Fazi v. Commissioner, 105 T. C. 436 (1995)

Assets merged from a qualified pension plan into an unqualified plan are not taxable to the beneficiary as contributions in the year of merger.

Summary

John and Sylvia Fazi challenged a tax deficiency assessed by the IRS for 1986, stemming from the merger of a qualified pension plan into an unqualified one. The Tax Court held that the merged assets were not taxable to the Fazis in 1986, as a merger does not constitute a contribution by the employer. Consequently, the IRS could not extend the statute of limitations to six years, and the Fazis' 1986 tax year remained closed to reassessment. The decision underscores that pension plan mergers are not taxable events for beneficiaries, and highlights the importance of timely IRS action in assessing deficiencies.

Facts

John U. Fazi, a dentist, incorporated Dr. J. U. Fazi, Dentist, Inc. , which established three pension plans. Plan 1 became unqualified in 1985. Plan 2, a qualified plan, was frozen in 1982 and merged into Plan 1 in 1986. The corporation dissolved in 1986, and Plan 1 assets were distributed in 1987. The IRS asserted a deficiency for 1986, arguing that the merged assets from Plan 2 to Plan 1 were taxable as contributions in 1986.

Procedural History

In a prior case, Fazi I (102 T. C. 695 (1994)), the Tax Court held that distributions from Plan 1 in 1987 were taxable, except for amounts contributed in 1985 and 1986, including the merged amount from Plan 2, which the IRS conceded should be taxed in 1986. In the current case, the IRS reassessed the 1986 tax year, arguing the merged amount was taxable then. The Tax Court rejected this claim, ruling that the 1986 tax year was not open for reassessment.

Issue(s)

1. Whether the assets merged from a qualified pension plan (Plan 2) into an unqualified plan (Plan 1) in 1986 are properly includable in the Fazis' gross income for that year.
2. Whether the doctrine of judicial estoppel prevents the Fazis from denying the taxability of the merged amount in 1986.
3. Whether the IRS can extend the statute of limitations for assessing a deficiency to six years for the Fazis' 1986 tax year.

Holding

1. No, because the merger of Plan 2 into Plan 1 did not constitute a contribution by

the employer, and thus the merged amount was not properly includable in the Fazis' gross income for 1986.
2. No, because the Fazis did not successfully assert a position that the Court accepted in Fazi I, and judicial estoppel does not apply to prevent them from denying liability.
3. No, because the IRS failed to prove that the merged amount was properly includable in gross income for 1986, and thus the 3-year statute of limitations barred reassessment of the 1986 tax year.

Court's Reasoning

The Court reasoned that the merger of Plan 2 into Plan 1 was not a taxable event for the Fazis. The IRS argued that the merger was equivalent to an employer contribution, but the Court disagreed, stating that the employer had already contributed the assets to Plan 2 before the merger. The Court cited Section 402(b) and the regulations, which tax contributions to nonqualified plans, but found that a merger does not fit this definition. The Court also noted that the plans remained in operational compliance, suggesting no overfunding occurred due to the merger. On judicial estoppel, the Court found that it did not apply because the Fazis did not successfully assert a position that the Court accepted in Fazi I; rather, the IRS conceded the issue. Finally, the Court held that the IRS failed to meet its burden to show the merged amount was properly includable in 1986 income, thus the 6-year statute of limitations did not apply, and the 1986 tax year remained closed to reassessment.

Practical Implications

This decision clarifies that the merger of pension plans is not a taxable event for beneficiaries. Attorneys should advise clients that when merging pension plans, the tax consequences are not immediate for the beneficiaries. The ruling emphasizes the importance of the IRS timely assessing deficiencies within the 3-year statute of limitations, as failure to do so can result in lost revenue. For future cases involving pension plan mergers, practitioners should ensure that any tax implications are addressed in the year of distribution, not merger. This case also serves as a reminder of the limited applicability of judicial estoppel in tax litigation, particularly when the IRS has made concessions in prior proceedings.