Fehlhaber v. Commissioner, 94 T. C. 863 (1990)

The statute of limitations for assessing a shareholder's tax liability from an S corporation's income or loss is based on the filing date of the shareholder's personal tax return, not the S corporation's information return.

Summary

Robert Fehlhaber, the sole shareholder of an S corporation, challenged the timeliness of a deficiency notice from the IRS, asserting it was barred by the statute of limitations. The IRS had issued the notice within three years of Fehlhaber's personal tax return but beyond three years from the S corporation's information return filing. The Tax Court ruled that the statute of limitations applies at the shareholder level, not the S corporation level, thus the notice was timely. This decision was based on the interpretation of Sections 6037(a) and 6501(a) of the Internal Revenue Code, emphasizing the shareholder's personal tax return as the relevant document for limitations purposes.

Facts

Robert Fehlhaber was the sole shareholder of Fehlhaber Associates, Inc. , an S corporation. The corporation timely filed its information return for the taxable year ended November 30, 1985. Fehlhaber filed his personal income tax return for the 1985 calendar year on or before April 15, 1986. The IRS issued a notice of deficiency to Fehlhaber on April 12, 1989, disallowing a loss from the S corporation, which was within three years of his personal return but beyond three years from the S corporation's return.

Procedural History

Fehlhaber filed a motion for summary judgment in the U. S. Tax Court, arguing the statute of limitations barred the IRS's deficiency assessment. The Tax Court, considering the motion, reviewed the legislative history and regulations related to Sections 6037(a) and 6501(a) of the Internal Revenue Code. The court denied Fehlhaber's motion, ruling that the statute of limitations for assessing Fehlhaber's tax liability was based on the filing date of his personal tax return.

Issue(s)

1. Whether the statute of limitations for assessing a shareholder's tax liability from an S corporation's income or loss is triggered by the filing of the S corporation's information return or the shareholder's personal income tax return?

Holding

1. No, because the statute of limitations for assessing a shareholder's tax liability is based on the filing of the shareholder's personal income tax return, not the S

corporation's information return, as per Sections 6037(a) and 6501(a) of the Internal Revenue Code.

Court's Reasoning

The court analyzed the legislative intent behind Sections 6037(a) and 6501(a), emphasizing that an S corporation's information return is treated as a corporate return for limitations purposes only when the S election is ineffective or the corporation becomes liable for taxes. The court rejected the Ninth Circuit's decision in Kelley v. Commissioner, which applied the statute of limitations at the S corporation level, as incompatible with congressional intent. The court noted that the S corporation's information return does not compute the shareholder's tax liability and lacks necessary data for assessing deficiencies, unlike the shareholder's personal return. The court also considered the practical implications of the Ninth Circuit's approach, which could lead to unintended consequences, such as the expiration of the statute of limitations for non-filing shareholders or an indefinite period for late-filing S corporations. The court concluded that the statute of limitations should be strictly construed in favor of the government, and thus, the relevant return for limitations purposes is the shareholder's personal return.

Practical Implications

This decision clarifies that the IRS has three years from the filing of a shareholder's personal income tax return to assess any tax related to S corporation income or loss. Practitioners should advise S corporation shareholders to keep personal records accessible for at least three years after filing their returns, regardless of the S corporation's record-keeping. This ruling may impact how S corporations and their shareholders approach tax planning and compliance, as it underscores the importance of the shareholder's personal return in tax assessments. Later cases have generally followed this precedent, reinforcing the distinction between S corporation information returns and shareholder personal returns for statute of limitations purposes.

