Chapman Glen Ltd. v. Commissioner, 140 T. C. No. 15 (2013)

In Chapman Glen Ltd. v. Commissioner, the U. S. Tax Court ruled that the termination of a foreign insurance company's election to be treated as a domestic corporation under I. R. C. sec. 953(d) resulted in a taxable exchange of its assets. The court also valued the company's real property holdings at over $20 million, rejecting the taxpayer's lower valuation. This decision clarifies the tax consequences of electing out of foreign corporation status and the standards for valuing real estate for tax purposes.

Parties

Chapman Glen Limited (Petitioner) v. Commissioner of Internal Revenue (Respondent). Petitioner was a foreign insurance company that elected to be treated as a domestic corporation for U. S. tax purposes under I. R. C. sec. 953(d). Respondent is the Commissioner of the Internal Revenue Service.

Facts

Chapman Glen Limited (CGL) was a foreign insurance company formed in the British Virgin Islands in 1996. In 1998, CGL elected under I. R. C. sec. 953(d) to be treated as a domestic corporation for U. S. tax purposes, effective December 27, 1997. In 1999, CGL applied for and was granted tax-exempt status under I. R. C. sec. 501(c)(15) as an insurance company, effective January 1, 1998. In 2001, the Enniss family purchased CGL through BC Investments, L. L. C. CGL's primary asset was its ownership of Enniss Family Realty I, L. L. C. (EFR), a disregarded entity that owned various pieces of real property in California. In 2006, CGL consented to the revocation of its tax-exempt status effective January 1, 2002. The IRS determined that CGL's election under sec. 953(d) terminated in 2002 because it was no longer an insurance company, resulting in a deemed sale of its assets on January 1, 2003.

Procedural History

CGL filed Forms 990 for 2002, 2003, and 2004, claiming exempt status. In 2006, CGL consented to the revocation of its exempt status effective January 1, 2002. The IRS then determined deficiencies for 2002, 2003, and 2004, including a deemed sale of CGL's assets on January 1, 2003, resulting in a one-day taxable year. CGL petitioned the Tax Court to redetermine the deficiencies. The court consolidated two cases for trial, briefing, and opinion.

Issue(s)

1. Whether the three-year period of limitations under I. R. C. sec. 6501(a) had expired for the 2003 taxable year? 2. Whether CGL properly elected under I. R. C. sec. 953(d) to be treated as a domestic corporation? 3. Whether the termination of CGL's sec. 953(d) election resulted in a taxable exchange under I. R. C. secs. 354, 367, and 953(d)(5) during a one-day taxable year in 2003? 4. Whether EFR's real

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property was included in the taxable exchange? 5. What was the fair market value of EFR's real property on January 1, 2003? 6. Whether CGL's gross income included amounts determined to be "insurance premiums" by the IRS?

Rule(s) of Law

1. I. R. C. sec. 6501(a) provides a three-year statute of limitations for assessing tax, which begins when a return is filed. An unsigned return does not commence the running of the period. See Lucas v. Pilliod Lumber Co. , 281 U. S. 245 (1930). 2. I. R. C. sec. 953(d) allows a foreign insurance company to elect to be treated as a domestic corporation. The election terminates if the company fails to meet the requirements of sec. 953(d)(1). See I. R. C. sec. 953(d)(2)(B). 3. Upon termination of a sec. 953(d) election, the corporation is treated as a domestic corporation that transfers all its assets to a foreign corporation in an exchange to which I. R. C. sec. 354 applies. See I. R. C. sec. 953(d)(5). 4. I. R. C. sec. 367(a)(1) generally treats a foreign corporation receiving property in an exchange to which sec. 354 applies as not a corporation for purposes of determining gain recognition by the transferor. 5. The fair market value of property is determined based on the highest and best use of the property on the valuation date, taking into account all relevant evidence. See Commissioner v. Scottish Am. Inv. Co. , 323 U. S. 119 (1944).

Holding

1. The three-year period of limitations under sec. 6501(a) did not expire for the 2003 taxable year because CGL's Form 990 for 2003 was not signed by an officer and thus was not a valid return. 2. CGL properly elected under sec. 953(d) to be treated as a domestic corporation. 3. The termination of CGL's sec. 953(d) election resulted in a taxable exchange under secs. 354, 367, and 953(d)(5) during a one-day taxable year beginning and ending on January 1, 2003. 4. EFR's real property was included in the taxable exchange because EFR was a disregarded entity owned by CGL. 5. The fair market value of EFR's real property on January 1, 2003, was over $20 million, with specific values determined for each property group. 6. CGL's gross income did not include the amounts determined to be "insurance premiums" by the IRS, as CGL did not provide insurance during the relevant years.

Reasoning

1. The court held that the period of limitations for the 2003 taxable year did not expire because CGL's Form 990 for 2003 was not signed by an officer, as required by I. R. C. sec. 6062. An unsigned return is not valid for commencing the running of the statute of limitations. 2. The court found that CGL's sec. 953(d) election was valid because the individual who signed the election was a responsible corporate officer. The election terminated in 2002 when CGL ceased to be an insurance company. 3. The termination of the sec. 953(d) election resulted in a taxable exchange under sec. 953(d)(5), which treats the termination as a transfer of all assets to a foreign corporation in an exchange to which sec. 354 applies. The court

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rejected CGL's argument that sec. 367 was not intended to apply in this context, finding the plain language of the statute controlling. 4. The court held that EFR's real property was included in the taxable exchange because EFR was a disregarded entity owned by CGL. The court rejected CGL's argument that the Enniss family directly owned EFR, finding that CGL's ownership of EFR was established by the facts and CGL's tax returns. 5. The court determined the fair market value of EFR's real property based on expert testimony and comparable sales data. The court found that CGL's expert's valuation was more persuasive for most property groups but adjusted the valuation to account for tipping fees that the property owner could receive. 6. The court held that the amounts CGL reported as insurance premiums on its Forms 990 were not taxable as such because CGL did not provide insurance during the relevant years. The court rejected the IRS's attempt to recharacterize the amounts as rental income, finding that the issue was raised too late in the proceedings.

Disposition

The Tax Court held that the IRS properly determined deficiencies for the 2003 taxable year, including the one-day taxable year on January 1, 2003, resulting from the termination of CGL's sec. 953(d) election. The court determined the fair market value of EFR's real property and held that the amounts reported as insurance premiums were not taxable income. Decisions were to be entered under Rule 155.

Significance/Impact

This case clarifies the tax consequences of a foreign insurance company electing out of sec. 953(d) status, resulting in a taxable exchange of its assets under sec. 367. The decision also provides guidance on valuing real property for tax purposes, including the consideration of tipping fees and the application of market absorption discounts. The court's rejection of the IRS's attempt to recharacterize income at a late stage in the proceedings underscores the importance of timely raising issues in tax litigation.

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