Pizza Pro Equipment Leasing, Inc. v. Commissioner of Internal Revenue, 147 T. C. No. 14 (2016)

In *Pizza Pro Equipment Leasing, Inc. v. Commissioner*, the U. S. Tax Court ruled that the employer's method for calculating the maximum benefit under a defined benefit pension plan with an early retirement age was incorrect. The court upheld the IRS's method of converting benefits to a lump sum, discounting for interest, and reconverting to an annuity, finding it necessary to ensure actuarial equivalence. This decision clarifies the calculation of benefits for early retirement, impacting how employers fund such plans and manage associated tax liabilities.

Parties

Pizza Pro Equipment Leasing, Inc. (Petitioner) v. Commissioner of Internal Revenue (Respondent). Petitioner was the plaintiff at the trial level and on appeal before the U. S. Tax Court.

Facts

Pizza Pro Equipment Leasing, Inc. (Petitioner) adopted a defined benefit pension plan (the Plan) effective January 1, 1995, with a single participant, Scott A. Stevens, also the company's president. The Plan's normal retirement age (NRA) was set at age 45, earlier than the statutory threshold of age 62. The Plan provided for full vesting of accrued benefits at the participant's death, payable as a death benefit to the designated beneficiary. The Plan filed Form 5500 returns for plan years 2002 through 2006, but Petitioner did not file Form 5330 returns for those years to report excise taxes related to nondeductible contributions. Respondent, the IRS, audited the Plan and filed substitute Form 5330 returns on Petitioner's behalf, determining deficiencies and additions to tax related to nonpayment of excise taxes under IRC section 4972 for the years at issue.

Procedural History

The case was submitted fully stipulated without trial to the U. S. Tax Court. Respondent issued a notice of deficiency on March 11, 2015, determining deficiencies and additions to tax for Petitioner's tax years 2002 through 2006. Petitioner had previously agreed to deficiencies determined by Respondent in separate proceedings for tax years 2004 and 2005 related to disallowed deductions for contributions to the Plan. The U. S. Tax Court entered stipulated decisions on March 3, 2010, for those years. The instant case was decided on November 17, 2016, with the court ruling in favor of Respondent.

Issue(s)

Whether Petitioner applied the correct method to reduce the maximum benefits under IRC section 415(b)(2)(C) for a retirement age before age 62, where the Plan does not provide for forfeiture of the participant's benefits at death?

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Whether Petitioner is liable for excise taxes under IRC section 4972 for nondeductible contributions made to the Plan for tax years 2002 through 2006?

Whether Petitioner made a valid election under IRC section 4972(c)(7) to disregard certain nondeductible contributions?

Whether Petitioner is liable for additions to tax under IRC section 6651(a)(1) and (2) for failing to file Form 5330 returns and pay excise taxes?

Whether the statute of limitations bars the assessment and collection of IRC section 4972 excise taxes for nondeductible contributions made to the Plan?

Rule(s) of Law

IRC section 404(a) allows an employer's contributions to a pension plan to be deductible if they meet certain limitations, including those under IRC section 415. IRC section 415(a)(1)(A) limits the annual benefit that a defined benefit plan can provide to a participant. IRC section 415(b)(2)(C) requires the maximum benefit to be reduced to its actuarial equivalent for benefits beginning before age 62. IRC section 4972 imposes a 10% excise tax on nondeductible contributions to a qualified employer plan. IRC section 4972(c)(7) allows an employer to elect to disregard nondeductible contributions to a defined benefit plan, except to the extent they exceed the full-funding limitation defined in IRC section 412(c)(7). IRC section 6651(a)(1) and (2) impose additions to tax for failure to file a return or pay tax, respectively, unless the failure is due to reasonable cause and not willful neglect. IRC section 6501(a) generally allows the Commissioner three years after a return is filed to assess a tax, but IRC section 6501(c)(3) allows assessment at any time if a required return is not filed.

Holding

The U. S. Tax Court held that Petitioner did not apply the correct method to reduce the maximum benefits under IRC section 415(b)(2)(C) for a retirement age before age 62, where the Plan did not provide for forfeiture of the participant's benefits at death. The court upheld Respondent's method, finding it necessary to achieve actuarial equivalence. Petitioner was liable for IRC section 4972 excise taxes for nondeductible contributions made to the Plan for tax years 2002 through 2006. Petitioner did not make a valid election under IRC section 4972(c)(7) to disregard certain nondeductible contributions. Petitioner was liable for additions to tax under IRC section 6651(a)(1) and (2) for failing to file Form 5330 returns and pay excise taxes, without reasonable cause. The statute of limitations did not bar the assessment and collection of IRC section 4972 excise taxes for the years at issue.

Reasoning

The court analyzed the concept of actuarial equivalence, which requires that two modes of payment have equal present values under given actuarial assumptions. The

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court found that Petitioner's method of merely discounting for interest was insufficient, as it did not account for life contingencies. Respondent's method, involving converting the benefit to a lump sum, discounting for interest, and reconverting to an annuity, was deemed correct because it ensured actuarial equivalence by considering both interest and mortality factors. The court relied on the expert testimony of Steven H. Klubock, an experienced actuary, who explained the necessity of using mortality tables to account for life contingencies, even when no mortality decrement is applied due to the absence of forfeiture upon death. The court rejected Petitioner's expert, Xiaoshen Wang, a mathematician, for treating the Plan's payments as annuities certain rather than life annuities, and for not addressing the validity of the underlying amounts supplied by Petitioner. The court also found that Petitioner failed to make a valid election under IRC section 4972(c)(7) due to the lack of concrete evidence of such an election. Petitioner's failure to file Form 5330 returns and pay excise taxes was not due to reasonable cause, as it could not establish good faith reliance on the advice of its former counsel, Barry Jewell, who was found to be a promoter of the Plan. Finally, the court held that the statute of limitations did not bar Respondent's assessment, as Petitioner never filed the required Form 5330 returns.

Disposition

The U. S. Tax Court entered a decision in favor of Respondent, affirming the deficiencies and additions to tax determined by Respondent.

Significance/Impact

The decision in *Pizza Pro Equipment Leasing, Inc. v. Commissioner* has significant implications for employers with defined benefit pension plans offering early retirement benefits. It clarifies the method for calculating actuarial equivalence for such benefits, requiring the use of mortality tables to account for life contingencies, even when no mortality decrement is applied due to the absence of forfeiture upon death. This ruling may lead to increased funding requirements for such plans and potential tax liabilities for nondeductible contributions. The case also underscores the importance of timely filing of excise tax returns and making valid elections to avoid penalties and additions to tax. Subsequent courts and practitioners may rely on this decision to interpret and apply the relevant provisions of the Internal Revenue Code.

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