Fujinon Optical, Inc. v. Commissioner, 76 T. C. 499 (1981)

All employees of a controlled group must be treated as employed by a single employer for purposes of determining pension plan coverage under IRC Section 410(b)(1).

Summary

Fujinon Optical, Inc. , a subsidiary in a controlled group, challenged the IRS's determination that its profit-sharing plan did not qualify under IRC Section 401(a) due to non-compliance with coverage requirements. The Tax Court upheld the IRS's decision, ruling that all employees of the controlled group must be considered together for coverage tests under Section 414(b), regardless of whether the companies were functionally related. The court found that Fujinon's plan discriminated in favor of highly compensated employees when assessed against the entire controlled group's workforce, thus failing the non-discriminatory classification test of Section 410(b)(1)(B).

Facts

Fujinon Optical, Inc. , a U. S. subsidiary of Fuji Photo Optical Co. , Ltd. , operated independently from its parent's other U. S. subsidiaries, Fuji Photo Film U. S. A. , Inc. and Fuji Photo Film Hawaii, Inc. , forming a controlled group under IRC Section 1563(a). Fujinon's profit-sharing plan covered 8 out of its 15 employees in 1976, excluding those under 25 years old or with less than one year of service. The IRS determined that the plan did not meet the coverage requirements of IRC Section 410(b)(1) because it failed to cover 70% of all eligible employees when considering the entire controlled group and discriminated in favor of highly compensated employees.

Procedural History

Fujinon received an initial favorable determination for its profit-sharing plan in 1975. After amending the plan in 1976 to comply with ERISA, Fujinon sought another determination in 1977, which was denied by the IRS in 1979. Fujinon then petitioned the U. S. Tax Court for a declaratory judgment under IRC Section 7476 that its plan qualified under Section 401(a). The Tax Court ruled in favor of the IRS, affirming the plan's disqualification.

Issue(s)

1. Whether all employees of the controlled group must be considered together for purposes of determining if Fujinon's plan satisfies the coverage requirements of IRC Section 410(b)(1).
2. Whether Fujinon's plan, when considered alone, satisfies the coverage requirements of IRC Section 410(b)(1)(B).

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Holding

1. Yes, because IRC Section 414(b) mandates that all employees of a controlled group be treated as employed by a single employer for purposes of applying Section 410(b)(1), without a requirement of manipulative purpose.
2. No, because the plan, when assessed against the entire controlled group's workforce, discriminated in favor of highly compensated employees, and the Commissioner's determination was not an abuse of discretion or arbitrary.

Court's Reasoning

The court applied IRC Section 414(b), which requires aggregation of all controlled group employees for coverage tests under Section 410(b)(1). The court rejected Fujinon's argument that aggregation should only apply when companies within the group were established to discriminate, as no such limitation exists in the statute or legislative history. The court emphasized that the legislative intent was to prevent circumvention of anti-discrimination rules through corporate structuring, even if Fujinon's business was independent of the other subsidiaries. For the second issue, the court applied the "fair cross-section" test and found that Fujinon's plan covered only one moderately compensated employee, failing to represent the broader employee base of the controlled group. The court upheld the IRS's determination that the plan discriminated in favor of highly compensated employees, as it was not an abuse of discretion or arbitrary.

Practical Implications

This decision requires employers to consider all employees within a controlled group when designing and evaluating pension and profit-sharing plans for compliance with IRC Section 410(b)(1). It underscores the importance of ensuring that such plans do not disproportionately benefit highly compensated employees when viewed across the entire group. Practitioners must advise clients to carefully structure plans to meet the non-discriminatory classification test, potentially by covering part-time and temporary employees if necessary. The ruling also impacts businesses operating in controlled groups, as it may necessitate adjustments to existing plans or the establishment of group-wide plans to meet coverage requirements. Subsequent cases like *Tamko Asphalt Products, Inc. v. Commissioner* have followed this precedent, affirming the aggregation rule's broad application.

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