Jones v. Commissioner, 71 T. C. 128 (1978)

The ‘sick-pay’ exclusion under section 105(d) does not apply to retirement benefits received by individuals beyond the age of 65 or those without a mandatory retirement age who cannot prove they would have worked if not disabled.

Summary

Ross F. Jones, a retired Arizona Superior Court judge, claimed a ‘sick-pay’ exclusion under section 105(d) for his disability retirement payments. The court held that Jones, who retired at age 70 due to disability, was not entitled to the exclusion because he was beyond the default retirement age of 65 as defined by the tax regulations. Additionally, the court noted that Jones’s elected position could have ended at the voters’ discretion, effectively imposing a mandatory retirement. This decision clarifies that the ‘sick-pay’ exclusion is not available for retirement payments to individuals past age 65, regardless of the absence of a formal mandatory retirement age in their employment.

Facts

Ross F. Jones served as an Arizona Superior Court judge from 1960 until his retirement on December 31, 1970, due to physical disability. At the time of his retirement at age 70, Jones had two years remaining in his term, which would have ended on December 31, 1972. He began receiving disability retirement payments from the Arizona judges’ retirement fund on January 1, 1971. Jones excluded $5,200 per year of these payments from his gross income under section 105(d), claiming that he would have run for reelection and continued working if not for his disability.

Procedural History

Jones and his wife filed a petition in the U. S. Tax Court challenging the Commissioner’s determination of deficiencies in their income tax for the taxable years 1973 and 1974. The case was submitted to the court under Rule 122, with all facts stipulated by the parties. The court’s decision focused solely on the applicability of the section 105(d) exclusion to Jones’s retirement payments.

Issue(s)

1. Whether Jones may exclude $5,200 per year of his disability retirement payments from gross income under section 105(d) for the taxable years 1973 and 1974.

Holding

1. No, because Jones was beyond the default retirement age of 65 as defined by the tax regulations, and the ‘sick-pay’ exclusion under section 105(d) does not apply to retirement payments received after reaching retirement age.

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Court’s Reasoning

The court applied the definition of ‘retirement age’ from section 1. 79-2(b)(3) of the Income Tax Regulations, which states that if there is no mandatory retirement age, retirement age is considered to be 65. Since Jones was over 65 when he received the payments in question, the court found that he was not ‘absent from work’ due to disability but was instead receiving retirement benefits. The court also considered that Jones’s position was elective, and his term could have ended due to voter decision, effectively imposing a mandatory retirement. The court distinguished prior cases that invalidated the regulatory definition of retirement age because those cases involved mandatory retirement ages, whereas Jones’s case did not. The court concluded that applying the default age of 65 as the retirement age was consistent with the purpose of section 105(d), which is to provide relief to those unable to work due to disability before normal retirement age.

Practical Implications

This decision impacts how similar cases involving disability retirement should be analyzed, particularly for individuals without a formal mandatory retirement age. It clarifies that the section 105(d) exclusion is not available for retirement payments received by individuals past the age of 65, even if they are receiving disability benefits. Legal practitioners must consider this ruling when advising clients on the tax treatment of retirement benefits, especially in the context of disability retirement. The decision also has implications for state and local government retirement systems, which may need to adjust their policies or communications to reflect that disability retirement payments may not be eligible for the ‘sick-pay’ exclusion after age 65. Subsequent cases, such as Golden v. Commissioner, have followed this reasoning, reinforcing the practical application of this ruling.

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