Law Office of John H. Eggertsen P. C. v. Commissioner, 142 T. C. 4 (2014)

In a significant ruling on ESOP-related excise taxes, the U. S. Tax Court held that Law Office of John H. Eggertsen P. C. was liable for a 50% excise tax under I. R. C. § 4979A(a) for the 2005 tax year due to a nonallocation year in its employee stock ownership plan (ESOP). However, the court also determined that the IRS's period to assess this tax had expired, effectively nullifying the tax obligation. This decision clarifies the application of excise taxes on S corporations with ESOPs and underscores the importance of statutory time limits for tax assessments.

Parties

Law Office of John H. Eggertsen P. C. (Petitioner) v. Commissioner of Internal Revenue (Respondent). Petitioner, an S corporation, challenged the excise tax determination made by the Respondent, the Commissioner of Internal Revenue, for the taxable year 2005.

Facts

John H. Eggertsen purchased all 500 shares of J & R's Little Harvest, Inc. in 1998, which later became Law Office of John H. Eggertsen P. C. In 1999, the company established an ESOP, to which Eggertsen transferred the shares. Throughout the relevant period, 100% of the company's stock was allocated to Eggertsen under the ESOP. In 2005, the ESOP held assets valued at $401,500, exclusively in employer securities. The company filed its 2005 tax return in 2006, and the ESOP filed its annual report for 2005 during the same year.

Procedural History

The Commissioner determined a deficiency and addition to the petitioner's federal excise tax for the 2005 tax year under I. R. C. § 4979A(a) and § 6651(a)(1), respectively. The petitioner contested the deficiency, leading to the Tax Court case. The court's review was de novo, with the burden of proof on the petitioner to show the determinations were erroneous. The case was fully stipulated under Rule 122 of the Tax Court Rules of Practice and Procedure.

Issue(s)

Whether I. R. C. § 4979A(a) imposes a federal excise tax on the petitioner for its taxable year 2005?

Whether the period of limitations under I. R. C. § 4979A(e)(2)(D) for assessing the excise tax has expired?

Rule(s) of Law

I. R. C. § 4979A(a) imposes a 50% excise tax on certain allocations or ownerships in an ESOP, including allocations that violate § 409(p) or occur during a nonallocation year as described in § 4979A(e)(2)(C). I. R. C. § 4979A(e)(2)(D) sets the period of limitations for assessing the excise tax at three years from the later of the ownership giving rise to the tax or the date the Secretary is notified of such ownership.

Holding

The court held that I. R. C. § 4979A(a) imposed an excise tax on the petitioner for its taxable year 2005 due to the ownership of all the stock by a disqualified person, John H. Eggertsen, during a nonallocation year. However, the period of limitations under I. R. C. § 4979A(e)(2)(D) for assessing this tax had expired by the time the Commissioner issued the notice of deficiency.

Reasoning

The court reasoned that the occurrence of a nonallocation year, as defined by § 409(p)(3)(A), triggered the excise tax under § 4979A(a) due to the ownership of stock by disqualified persons. The court rejected the petitioner’s argument that the tax could only be triggered by an allocation of employer securities, emphasizing that ownership by disqualified persons during a nonallocation year was sufficient. The court also analyzed the legislative history of § 4979A(a), which supported the imposition of the tax on ownership in the first nonallocation year. Regarding the statute of limitations, the court found that the IRS was notified of the ownership through the 2005 tax filings, and thus the three-year period for assessment began in 2006, expiring in 2009 before the notice of deficiency was issued in 2011.

Disposition

The court entered a decision for the petitioner, holding that the period of limitations for assessing the excise tax had expired, thereby nullifying the tax obligation.

Significance/Impact

This case is significant for clarifying that the excise tax under § 4979A(a) can be triggered by the ownership of stock by disqualified persons during a nonallocation year in an ESOP. It also reinforces the importance of the statute of limitations in tax assessments, demonstrating that timely notification of ownership to the IRS can limit the period during which the IRS can assess taxes. The decision impacts the management of ESOPs by S corporations and underscores the need for careful monitoring of statutory deadlines.

