Zinniel v. Commissioner, 89 T. C. 357, 1987 U. S. Tax Ct. LEXIS 122, 89 T. C. No. 32 (1987)

A new shareholder's affirmative refusal to consent to a corporation's subchapter S election need not be filed with the IRS to terminate the election, absent specific regulatory requirements.

Summary

In Zinniel v. Commissioner, the Tax Court ruled that the shareholders of Sierra Limited effectively terminated the corporation's subchapter S election by filing a refusal to consent with the corporation itself, rather than with the IRS. The shareholders transferred stock to their spouses, who then refused to consent to the election. The court found that the statutory language of section 1372(e)(1) did not mandate filing with the IRS and that the absence of regulations prescribing a specific filing method meant the refusal to consent was valid. This decision highlights the importance of statutory interpretation and the impact of regulatory delays on tax law application.

Facts

Sierra Limited, a Wisconsin corporation, elected to be taxed under subchapter S starting March 31, 1977. In November 1977, the three original shareholders transferred 30 shares each to their spouses. The new shareholders signed a document refusing to consent to the subchapter S election and filed it with Sierra Limited. No such refusal was filed with the IRS. The IRS later argued that the subchapter S election remained in effect because the refusal was not filed with them.

Procedural History

The IRS issued deficiency notices to the shareholders for the taxable years 1978 and 1979, asserting that the subchapter S election was not terminated. The shareholders petitioned the U. S. Tax Court, which heard the case and issued its decision on August 26, 1987, amended on September 25, 1987.

Issue(s)

1. Whether a new shareholder in a corporation that has made a subchapter S election must file an affirmative refusal to consent with the IRS to terminate the election?

Holding

1. No, because the plain meaning of section 1372(e)(1) does not require a new shareholder to file an affirmative refusal with the IRS, and the legislative history does not clearly indicate such an intent by Congress.

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Court’s Reasoning

The court focused on the statutory language of section 1372(e)(1), which states that a new shareholder must affirmatively refuse to consent “in such manner as the Secretary shall by regulations prescribe. ” Since no regulations were in place at the time of the shareholders’ actions, the court interpreted the statute’s plain meaning as not requiring a filing with the IRS. The court also reviewed legislative history and found no unequivocal evidence that Congress intended to mandate IRS filing. The court criticized the delay in issuing regulations, noting it created uncertainty and potentially new traps for taxpayers. The court concluded that the refusal to consent filed with Sierra Limited was sufficient to terminate the subchapter S election.

Practical Implications

This decision underscores the importance of statutory interpretation in tax law and the potential consequences of regulatory delays. Practitioners must carefully review existing statutes and regulations when advising clients on subchapter S elections. The ruling suggests that in the absence of specific regulatory requirements, taxpayers may take reasonable actions to terminate elections without filing with the IRS. This case may influence how similar situations are handled until regulations are updated. It also highlights the need for the IRS to promptly issue regulations to avoid confusion and ensure consistent application of tax laws.

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