Dial USA, Inc. v. Commissioner, 95 T. C. 1 (1990)

The Tax Court lacks jurisdiction to determine a shareholder's basis in an S corporation during corporate-level proceedings under section 6241 et seq.

Summary

In Dial USA, Inc. v. Commissioner, the U. S. Tax Court addressed whether it could determine the basis of individual shareholders in an S corporation during a corporate-level audit and litigation proceeding. The IRS sought to decide shareholder basis as part of these proceedings, but the court held that it lacked jurisdiction to do so. The decision was based on the statutory definition of "subchapter S items," which do not include shareholder basis. The court emphasized that while certain subchapter S items might affect shareholder basis, the determination of basis itself is not required to be taken into account at the corporate level and thus cannot be adjudicated there.

Facts

Dial USA, Inc. , formerly Tritelco, Inc. , was an S corporation subject to the S corporation audit and litigation procedures under section 6241 et seq. The IRS filed a motion for entry of decision to determine the basis of each shareholder in the corporation for the taxable year 1984. The proposed decision sought to address these basis amounts based on subchapter S items. No objections were filed by the shareholders or the corporation against the IRS's motion.

Procedural History

The IRS initially filed a motion for entry of decision on November 20, 1989, which included proposed findings on shareholder basis. The Tax Court held hearings and questioned its jurisdiction to determine basis at the corporate level. After the IRS withdrew its first motion and filed a second one, specifying that it sought to determine basis "to the extent the bases are comprised of subchapter S items," the court again considered the issue and ultimately denied the motion.

Issue(s)

1. Whether the Tax Court has jurisdiction to determine a shareholder's basis in an S corporation during proceedings conducted under section 6241 et seq.

Holding

1. No, because a shareholder's basis in an S corporation is not a "subchapter S item" that can be determined at the corporate level under section 6241 et seq.

Court's Reasoning

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The court's decision was grounded in the statutory and regulatory framework governing S corporation audits and litigation. Section 6245 defines "subchapter S items" as items of an S corporation required to be taken into account for the corporation's taxable year. The regulations under this section do not list shareholder basis as such an item. The court distinguished between items required to be taken into account at the corporate level (subchapter S items) and those determined at the shareholder level, such as basis. The court also noted that while certain subchapter S items like contributions and distributions might affect basis, the basis itself cannot always be determined solely by these items. The court rejected the IRS's argument that it should decide basis "to the extent" it is comprised of subchapter S items, citing potential confusion and the lack of clarity in such a qualified decision. The court emphasized that any subsequent litigation over basis would be bound by the determination of subchapter S items made in the corporate proceeding.

Practical Implications

This decision clarifies that the Tax Court cannot adjudicate shareholder basis in S corporation proceedings, limiting such determinations to the shareholder level. Practitioners must be aware that while subchapter S items can impact basis, the actual determination of basis must occur separately from corporate-level proceedings. This ruling may increase the administrative burden on the IRS, which will need to issue individual notices of deficiency to shareholders to address basis issues. It also underscores the importance of precise record-keeping by S corporations and their shareholders regarding basis adjustments. Subsequent cases like *Roberts v. Commissioner* have further explored the boundaries of what constitutes a "subchapter S item," reinforcing the Dial USA decision's impact on S corporation tax practice.

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