Ziegler v. Commissioner, 62 T. C. 147 (1974)

A premature distribution to an owner-employee from a qualified retirement plan triggers a 5-year prohibition on participating in any qualified retirement plan.

Summary

Donald Ziegler, a lawyer, received a premature distribution from his individual retirement plan upon joining a law partnership. The IRS disallowed his subsequent contributions to the partnership's plan, asserting a 5-year prohibition under IRC section 401(d)(5)(C). The Tax Court agreed, ruling that the prohibition extends to any qualified plan, not just the one from which the distribution was made, to prevent abuse of retirement plans for tax benefits.

Facts

Donald E. Ziegler, a Pennsylvania lawyer, established a retirement plan as a sole practitioner in 1966, contributing until 1968. In 1969, he joined a law partnership and requested a distribution of $2,886. 24 from his individual plan, intending to roll it into the partnership's new plan. He paid the penalty for this premature distribution under IRC section 72(m)(5). From December 1969 to 1973, the partnership made annual contributions to a new plan on Ziegler's behalf, which he deducted on his tax returns. The IRS disallowed these deductions, citing a 5-year prohibition after a premature distribution.

Procedural History

The Commissioner determined tax deficiencies for 1971-1973 based on Ziegler's retirement plan contributions. Ziegler petitioned the Tax Court, which heard the case based on stipulated facts and issued its opinion in 1974.

Issue(s)

1. Whether an owner-employee who receives a premature distribution from a qualified retirement plan is prohibited from participating in any qualified retirement plan for 5 years under IRC section 401(d)(5)(C).

Holding

1. Yes, because the court interpreted the prohibition to apply to any qualified retirement plan, not just the one from which the distribution was made, to fulfill the legislative intent of discouraging premature distributions.

Court's Reasoning

The court examined the language of IRC section 401(d)(5)(C) and found it ambiguous regarding whether the prohibition applied only to the original plan or to

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any qualified plan. It relied on legislative history from the House and Senate reports, which indicated that the prohibition was meant to prevent abuse of retirement plans for tax benefits. The court concluded that allowing an owner-employee to establish a new plan after a premature distribution would undermine the purpose of the statute. The court also noted that the penalty under section 72(m)(5) and the prohibition under section 401(d)(5)(C) were intended to work together to discourage premature distributions. The court rejected Ziegler's arguments based on the regulation and the possibility of contributing in the year of distribution, as those facts were not at issue.

Practical Implications

This decision clarifies that owner-employees must carefully consider the consequences of premature distributions from qualified retirement plans. It impacts how tax professionals advise clients on retirement planning, emphasizing the need to avoid premature distributions to maintain eligibility for tax-favored retirement plans. The ruling also affects business planning, as it limits flexibility for self-employed individuals or partners in changing their retirement arrangements. Subsequent cases and IRS guidance have followed this interpretation, reinforcing the need for strict adherence to the rules governing qualified plans.

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