Lansons, Inc. v. Commissioner, 69 T. C. 773 (1978)

A profit-sharing plan must be nondiscriminatory in operation, not just in form, to qualify under section 401(a)(3)(B) of the Internal Revenue Code.

Summary

Lansons, Inc. established a profit-sharing plan that the IRS initially approved but later revoked due to alleged discriminatory operation favoring officers and highly compensated employees. The Tax Court held that the plan was qualified under section 401(a)(3)(B) because its eligibility requirements were reasonable and did not discriminate in favor of the prohibited group. Additionally, the court found that the IRS abused its discretion by retroactively revoking the plan's qualified status, as Lansons relied on the initial ruling in good faith.

Facts

Lansons, Inc. set up a profit-sharing plan in 1968 for its employees, which initially included a minimum wage requirement, later removed at the IRS's suggestion. The plan covered employees aged 25-65 with at least one year of service. The IRS issued a favorable determination letter in 1969 but revoked it in 1972 after an audit, claiming the plan discriminated in favor of officers and highly compensated employees due to the exclusion of younger and older employees and high turnover among lower-paid workers. Lansons amended the plan in 1972 to remove age restrictions.

Procedural History

The IRS determined deficiencies in Lansons' federal income tax for fiscal years 1969, 1970, and 1971 due to the disallowed deductions for contributions to the profit-sharing plan. Lansons petitioned the Tax Court, which heard the case and issued its opinion in 1978.

Issue(s)

1. Whether Lansons, Inc. 's profit-sharing plan was a qualified trust under section 401(a)(3)(B) of the Internal Revenue Code for the years 1969, 1970, and 1971.
2. Whether the IRS abused its discretion in retroactively revoking its ruling that the trust was qualified.

Holding

1. Yes, because the plan's eligibility requirements were reasonable and did not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees.
2. Yes, because Lansons relied in good faith on the IRS's initial ruling, and there were no material misstatements or changes in facts justifying the retroactive

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revocation.

Court’s Reasoning

The court found that the plan’s eligibility requirements (full-time employment, one year of service, and age 25-65) were reasonable and did not inherently favor the prohibited group. The court emphasized that discrimination under section 401(a)(3)(B) requires real preferential treatment, not just a higher coverage percentage among permanent employees. The court cited *Ryan School Retirement Trust v. Commissioner* to support its view that discrimination must be intentional or foreseeable, not a result of employee turnover. The court also noted that the IRS’s initial approval and Lansons’ good faith reliance on it meant that retroactive revocation was an abuse of discretion, especially since Lansons made changes to the plan at the IRS’s suggestion.

Practical Implications

This decision underscores the importance of a plan’s operational nondiscrimination for qualification under section 401(a)(3)(B). Employers must ensure that eligibility requirements are not only facially nondiscriminatory but also do not result in de facto discrimination in favor of the prohibited group. The ruling also highlights the reliance taxpayers can place on IRS determinations, as retroactive revocation should be rare and justified by significant changes or misrepresentations. Subsequent cases must consider both the form and operation of plans when assessing discrimination, and the IRS should be cautious in retroactively revoking favorable determinations.

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