity were, in essence, health insurance, and thus excluded from gross income. The court emphasized that the payments were made for incapacity, which continued during the retirement period.

Practical Implications

This case underscores the importance of understanding the scope of Section 22(b)(5) and the broad interpretation given to "health insurance". Legal practitioners should consider that retirement payments under state plans, especially when based on disability or health issues, may be excludable from gross income. The case highlights that the specific terms of the retirement plan are critical in determining whether it provides for sickness benefits. Lawyers advising clients who receive similar payments need to carefully analyze the factual circumstances of each case. Taxpayers in similar situations may be able to rely on *Sibole* to exclude retirement payments from their gross income. This case also emphasizes that the source of funding for the benefit is not determinative, as the benefit still qualified as excludable under Section 22(b)(5).

