Sullivan v. Commissioner, 76 T. C. 1156; 1981 U. S. Tax Ct. LEXIS 105 (U. S. Tax Court, June 30, 1981)

One-half of lump-sum distributions from qualified pension and profit-sharing plans, treated as long-term capital gains, are subject to the minimum tax as tax preference items.

Summary

In Sullivan v. Commissioner, the U. S. Tax Court ruled that lump-sum distributions from pension and profit-sharing plans, when treated as long-term capital gains under Section 402(a)(2), trigger the minimum tax under Section 56(a). The Sullivans received distributions totaling $82,737 and argued against their classification as tax preference items subject to the minimum tax. The court rejected their arguments, emphasizing that the statute clearly includes one-half of net capital gains as tax preference items, and upheld the retroactive application of the Tax Reform Act of 1976.

Facts

Robert J. Sullivan retired from the First National Bank of Denver in March 1976 and received a lump-sum pension distribution of $58,729 in April. He also received a $24,008 lump-sum distribution from a profit-sharing plan in October. The Sullivans reported these distributions as long-term capital gains under Section 402(a)(2). The IRS asserted that one-half of these gains, $41,368, were subject to the minimum tax as tax preference items under Section 57(a)(9).

Procedural History

The Sullivans filed a petition in the U. S. Tax Court challenging the IRS's determination of a $4,705 deficiency in their 1976 income tax, stemming from the application of the minimum tax to their lump-sum distributions. The Tax Court heard the case and ruled in favor of the Commissioner.

Issue(s)

1. Whether one-half of the lump-sum distributions from qualified pension and profit-sharing plans, treated as long-term capital gains under Section 402(a)(2), constitute tax preference items subject to the minimum tax under Section 56(a)?
2. Whether the retroactive application of the Tax Reform Act of 1976 to the Sullivans' 1976 tax year is constitutional?

Holding

1. Yes, because the statute clearly includes one-half of net capital gains as tax preference items under Section 57(a)(9)(A), and lump-sum distributions treated as long-term capital gains fall within this category.

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2. Yes, because the U. S. Supreme Court upheld the constitutionality of the retroactive application of the Tax Reform Act of 1976 in United States v. Darusmont.

Court’s Reasoning

The Tax Court applied the plain language of Section 57(a)(9)(A), which defines one-half of an individual’s net capital gain as a tax preference item. The court rejected the Sullivans’ argument that the legislative history did not explicitly mention lump-sum distributions, emphasizing that the statute’s clear language was determinative. The court also dismissed the notion that the “deemed” capital gain from lump-sum distributions should be treated differently from other capital gains, citing Parker v. Commissioner, where similar arguments were rejected. The court further upheld the retroactive application of the Tax Reform Act of 1976, relying on the Supreme Court’s decision in United States v. Darusmont. The court’s decision was influenced by the policy goal of the minimum tax to ensure that income receiving preferential treatment under the tax code still incurs some tax liability.

Practical Implications

This decision clarifies that lump-sum distributions from pension and profit-sharing plans, when treated as long-term capital gains, are subject to the minimum tax. Attorneys should advise clients receiving such distributions to plan for the additional tax liability. The ruling also affirms the IRS’s ability to apply tax law changes retroactively, impacting how tax professionals counsel clients on the timing of distributions. The decision has influenced subsequent cases, such as Short v. Commissioner, where similar principles were applied. Businesses offering pension and profit-sharing plans may need to adjust their planning to account for the tax implications of lump-sum distributions for employees.

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