31 T.C. 165 (1958)

Lump-sum distributions from qualified pension plans to beneficiaries are taxable as capital gains to the extent they exceed the employee's contributions, while beneficiaries may exclude up to $5,000 as a death benefit. Also, beneficiaries are not entitled to a deduction for a portion of the estate tax on their father's estate.

Summary

The United States Tax Court addressed the tax treatment of lump-sum distributions from qualified pension plans made to the children of a deceased employee. The court held that these distributions were taxable as capital gains to the beneficiaries under I.R.C. § 165(b) because they represented distributions of previously untaxed income. The court further addressed the application of I.R.C. § 22(b)(1)(B), which allows an exclusion for death benefits. The court ruled that the beneficiaries were entitled to the exclusion provided for in I.R.C. § 22(b)(1)(B). Finally, the court held that beneficiaries were not entitled to a deduction for estate tax attributable to the distributions, as it held that such distributions were not items of gross income in respect of a decedent.

Facts

Eli L. Garber, the father of the petitioners, was an employee and president of two corporations, Penn Dairies, Inc. (Penn) and Garber Ice Cream Company (Garber), both of which had established qualified pension plans. After Eli L. Garber's death in 1951, the pension trusts made lump-sum cash distributions to his children, the petitioners in this case, as designated beneficiaries. The distributions were made in accordance with the pension plans and Eli L. Garber's beneficiary designations.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the income tax of the petitioners, claiming that the distributions should have been included in gross income as gain from the sale or exchange of a capital asset. The petitioners challenged this determination in the U.S. Tax Court, disputing both the characterization of the distributions as income and the applicability of certain exclusions and deductions. The Tax Court consolidated the cases.

Issue(s)

1. Whether the lump-sum cash distributions made to the petitioners were taxable as gain from the sale or exchange of a capital asset under I.R.C. § 165(b).

2. Whether the petitioners are entitled to exclude portions of the distributions from gross income under I.R.C. § 22(b)(1)(B) as a death benefit.

3. Whether the petitioners are entitled to a deduction for estate tax under I.R.C. §

© 2025 SCOTUSreports.com. All rights reserved.

126(c).

Holding

1. Yes, because the distributions constituted distributions of income and were taxable under I.R.C. § 165(b).

2. Yes, because the beneficiaries were entitled to the death benefit exclusion provided for under I.R.C. § 22(b)(1)(B).

3. No, because the distributions were not items of gross income in respect of a decedent, as required for the deduction under I.R.C. § 126(c).

Court's Reasoning

The court determined that the distributions from the pension trusts represented income, not corpus, and were thus taxable under I.R.C. § 165(b). The court found that the contributions made by the corporations to the pension trusts constituted compensation to the employees. The court distinguished the present case from the historical trust situation where property is transferred in trust with directions that the income be distributed to one person for a stated period and the corpus be distributed to another, finding that the pension plans involved here were intended to be for the exclusive benefit of employees and were not to be used for purposes other than compensating employees.

Regarding the I.R.C. § 22(b)(1)(B) exclusion for death benefits, the court held that the petitioners were entitled to exclude a portion of the distribution, up to the $5,000 limit specified. The court rejected the Commissioner's argument that because the decedent possessed a nonforfeitable right to the amounts while living, the exclusion did not apply. The court concluded that since Congress expressly limited the section to $5,000, it would have intended to include other limitations if such was desired.

Finally, the court held that the petitioners were not entitled to a deduction under I.R.C. § 126(c). This was based on its finding that the distributions were not considered "items of gross income in respect of a decedent" since they were of income which had been received by the pension trusts and which were exempt from taxation. The court reasoned that I.R.C. § 126(c) applies only when an amount is included in gross income under I.R.C. § 126(a).

There was a dissent on issues two and three.

Practical Implications

This case is significant for attorneys and tax professionals dealing with the tax treatment of distributions from qualified pension plans. It clarifies how lump-sum distributions are taxed, as gain from the sale or exchange of a capital asset, while

© 2025 SCOTUSreports.com. All rights reserved.

also affirming the availability of the death benefit exclusion under I.R.C. § 22(b)(1)(B) for distributions from employer-provided plans, up to the statutory limit. The case illustrates the importance of distinguishing between distributions of income and distributions of corpus and its impact on tax liabilities.

Attorneys should consider:

- Properly characterizing distributions from qualified retirement plans.
- Advising beneficiaries on the potential exclusion of death benefits.
- Understanding the conditions under which the estate tax deduction may or may not apply.

The case underscores the importance of careful planning and understanding the interplay between various tax code provisions when dealing with retirement plan distributions and the death of an employee.

© 2025 SCOTUSreports.com. All rights reserved.