Leib v. Commissioner, 88 T. C. 1474 (1987)

The sale of property by a disqualified person to a pension plan is a prohibited transaction under IRC Section 4975, regardless of whether it would be considered a prudent investment.

Summary

Alden M. Leib, a dentist, sold Cunningham Drug Stores stock to his professional corporation's pension trust, of which he was the trustee, at a price slightly below market value. The sale was deemed a prohibited transaction under IRC Section 4975, as Leib was a disqualified person. Despite his attempts to correct the transaction by repaying the trust the difference between the sale price and the market price, the court held that the transaction remained prohibited and Leib was liable for excise taxes for both 1980 and 1981. The court emphasized that the prudence of the transaction or any benefit to the plan was irrelevant to its prohibited nature, and that the transaction was not corrected until after 1980.

Facts

Alden M. Leib, a dentist, owned a professional corporation that established a pension trust for its employees. Leib, as the trustee, sold 8,900 shares of Cunningham Drug Stores stock to the trust on December 12, 1980, for $17. 50 per share, receiving $25,750 in cash and a non-interest-bearing demand note for $130,000. On February 20, 1981, the trust sold the stock to a third party for $18 per share. In December 1981, Leib determined that the sale price to the trust was $0. 50 per share above the market price and repaid the trust $4,450.

Procedural History

The Commissioner of Internal Revenue determined that Leib was liable for excise taxes under IRC Section 4975 for the years 1980 and 1981 due to the prohibited transaction. Leib petitioned the U. S. Tax Court, which upheld the Commissioner's determination, ruling that the transaction was prohibited and not corrected until after 1980, thus imposing the tax for both years.

Issue(s)

1. Whether the excise tax under IRC Section 4975(a) should be imposed when a transaction would qualify as a prudent investment under the highest fiduciary standards.
2. Whether Leib is liable for the excise tax under IRC Section 4975(a) for both 1980 and 1981.
3. Whether the Commissioner correctly determined the amount involved for computing the excise tax under IRC Section 4975(a).

Holding

1. No, because the excise tax under IRC Section 4975(a) is imposed regardless of the prudence of the transaction or any benefit to the plan.
2. Yes, because the transaction was not corrected until after 1980, thus extending liability to 1981.
3. Yes, because the amount involved is determined as of the date of the prohibited transaction and subsequent repayments do not reduce this amount.

Court's Reasoning

The court reasoned that IRC Section 4975(c)(1) categorically prohibits certain transactions, including sales between a plan and a disqualified person, without regard to the transaction's prudence or benefit to the plan. The court cited the legislative history of ERISA and IRC Section 4975, which aimed to prevent potential abuse by imposing bright-line rules. The court rejected Leib's argument that the transaction should be excused due to its prudence, stating that such considerations are irrelevant to the determination of a prohibited transaction. Regarding the timing of the correction, the court held that since no corrective action was taken until after 1980, the tax liability extended into 1981. Finally, the court upheld the Commissioner's calculation of the amount involved, rejecting Leib's contention that the non-interest-bearing demand note should be discounted or that subsequent repayments should reduce the amount involved.

Practical Implications

This decision reinforces the strict application of IRC Section 4975, emphasizing that the prudence of a transaction or any benefit to the plan does not excuse it from being considered prohibited. Practitioners should advise clients to avoid transactions between a plan and disqualified persons unless they fall within a statutory or administrative exemption. The decision also clarifies that the correction of a prohibited transaction must occur promptly to avoid ongoing tax liability. For similar cases, attorneys should ensure that any corrective action is taken as soon as possible after the transaction. The ruling may impact how pension plans manage their investments, particularly when involving transactions with disqualified persons. Subsequent cases, such as *Calfee, Halter & Griswold v. Commissioner*, have cited *Leib* in interpreting the scope of prohibited transactions under IRC Section 4975.

