Flahertys Arden Bowl, Inc. v. Commissioner, 108 T. C. 3 (1997)

Participant-directed retirement plans do not exempt participants from excise tax liability under section 4975 for prohibited transactions, even if they are not considered fiduciaries under ERISA section 404(c).

Summary

In Flahertys Arden Bowl, Inc. v. Commissioner, the Tax Court ruled that loans from participant-directed retirement plans to a corporation owned by the participant were prohibited transactions under section 4975 of the Internal Revenue Code, resulting in excise tax liability. The case centered on whether the participant, who directed the loans, was a fiduciary under section 4975 despite being exempt under ERISA section 404(c). The court held that the ERISA exemption did not apply to section 4975, leading to excise tax deficiencies. However, the court found reasonable cause for not filing the required tax returns, based on reliance on legal advice, and thus did not impose additions to tax.

Facts

Patrick F. Flaherty, an attorney and major shareholder of Flahertys Arden Bowl, Inc. , directed loans from his profit sharing and pension plans to the corporation. He owned 57% of the corporation's stock and relied on legal advice from Marvin Braun, who believed the loans did not violate ERISA or trigger section 4975 liability. The loans were repaid in 1994, but the IRS determined deficiencies in excise taxes for 1993 and 1994, as well as additions to tax for failure to file returns.

Procedural History

The case was initially assigned to Special Trial Judge Carleton D. Powell, whose opinion was adopted by the Tax Court. The court addressed the issues of whether Flahertys Arden Bowl, Inc. was a disqualified person under section 4975 and whether it was liable for additions to tax under section 6651(a)(1).

Issue(s)

1. Whether the participant's direction of loans from his retirement plans to his corporation makes the corporation a disqualified person under section 4975, despite the participant not being a fiduciary under ERISA section 404(c).
2. Whether the corporation is liable for additions to tax under section 6651(a)(1) for failure to file excise tax returns.

Holding

1. Yes, because the participant's direction of the loans made the corporation a disqualified person under section 4975, as the ERISA section 404(c) exemption does not apply to section 4975 liability.

© 2025 SCOTUSreports.com. All rights reserved.

2. No, because the corporation had reasonable cause for not filing the returns, having relied on legal advice that the loans did not trigger section 4975 liability.

Court's Reasoning

The court's decision hinged on statutory interpretation and legislative intent. It noted that while ERISA section 404(c) exempts participants from fiduciary status in participant-directed plans, this exemption does not extend to section 4975 liability. The court emphasized that the language of section 4975(e)(3) does not include an exception similar to ERISA section 404(c)(1). Furthermore, the legislative history and Department of Labor regulations supported the view that the ERISA exemption does not apply to section 4975. The court also considered the reliance on legal advice as reasonable cause for not filing the required excise tax returns, citing precedent that reliance on expert advice can constitute reasonable cause.

Practical Implications

This decision clarifies that participants in self-directed retirement plans must still be cautious of section 4975 prohibited transactions, as the ERISA section 404(c) exemption does not shield them from excise tax liability. Legal practitioners advising clients on retirement plan transactions should ensure compliance with both ERISA and tax provisions. Businesses receiving loans from participant-directed plans need to be aware of potential excise tax implications. The ruling also underscores the importance of seeking and relying on qualified legal advice, as such reliance can provide a defense against additions to tax for failure to file. Subsequent cases have followed this precedent, reinforcing the distinction between ERISA and tax law in the context of retirement plans.

© 2025 SCOTUSreports.com. All rights reserved.