Brown v. Commissioner, 93 T. C. 736 (1989)

The capital gains deduction from a lump-sum distribution from a qualified retirement plan is a tax preference item for purposes of the alternative minimum tax.

Summary

In Brown v. Commissioner, the U. S. Tax Court ruled that a capital gains deduction claimed on a lump-sum distribution from a qualified retirement plan must be treated as a tax preference item in computing the alternative minimum tax (AMT). William Brown received a $344,505. 97 lump-sum distribution upon retirement, with half treated as capital gain. The court rejected Brown's argument that the capital gain deduction should not be a tax preference item, affirming prior rulings like Sullivan v. Commissioner. The court also clarified that the 'regular tax' for AMT computation excludes the 'separate tax' on the ordinary income portion of the distribution, leading to an AMT deficiency of $11,117.

Facts

William Brown, a 62-year-old retiree, received a $344,505. 97 lump-sum distribution from the Brown & Root, Inc. Employees' Retirement and Savings Plan in January 1984. This distribution was his entire interest in the plan, with $30,199. 69 being a nontaxable return of his contributions and $314,306. 28 as the taxable portion. Under Internal Revenue Code section 402(a)(2), half of the taxable portion, $157,153. 14, was treated as capital gain due to his participation in the plan before and after 1974. Brown reported this on Schedule D of his tax return, claiming a 60% capital gain deduction of $90,169. 80. The Commissioner determined an AMT deficiency of $11,117 based on this deduction being a tax preference item.

Procedural History

The case was submitted to the U. S. Tax Court on a stipulation of facts. The Commissioner determined a deficiency of $11,117 due to the alternative minimum tax. The taxpayers contested this deficiency, arguing that the capital gains deduction should not be treated as a tax preference item. The Tax Court upheld the Commissioner's determination, affirming prior case law and clarifying the computation of the alternative minimum tax.

Issue(s)

1. Whether the capital gains deduction from a lump-sum distribution from a qualified retirement plan is a tax preference item for purposes of computing the alternative minimum tax.
2. Whether the 'regular tax' for purposes of computing the alternative minimum tax includes the 'separate tax' imposed on the ordinary income portion of the lump-sum distribution.

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Holding

1. Yes, because the capital gains deduction is explicitly listed as a tax preference item under section 57(a)(9)(A) of the Internal Revenue Code, and the court followed precedent set in Sullivan v. Commissioner.
2. No, because the 'regular tax' as defined in section 55(f)(2) excludes the 'separate tax' imposed by section 402(e) on the ordinary income portion of the lump-sum distribution.

Court's Reasoning

The court applied the plain language of the Internal Revenue Code, particularly sections 55, 57, and 402, to determine that the capital gains deduction was indeed a tax preference item. The court rejected the taxpayers' argument that the capital gain should be treated differently because it arose from a lump-sum distribution, emphasizing the clear statutory language and following the precedent set in Sullivan v. Commissioner. Regarding the computation of the AMT, the court clarified that 'regular tax' under section 55(a)(2) excludes the 'separate tax' on the ordinary income portion of the distribution as defined in section 55(f)(2). This interpretation was supported by the stipulation of the parties regarding the breakdown of the total tax paid, which aligned with the statutory definition. The court's decision was guided by the need to adhere to statutory definitions and maintain consistency with prior rulings.

Practical Implications

This decision clarifies that capital gains deductions from lump-sum distributions are subject to the alternative minimum tax, impacting how such distributions are treated for tax purposes. Taxpayers and practitioners must include these deductions as tax preference items when calculating AMT, potentially increasing their tax liability. The ruling also provides guidance on the calculation of 'regular tax' for AMT purposes, excluding the 'separate tax' on ordinary income from lump-sum distributions. This case has been influential in subsequent tax cases involving AMT computations and has shaped the practice of tax planning for retirement distributions. It underscores the importance of understanding the interplay between different tax provisions and the need for careful tax planning to minimize AMT exposure.

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