E. F. Higgins & Co. , Inc. v. Commissioner, 74 T. C. 1029 (1980)

A profit-sharing plan must be compared with other employer plans to determine if contributions or benefits discriminate in favor of the prohibited group under Section 401(a)(4).

Summary

E. F. Higgins & Co. established a profit-sharing plan for its non-union employees, while its union employees participated in separate pension plans. The court found that the profit-sharing plan's contributions and benefits were significantly more favorable to the prohibited group (officers, shareholders, supervisors, and highly compensated employees) than those provided to union employees. The court clarified that the Commissioner does not have discretionary authority under Section 401(a)(4) to determine discrimination, and the taxpayer must prove nondiscrimination by a preponderance of the evidence. This decision underscores the importance of ensuring comparable benefits across different employee groups when establishing multiple retirement plans.

Facts

E. F. Higgins & Co. , an electrical contractor, established a profit-sharing plan for its non-union employees, primarily officers, shareholders, supervisors, and highly compensated employees. Union employees, covered by separate pension plans negotiated through collective bargaining, received lower contributions as a percentage of compensation. The profit-sharing plan allowed for contributions of 5-15% of participants' compensation, while the union plans had fixed contributions of 1% and 3% to the national and local pension funds, respectively. The profit-sharing plan also offered more favorable vesting and benefit terms compared to the union plans.

Procedural History

The Commissioner determined deficiencies and additions to tax for both Higgins and its profit-sharing trust, asserting that the plan discriminated in favor of the prohibited group. The Tax Court consolidated the cases and found for the Commissioner, ruling that the profit-sharing plan failed to meet the nondiscrimination requirements of Section 401(a)(4).

Issue(s)

1. Whether the taxpayer must prove that the Commissioner's determination of discrimination under Section 401(a)(4) was arbitrary or an abuse of discretion.
2. Whether contributions to the profit-sharing plan discriminated in favor of the prohibited group when compared to contributions to union pension plans.
3. Whether benefits under the profit-sharing plan discriminated in favor of the prohibited group when compared to benefits under union pension plans.

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Holding

1. No, because the Commissioner does not have discretionary authority under Section 401(a)(4); the taxpayer must prove nondiscrimination by a preponderance of the evidence.
2. Yes, because the contributions to the profit-sharing plan were significantly higher than those to the union plans, favoring the prohibited group.
3. Yes, because the benefits under the profit-sharing plan, including vesting, early retirement, death benefits, disability benefits, and severance, were substantially more favorable than those under the union plans, discriminating in favor of the prohibited group.

Court’s Reasoning

The court applied Section 401(a)(4), which prohibits discrimination in contributions or benefits in favor of officers, shareholders, supervisors, or highly compensated employees. The court found that the profit-sharing plan’s contributions ranged from 2. 25 to 15 times higher than the union plans’ contributions. The court rejected the taxpayer’s argument that the union’s choice of lower contributions should preclude a finding of discrimination, citing cases that held such variations do not negate discrimination. The court also found the profit-sharing plan’s benefits to be significantly more favorable, including faster vesting, more flexible retirement options, and better death and disability benefits. The court clarified that under Section 401(a)(4), the Commissioner has no discretionary authority to determine discrimination, and the taxpayer must prove nondiscrimination by a preponderance of the evidence, modifying its prior holding in Loevsky v. Commissioner on this point.

Practical Implications

This decision requires employers to carefully structure multiple retirement plans to ensure comparable contributions and benefits across all employee groups. When establishing a profit-sharing plan alongside union pension plans, employers must consider the total compensation package for all employees to avoid discrimination under Section 401(a)(4). This case highlights the importance of integrating all retirement plans to meet nondiscrimination requirements. Subsequent cases and IRS guidance have addressed this issue, with the 1974 ERISA amendments providing relief by excluding union employees from certain nondiscrimination tests. Practitioners must be aware of these developments when advising clients on the design and administration of retirement plans.

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