34 T.C. 407 (1960)

Disability retirement payments received under a teachers' retirement act are considered to be received through health insurance and may be excluded from gross income, except for any portion attributable to employer contributions that were not included in the employee's gross income.

Summary

In *Trappey v. Commissioner*, the U.S. Tax Court addressed whether retirement pay received by a teacher due to physical disability was includible in gross income. The court held that such payments are considered to be received through health insurance and are therefore excludable from gross income under Section 104(a)(3) of the 1954 Internal Revenue Code. However, the court clarified that the exclusion did not apply to the portion of payments attributable to employer contributions that were not initially included in the employee's gross income. The court followed prior precedent, interpreting the disability retirement pay as analogous to payments received through health insurance for personal injury or sickness.

Facts

Adam S. H. Trappey, a teacher, retired on June 30, 1949, due to physical disability after 33 years of service. He received retirement pay under the District of Columbia Teachers' Retirement Act. In 1955, the Trappeys filed a joint income tax return and did not include the retirement pay in their taxable income. The Commissioner of Internal Revenue determined a deficiency, including the full amount of the retirement pay in their income. The Trappeys contended that the retirement pay was excludable under either Section 104 or Section 105 of the 1954 Code.

Procedural History

The case was brought before the United States Tax Court. The Commissioner determined a deficiency in the Trappeys' income tax for 1955, which was challenged by the taxpayers. The Tax Court reviewed the facts and legal arguments presented, focusing on whether the retirement pay was excludable from income under the relevant sections of the Internal Revenue Code.

Issue(s)

1. Whether retirement pay received by a teacher under the District of Columbia Teachers' Retirement Act due to physical disability constitutes amounts received through health insurance for personal injury or sickness under section 104(a)(3) of the 1954 Code.
2. Whether any portion of the retirement payments is includible in gross income due to employer contributions.

Holding

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1. Yes, because the court found that the disability retirement payments were analogous to amounts received through health insurance for personal injury or sickness, therefore falling under the exclusion of section 104(a)(3).
2. Yes, because the court held that the portion of the payments attributable to employer contributions which were not includible in the employee's gross income are not excludable.

Court's Reasoning

The Tax Court referenced prior cases and considered the differences between Section 22(b)(5) of the 1939 Code and Section 104(a)(3) of the 1954 Code, particularly the parenthetical qualification in the latter. The court found that the reasoning in the prior cases was still applicable to the extent that the payments were not attributable to employer contributions. The court emphasized the exclusion from gross income of "amounts received through accident or health insurance for personal injuries or sickness," as stated in section 104(a)(3), but noted the limitation regarding employer contributions.

The Court stated, "The reasoning of the cited cases thus applies here to require exclusion from gross income of that part of the payments not attributable to contributions by the employer, since contributions were made by the employer and were not includible in the income of the employee when made."

Practical Implications

This case is significant for taxpayers receiving disability retirement pay under similar circumstances and for tax professionals. The court's interpretation provides guidance on the excludability of such payments from gross income. The distinction regarding employer contributions is important. Similar cases involving retirement plans that function like health insurance for disabilities should be analyzed under the same principle. Taxpayers and their advisors should document both employee and employer contributions to properly calculate any excludable amounts. The case highlights how seemingly straightforward provisions in the Internal Revenue Code, such as those related to health insurance, require careful interpretation when applied to complex factual situations, such as disability retirement.

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