Winger's Department Store, Inc. v. Commissioner, 82 T. C. 869 (1984)

A pension trust must operate for the exclusive benefit of employees to maintain its qualified status under section 401(a) of the Internal Revenue Code.

Summary

In Winger's Department Store, Inc. v. Commissioner, the U. S. Tax Court ruled that the company's pension trust did not qualify under IRC section 401(a) because it was not operated for the exclusive benefit of employees. The trust's assets were primarily loaned to the company's sole shareholder and president, Richard Winger, who then loaned the funds back to the company for working capital. These loans were unsecured, interest payments were delinquent, and most of the principal remained unpaid, leading the court to conclude that the trust was operated to serve the company's and Winger's interests, not those of the employees. The court also noted that the enactment of ERISA did not preclude the IRS from disqualifying a trust for failing to meet the exclusive benefit rule.

Facts

Winger's Department Store, Inc. , adopted a pension plan in 1976, with Richard Winger and his wife as trustees. Winger was the company's president and sole shareholder. Between 1976 and 1979, the company made contributions to the pension plan, which were immediately loaned to Winger, who then loaned the funds back to the company. These loans were unsecured, interest payments were delinquent, and most of the principal remained outstanding by the time of trial. The trust's remaining assets were invested in insurance policies borrowed against to the maximum extent and cash held in a non-interest-bearing account to provide ready capital for the company.

Procedural History

The IRS issued a notice of deficiency to Winger's Department Store for the years 1976-1979, asserting that the pension plan contributions were not deductible because the trust was not qualified under IRC section 401(a). The company petitioned the U. S. Tax Court, which found that the trust did not operate for the exclusive benefit of employees and upheld the IRS's determination.

Issue(s)

1. Whether the pension trust operated for the exclusive benefit of employees as required by IRC section 401(a) during the taxable years 1977, 1978, and 1979.

Holding

1. No, because the trust's operation, characterized by unsecured loans to Winger and the use of trust assets for the company's working capital, did not serve the

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exclusive benefit of employees.

Court’s Reasoning

The court reasoned that the trust’s operation violated the exclusive benefit rule of IRC section 401(a) because the loans to Winger were unsecured, interest payments were delinquent, and the trust’s assets were used to meet the company’s working capital needs rather than for the benefit of employees. The court emphasized that even though ERISA introduced new fiduciary standards and sanctions, it did not preclude the IRS from enforcing the exclusive benefit rule. The court distinguished this case from prior cases where trusts were found to operate for employees’ benefit, noting the lack of security and the delinquent interest payments in this case. The court also rejected the argument that ERISA’s excise tax sanctions preempted the disqualification sanction, stating that the totality of the trust’s transgressions justified disqualification.

Practical Implications

This decision underscores the importance of operating pension trusts strictly for the benefit of employees to maintain their qualified status. It serves as a warning to employers and trustees that using trust assets for other purposes, such as company working capital, can lead to disqualification. The case also clarifies that ERISA does not preclude the IRS from enforcing the exclusive benefit rule, though the IRS should exercise restraint in seeking disqualification given the alternative remedies available. For legal practitioners, this case emphasizes the need to carefully monitor the operation of pension trusts to ensure compliance with the exclusive benefit rule. Subsequent cases have cited Winger’s Department Store to support the principle that a trust’s operation, not just its terms, is crucial for maintaining its qualified status.

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