Coggin Automotive Corp. v. Commissioner, T.C. Memo. 2001-123 (2001)

When a corporation revokes its S corporation election and later re-elects S status, the ‘most recent election’ rule of Section 1374(d)(9) of the Internal Revenue Code applies, subjecting the corporation to the built-in gains tax for a new 10-year period based on the re-election date, regardless of a prior S election before 1989 and associated transition rules.

Summary

Coggin Automotive Corp., initially a C corporation, elected S corporation status in 1988. It revoked this election in 1989 and operated as a C corporation until re-electing S status in 1994. During 1994-1996, the IRS assessed deficiencies against Coggin, arguing that gains from asset sales were subject to the built-in gains tax under Section 1374 as amended by the Tax Reform Act of 1986 (TRA). Coggin argued that the transition rule of TRA Section 633(d) should apply because its initial S election was before 1989. The Tax Court held that Section 1374(d)(9), as amended, explicitly refers to the ‘most recent election,’ which was the 1994 re-election, thus subjecting Coggin to the amended built-in gains tax rules for a new 10-year period. The transition rule was deemed inapplicable due to the intervening revocation of S status.

Facts

Coggin Automotive Corp. was incorporated in 1977 and operated as a C corporation until February 1, 1988, when it made a valid S corporation election. At the time of the 1988 election, Coggin held assets with unrealized gains and earnings and profits accrued during its C corporation years. These assets included securities, real estate interests, and oil and gas partnership interests. Effective December 1, 1989, Coggin revoked its S election and filed as a C corporation through 1993. On January 1, 1994, Coggin again made a valid S corporation election. During 1994-1996, Coggin sold assets, primarily acquired before 1988, generating gains.

Procedural History

The Internal Revenue Service (IRS) issued a notice of deficiency to Coggin for the tax years 1994, 1995, and 1996, asserting deficiencies related to the built-in gains tax. Coggin petitioned the Tax Court to dispute these deficiencies. The case was submitted to the Tax Court fully stipulated, meaning the parties agreed on all the factual details, and the court only needed to decide the legal issue.

Issue(s)

1. Whether the transition rule of Section 633(d) of the Tax Reform Act of 1986 applies to Coggin Automotive Corp. for the years 1994-1996, given that Coggin made an S election before 1989 but revoked and re-elected S status.

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2. Whether Section 1374 of the Internal Revenue Code, as amended by the Tax Reform Act of 1986, applies to Coggin's 1994, 1995, and 1996 taxable years due to its 1994 S corporation re-election.

Holding

1. No, the transition rule of TRA Section 633(d) does not apply because Coggin's S election was not continuous from before 1989 to the years in issue due to the revocation and subsequent re-election.

2. Yes, Section 1374, as amended, applies because Section 1374(d)(9) explicitly states that references to the '1st taxable year for which the corporation was an S corporation' refer to the '1st taxable year for which the corporation was an S corporation pursuant to its most recent election under section 1362.' Coggin's 'most recent election' was in 1994.

Court's Reasoning

The Tax Court reasoned that the plain language of Section 1374(d)(9), as amended, is clear and unambiguous. The statute directs the court to consider the 'most recent election' when determining the applicability of the built-in gains tax. The court stated, "Section 1374, as amended, is applicable to the 10-year period after an S corporation's 'most recent election'. Sec. 1374(d)(9)." Coggin's 'most recent election' was in 1994. The court rejected Coggin's argument that the 1988 election and the transition rule should govern, emphasizing that the revocation of the S election in 1989 interrupted the continuity required for the transition rule to apply. The court noted that when Coggin became a C corporation in 1989, the transition rule became inapplicable. Upon re-electing S status in 1994, Coggin became subject to Section 1374 as amended and in effect at that time. The court also found that this interpretation was consistent with the legislative history of TRA Section 633, which aimed to tax built-in gains of corporations electing S status after 1986.

Practical Implications

Coggin Automotive Corp. clarifies that the 'most recent election' rule in Section 1374(d)(9) is strictly applied. For practitioners, this case highlights the importance of considering the built-in gains tax implications whenever a corporation re-elects S status after a revocation. Even if a corporation had an S election in place before the Tax Reform Act of 1986 and might have initially benefited from transition rules, a subsequent revocation and re-election resets the clock. The 10-year built-in gains tax period begins anew with the 'most recent election.' This decision emphasizes the need for careful tax planning when considering S corporation revocations and re-elections, particularly for corporations holding appreciated assets. It underscores that the IRS and courts will adhere to the literal language of Section 1374(d)(9), focusing on the most recent S election to determine the applicable tax regime.

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