Keeler v. Commissioner, 70 T. C. 24 (1978)

A taxpayer cannot elect income averaging under sections 1301-1305 and special averaging under section 72(n)(4) for lump-sum pension distributions in the same taxable year.

Summary

In 1973, Harry C. Keeler received a lump-sum distribution from a qualified pension plan upon retirement. The Keelers elected to use five-year income averaging under sections 1301-1305 for their 1973 tax return. They also attempted to apply the special seven-year averaging rule under section 72(n)(4) to the ordinary income portion of the pension distribution. The Tax Court held that electing income averaging precluded the use of the special averaging for pension distributions in the same year, based on the statutory language and legislative history, resulting in a tax deficiency of $3,250. 61.

Facts

Harry C. Keeler retired from Michigan National Bank in 1973 and received a $230,974 lump-sum distribution from the bank's qualified pension plan. Of this amount, $219,632 qualified for long-term capital gain treatment, while $11,342 was ordinary income. The Keelers elected to use five-year income averaging under sections 1301-1305 for their 1973 tax return. They also sought to apply the special seven-year averaging rule of section 72(n)(4) to the ordinary income portion of the pension distribution.

Procedural History

The Commissioner of Internal Revenue determined a tax deficiency of $3,250. 61 against the Keelers for 1973, disallowing their use of the special averaging under section 72(n)(4). The Keelers petitioned the Tax Court for relief, which heard the case and issued an opinion on April 17, 1978, affirming the Commissioner's determination.

Issue(s)

1. Whether the Keelers' election to use income averaging under sections 1301-1305 precluded their use of the special averaging provisions of section 72(n)(4) for the ordinary income portion of a lump-sum pension distribution in the same taxable year.

Holding

1. No, because the statutory language of section 1304(b)(2) and the legislative history of the Employee Retirement Income Security Act of 1974 (ERISA) indicate that electing income averaging under sections 1301-1305 precludes the use of

section 72(n)(4) in the same year.

Court’s Reasoning

The Tax Court relied on the statutory language of section 1304(b)(2), which states that if a taxpayer elects income averaging, section 72(n)(2) does not apply. The court interpreted this to mean that all subsections of section 72(n), including the special rule under section 72(n)(4), were also inapplicable. The court further supported its decision by citing the legislative history of ERISA, which confirmed that prior to its enactment, a “double election” of averaging provisions was not permitted. The court rejected the Keelers’ arguments based on subsequent changes in the law and outdated regulations, concluding that the law as it stood in 1973 did not allow for the use of both averaging methods in the same year.

Practical Implications

This decision underscores the importance of understanding the interaction between different tax election provisions. Taxpayers must be aware that electing income averaging under sections 1301-1305 can preclude the use of other beneficial tax treatments, such as the special averaging for pension distributions under section 72(n)(4), in the same tax year. This ruling was applicable to tax years before the enactment of ERISA, which changed the law to allow such dual elections. Legal practitioners should advise clients to carefully consider their tax elections to avoid similar pitfalls, especially in planning for retirement distributions. Subsequent cases have distinguished this ruling based on the changes introduced by ERISA, allowing for more flexible tax planning strategies post-1974.

