***Tionesta Sand & Gravel, Inc. v. Commissioner of Internal Revenue*, 73 T.C. 758 (1980)**

A profit-sharing plan must explicitly provide for the full vesting of participants' rights upon the complete discontinuance of contributions to qualify for tax benefits under section 401(a)(7) of the Internal Revenue Code, and the absence of such explicit language is a fatal flaw, regardless of whether contributions were actually discontinued.

Summary

Tionesta Sand & Gravel, Inc. challenged the Commissioner of Internal Revenue's denial of a deduction for contributions to its profit-sharing plan. The Tax Court upheld the Commissioner's determination because the plan document, adopted in 1968, failed to explicitly provide for the full vesting of employees' rights upon a complete discontinuance of contributions, as required by section 401(a)(7) of the Internal Revenue Code (IRC) as then in effect. Even though the plan had not been terminated and contributions had not been discontinued, the court found the lack of explicit vesting language in the plan document to be non-compliant with statutory requirements, thus disqualifying the plan for the tax year in question.

Facts

Petitioner, Tionesta Sand & Gravel, Inc., established a profit-sharing plan and trust agreement in 1968. The plan provided for vesting at a rate of 10% per year of participation, with full vesting upon death, disability, early retirement after age 55, or retirement at or after retirement age. The plan also specified three events that would trigger plan termination and full vesting: (A) employer notice, (B) bankruptcy, assignment for creditors, or dissolution, and (C) rule against perpetuities violation. Critically, the plan did not include a provision for full vesting upon a complete discontinuance of contributions. For its fiscal year ending February 28, 1973, Tionesta deducted a contribution to the plan. The IRS disallowed the deduction, arguing the plan did not qualify under section 401(a) of the IRC.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency disallowing Tionesta's deduction for its 1973 profit-sharing plan contribution. Tionesta petitioned the United States Tax Court. The Tax Court upheld the Commissioner's determination, finding the plan did not meet the requirements of section 401(a)(7) due to the absence of an explicit provision for full vesting upon complete discontinuance of contributions.

Issue(s)

1. Whether the petitioner's profit-sharing plan and trust qualified under section 401(a) of the Internal Revenue Code during its fiscal year ended February 28,

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1973, specifically with regard to the vesting requirements of section 401(a)(7).

Holding

1. No. The Tax Court held that the profit-sharing plan did not qualify under section 401(a)(7) because it failed to expressly provide for the full vesting of employees' rights upon a complete discontinuance of contributions.

Court's Reasoning

The court reasoned that section 404(a) of the IRC allows deductions for contributions to a profit-sharing plan only if the plan's trust is exempt under section 501(a), which in turn requires meeting the qualifications of section 401(a). Section 401(a)(7), at the time, mandated that a qualified plan must provide that upon its termination or upon complete discontinuance of contributions, the rights of all employees to accrued benefits are nonforfeitable. The court emphasized that Treasury Regulation § 1.401-6(a)(1) explicitly requires that the plan must **expressly provide** for this vesting upon termination or discontinuance.

The court found Tionesta's plan deficient because it listed specific termination events for full vesting but omitted 'complete discontinuance of contributions.' The court rejected Tionesta's argument that 'termination' implicitly included 'discontinuance,' stating that Congress used both terms distinctly, and regulations further differentiate them. The court cited *Jarecki v. G. D. Searle & Co.*, 367 U.S. 303 (1961), noting that statutes should be construed to give effect to all provisions, avoiding redundancy. The court stated, "The plan provision required by this paragraph must be express. Sec. 1.401-6(a)(1), Income Tax Regs."

The court dismissed Tionesta's argument that the defect was merely technical and harmless because no discontinuance had occurred, asserting that the legislative intent of section 401(a)(7) was to prevent potential abuses of forfeitable plans, regardless of actual events. The court also distinguished cases cited by Tionesta, such as *Time Oil Co. v. Commissioner*, 258 F.2d 237 (9th Cir. 1958) and *Community Services, Inc. v. United States*, 422 F.2d 1353 (Ct. Cl. 1970), noting they were not decided under section 401(a)(7) or involved plans with favorable determination letters, unlike Tionesta's plan.

Practical Implications

Tionesta Sand & Gravel underscores the critical importance of precise plan drafting in the context of qualified retirement plans. It establishes that for a profit-sharing or pension plan to achieve and maintain qualified status under section 401(a) and secure associated tax deductions under section 404(a), it must explicitly state in the plan document that full vesting of participants' accrued benefits will occur not only upon plan termination but also upon a complete discontinuance of contributions. This case serves as a cautionary example that even seemingly minor omissions in

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plan language can lead to disqualification, regardless of the plan's operational history or the employer's intent. Legal professionals drafting and reviewing retirement plan documents must ensure strict adherence to the express language requirements of section 401(a)(7) and related regulations to avoid adverse tax consequences for employers and plan participants. Later cases and IRS guidance continue to emphasize the need for explicit plan provisions to meet qualification requirements, building upon the principles articulated in *Tionesta Sand & Gravel*.

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