Medina v. Commissioner, 112 T. C. 51 (1999)

The “amount involved” for calculating excise taxes on prohibited transactions under I. R. C. § 4975 is the greater of the interest paid or the fair market interest on a loan from a qualified pension plan.

Summary

In Medina v. Commissioner, the Tax Court ruled that a loan from a qualified pension plan to disqualified persons (the Medinas) was subject to excise taxes under I. R. C. § 4975, despite being treated as a distribution under § 72(p). The Medinas borrowed $340,000 from their plan and failed to repay any interest or principal. The court clarified that the “amount involved” for tax calculation purposes is the greater of interest paid or fair market interest, setting the fair market rate at 10. 5%. The Medinas were also liable for failure-to-file penalties. This decision establishes the method for calculating excise taxes on prohibited transactions involving loans from pension plans.

Facts

Gideon and Corazon Medina borrowed $340,000 from the pension plan of Gideon’s wholly owned corporation on December 1, 1986, to purchase Sunshine Villa Apartments. They were both participants and disqualified persons under I. R. C. § 4975. The loan terms required annual interest payments at 10. 5% and repayment of the principal within 8 years or upon the sale of the property. In 1991, Gideon assigned future sales proceeds of the property to the plan, but no interest or principal payments were made during the years in issue (1991-1997). The Medinas did not file required excise tax returns for these years.

Procedural History

The Commissioner of Internal Revenue determined deficiencies and additions to tax for the Medinas, which they contested in the U. S. Tax Court. The court addressed whether the loan was subject to § 4975 excise taxes despite being treated as a distribution under § 72(p), the definition of “amount involved” for calculating these taxes, and the applicable interest rate. The court ruled in favor of the Commissioner on all issues.

Issue(s)

1. Whether I. R. C. § 4975 applies to a loan treated as a distribution under § 72(p)?
2. Whether the Medinas corrected the prohibited transaction within the meaning of § 4975(f)(5)?
3. What constitutes the “amount involved” for calculating § 4975 excise taxes on a loan?
4. What is the fair market interest rate for determining the “amount involved”?
5. Whether the Medinas are liable for additions to tax under § 6651(a) for failing to

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file excise tax returns?

Holding

1. Yes, because the characterization of a loan as a distribution for income tax purposes under § 72(p) does not change its inherent character for excise tax purposes under § 4975.
2. No, because the assignment of future sales proceeds did not result in the repayment of principal or interest, which is required to correct a prohibited transaction involving a loan.
3. The "amount involved" is the greater of the interest paid or the fair market interest, as the statute refers to money "given" or "received," which in the case of a loan is the interest paid.
4. The fair market interest rate is 10. 5%, as determined by the Commissioner and not contested by the Medinas.
5. Yes, because the Medinas failed to file required excise tax returns and did not establish reasonable cause for this failure.

Court's Reasoning

The court applied the plain language of the statutes involved, emphasizing that the treatment of a loan as a distribution under § 72(p) does not affect its status as a prohibited transaction under § 4975. The court rejected the Medinas' argument that the loan's characterization as a distribution negated the applicability of § 4975. Regarding the "amount involved," the court clarified that it is based on the interest paid or the fair market interest, not the stated or billed interest rate. The court also determined that the fair market interest rate of 10. 5% was appropriate, rejecting the Medinas' argument that Michigan's usury laws should apply. The court found that the Medinas' failure to file excise tax returns was not due to reasonable cause, making them liable for the penalties under § 6651(a).

Practical Implications

This decision provides clarity on how to calculate excise taxes for prohibited transactions involving loans from qualified pension plans. Practitioners should note that loans treated as distributions for income tax purposes remain subject to § 4975 excise taxes. The ruling establishes that the "amount involved" for these taxes is based on the interest paid or the fair market interest rate, not the stated interest rate in the loan agreement. This case also underscores the importance of timely filing excise tax returns to avoid penalties. Subsequent cases, such as those involving similar pension plan loans, will likely reference Medina for guidance on calculating the "amount involved" and the applicability of § 4975 to loans treated as distributions.

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