Eastern States Casualty Agency, Inc. v. Commissioner, 96 T. C. 773 (1991)

No small S corporation exception existed under the unified audit and litigation procedures for S corporations before the effective date of the 1987 temporary regulations.

Summary

The case involved Eastern States Casualty Agency, an S corporation with four shareholders, challenging the IRS's issuance of a final S corporation administrative adjustment (FSAA) for the 1984 tax year. The key issue was whether S corporations with 10 or fewer shareholders were exempt from unified audit procedures prior to 1987. The Tax Court, overturning its prior decisions, ruled that no such exception existed before the 1987 temporary regulations, meaning the FSAA was validly issued. This decision had significant implications for how S corporations would be audited until the regulations were enacted.

Facts

Eastern States Casualty Agency, Inc. , an S corporation, had four shareholders during the 1984 tax year. The IRS issued a notice of final S corporation administrative adjustment (FSAA) on December 20, 1989, adjusting the corporation's tax return for that year. Wilma Smith, the tax matters person for Eastern States, filed a petition for readjustment on February 26, 1990, and later moved to dismiss the case for lack of jurisdiction, arguing that the FSAA was invalid because S corporations with 10 or fewer shareholders were exempt from the unified audit and litigation procedures under sections 6244 and 6231(a)(1)(B) of the Internal Revenue Code.

Procedural History

The IRS issued an FSAA to Eastern States on December 20, 1989. On February 26, 1990, Wilma Smith, as tax matters person, filed a timely petition for readjustment. On January 31, 1991, Smith moved to dismiss the case for lack of jurisdiction. The Tax Court, reconsidering its prior decisions in Blanco Investments & Land, Ltd. v. Commissioner and 111 West 16th St. Owners, Inc. v. Commissioner, held that no small S corporation exception existed before the 1987 temporary regulations and denied the motion to dismiss.

Issue(s)

1. Whether S corporations with 10 or fewer shareholders were exempt from the unified audit and litigation procedures under sections 6244 and 6231(a)(1)(B) of the Internal Revenue Code prior to the effective date of the 1987 temporary regulations.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. No, because prior to the effective date of the 1987 temporary regulations, no such exception existed, and thus the FSAA was validly issued to Eastern States.

Court's Reasoning

The Tax Court's decision hinged on its interpretation of sections 6241, 6244, and 6231 of the Internal Revenue Code. The court rejected its prior holdings in Blanco and 111 West, which had recognized a small S corporation exception based on section 6244's reference to partnership items. The court reasoned that the term "partnership items" in section 6244 referred specifically to items of income, loss, deductions, and credits, not to the definition of a partnership under TEFRA, which included the small partnership exception. The court emphasized that Congress had given the Secretary discretion under section 6241 to issue regulations excepting S corporations from unified procedures, and no such exception was in place before the 1987 regulations. The majority opinion also noted that extending the small partnership exception to S corporations would render section 6241 meaningless. Judge Whalen dissented, arguing that the small partnership exception was integral to the definition of partnership items and should have been extended to S corporations.

Practical Implications

This decision clarified that no small S corporation exception existed under the unified audit procedures before the 1987 temporary regulations. Practically, this meant that S corporations with 10 or fewer shareholders were subject to unified audit procedures for tax years before 1987, contrary to what had been assumed based on prior Tax Court rulings. The decision impacted how tax professionals and the IRS approached audits of S corporations for those years, requiring adjustments to be determined at the corporate level rather than the shareholder level. The case also highlighted the importance of waiting for regulatory guidance before assuming exceptions to statutory provisions. Subsequent cases and regulations have built upon this ruling, further defining the scope of the small S corporation exception and its application to tax years after 1987.

© 2025 SCOTUSreports.com. All rights reserved.