Bone v. Commissioner, 52 T. C. 913 (1969)

A new corporation must file its election to be treated as a small business corporation within one month of acquiring assets or beginning business operations.

Summary

In Bone v. Commissioner, the U. S. Tax Court ruled that Tom Bone Citrus, Inc. (TBC) did not qualify as an electing small business corporation under IRC Section 1372 because its election was filed over a year after it began operations and acquired assets. TBC, formed to operate a citrus grove, was deemed to have started business and acquired property by October 1963, but did not file its election until November 1964. The court held that the election was untimely and thus invalid, rejecting the argument that the election could be delayed until stock issuance was authorized by the state. This decision underscores the strict adherence to the statutory deadlines for filing elections under Subchapter S.

Facts

Thomas E. Bone formed Tom Bone Citrus, Inc. (TBC) in August 1963 to develop a citrus grove. On October 7, 1963, Bone transferred a 33. 48-acre parcel to TBC, and the corporation began operations. However, TBC did not receive authorization to issue stock until October 28, 1964. TBC filed its election to be treated as a small business corporation under IRC Section 1372 on November 16, 1964, along with its tax returns for the fiscal periods ending August 31, 1964, and August 31, 1965, claiming losses for those years.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Bone's income tax for 1964 and 1965, disallowing the claimed loss deductions. Bone petitioned the U. S. Tax Court, arguing that the losses were deductible either as partnership losses before October 28, 1964, or as losses from an electing small business corporation after that date. The Tax Court held for the Commissioner, ruling that TBC's election was untimely and that the losses were not deductible.

Issue(s)

1. Whether Tom Bone Citrus, Inc. (TBC) was entitled to elect small business corporation status under IRC Section 1372 for its taxable years ending August 31, 1964, and August 31, 1965, given that the election was filed on November 16, 1964.

Holding

1. No, because TBC's election under IRC Section 1372 was filed over a year after it acquired assets and began business operations, making it untimely under the statute and regulations.

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Court's Reasoning

The court's decision was grounded in the strict interpretation of IRC Section 1372 and the related regulations. The court found that TBC's first taxable year began no later than October 7, 1963, when it acquired the citrus grove property and began operations. The court rejected Bone's argument that the election could be delayed until stock issuance was authorized, noting that under California law, a corporation's existence does not depend on the issuance of stock. The court emphasized that the statutory deadlines for electing small business corporation status are "demanding and explicit" and do not allow for leniency. The court also clarified that Bone and his father were shareholders by virtue of their stock subscriptions, capable of consenting to the election prior to October 1964.

Practical Implications

This decision reinforces the importance of adhering to statutory deadlines for electing small business corporation status. Practitioners must advise clients to file elections promptly after a corporation acquires assets or begins operations, regardless of delays in stock issuance. The ruling impacts how similar cases should be analyzed, emphasizing that the timing of the election is critical and not subject to exceptions for delays in corporate formalities. Businesses must be aware that failure to meet these deadlines can result in the loss of tax benefits associated with Subchapter S status. Subsequent cases have continued to uphold the strict interpretation of election deadlines, reinforcing the precedent set by Bone v. Commissioner.

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