Mourad v. Commissioner, 121 T. C. 1 (U. S. Tax Court 2003)

In Mourad v. Commissioner, the U. S. Tax Court ruled that filing for bankruptcy under Chapter 11 does not terminate an S corporation's status, and its income remains taxable to shareholders. The court also denied the petitioner's claim for low-income housing credits due to non-compliance with procedural requirements. This decision clarifies that S corporation tax obligations persist through bankruptcy proceedings, impacting how shareholders report income from such entities.

Parties

Alphonse Mourad, the petitioner, filed a petition in the United States Tax Court against the Commissioner of Internal Revenue, the respondent. Mourad was the sole shareholder of V&M Management, Inc. , an S corporation.

Facts

Alphonse Mourad was the sole shareholder of V&M Management, Inc. , an S corporation that elected this status on January 1, 1984. V&M Management owned and operated Mandela Apartments, a 275-unit complex in Roxbury, Massachusetts, purchased from the Secretary of Housing and Urban Development on December 11, 1981. On January 8, 1996, V&M Management filed for Chapter 11 bankruptcy reorganization. An independent trustee, Stephen S. Gray, was appointed by the U. S. Bankruptcy Court, District of Massachusetts, to administer the reorganization. The Commissioner filed proofs of claim for unpaid employment taxes owed by V&M Management. On September 26, 1997, a reorganization plan was confirmed, and on December 18, 1997, the trustee sold Mandela Apartments and related property for $2,872,351. The 1997 tax return filed by the trustee on behalf of V&M Management reported a gain of $2,088,554 from the sale. Mourad did not file individual income tax returns for 1996 and 1997. The Commissioner determined Mourad's 1997 income tax deficiency based on V&M Management's reported gain, issuing a notice of deficiency on August 13, 2001.

Procedural History

V&M Management filed for Chapter 11 bankruptcy on January 8, 1996, and an independent trustee was appointed. A reorganization plan was confirmed on September 26, 1997. The trustee sold the principal asset, Mandela Apartments, on December 18, 1997. Mourad did not file individual income tax returns for 1996 and 1997. On August 13, 2001, the Commissioner issued a notice of deficiency to Mourad for the 1997 tax year. Mourad filed a petition with the United States Tax Court for redetermination of the deficiency. The Tax Court reviewed the case de novo.

Issue(s)

Whether the filing of a Chapter 11 bankruptcy petition by an S corporation terminates its S corporation status, thereby affecting the taxability of its income to shareholders?

Whether Mourad is entitled to low-income housing tax credits for the year at issue?

Whether statements made by the Commissioner’s representative at the bankruptcy plan confirmation hearing waived the Commissioner’s claim for Mourad’s 1997 income tax?

Rule(s) of Law

An S corporation election continues until terminated by one of three methods: revocation by shareholders, ceasing to be a “small business corporation,” or exceeding the passive income limit. *See* 26 U. S. C. § 1362(d). A “small business corporation” is defined by specific criteria, none of which are affected by filing for bankruptcy. *See* 26 U. S. C. § 1361(b). The filing of a bankruptcy petition does not create a separate taxable entity for corporations. *See* 26 U. S. C. § 1399. To claim low-income housing credits, a taxpayer must comply with specific statutory and regulatory requirements, including obtaining a housing credit allocation from a state or local agency. *See* 26 U. S. C. § 42; 26 C. F. R. § 1. 42-1T.

Holding

The Tax Court held that filing for Chapter 11 bankruptcy does not terminate an S corporation’s status, and the income of V&M Management remained taxable to Mourad. Mourad was not entitled to low-income housing tax credits due to his failure to comply with the necessary procedures. The statements made by the Commissioner’s representative at the bankruptcy plan confirmation hearing did not waive the Commissioner’s claim for Mourad’s 1997 income tax.

Reasoning

The court reasoned that the Internal Revenue Code specifies only three methods for terminating an S corporation election, none of which include filing for bankruptcy. The court cited *In re Stadler Associates, Inc.* , 186 B. R. 762 (Bankr. S. D. Fla. 1995), which held that filing for bankruptcy does not cause an S corporation to cease being a “small business corporation. ” The court also noted that no separate taxable entity is created by a corporation’s bankruptcy filing under 26 U. S. C. § 1399. Regarding low-income housing credits, the court emphasized Mourad’s failure to comply with the statutory and regulatory requirements, such as obtaining a housing credit allocation and filing the necessary forms. The court rejected Mourad’s argument that statements made by the Commissioner’s representative at the bankruptcy hearing waived the Commissioner’s claim for Mourad’s 1997 income tax, clarifying that those statements pertained to employment taxes owed by V&M Management, not Mourad’s personal income tax liability.

Disposition

The Tax Court entered judgment for the Commissioner, affirming the deficiency determination for Mourad's 1997 income tax.

Significance/Impact

This case establishes that filing for Chapter 11 bankruptcy does not terminate an S corporation's tax status or create a separate taxable entity, thereby maintaining the tax liability of shareholders on the corporation's income. It also underscores the importance of adhering to procedural requirements for claiming low-income housing credits. The decision has implications for shareholders of S corporations in bankruptcy and highlights the need for careful tax planning and compliance with tax credit regulations.

