Michigan Law Review

Volume 49 | Issue 7

1951

TAXATION-INCOME TAX-TAXABILITY OF PAYMENTS MADE TO WIDOWS OF DECEASED EMPLOYEES

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TAXATION—INCOME TAX—TAXABILITY OF PAYMENTS MADE TO WIDOWS OF DECEASED EMPLOYEES—Payments were made by an employer to the widow of a deceased employee in consideration of services rendered by the employee. *Held,* the payments were includible in the widow's gross income for federal income tax purposes. I.T. 4027, Int. Rev. Bul., Oct. 16, 1950, 2, 505 CCH ¶6208.[1]

The Treasury Regulations provide that "so-called pensions awarded by one *to whom no services have been rendered* are mere gifts or gratuities and are not taxable."[2] Apparently relying on this regulation,[3] the Commissioner ruled in I.T. 3329 that payments made by an employer to the widow of a deceased employee are gifts and not taxable to the widow *when she had rendered no services* to the employer.[4] This ruling, however, has received little attention from either the courts or the Treasury itself. Indeed, payments made to widows who had rendered no services have been held taxable[5] when made pursuant to a contract between employer and deceased employee;[6] when pro-

[1] O.D. 1017, Cum. Bul. 5, 101 (1921), revoked and I.T. 3329, 1939-2 Cum. Bul. 153, modified. The ruling is not applicable to payments received prior to January 1, 1951.

[2] Treas. Regs. 111, §29.22(a)-2 (italics added).

[3] See principal ruling at 2.

[4] 1939-2 Cum. Bul. 153. These payments were also held to be deductible by the employer as business expenses.

[5] Under I.R.C. §22(a).

[6] Flarsheim v. United States, (8th Cir. 1946) 156 F. (2d) 105.

vided for by law;[7] and when made under death benefit plans.[8] On the other hand, where the employer was under no obligation to make the payments and they were not compensation for past services of the deceased employee, the widow has not been required to include them in her gross income.[9] It is obvious from these holdings that the question of taxability is not determined by whether or not the widow has rendered services to the payor,[10] but rather, by whether or not the payments can, in fact, be considered as gifts from the employer in order to exclude them from gross income under §22(b)(3).[11] The present ruling by the Commissioner is in complete accord with this concept, for the fact that the payments are made in consideration of past services rendered to the employer, even though there is no obligation to make them, negatives the notion that they are gifts.[12] It follows that payments to widows of deceased employees are now, logically enough, to be treated in the same manner as bonus payments made to the employee himself, and for the same reasons.[13]

In applying the test of whether payments made are in consideration of past services rendered to the employer, the possibility of holding such payments to be deductible by the employer as business expenses and, at the same time, not taxable to the recipients as gifts is all but eliminated.[14] Such dual treat-

[7] Varnedoe v. Allen, (5th Cir. 1946) 158 F. (2d) 467, cert. den., 330 U.S. 821, 67 S.Ct. 771 (1947); I.T. 3972, 1949-2 Cum. Bul. 15. But see, Special Ruling, 464 C.C.H. 6241 (1946). Where the deceased employee has, pursuant to statute, contributed to a fund out of his salary, the payments to his widow made partly out of this fund have been held taxable as annuities under I.R.C. §22(b)(2). Anna E. Curtis, 8 T.C. 266 (1947); I.T. 3653, 1944 Cum. Bul. 75.

[8] Mary Sutro v. United States, unreported, (D.C. Cal. 1942) 30 A.F.T.R. 1618; I.T. 3840, 1947-1 Cum. Bul. 7. The payments under such plans are held to be enforceable obligations even though voluntary, the consideration being the good will and long and faithful service of the deceased employee. Psutka v. Michigan Alkali Co., 274 Mich. 318, 264 N.W. 385 (1936); Mabley & Carew Co. v. Borden, 129 Ohio St. 375, 195 N.E. 697 (1935); Schoefield v. Zion's Co-op. Mercantile Institution, 85 Utah 281, 39 P. (2d) 342 (1934).

[9] W. D. Haden Co., 5 T.C.M. 250, P-H T.C.M. Dec. ¶46,089 (1946).

[10] And Treas. Regs. 111, §29.22(a)-2, quoted above, add weight to this analysis.

[11] In Louise K. Aprill, 13 T.C. 707 (1949), the latest case in point, the payments to the widow were held not taxable. However, little reliance can be placed on this decision, for it is not at all clear whether the court felt that the payments were gifts or whether it was following I.T. 3329.

[12] "It is not necessary that the services should have been rendered by the payee. The payor is the one to whom the services must have been rendered." Varnedoe v. Allen, (5th Cir. 1946) 158 F. (2d) 467 at 468, cert. den., 330 U.S. 821, 67 S.Ct. 771 (1947).

[13] In the cases involving bonus payments to employees, it should be noted that there is a strong presumption that any beneficial payment to an employee beyond his salary is intended as additional compensation, and the burden of overcoming this presumption rests heavily on the recipient. See e.g., Bogardus v. Commissioner, 302 U.S. 34, 57 S.Ct. 61 (1937); Old Colony Trust Co. v. Commissioner, 279 U.S. 716, 49 S.Ct. 499 (1929); Schall v. Commissioner, (5th Cir. 1949) 174 F. (2d) 893; Van Dusen v. Commissioner, (9th Cir. 1948) 166 F. (2d) 647; Willkie v. Commissioner, (6th Cir. 1942) 127 F. (2d) 953, cert. den., 317 U.S. 659, 63 S.Ct. 58 (1942); Noel v. Parrott, (4th Cir. 1926) 15 F. (2d) 669.

[14] Although this result has never been reached in any judicial decisions, it is possible under the reasoning of I.T. 3329, and, in fact, this was the result in that ruling. Flarsheim v. United States, supra note 6, and Seavey & Flarsheim Brokerage Co., 41 B.T.A. 198

ment is obviously incongruous and should not be tolerated.[15] However, the Treasury Regulations provide that "when the amount of the salary of any officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of services rendered by the individual, such payments may be deducted."[16] Since the department allows this limited deduction by the employer even though the payments appear to be gratuities,[17] it is still theoretically possible to permit a deduction by the employer while not requiring the widow to include the payments in her gross income. This inconsistency can be resolved by recognizing that the deduction is allowed on the theory that it is customary for employers to make such payments,[18] and thus it would follow that they are not gifts and should be taxable to the widow for this limited period.

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(1940), appear to be the only two cases which have considered the same payment; the treatment was consistent. Because of the fact that business expenses must be reasonable as well as ordinary and necessary to be deductible, it would seem possible that only a part of the payment may be allowed as a deduction while the excess over that amount goes tax-free to the recipient.

[15] In dealing with this specific problem, it was said "that transactions between two or more parties should be treated under the same point of view for each of the parties involved." Gruneberg, "The Weak Spots," 27 TAXES 347 (1949).

[16] Treas. Regs. 111, §29.23(a)-9. The "limited period" appears to be somewhere in the vicinity of two years. I. Putnam, Inc., 15 T.C. 86 (1950) (24 months); McLauglin Gormley King Co., 11 T.C. 569 (1948) (29 months). "In recognition of services" is here to be distinguished from "as compensation for services."

[17] I. Putnam, Inc., supra note 16; McLauglin Gormley King Co., supra note 16.

[18] 505 C.C.H. ¶8713-D (1950).