Centre v. Commissioner, 55 T. C. 16 (1970)

An employee realizes taxable income when employer-owned life insurance policies, used to fund deferred compensation, are assigned to the employee upon termination, not when premiums are paid.

Summary

In Centre v. Commissioner, the U. S. Tax Court ruled that David Centre was taxable on the value of life insurance policies and cash received from his former employer in 1964, rather than on the premiums paid from 1954 to 1962. The policies were owned by the employer, Charles C. Loehmann Corp. , and were intended to fund deferred compensation. Centre argued he should be taxed on the premiums as they were paid, but the court held that he realized income only when the policies were assigned to him upon termination of employment, emphasizing that until then, he had no immediate rights to the policies, which remained the employer's assets.

Facts

David Centre was employed by Charles C. Loehmann Corp. from 1951 to 1962. In 1954, they entered into an employment agreement that included deferred compensation funded by life insurance policies owned by Loehmann. These policies were to be assigned to Centre if he terminated employment before age 65 without cause. Upon termination in 1962, Loehmann initially refused to transfer the policies, leading to a lawsuit settled in 1964. As part of the settlement, Loehmann transferred the policies with a cash surrender value of $24,670. 97 and paid $2,698. 58 in cash to Centre.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Centre's 1964 federal income tax, asserting that the value of the insurance policies and cash received should be taxed as ordinary income. Centre petitioned the U. S. Tax Court, arguing that he should be taxed on the premiums paid by Loehmann from 1954 to 1962. The Tax Court ruled in favor of the Commissioner, holding that Centre realized taxable income in 1964 when the policies were assigned to him.

Issue(s)

1. Whether David Centre realized taxable income from the life insurance policies when the premiums were paid by Loehmann from 1954 to 1962, or when the policies were assigned to him in 1964.

Holding

1. No, because Centre did not realize taxable income from the premiums paid by Loehmann from 1954 to 1962; he realized taxable income when the policies were

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assigned to him in 1964.

Court's Reasoning

The court applied Section 61(a)(1) of the Internal Revenue Code of 1954, which defines gross income broadly to include all income from whatever source derived, including compensation for services. The court relied on cases like *Commissioner v. LoBue* and *Commissioner v. Smith* to establish that any economic or financial benefit conferred on an employee as compensation is taxable. However, the court distinguished that for the benefit to be taxable, it must be conferred in the tax year. In this case, the policies were owned by Loehmann, and Centre had only a contract right to deferred compensation without immediate rights to the policies. The court cited *Casale v. Commissioner* to support the conclusion that Centre realized income only when the policies were assigned to him in 1964. The court rejected Centre's reliance on *Paul L. Frost*, noting that the policies in Frost were irrevocably committed to a trust, unlike in Centre's case where the policies remained Loehmann's assets until assigned.

Practical Implications

This decision clarifies that employees do not realize taxable income from employer-owned life insurance policies used to fund deferred compensation until those policies are assigned to them. It impacts how deferred compensation arrangements are structured and taxed, emphasizing that such arrangements must be carefully designed to avoid unintended tax consequences. Employers should be aware that maintaining control over such policies until assignment can defer the employee's tax liability. Subsequent cases like *Childs v. Commissioner* have followed this ruling, reinforcing that the timing of income realization for deferred compensation depends on when the employee gains control over the funding mechanism.

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