***Tamko Asphalt Products, Inc. v. Commissioner, 71 T. C. 824 (1979)***

The controlled group rule under IRC Section 414(b) requires that employees of all corporations in a controlled group be treated as employed by a single employer when evaluating the qualification of an employee benefit plan.

## Summary

Tamko Asphalt Products, Inc. , a subsidiary of Tamko Asphalt Products, Inc. of Missouri, sought a determination that its profit-sharing plan qualified under IRC Section 401(a). The IRS denied qualification, citing discrimination in favor of highly compensated employees under Section 401(a)(4) and 411(d)(1)(B). The court upheld the IRS's decision, emphasizing that Section 414(b) mandates considering all employees within a controlled group as employed by one employer. This ruling impacts how employee benefit plans must be structured across affiliated companies to avoid discrimination and achieve tax-exempt status.

## Facts

Tamko Asphalt Products, Inc. of Kansas, a wholly owned subsidiary of Tamko Asphalt Products, Inc. of Missouri, adopted a profit-sharing plan effective May 1, 1975. The plan's vesting schedule complied with the minimum standards under Section 411(a)(2)(B) but failed to meet the nondiscrimination requirements of Section 401(a)(4) and 411(d)(1)(B). The IRS's adverse determination was based on the plan's failure to pass the turnover test and the fact that it discriminated in favor of officers, shareholders, and highly compensated employees when considering the employees of both the subsidiary and the parent corporation as a single employer under Section 414(b).

## Procedural History

Tamko filed an application for determination of its profit-sharing plan's qualified status on July 30, 1976. After receiving a proposed adverse determination on April 12, 1977, Tamko appealed through the IRS's administrative channels without success. On January 27, 1978, the IRS issued a final adverse determination letter. Tamko then filed a petition for declaratory judgment with the U. S. Tax Court on April 13, 1978. The case was submitted on the administrative record, and the court denied Tamko's motion for a trial.

## Issue(s)

1. Whether Tamko's profit-sharing plan discriminates, or there is reason to believe it will discriminate, in the accrual of benefits or forfeitures, in favor of employees who are officers, shareholders, or highly compensated in violation of IRC Section 401(a)(4) and 411(d)(1)(B).

2. Whether the Tax Court erred in refusing to grant Tamko a trial in this case.

## Holding

1. Yes, because the plan fails to meet the nondiscrimination requirements of Section 401(a)(4) and 411(d)(1)(B) when considering all employees of the controlled group as employed by a single employer under Section 414(b).

2. No, because the Tax Court correctly adhered to the rule that declaratory judgment proceedings are based on the administrative record and do not involve a trial de novo.

## Court's Reasoning

The court's reasoning focused on the application of Section 414(b), which treats employees of all corporations within a controlled group as employed by one employer for purposes of Sections 401, 410, 411, and 415. This interpretation was supported by legislative history indicating Congress's intent to prevent discrimination through separate corporate structures. The court found that Tamko's plan discriminated in favor of the prohibited group because the turnover rate for rank-and-file employees was significantly higher than for the prohibited group, and the allocation of employer contributions favored those with longer service, typically members of the prohibited group. The court also noted that forfeitures were reallocated in a manner that benefited the prohibited group. The court rejected Tamko's argument that only the subsidiary's employees should be considered, emphasizing that deductions are a matter of legislative grace and that Tamko must comply with the statutory requirements. The court upheld the IRS's authority to use revenue procedures to test plan compliance with nondiscrimination standards.

## Practical Implications

This decision clarifies that employee benefit plans must consider all employees within a controlled group as employed by a single employer when evaluating qualification under Sections 401 and 411. Companies with multiple plans across affiliated entities must ensure that their plans do not discriminate when viewed collectively. This ruling may require adjustments in plan design to meet the nondiscrimination requirements, potentially affecting how benefits are allocated and vested. It also underscores the importance of adhering to the IRS's revenue procedures in plan administration. Subsequent cases have followed this ruling, emphasizing the need for a holistic view of employee benefit plans within controlled groups.

 