

## ***Tipton & Kalmbach, Inc. v. Commissioner, 83 T. C. 154 (1984)***

Significant reductions in the number of plan participants may constitute partial terminations of a profit-sharing plan, requiring nonforfeitable rights to benefits for discharged employees.

### **Summary**

In *Tipton & Kalmbach, Inc. v. Commissioner*, the Tax Court addressed whether significant workforce reductions in 1971 and 1972 constituted partial terminations of the company's profit-sharing plan. The court held that the 34% and 51% reductions in plan participants were partial terminations, thus requiring nonforfeitable rights to benefits for the discharged employees. Since the plan did not grant these rights, it was deemed unqualified under IRC § 401(a). The decision emphasizes that the effect of significant participant reductions, rather than employer intent, is key in determining partial terminations.

### **Facts**

*Tipton & Kalmbach, Inc.*, a consulting engineering firm, experienced workforce reductions in 1971 and 1972 due to decreased business volume. These reductions resulted in a 34% drop in plan participants in 1971 (from 64 to 43) and a 51% drop in 1972 (from 43 to 21). The company's profit-sharing plan did not grant nonforfeitable rights to benefits for the discharged employees, leading to forfeitures of their accrued benefits.

### **Procedural History**

*Tipton & Kalmbach* sought a declaratory judgment from the Tax Court to determine if its profit-sharing plan was qualified under IRC § 401(a). The IRS had issued a proposed adverse determination letter, which the company contested. The court denied the IRS's motion to dismiss for lack of jurisdiction and proceeded to address the sole issue of whether partial terminations had occurred in 1971 and 1972.

### **Issue(s)**

1. Whether the 34% reduction in plan participants in 1971 constituted a partial termination of the profit-sharing plan.
2. Whether the 51% reduction in plan participants in 1972 constituted a partial termination of the profit-sharing plan.

### **Holding**

1. Yes, because the 34% reduction in plan participants was significant enough to be considered a partial termination under the facts and circumstances test.
2. Yes, because the 51% reduction in plan participants was significant enough to be considered a partial termination under the facts and circumstances test.

## **Court's Reasoning**

The court applied the facts and circumstances test outlined in the IRS regulations and prior revenue rulings, focusing on the percentage of participants discharged rather than the employer's intent. The court noted that Congress intended to protect employees from forfeiting retirement benefits upon plan termination, as evidenced by the legislative history of IRC § 401(a)(7). The court rejected the company's argument that economic conditions justified the reductions, stating that the effect on employees was the same regardless of intent. The court also addressed the company's concerns about the impact on long-term employees, emphasizing that the reductions were permanent, not temporary. The court concluded that the significant percentage reductions in plan participants in 1971 and 1972 constituted partial terminations, thus requiring nonforfeitable rights to benefits under IRC § 401(a)(7).

## **Practical Implications**

This decision has significant implications for employers with profit-sharing plans. It establishes that significant reductions in plan participants, even if due to economic necessity, can trigger partial termination rules. Employers must be aware that they may need to grant nonforfeitable rights to benefits for discharged employees in such situations to maintain plan qualification. The ruling also highlights the importance of considering the effect on employees rather than the employer's intent when determining partial terminations. This case has been cited in subsequent litigation involving partial terminations and has influenced IRS guidance on the topic. Practitioners advising employers on plan design and administration should carefully monitor workforce changes and ensure compliance with partial termination rules to avoid disqualification of the plan.