***N. Y. Football Giants, Inc. v. Commissioner, 117 T. C. 152 (U. S. Tax Ct. 2001)***

In a significant ruling on S corporation taxation, the U. S. Tax Court held that the built-in gains tax under IRC section 1374 is a subchapter S item, necessitating a unified audit and litigation procedure at the corporate level. This decision impacts how S corporations must handle the tax on gains from assets held at the time of conversion from C to S status, affirming the IRS's jurisdiction over such items without issuing a notice of deficiency for fiscal years 1996 and 1997.

**Parties**

New York Football Giants, Inc. (Petitioner) filed a petition against the Commissioner of Internal Revenue (Respondent) in the U. S. Tax Court. The petitioner was an S corporation challenging the respondent's determination of built-in gains tax liability for fiscal years 1996, 1997, and 1998.

**Facts**

New York Football Giants, Inc. , an S corporation since 1993, received expansion payments from the NFL in 1996, 1997, and 1998. These payments were reported as capital gains on the corporation's tax returns. The Commissioner determined that these payments were subject to the built-in gains tax under section 1374 of the Internal Revenue Code, which imposes a corporate-level tax on recognized built-in gains during the first ten years of S corporation status. The Commissioner issued a notice of deficiency for these years, asserting the tax liability, which the petitioner contested, arguing the built-in gains tax was not a subchapter S item.

**Procedural History**

The Commissioner moved to dismiss the case for lack of jurisdiction regarding fiscal years 1996 and 1997, asserting that the built-in gains tax is a subchapter S item that should be determined through a unified audit and litigation procedure, and thus a notice of deficiency was improper. The petitioner argued against this classification and the validity of the relevant regulations. The Tax Court granted the Commissioner's motion to dismiss and strike as to fiscal years 1996 and 1997, affirming that the built-in gains tax is a subchapter S item and must be addressed through the unified audit procedures.

**Issue(s)**

Whether the built-in gains tax imposed under section 1374 of the Internal Revenue Code is a subchapter S item that must be determined through a unified audit and litigation procedure at the corporate level?

**Rule(s) of Law**

 

The Internal Revenue Code section 6245 defines a subchapter S item as any item of an S corporation that is more appropriately determined at the corporate level than at the shareholder level, as provided by regulations. Temporary Regulation section 301. 6245-1T(a)(1)(vi)(G) specifically includes taxes imposed at the corporate level, such as the section 1374 built-in gains tax, as subchapter S items.

**Holding**

The U. S. Tax Court held that the built-in gains tax under section 1374 is a subchapter S item. As such, it must be determined through a unified audit and litigation procedure at the corporate level, and the Commissioner's notice of deficiency was invalid for fiscal years 1996 and 1997.

**Reasoning**

The court's reasoning centered on the statutory framework and regulations governing S corporations. It emphasized that the built-in gains tax is determined based on events at the corporate level, specifically the appreciation of assets held at the time of conversion from C to S status. The court found that Temporary Regulation section 301. 6245-1T, which classifies the built-in gains tax as a subchapter S item, was not arbitrary, capricious, or contrary to the statute, and thus valid under the Chevron deference standard. The court rejected the petitioner's contention that the tax should be considered an S item at the shareholder level, noting that it is assessed against and paid directly by the S corporation, not the shareholders. Furthermore, the court considered policy considerations favoring a unified audit process to avoid inconsistent determinations and to streamline the tax administration process for S corporations.

**Disposition**

The court granted the Commissioner's motion to dismiss and to strike as to fiscal years 1996 and 1997, indicating that a notice of final S corporation administrative adjustment should have been issued for those years instead of a notice of deficiency.

**Significance/Impact**

This decision has significant implications for S corporations regarding the handling of the built-in gains tax. It clarifies that such tax must be addressed through the unified audit and litigation procedures, ensuring consistent treatment among shareholders. The ruling reinforces the IRS's authority to regulate S corporation items at the corporate level and may affect how S corporations report and challenge tax liabilities related to built-in gains. Subsequent courts have cited this case when dealing with similar issues of subchapter S items, and it has influenced the practical approach to S corporation taxation.

 