Kress v. Commissioner, 73 T. C. 382 (1979)

A profit-sharing plan must expressly provide for full vesting of employees' benefits upon plan termination or complete discontinuance of contributions to qualify under Section 401(a).

Summary

In Kress v. Commissioner, the Tax Court ruled that a profit-sharing plan failed to qualify under Section 401(a) because it did not provide for full vesting upon termination or complete discontinuance of contributions. The case involved a Pennsylvania corporation's profit-sharing plan that only provided for vesting upon specific termination events, not meeting the statutory requirements. The court rejected the taxpayer's arguments that the plan's defects were harmless since they were never triggered, emphasizing the need for compliance with statutory language. This decision underscores the importance of clear, express provisions in employee benefit plans to ensure they meet IRS standards.

Facts

Kress, a Pennsylvania corporation, established a profit-sharing plan in 1968. The plan allowed discretionary contributions and provided for vesting only upon certain specific termination events: notice of termination by the employer, bankruptcy or dissolution of the employer, or after a specified period if the state had not adopted relevant legislation. The plan did not include a provision for full vesting upon any termination or complete discontinuance of contributions. In 1973, Kress claimed a deduction for contributions to this plan, which the IRS disallowed, asserting the plan did not qualify under Section 401(a).

Procedural History

The IRS issued a notice of deficiency for the tax year ending February 28, 1973, disallowing Kress's deduction for contributions to its profit-sharing plan. Kress petitioned the Tax Court for a redetermination. After filing the petition, Kress amended its plan in 1978, effective from 1976, and received a favorable determination letter for those later years. However, the issue before the court was the qualification of the plan for the 1973 tax year.

Issue(s)

1. Whether the profit-sharing plan qualified under Section 401(a) for the tax year ending February 28, 1973, given that it did not provide for full vesting of employees' benefits upon plan termination or complete discontinuance of contributions.

Holding

1. No, because the plan failed to comply with Section 401(a)(7), which requires

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express provision for full vesting upon termination or complete discontinuance of contributions.

Court’s Reasoning

The Tax Court focused on the statutory requirement under Section 401(a)(7), which mandates that a plan must expressly provide for full vesting upon its termination or upon complete discontinuance of contributions. The court found that Kress’s plan, which only provided for vesting upon specific termination events, did not meet this requirement. The court rejected Kress’s argument that the absence of a vesting provision was harmless because the plan had not been terminated or contributions discontinued, emphasizing that compliance with the statutory language is essential. The court also noted that subsequent amendments to the plan in 1978 did not retroactively qualify the plan for the 1973 tax year. The decision was supported by references to the legislative intent behind Section 401(a)(7) and prior case law, such as Mendenhall Corp. v. Commissioner, which similarly disallowed retroactive qualification of plans with defective provisions.

Practical Implications

This decision has significant implications for employers and plan administrators. It highlights the necessity of ensuring that employee benefit plans strictly comply with statutory requirements, particularly regarding vesting provisions upon termination or discontinuance of contributions. Legal practitioners must advise clients to review and amend existing plans to include express language mandating full vesting in these scenarios to avoid disqualification. The ruling also affects tax planning, as contributions to non-qualified plans are not deductible. Businesses must be diligent in seeking IRS determination letters promptly to avoid issues with retroactivity. Subsequent cases, like Aero Rental v. Commissioner, have reinforced the principle that timely amendments are crucial for maintaining plan qualification.

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