Houg v. Commissioner, 54 T. C. 792, 1970 U. S. Tax Ct. LEXIS 161 (U. S. Tax Court, April 20, 1970)

Lump-sum distributions from a qualified profit-sharing plan can be treated as long-term capital gain when the distribution is made upon separation from service due to a corporate merger, even if the new employer does not adopt the plan.

Summary

Clifford Houg received a lump-sum distribution from General Controls Co. 's profit-sharing plan following its merger with ITT. The key issue was whether this distribution qualified for capital gains treatment under IRC Section 402(a)(2). The court held that since the plan was not adopted or continued by ITT, Houg's separation from General Controls upon the merger triggered capital gains treatment for the distribution, as he was separated from the service of his original employer.

Facts

General Controls Co. maintained a profit-sharing plan, contributing 15% of net profits to the "Company Fund. " Following a merger with ITT on May 15, 1963, General Controls ceased to exist, and its employees became ITT employees. The plan was amended to allow participants to receive their vested interests within 90 days post-merger, with no further contributions to be made. Clifford Houg, an employee, elected to receive his share of the Company Fund, totaling $5,950. 25, and reported it as long-term capital gain.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Houg's 1963 income tax, treating the distribution as ordinary income. Houg petitioned the U. S. Tax Court, which ruled in his favor, holding that the distribution was eligible for capital gains treatment under IRC Section 402(a)(2).

Issue(s)

1. Whether a lump-sum distribution from a qualified profit-sharing plan, made upon the merger of the employer with another company, qualifies for capital gains treatment under IRC Section 402(a)(2)?

Holding

1. Yes, because the distribution was made on account of Houg's separation from the service of General Controls Co. , his original employer, and the new employer did not adopt or continue the plan.

Court's Reasoning

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The court found that Houg's separation from General Controls upon the merger satisfied the "separation from service" requirement under IRC Section 402(a)(2). The amended plan explicitly stated that neither General Controls nor ITT would make further contributions, indicating the plan was not adopted or continued by ITT. The court relied on the precedent set in *Mary Miller*, where a similar situation led to capital gains treatment due to the separation from the original employer. The court rejected the Commissioner's argument that the new employer's advice to keep funds in the plan affected the distribution's tax treatment, emphasizing that the right to the distribution arose from the separation from service.

Practical Implications

This decision clarifies that in corporate mergers where the acquiring company does not adopt the original employer's profit-sharing plan, employees receiving lump-sum distributions due to separation from the original employer can treat these distributions as long-term capital gains. This ruling influences how attorneys advise clients involved in mergers regarding the tax treatment of retirement plan distributions. It also impacts corporate planning, as companies must consider the tax implications for employees when deciding whether to adopt or terminate existing retirement plans during mergers. Subsequent cases, such as *Gittens* and *Stewart*, have referenced this decision when addressing similar issues, reinforcing its significance in tax law concerning employee benefits during corporate restructuring.

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