Evans v. Commissioner, 56 T. C. 1142 (1971)

The cash surrender value of distributed retirement income contracts from a qualified pension plan is not taxable if it equals or exceeds the face amount, converting them into annuities; otherwise, it is taxable unless made nontransferable within 60 days.

Summary

Evans received eight contracts from a terminated qualified pension plan. Seven of these contracts had cash surrender values equal to or exceeding their face amounts at distribution, transforming them into annuities and thus not taxable under IRC section 402(a). The eighth contract, with a face amount exceeding its cash surrender value, retained life insurance protection and was taxable because it was not made nontransferable within 60 days as required by the regulations. The court's decision hinged on the nature of the contracts at the time of distribution, applying IRC section 402(a) and related regulations to differentiate between annuity and life insurance elements.

Facts

Aubrey Rolph Evans participated in a pension plan from 1945 until its termination in 1964. The plan purchased eight contracts from Occidental Life Insurance Company, which included both annuity and life insurance elements. By the time of distribution in 1965, seven contracts had cash surrender values equal to or greater than their face amounts, while the eighth had a face amount exceeding its cash surrender value. Evans did not make the contracts nontransferable within 60 days of distribution.

Procedural History

Evans filed a tax return for 1965 without reporting income from the distributed contracts. The Commissioner of Internal Revenue issued a deficiency notice, asserting that the cash surrender values of the contracts were taxable income. Evans petitioned the Tax Court, which ruled that the cash surrender values of the seven contracts were not taxable, but the value of the eighth contract was taxable due to its retained life insurance protection.

Issue(s)

1. Whether the cash surrender values of the seven contracts, whose values equaled or exceeded their face amounts at distribution, are includable in the taxpayer's gross income.
2. Whether the cash surrender value of the eighth contract, whose face amount exceeded its cash surrender value at distribution, is includable in the taxpayer's gross income.

Holding

1. No, because the seven contracts had transformed into pure annuities at the time of distribution, and thus, their cash surrender values were not taxable under IRC section 402(a).
2. Yes, because the eighth contract retained life insurance protection and was not made nontransferable within 60 days as required by the regulations, making its cash surrender value taxable.

Court's Reasoning

The court analyzed the nature of the contracts at distribution, applying IRC section 402(a) and related regulations. The primary purpose of the plan was to provide retirement benefits, with life insurance being incidental. When the cash surrender value of a contract equals or exceeds its face amount, the life insurance protection disappears, leaving a pure annuity contract. The seven contracts met this criterion and were thus not taxable. The eighth contract, however, retained life insurance protection and was subject to taxation because it was not made nontransferable within 60 days, as required by the regulations. The court rejected the taxpayer's argument to treat all eight contracts as one, emphasizing that each contract's nature must be determined separately. The court also referenced prior cases and regulations to support its interpretation of the tax treatment of such contracts.

Practical Implications

This decision clarifies the tax treatment of distributed pension plan contracts based on their nature at the time of distribution. Taxpayers and practitioners should carefully assess whether distributed contracts are annuities or retain life insurance elements, as this affects their taxability. The ruling underscores the importance of timely action to make contracts nontransferable when life insurance protection is present. It also impacts how similar cases should be analyzed, emphasizing the need to evaluate each contract individually. Later cases and IRS guidance may further refine these principles, but this case remains a key reference for distinguishing between taxable and non-taxable distributions from qualified plans.