

ACTION ON DECISION

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Subject: Murillo v. Commissioner
T.C. Memo. 1998-13
T.C. Dkt. No. 18163-96

Issue:

Whether the forfeiture of an Individual Retirement Account ("IRA") to the United States pursuant to a civil proceeding causes the IRA owner to be liable for the 10 percent early distribution tax under I.R.C. § 72(t).

Discussion:

Petitioner was indicted in 1991 on charges of violating federal currency transaction reporting laws. In 1992, he entered into a plea agreement and was sentenced. In a related civil proceeding, all funds on deposit in a number of petitioner's accounts were forfeited to the United States pursuant to 18 U.S.C. § 981, including petitioner's Individual Retirement Accounts (IRA's) at Merrill Lynch and Fidelity Investments. The total amount forfeited from the IRA's was \$ 230,161. The distributions did not satisfy any of the statutory exceptions to the section 72(t) 10% additional tax on early distributions.

Petitioner reported the IRA distributions as taxable income on his 1992 Federal income tax return. He did not include the 10% additional tax under section 72(t). Petitioner also claimed a Schedule C loss in the amount of \$ 273,417.47, attributed to the forfeiture. The Tax Court held in favor of the Service in ruling that petitioner was not entitled to take a deduction for losses arising out of illegal activities. However, the court rejected the Service's position that the section 72(t) 10% additional tax on early distributions should apply.

In reaching its decision, the court reasoned that the IRA forfeiture was similar to the Service's levy on a Keogh account in Larotonda v. Commissioner, 89 T.C. 287 (1987)(involving the predecessor to section 72(t)), and was outside the class of early distributions that Congress intended to discourage in enacting section 72(t). The court did not rely on its finding that the IRA forfeiture was involuntary.

The Restructuring and Reform Act of 1988, Pub. L. No. 105-206, 112 Stat. 685 (1998), enacted on July 22, 1998, clarifies congressional intent with respect to this issue. Section 3436 of the Act amends section 72(t) to provide that the

early distribution tax shall not apply to a distribution made on account of a levy under section 6331 on a qualified retirement plan. Accordingly, the Service will apply section 72(t) as amended and no longer assess section 72(t) tax on distributions made on account of levy. In addition, the Service will not assess section 72(t) tax under the narrow circumstances of Murillo. However, in all other cases involving early distributions, the Service will continue to assess section 72(t) tax unless a statutory exception applies. See, e.g. In re Kochell, 804 F.2d 84 (7th Cir. 1986) (10 percent early distribution tax applied to a withdrawal made by bankruptcy trustee from an IRA under I.R.C. § 408(f)(1)).

Recommendation:

Acquiescence in result only

Reviewers:

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