The Slaughter Of The Innocent: Disagreement Regarding The Interpretation Of Section 402(A) "Rolls On"

THE SLAUGHTER OF THE INNOCENT: DISAGREEMENT REGARDING THE INTERPRETATION OF SECTION 402(a) "ROLLS ON"

Congress has recognized the need to aid working individuals in accumulating funds to meet personal consumption needs upon retirement.[1] Congress traditionally has effectuated the policy of aiding working individuals to accumulate retirement funds by promulgating tax laws that confer tax advantages[2] to qualified retirement plan[3] participants.[4] Participants of non-

1. *See* H.R. REP. No. 807, 93d Cong., 2d Sess. 1 (purpose of pension benefit legislation is to provide retirement income for workers who have dedicated careers to socially productive work), *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 4670, 4670; H.R. REP. No. 533, 93d Cong., 2d Sess. 1 (purpose of pension benefit legislation includes protecting workers' pension benefit rights), *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 4639, 4639; *see also* Freyburger, *Pension Plans—The Philosophy of Section 165(a),* 22 TAXES 60, 60 (1944) (in adopting Revenue Act of 1942, Congress recognized that small percentage of workers have ability to save adequate amount of funds for retirement); Rice, *Employee Trusts Under the Revenue Act of 1974,* 20 TAXES 721, 721 (1942) (Congress' purpose for enacting Revenue Act was to improve welfare of retiring work force). *See generally* Brillembourg, *The Taxation of Lump Sum Distributions From Employee Benefit Plans Under Section 402(a)(2),* 35 TAX LAW. 1187, 1187-89 (1982) (discussing historic development of pension tax laws); Hosford, *Deferred Compensation: Lump Sum Distributions from Disqualified Plans,* 34 U. FLA. L. REV. 136, 136-46 (1981) (summarizing development of pension tax laws in United States).

2. *See* I.R.C. § 404 (West 1985) (allowing employer deduction for contributions to qualified employee retirement plans); *id.* § 402(a)(2) (allowing taxpayers to treat retirement plan distributions as capital gains); *id.* § 402(a)(5) (allowing taxpayers to rollover retirement plan distributions to defer tax liability); *infra* note 3 (discussing requirements that employee retirement plans must meet to achieve qualified status); *infra* notes 6-15 and accompanying text (discussing tax benefits available to qualified employee retirement plan participants).

3. *See* I.R.C. § 401 (West 1985) (prescribing requirements that employee retirement plan must meet for Commissioner to deem retirement plan qualified). Section 401(a) of the Internal Revenue Code of 1954 (Code) requires that a qualified retirement plan include a trust, which administers the assets of a stock bonus, pension, or profit sharing plan. *Id.* § 401(a). Additionally, the retirement plan employer must operate the retirement plan and related trust for the exclusive benefit of the employer's employees. *Id.* The employer also must operate the retirement plan and related trust for the purpose of distributing the trust assets to the retirement plan participants or the participants' beneficiaries. *Id.* § 401(a)(1). The instrument prescribing the rules for operation of a retirement plan and related trust must prohibit the diversion of assets to other than retirement plan participants. *Id.* § 401(a)(2). The retirement plan must allow participation by all full time employees who have worked with the retirement plan employer for one year and have reached the age of 25. *Id.* § 402(a)(3). The retirement plan cannot discriminate in favor of officers, shareholders, or highly compensated employees. *Id.* § 401(a)(4). To achieve qualification, the retirement plan must meet minimum vesting requirements. *Id.* § 401(a)(7) The retirement plan instrument must prohibit the employer from using forfeited retirement plan benefits to make retirement plan distributions to other retirement plan participants. *Id.* § 401(a)(8). Additionally, the employee must make all required distributions to retirement plan participants. *Id.* § 401(a)(9). *See generally* 4A J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 22B.02-20 (rev. ed. 1983 & Supp. 1985) (explaining requirements for qualification of employee retirement plan); Sollee & Shapiro, *Pension Plans—Qualification,* TAX MGMT. (BNA) 351, at A-6 to A-85 (1985) (analyzing qualification requirements for employee retirement plans).

4. *See* S. REP. No. 530, 97th Cong., 2d Sess. 314 (legislators recognize importance of

tax incentives in developing strong pension system), *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 781, 1055; Goodman, *Legislative Development of the Federal Tax Treatment of Pension and Profit-Sharing Plans,* 49 TAXES 226, 230 (1971) (tax laws regulating retirement plans encourage employers to establish retirement plans that provide retirement funds for retired employees); *see also* Brillembourg, *supra* note 1, at 1187-89 (discussing legislative incentives provided through evolution of pension tax laws); Hosford, *supra* note 1, at 136-46 (summarizing development of pension tax laws in United States). *See generally* J. MERTENS, *supra* note 3, § 25B.02 (overview of historical development of pension benefit legislation). Congress first enacted legislation to aid employees in accumulating retirement funds in the form of the Revenue Act of 1921. Goodman, *supra,* at 226. The Revenue Act of 1921 provided an exemption from income tax for employer and employee contributions to a qualifying stock bonus or profit sharing plan. Revenue Act of 1921, ch. 136, § 219(f), 42 Stat. 227, 247. Subsequently, Congress extended the exemption from income tax to contributions made by employees and employers to pension plans. Revenue Act of 1926, ch. 27, § 219(f), 44 Stat. 9, 33.

In 1942 Congress determined that many employers who had adopted employee retirement plans limited participation in the retirement plans to a small percentage of employees. H.R. REP. No. 2333, 77th Cong., 2d Sess. 51, *reprinted in* 1942-2 C.B. 372, 413. Congress perceived the employers' limitation of employee participation in employee retirement plans as an abuse of the tax laws. *Id.* Accordingly, Congress enacted the Revenue Act of 1942 (1942 Act), which required employers to meet participation requirements in order to qualify for the tax exempt status. Revenue Act of 1942, ch. 619, § 165, 56 Stat. 798, 862. Congress' purpose in adopting the participation requirements was to insure that employers operated employee retirement plans for the welfare of employees in general, and not only for the benefit of officers, shareholders, and highly paid employees. H.R. REP. No. 2333, 77th Cong., 2d Sess. 104, *reprinted in* 1942-2 C.B. 372, 450. The 1942 Act required retirement plan sponsors to include 70% of all full time employees in a retirement plan to achieve the qualifed status. Revenue Act of 1942, ch. 619, § 165(a)(3)(A), 56 Stat. 798, 862. Additionally, the 1942 Act entitled retirement plan participants to treat lump sum distributions from qualified retirement plans as capital gains. Revenue Act of 1942, ch. 619, § 165(b), 56 Stat. 798, 863.

In 1962, Congress enacted legislation to aid self-employed individuals in accumulating funds for retirement. *See* Self-Employed Individuals Retirement Act of 1962, Pub. L. No. 87-792, § 2(d), 76 Stat. 809, 814. The Self-Employed Individuals Retirement Act of 1962 allowed self-employed individuals to utilize 5 year income averaging when determining tax liability. *Id.* Subsequently, Congress realized that the 5 year income averaging available to self-employed individuals created a distinction in the tax treatment of self-employed individuals and common law employees. H.R. REP. No. 413, 91st Cong., 1st Sess. 154, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 1645, 1806-07. Accordingly, Congress enacted the Tax Reform Act of 1969, which granted an income averaging provision to employees who receive lump sum distributions from qualified employee retirement plans. Tax Reform Act of 1969, Pub. L. No. 91-172, § 668(b), 83 Stat. 487, 595.

In 1974, Congress saw the need to implement safeguards to provide security to participants of private retirement funds. H.R. REP. No. 533, 93d Cong., 2d Sess. 1, *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 4639, 4639. Accordingly, Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA). *See* Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829. ERISA's major provisions established minimum funding standards, fiduciary reporting requirements, and established requirements for the vesting of accumulated retirement plan rights. *See* H.R. REP. No. 533, 93d Cong., 2d Sess. 5-8 (describing ERISA's major provisions), *reprinted in 1974* U.S. CODE CONG. & AD. NEWS 4639, 4643-46. ERISA also granted favorable tax treatment to qualified employee retirement plan participants by enacting a rollover provision. *See* I.R.C. § 402(a)(5) (West 1985) (prescribing requirements plan must satisfy to utilize rollover provision); *infra* note 13 (defining rollover of distribution from employee retirement plan).

In 1981 Congress once again determined that workers needed additional savings mechanisms to prepare for retirement. S. REP. No. 144, 97th Cong., 2d Sess. 112, *reprinted in* 1981 qualified retirement plans, however, receive no special tax advantages.[5] Section 402(a)[6] of the Internal Revenue Code of 1954 (Code) contains provisions that confer tax advantages to qualified retirement plan participants.[7] Section 402(a)(2)[8] of the Code allows taxpayers to treat a portion of a lump sum distribution[9] from a qualified retirement plan as a capital gain rather than

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U.S. CODE CONG. & AD. NEWS 108, 214. Accordingly, Congress enacted legislation granting individuals a deduction from gross income for amounts deposited to individual retirement accounts. *See* I.R.C. § 219 (prescribing requirements for deductibility of individual retirement account savings). *See generally* Bildersee, *Encouraging Retirement Savings: Qualified Voluntary Employee Contributions and Payroll-Based Employee Stock Ownership Plans,* 41 INST. ON FED. TAX'N § 40.01 (1983) (discussing tax subsidized retirement savings vehicles).

In 1982 Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324. Through TEFRA, Congress attempted to equalize the treatment of retirement plans benefiting only common law employees and retirement plans for self-employed individuals. S. REP. No. 530, 97th Cong., 2d Sess. 314, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 781, 1055. TEFRA reduced the allowable annual contribution an employer could make to an employee retirement plan and increased the allowable annual contribution an individual could make to a self-employed retirement plan. *Id.* at 315. Congress' equalization attempt in TEFRA evolved into additional limitations on employee retirement plans through the "top heavy" retirement plan disqualification requirements. H.R. REP. No. 432, 98th Cong., 2d Sess. 1633, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS 697, 1257; *see infra* notes 168-69 (discussing "top heavy" employee retirement plan disqualification).

5. *See* I.R.C. § 402(b) (West 1985) (taxpayer must include employer contributions to nonqualified employee retirement plan in gross income for year of contribution). *See generally* J. MERTENS, *supra* note 3 § 25B.154 (analyzing effect of Commissioner disqualifying previously qualified employee retirement plan); Comment, *Implementing Policy Objectives in the Taxation of Deferred Compensation Arrangements,* 1978 DUKE L.J. 1460, 1468-73 (discussing rules governing taxation of nonqualified employee retirement plan participants).

6. I.R.C. § 402(a) (West 1985).

7. *See infra* notes 8-15 and accompanying text (describing tax advantages of Code § 402(a)).

8. I.R.C. § 402(a)(2) (West 1985). Section 402(a)(2) of the Code provides:

> (2) Capital gains treatment for portion of lump sum distributions.—In the case of an employee trust described in section 401(a), *which is exempt from tax under section 501(a),* so much of the total taxable amount (as defined in subparagraph (D) of subsection (e)(4)) of a lump sum distribution as is equal to the product of such total taxable amount multiplied by a fraction—
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> (A) the numerator of which is the number of calendar years of active participation by the employee in such plan before January 1, 1974, and
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> (B) the denominator of which is the number of calendar years of active participation by the employee in such plan,
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> shall be treated as a gain from the sale or exchange of a capital asset held for more than 6 months.

Id. (emphasis added).

9. *See id.* § 402(e)(4)(A) (defining lump sum distribution for purposes of § 402 of Code). A lump sum distribution is the distribution or payment of the entire balance of an employee's interest in a qualified employee retirement plan. *Id.* Payment of the lump sum distribution must

ordinary income.[10] In addition, section 402(a)(5)[11] enables qualified retirement plan participants to defer tax liability on accumulated retirement plan funds.[12]

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be contingent upon the employee's death, age, separation from service, or disabled status. *Id. See generally* J. MERTENS, *supra* note 3 § 25B.191 (explaining criteria for determining whether payment or distribution constitutes lump sum distribution).

10. *See supra* note 8 (quoting language from Code § 402(a)(2)). Congress first allowed capital gains treatment of lump sum distributions from qualified plans under the Revenue Act of 1942. *See supra* note 4 (discussing development of federal tax laws regulating employee retirement plans). Congress extended capital gain treatment for lump sum distributions to alleviate a problem that Congress characterized as income bunching. H.R. REP. No. 413, 91st Cong., 1st Sess. 154, 155-56, *reprinted in 1969* U.S. CODE CONG. & AD. NEWS 1645, 1806-07. Income bunching occurs when a taxpayer receives an amount of money, includable in gross income, which has accumulated over many years. *Id.; see* Chadwick, *Taxation of Certain Lump Sum Distributions,* 28 TAX LAW. 555, 556 (1975) (capital gain treatment mitigates harsh consequence of receiving large amount of income that accumulated over prolonged period from participation in employee retirement plan). *See generally* Brillembourg, *supra* note 1, at 1188 (discussing bunching concept); Hosford, *supra* note 1 at 139-40 (same).

11. I.R.C. § 402(a)(5) (West 1985). Section 402(a)(5) of the Code provides:

(5) Rollover amounts.—

(A) General rule.—If—

(i) any portion of the balance to the credit of an employee in a *qualified trust* is paid to him,

(ii) the employee transfers any portion of the property he receives in such distribution to an eligible retirement plan, and

(iii) in the case of a distribution of property other than money, the amount so transferred, consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includable in gross income for the taxable year in which paid.

Id. (emphasis added). Section 402(a)(5)(E)(iii) of the Code defines a qualified trust: "(iii) Qualified trust.—The term 'qualified trust' means an employees' trust described in section 401(a) *which is exempt from tax under section 501(a).*" *Id.* § 402(a)(5)(E)(iii) (emphasis added).

To qualify for the rollover treatment, the distribution must either qualify as a lump sum distribution or result from termination of the retirement plan or from a discontinuance of contributions to a profit-sharing or stock bonus plan. *See id.* § 402(a)(5)(E)(i)(I) & (II) (defining distributions qualifying for rollover treatment). Additionally, a taxpayer must transfer the qualifying distribution to an eligible retirement plan within 60 days of receipt. *Id.* § 402(a)(5)(C). *See generally* J. MERTENS, *supra* note 3, § 25B.84 (explaining requirements that taxpayers must achieve to utilize rollover provision); Lowe, *An analysis of New Opportunities for Rollovers of Distributions from Qualified Plans,* 52 J. TAX'N 82, 82-83 (1980) (explaining requirements of rollover provision); Roche, *Developments in Plan-to-Plan Tax-Free Transfers,* 7 J. PENSION PLAN & COMPLIANCE 202, 203 (1981) (identifying when use of rollovers is appropriate).

Congress, in adopting the rollover provision, recognized the highly mobile nature of the American labor market. H.R. REP. No. 807, 93d Cong., 2d Sess. 158, *reprinted in 1974* U.S. CODE CONG. & AD. NEWS 4670, 4823. Congress concluded that a highly mobile worker could accumulate vested retirement rights under several employees' retirement plans. *Id.* Accordingly, Congress allowed tax free rollovers to permit taxpayers to transfer retirement plan funds to another retirement plan without incurring tax liability. *Id.*

12. *See* Carlson & Schmid, *IRA Rollovers Can Defer Income Taxes and, with Trust-Beneficiary, Save Taxes,* 7 ESTATE PLANNING 332, 332 (1980) (rollover provision allows deferral of tax liability until final distribution); Esterces, *When a Rollover or Annuity Option for Plan*

Under section 402(a)(5) of the Code, a taxpayer can rollover[13] any portion of a distribution from a qualified retirement plan to another eligible retirement plan,[14] without incurring any immediate tax liability.[15] To qualify for the special treatment provided by section 402(a)(2) and 402(a)(5), however, a taxpayer must receive the retirement plan distribution from an employees' trust[16] "which is exempt from tax."[17]

The language of Code sections 402(a)(2) and 402(a)(5) expresses clearly that sections 402(a)(2) and 402(a)(5) entitle taxpayers to the favorable tax treatment when the employee retirement plan and related employees' trust meet the relevant qualification requirements at the time of asset distribution.[18]

Benefits Should Be Used to Defer Tax, 26 TAX'N FOR ACCT. 72, 72-73 (1981) (participant in qualified retirement plan can avoid immediate tax liability from lump sum distribution by utilizing rollover provision); Sacher, *How and When a Rollover IRA Should Be Used to Receive a Lump-Sum Distribution,* 24 TAX'N FOR ACCT. 82, 82 (1980) (taxpayers can defer tax liability on lump sum distributions by effectuating rollover into individual retirement account); Note, *Qualified Plan Distributions: Tax Deferral, ERISA and the IRA,* 45 FORDHAM L. REV. 389, 391-96 (1976) (taxpayers may consider rollover of lump sum distributions to avoid taxation in year of distribution). *See generally* Blum, *An Introduction to the Mathematics of Tax Planning,* 57 TAXES 707, 708-09 (1979) (explaining principles underlying benefits of tax liability deferral).

13. *See* I.R.C. § 402(a)(5) (West 1985) (defining rollover as nontaxable transfer of funds from qualified retirement plan trust to eligible retirement plan); *supra* notes 11-12 (discussing requirements, legislative purpose, and benefits of rollover provision).

14. *See* I.R.C. § 402(a)(5)(E)(iv) (West 1985) (defining eligible retirement plan as individual retirement account, individual retirement annuity, qualified trust, and qualifying annuity plan); *id.* § 408(a) (defining individual retirement account); *id.* § 408(b) (defining individual retirement annuity); *id.* § 402(a)(5)(E)(iii) (defining qualified trust); *id.* § 403(a) (defining qualified annuity plan). *See generally* Baker, *Individual Retirement Arrangements,* TAX MGMT. (BNA) 355, A-37 to A-51 (1985) (explaining requirements for obtaining and maintaining qualification of individual retirement plans created as rollover conduit).

15. *See* I.R.C. § 402(a)(5) (West 1985) (allowing exclusion from gross income for qualifying receipts that taxpayer transfers to eligible retirement account); *supra* notes 11-12 (discussing requirements, legislative purpose, and benefits of rollover provision).

16. *See* I.R.C. § 401(a) (West 1985) (defining employee trust as entity formed in United States, which serves as fiduciary to assets of stock bonus, pension, or profit-sharing plan of employer).

17. *Id.* §§ 402(a)(2), 402(a)(5)(E)(iii). Code § 501(a) described the requirement that an employees' trust must meet to achieve tax exempt status. *Id.* § 501(a). The Commissioner will consider an employees' trust exempt from tax if the employees' trust forms a part of a qualified employee retirement plan under code § 401(a), unless the Commissioner denies the exemption pursuant to Code sections 502 or 503. *Id.; see id.* § 401(a) (prescribing qualification requirements for employee retirement plans); *id.* § 502 (proscribing tax exempt status for feeder organizations); *id.* § 503 (proscribing tax exempt status for entities which engage in prohibited transactions). Accordingly, the tax exempt status of the employees' trust generally depends on the qualification status of the related employee retirement plan. *See* Baetens v. Commissioner, 777 F.2d 1160, 1163 (6th Cir. 1985) (describing relationship between qualification status of employee retirement plan and tax exempt status of related employees' trust).

18. *See supra* note 11 and accompanying text (quoting language at issue from Code sections 402(a)(2) and 402(a)(5)(E)(iii)).

The language of Code sections 402(a)(2) and 402(a)(5), however, does not clarify whether assets contributed to a qualified employee retirement plan lose the favorable tax treatment provided by sections 402(a)(2) and 402(a)(5) if the retirement plan and related employees' trust subsequently become nonqualified.[19] Federal courts agree that the language, "which is exempt from tax," contained in both sections 402(a)(2) and 402(a)(5) of the Code is identical.[20] Federal courts, however, do not agree on the proper interpretation of the language, "which is exempt from tax," contained in sections 402(a)(2) and 402(a)(5) of the Code.[21] Some federal courts interpret the language of Code sections 402(a)(2) and 402(a)(5) to require that an employee retirement plan must meet the qualification requirements only at the time of employer contribution to enable a taxpayer to utilize the favorable tax treatment of Code sections 402(a)(2) and 402(a)(5).[22] Other federal courts interpret the language of Code sections 402(a)(2) and 402(a)(5) to require that an employee retirement plan must meet the qualification requirements at the time of employer contribution and at the time of distribution to enable a taxpayer to utilize the tax advantages of Code sections 402(a)(2) and 402(a)(5).[23] In *Baetens v. Commissioner*,[24] the United States Court of Appeals for the Sixth Circuit interpreted the language of Code section 402(a)(5) to require that for a taxpayer to utilize the favorable tax treatment of Code section 402(a)(5), a taxpayer must receive a distribution from a retirement plan that meets the qualification requirements at the time of employer contribution and distribution.[25]

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19. *Id.*

20. *See* Baetens v. Commissioner, 777 F.2d at 1163 (discussing similarity of language at issue contained in sections 402(a)(2) and 402(a)(5)(E)(iii)); Cass v. Commissioner, 774 F.2d 740, 742 (7th Cir. 1985) (noting that pertinent language contained in sections 402(a)(2) and 402(a)(5)(E)(iii) is identical).

21. *See infra* notes 22-23 and accompanying text (noting courts' differing interpretation of Code § 402(a)).

22. *See, e.g.*, Greenwald v. Commissioner, 366 F.2d 538, 541 (2d Cir. 1966) (Code § 402(a) does not require harsh treatment of denying capital gain rates to distributions attributable to employer contributions made to qualified retirement plan that Commissioner subsequently disqualified); Hesse v. Commissioner, 47 A.F.T.R.2d (P-H) 81-1024, at 1026 (E.D. Mo. 1980) (Commissioner should allow taxpayers to utilize rollover provision for distributions related to portion of employer contributions made to qualified employee retirement plan); Boggs v. Commissioner, 83 T.C. 132, 152 (1984) (with respect to availability of rollover provision, controlling consideration is whether employee retirement plan maintained qualified or nonqualified status in year of employer contribution). *See generally* Brillembourg, *supra* note 1, at 1208-11 (discussing cases that have interpreted Code § 402(a)); Hosford, *supra* note 1, at 146-51 (same).

23. *See, e.g.*, Cass v. Commissioner, 774 F.2d 740, 744 (7th Cir. 1985) (§ 402(a)(5) explicitly limits tax-free rollover to cases in which employee retirement plan maintains qualified status in year of distribution); Woodson v. Commissioner, 651 F.2d 1094, 1095 (5th Cir. 1981) (§ 402(a)(2) clearly restricts capital gain treatment to distribution from employee benefit plan that Commissioner considers qualified in year of distribution).

24. 777 F.2d 1160 (6th Cir. 1985), *rev'g* 82 T.C. 941 (1984) *and* 82 T.C. 152 (1984).

25. *Id.* at 1161.

In *Baetens v. Commissioner,* the Sixth Circuit, combined the separate appeals from two United States Tax Court (Tax Court) cases.[26] The first case involved a taxpayer, Theodore Baetens, who had worked as an employee at the time that he filed his 1977 tax return.[27] Baetens' employer maintained a qualified employee retirement plan.[28] The employer made contributions to the retirement plan on Baetens' behalf from 1966 through 1973.[29] In 1977 the employer terminated the retirement plan and distributed the retirement plan's assets to the retirement plan participants, including Baetens.[30] Baetens rolled over his portion of the distribution pursuant to section 402(a)(5) of the Code.[31] In 1979 the Commissioner of Internal Revenue (Commissioner) retroactively disqualified[32] the retirement plan in which Baetens participated because Baetens' employer failed to allow adequate vesting of employee retirement benefits.[33] Accordingly, the Commissioner considered the retirement plan nonqualified at the time of distribution.[34] As a result, the Commissioner determined that Baetens' distribution did not qualify for a tax-free rollover under section 402(a)(5) of the Code.[35] Accordingly, the

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26. *Id.*

27. *Id.* In *Baetens v. Commissioner,* the taxpayer owned stock in his employer during the years that the employer contributed funds to the retirement plan. *Id.*

28. *Id.* In *Baetens,* the retirement plan adopted by the employer was a profit-sharing plan. *Id.*

29. *Id.*

30. *Id.* In *Baetens,* the taxpayer received a distribution from the retirement plan of $21,077. *Id.*

31. *Id.* In *Baetens,* the taxpayer reinvested the distribution in an individual retirement account. *Id.; see supra* note 14 (defining individual retirement account).

32. *See* Automobile Club of Mich. v. Commissioner, 353 U.S. 180, 184 (1957) (Commissioner has broad discretion to revoke ruling retroactively, and federal courts cannot interfere with Commissioner's action unless Commissioner abuses discretion); Pulver Roofing Co. v. Commissioner, 70 T.C. 1001, 1011 (1978) (§ 7805(b) of Code grants Commissioner authority to revoke retroactively qualified status of retirement plan); I.R.C. § 7805(b) (West 1985) (empowering Commissioner to revoke retroactively prior rulings); *see also* REV. RUL. 24, 1969-1 C.B. 110, 111 (when employer elects to terminate retirement plan, Commissioner evaluates whether retirement plan maintained qualified status throughout operation and at time of termination). *See generally* Hildebrandt & Goldberg, *(ERISA)—Qualified Plans—IRS Determination Letter Procedures,* TAX MGMT. (BNA) 360, A-12 to A-17 (1984) (describing Commissioner's procedure for determining retirement plan qualification status at time of plan termination). In *Baetens,* the taxpayers did not challenge the retirement plan disqualification or the retroactive nature of the disqualification. *Baetens,* 777 F.2d at 1162.

33. *Baetens,* 777 F.2d at 1161. In *Baetens,* the Commissioner disqualified the retirement plan because the retirement plan did not comply with the vesting requirements of § 401(a)(7) of the Code. *Id.; see* I.R.C. § 401(a)(7) (West 1985) (prescribing minimum vesting requirements that retirement plan must include to maintain qualified status). Baetens had no control over the administration or management of the retirement plan. Appellees' Brief at 18, Baetens v. Commissioner, 777 F.2d 1160 (6th Cir. 1985).

34. *Baetens,* 777 F.2d at 1161.

35. *Id.*

Commissioner assessed Baetens with an income tax deficiency for 1977.[36] Baetens filed a petition with the Tax Court for a redetermination of the Commissioner's assessment of deficiency in income tax due.[37]

The second case in *Baetens* involved a group of taxpayers who worked together as employees for the same employer at the time that they filed their 1978 tax returns.[38] The employer had maintained a qualified employee retirement plan and had made contributions to the retirement plan on behalf of the taxpayers from 1959 through 1977.[39] In 1977 the employer terminated the retirement plan and distributed the retirement plan assets to the taxpayers.[40] The taxpayers rolled over the entire distributions pursuant to section 402(a)(5) of the Code.[41] Subsequently, the Commissioner retroactively disqualified the retirement plan in which the taxpayers participated, because the employer had discriminated in the operation of the employee retirement plan.[42] As a result of that discrimination, the Commissioner determined the retirement plan nonqualified at the time of the distribution.[43] Accordingly, the Commissioner reasoned that the distributions did not qualify for a tax-free rollover under section 402(a)(5) of the Code.[44] As a result, the Commissioner assessed the taxpayers with an income tax deficiency for 1978.[45] The taxpayers filed a petition with the Tax Court for a redetermination of the Commissioner's assessment of deficiency in income tax due.[46]

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36. *Id.* In *Baetens,* the Commissioner assessed Baetens with an income tax deficiency of $7,239.16. *Id.* The taxpayer in *Baetens* could not have treated the distribution as a capital gain under § 402(a)(2) because the Commissioner took the position that a retirement plan must maintain a qualified status in the year of distribution to enable a taxpayer to utilize § 402(a)(2). *See supra* note 5 (discussing Commissioner's tax treatment of distributions from disqualified employee retirement plans).

37. Baetens v. Commissioner, 82 T.C. 152, 152 (1984), *rev'd,* 777 F.2d 1160 (6th Cir. 1985).

38. *Baetens,* 777 F.2d at 1162.

39. *Id.*

40. *Id.*

41. *Id.* In *Baetens,* the taxpayers in the second case transferred the retirement plan distribution to an individual retirement account. *Id.; see supra* note 14 (defining individual retirement account).

42. *Baetens,* 777 F.2d at 1162; *see* I.R.C. § 401(a)(4) (West 1985) (prohibiting qualification of retirement plans that discriminate in favor of officers, shareholders, or highly compensated employees). In *Baetens,* the taxpayers in the second case had no control over the management or administration of the retirement plan. *Baetens,* 777 F.2d at 1162; *see supra* note 33 (employer in first case in *Baetens* caused retirement plan disqualification).

43. *Baetens,* 777 F.2d at 1162.

44. *Id.*

45. *Id.* In *Baetens,* the Commissioner assessed the taxpayers in the second case with a deficiency totaling $11,822.92. *Id.* The taxpayers in the second case in *Baetens* could not have treated the distribution as a capital gain under § 402(a)(2) because the Commissioner took the position that a retirement plan must maintain a qualified status in the year of distribution to enable a taxpayer to utilize § 402(a)(2). *See supra* note 5 (discussing Commissioner's treatment of distributions from disqualified employee retirement plans).

46. Benbow v. Commissioner, 82 T.C. 941, 941 (1984), *rev'd,* 777 F.2d 1160 (6th Cir. 1985). In *Baetens,* the taxpayers in the second case petitioned the Tax Court asserting that the

In both cases, the Tax Court determined that the tax treatment of a distribution should depend on the retirement plan and related trust's qualification status at the time of employer contribution rather than at the time of distribution.[47] Under the Tax Court's analysis, a taxpayer could treat the portion of a distribution attributable to contributions made while a retirement plan possessed a qualified status as a distribution from a qualified retirement plan.[48] Accordingly, in both cases, the Tax Court reduced the deficiency asserted against the taxpayers, holding that the taxpayers could utilize Code section 402(a)(5) to rollover distributions attributable to employer contributions made while the retirement plans maintained a qualified status.[49] The Commissioner appealed the Tax Court decisions to the United States Court of Appeals for the Sixth Circuit,[50] asserting that the express language of Code section 402(a)(5) did not support the Tax Court's decision.[51] The

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Commissioner must allow the use of Code § 402(a)(5)'s rollover provision to distributions attributable to employer contribution made to a qualified employee retirement plan. *Id.* at 946. The taxpayers of the second case in *Baetens* urged the Tax Court to apply the interpretation of Code § 402(a) which the United States Court of Appeals for the Second Circuit formulated in *Greenwald v. Commissioner,* and the interpretation which the Tax Court formerly adopted in *Woodson v. Commissioner. Id.* at 947; *see* Greenwald v. Commissioner, 366 F.2d 538, 541 (2d Cir. 1966) (allowing taxpayer to utilize capital gain rates in determining tax liability on distribution from disqualified retirement plan); Woodson v. Commissioner, 73 T.C. 779, 786 (1980) (requiring employee retirement plan to maintain qualification status only in year of employer contribution to enable taxpayer to utilize capital gain rate in determining tax liability on subsequent distribution), *rev'd,* 651 F.2d 1094 (5th Cir. 1981); *infra* notes 63-74 and accompanying text (discussing Second Circuit's analysis in *Greenwald v. Commissioner); infra* note 68 (discussing Tax Court's analysis in *Woodson v. Commissioner).*

47. *See* Benbow v. Commissioner, 82 T.C. 941, 947 (1984) (interpreting language contained in Code § 402(a)(5)), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); Baetens v. Commissioner, 82 T.C. 152, 163 (1984) (interpreting language contained in Code § 402(a)(5)), *rev'd,* 777 F.2d 1160 (6th Cir. 1985). The Tax Court, in both *Benbow v. Commissioner* and *Baetens v. Commissioner,* interpreted the language contained in Code § 402(a) by following the analysis formerly adopted by the Tax Court in *Woodson v. Commissioner. Benbow,* 82 T.C. at 947; *Baetens,* 82 T.C. at 160-63; *see* Woodson v. Commissioner, 73 T.C. 779, 785-86 (1980) (analyzing language contained in Code § 402(a)), *rev'd,* 651 F.2d 1094 (5th Cir. 1981); *infra* note 68 (discussing Tax Court's analysis of Code § 402(a) in *Woodson v. Commissioner).*

48. Benbow v. Commissioner, 82 T.C. 941, 948 (1984), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); Baetens v. Commissioner, 82 T.C. 152, 170 (1984), *rev'd,* 777 F.2d 1160 (6th Cir. 1985).

49. *See* Benbow v. Commissioner, 82 T.C. 941, 947 (1984) (allowing taxpayers to rollover portion of distributions from disqualified retirement plan that formerly maintained qualified status), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); Baetens v. Commissioner, 82 T.C. 152, 170 (1984) (allowing taxpayer to rollover distribution from disqualified plan that formerly maintained qualified status), *rev'd,* 777 F.2d 1160 (6th Cir. 1985).

50. *Baetens,* 777 F.2d at 1160. Section 7482(a) of the Code allows a taxpayer or the Commissioner to appeal a Tax Court decision to the proper United States Court of Appeals. I.R.C. § 7482(a) (West 1985). In *Baetens,* proper venue for the Commissioner's appeal rested in the Sixth Circuit because the taxpayers resided in Michigan and Ohio. *See* Benbow v. Commissioner, 82 T.C. 941, 943 (1984) (taxpayers resided in Ohio), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); Baetens v. Commissioner, 82 T.C. 152, 152 (1984) (taxpayer resided in Michigan), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); *see also* I.R.C. § 7482(b)(1)(A) (West 1985) (circuit in which taxpayer resides is proper venue for redetermination of tax liability).

51. Appellant's Brief at 15, Baetens v. Commissioner, 777 F.2d 1160 (6th Cir. 1985); *see*

Commissioner also argued that a relevant Treasury Department regulation requires that a retirement plan must meet the qualification requirements in the year of a distribution for section 402(a) of the Code to apply to the distribution.[52] The Sixth Circuit adopted the Commissioner's arguments and reversed the Tax Court's decisions.[53]

In *Baetens,* the Sixth Circuit reviewed the express language, legislative history, and applicable Treasury regulations of Code section 402(a)(5).[54] Based on that review, the Sixth Circuit rejected the Tax Court's interpretation of Code section 402(a)(5).[55] The Sixth Circuit, in construing the language of Code section 402(a)(5), determined that the phrase "which is exempt from tax" clearly required a retirement plan and related trust to meet the qualification requirements at the time of distribution to entitle a taxpayer to utilize the tax-free rollover provision.[56] The Sixth Circuit reasoned that, to adopt the Tax Court's interpretation, section 402(a)(5) of the Code must read "which is or has been exempt from tax."[57] The Sixth Circuit criticized the Tax Court's expansive interpretation as an accommodation to meet the equities of the particular case.[58] The *Baetens* court noted that the inequitable result of penalizing innocent employees through plan disqualification should not influence the objective interpretation of a statute.[59] The Sixth Circuit stated that Congress, in drafting any legislation, had the responsibility to consider the equitable ramifications.[60] Additionally, the Sixth Circuit determined that Congress had considered the punitive effects of retirement plan disqualification, yet had retained retirement plan disqualification as a penalty for violation of the qualification requirements.[61] Accordingly, the *Baetens* court determined that the Tax Court's expansive interpretation of Code section 402(a)(5), permitting a partial rollover, contravened Congress' legislative purpose.[62]

In criticizing the Tax Court's expansive interpretation of Code section 402(a)(5), the *Baetens* court also criticized the United States Court of Appeals

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infra notes 86-115 and accompanying text (analyzing *Baetens* court's interpretation of language contained in § 402(a)(5)).

52. Appellant's Brief at 21, Baetens v. Commissioner, 777 F.2d 1160 (6th Cir. 1985); *see infra* notes 122-39 and accompanying text (analyzing *Baetens* court's application of Treasury regulation § 1.402(a)-1(a)(1)(ii)).

53. *Baetens,* 777 F.2d at 1167.

54. *Id.* at 1163-67.

55. *Id.* at 1167.

56. *Id.; see infra* notes 86-115 and accompanying text (analyzing *Baetens* court's interpretation of language contained in § 402(a)(5)).

57. *Baetens,* 777 F.2d at 1163.

58. *Baetens,* 777 F.2d at 1164.

59. *Id.* at 1167.

60. *Id.* at 1164.

61. *Id.; see* S. Rep. No. 383, 93d Cong., 1st Sess. 94-95 (when Commissioner disqualifies retirement plan because of employer's act, innocent employees lose tax benefits and must pay tax out of funds otherwise available for retirement), *reprinted in* 1974 U.S. Code Cong. & Ad. News 4890, 4978.

62. *Baetens,* 777 F.2d at 1164.

for the Second Circuit's liberal interpretation of section 402(a)(2) in *Greenwald v. Commissioner.*[63] In *Greenwald,* a taxpayer had received a distribution from an employee retirement plan.[64] The employee retirement plan had maintained a qualified status during a portion of the time that the employer had made contributions to the retirement plan.[65] The Commissioner, however, disqualified the retirement plan prior to the time of the distribution.[66] The *Greenwald* court held that the language "which is exempt from tax" did not require a complete denial of the capital gain treatment.[67] The Second Circuit reasoned that a comprehensive denial would favor inequitably taxpayers who withdrew from a retirement plan prior to disqualification.[68]

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63. *Id.* at 1163-64; *see* Greenwald v. Commissioner, 366 F.2d 538 (2d Cir. 1966) (Code § 402(a) does not require harsh treatment of denying capital gain rates to distributions attributable to employer contributions made to qualified retirement plan that Commissioner subsequently disqualifies).

64. *Greenwald,* 366 F.2d at 540. In *Greenwald v. Commissioner,* the taxpayer received a distribution totaling $168,923. *Id.*

65. *Id.* at 541.

66. *Id.* at 540.

67. *Id.* at 541.

68. *Id.* In *Woodson v. Commissioner,* the Tax Court followed *Greenwald's* equitable interpretation of Code § 402(a)(2) in allowing a taxpayer to treat a distribution from a disqualified retirement plan as a capital gain. *See* Woodson v. Commissioner, 73 T.C. 779, 786 (1980) (interpreting language contained in § 402(a)(2)), *rev'd,* 651 F.2d 1094 (5th Cir. 1981). The *Woodson* Tax Court reasoned that, because Congress had not mandated expressly a comprehensive disqualification under Code § 402(a)(2), no reason existed to adopt a rule of law that could cause inequities. *Id.* at 784. The *Woodson* Tax Court, in supporting their interpretation of § 402(a)(2) compared the application of other sections of the Code with § 402(a)(2). *Id.* at 785. The Tax Court in *Woodson* first analyzed the statutory symmetry of sections 402(a) and 402(b). *Id.; see* I.R.C. § 402(b) (West 1985) (prescribing tax treatment of employer contributions to nonqualified employee retirement plan). The *Woodson* Tax Court noted that Code § 402(b) requires the Commissioner to tax employer contributions to employee retirement plans based on the retirement plan's qualification status in the year of contribution. *Woodson,* 73 T.C. at 785. The Tax Court in *Woodson* noted that, when a nonqualified retirement plan becomes qualified in a later year and then makes a distribution, the Commissioner does not tax the distribution as solely from a qualified retirement plan. *Id.* Rather, the Commissioner would tax any contribution made to a retirement plan after achieving qualified status under § 402(a). *Id.* Accordingly, the *Woodson* Tax Court rationalized that, in order to achieve statutory symmetry between Code sections 402(a) and 402(b), the Commissioner must not tax distributions from a retirement plan that once maintained a qualified status yet later became disqualified as a distribution solely from a nonqualified retirement plan. *Id.* Consequently, the Tax Court in *Woodson* concluded that the Commissioner should treat an amount contributed to a qualified retirement plan as a distribution from a qualified retirement plan. *Id.*

In addition to analyzing the symmetry of sections 402(a) and 402(b), the *Woodson* Tax Court also looked to § 404(a)(3)(A) to support the court's conclusion that, when an employer makes a contribution to a qualified retirement plan, the amount contributed should retain the characteristics of qualification regardless of subsequent disqualification. *Id.; see* I.R.C. § 404(a)(3)(A) (allowing carry forward of deduction for employer contribution to qualified employee retirement plan). Under § 404(a)(3)(A), when an employer makes a contribution in excess of the maximum amount allowable, the employer can deduct the excess contribution in the following year regardless of whether the retirement plan remains qualified. I.R.C. § 404(a)(3)(A); *see* Royer's, Inc. v. United States, 265 F.2d 615, 618 (3d Cir. 1959) (allowing employer to carry forward excess retirement plan contribution deduction to year in which retirement plan did not meet qualification requirements).

Accordingly, the *Greenwald* court allowed capital gains treatment under Code section 402(a)(2) for the portion of the distribution attributable to employer contributions made to the retirement plan while the retirement plan met the qualification requirements.[69] The Sixth Circuit criticized the *Greenwald* court's analysis because the *Greenwald* court relied on equitable principles rather than statutory support in determining the outcome of the case.[70] Additionally, the *Baetens* court criticized the Second Circuit's complete failure to acknowledge a Treasury regulation that required both the employee retirement plan and related trust to meet the qualification requirements in the year of distribution for Code section 402(a) to apply.[71]

The Sixth Circuit, however, in reaching its decision in *Baetens* to disallow the rollover, analyzed the relevant Treasury regulation in interpreting section 402(a)(5) of the Code.[72] The *Baetens* court found that section 1.402(a)-1(a)(1)(ii)[73] of the Treasury regulations supported the holding that an employee retirement plan and related trust must meet the qualification requirements in the year of distribution for such distribution to be eligible for the favorable tax treatment provided by Code section 402(a).[74] Section 1.402(a)-1(a)(1)(ii) of the Treasury regulations states that the provisions of Code section 402(a) relate only to a distribution by a retirement plan that meets the qualification requirements in the tax year in which the employer makes the distribution.[75] Additionally, the Sixth Circuit noted that the Tax Court, in *Baetens,* had confused the Treasury regulations applicable to Code section 402(a) because of cross referencing errors that resulted when the Commissioner renumbered the applicable Treasury regulations.[76]

In addition to evaluating the specific language of Code section 402(a)(5) and the applicable Treasury regulation, the *Baetens* court also reviewed the

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69. *Greenwald,* 366 F.2d at 541.

70. *Baetens,* 777 F.2d at 1163. In *Greenwald,* the United States Court of Appeals for the Second Circuit reasoned that denial of the long term capital gain treatment to the taxpayer would favor inequitably other employees of the same employer who had terminated employment and had received a distribution prior to the disqualification of the retirement plan. *Greenwald,* 366 F.2d at 541. The Second Circuit noted that employees terminating before plan disqualification could apply capital gain treatment to a distribution attributable to funds contributed to the retirement plan during the same period in which the employer contributed funds on the *Greenwald* taxpayer's behalf. *Id.*

71. *Baetens,* 777 F.2d at 1164; *see infra* notes 122-39 and accompanying text (analyzing applicability of Treasury regulation to *Baetens* decision).

72. *Baetens,* 777 F.2d at 1164.

73. Treas. Reg. § 1.402(a)-1(a)(1)(ii), T.D. 6203, 1956-2 C.B. 219, 234.

74. *Baetens,* 777 F.2d at 1164.

75. Treas. Reg. § 1.402(a)-1(a)(1)(ii), T.D. 6203, 1956-2 C.B. 219, 234.

76. *Baetens,* 777 F.2d at 1166. The Tax Court in *Baetens* stated that the Treasury regulations underlying § 402(a) did not address the circumstances of the case. Baetens v. Commissioner, 82 T.C. 152, 163-64 (1984), *rev'd,* 777 F.2d 1160 (6th Cir. 1985). The Sixth Circuit, however, determined that an error by the Commissioner in renumbering the Treasury regulations confused the *Baetens* Tax Court. *Baetens,* 777 F.2d at 1166; *see* Baetens v. Commissioner, 82 T.C. 152, 163-64 (1984) (discussing relevancy of Treasury regulations to interpretation of Code section 402(a)), *rev'd,* 777 F.2d 1160 (6th Cir. 1985).

legislative history of Code section 402(a)(5).[77] The Sixth Circuit noted that Congress enacted Code section 402(a)(5) to enhance the mobility of accumulated retirement benefits.[78] The *Baetens* court also noted that Congress previously had considered establishing a central portability fund in lieu of Code section 402(a)(5) to enhance the portability of accumulated retirement benefits.[79] Under the central portability fund concept, an employee upon leaving a job could direct his employer to pay the value of the employee's accumulated retirement funds to a central fund.[80] Under the proposed central fund concept, however, only transfers from qualified retirement plans were eligible for deposit into the central fund.[81] In discussing the central fund concept, Congress noted that not allowing participants of nonqualified employee retirement plans to participate in the central portability fund was consistent with the present law of taxing distributions from nonqualified retirement plans as ordinary income.[82] Accordingly, the Sixth Circuit concluded that, at the time of enacting Code section 402(a)(5), Congress understood the tax law as requiring that a retirement plan must meet the qualification requirements at the time of a distribution before enabling a taxpayer to utilize the favorable provisions of Code section 402(a).[83]

The Sixth Circuit in *Baetens,* correctly determined that an employee retirement plan must maintain a qualified status, in the year of distribution, for a participant to utilize the favorable tax treatment of Code section 402(a)(5).[84] The language of Code section 402(a)(5), the applicable Treasury regulation, and the legislative history clearly support the Sixth Circuit's interpretation and application of Code section 402(a)(5).[85] In interpreting a statute, courts generally begin by analyzing the specific language at issue.[86] Courts analyze the specific language by applying ordinary meanings to the

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77. *Baetens,* 777 F.2d at 1164-65.

78. *Id.* at 1165; *see* H.R. REP. No. 1280, 93d Cong., 1st Sess. 341 (discussing need to provide mechanism to facilitate transfer of employee's retirement plan funds when employee changes jobs), *reprinted in* 1974-3 C.B. 415, 502.

79. *Baetens,* 777 F.2d at 1165.

80. H.R. REP. No. 1280, 93d Cong., 1st Sess. 341, *reprinted in* 1974-3 C.B. 415, 502.

81. *Id.*

82. *Id.*

83. *Baetens,* 777 F.2d at 1165; *see infra* notes 140-48 and accompanying text (discussing *Baetens* court's analysis of legislative history).

84. *See Baetens,* 777 F.2d at 1167 (Baetens court interpreted language in § 402(a)(5) to require retirement plan to meet qualifications requirements at time of distribution); *supra* notes 11-12 (explaining requirements that taxpayers must satisfy to utilize § 402(a)(5) rollover provision).

85. *See infra* notes 86-146 and accompanying text (analyzing language of § 402(a)(5), applicable Treasury regulation, and legislative history).

86. Touche Ross & Co. v. Redington, 442 U.S. 560, 568 (1979) (analysis of any case involving interpretation of statute must begin with language of statute itself); Teamsters v. Daniel, 439 U.S. 551, 558 (1979) (starting point in every case concerning construction of statute is language of statute); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) (starting point in cases dealing with statutory interpretation is analysis of statutory language).

words contained in the statute.[87] The Tax Court in *Baetens* had suggested that the language "which is exempt from tax" was ambiguous.[88] The Tax Court had complained that the language indicated that the qualified status must exist but that the language failed to specify when the qualified status must exist.[89] Ultimately, however, the *Baetens* Tax Court determined that the qualified status need exist only at the time of employer contribution to entitle a retirement plan participant to utilize the favorable treatment of Code section 402(a)(5).[90] Such a determination requires an expansive rather than ordinary interpretation of the language, "which is."[91] In *Cass v. Commissioner*,[92] the United States Court of Appeals for the Seventh Circuit previously had rejected a Tax Court decision that had espoused a liberal interpretation of the language contained in Code section 402(a)(5).[93] *Cass v. Commissioner* arose from the identical retirement plan distribution that the Sixth Circuit had considered in the second case in *Baetens*.[94] In *Cass*, the Seventh Circuit concluded that the language "which is exempt from tax" clearly meant exempt from tax at the time the employer made the distribution.[95] The Seventh Circuit reasoned that the Tax Court's expansive interpretation, permitting a partial rollover, would require the Commissioner to tax retirement plan distributions in two components.[96] One component would represent contributions made while the retirement plan maintained a qualified status.[97] The other component would represent contributions made while the retirement plan maintained a nonqualified status.[98] The Seventh Circuit concluded that an interpretation requiring the separate treatment of a distribution's components clearly exceeded the ordinary meaning of the language "which is exempt from tax."[99]

Similarly, in *Woodson v. Commissioner*,[100] the United States Court of Appeals for the Fifth Circuit had determined that the Tax Court's liberal interpretation of the language in Code section 402(a)(2) exceeded the ordinary

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87. *See* David Bros., Inc. v. Donovan, 700 F.2d 1368, 1370 (11th Cir. 1983) (courts presume that, in drafting statutes, Congress uses words in their ordinary sense, unless Congress expressly indicated contrary).

88. Baetens v. Commissioner, 82 T.C. 152, 163 (1984), *rev'd*, 777 F.2d 1160 (6th Cir. 1985).

89. *Id.*

90. *Id.* at 167.

91. Woodson v. Commissioner, 651 F.2d 1094, 1095 (5th Cir. 1981).

92. 774 F.2d 740 (7th Cir. 1985), *rev'g* 82 T.C. 941 (1984).

93. *Id.* at 745; *see infra* note 99 and accompanying text (Seventh Circuit found expansive interpretation of § 402(a)(5) unreasonable).

94. *Baetens*, 777 F.2d at 1164; *see supra* notes 38-46 and accompanying text (discussing facts from which second case in *Baetens* arose).

95. *Cass*, 774 F.2d at 742.

96. *Id.* at 744.

97. *Id.*

98. *Id.*

99. *See id.* at 744 (Seventh Circuit found expansive interpretation of language contained in Code section 402(a)(5) unreasonable).

100. 651 F.2d 1094 (5th Cir. 1981), *rev'g* 73 T.C. 779 (1980).

meaning of the language in issue.[101] In *Woodson,* the taxpayer had participated in an employee retirement plan from 1966 through 1974.[102] In 1974 the taxpayer received a distribution from the retirement plan.[103] The taxpayer treated the distribution as a capital gain, pursuant to Code section 402(a)(2).[104] In 1975 the Commissioner retroactively revoked the retirement plan's qualified status because the *Woodson* employer diverted plan funds for purposes other than payment of retirement benefits.[105] As a result of the employer's diversion of retirement funds, the Commissioner claimed that the distribution did not qualify for capital gain treatment because the retirement plan did not have a qualified status at the time of distribution.[106] Accordingly, the Commissioner assessed the taxpayer with a deficiency for income tax due.[107] In determining that the distribution did not qualify for capital gain treatment, the Fifth Circuit concluded that the Tax Court's expansive interpretation of Code section 402(a)(2) would force a modification of the absolute word "is" to include "is or has been."[108] Additionally, in interpreting the language contained in section 402(a)(2), the Fifth Circuit criticized the Tax Court's consideration of the fact that the employer, and not the employees, had caused the plan disqualification.[109] Thus, the Fifth Circuit in *Woodson* rejected the Tax Court's expansive interpretation of Code section 402(a)(2).[110]

Despite the Fifth Circuit's reversal of the Tax Court's decision in *Woodson v. Commissioner,* the Tax Court adheres to its earlier interpretation of Code section 402(a).[111] Because of the rule established in *Golsen v.*

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101. *Id.* at 1095. In *Woodson,* the retirement plan adopted by the employer was a profit sharing plan. *Id.* at 1094.

102. *Id.*

103. *Id.* In *Woodson,* the taxpayer received a distribution totaling $30,052.81. Woodson v. Commissioner, 73 T.C. 779, 780 (1980), *rev'd,* 651 F.2d 1094 (1981).

104. *Woodson,* 651 F.2d at 1094.

105. Woodson v. Commissioner, 73 T.C. 779, 781 (1980), *rev'd,* 541 F.2d 1094 (5th Cir. 1981). In *Woodson,* the taxpayer had no control over the management or administration of the employee retirement plan. *Id.* at 784; *see supra* notes 33, 42 (in *Baetens,* employers' actions caused Commissioner to disqualify retirement plans); *see also* I.R.C. § 401(a)(2) (West 1985) (proscribing employer diversion of retirement plan funds for purposes other than exclusive benefit of retirement plan participants).

106. Woodson v. Commissioner, 73 T.C. 779, 780 (1980), *rev'd,* 651 F.2d 1094 (5th Cir. 1981).

107. *Id.*

108. *Woodson,* 651 F.2d at 1095.

109. *Id.* In *Woodson,* the Fifth Circuit rejected the Tax Court's reliance on equitable policy considerations to allow the capital gain treatment because the Fifth Circuit recognized countervailing policy considerations for denying the capital gain treatment. *Id.* n.4. The Fifth Circuit reasoned that plan disqualification serves as a valuable deterrent that inhibits employers from violating pension tax laws. *Id.*

110. *Id.* at 1096.

111. *See, e.g.,* Boggs v. Commissioner, 83 T.C. 132, 152 (1984) (allowing taxpayer to utilize rollover treatment of distribution from disqualified retirement plan); Benbow v. Commissioner, 82 T.C. 941, 948 (1984) (allowing taxpayer to utilize rollover treatment of distribution from disqualified retirement plan), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); Baetens v. Commissioner, 82 T.C. 152, 170 (1984) (allowing taxpayer to utilize rollover treatment of distribution

Commissioner,[112] the Tax Court can continue to allow taxpayers to partially utilize the benefits of Code sections 402(a)(2) and 402(a)(5), in cases involving taxpayers who reside in circuits that have not rejected the Tax Court's expansive interpretation of Code sections 402(a)(2) and 402(a)(5).[113] Additionally, several federal district courts have adopted the Tax Court's partial application of Code sections 402(a)(2) and 402(a)(5).[114] Nevertheless, the Seventh Circuit's analysis in *Cass* and the Fifth Circuit's analysis in *Woodson* show clearly that an expansive interpretation of Code sections 402(a)(2) and 402(a)(5) is unreasonable, and support the Sixth Circuit's interpretation of section 402(a)(5) in *Baetens.*[115]

In interpreting the language of Code section 402(a)(5), the Sixth Circuit correctly criticized the *Greenwald* court's sole reliance on equitable considerations in adopting a partial application of Code section 402(a)(2).[116] The United States Supreme Court has declared that federal courts do not have the power to expand the language of a statute to mitigate or improve the statute's effects.[117] Expansion of a statute is a legislative power reserved for Congress, not for courts.[118] In drafting legislation relating to the disqualifi-

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from disqualified retirement plan), *rev'd,* 777 F.2d 1160 (6th Cir. 1985); Sturdivant v. Commissioner, 39 T.C.M. (CCH) 1022, 1025 (1980) (allowing taxpayer to utilize capital gain treatment of distribution from disqualified retirement plan). *But see* Woodson v. Commissioner, 651 F.2d 1094, 1096 (5th Cir. 1981), *rev'g* 73 T.C. 779 (1980) (rejecting *Woodson* Tax Court's liberal interpretation of language contained in § 402(a)).

112. 54 T.C. 742 (1970), *aff'd,* 445 F.2d 985 (10th Cir. 1971), *cert. denied,* 404 U.S. 940 (1971).

113. *Id.* at 756-58. In *Golsen v. Commissioner,* the Tax Court announced that the Tax Court will follow circuit court decisions from a circuit to which a particular taxpayer could appeal. *Id.* at 757. In *Golsen,* the taxpayer presented a Fifth Circuit decision, directly on point, that supported the deduction of the item in question. *Id.* at 756. The Commissioner, however, offered authority directly on point from the United States Court of Appeals for the Tenth Circuit that supported the denial of a deduction for the item in question. *Id.* The *Golsen* court concluded that, because an appeal by the taxpayer would lie in the Tenth Circuit, the Tax Court would follow the Tenth Circuit precedent and deny the deduction in issue. *Id.* at 757.

114. *See, e.g.,* Hesse v. Commissioner, 47 A.F.T.R.2d (P-H) 81-1024, at 1025 (E.D. Mo. 1980) (allowing taxpayer to utilize rollover treatment of distribution from disqualified retirement plan); Dudinsky v. United States, 46 A.F.T.R.2d (P-H) 80-5111, at 5113 (M.D. Fla. 1978) (allowing taxpayer to utilize capital gain treatment of distribution from disqualified retirement plan); Pitt v. United States, 75 A.F.T.R.2d (P-H) 75-1492, at 1493 (M.D. Fla. 1975) (allowing taxpayer to utilize capital gain treatment of distribution from disqualified retirement plan).

115. *See supra* notes 97-110 and accompanying text (discussing *Cass* and *Woodson* courts' interpretation of language contained in § 402(a)).

116. *See Baetens,* 777 F.2d at 1163 (Baetens court criticized *Greenwald* court's policy oriented interpretation of language in § 402(a)).

117. *See* United States v. Rutherford, 442 U.S. 544, 555 (1979) (under constitutional framework federal courts do not have power to sit as councils to revise legislation to comply with federal courts' own conceptions of public policy); Anderson v. Wilson, 289 U.S. 20, 27 (1933) (in interpreting statutes, federal courts should not consider whether reconstructing statute would allow fairer results).

118. *See* Tennessee Valley Auth. v. Hill, 437 U.S. 153, 194 (1978) (Congress has exclusive power through legislation to formulate legislative policy and to establish priority of policy considerations).

cation of employee retirement plans, Congress expressly recognized the possibility that the use of disqualification as a punishment might cause innocent employees to lose tax benefits.[119] Congress, nevertheless, retained disqualification as a penalty to deter employer abuses of employee retirement plans.[120] Accordingly, the *Baetens* court acted properly by not adopting an expansive interpretation of Code section 402(a)(5) in light of Congress' awareness of the potential inequitable results of retirement plan disqualification and informed retention of plan disqualification as a method of regulating employee retirement plans.[121]

In determining the proper tax treatment of a distribution from a disqualified employee retirement plan, the Sixth Circuit correctly upheld the validity of Treasury regulation section 1.402(a)-1(a)(1)(ii).[122] The *Baetens* Tax Court had invalidated Treasury regulation section 1.402(a)-1(a)(1)(ii), asserting that the Treasury regulation was an unreasonable interpretation of Code section 402(a).[123] Generally, federal courts give substantial deference to Treasury regulations.[124] Federal courts, however, can invalidate Treasury

119. *See* S. REP. No. 383, 93d Cong., 1st Sess. 94-95 (1973) (consequences of employers' violations of tax laws regulating employee retirement plans tend to fall upon innocent employees), *reprinted in* 1974-4 C.B. SUPP. 80, 173-74.

120. *See* I.R.C. § 401 (West 1985) (proscribing employer abuses of employee retirement plans).

121. *See supra* notes 86-120 and accompanying text (analyzing Sixth Circuit's interpretation of language contained in § 402(a)(5)).

122. *See Baetens,* 777 F.2d at 1166 (Baetens court upheld validity of Treasury regulation § 1.402(a)-1(a)(1)(ii)); *infra* note 127 and accompanying text (discussing requirements of Treasury regulation § 1.402(a)-1(a)(1)(ii)).

123. Baetens v. Commissioner, 82 T.C. 152, 165 (1984), *rev'd,* 777 F.2d 1160 (6th Cir. 1985).

124. *See* Koshland v. Helvering, 298 U.S. 441, 446-47 (1936) (federal courts must give great weight to Treasury regulations developed by Commissioner); Brewster v. Gage, 280 U.S. 327, 336 (1930) (federal courts must not invalidate Treasury regulations adopted by Commissioner except for weighty reasons); Commissioner v. Pepsi-Cola Niagara Bottling Corp., 399 F.2d 390, 393 (2d Cir. 1968) (when Congress grants administrator power to promulgate regulations, federal courts must respect regulations within reason). The Commissioner has the authority to promulgate two types of Treasury regulations. *See* Westin, *Dubious Interpretative Rules for Constructing Federal Taxing Statutes,* 17 WAKE FOREST L. REV. 1, 16 (1981) (discussing authoritative value of Treasury regulations). Federal courts refer to one type of Treasury regulations as interpretative regulations. *Id.* at 17. Section 7805(a) of the Code grants the Commissioner the authority to promulgate interpretative Treasury regulations. I.R.C. § 7805(a) (West 1985). Treasury regulation § 1.402(a)-1(a)(1)(ii) is an interpretative regulation. *See* I.R.C. § 402(a) (§ 402(a) does not grant Commissioner specific authority to promulgate Treasury regulations concerning taxation of retirement plan distributions). Federal courts classify the second category of Treasury regulations as legislative regulations. Westin, *supra,* at 17. The Commissioner promulgates legislative regulations that address Congress' specific concerns with the application of the Code, pursuant to authority granted by a particular Code section. *Id.; see, e.g.,* I.R.C. § 1442(b) (granting Commissioner authority to issue Treasury regulations allowing exemptions to foreign corporations for withholding of income tax); *id.* § 1494 (granting Commissioner authority to issue Treasury regulations to regulate payment and collection of income tax); *id.* § 1502 (granting Commissioner authority to issue Treasury regulations necessary to determine tax liability of corporations filing consolidated returns). *See generally* J. CHOMMIE,

regulations that contradict the congressional intent of the applicable statute, contradict the express terms of the statute, or are unreasonable.[125] In determining whether a Treasury regulation is reasonable, courts evaluate the Treasury regulation's requirements in light of the language of the applicable statute.[126] Treasury regulation section 1.402(a)-1(a)(1)(ii) mandates that the provisions of Code section 402(a) apply only to distributions by a retirement plan that the Commissioner considers qualified in the year in which the employer makes the distribution.[127] Both the Seventh Circuit in *Cass v. Commissioner* and the Fifth Circuit in *Woodson v. Commissioner* determined that the language of Treasury regulation section 1.402(a)-1(a)(1)(ii) reasonably interpreted the language of Code section 402(a).[128] Accordingly, the Sixth Circuit in *Baetens* had sufficient precedent to find Treasury regulation section 1.402(a)-1(a)(1)(ii) reasonable.[129]

In evaluating the legal force of Treasury regulations, federal courts consider several elements.[130] One element that federal courts take into account is the length of time that the Treasury regulation has existed.[131] Treasury

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FEDERAL INCOME TAXATION 13 (2d ed. 1973) (describing types of Treasury regulations which Commissioner issues); Rogorin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity—A View From Within*, 43 TAXES 756, 758 (1965) (discussing role of Treasury regulations in federal income taxation).

125. *See* United States v. Correll, 389 U.S. 299, 307 (1967) (in evaluating Treasury regulations federal courts must evaluate whether Commissioner's Treasury regulations implement Congress' mandate in reasonable manner); Caterpillar Tractor Co. v. United States, 589 F.2d 1040, 1045 (U.S. Ct. Cl. 1978) (federal courts consider Treasury regulations that are unreasonable and contradict terms of applicable statute invalid).

126. *See, e.g.*, United States v. Vogal Fertilizer Co., 455 U.S. 16, 25 (1982) (in determining whether Treasury regulation is valid, federal courts should consider whether Treasury regulation harmonizes with statutory language); National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (federal courts should analyze validity of Treasury regulation by comparing related statutes plain language); Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501 (1948) (in determining whether Treasury regulation is valid, federal courts should determine whether Treasury regulation is consistent with language of related statute).

127. Treas. Reg. § 1.402(a)-1(a)(1)(ii), T.D. 6203, 1956-2 C.B. 219, 234.

128. *See Cass*, 774 F.2d at 743 (Cass court determined that Treasury regulation § 1.402(a)-1(a)(1)(ii) interprets Code section 402(a) in reasonable manner); *Woodson*, 651 F.2d at 1096 (Woodson court concluded that Treasury regulation § 1.402(a)-1(a)(1)(ii) interprets Code § 402(a) in reasonable manner). *But see* Brillembourg, *supra* note 1, at 1202-05 (evaluating Treasury regulations interpreting code § 402(a)).

129. *See supra* note 128 and accompanying text (discussing cases which have held Treasury regulation § 1.402(a)-1(a)(1)(ii) reasonable and valid).

130. *See infra* notes 131-39 and accompanying text (discussing elements that federal courts consider in evaluating validity of Treasury regulations).

131. *See, e.g.*, National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (in evaluating validity of Treasury regulations, federal courts should consider length of time regulation has been in effect); Commissioner v. Estate of Noel, 380 U.S. 678, 682 (1965) (Supreme Court has held in many cases that longstanding interpretative Treasury regulation, applying to substantially reenacted statute, has received congressional approval and effect of law); Helvering v. Winmill, 305 U.S. 79, 83 (1938) (Supreme Court deems Treasury regulations long continued without substantial change to have force of law); *see also* Westin, *supra* note 124, at 19 (with passage of time, federal courts assume that taxpayers have relied on Treasury

regulation section 1.402(a)-1(a)(1)(ii) restates Treasury regulation section 29.165-6,[132] which the Commissioner promulgated in 1943. Accordingly, federal courts should grant Treasury regulation section 1.402(a)-1(a)(1)(ii) substantial deference based on its longstanding presence.[133] Another element that federal courts consider in appraising the legitimacy of a Treasury regulation is whether other federal courts have relied on the Treasury regulation in deciding tax cases.[134] Both the Fifth Circuit in *Woodson* and the Seventh Circuit in *Cass* relied on Treasury regulation section 1.402(a)-1(a)(1)(ii) in disallowing the partial application of Code section 402(a).[135] In evaluating the validity of Treasury regulations, federal courts also consider the degree of scrutiny that Congress gives a Treasury regulation during subsequent reenactments of the related Code section.[136] During the reenactment of Code section 402(a), Congress did not mention specifically Treasury regulation section 1.402(a)-1(a)(1)(ii). Congress, however, did state that, under the present tax laws, the Commissioner taxes distributions from a retirement plan as ordinary income unless the retirement plan has a qualified status in the year the employer makes the distribution.[137] Congress' statement

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regulation and that reversal of longstanding Treasury regulation would cause more inconvenience and confusion than benefit).

132. Treas. Reg. 111, § 29.165-6, T.D. 5278, 1943 C.B. 478, 486; *see* Baetens v. Commissioner, 82 T.C. 152, 164 n.13 (1984) (Baetens Tax Court acknowledged that Treasury regulation § 1.402(a)-1(a)(1)(ii) was longstanding Treasury regulation), *rev'd*, 777 F.2d 1160 (6th Cir. 1985).

133. *See supra* note 131 and accompanying text (federal courts generally do not invalidate longstanding Treasury regulations).

134. *See* National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (in evaluating validity of Treasury regulations federal courts should consider reliance that other federal courts have placed on particular Treasury regulation in deciding cases); Cammarano v. United States, 358 U.S. 498, 510 (1959) (federal courts should consider consistent application of Treasury regulation by other federal courts, in determining Treasury regulation's validity).

135. *See Cass*, 774 F.2d at 743 (Cass court relied on Treasury regulation § 1.402(a)-1(a)(1)(ii) in determining taxability of distribution from disqualified retirement plan); *Woodson*, 651 F.2d at 1096 (Woodson court cited Treasury regulation § 1.402(a)-1(a)(1)(ii) to support denial of capital gain treatment to distribution from disqualified retirement plan); *see also* Oliphant v. Commissioner, 24 T.C. 744, 748-49 (1955) (relying on § 29.165-6 of Regulation 111 of Internal Revenue Code of 1939 to deny favorable treatment to distribution from disqualified retirement plan), *aff'd*, 234 F.2d 699 (5th Cir. 1956); Lyon v. Commissioner, 23 T.C. 187, 188 (1954) (relying on § 29.165-6 of Regulation 111 of Internal Revenue Code of 1939 to deny favorable treatment to distribution from disqualified retirement plan); *supra* note 132 and accompanying text (Treasury regulation § 1.402(a)-1(a)(1)(ii) essentially restatement of § 29.165-6 of Regulation 111 of Internal Revenue Code of 1939).

136. *See* National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (to evaluate validity of Treasury regulation federal courts should consider Congress' consideration of particular Treasury regulation in Congress' reenacting related statute); Helvering v. Winmill, 305 U.S. 79, 82 (1938) (federal courts should consider longstanding Treasury regulations that apply to unamended or substantially reenacted statute to have received congressional approval and to have effect of law); *see also* J. CHOMMIE, FEDERAL INCOME TAXATION 13 (2d ed. 1973) (when Congress reenacts statute, federal courts deem Congress to have approved consistent and longstanding Treasury regulations that interpret statute).

137. *See* S. REP. No. 383, 93d Cong., 1st Sess. 75 (1973) (under current tax law,

basically restates the requirement of Treasury regulation section 1.402(a)-1(a)(1)(ii).[138] Accordingly, because of Treasury regulation section 1.402(a)-1(a)(1)(ii)'s reasonable comparison with Code section 402(a), because of Treasury regulation section 1.402(a)-1(a)(1)(ii)'s longstanding presence and because of other federal courts' reliance thereon, the *Baetens* court properly upheld and followed Treasury regulation section 1.402(a)-1(a)(1)(ii).[139]

In evaluating the legislative history of Code section 402(a)(5), the *Baetens* court correctly concluded that, at the time of enacting section 402(a)(5), Congress understood the tax laws to require a retirement plan to have a qualified status in the year of distribution to allow participants to utilize the favorable provisions of Code section 402(a).[140] Congress' assessment dispells a great deal of uncertainty in the interpretation of Code section 402(a).[141] In 1966 the Second Circuit in *Greenwald v. Commissioner* had interpreted the language "which is exempt from tax" to require that a plan must maintain a qualified status only at the time of employer contribution, for a participant to utilize the favorable treatment of Code section 402(a).[142] In 1969 Congress reenacted Code section 402(a) retaining the language "which is exempt from tax."[143] In 1974, Congress again reenacted Code section 402(a), leaving the language "which is exempt from tax" unchanged.[144] Additionally, in 1974, Congress enacted Code section 402(a)(5), employing the identical phrase "which is exempt from tax."[145] One commentator has proposed that, because Congress reenacted Code section 402(a) without modifying the language "which is exempt from tax," Congress may have approved the *Greenwald* interpretation of Code section 402(a), requiring a qualified status only at the time of contribution.[146] Congress, however, in drafting Code section 402(a)(5),

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Commissioner taxes retirement plan participants as receiving ordinary income when participants receive distributions from retirement plans that do not possess qualified status in year of distribution), *reprinted in* 1974-4 C.B. SUPP. 80, 154.

138. *See supra* note 127 and accompanying text (discussing requirements of Treasury regulation § 1.402(a)-1(a)(1)(ii)).

139. *See supra* notes 130-38 and accompanying text (discussing elements that federal courts should consider in evaluating validity of Treasury regulations).

140. *See Baetens,* 777 F.2d at 1165 (Baetens court reviewed legislative history of Code § 402(a)(5)); *infra* notes 141-48 and accompanying text (discussing Sixth Circuit's review in *Baetens* of § 402(a)(5)'s legislative history).

141. *See infra* notes 143-48 and accompanying text (analyzing Congress' understanding of tax laws governing taxation of distributions from disqualified retirement plans).

142. *Greenwald,* 366 F.2d at 541; *see supra* notes 63-71 and accompanying text (discussing Sixth Circuit's criticism of Second Circuit's analysis in *Greenwald v. Commissioner).*

143. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 515, 83 Stat. 487, 643 (reenacting Code § 402(a)(2) providing capital gain treatment to retirement plan distributions).

144. *See* Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 2005(b), 88 Stat. 829, 990 (reenacting Code § 402(a)(2) providing capital gain treatment to retirement plan distributions).

145. *See* Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 6693(g)(5), 88 Stat. 829, 968-69 (enacting Code § 402(a)(5) to allow rollover of retirement plan distributions).

146. *See* Brillembourg, *supra* note 1, at 1210 (fact that language of § 402(a)(2) was not changed at time of 1969 and 1974 amendments may indicate implicit congressional approval of *Greenwald).*

expressly stated that the current tax laws require a retirement plan to maintain a qualified status in the year of distribution to allow participants to utilize the provisions of Code section 402(a).[147] Accordingly, Congress recognized the principle stated by Treasury regulation section 1.402(a)-1(a)(1)(ii) as an accurate interpretation of Code section 402(a), rather than the *Greenwald* court's interpretation.[148]

The legislative history of Code section 408(d)(3)[149] also supports the principle that a retirement plan must maintain a qualified status in the year of distribution for participants to utilize a favorable tax provision.[150] Code section 408(d)(3) allows taxpayers to rollover funds tax-free from an individual retirement account[151] to another individual retirement account, retirement annuity,[152] or qualified employee retirement plan.[153] Congress enacted Code section 408(d)(3) at the same time that Congress enacted Code section 402(a)(5).[154] Additionally, Congress enacted Code section 408(d)(3) for the same purpose that Congress enacted Code section 402(a)(5).[155] Congress enacted Code section 408(d)(3) to allow working individuals to transfer funds from one retirement savings device to another, without incurring tax liability at the time of the transfer.[156] Congress saw the need for the flexible transfers of funds because of the highly mobile American workforce.[157] Congress,

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147. *See* S. Rep. No. 383, 93d Cong., 1st Sess. 75 (1973) (under current tax laws, Commissioner taxes retirement plan participants as receiving ordinary income when participants receive distributions from retirement plans that do not meet qualification requirements in year of distribution), *reprinted in* 1974-4 C.B. Supp. 80, 154.

148. *See supra* notes 122-39 and accompanying text (discussing Treasury regulation § 1.402(a)-1(a)(1)(ii)).

149. I.R.C. § 408(d)(3) (West 1985).

150. *See* H.R. Rep. No. 807, 93d Cong., 2d Sess. 139 n.17 (taxpayers cannot rollover funds from individual retirement account that Commissioner has disqualified), *reprinted in* 1974 U.S. Code Cong. & Ad. News 4670, 4804; *infra* note 155 and accompanying text (discussing similarities between Code § 408(d)(3) and § 402(a)(5)).

151. *See* I.R.C. § 408(a) (West 1985) (defining individual retirement account as domestic trust created by taxpayer for exclusive benefit of taxpayer and beneficiaries).

152. *See id.* § 408(b) (defining retirement annuity as endowment contract issued by insurance company).

153. *Id.* § 408(d)(3). Section 408(d)(3) of the Code allows a taxpayer to withdraw the entire balance of funds from an individual retirement account and to reinvest the funds in another eligible retirement account. *Id.* The taxpayer, however, must reinvest the withdrawn funds within 60 days of receipt. *Id.* § 408(d)(3)(A)(i); *see supra* note 3 (defining qualified employee retirement plan and qualification requirements).

154. *See* Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, §§ 408(d)(3), 2002(g)(5), 88 Stat. 829, 961, 968-69 (enacting Code sections 408(d)(3) and 402(a)(5) to allow rollovers of accumulated retirement funds).

155. *See infra* notes 156-57 and accompanying text (discussing Congress' purpose for enacting Code § 408(d)(3)); *supra* note 11 (Congress enacted code § 402(a)(5) to provide flexibility with respect to retirement savings and related investments).

156. *See* H.R. Rep. No. 807, 93d Cong., 2d Sess. 29-30 (because America has highly mobile economy with high employee turnover, need exists to establish system for transfer of retirement benefits from one plan to another), *reprinted in* 1974 U.S. Code Cong. & Ad. News 4670, 4696.

157. *Id.*

however, in enacting Code section 408(d)(3), expressly stated that a taxpayer could not rollover funds from an individual retirement account that the Commissioner had disqualified.[158] Congress gave no indication that rollovers pursuant to Code section 402(a)(5) deserve more favorable treatment than rollovers pursuant to Code section 408(d)(3). Accordingly, because Congress enacted both Code sections 402(a)(5) and 408(d)(3) to enhance the mobility of accumulated retirement funds, by analogy the legislative history of Code section 408(d)(3) supports the principle that a taxpayer cannot utilize the rollover treatment pursuant to Code section 402(a)(5), unless the taxpayer receives the distribution from a retirement plan qualified in the year of distribution.[159]

Baetens v. Commissioner imports harsh consequences for Sixth Circuit taxpayers.[160] Under *Baetens'* strict interpretation of Code section 402(a), a taxpayer who receives a distribution from a disqualified retirement plan will lose the favorable tax treatment afforded by Code section 402(a).[161] The Sixth Circuit's decision clearly reflects Congress' understanding of tax laws dealing with retirement plan distributions.[162] The practical effects of the *Baetens* decision, however, do not reconcile with the broad policy of aiding working individuals in accumulating funds for retirement that underlies the federal tax laws that regulate retirement plans.[163] The *Baetens* decision allows the Commissioner to penalize innocent taxpayers, who have no control over the management of a retirement plan, by denying tax advantages that the innocent taxpayers anticipated in planning for retirement.[164] This outcome contradicts Congress' traditional policy to aid and protect workers in accumulating funds for retirement needs.[165] The Sixth Circuit in *Baetens* noted that the *Baetens* decision could produce fundamentally unfair results.[166] The Sixth Circuit, however, noted that Congress, and not the courts, must change the tax laws to remedy any inequitable consequences of the tax laws.[167]

Congress should amend Code section 402(a) to remedy the inequitable consequences that innocent taxpayers face upon retirement plan disqualifi-

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158. *Id.* at 4807 n.17.

159. *See supra* notes 155-57 and accompanying text (discussing similarities between benefits and congressional purpose of Code sections 402(a)(5) and 408(d)(3)).

160. *See infra* notes 161-62 and accompanying text (discussing implication of *Baetens v. Commissioner).*

161. *See supra* notes 6-15 and accompanying text (discussing favorable tax benefits provided by Code § 402(a)).

162. *See supra* note 147 (Congress' understanding of tax laws regarding distributions from disqualified retirement plans).

163. *See supra* notes 1-2 and accompanying text (discussing policy underlying development of tax laws that regulate retirement funds).

164. *See supra* notes 67-68 (discussing inequitable results from strict interpretation of Code § 402(a)); *supra* notes 33, 42 (in *Baetens,* employer's actions, and not taxpayer's actions, caused Commissioner to disqualify retirement plans).

165. *See supra* notes 1-2 and accompanying text (discussing policy underlying development of tax laws regulating retirement plans).

166. *Baetens,* 777 F.2d at 1167.

167. *Id.* at 1164.

cation resulting from actions by employers. Because of the recently enacted "top heavy"[168] retirement plan requirements, disqualification of retirement plans could become much more common.[169] Furthermore, actuaries predict that within forty years the number of elderly persons in the overall population will increase by fifty percent.[170] Actuaries claim that such an increase will reduce greatly the aid that the Social Security System will provide for retired workers.[171] Accordingly, retired individuals will have to rely more heavily on funds from private retirement plans. Congress should modify Code section 402(a) to allow innocent employees, in the event of disqualification, to retain the tax benefits associated with a qualified retirement plan when the employees have no control over a retirement plan's management and subsequent disqualification. Congress, in enacting Code section 132, has adopted the approach of allowing innocent employees to retain tax benefits when employers violate discrimination requirements.[172] Code section 132 allows employees to exclude certain fringe benefits from gross income.[173] Section 132

168. *See* I.R.C. § 416(g) (West 1985) (defining "top heavy" retirement plan as retirement plan in which greater than 60% of present value of cumulative benefits represent cumulative benefits of key employees). Section 416(a) of the Code allows the Commissioner to disqualify a "top heavy" retirement plan. *Id.* § 416(a). An employer, however, can avoid disqualification due to top heaviness by modifying the retirement plan to provide certain minimum vesting and benefit payment provisions. *See id.* § 416(b) (prescribing vesting requirements that allow employer to overcome "top heavy" classification and subsequent disqualification); *id.* § 416(c) (prescribing requirements that allow employer to overcome "top heavy" classification and related disqualification). Code § 416(b) provides that, if an employer allows 100% vesting within three years or 100% vesting on a graduated basis over six years, then the Commissioner will not disqualify the employer's retirement plan for top heaviness. *Id.* § 416(b). Code § 416(c) allows employers to avoid retirement plan disqualification due to top heaviness when the employer makes contributions on behalf of the non-key employees that exceed a minimum percentage of the non-key employees' salaries. *Id.* § 416(c). *See generally* 3 J. RABKIN & M. JOHNSON, FEDERAL INCOME GIFT AND ESTATE TAXATION § 15.04E (rev. perm. ed. 1985) (discussing "top heavy" retirement disqualification and conforming amendments to avoid disqualification); Bluestein & Levy, *Owner-Dominated Plans—Top-Heavy PLans and H.R. 10 Plans,* TAX MGMT. (BNA) 353, at A-2 to A-15 (1984) (discussing Code sections proscribing "top heavy" retirement plans).

169. *See* Musick, *TC Allows Partial Favorable Treatment On Distributions From Formerly Qualified Plans,* 62 J. TAX'N 134, 134 (1985) (new "top heavy" plan requirements threaten to increase involuntary and inadvertent retirement plan disqualification).

170. *See* C. WEAVER, THE CRISIS IN SOCIAL SECURITY 181 (1982). Currently, 15% of the United States population receives benefits from Social Security. *Id.* Actuaries predict that within 40 years 34% of the United States population will receive Social Security benefits. *Id.* at 182. This change in the complexion of the age distribution in the United States will result in a shift from 3.3 workers contributing to Social Security per beneficiary to 1.3 workers contributing to each Social Security beneficiary. *Id.*

171. *Id.* at 176. Actuaries predict that the Social Security system will operate with a surplus for about 20 years. *Id.* Within 30 years, however, the Social Security system should begin to operate at a deficit. *Id.* By the end of 40 years, Social Security beneficiaries will have depleted totally all Social Security funds. *Id.*

172. I.R.C. § 132 (West 1985).

173. *See id.* (Code § 132 allows exclusion from gross income for any fringe benefit which qualifies as no-additional-cost service, qualified employee discount, working condition fringe or

of the Code prohibits discrimination in the operation of such fringe benefit plans.[174] When the Commissioner discovers such discrimination, however, the Commissioner disallows the exclusion only to the extent that the fringe benefit plan discriminates.[175] Accordingly, the Commissioner avoids the unjust result of penalizing innocent employees who have no control over the management of the fringe benefit plan. Disallowing tax advantages to management but not innocent employees would remedy the present unjust consequences of retirement plan disqualification. Moreover, the equitable treatment of innocent participants of a disqualified retirement plan would further Congress' traditional policy of aiding working individuals in accumulating funds to provide for retirement needs.[176]

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de minimis fringe). *See generally* McKinney, *Certainty Provided as to the Treatment of Most Fringe Benefits by Deficit Reduction Act,* 61 J. TAX'N 134, 134 (1984) (§ 132 of Code legitimizes employer fringe benefit programs that have valid business purposes and provides clear procedural guidelines for Commissioner, employers, and employees); Shaller, *The New Fringe Benefit Legislation: A Codification of Historical Inequities,* 34 CATH. U. L. REV. 425, 429-32 (1985) (Code § 132 attempts to eliminate Commissioner's favoritism toward specific industries by codifying fringe benefit provisions available for all industries).

174. *See* I.R.C. § 132(h)(1) (West 1985) (discrimination results when employer offers fringe benefits to officers, owners, or highly compensated employees on different terms from other employees); *see also* H.R. REP. No. 432, 98th Cong., 2d Sess. 1592 (Congress implemented nondiscrimination provision in § 132 to prohibit fundamentally unfair result of allowing employers to provide tax free benefits only to highly paid executives), *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS 697, 1216.

175. *See* JOINT COMMITTEE ON TAXATION, 98TH CONG., 2D SESS., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 861 (Comm. Print 1984) (when availability of fringe benefit program does not satisfy nondiscrimination rules, exclusion still applies to employees who are not members of favored group).

176. *See supra* notes 1-2 and accompanying text (discussing policy underlying development of tax laws regulating retirement plan distributions).