Larotonda v. Commissioner, 89 T. C. 287 (1987)

An involuntary withdrawal from a Keogh account due to a tax levy constitutes a taxable distribution, but does not trigger the premature distribution penalty.

Summary

In Larotonda v. Commissioner, the Tax Court held that funds withdrawn from a Keogh retirement account pursuant to an IRS levy are taxable as income to the account owner. Jerry Larotonda's Keogh account was levied to satisfy a tax debt, and the court ruled that this constituted a constructive receipt of the funds. However, the court declined to impose the 10% premature distribution penalty, reasoning that it was designed to deter voluntary withdrawals, not involuntary ones like the levy in this case. The court also found no negligence in the taxpayer's failure to report the distribution, thus no additions to tax were imposed.

Facts

Jerry Larotonda, a self-employed attorney, established a Keogh retirement account in 1976 and made contributions over several years. In 1981, the IRS levied on this account to collect an unpaid 1979 tax liability of $22,340. 94. The bank complied with the levy, withdrawing the full amount from Larotonda's account and sending it to the IRS. At the time, Larotonda was under 59 1/2 years old and not disabled. The IRS then determined a deficiency in Larotonda's 1981 income tax, asserting that the levied funds constituted a taxable distribution subject to a 10% premature distribution penalty and negligence penalties.

Procedural History

The IRS issued a notice of deficiency to Larotonda for the 1981 tax year. Larotonda contested the deficiency in the U. S. Tax Court, arguing against the inclusion of the levied funds as income, the imposition of the premature distribution penalty, and the negligence penalties. The Tax Court heard the case and issued its opinion on August 13, 1987.

Issue(s)

1. Whether a payment made from a Keogh account in compliance with an IRS levy constitutes a taxable distribution.
2. Whether the taxpayers are liable for the 10% premature distribution penalty under section 72(m)(5).
3. Whether the taxpayers are liable for additions to tax under sections 6653(a)(1) and 6653(a)(2).

Holding

1. Yes, because the levy constituted an involuntary assignment of the funds, making

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them constructively received by the taxpayer under sections 402(a) and 72(m)(4)(A).
2. No, because the premature distribution penalty was intended to prevent voluntary withdrawals, not involuntary ones like this levy.
3. No, because the taxpayers' failure to include the distribution in income was not due to negligence.

Court's Reasoning

The court applied the constructive receipt doctrine, finding that the levy constituted an assignment of the Keogh funds, thus triggering taxable income under sections 402(a) and 72(m)(4)(A). However, the court reasoned that the 10% premature distribution penalty under section 72(m)(5) was not applicable, as it was designed to deter voluntary withdrawals for tax planning purposes, not involuntary ones like the levy here. The court emphasized that "taxing acts are not to be extended by implication beyond the clear impact of the language used," resolving doubts in favor of the taxpayer. Regarding the negligence penalties, the court found that the taxpayers' failure to report the distribution was a reasonable, albeit erroneous, assumption given the involuntary nature of the withdrawal.

Practical Implications

This decision clarifies that involuntary withdrawals from retirement accounts due to IRS levies are taxable, but do not trigger premature distribution penalties. Practitioners should advise clients that such levies may result in immediate tax liability. However, the decision also provides relief by limiting the applicability of penalties to voluntary withdrawals. This ruling may influence how the IRS approaches levies on retirement accounts, potentially leading to more nuanced enforcement strategies. Subsequent cases, like Amos v. Commissioner, have similarly distinguished between voluntary and involuntary distributions in the context of retirement accounts.

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