Artukovich v. Commissioner, 61 T. C. 100 (1973); 1973 U. S. Tax Ct. LEXIS 32

For a new corporation, the first month of its taxable year begins when it has shareholders, acquires assets, or begins doing business, whichever occurs first, for purposes of making a timely Subchapter S election.

Summary

Ron Waller Enterprises, Inc. , a new corporation, attempted to elect Subchapter S status under IRC section 1372(a) on March 25, 1965. The IRS challenged the timeliness of this election, asserting it was filed more than one month after the corporation had acquired assets and begun business operations. The Tax Court held that the election was untimely because the corporation had acquired assets and incurred tax consequences more than one month before filing, thus starting the running of its first taxable year. This case establishes that a new corporation's Subchapter S election must be made within the first month of its taxable year, which begins when the corporation has shareholders, acquires assets, or starts doing business.

Facts

Ron Waller Enterprises, Inc. , was incorporated on December 23, 1964, and planned to operate a restaurant-nightclub. On January 13, 1965, the corporation borrowed $20,000 and opened bank accounts. On February 17, 1965, a lease for the business premises was assigned to the corporation, and before February 26, 1965, it spent over $7,000 on remodeling. The corporation filed its Subchapter S election on March 25, 1965, and opened for business on April 20, 1965. It incurred a net operating loss for its taxable year ending November 30, 1965, which the shareholders, Nick and Stella Artukovich, attempted to claim on their personal tax return.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Artukoviches' 1965 federal income tax, disallowing the deduction of the corporation's net operating loss due to the untimely Subchapter S election. The Artukoviches petitioned the U. S. Tax Court for a redetermination of the deficiency, arguing that the election was timely made. The Tax Court upheld the Commissioner's determination, ruling that the election was not timely within the meaning of IRC section 1372(c)(1).

Issue(s)

1. Whether the Subchapter S election filed by Ron Waller Enterprises, Inc. , on March 25, 1965, was timely under IRC section 1372(c)(1).

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Holding

1. No, because the corporation acquired assets and incurred tax consequences more than one month before the election was filed, starting the running of its first taxable year.

Court's Reasoning

The Tax Court applied IRC section 1372(c)(1) and its implementing regulation, section 1. 1372-2(b)(1), which states that the first month of a new corporation's taxable year begins when it has shareholders, acquires assets, or begins doing business. The court found that the corporation had acquired assets, including a $20,000 loan and a lease, and had incurred tax consequences before February 26, 1965, more than one month before the election was filed. The court rejected the taxpayers' argument that only "operating assets" trigger the start of the taxable year, holding that any asset acquisition with tax consequences does so. The court emphasized that the regulation's purpose is to postpone the need for an election until the corporation is no longer a "hollow shell," which occurred when the corporation engaged in these activities.

Practical Implications

This decision clarifies that new corporations must make their Subchapter S election within one month of acquiring assets or incurring tax consequences, not merely from the date of incorporation. Practitioners advising new corporations should ensure that the election is filed promptly after any asset acquisition or business commencement to avoid losing Subchapter S status. This ruling impacts how new businesses structure their initial operations and financing, as any asset acquisition, even if not directly related to the business's primary operations, can trigger the start of the taxable year. Subsequent cases have followed this ruling, reinforcing the strict interpretation of the timing requirement for Subchapter S elections.

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