Estate of Jack A. Benjamin, Deceased, John F. Benjamin, Co-Executor and Alice U. Benjamin, Petitioners v. Commissioner of Internal Revenue, Respondent, 54 T. C. 953 (1970)

The conversion of a trusteed pension plan to a nontrusteed qualified annuity plan can qualify for capital gains treatment under IRC Section 403(a)(2) upon lump-sum distribution.

Summary

The Uhlmann Grain Co. established a pension plan trust for its employees, funded by individual annuity policies. Upon termination of the trust in 1957, the policies were assigned to the participants, effectively converting the plan to a nontrusteed annuity plan. After the death of employee Jack Benjamin in 1961, his widow Alice received a lump-sum payment from the policy. The court held that this distribution qualified for capital gains treatment under Section 403(a)(2) of the Internal Revenue Code, as the conversion to a nontrusteed plan met the statutory requirements for qualification. This decision also allowed Alice a $5,000 exclusion from income under Section 101(b).

Facts

Uhlmann Grain Co. established a pension plan trust on October 11, 1945, funded by individual annuity policies for each participant. Jack Benjamin, an employee, participated in the plan until his death in 1961. Upon reaching normal retirement age in 1955, Benjamin continued working and received monthly annuity payments starting in November 1960. After receiving four payments, he died in February 1961. The trust was terminated in 1957, and the annuity policies were assigned to the participants, including Benjamin. In 1961, Alice Benjamin, as the secondary beneficiary, surrendered the policy and received a lump-sum payment of $30,606. 88.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the income tax of Alice Benjamin for 1961, treating the lump-sum payment as ordinary income. The petitioners appealed to the United States Tax Court, which held in favor of the petitioners, allowing capital gains treatment under Section 403(a)(2) and a $5,000 exclusion under Section 101(b).

Issue(s)

1. Whether the lump-sum payment received by Alice Benjamin from the surrendered annuity policy is taxable as capital gain under Section 403(a)(2) of the Internal Revenue Code?
2. Whether Alice Benjamin is entitled to a $5,000 exclusion from income under Section 101(b) of the Internal Revenue Code?

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Holding

1. Yes, because the assignment of the annuity policies to the participants in 1957 converted the trusteed pension plan into a qualified nontrusteed annuity plan under Section 403(a)(1), and the lump-sum payment met the requirements for capital gains treatment under Section 403(a)(2).
2. Yes, because the capital gains treatment under Section 403(a)(2) entitles Alice Benjamin to a $5,000 exclusion from income under Section 101(b).

Court's Reasoning

The court reasoned that the assignment of the annuity policies to the participants in 1957 effectively converted the trusteed pension plan into a nontrusteed qualified annuity plan. This conversion did not adversely affect the plan's qualified status, as evidenced by a letter ruling from the IRS. The court applied the statutory requirements for a qualified annuity plan under Section 403(a)(1), which references the requirements of Section 404(a)(2) and, in turn, Section 401(a)(3) through (a)(8). The court found that the annuity plan met these requirements, as it continued the fundamental characteristics of the prior pension plan, such as nondiscrimination in coverage and benefits. The court rejected the Commissioner's arguments that the plan lacked permanency or a written program, as these requirements do not apply to nontrusteed annuity plans. The court also noted that the ability of participants to redeem their policies for cash surrender value before retirement did not preclude qualification, as this is a feature of Section 403 plans. The court concluded that the lump-sum payment to Alice Benjamin qualified for capital gains treatment under Section 403(a)(2) and the $5,000 exclusion under Section 101(b).

Practical Implications

This decision clarifies that a trusteed pension plan can be converted to a nontrusteed qualified annuity plan without losing its tax-qualified status, and lump-sum distributions from such a plan can qualify for capital gains treatment under Section 403(a)(2). This ruling is significant for employers considering the termination of pension trusts and the distribution of annuity policies to participants. It also provides guidance for tax practitioners advising clients on the tax treatment of lump-sum distributions from annuity plans. The decision reaffirms the IRS's position on the requirements for qualified annuity plans and the availability of capital gains treatment and exclusions under Sections 403 and 101(b). Subsequent cases have applied this ruling in similar situations involving the conversion of pension plans to annuity plans and the tax treatment of lump-sum distributions.

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