78 T.C. 86 (1982)

An individual who is an active participant in a qualified retirement plan for any part of a taxable year is not entitled to deduct contributions made to an Individual Retirement Account (IRA) for that same taxable year.

Summary

In 1976, Virginia Horvath contributed $1,500 to an IRA and deducted it on her tax return. The IRS disallowed the deduction because Mrs. Horvath was an active participant in her employer's qualified pension plan for part of the year. The Tax Court upheld the IRS's decision, finding that under Section 219 of the Internal Revenue Code, active participation in a qualified plan during any part of the taxable year disqualifies an individual from making deductible IRA contributions for that year. The court also held that interest earned on the IRA was not taxable in 1976 and that the taxpayers failed to prove an overreported income item. Finally, the court sustained a penalty for the late filing of the tax return.

Facts

Petitioners, Albert and Virginia Horvath, filed a joint tax return for 1976. Virginia Horvath worked for U.S. Steel Corp. from June 1975 to October 1976 and participated in their pension fund, a qualified plan under Section 401(a). Upon leaving U.S. Steel, she received a refund of her pension contributions. Subsequently, in October 1976, she began working for EG&G, Inc. and became a participant in their qualified retirement plan. In November 1976, Mrs. Horvath established an IRA and contributed $1,500, which they deducted on their 1976 tax return. The IRS disallowed the IRA deduction and determined interest earned on the IRA was taxable income. The IRS also assessed a penalty for late filing.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Horvaths' 1976 federal income tax and an addition to tax for failure to timely file. The Horvaths petitioned the Tax Court, contesting the disallowance of the IRA deduction, the inclusion of IRA interest as income, and the late filing penalty.

Issue(s)

1. Whether the petitioners are entitled to deduct a $1,500 contribution to an IRA under Section 219, given that Mrs. Horvath was an active participant in a qualified pension plan during 1976.
2. Whether interest income credited to the IRA should be included in the petitioners' gross income for 1976.
3. Whether the petitioners have proven that $133.21 reported as taxable income from Bethlehem Steel was erroneously reported.
4. Whether the petitioners are liable for an addition to tax under Section 6651(a)

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for failure to timely file their 1976 income tax return.

Holding

1. No, because Section 219(b)(2)(A)(i) disallows IRA deductions for individuals who are active participants in a qualified retirement plan for any part of the taxable year.
2. No, because interest income earned within a valid IRA is not taxable until distributed, even if the contributions are not deductible.
3. No, because the petitioners failed to provide evidence substantiating that the $133.21 was a non-taxable refund of pension contributions.
4. Yes, because the petitioners failed to prove that their return was timely filed, and the postmark date indicated late filing.

Court's Reasoning

The court reasoned that Section 219(a) generally allows deductions for IRA contributions, but Section 219(b)(2)(A)(i) specifically disallows this deduction for individuals who are "active participants" in a qualified plan under Section 401(a) for any part of the taxable year. The court cited *Orzechowski v. Commissioner*, stating that an individual is considered an active participant if they are accruing benefits under a qualified plan, even if those benefits are forfeitable. Since Mrs. Horvath was a participant in U.S. Steel's qualified pension plan for a portion of 1976, she was deemed an active participant, regardless of whether she ultimately received benefits. The court distinguished *Foulkes v. Commissioner*, where a deduction was allowed because the taxpayer had forfeited all rights to benefits by year-end, a situation not applicable to Mrs. Horvath due to potential reinstatement of benefits. Regarding the IRA interest, the court clarified that while the IRA contribution was not deductible, the IRA itself remained valid and tax-exempt under Section 408(e)(1). Therefore, the interest earned within the IRA is not taxable until distribution, according to Section 408(d). On the Bethlehem Steel income and late filing penalty, the court held that the petitioners failed to meet their burden of proof, as they presented no evidence to support their claims.

Practical Implications

Horvath v. Commissioner clarifies the strict application of the "active participant" rule under Section 219 as it existed in 1976. It underscores that even participation for a single day in a qualified retirement plan during a taxable year can disqualify an individual from making deductible IRA contributions for that entire year. This case highlights the importance of determining active participant status based on plan participation at any point during the year, not just at year-end or based on benefit vesting. For legal practitioners, this case serves as a reminder of the then-stringent rules regarding IRA deductions for those also covered by employer-sponsored retirement plans and emphasizes the taxpayer's burden of proof in tax disputes. While the law has since changed to allow IRA deductions for active participants

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under certain circumstances, *Horvath* remains relevant for understanding the historical context and the original intent behind the active participant rule.

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