31 T.C. 1022 (1959)

A lump-sum distribution from a qualified retirement plan, triggered by a corporate ownership change and an employee's subsequent separation from service, qualifies for capital gains treatment under the Internal Revenue Code even if the plan itself did not explicitly provide for such distributions upon separation from service.

Summary

The case concerned whether a lump-sum distribution from a retirement plan should be taxed as ordinary income or as a capital gain. The taxpayer, Thomas Judkins, received a distribution after his employer, Waterman Steamship Corporation, underwent a change in ownership and terminated its retirement plan. The Tax Court held that the distribution was a capital gain because it was paid "on account of" Judkins' separation from service, even though the plan didn't explicitly provide for lump-sum payments upon separation. The court reasoned that the change in ownership and subsequent termination of employment effectively triggered the distribution and qualified it for favorable tax treatment.

Facts

Waterman Steamship Corporation established a noncontributory retirement plan for its employees in 1945, in which Judkins participated. In May 1955, C. Lee Co., Inc. acquired control of Waterman. The new board of directors terminated the retirement plan, contingent on IRS approval. The IRS approved the termination. Judkins' employment with Waterman ended on June 1, 1955. On August 1, 1955, Judkins received a lump-sum distribution from the plan. The plan did not explicitly provide for lump-sum distributions upon separation from service, but rather, provided that a participant would be entitled to retirement benefits accrued to date in the form of an annuity commencing on his normal retirement date.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Judkins' 1955 income taxes, arguing the distribution was ordinary income. The case was submitted to the United States Tax Court on a stipulation of facts.

Issue(s)

Whether the lump-sum distribution received by Thomas Judkins in 1955 from the Waterman Steamship Corporation retirement plan should be taxed as ordinary income or as a long-term capital gain.

Holding

Yes, the distribution is taxable as a long-term capital gain because the payment was made to Judkins "on account of" his separation from the service of Waterman. This

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qualifies for capital gains treatment under the Internal Revenue Code.

Court’s Reasoning

The court analyzed Section 402(a)(2) of the Internal Revenue Code of 1954, which provides for capital gains treatment if a lump-sum distribution is paid “on account of the employee’s … separation from the service.” The Commissioner argued that the payment was made due to the plan termination, not Judkins’ separation. The court disagreed, emphasizing that the change in ownership triggered the plan termination and, consequently, Judkins’ separation. The court cited prior cases, such as *Mary Miller* and *Lester B. Martin*, where similar ownership changes and plan terminations were found to constitute a separation from service, even though the employees continued in their same jobs with the new owner. The court noted that while the retirement plan did not expressly provide for lump-sum distributions upon separation from service, the actual distribution of the plan assets was nonetheless directly linked to his separation. The court emphasized that the IRS had taken similar positions in revenue rulings relating to corporate reorganizations and lump-sum distributions.

Practical Implications

This case clarifies that a change in corporate ownership that leads to plan termination can result in a “separation from service” for tax purposes, even if the employee’s job duties remain the same or if the employee separates from service before the actual termination of the plan. Attorneys should advise clients that in such situations, lump-sum distributions may qualify for capital gains treatment, even if the retirement plan itself doesn’t explicitly provide for a lump-sum distribution upon separation. The case reinforces the importance of looking at the substance of the transaction—the change in ownership and its effect on employment—rather than merely the technical terms of the retirement plan. This case also helps to interpret whether a payment is made on account of separation from service. It highlights how the IRS and courts may interpret statutory language in light of broader policy considerations, such as the impact of corporate reorganizations on employee benefits.

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