111 West 16 Street Owners, Inc. v. Commissioner, 90 T. C. 1243, 1988 U. S. Tax Ct. LEXIS 80, 90 T. C. No. 80 (1988)

The IRS Commissioner has discretion to determine the number of shareholders that qualifies an S corporation as a small S corporation exempt from unified audit and litigation procedures.

Summary

In this case, the Tax Court addressed whether an S corporation with three shareholders in 1983 qualified as a small S corporation exempt from the unified audit and litigation procedures under the Internal Revenue Code. The court held that the IRS Commissioner has the discretion to set the number of shareholders for the small S corporation exception, affirming that only single shareholder S corporations are statutorily required to be exempted. The decision emphasizes the administrative nature of setting the qualifying number and rejects the argument that a lack of regulations automatically sets the number at 10 or fewer shareholders, as seen in partnership rules.

Facts

111 West 16 Street Owners, Inc. (Owners) was an S corporation with three shareholders in 1983. The IRS issued a Notice of Final S Corporation Administrative Adjustment for the 1983 taxable year. Alan Silverman, the tax matters person for Owners, moved to dismiss the case, arguing that Owners should be exempt from the S corporation audit and litigation procedures as a small S corporation. The IRS had not yet promulgated regulations defining what constituted a small S corporation at the time.

Procedural History

The IRS mailed a Notice of Final S Corporation Administrative Adjustment to Owners on March 4, 1987. Owners timely filed a petition with the U. S. Tax Court seeking readjustment. On February 1, 1988, Owners moved to dismiss the case for lack of jurisdiction, asserting they were a small S corporation. The IRS objected on March 8, 1988. The Tax Court heard the motion on April 11, 1988, and ultimately denied the motion to dismiss.

Issue(s)

1. Whether the Tax Court has jurisdiction over an S corporation with three shareholders under the S corporation audit and litigation procedures when the IRS has not set a number of shareholders for the small S corporation exception.

Holding

1. No, because the IRS Commissioner has discretion to determine the number of

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shareholders that qualifies an S corporation as a small S corporation exempt from these procedures, and the statute only mandates an exception for single shareholder S corporations.

Court’s Reasoning

The court reasoned that setting the number of shareholders for the small S corporation exception is an administrative function best left to the IRS Commissioner. The court noted that while the statute requires an exception for single shareholder S corporations, the IRS has discretion to set the qualifying number above one. The court rejected the argument that the absence of regulations automatically sets the number at 10 or fewer, as in the partnership context, due to significant differences between partnerships and S corporations. The court emphasized that the unified audit and litigation procedures aim to ensure consistent tax treatment for all shareholders and the government, which is meritorious for S corporations with more than one shareholder. The court found no abuse of discretion by the IRS in applying these procedures to Owners, as the petitioner did not show that a unified proceeding would be futile or useless.

Practical Implications

This decision clarifies that the IRS has discretion in setting the threshold for the small S corporation exception, impacting how S corporations are audited and litigated. Legal practitioners must be aware that only single shareholder S corporations are automatically exempt from unified procedures, and that the IRS can set higher thresholds. This ruling influences the planning and structuring of S corporations, particularly those with multiple shareholders, as they must prepare for potential unified audit procedures. Subsequent cases and IRS regulations have further defined the small S corporation exception, but this case remains pivotal for understanding the IRS’s administrative discretion in this area.

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