Gallade v. Commissioner, T. C. Memo. 1996-53

A waiver of pension plan benefits in favor of a wholly owned corporation results in a taxable distribution to the individual.

Summary

Petitioner Gallade, sole shareholder of Gallade Chemical, Inc. , waived his fully vested pension benefits to provide working capital for his company. The Tax Court ruled that this waiver constituted an impermissible assignment under ERISA and the Internal Revenue Code, thus the benefits were a taxable distribution to Gallade in 1986. The court found Gallade did not have constructive receipt of the funds in 1985 due to a two-signature requirement on the account holding the funds. Despite Gallade's reliance on professional advice, the court held the distribution was taxable but waived the addition to tax under section 6661 for substantial understatement due to Gallade's good faith.

Facts

Petitioner, the sole shareholder of Gallade Chemical, Inc. , participated in a qualified defined benefit pension plan. In 1985, facing financial difficulties, he waived his fully vested pension benefits to provide working capital for the company. The plan's termination was approved by the Pension Benefit Guaranty Corporation (PBGC), but Gallade did not report the distribution on his 1985 or 1986 tax returns. The funds were deposited into a bank account requiring signatures from both Gallade and a representative of the plan's trustee. In 1986, the funds were used to pay suppliers and for other corporate purposes.

Procedural History

The IRS determined a tax deficiency and an addition to tax for substantial understatement against Gallade for either 1985 or 1986. Gallade petitioned the Tax Court, which heard the case and issued a memorandum decision. The court ruled on the taxability of the distribution and the applicability of the addition to tax.

Issue(s)

1. Whether petitioner's waiver of his pension plan benefits and use of them by his wholly owned corporation resulted in a taxable distribution to him.
2. If it is a taxable distribution, whether it is recognizable in 1985 or 1986.
3. Whether petitioner is liable for an addition to tax under section 6661 for substantial understatement.

Holding

1. Yes, because the waiver constituted an assignment or alienation of benefits in violation of ERISA and the Internal Revenue Code.

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2. No, because the funds were not constructively received by petitioner until 1986 due to the two-signature requirement on the account.
3. No, because petitioner acted in good faith and with reasonable cause in relying on professional advice.

Court’s Reasoning

The court applied the anti-assignment and anti-alienation rules of ERISA section 206(d)(1) and I. R. C. section 401(a)(13), finding that Gallade’s waiver was an impermissible assignment of benefits. The court emphasized that these statutory provisions must be given effect to maintain the plan’s qualified status. Regarding the timing of the distribution, the court used the constructive receipt doctrine, concluding that the two-signature requirement on the account was a substantial limitation on Gallade’s control over the funds until 1986. On the section 6661 penalty, the court found that Gallade’s reliance on professional advice constituted reasonable cause and good faith, leading to an abuse of discretion by the IRS in not waiving the penalty.

Practical Implications

This decision clarifies that waivers of pension benefits to benefit a closely held corporation are taxable to the individual under ERISA and the IRC. It underscores the importance of the anti-assignment provisions in qualified plans and the need for careful planning when considering the use of pension assets for corporate purposes. The ruling on constructive receipt provides guidance on when funds are considered received for tax purposes, particularly in scenarios involving joint control over accounts. For legal practitioners, this case highlights the significance of advising clients on the tax consequences of such waivers and the potential for penalties, as well as the importance of demonstrating good faith and reasonable cause in tax disputes.

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