UNITED STATES TAX COURT
WASHINGTON, DC 20217

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RENKA, INC.,

Petitioner(s),

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

Docket No. 15988-11R.

ORDER

This case was assigned to this division of the Court because it is related to four others that were on the June 18, 2012 San Francisco trial calendar. It arises from the Commissioner's determination that Renka's ESOP no longer qualified as a tax-exempt trust under I.R.C. § 401(a). The Commissioner's explanation of revocation concluded that the ESOP failed in 1998 because it did not meet the coverage requirements of § 410(b).[1] Renka timely filed a petition for a declaratory judgment under § 7476 that the Commissioner's determination was wrong – that in fact the ESOP did continue to qualify under § 401(a). The parties stipulated to the administrative record, but did not agree to submit the case for decision under Rule 122 because petitioner (despite the stipulation) objected to the completeness of that record.

The case then moved into motions practice and there are two motions pending. The Commissioner moved for summary judgment on the basis of the stipulated record, and the Court received briefs from both him and Renka. But the

[1] The Court assumes the parties' familiarity with the record, the terms of art in this complicated area of tax law, and the general principles of summary-judgment law. Section reference are to the Internal Revenue Code and regulations.

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Court did not get a reply brief from the Commissioner. Renka then moved for default and sanctions - it argued that the Commissioner's failure to file a reply brief meant that he should lose the case. The Court agrees with the Commissioner, however, that even were some sanction called for the appropriate penalty would not be the loss of a mulitmillion-dollar case but only loss of the right to file an untimely reply brief. The Court will deny this motion on grounds of disproportionality if nothing else. (The Court itself also acknowledges using the somewhat ambiguous phrase "*shall* file *any* reply brief on or before December 21," but agrees with the Commissioner that this made the filing of a reply brief optional.)

The Commissioner's summary-judgment motion is far more substantial, and we heard argument on it on August 19, 2014. This motion seeks a decision in the Commissioner's favor on the ground that Renka's ESOP failed to qualify under § 401(a) as of 1999 – not 1998 as in the explanation of revocation. In the Commissioner's view, it doesn't matter what year the Plan failed to work, because there is solid precedent that a Plan once disqualified stays disqualified – at least when the reason is a failure to meet the coverage requirements of § 410(b). *Pulver Roofing Co., Inc. v. Commissioner*, 70 T.C. 1001, 1015 (1978).

There are at least two problems here. The first is the Commissioner's seeming abandonment of his explanation of revocation, which disqualified the ESOP only because of facts as they supposedly existed in 1998. This raises a *Chenery* question. *See SEC v. Chenery Corp.,* 332 U.S. 194 (1947) (*Chenery II*); *SEC v. Chenery Corp.,* 318 U.S. 80 (1943) (*Chenery I*). The *Chenery* doctrine is an administrative-law principle that says "a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency." *Chenery II,* 332 U.S. at 196 (describing its holding in *Chenery I*). The Supreme Court not too long ago announced that "we are not inclined to carve out an approach to administrative review good for tax law only" and noted "the importance of maintaining a uniform approach to judicial review of administrative action." *Mayo Found. for Med. Educ. & Research v. United States,* 562 U.S. ___, ___, 131 S. Ct. 704, 713 (2011) (citation and internal quotation marks omitted).

After *Mayo*, we have followed the *Chenery* doctrine in CDP cases. *See Antioco v. Commissioner,* 105 T.C.M. (CCH) 1234, at *6-*7 (2013); *Jones v. Commissioner,* 104 T.C.M. (CCH) 364, at *22-*23 (2012); *Salahuddin v. Commissioner,* 103 T.C.M. (CCH) 1764, at *7 (2012). Although the Court has not ruled on the question of whether the doctrine applies in § 401 revocation proceedings, such proceedings also stem from an IRS determination made after the assembly of an administrative record and that determination is also reviewed for abuse of discretion. This inclines us to think that *Chenery* might be a reason all by itself to deny the Commissioner's motion. *But see Catholic Health Initiatives Iowa Corp. v. Sebelius,* 718 F.3d 914, 922 n. 6 (D.C. Cir. 2013) (*Chenery* waived if not raised, and Renka didn't raise it in opposing this motion.)

At least at this point in the proceedings, however, we don't need to reach for a precedent-setting reason; there's a bigger flaw in the Commissioner's argument that Renka's ESOP failed to qualify for the 1999 plan year. And that's the Commissioner's chain of reasoning that links Dieter Jr.'s attributed ownership of Renka stock to Dieter Sr.'s ownership of ANC stock that year. The Commissioner has to forge this chain because only if ANC and Renka are a brother-sister controlled group under § 1563(c)(2)(B) can the Commissioner treat all employees of both ANC and Renka as employees of a single employer under § 414(b). And only if ANC and Renka are members of a controlled group does Renka's ESOP fail to meet the minimum coverage requirements of § 410(b).

> Here's the chain as hammered together by the Commissioner in his motion: Dieter Jr. was the only Participant[2] in the Plan in 1999;
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> - On the Anniversary Date of the Plan that year, Dieter Jr. received a large block of Renka stock in his Plan Account;
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> - This Allocation under the Plan to Dieter Jr. meant that § 1563(e)(2)(3)(A) applied to make Dieter Jr. the constructive owner of the Renka stock that he was allocated;
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> - Section 1563(e)(6)(A) – which considers an individual as "owning stock owned . . . indirectly by . . . his children who have not attained the age of 21 years . . . – then makes Dieter Jr.'s stock constructively owned by Dieter Sr.; and
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> - Dieter Sr. owned 50% of ANC stock during 1999

which makes ANC and Renka a brother-sister control group.

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[2] When we capitalize otherwise ordinary words, we are referring to defined terms under Renka's ESOP.

The problem with this reasoning became evident during oral argument. Dieter Jr. turned 21 at the end of October 1999. But the Plan's Anniversary Date was December 31, 1999, which means Dieter Jr. wasn't allocated any Renka stock – and so isn't treated as constructively owning that stock – till after he had turned 21. The Commissioner argued that the characterization of a group of companies as a brother-sister controlled group is one that sticks to the group even if those companies meet the definition of controlled group for only one day during a year, because the definition of an "employee" as a "highly compensated employee" sticks to that employee for the entire year if he was a "5-percent owner *at any time during the year,*" *see* § 414(q)(1)(A).

This turns out to be just wrong. Section 1.410(b)-8(a) of the regs lets a plan qualify using a daily, quarterly, or annual "testing option." Any one will do, *see* § 1.410(b)-8(a)(1), so let's take a look at the annual option, which directs us to the state of a plan on the last day of the plan year. For Renka's Plan, this means December 31. On December 31, 1999, Dieter Jr. received his allocation of Renka stock, which made him constructive owner of the entire company.

Were Renka and ANC on that day a brother-sister controlled group? The answer to this question is in the § 1563 regulations. They also tell us to start with the state of affairs on December 31. § 1.1563-1(b)(1)(i). Well, on that date, Dieter Jr. was already 21, so we know from § 1563(e)(6) that Dieter Sr. isn't treated as constructively owning Dieter Jr.'s Renka stock, and that Dieter Jr. isn't treated as owning Dieter Sr.'s ANC stock.

Still, we're not quite done. Section 1.1563-1(b)(3) tells us to include in a controlled group companies that are not part of a controlled group if they would have been a member of a controlled group "for one-half (or more) of the number of days in such taxable year which precede such December 31." Dieter Jr. was a minor for more than half of 1999, which means that for more than half of that year, he *would* be treated as owning Dieter Sr.'s stock and *vice versa.* But here again the Commission runs into an obstacle – because all Renka stock was unallocated to Dieter Jr. until the very end of 1999, no Renka stock was constructively owned by Dieter Jr. until the end of that year and there's nothing to trigger the attribution rules to make that stock constructively owned by Dieter Sr. at any point. Which then means that there's nothing to make ANC and Renka a brother-sister controlled group for that year.

To sum up, it is

ORDERED that the Commissioner's October 9, 2012 motion for summary judgment is denied. It is also

ORDERED that Renka's April 29, 2013 motion for default and sanctions is denied. It is also

ORDERED Renka's June 5, 2014 motion for oral argument (reflected on the docket as undecided despite the Court's July 21, 2014 order granting oral argument) is denied as moot. It is also

ORDERED that Renka shall file any motion concerning its stipulation to the administrative record in this case on or before October 24, 2014.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
August 20, 2014