Loevsky v. Commissioner, 55 T. C. 514 (1970)

A pension plan that covers only salaried employees is discriminatory if it disproportionately benefits officers, shareholders, supervisors, or highly compensated employees.

Summary

In Loevsky v. Commissioner, the Tax Court upheld the IRS's determination that a pension plan established by L & L White Metal Casting Corp. for its salaried employees was discriminatory under the Internal Revenue Code sections 401(a)(3)(B) and 401(a)(4). The plan excluded hourly employees, most of whom were unionized, resulting in a disproportionate benefit to the salaried employees, who were predominantly officers, shareholders, supervisors, or highly compensated. The court reasoned that despite the plan's salaried-only classification, the disproportionate coverage favoring the prohibited group made it discriminatory. This case highlights the importance of ensuring that pension plans do not unfairly favor certain employee groups over others to qualify for tax exemptions.

Facts

L & L White Metal Casting Corp. established a pension plan effective April 15, 1964, for its salaried employees. The plan excluded hourly employees, who were mostly unionized and constituted the majority of the workforce. In 1964 and 1965, the plan covered 13 and 10 salaried employees, respectively, while excluding 151 and 144 hourly employees. The salaried group included officers, shareholders, and highly compensated employees, making up 61. 5% and 70% of the plan's beneficiaries in those years. The company sought a determination letter from the IRS, which ruled that the plan was discriminatory and not qualified under sections 401(a) and 501(a) of the Internal Revenue Code.

Procedural History

The IRS initially determined the pension plan did not qualify under section 401(a) and the trust was not exempt under section 501(a). L & L requested a review from the IRS's national office, which affirmed the initial determination. The taxpayers then appealed to the Tax Court, arguing the plan was not discriminatory.

Issue(s)

1. Whether a pension plan that covers only salaried employees is discriminatory under sections 401(a)(3)(B) and 401(a)(4) of the Internal Revenue Code when it results in disproportionate benefits for officers, shareholders, supervisors, or highly compensated employees?

Holding

1. Yes, because the plan's classification, despite being salaried-only, operated to discriminate in favor of the prohibited group, with 61. 5% and 70% of the plan's beneficiaries in 1964 and 1965 being officers, shareholders, supervisors, or highly compensated employees.

Court's Reasoning

The court applied sections 401(a)(3)(B) and 401(a)(4) of the Internal Revenue Code, which prohibit discrimination in favor of officers, shareholders, supervisors, or highly compensated employees. The court found that even though the plan was limited to salaried employees, this did not automatically render it nondiscriminatory. The court relied on the factual determination that a significant percentage of the plan's beneficiaries fell into the prohibited group. The court referenced the Pepsi-Cola Niagara Bottling Corp. case, noting that Congress intended to prevent tax avoidance through retirement plans. The court concluded that the Commissioner's determination of discrimination was not arbitrary, unreasonable, or an abuse of discretion. The court also rejected the argument that the absence of union demands for a similar plan for hourly employees justified the plan's discriminatory nature, stating that such extraneous circumstances could not override the statutory requirements.

Practical Implications

This decision impacts how employers structure pension plans to ensure they do not discriminate in favor of certain employee groups. It underscores the need for careful analysis of employee classifications and plan coverage to maintain tax-qualified status. Employers must consider the composition of their workforce and the potential for disproportionate benefits to officers, shareholders, supervisors, or highly compensated employees. This ruling may influence future cases involving similar pension plan structures, prompting employers to either include all employees or establish separate but equitable plans for different employee groups. The decision also highlights the limited role of courts in modifying statutory language, emphasizing that any adjustments to address potential inequities must come from legislative action.

