Forsyth Emergency Services, P. A. v. Commissioner, 68 T. C. 881 (1977)

A pension plan's operational defects cannot be cured retroactively if they result in discriminatory coverage in favor of officers, shareholders, or highly compensated employees.

Summary

Forsyth Emergency Services, P. A. (FESPA) sought to deduct contributions to its pension plan for 1972 and 1973. The IRS disallowed these deductions, arguing that FESPA's plan failed to meet the coverage requirements under IRC § 401(a)(3) and was discriminatorily operated in favor of highly compensated employees, violating IRC § 401(a)(4). The court agreed, finding that the plan covered less than the required percentage of employees and favored officers and shareholders. Additionally, the court ruled that FESPA could not retroactively cure these operational defects, emphasizing that such relief is unavailable when a plan's operation discriminates against certain employees.

Facts

FESPA, a corporation providing emergency medical services, established a pension plan on December 24, 1970, which required employees to be 30 years old and have 9 months of service to participate. In 1972 and 1973, the plan covered only three of FESPA's officers and shareholders, excluding other eligible employees like Taylor, Wells, and Robbins due to a misinterpretation of the plan's terms. FESPA attempted to correct these exclusions retroactively after an IRS audit, but the IRS rejected this attempt and disallowed deductions for contributions made to the plan.

Procedural History

FESPA filed a petition with the U. S. Tax Court after receiving a notice of deficiency from the IRS disallowing deductions for contributions to its pension plan for 1972 and 1973. The IRS had previously issued a determination letter approving the plan's form but later revoked it due to its discriminatory operation. The Tax Court upheld the IRS's decision, ruling that the plan did not meet the statutory requirements and could not be retroactively corrected.

Issue(s)

1. Whether FESPA's pension plan met the eligibility requirements under IRC § 401(a)(3) for the years 1972 and 1973.
2. Whether the improper operation of the pension plan can be cured retroactively by funding contributions for eligible employees who were initially excluded.

Holding

1. No, because FESPA's plan did not cover 70% of all employees or 80% of eligible

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employees, and it discriminated in favor of officers and shareholders, violating IRC § 401(a)(3) and § 401(a)(4).
2. No, because operational defects that result in discriminatory coverage cannot be retroactively corrected under the law, as established in cases like Myron v. United States.

Court's Reasoning

The court applied the statutory rules under IRC § 401(a)(3) and § 401(a)(4), finding that FESPA's plan failed to meet the required coverage percentages and operated discriminatorily in favor of highly compensated employees. The court rejected FESPA's attempt at retroactive correction, citing that IRC § 401(b) allows for retroactive fixes only for defects in the plan's form, not its operation. The court also distinguished cases like Aero Rental and Ray Cleaners, which allowed retroactive corrections for non-discriminatory plans. The court emphasized that the discriminatory operation of the plan was a crucial factor in denying retroactive relief, aligning with precedents such as Myron v. United States and Quality Brands, Inc. v. Commissioner.

Practical Implications

This decision reinforces that pension plans must be operated in compliance with IRC § 401(a) to ensure non-discriminatory coverage. Employers cannot retroactively correct operational defects that favor highly compensated employees. Legal practitioners should advise clients to strictly adhere to plan terms and ensure broad employee coverage to avoid disqualification of their pension plans. Businesses must carefully administer their plans to prevent discrimination, as operational errors cannot be fixed after the fact. Subsequent cases like Ludden v. Commissioner have continued to apply this ruling, underscoring its impact on pension plan administration and tax deductions.

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