Clark v. Commissioner, 101 T. C. 215 (1993)

Distributions from terminated pension plans do not qualify as lump sum distributions for tax averaging unless they meet specific statutory criteria.

Summary

Katherine Clark received a full distribution of her accrued benefits from her employer's terminated pension plan at age 54. She argued the distribution should be treated as a lump sum, eligible for 10-year tax averaging. The Tax Court held that the distribution did not qualify as a lump sum under IRC § 402(e)(4)(A) because it was not made on account of death, age 59 1/2, separation from service, or disability. The court rejected Clark's reliance on transitional provisions and other sections of the Code, emphasizing the strict statutory definition of a lump sum distribution. The decision clarifies that plan terminations alone do not trigger favorable tax treatment unless other qualifying events occur simultaneously.

Facts

Katherine Clark was employed by Charleston National Bank and participated in its defined benefit pension plan, which was tax-qualified under IRC § 401. In 1988, at age 54, the bank terminated the plan, and Clark received her total accrued benefit of $13,179. The distribution was made solely because of the plan's termination, not due to Clark's separation from service or disability. Clark reported the distribution using the 10-year averaging method on her 1988 tax return, which the Commissioner challenged.

Procedural History

The Commissioner issued a deficiency notice to Clark, disallowing the 10-year averaging and asserting an additional 10% tax under IRC § 72(t). Clark petitioned the Tax Court, which upheld the Commissioner's position on both issues.

Issue(s)

1. Whether the distribution from the terminated pension plan qualified as a lump sum distribution under IRC § 402(e)(4)(A), allowing Clark to use the 10-year averaging method.
2. Whether the distribution was subject to the 10% additional tax under IRC § 72(t).

Holding

1. No, because the distribution was not made on account of death, attainment of age 59 1/2, separation from service, or disability as required by IRC § 402(e)(4)(A). The court found that the plan termination alone did not qualify the distribution as a lump sum.
2. Yes, because the distribution was made prior to Clark attaining age 59 1/2 and did

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not meet any exceptions under IRC § 72(t)(2).

Court’s Reasoning

The court focused on the strict statutory definition of a lump sum distribution under IRC § 402(e)(4)(A), which requires the distribution to be made on account of one of four specific events. The court rejected Clark’s arguments that relied on other sections of the Code and transitional provisions from the Tax Reform Act of 1986, stating that these provisions did not alter the definition in § 402(e)(4)(A). The court emphasized that the distribution, made solely due to plan termination, did not meet any of the required events. Regarding the 10% additional tax, the court found it applicable because Clark had not reached age 59 1/2 and no other exceptions applied. The court’s decision highlights the importance of adhering to the statutory language in determining eligibility for tax benefits.

Practical Implications

This case underscores the need for careful analysis of the statutory criteria for lump sum distributions. Attorneys advising clients on pension plan terminations should ensure that any distributions meet the requirements of IRC § 402(e)(4)(A) to qualify for tax averaging. The decision also serves as a reminder of the potential applicability of the 10% additional tax under IRC § 72(t) for premature distributions. Subsequent cases have followed this ruling, reinforcing the strict interpretation of what constitutes a lump sum distribution. Practitioners should advise clients that plan terminations alone do not automatically qualify distributions for favorable tax treatment unless other statutory events occur concurrently.

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