Wisconsin Nipple & Fabricating Corp. v. Commissioner, 67 T. C. 490 (1976)

A profit-sharing plan that discriminates in favor of highly compensated employees does not qualify under IRC § 401(a), and the IRS may retroactively revoke a plan's qualified status if there are material changes in the plan's operation or applicable law.

Summary

In Wisconsin Nipple & Fabricating Corp. v. Commissioner, the U. S. Tax Court held that the company's profit-sharing plan discriminated in favor of highly compensated employees, violating IRC § 401(a)(3)(B). The court also upheld the IRS's retroactive revocation of the plan's qualified status, finding that significant changes in plan participation and a subsequent revenue ruling justified the action. The case illustrates the importance of ensuring non-discriminatory plan coverage and the limits of reliance on IRS determination letters when circumstances change.

Facts

Wisconsin Nipple & Fabricating Corp. adopted a profit-sharing plan in 1960, covering only salaried employees with at least one year of service. The company continued to pay cash bonuses to hourly employees. By 1972 and 1973, the plan covered six employees, five of whom were officers, supervisors, or highly compensated. In 1973, after an IRS audit, the company amended the plan to include hourly employees, but the IRS retroactively revoked the plan's qualified status for 1972 and 1973.

Procedural History

The company received favorable determination letters from the IRS in 1960 and 1962. After an audit in 1973, the IRS notified the company in 1974 that the plan was not qualified for the tax years 1972 and 1973. The company petitioned the U. S. Tax Court for a redetermination of the deficiencies assessed by the IRS.

Issue(s)

1. Whether the profit-sharing plan discriminated in favor of highly compensated employees under IRC § 401(a)(3)(B) during the tax years 1972 and 1973?
2. Whether the IRS's retroactive revocation of the plan's qualified status constituted an abuse of discretion?

Holding

1. Yes, because the plan covered only six employees, five of whom were officers, supervisors, or highly compensated, while excluding lower-paid hourly employees.
2. No, because material changes in plan participation and a subsequent revenue ruling justified the IRS's action.

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Court’s Reasoning

The court found that the plan violated IRC § 401(a)(3)(B) by discriminating in favor of highly compensated employees, as evidenced by the fact that five out of six participants were officers, supervisors, or highly compensated, while lower-paid hourly employees were excluded. The court rejected the company’s argument that cash bonuses paid to hourly employees negated the discrimination. Regarding the retroactive revocation, the court noted that the addition of two new participants from the prohibited group and the issuance of Rev. Rul. 69-398 constituted material changes, justifying the IRS’s action. The court emphasized that taxpayers must stay informed about subsequent IRS rulings that may affect their private rulings and cannot rely on them indefinitely if circumstances change.

Practical Implications

This case underscores the importance of ensuring that profit-sharing plans do not discriminate in favor of highly compensated employees. Employers must carefully design and monitor their plans to comply with IRC § 401(a)(3)(B). The decision also highlights the limits of reliance on IRS determination letters, emphasizing that material changes in plan operation or subsequent IRS rulings can lead to retroactive revocation. Practitioners should advise clients to regularly review their plans and stay informed about changes in IRS policy. The case has been cited in subsequent rulings and cases addressing plan discrimination and the retroactive revocation of IRS rulings, reinforcing these principles in tax law.

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