***Law Office of John H. Eggertsen P. C. v. Commissioner, 142 T. C. 110 (2014)***

The U. S. Tax Court ruled that the IRS could impose a 50% excise tax on an S corporation's Employee Stock Ownership Plan (ESOP) for a nonallocation year under IRC section 4979A, but the statute of limitations had expired for assessing the tax. This decision clarifies the application of excise taxes to ESOPs and emphasizes the importance of timely IRS action in such cases.

**Parties**

Petitioner: Law Office of John H. Eggertsen P. C. , an S corporation, at the trial and appeal stages.
Respondent: Commissioner of Internal Revenue, at the trial and appeal stages.

**Facts**

John H. Eggertsen purchased all 500 shares of J & R's Little Harvest, Inc. on January 1, 1998. On January 1, 1999, J & R's Little Harvest established an ESOP, and on December 10, 1999, Eggertsen transferred the 500 shares to the ESOP. The company later changed its name to Law Office of John H. Eggertsen P. C. Effective January 1, 2002, the ESOP trust agreement was amended to reflect the name change. At all relevant times, 100% of the stock of the petitioner was allocated to Eggertsen under the ESOP. The ESOP held the stock in a Company Stock Account until June 30, 2005, and thereafter in an Other Investment Account. In 2006, the ESOP filed its 2005 annual return, reporting three participants and assets valued at $401,500, consisting exclusively of employer securities. An amended return was later filed, increasing the reported asset value to $868,833 but maintaining the value of employer securities at $401,500. The petitioner did not file Form 5330 for the excise tax for 2005, and the IRS filed a substitute return. On April 14, 2011, the IRS issued a notice of deficiency to the petitioner, determining a deficiency and addition to the excise tax for 2005.

**Procedural History**

The IRS issued a notice of deficiency to the petitioner on April 14, 2011, determining a deficiency of $200,750 and an addition of $50,187. 50 to the petitioner's excise tax for 2005. The petitioner filed a petition with the U. S. Tax Court. The case was submitted fully stipulated under Rule 122 of the Tax Court Rules of Practice and Procedure. The Tax Court held that section 4979A(a) imposed an excise tax on the petitioner for 2005 but found that the period of limitations for assessing the tax had expired under section 4979A(e)(2)(D).

**Issue(s)**

Whether section 4979A(a) imposes an excise tax on the petitioner for its taxable year 2005 due to the occurrence of a nonallocation year under section 4979A(a)(3)?

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Whether the period of limitations under section 4979A(e)(2)(D) has expired for assessing the excise tax that section 4979A(a) imposes on the petitioner for its taxable year 2005?

**Rule(s) of Law**

Section 4979A(a) imposes a 50% excise tax on an S corporation if, among other events, there is a nonallocation year described in section 4979A(e)(2)(C) with respect to an employee stock ownership plan. A nonallocation year occurs when disqualified persons own at least 50% of the S corporation's stock, as defined in section 409(p)(3)(A). The period of limitations for assessing the excise tax under section 4979A(a) does not expire before three years from the later of the ownership referred to in that section or the date on which the Secretary of the Treasury is notified of such ownership, as per section 4979A(e)(2)(D).

**Holding**

The court held that section 4979A(a) imposes an excise tax on the petitioner for its taxable year 2005, as 2005 was the first nonallocation year with respect to the ESOP in question, and disqualified persons owned all of the stock of the petitioner. However, the court also held that the period of limitations under section 4979A(e)(2)(D) for assessing that tax had expired.

**Reasoning**

The court reasoned that the occurrence of a nonallocation year triggers the excise tax under section 4979A(a)(3) because it necessitates ownership by disqualified persons of at least 50% of the S corporation's stock. The court rejected the petitioner's argument that the tax only applies to an "allocation" or "ownership" and not to a nonallocation year, citing the legislative history and the statutory language indicating that the tax applies to the first nonallocation year. Regarding the statute of limitations, the court found that the IRS was notified of the ownership giving rise to the excise tax through the 2005 Form 1120S and the ESOP's 2005 annual return, which provided all necessary details. The court determined that the IRS was notified later than the ownership that gave rise to the tax, and thus the three-year period of limitations under section 4979A(e)(2)(D) had expired by the time the notice of deficiency was issued on April 14, 2011.

**Disposition**

The court entered a decision for the petitioner, holding that while section 4979A(a) imposed an excise tax for the taxable year 2005, the period of limitations for assessing that tax had expired.

**Significance/Impact**

This case clarifies that the excise tax under section 4979A(a) can be triggered by the

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occurrence of a nonallocation year in an ESOP, emphasizing the importance of the ownership element in such a determination. It also highlights the strict enforcement of the statute of limitations under section 4979A(e)(2)(D), requiring the IRS to act within three years of being notified of the ownership that gives rise to the tax. The decision impacts how S corporations with ESOPs manage their tax filings and how the IRS must timely assess excise taxes related to nonallocation years. Subsequent cases have referenced this decision in interpreting similar provisions of the tax code.

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