

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

**CHAPTER 7 CURRENT DEVELOPMENTS IN IRS BENEFITS
LITIGATION**

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I. Distributions

Plan Loans -- IRC ' 72(p)

- A. Ramon A. Garcia, et ux. v. Commissioner, 190 F. 3d 538 (5th Cir. 1999), aff-g, T.C. Memo. 1998-203. Petitioners=outstanding qualified plan loans were taxable as distributions at the end of the repayment periods but, consistent with Chapman et al. v. Commissioner, T.C. Memo. 1997-147, unpaid accrued interest was not taxable as an additional distribution under IRC ' 72(p).

In addition, a loan made prior to December 31, 1986, which was not renewed, extended, renegotiated or modified is not subject to the "substantially level amortization" requirement of IRC ' 72(p)(2)(C) and, thus, the amount of the unpaid loans was properly included in income in the tax year in which the repayment period expired.

- B. Patrick v. Commissioner, 181 F.3d 103 (6th Cir. 1999), cert. denied, S. Ct. Dkt. No. 99-209 (October 4, 1999). Taxpayers received and failed to include in income amounts distributed from profit-sharing plan, arguing that such amounts to the extent of \$50,000 were loans.

Tax Court held amounts were taxable distributions, not loans, given that the loan documents were unsigned and executed after the distributions were made and there was no other credible evidence that the distributions were intended to be loans at the time made.

Application of Section 72(t)

1. Kute v United States, 191 F. 3d 371 (3rd Cir. 1999). Third Circuit, affirming District Court, held that payment to state police officer was a distribution from the State Employees= Retirement System (SERS), a qualified retirement plan subject to the IRC ' 72(t) addition to tax.

The court rejected taxpayer=s argument that the payment was an arbitration award relating to a collective bargaining agreement and, thus, not subject to

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IRC ' 72(t) because it does not conform to the realities of the situation. The SERS has been treated as a qualified plan, pension rights of state employees are determined solely by the SERS and cannot be altered by collective bargaining agreements, and that the award at issue had been inserted into SERS by the state legislature.

2. Peaslee v. Commissioner, T.C. Memo. 1999-4. Taxpayer liable for addition to tax imposed by IRC ' 72(t) because no exception applied and amount was not rolled over.

Other Cases Involving Distributions

1. Dzuris v. United States, 2000 US LEXIS 63335 (April 7, 2000), *aff-g*, 44 Fed. Cl. 452 (1999). In an unpublished decision, the Federal Circuit affirmed the Court of Federal Claims decision that Dzuris failed to prove that she filed a timely income averaging election or refund claim in connection with her 1987 lump sum pension distribution and, thus, the Service appropriately denied her refund claim. Under ' 1124 of the Tax Reform Act of '86, Dzuris could have treated the distribution as having been received in 1986 (when she terminated employment), and elected 10-year averaging on her 1986 tax return or amended return filed by the due date for the 1987 return.
2. Special Averaging B Wantz v. United States, 1999 U.S. Dist. LEXIS 7396, 22 E.B.C. 1106 (D.C.Md. 1999). District Court held that Maryland State Retirement System transfer refund distribution was not eligible for special averaging because the distribution was not a lump sum distribution of the balance to the credit under IRC ' 402(e)(4). Citing Powell v. Commissioner, 129 F.3d 321 (4th Cir. 1997), the court also held that the distribution constituted an excess distribution under IRC ' 4980A.
3. Net Unrealized Appreciation -- Villaroel v. Commissioner, 85 AFTR2d Par.2000-338 (January 7, 1999), *aff-g*, T.C. Memo 1998-247. In an unpublished opinion, the Sixth Circuit affirmed the Tax Court's determination that taxpayers were required to include in income that portion of the fair market value of a lump-sum distribution of securities from an ESOP that exceeded the net unrealized appreciation in the securities. Taxpayers were also required to include in income the amount of cash distributed even though such amount was never received because an equal amount was withheld for Federal income tax purposes. Such amounts were also subject to the additional early distribution tax imposed by ' 72(t).

II. Individual Retirement Accounts and Simplified Employee Pensions

A. Investment in the Contract@ - IRC ' 408(d)(2)

Alpern v. Commissioner, T.C. Memo. 2000-246. Tax Court held that IRA distribution was fully includable in income since taxpayer provided no evidence to substantiate his claim that a portion of the distribution was attributable to his basis in the IRA contributions and therefore nontaxable.

B. "Transfer Incident to Divorce" - IRC ' 408(d)(6)

Jones v. Commissioner, T.C. Memo. 2000-219. Tax Court held that the exception to tax for transfers incident to divorce under IRC ' 408(d)(6) requires the transfer of an individual's interest in an IRA to the former spouse pursuant to a divorce decree. That requirement is not satisfied if the amounts involved are distributed and simultaneously transferred to the former spouse. Mr. Jones did not transfer his interest in his IRA to his ex-wife when he received a distribution and simultaneously endorsed the check over to her. Mr. Jones taxable distribution was also subject to the additions to tax under ' 72(t) and 6651. See also Bunney v. Commissioner, 114 T.C. 259 (2000) and Czepiel v. Commissioner, T.C.Memo. 1999-289 (Tax Court held that IRA distribution is includable in husband's gross income when husband received a distribution and transferred the amounts, rather than his interest in the IRA, to his ex-wife.)

C. Application of IRC ' 72(t)

Deal v. Commissioner, T.C. Memo. 1999-352. Tax Court rejected taxpayer's argument that she relied in good faith on IRS advice, holding instead that the early distribution addition to tax applied because none of the exceptions of IRC ' 72(t)(2) applied and incorrect tax advice from Service employees does not have the force of law.

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D. Investment in Contract under IRC ' 408(d)

Schmalzer v. Commissioner, T.C. Memo. 1999-399. Tax Court held that an individual has no basis in pre-1987 IRA contributions. However, post-1986 contributions that were not deducted constituted an investment in the contract. IRC ' 72(t) addition to tax also applied to the portion of the distribution that was includible in income. Note that the basis treatment applicable to such contributions does not apply to all amounts (i.e., excess contributions) contributed to an IRA which were not deducted on the individual's tax return.

E. "Compensation" Under IRC ' 219

Clarke v. Commissioner, T.C. Memo. 1999-199. The term "compensation" for purposes of determining an individual's IRA contribution limitation does not include capital gains, interest, dividends, or IRA distributions.

III. Issues Related to Plan Qualification

A. Lynn Esden et al. v. Bank of Boston, et al.,

86 AFTR2d Par. 2000-5304 (September 12, 2000). Second Circuit held that calculation of plaintiff's lump-sum pension distribution from a defined benefit cash balance plan violated the anti-cutback rule of IRC ' 411(d)(6). The Court held that calculation of plaintiff's lump-sum accrued benefit distribution did not comply with the Code and regulations because it was not the actuarial equivalent of the normal retirement benefit calculated according to the specified valuation rules of ' 417(e), as prescribed by the Code and regulations.

The court cited Notice 96-8, 1996-1 C.B. 359, as guidance on the applicability of ' 411(a) and 417(e) to lump-sum distributions from cash balance plans, in concluding that a cash balance plan must project the balance of the hypothetical account balance forward to normal retirement age and then pay out the present value of that projected balance, computed according to ' 417(e). Although Notice 96-8 was released after the calculation of plaintiff's 1991 lump-sum distribution, the Court found the Service's interpretation of its own regulations as embodied in Notice 96-8 to be consistent with its prior regulatory interpretations, and that it

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represented the agency's fair and considered judgment on the matter, which is therefore entitled to deference.

B. IRC ' 401(a)(2) Exclusive Benefit Rule and Plan Loans

Westchester Plastic Surgical Associates, P.C. v. Commissioner, T.C. Memo. 1999-369. Tax Court upheld the Service's revocation of a defined benefit plan's qualified status on the grounds that the plan failed to operate for the exclusive benefit of employees as required under IRC ' 401(a)(2).

When the plan ceased benefit accruals in 1990, benefits were paid in full to 2 of the plan's 3 participants, leaving the corporation's president, sole shareholder and plan trustee as the sole participant. Thereafter, the plan made 23 participant loans to that plan trustee, consisting of virtually all of the plan's assets, without requiring security or specifying repayment dates. The loans were not repaid.

The court concluded that the participant used the plan as a personal checking account, rather than a retirement plan. The court distinguished this case from Shedco, Inc. v. Commissioner, T.C. Memo. 1998-295, in which the court had previously held that plan loans to a corporate sponsor did not disqualify the plan where the plan trustee believed that such loans were a sound plan investment, loan repayments were made until the business experienced financial difficulty, and the loans were not made for personal benefit (other than as a plan beneficiary).

C. Termination, IRC ' 401(a)(26) Minimum Participation

Gant v. Commissioner, T.C. Memo. 1998-440. Company wholly owned by Gant maintained defined benefit and money purchase plans, of which he was trustee.

- In 1987 Board passed resolution to terminate defined benefit and money purchase plans and to convert money purchase plan to profit-sharing plan. However, actions required under ERISA sec. 4041 were not taken with respect to the pension plan until 1992. The court held that strict compliance with these requirements is necessary to terminate a defined benefit plan. Further, conversion of money purchase to profit-sharing plan, filing of Forms 5500 as ongoing plan, lack of communication to participants, failure to distribute all assets indicated that plan was not terminated and that company did not intend to terminate it. Hence both plans remained ongoing in 1991.

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- In the 1991 plan year, only 15 of 66 eligible employees participated in the plans. The Service therefore disqualified the plans, effective June 1, 1991, for failing to satisfy IRC 401(a)(26). The Tax Court agreed.
- Because Mr. Gant, as sole shareholder and president, was a highly compensated employee, Tax Court held that his vested accrued benefits (\$707,451) under defined benefit and profit sharing plans were includable in income for the 1991 tax year, and additional vested accrued benefits in 1992 and 1993 were includable in 1992 and 1993 respectively.

D. IRC ' 415 and Elective Deferrals

1. Van Roekel Farms v. Commissioner, T.C. Memo. 2000-171. Tax Court upheld the Service's disqualification of an employee stock ownership plan, on the grounds that management fees paid to Van Roekel as an independent contractor are not included in a participant's compensation and, as such, the annual additions attributable thereto caused Van Roekel's account to exceed IRC ' 415 limitations.
2. Clendenen, Inc. v. Commissioner, 85 AFTR2d Par. 2000-547 No. 98-4183 (8th Cir. March 29, 2000), aff-g T.C. Memo. 1998-318. Eighth Circuit affirmed Tax Court holding that employee stock ownership plan and trust was not qualified under IRC ' 401(a) because amounts contributed to the trust and allocated to one of the trust's participants exceeded IRC ' 415 limitations. Excess arose because amounts earned as independent contractor were improperly treated as compensation under plan not maintained by individual as sole proprietor; because elective deferrals were included in "compensation" for purposes of determining annual additions; and because the same elective deferrals were treated as employee rather than employer contributions for purposes of ' 415.
3. Roblene Inc. v. Commissioner, T.C. Memo. 1999-161. The Tax Court sustained the Service's disqualification of an employee stock ownership plan, because annual additions to the plan exceeded the limitations of IRC ' 415. Citing Clendenen, Inc. v. Commissioner, T.C. Memo. 1998-318, appeal filed, Dkt. No. 98-4183, the court held that commissions paid to independent contractors are not includable in participant's compensation for purposes of the IRC ' 415 limitations. The court determined that since the elective salary deferrals are employer contributions and not included in

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participant's compensation, that the full amounts of the elective deferrals are included in annual additions for IRC ' 415 limitation purposes.

IV. Selected Title I Decisions Addressing Tax Provisions

A. Robert J. Matz, et al. v. Household International Tax Reduction Investment Plan,

86 AFTR2d Par. 2000-5319 (September 21, 2000). The Seventh Circuit affirmed the district court in an issue of first impression, holding that the Internal Revenue Service's position that vested and nonvested termines must be considered in determining whether a partial plan termination has occurred is reasonable. After reviewing the legislative history, the statute, and similar cases, the court noted that the purposes of the partial termination requirement that all affected employees receive full vesting is to protect employees' expectation of pension benefits and prevent employer abuse. The plaintiffs, nonvested termines who are seeking recovery of the nonvested portion of their benefits, also persuaded the court that the partial termination was the result of a multi-year corporate reorganization. Therefore, the court also held that multiple plan years may be aggregated in determining whether a partial plan termination occurred.

B. Lyons v. Georgia Pacific Corporation Salaried Employees Retirement Plan., et al.,

86 AFTR2d Par. 2000-5157; No. 99-10640 (August 11, 2000). The Eleventh Circuit reversed the district court, upheld Treas. Reg.' 1.411(a)-11 as valid, and held that ERISA ' 203(e) and Treas. Reg.' 1.411(a)-11 require the calculation of lump sum payments from defined benefit plans using an employee's normal retirement benefit discounted by the Pension Benefit Guarantee Corporation's annuity interest rate. The case involved the calculation of a lump sum payment from a cash balance defined benefit plan. The court rejected Georgia Pacific's contentions that cash balance plans were not required to calculate lump sum payments based on an employee's normal retirement benefit, and that the PBGC's interest rate was only required to be used for purposes of determining whether the consent requirements of IRC ' ' 411(a) and 417 were applicable. Because ERISA ' 203(e) and the legislative history relating thereto were

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ambiguous, the court concluded that Treas. Reg. ' 1.411(a)-11 was not unreasonable. Therefore, under the principles of Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), the court upheld Treas. Reg. ' 1.411(a)-11.

C. Spousal Benefits

1. Samaroo v. Samaroo et al, 193 F. 3d 185 (3rd Cir. 1999). Third Circuit, affirming district court, held that former spouse's nunc pro tunc amendment of divorce decree did not constitute a QDRO and, thus, did not entitle her to a pre-retirement survivor annuity under her former deceased husband's pension plan. The district court considered the issue a matter of plan interpretation. However, the Third Circuit considered the issue as a matter of law regarding the interpretation of one of the QDRO requirements; namely, the requirement that a domestic relations order is a QDRO only if it does not require a plan to provide increased benefits. In concluding that the former spouse's retroactive nunc pro tunc amendment of the divorce decree is not a QDRO because of the increased benefits such an amended order would require from the plan, the Third Circuit noted that plan administration is rendered impossible if determinations regarding survivorship benefits are not made as of the date of death or retirement. The court rejected the former spouse's argument that denying her claim to survivorship benefits deprives her former husband of plan benefits, citing ERISA for the proposition that the decedent effectively reserved the right during his life to remarry and provide survivorship benefits to that future spouse rather than amending the prior divorce decree (after REA amended ERISA) to provide survivorship benefits to his former spouse as alternate payee.
2. Rivers v. Central and South West Corporation, et al, 186 F.3d 681 (5th Cir. 1999). Fifth Circuit affirmed district court in rejecting former spouse's claim, over present wife, to decedent participant's death benefits under his pension plan. Noting that ERISA generally preempts state community property law, the court reasoned that present wife's right to participant's pension benefits vested on the participant's retirement date, and former spouse's failure to obtain a qualified domestic relations order (QDRO) recognizing her right to receive any portion of participant's pension benefits prior to his retirement date precludes any recovery by her after his death.

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3. Merchant and Henry's Pharmacy Incorporated, Profit Sharing Plan v. Corder, 182 F.3d 908 (4th Cir. April 7, 1999). In an unpublished opinion, the Fourth Circuit affirmed and adopted the district court's reasoning, that a decedent's former spouse, not his designated beneficiary, was entitled to the plan's death benefits. The decedent, the participant, changed his beneficiary designation without the spousal authorization required by ERISA, before he was divorced, and state law did not allow for legal separation; and the decedent had been required by court order to pay the benefits over to the former spouse prior to his death.

D. Permitted Forfeitures

Aramony v. United Way Replacement Benefit Plan, United Way Supplemental Benefits Agreement et al., 191 F. 3d 140 (2nd Cir. 1999). Second Circuit affirmed district court's determination that benefits provided under United Way's Supplemental Benefits Agreement were not forfeited as a result of Aramony's fraud conviction because the executed plan (rather than the draft plan) was the governing document, and it did not include a felony-forfeiture provision. However, the Second Circuit reversed the district court, in part, holding that United Way was not estopped from denying Aramony an additional benefit under its Replacement Benefit Plan (RBP) to offset the effect of the compensation limitation made applicable to qualified plans under IRC ' 401(a)(17) after the RBP was established. The court held that Aramony failed to prove "extraordinary circumstances," as required to support a claim of estoppel under ERISA, in addition to the four elements required to support a claim of estoppel under common law (a promise; reliance on a promise; injury caused by the reliance; and an injustice if the promise is not enforced). The court remanded the IRC ' 401(a)(17) issue back to the district court for a determination of whether the offset was required under the RBP's provisions.

E. Failure to State Actuarial Assumptions

1. Stamper v. Total Petroleum, Inc. Retirement Plan for Hourly Rated Employees With the Bargaining Unit Represented by Local 642 of the International Union of Operating Engineers (AFL-CIO), et al., 188 F.3d 1233 (10th Cir. August 27, 1999). Tenth Circuit rejected appellants assertion that pension plan's failure to satisfy IRC ' 401(a), including

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401(a)(25) which requires a qualified plan to specify actuarial assumptions used, provides a basis for monetary relief under ERISA. The Court noted that Congress codified certain requirements (such as IRC ' ' 411 and 412 and ERISA ') into ERISA and the Code, but codified others only in the Code ((e.g., ' 401(a)(25)) only into the Code. The Court also concluded that appellants failed to provide evidence sufficient to prove that benefits calculated under the plan's amended actuarial assumption provisions were less than benefits calculated under the assumptions used prior to the amendment.

2. McDaniel v Chevron, 2000 U.S. App. LEXIS 1704 (9th Cir. Jan. 13, 2000). Class action challenging plan administrator's application of nine month set forward to Plan's stated mortality table in determining actuarially equivalent benefits. Ninth Circuit concluded that plan administrator exercised permissible discretion B requirements of Rev. Rul. 79-90 apply to whether benefits are definitely determinable are not incorporated into section 204(c)(3) or ERISA , requiring actuarially equivalent benefits.

F. Accrued Benefits.

Arndt v. Security Bank S.S.B. Employees Pension Plan and Marshall & Ilsley Corporation, 182 F.3d 538 (7th Cir. 1999). Seventh Circuit held that benefits received by disabled participant under qualified pension plan were disability, not pension, benefits which could be reduced or eliminated by plan amendment upon plan termination. The court rejected arguments that the benefits were Accrued benefits@or Retirement-type subsidies@which would have been protected from reduction under ERISA ' 204(g), in part, because, under the plan, the benefits accrued ratably year-by-year (not immediately upon becoming disabled), and because the participant's disability was the reason for the benefit.

G. Leased Employees.

Florett Burrey, et al. v Pacific Gas and Electric Company, et al., 159 F. 3d 388 (9th Cir. October 20, 1998). In determining whether workers are entitled to employee benefits, status as common law employees must be determined prior to application of leased employee provisions.

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H. Benefit Entitlements after Normal Retirement Age.

Lunn v. Montgomery Ward & Co. Retirement Security Plan, 166 F.3d 880 (7th Cir. 1999). Petitioner contended that floor offset arrangement, under which annuity under defined benefit plan was reduced by the annuity value of a defined contribution plan funded by mandatory employee contributions, violated integration rules and resulted in age discrimination. Petitioner sought higher accruals for service past normal retirement age in order to compensate for the shorter period in which he would receive benefits. Judge Posner concluded that ERISA does not require such accruals.

I. Plan Termination.

Administrative Committee of the Sea Ray Employees- Stock Ownership and Profit-Sharing Plan et al v. Daniel Robinson et al., 164 F. 3d 981 (6th Cir. 1999), cert. denied 120 S. Ct 930. Sixth Circuit upheld administrative committee's determination that layoffs between 1989 and 1991 did not cause a partial termination of the company's stock ownership and profit-sharing plan and, thus, full vesting of all affected employees was not required under IRC ' 411(d)(3). The court reviewed the committee's decision under an arbitrary and capricious standard, finding that the administrative committee had the discretionary authority to determine whether a partial termination occurred under the plans terms. Relying on Treas. Reg. ' 1.411(d)-2(b)(1) (which provides that the partial termination of a profit-sharing plan is determined with regard to all facts and circumstances of the particular case), the court determined that the layoffs were due to two separate and independent events which could be evaluated separately, and that the percentage of involuntary terminations was 15.9% during 1989-90 and 27.9% during 1990-91. The court noted that the Committee's decision was reasonable and was made after careful deliberation of the governing legal standards and company actions taken in light of these standards.

V. Deductions

A. Voluntary Employee Beneficiary Association (VEBA) Contribution Deductions

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Neonatology Associates, P.A., et al. v. Commissioner, 115 T.C. No. 5 (July 31, 2000). Tax Court held, in part, that a corporate employer may not deduct VEBA contributions in excess of the cost of current-year term life insurance, and that the amount of the disallowed deductions are constructive dividends to the employee/owners that are taxable in the year contributed. In addition, neither a corporate employer nor a sole proprietorship may deduct VEBA contributions made to fund term life insurance for nonemployees. The court also held that petitioners are liable for accuracy-related penalty taxes under IRC ' 6662(a), however, petitioners are not liable for penalties under ' 6673(a)(1)(B) for litigating a frivolous or groundless action.

The case involved 2 VEBAs formed by life insurance salesmen to generate commissions on the sale of life insurance to the VEBAs, and to provide a tax-free savings device for the owner/employees. Premiums on the insurance policies exceeded the cost of term life insurance, and the portion of the premium that exceeded the term life insurance cost was accumulated as a conversion credit later available to the owner/ employee through the use of individual universal life policies that were distributed to the owner/employee when the employer terminated its participation in the trust.

B. Payment of Plan's Litigation Expenses

Sklar, Greenstein & Scheer, P.C. v. Commissioner, 113 T.C. No.9 (August 13, 1999). Tax Court held that corporation's payment to a third party of money purchase pension plan's litigation expenses are not deemed contributions to the plan. Therefore, the payments are not subject to IRC ' 404 deduction limits, and deductibility is determined under IRC ' 162.

C. Section 404(a)(6) -- Contributions Attributable to Service Rendered After Tax Year

1. American Stores, Inc. v. Commissioner, 170 F.3d 1267 (10th Cir. 1999), cert. denied, 145 L. Ed. 2d 153 (October 4, 1999). The facts and issues are essentially the same as those decided in favor of the Commissioner in Lucky Stores, discussed below. The Court held, based on the anticipated contribution language of IRC ' 413 (requiring that anticipated contributions be determined in the same manner as actual contributions), that contributions must be limited to those contributions attributable to services

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performed over a 12-month period. IRC ' 404(a)(1), (a)(6) and 413(b)(7) collectively provide the deduction limitations applicable to collectively bargained plans. Although the Ninth and Tenth Circuit's reasoning in American Stores and Lucky Stores differs, the conclusions are the same; namely, that IRC ' 404(a)(6) precludes accelerated deductions by multiemployer pension plans with respect to post-year end contributions attributable to services rendered after the end of the taxable year.

2. Lucky Stores, Inc. v. Commissioner, 153 F. 3d 964 (9th Cir. 1998), cert. denied, 119 S. Ct. 1755 (May 17, 1999).

Taxpayer made contractually required monthly contributions to 29 collectively bargained defined benefit pension plans. For each plan, the amount of the monthly contribution was the arithmetical result obtained by multiplying the covered hours worked by the contribution rate, a dollar amount set forth in the collective bargaining agreements. For tax year ended February 2, 1986, taxpayer obtained an extension of the time within which to file federal income tax returns to October 15, 1986. Between the date on which the current taxable year ended and the due date of the returns, as extended, taxpayer made 8 or 9 monthly contributions to the plans and claimed these post-year end contributions as a deduction for the current taxable year, in addition to the usual 12 monthly contributions.

- (a) The Tax Court ruled that the grace period contributions were not on account of taxpayer's February 2, 1986, fiscal year, as required by IRC ' 404(a)(6), and, therefore, not deductible in that year. The court noted that the legislative history shows that the purpose of amending ' 404(a)(6) was simply to place cash basis taxpayers on the same footing as accrual basis taxpayers insofar as contributions actually paid in to the trust after the close of the taxable year are concerned. The court further noted that the conference report states that the intent of permitting grace period contributions is so that they may be related back to the plan year "for purposes of the minimum funding standards".
- (b) On appeal, the Ninth Circuit affirmed the Tax Court's decision, holding that the deduction of contributions paid after the end of the taxable year that are attributable to services rendered after the end of the taxable year violates the plain language of IRC ' 404(a)(6), which requires that contributions be "on account of" a prior tax year in order to be deemed paid on the last day of that tax year and,

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thus, deductible under IRC ' 404(a).

3. Airborne Freight Corporation v. United States, 153 F. 3d 967 (9th Cir. 1998), cert. denied, 119 S.Ct. 1755 (May 17, 1999). Facts essentially the same as Lucky Stores, except that taxpayer prevailed in District Court. Appeal consolidated with Lucky Store.

VI. Procedural Issues

A. IRC ' 7476(a) -- Declaratory Judgment Petition Requires AInterested Party@

Flynn et al. v. Commissioner, T.C. Memo. 2000-223. Tax Court dismissed declaratory judgment petition on the grounds that, as former employees, the petitioners were not Ainterested parties,@ as defined by Treas. Reg. ' 1.7476-1(b). Therefore, they lacked standing to bring the action. The court rejected petitioners' arguments that the Ainterested party@ requirement should be waived because the union (plan sponsor) treated them as interested parties by providing them an interested party notice regarding the plan's determination letter application, or that Treas. Reg. ' 1.7476-1(b) is invalid.

B. IRC ' 7476(a) -- Declaratory Judgment Petition Requires AActual Controversy@

Sonier v. Commissioner, T.C. Memo. 1999-275. Tax Court granted Service's motion to dismiss a declaratory judgment action because there was no apparent controversy that would even potentially result in the plan's disqualification as required under IRC ' 7476(a). Sonier argued that (i) he had not received proper notification of the plan's determination letter request, (ii) the rate of return on his plan's investments was inadequate; and (iii) he would prefer to have plan assets invested in a 401(k) plan.

C. Closing Agreements

William C. Kercheval v. United States, 1999 U.S. Dist. LEXIS 19057, 22 E.B.C. 2361

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(4th Cir. 1999). In an unpublished decision, the Fourth Circuit held that a retired Maryland teacher is bound by the terms of a closing agreement relating to his receipt of a pension transfer refund from the Maryland Retirement System. Mr. Kercheval participated in a group closing agreement with the Service in connection with the rollover of his transfer refund, under which he agreed to close the IRA in which funds were deposited. After the Fourth Circuit subsequently held in a separate case that a transfer refund could be rolled over in certain circumstances, Mr. Kercheval filed a claim for refund which the Service denied. The district court and the Fourth Circuit rejected Kercheval's claim that the closing agreement was based on a material misrepresentation of fact by the Service, and held that the statement on which Mr. Kercheval relied (i.e., that the distribution did not qualify for tax free rollover under IRC ' 402(a)) was not a misrepresentation of fact, but was a mistake of law which did not justify setting the agreement aside.

VII. Qualified plan related excise tax issues

A. Prohibited Transactions

1. Flaherty's Arden Bowl Inc. v. Commissioner, 115 T.C. No. 19 (2000). Tax Court held majority-owned corporation liable, as a disqualified person under IRC ' 4975(e)(2)(G), for prohibited transaction excise taxes relating to a participant-directed loan from his qualified plan account to the petitioner corporation in which he had a majority interest. The loans were repaid and provided for market interest rates.

The court rejected petitioner's argument that it could not be a disqualified person because the participant who directed the loan was not a fiduciary pursuant to the ERISA ' 404(c)(1) exception for participants in self-directed accounts. Based in part on Labor Department Regulations and the preamble thereof, the court determined that the ERISA ' 404(c)(1) exception does not apply to ' 4975. (DOL Regulations provide there is no provision in the Internal Revenue Code corresponding to ERISA ' 404. The preamble to the regulations indicates that ERISA ' 404(c)(2) extends only to the provisions of part 4 of ERISA, Title I, and that even if a prohibited transaction is a direct and necessary consequence of a participant's exercise of control, nothing in ERISA ' 404(c) would relieve a disqualified person from liability.) Therefore, the court concluded that neither the Code, ERISA, nor the regulations provide relief from liability for

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the petitioner corporation. However, the court declined to find petitioner corporation liable for the failure to file a Form 5330 because the participant directing the loan relied upon advice from an attorney familiar with qualified retirement plan issues.

2. Edward Clasby and C.T. Garrahan Insurance Agency, Inc. v. Commissioner, T.C. Memo. 1999-80. Tax Court held that president and 100 percent owner of insurance agency who was also pension plan trustee and member of the plan committee, and officer and trustee of the hospital maintaining the IRC ' 401(a) plan was a disqualified person and a fiduciary under IRC ' ' 4975(e)(2)(A) and (H). In addition, the insurance agency was a disqualified person under IRC ' ' 4975(e)(2)(B) and (G) because the agency serviced and processed the life insurance policies purchased for the plan, and because 50% or more of the voting stock of the agency was owned directly or indirectly by a person described in IRC ' 4975(e)(2)(A). Accordingly, Tax Court held that both petitioners were jointly and severally liable for excise tax under IRC ' 4975(a). The court rejected taxpayer's argument that he was not a disqualified person because he did not actually exercise discretionary control over the plan's assets nor did he exercise the powers of an officer or director. The court concluded that taxpayer was a fiduciary because he clearly influenced the plan committee's decision to purchase the insurance policies and he was also a disqualified person under IRC ' 4975(e)(2)(H) because he exercised the powers of an officer or director.
3. Medina v. Commissioner, 112 T.C. No. 2 (1999). IRC ' 4975 prohibited transaction excise taxes continue to apply even if the loan involved was treated as a deemed distribution in an earlier year for income tax purposes under IRC ' 72(p). The court also held that the prohibited transaction was not Acorrected@ by assignment to plan of future sale proceeds from apartments financed by the loan. The court rejected the Service's argument that the Aamount involved@ should be calculated using the greater of interest charged (10.5%) or the fair market interest rate, holding instead that the Aamount involved@ is the greater of interest paid(zero) or the fair market interest rate (10.5%).
4. Baizer v. Commissioner, 85 AFTR2d Par. 2000-498 (9th Cir. March 1, 2000), aff-g, T.C. Memo 1998-36. Assignment of accounts receivable to a defined benefit plan by corporation maintaining the plan constituted a sale or exchange and was therefore a prohibited transaction giving rise to the first and second-tier excise taxes under IRC ' 4975. The corporation had previously entered into a consent judgment with the Department of Labor settling its liability under Title I of ERISA. The Ninth Circuit affirmed the Tax Court's rejection of petitioner's argument that the IRS was bound by the judgment, noting that the judgment

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specifically stated that it was not binding on any agency other than the Department of Labor.

B. IRC ' 4971 Funding Deficiency Excise Tax

Phillip M. Wenger, T.C. Memo. 2000-156 (May 12, 2000). Tax Court held petitioner liable for an IRC ' 4971 accumulated funding deficiency with respect to the money purchase pension plan it sponsors, and an addition to tax for failure to timely file an excise tax return. Treasury Reg. ' 11.412(c)-12(b) provides that if an employer's contributions are credited to the plan's funding standard account for a particular plan year after the end of the plan year, they are deemed to have been made on the last day of the plan year if the contributions are made within 8 2 months after the last day of the plan year. Petitioner's plan year ended December 31, thus the 8 2 month period expired on September 15th. Since the contribution was not made until October 16th, petitioner was liable for the 10-percent excise tax under ' 4971. The court rejected petitioner's argument that the prototype plan language, which required that the employer had to make the contribution for each year not later than the due date for filing the employer's income tax return including extensions, should control because the plan received a favorable determination letter from the Service regarding the plan's qualified status under ' 401(a). The court explained that the minimum funding standards described in ' 412 are not a qualification requirement of ' 401(a), and that ' 404(a), relating to deductibility, and ' 412, relating to minimum funding standards, provide different periods within which a contribution must be made in order to be timely. The court also rejected petitioner's argument that statements in Pub. 560 regarding timely contributions should control, noting that the authoritative sources of law in the area of Federal taxation are the relevant statutes, regulations, and judicial decisions and not informal publications issued by the IRS.

VIII. Bankruptcy, Liens, and Levies

A. McIntyre v. U.S., 86 AFTR2d Par. 2000-5087 (2000).

Ninth Circuit held that IRS's levy on pension benefits was appropriate under both ERISA's anti-alienation provisions and California community property law against a spouse's community property interest claim in the benefits. In 1996, pursuant

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to an IRS levy, the plan began paying Mr. McIntyre's benefits directly to the IRS. In 1997, as part of the couple's joint chapter 13 bankruptcy, Mrs. McIntyre initiated an adversary proceeding objecting to the IRS's levy on her alleged one-half interest in her husband's pension. In holding that the levy was valid under the broad authority of IRC ' 6331, the Ninth Circuit noted that, under ERISA ' 514(d), ERISA does not alter, amend, modify, invalidate, impair, or supersede other U.S. laws and that, under California community property law, Mrs. McIntyre possesses only an equal interest—not an exclusive interest in any portion of the community property.

B. Valid Levy Despite Alleged Invalid Spousal Consent

Kopec v. Kopec, 70 F. Supp 2d 217 (E.D.N.Y. 1999). U.S. district court held that the IRS did not wrongfully levy on IRA, and that IRA owner's wife did not acquire a one-half ownership interest in the IRA assets because they were rolled over from a qualified plan without spousal consent. The court rejected the wife's arguments that, because she never waived her right to survivorship benefits, she therefore has a right to one-half of the IRA and, as such, she is not subject to the IRS levy as to her share of the assets. The court concluded that the plan, and its administrators and trustees, have an obligation to provide survivorship benefits in accordance with the plan, which is in no way extinguished by the IRS's levy on the full amount of the IRA. Therefore, the appropriate action is against the plan and its fiduciaries. The court noted that the Supreme Court's decision in Boggs v. Boggs, 520 U.S. 833 (1997) did not affect its conclusion.

C. Prepetition Tax Lien Attaches to Postpetition Pension Payments

In re: Ronald J. Allison and Martha J. Allison, 232 B.R. 195 (Bankr. D. Mont. 1999). Bankruptcy Court dismissed complaint that Service's lien on future payments from pension trust was invalid, reasoning that, under IRC ' 6321, property includes a vested interest in future pension benefits. In addition, the court rejected debtors' assertion that the tax lien could not attach to exempt property, concluding that a federal tax lien enjoys special legal status which would even allow the Service to attach pension benefits that were exempt property.

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D. Status of Tax Liabilities in Bankruptcy Proceedings –

In re Mounier, 232 B.R. 186 (S.D. Cal. 1998). The Bankruptcy Court held that the IRC '72(t) addition to tax was a nonpecuniary loss penalty (not a tax) that was nondischargeable in a chapter 7 bankruptcy because it became due less than three years before the petitioners filed for bankruptcy.

E. Pension Benefits Exclusion From the Bankruptcy Estate

In re Sewell, 180 F.3d 707 (5th Cir. 1999). Fifth Circuit held that whether retirement plan benefits are excludable from the bankruptcy estate under Bankruptcy Code '541(c)(2) depends on whether the plan is covered by ERISA Title I, not whether the plan is qualified under IRC '401(a). The court relied on the Seventh Circuit's opinion in Baker v. LaSalle, 114 F.3d 636 (7th Cir. 1997), in addition to the Supreme Court's decision in Patterson v. Schumate, 504 U.S. 753 (1992), noting that Patterson alone did not resolve the question of whether a plan necessarily must be tax qualified under IRC '401(a) to be excluded from the bankruptcy estate under B.C. '541(c)(2). The court also noted that its opinion should not be interpreted to mean that all benefits under ERISA Title I plans would necessarily be excludable from the bankruptcy estate if, for example, plan provisions allow for current benefit availability (e.g., plan loans; in-service distributions under defined contribution plans).