

Gunnison v. Commissioner, 54 T. C. 1766 (1970)

Lump-sum distributions from qualified employee trusts received by secondary beneficiaries after the death of the primary beneficiary do not qualify for capital gains treatment under IRC section 402(a)(2) unless received solely on account of the employee's death.

Summary

Richard Gunnison received lump-sum distributions from his father's qualified employee profit-sharing and pension trusts after his mother, the primary beneficiary, passed away. The issue was whether these distributions qualified for capital gains treatment under IRC section 402(a)(2). The Tax Court held that they did not, reasoning that the distributions were not made solely on account of the employee's (Richard's father) death but rather due to the subsequent death of the primary beneficiary. The court's strict interpretation of the phrase 'on account of the employee's death' meant that distributions triggered by other events, such as the death of a primary beneficiary, were taxable as ordinary income.

Facts

Walter Gunnison was an employee of Enterprise Railway Equipment Co. and a participant in both its profit-sharing and pension trusts. Upon his death in 1958, his wife Josephine was the primary beneficiary of these trusts. Richard and his brother were named secondary beneficiaries. Josephine received distributions in 1959 and 1960, but after her death in 1960, the remaining funds were distributed to Richard and his brother. Richard reported these distributions as capital gains on his 1960 tax return, but the IRS determined they should be treated as ordinary income.

Procedural History

The IRS issued a notice of deficiency to Richard Gunnison for the tax year 1960, asserting that the distributions he received should be taxed as ordinary income. Gunnison petitioned the U. S. Tax Court for a redetermination of this deficiency. The Tax Court heard the case and issued its opinion on September 30, 1970.

Issue(s)

1. Whether lump-sum distributions received by Richard Gunnison from his father's qualified employee trusts qualify for capital gains treatment under IRC section 402(a)(2).

Holding

1. No, because the distributions were not made solely 'on account of the employee's death' but were also triggered by the death of the primary beneficiary, Josephine Gunnison.

Court's Reasoning

The court focused on the interpretation of IRC section 402(a)(2), which allows capital gains treatment for lump-sum distributions paid 'on account of the employee's death' or other specified events. The court interpreted 'on account of' to mean that the specified event must be the sole trigger for the distribution. Since Richard received the distributions due to both his father's death and his mother's subsequent death, the court held that they did not qualify for capital gains treatment. The court supported its interpretation with prior case law and legislative history, emphasizing a literal reading of the statute. Judge Scott concurred but based his agreement on the validity of the regulation requiring all distributions to be paid within the same taxable year to all distributees.

Practical Implications

This decision clarifies that distributions from qualified employee trusts are subject to ordinary income tax unless they are made solely due to the employee's death, separation from service, or death after separation. For estate planning and tax purposes, it is crucial to understand that secondary beneficiaries receiving distributions after the death of a primary beneficiary cannot claim capital gains treatment. This ruling affects how trusts are structured and how beneficiaries plan their taxes. Subsequent cases have followed this interpretation, reinforcing the need for careful planning in the administration of employee benefit trusts.