Estate of Robert A. Stefanowski, Deceased, June Stefanowski, Surviving Spouse, and June Stefanowski, Petitioners v. Commissioner of Internal Revenue, Respondent, 63 T. C. 386 (1974)

Lump-sum distributions from terminated profit-sharing plans do not qualify for capital gains treatment or death benefit exclusion if made on account of plan termination rather than the employee's death.

Summary

In Estate of Stefanowski v. Commissioner, the U. S. Tax Court held that a lump-sum distribution from a terminated profit-sharing plan, received by the beneficiary of a deceased participant, was not eligible for capital gains treatment or a death benefit exclusion. The court reasoned that the distribution was made due to the plan's termination, not the participant's death, despite the beneficiary receiving the payment after the participant's death. This ruling emphasizes that the origin of the right to receive a distribution, rather than the sequence of events, determines its tax treatment. The case highlights the importance of distinguishing between distributions made on account of plan termination versus those made due to an employee's death or separation from service.

Facts

Robert A. Stefanowski was a participant in the Kroger Employees' Savings and Profit Sharing Plan, a qualified profit-sharing trust. The plan was set to terminate as of January 2, 1971, and Stefanowski died on February 23, 1971. The plan's assets were liquidated and distributed to participants or their beneficiaries on March 25, 1971. June Stefanowski, as the designated beneficiary, received a lump-sum distribution of $15,278. 49, which included appreciation in the plan's assets from January 3, 1971, to the distribution date. She sought to treat part of the distribution as long-term capital gain and claimed a death benefit exclusion.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Stefanowskis' 1971 federal income tax and denied the capital gains treatment and death benefit exclusion. June Stefanowski, acting pro se, petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court heard the case and issued its opinion on December 19, 1974.

Issue(s)

1. Whether the lump-sum distribution received by June Stefanowski qualifies for capital gains treatment under section 402(a)(2) of the Internal Revenue Code.
2. Whether any amount of the distribution is excludable from gross income as an employee's death benefit under section 101(b) of the Internal Revenue Code.

Holding

1. No, because the distribution was made on account of the termination of the plan, not on account of the employee's death.
2. No, because the distribution was not paid by reason of the employee's death but due to the plan's termination.

Court's Reasoning

The court focused on the origin of the right to receive the distribution, citing United States v. Johnson and other cases. It determined that the right to receive the distribution arose from the plan's termination, not Stefanowski's death. The court noted that the plan's assets were liquidated and the distribution amount included post-termination appreciation, which would not have occurred if the distribution were solely due to death. The court distinguished this case from Smith v. United States and Thomas E. Judkins, where distributions were linked to the employee's separation from service. The court also emphasized that the identity of the distributee (the beneficiary) was determined by the participant's death, but this did not affect the tax treatment of the distribution itself.

Practical Implications

This decision clarifies that distributions from terminated profit-sharing plans are not eligible for capital gains treatment or death benefit exclusion if the right to receive them originates from the plan's termination rather than the employee's death or separation from service. Practitioners should carefully analyze the source of a distribution's entitlement when advising clients on its tax treatment. The ruling may impact how employers structure plan terminations and communicate with participants about the tax consequences of distributions. Subsequent legislative changes, such as the Tax Reform Act of 1969, have eliminated capital gains treatment for all such distributions, but this case remains relevant for understanding the principles governing pre-1969 distributions.

