Hang v. Commissioner, 95 T. C. 74 (1990)

The reallocation of S corporation income from shareholders of record to non-shareholders is not within the scope of judicial review in an S corporation proceeding.

Summary

In Hang v. Commissioner, the Tax Court addressed whether it could review the IRS's reallocation of income from shareholders of record in an S corporation to a non-shareholder. The case involved Davidan Orthodontic Lab, Inc. , an S corporation whose shareholders of record were minors David and Daniel Hang. The IRS sought to reallocate income to William Hang, who they claimed was the beneficial owner. The court held that such reallocations to non-shareholders are not within the scope of judicial review in S corporation proceedings, as they cannot be determined at the corporate level. This decision emphasizes the importance of distinguishing between corporate-level and shareholder-level determinations in S corporation cases.

Facts

Davidan Orthodontic Lab, Inc. , an S corporation, had two shareholders of record, David and Daniel Hang, who were minors. Their mother, Deborah Hang, was their legal guardian. The IRS issued Final S Corporation Administrative Adjustments (FSAA) for 1984 and 1985, reallocating income from David and Daniel Hang to William Hang, who was not a shareholder of record but was alleged to be the beneficial owner. The petitioners moved to dismiss and/or for partial judgment on the pleadings regarding these reallocations.

Procedural History

The IRS issued notices of deficiency to William and Deborah Hang for unreported income from Davidan for 1983-1985. Subsequently, FSAA's were issued for Davidan for 1984 and 1985, reallocating income to William Hang. The petitioners filed a petition in the Tax Court to redetermine the tax deficiencies and readjust the income reallocation. The court granted the IRS's motion to dismiss the part of the case involving income tax deficiencies for 1984 and 1985 due to the S corporation involvement. The petitioners then moved to dismiss the reallocations made in the FSAA's.

Issue(s)

1. Whether the reallocation of income from shareholders of record to a non-shareholder of record is within the scope of judicial review in an S corporation proceeding.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. No, because the determination of who is the beneficial shareholder cannot be made at the corporate level and thus falls outside the scope of review in an S corporation proceeding.

Court's Reasoning

The court reasoned that the S corporation audit and litigation procedures, under sections 6241 et seq. of the Internal Revenue Code, aim to determine subchapter S items at the corporate level. However, the reallocation of income from shareholders of record to a non-shareholder, such as William Hang, involves factors that cannot be determined at the corporate level. The court highlighted that beneficial ownership is a factual question based on who has control and enjoyment of the stock's economic benefits, which must be determined at the shareholder level. Furthermore, the court noted that allowing such reallocations to be reviewed in an S corporation proceeding would preclude the alleged beneficial shareholders from participating until their status was determined, which contradicts the statutory intent of section 6243. The court concluded that the reallocation of income to a non-shareholder is not within the scope of judicial review under section 6226(f), and thus granted the petitioners' motion to dismiss the FSAA's for 1984 and 1985.

Practical Implications

This decision limits the IRS's ability to reallocate S corporation income to non-shareholders through S corporation proceedings. Practitioners should be aware that disputes over beneficial ownership must be addressed at the shareholder level, not through corporate-level proceedings. This ruling may affect how the IRS pursues similar cases, potentially requiring separate actions against non-shareholders to reallocate income. It also underscores the importance of clear record-keeping and documentation of shareholder status in S corporations to avoid disputes over beneficial ownership. Subsequent cases may need to address the practical challenges of determining beneficial ownership when it diverges from the shareholders of record.

© 2025 SCOTUSreports.com. All rights reserved.