Sarmir v. Commissioner, 66 T. C. 82 (1976)

Distributions from a pension plan due to plan termination, rather than separation from service, are taxable as ordinary income.

Summary

Robert M. Sarmir received a lump-sum payment from his employer's pension plan after the plan was terminated upon the sale of the mill where he worked. He argued the payment should be treated as a long-term capital gain under section 402(a)(2) due to his separation from service. The court held that the distribution was not 'on account of' his separation from service but was solely due to the plan's termination. Therefore, it must be treated as ordinary income. This case clarifies that the reason for the distribution, not just the fact of separation, determines the tax treatment of pension plan payouts.

Facts

Robert M. Sarmir worked at Kimberly-Clark Corp. 's Moraine, Ohio mill and was a participant in the company's pension plan. In 1972, Kimberly-Clark sold the mill to Bergstrom Paper Co. , and as part of the sale, the pension plan was terminated for employees at the mill. Sarmir, then 40 years old with less than 13 years of service, was not eligible for benefits under the plan's regular terms. However, due to the plan's termination, his benefits became fully vested, and he elected to receive a lump-sum payment of $2,126. 57. On his 1972 tax return, Sarmir treated this distribution as a long-term capital gain, but the Commissioner of Internal Revenue determined it should be taxed as ordinary income.

Procedural History

Sarmir and his wife filed a petition with the United States Tax Court challenging the Commissioner's determination of a $233. 95 deficiency in their 1972 federal income tax. The Tax Court, after considering the stipulated facts and applicable law, ruled in favor of the Commissioner.

Issue(s)

1. Whether the distribution to Sarmir from the pension plan was made 'on account of' his separation from service with Kimberly-Clark, thus qualifying for long-term capital gain treatment under section 402(a)(2).

Holding

1. No, because the distribution was made solely due to the termination of the pension plan, not Sarmir's separation from service. The court found that Sarmir's right to receive the distribution originated from the plan's termination, not his separation from Kimberly-Clark.

Court’s Reasoning

The court applied section 402(a)(2) of the Internal Revenue Code, which requires distributions to be made ‘on account of’ the employee’s separation from service to qualify for capital gains treatment. The court emphasized that the distribution must be made ‘solely because of’ the employee’s separation from service. In Sarmir’s case, the court found that his right to receive the distribution was engendered by the plan’s termination, not his separation from service. The court noted that Sarmir would not have received any benefit if he had separated from service without the plan’s termination. The court distinguished this case from Smith v. United States, where the distribution had a dual cause, one of which was separation from service. The court also rejected Sarmir’s argument of constructive receipt before a change in IRS policy, as he lacked the ability to demand payment before the plan’s termination.

Practical Implications

This decision impacts how pension plan distributions are treated for tax purposes when linked to plan terminations rather than employee separations. Attorneys advising clients on pension plan distributions must carefully analyze the causal relationship between the distribution and the employee’s separation from service. The ruling clarifies that plan terminations triggered by business sales do not automatically entitle employees to capital gains treatment for their distributions. This case has been cited in subsequent rulings to support the principle that the reason for a distribution, not merely the fact of separation, determines its tax treatment. Legal practitioners should consider this when structuring pension plans and advising on the tax implications of plan terminations.