Hicks Nurseries, Inc. v. Commissioner, 62 T. C. 138 (1974)

A husband and wife who own stock individually and jointly are considered one shareholder for the purpose of the 10-shareholder limit in small business corporation elections.

Summary

Hicks Nurseries, Inc. sought to be treated as a small business corporation under IRC section 1372, which required no more than 10 shareholders. To meet this requirement, two married couples transferred one share each into joint ownership. The court held that, under the regulations, these couples should be treated as single shareholders despite individual ownership of other shares, validating the election. Additionally, the court found that the IRS's revocation of an extension for a new shareholder's consent to the election was unreasonable, thus upholding the election's continued validity.

Facts

Hicks Nurseries, Inc. aimed to qualify as a small business corporation under IRC section 1372 in 1964, requiring no more than 10 shareholders. Initially, the corporation had 12 shareholders, including Edwin and Eloise Hicks, and John and Esther Emory. To reduce the shareholder count, each couple transferred one share into joint tenancy on December 31, 1963. The corporation filed its election on January 30, 1964, with shareholder consents reflecting both individual and joint ownership. Following Mr. Emory's death in 1966, his estate became a new shareholder, and Mrs. Emory, as executrix, did not file the required consent within 30 days. An extension was requested and granted in 1972 but later revoked by the IRS.

Procedural History

The IRS determined deficiencies in Hicks Nurseries, Inc. 's federal income taxes for the years 1964-1967, asserting that the corporation did not qualify as a small business corporation due to exceeding the 10-shareholder limit. Hicks Nurseries contested this in the U. S. Tax Court. The court examined the validity of the 1964 election and the effectiveness of the consent filed by Mrs. Emory's estate after the IRS's revocation of the extension.

Issue(s)

1. Whether a husband and wife, who own stock individually and jointly, should be counted as one or two shareholders for the purpose of the 10-shareholder limit under IRC section 1371(a)(1).
2. Whether the IRS had adequate grounds for revoking the extension of time granted to Mrs. Emory's estate to file a consent to the election.

Holding

1. Yes, because the regulations treat a husband and wife as one shareholder when they own stock jointly, even if they also own stock individually.
2. No, because the IRS's revocation of the extension was arbitrary and lacked sufficient reason, thus the consent filed within the extension period was effective.

Court's Reasoning

The court reasoned that the shareholders of Hicks Nurseries acted reasonably based on a plausible interpretation of the regulations, which treat spouses as a single shareholder when they own stock jointly, despite individual ownership. The court emphasized the importance of not retroactively applying a more restrictive interpretation that would unfairly disadvantage the shareholders who relied on the existing regulations. The court also criticized the IRS's revocation of the extension as arbitrary, noting that the IRS's reasoning was based on the challenged validity of the election, which should not affect the extension's validity. The court referenced prior cases like *Zellerbach Co. v. Helvering* and *Kean v. Commissioner* to support its decision against retroactive application of regulations and arbitrary IRS actions.

Practical Implications

This decision clarifies that for small business corporation elections, spouses can be counted as one shareholder even if they own stock both individually and jointly. This ruling guides tax professionals in advising clients on how to structure ownership to meet the 10-shareholder limit. Additionally, it sets a precedent against the IRS's arbitrary revocation of extensions for filing consents, emphasizing the need for clear and reasonable grounds for such actions. Subsequent cases applying this ruling include *Kean v. Commissioner*, which also dealt with the IRS's handling of extensions. This decision impacts how small businesses plan their tax strategies, ensuring that they can rely on the regulations as they exist when making elections.