Benbow v. Commissioner, 82 T. C. 941 (1984)

Distributions from a pension plan that loses its tax-qualified status can be partially rolled over tax-free if attributable to the period when the plan was qualified.

Summary

In Benbow v. Commissioner, the U. S. Tax Court addressed the tax treatment of distributions from a pension plan that had lost its tax-qualified status retroactively. The petitioners received distributions in 1978 and rolled them into Individual Retirement Accounts (IRAs). The court held that the portion of the distributions attributable to the period before the plan's disqualification could be rolled over tax-free, while the post-disqualification portion was taxable. The court also clarified that the tax-free rolled over amounts were not considered excess contributions, but the post-disqualification portion was subject to an excise tax for being an excess contribution to the IRA.

Facts

Electric Cord Sets, Inc. established a pension plan in 1958, which was tax-qualified under IRC § 401(a) and exempt under IRC § 501(a). In 1978, the company terminated the plan, and the petitioners, who were participants, received distributions and rolled them over into IRAs. In 1980, the IRS revoked the plan's tax-qualified status retroactively to January 1, 1976, due to discrimination among salaried employees. The petitioners argued that the pre-1976 portion of their distributions should be treated as coming from a qualified plan and thus be eligible for tax-free rollover.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' federal income and excise taxes for 1978-1980. The petitioners filed a petition with the U. S. Tax Court to challenge these deficiencies. The case was submitted fully stipulated, and the Tax Court rendered its decision on June 7, 1984.

Issue(s)

1. Whether any portion of the terminating distributions from a pension plan received by petitioner-husbands in 1978 may be rolled over tax-free to IRAs under IRC § 402(a)(5), given that the plan lost its tax-qualified status for periods after December 31, 1975.
2. Whether petitioner-husbands are liable for excise taxes under IRC § 4973 on excess contributions to IRAs, and if so, in what amounts.

Holding

1. Yes, because the portion of the distributions attributable to contributions made

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before January 1, 1976, were treated as coming from a qualified plan and thus eligible for tax-free rollover under IRC § 402(a)(5). The post-1975 portion was taxable under IRC § 402(b).
2. Yes, because the post-1975 portion of the distributions, which was rolled over, constituted excess contributions to the IRAs and was subject to excise tax under IRC § 4973.

Court's Reasoning

The court reasoned that distributions from a formerly exempt trust should be treated differently based on the timing of the contributions. For contributions made during the period when the plan was qualified, the court applied IRC § 402(a)(5), allowing for tax-free rollovers. For contributions made after the plan's disqualification, the court applied IRC § 402(b), treating these as taxable distributions. The court relied on previous cases like Baetens v. Commissioner, which established this bifurcated approach. The court also noted that the intent of the petitioners in making the excess contributions was irrelevant for the imposition of the excise tax under IRC § 4973. The court emphasized that the law does not provide for relief from the excise tax based on the taxpayer's intent or the inadvertent nature of the excess contributions.

Practical Implications

This decision clarifies how to handle distributions from pension plans that lose their tax-qualified status retroactively. For similar cases, attorneys should analyze the timing of contributions to determine the tax treatment of distributions. The ruling affects how legal practitioners advise clients on the tax implications of rolling over distributions from disqualified plans into IRAs. Businesses must ensure their pension plans comply with IRS regulations to avoid retroactive disqualification and the associated tax consequences. Subsequent cases, such as Woodson v. Commissioner, have applied this bifurcated approach to other types of plans, reinforcing the principle established in Benbow.

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