Hockaden & Associates, Inc. v. Commissioner, 84 T. C. 13 (1985)

ERISA's excise taxes on prohibited transactions apply to pre-1975 loans if they remain outstanding after ERISA's effective date, unless specific conditions are met.

Summary

Hockaden & Associates borrowed from its employee profit-sharing plan before ERISA's effective date of January 1, 1975. The IRS assessed excise taxes under IRC section 4975 on the outstanding loans, arguing they were prohibited transactions. The court held that the excise taxes applied because the loans, though pre-1975, remained outstanding post-ERISA and did not qualify for transitional relief. The decision hinged on the interpretation of ERISA's transitional rules and the principle that maintaining pre-existing loans post-ERISA constitutes a taxable event, not a retroactive application of the law.

Facts

Hockaden & Associates established a profit-sharing plan in 1964, which was deemed tax-exempt under IRC sections 401 and 501. From 1971 to 1975, Hockaden borrowed money from the plan, with the loans remaining outstanding after ERISA's effective date. The loans were unsecured and carried a 6% annual interest rate, though no interest was paid. The IRS assessed excise taxes under IRC section 4975, asserting these were prohibited transactions.

Procedural History

The IRS determined excise taxes for the tax years ending August 31, 1979, 1980, and 1981. Hockaden petitioned the U. S. Tax Court, challenging the applicability of section 4975 to loans made before January 1, 1975, and arguing that its application constituted an ex post facto law.

Issue(s)

1. Whether the excise taxes on prohibited transactions under IRC section 4975 apply to the balances outstanding on pre-1975 loans from Hockaden's profit-sharing plan?
2. If so, whether applying section 4975 to such loans constitutes an ex post facto law?

Holding

1. Yes, because the loans, though made before ERISA's effective date, remained outstanding thereafter and did not meet the criteria for transitional relief under ERISA section 2003(c)(2)(A).
2. No, because the application of section 4975 to the maintenance of the loans post-ERISA is not a retroactive application of the law and thus does not violate the ex post facto clause.

Court’s Reasoning

The court interpreted ERISA’s transitional rules, specifically section 2003(c)(2)(A), which exempts pre-1975 loans from section 4975 if they were under a binding contract in effect on July 1, 1974, and were not prohibited transactions under pre-ERISA law. Hockaden’s loans did not qualify for this exemption as they were unsecured and thus prohibited under pre-ERISA section 503(b). The court emphasized that the taxable event was not the making of the loans but their maintenance after ERISA’s effective date. The court rejected Hockaden’s argument that section 4975 was intended to apply only prospectively, citing case law that distinguishes between the making and maintenance of loans. The court also held that applying section 4975 to post-ERISA conduct did not violate the ex post facto clause, as it did not penalize past conduct but the continuation of it.

Practical Implications

This decision clarifies that ERISA’s excise taxes on prohibited transactions can apply to pre-existing loans if they remain outstanding after the law’s effective date and do not meet specific transitional criteria. Practitioners should advise clients to review existing loans from employee benefit plans to ensure compliance with ERISA or to correct any prohibited transactions to avoid excise taxes. The ruling underscores the importance of understanding ERISA’s transitional rules when dealing with pre-existing arrangements. Subsequent cases have applied this principle, confirming that maintaining prohibited transactions post-ERISA triggers tax liability.

