Foster Garvey

Larry's Tax Law

Avoid Owning Real Property In Closely-Held Corporations

By Larry Brant on 10.7.14 | Posted in Individual Income Tax

Trugman v. Commissioner, 138 T.C. 22 (2012) exemplifies one of many reasons why you do not put real estate in a corporation, especially your personal residence.

The Trugmans were the sole shareholders of Sanstu corporation, an S corporation. Over the years, the S corporation acquired rental real estate all across the country. The Trugmans likely did not utilize professional tax advisors.

In 2009, for some reason, the Trugmans awoke from a deep sleep and started thinking about tax planning. To avoid tax on the income from their stock portfolio, they moved to Nevada which has no state income tax.

That same year, the Trugmans caused Santsu to purchase a single family dwelling they could occupy as their home. Santsu contributed about 98% of the purchase price; and the Trugmans put in the other 2% or about $7500 toward the purchase. The deed to the property listed Santsu as the sole owner.

Since they had not been homeowners in over three years, the Trugmans claimed a first-time homebuyer credit on their 2009 joint individual tax return under now expired IRC Section 36.

-->

-->

The Service audited the Trugmans and disallowed the credit on the ground the credit was only available to individuals. The statute is clear; the credit only applies to individuals.

The Trugmans, rather than give up on the $8000 refundable tax credit, appealed. After losing at appeals, they marched pro se into the US Tax Court.

The issue, a matter of first impression for the US Tax Court, was whether an individual may claim a credit under Section 36 for a principal residence that was actually purchased and owned by his or her wholly owned S corporation.

Judge Kroupa, who has the patience of a saint, gently told the Trugmans that they lost the battle – an S corporation is not an individual. Consequently, since the Corporation owned the home, it could not claim the credit. Likewise, the Trugmans, because they were not the owners of the home, could not claim the credit. The saga ends.

What happens if the Trugmans keep the home in the S corporation; the real estate market in Nevada recovers; and the corporation sells the home at a significant profit this year? Under Judge Kroupa's ruling, no IRC Section 121 exclusion is available – the IRC Section 121 exclusion is only available to individuals since it applies to the sale of personal residences; Judge Kroupa pointed out to the Trugmans that only individuals have personal residences; corporations may have a place of organization; they do not have personal residences.

Tags: Individual Income Tax