Oakton Distributors, Inc. v. Commissioner, T.C. Memo. 1980-22

A profit-sharing plan that initially fails to meet qualification requirements under Section 401(a) of the Internal Revenue Code cannot be retroactively amended to achieve qualified status after the remedial amendment period has expired, particularly when the initial qualification application contained a misstatement of material fact.

Summary

Oakton Distributors adopted a profit-sharing plan that, when combined with its existing pension plan, resulted in excessive integration with Social Security, violating IRS rules. Despite receiving an initial favorable determination letter, the IRS retroactively revoked the plan's qualified status upon discovering the excessive integration during a later review. Oakton attempted to retroactively amend the profit-sharing plan to remove the discriminatory integration, but the Tax Court upheld the retroactive revocation. The court reasoned that the remedial amendment period had expired, Oakton had not requested an extension, and the initial application contained a material misstatement regarding the pension plan's contribution rate. The court concluded that the IRS did not abuse its discretion in retroactively revoking the plan's qualified status.

Facts

Oakton Distributors, Inc. had a money purchase pension plan since 1970. In 1972, Oakton adopted a profit-sharing plan, effective January 1, 1972, which was also integrated with Social Security. The contribution formula in the profit-sharing plan, when combined with the pension plan, resulted in total integration exceeding IRS limits. Oakton applied for and received a favorable determination letter for the profit-sharing plan in March 1973. In 1976, while seeking a determination letter for ERISA compliance amendments, the IRS discovered that the combined plans were excessively integrated. Oakton then attempted to retroactively amend the profit-sharing plan to eliminate the integration for prior years.

Procedural History

The IRS District Director retroactively revoked the favorable determination letter for the profit-sharing plan. Oakton challenged this revocation in Tax Court, seeking a declaratory judgment under Section 7476. The case was submitted to the Tax Court based on the stipulated administrative record.

Issue(s)

1. Whether a profit-sharing plan, for which a favorable determination letter was issued, can be retroactively amended in 1977 to remove a disqualifying provision when the plan was adopted in 1972, effective in 1972, and the favorable determination was issued in 1973.

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2. Whether the IRS abused its discretion by retroactively revoking the prior favorable determination letter for Oakton's profit-sharing plan.

Holding

1. No, because the attempted retroactive amendment occurred after the expiration of the remedial amendment period allowed under Section 401(b) and related regulations.
2. No, because Oakton omitted a material fact (the correct contribution rate of the pension plan) in its initial application for the profit-sharing plan's qualification, justifying retroactive revocation under Section 7805(b) and administrative guidelines.

Court's Reasoning

The Tax Court reasoned that Section 401(b) allows retroactive amendments within a specified remedial amendment period, which had expired long before Oakton attempted to amend the plan in 1977. The court noted that Oakton did not request an extension of this period. Referencing *Aero Rental v. Commissioner*, the court distinguished the present case by stating that unlike *Aero Rental*, Oakton's disqualifying provisions were in operation from the plan's inception and Oakton was not diligent in correcting the defect within a reasonable time. Regarding retroactive revocation, the court relied on Section 7805(b) and Rev. Proc. 72-3, which permits retroactive revocation if there was a misstatement or omission of material facts in the initial application. The court found that Oakton misstated the pension plan's contribution rate in its profit-sharing plan application, which was a material fact because it concealed the excessive integration issue. The court stated, "In the initial application for qualification of the profit-sharing plan, petitioner answered the question 'Rate of employee contribution, if fixed' with the formula '10 percent of compensation.' If that statement had been accurate, the profit-sharing plan would not have been defective. Yet the statement was not accurate." The court concluded that the IRS was justified in retroactively revoking the determination letter because of this material misstatement and was not required to conduct an independent investigation to uncover the discrepancy.

Practical Implications

Oakton Distributors underscores the importance of accuracy and completeness in applications for qualified retirement plan status. It clarifies that a favorable determination letter can be retroactively revoked if material misstatements are found in the application. The case also reinforces that retroactive amendments to correct plan defects are only permissible within the strictures of Section 401(b)'s remedial amendment period and any extensions granted at the Commissioner's discretion, which requires timely action and cannot be used to remedy long-standing oversights. For practitioners, this case highlights the need for thorough due diligence in plan design and application preparation, especially when multiple plans

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are involved and integration with Social Security is a factor. It also serves as a cautionary tale against assuming that an initial favorable determination letter provides permanent protection against later disqualification if the initial application is flawed.

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