

UNITED STATES TAX COURT
WASHINGTON, DC 20217

JASON CHAI,)	
)	
Petitioner(s),)	CZ
)	
v.)	Docket No. 18330-09.
)	
COMMISSIONER OF INTERNAL REVENUE,)	
)	
Respondent)	

ORDER

This case was commenced on July 31, 2009, by the petition challenging the determination of a \$63,751 deficiency and a \$12,750.20 section 6662(a) penalty for 2003.

On October 30, 2009, respondent filed an Amendment to Answer asserting an increased deficiency and increased penalty in the amounts of \$627,619 and \$125,524, respectively. The case was tried on December 17 and 19, 2013. On December 17, 2013, petitioner filed a Motion to Dismiss for Lack of Subject Matter Jurisdiction on the ground that respondent’s asserted increased deficiency and increased penalty are related to Mercato Global Opportunities Fund, LP (“Mercato”), a Tax Equity and Fiscal Responsibility Act (“TEFRA”), Pub. L. 97-248, sec. 402(a), 96 Stat. 648, partnership that was subject to a separate TEFRA partnership-level proceeding before the Court. Specifically, petitioner argues that this Court does not have subject matter jurisdiction with regard to the TEFRA partnership items that were subject to the TEFRA partnership-level proceeding. On January 31, 2014, respondent filed an Opposition to Motion to Dismiss for Lack of Jurisdiction.

Concurrent with the filing of its Opposition to Motion to Dismiss for Lack of Jurisdiction, respondent filed a Motion for Leave to File First Amendment to Answer and a First Amendment to Answer, wherein respondent attempted to cure the jurisdictional deficiencies in the Amendment to Answer by alleging that the partnership-level adjustments had been sustained by a final decision in the TEFRA proceeding. On April 11, 2014, petitioner filed a Response to Motion for Leave to

File First Amendment to Answer, indicating that petitioner did not object to the amendment but did not waive his jurisdictional objection previously asserted. On April 24, 2014, the Court granted the Motion for Leave to File First Amendment to Answer and the First Amendment to Answer was filed on the same date. The increased penalty is no longer at issue. Respondent has conceded that the Court lacks jurisdiction over the increased penalty.

In the Amendment to Answer respondent asserted an increased deficiency and increased penalty based on his assertion that petitioner incorrectly reported his distributive share of partnership losses attributable to Mercato in the amount of \$11,149,621 on his Federal income tax return for taxable year 2003. Relying on Munro v. Commissioner, 92 T.C. 71 (1989), respondent argued that in calculating petitioner's deficiency he could ignore petitioner's claimed partnership losses, the validity of which were being challenged in an ongoing TEFRA partnership-level proceeding.

Here, the increased deficiency resulted from respondent recalculating petitioner's deficiency by eliminating the Mercato losses that were reported on petitioner's 2003 return. In effect, respondent attempted to disallow petitioner's claimed partnership losses (for purposes of determining petitioner's deficiency) before this Court disallowed the partnership's losses in the TEFRA partnership-level proceeding. Thus, the increased deficiency and increased penalties were based on respondent's proposed, but unadjudicated, adjustments to petitioner's partnership items.

Respondent misinterprets Munro. In Munro this Court did not authorize the Commissioner to increase a taxpayer's deficiency based on the Commissioner's proposed, but unadjudicated, adjustments to a taxpayer's partnership items. Rather, this Court held that the Commissioner may ignore a taxpayer's partnership items to determine whether there is a deficiency that is solely attributable to non-partnership items. To be sure, the Court stated: "Notwithstanding the existence of a deficiency, the deficiency determined by respondent does not correlate with the deficiency that arises out of his adjustments to nonpartnership items, and only the deficiency attributable to nonpartnership items can be at issue in this case. As to the balance, the deficiency [resulting from the Commissioner's proposed but unadjudicated adjustments to partnership items], if any, must await the outcome of the partnership proceedings." Munro v. Commissioner, 92 T.C. at 74.

Respondent's interpretation and application of Munro are contrary to Munro's holding. This Court's opinion in Munro made clear that any proposed increased deficiency or increased penalty attributable to a proposed adjustment to a partnership item that was at issue in a related TEFRA partnership-level proceeding must await the outcome of the TEFRA partnership-level proceeding. This Court reaffirmed that proposition in GAF Corp. v. Commissioner, 114 T.C. 519 (2000), holding that a valid notice of deficiency based on affected partnership items could not be issued prior to completion of related partnership-level proceedings. See id. at 528. The present case is indistinguishable from GAF Corp. v. Commissioner. As a result, we lack subject matter jurisdiction over the increased deficiency asserted in the Amendment to Answer because it is based on respondent's proposed adjustments to petitioner's affected partnership items before the conclusion of the related Mercato TEFRA partnership-level proceedings.

Moreover, respondent's alternative argument does not otherwise cure the Court's lack of jurisdiction. Respondent argues that even if the Amendment to Answer was untimely when it was filed, this Court now has jurisdiction over the increased deficiency because he filed the First Amendment to Answer after the conclusion of the TEFRA proceeding. Respondent's argument assumes that the subchapter B deficiency procedures are the proper method for applying the results of the TEFRA proceeding to petitioner.

Subchapter B deficiency procedures apply to income, estate and gift taxes under subtitles A and B. See sec. 6211(a). A "deficiency" is defined in section 6211(a) as:

the amount by which the tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44, exceeds the excess of –

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over –

(2) the amount of rebates, as defined in subsection (b)(2), made.

Section 6211(a) does not prohibit or limit taking partnership items into account in determining a deficiency. Similarly, section 6214 sets forth the Court's jurisdiction to determine a deficiency and does not restrict the Court's jurisdiction over partnership items.

Partnership items are distinguished from affected items, which are defined in section 6231(a)(5) as "any item to the extent such item is affected by a partnership item." See sec. 6231(a)(5); White v. Commissioner, 95 T.C. 209, 211 (1990). The first type of affected item is purely a computational adjustment made to record the change in a partner's tax liability resulting from the proper treatment of partnership items. See sec. 6231(a)(6); White v. Commissioner, 95 T.C. at 211. The second type of affected item is an adjustment to a partner's tax liability to reflect the proper treatment of a partnership item that is dependent upon factual determinations to be made at the individual partner level. See N.C.F. Energy Partners v. Commissioner, 89 T.C. 741, 743-744 (2010); see also Crowell v. Commissioner, 102 T.C. 683, 689 (1994).

Section 6230 coordinates the results of TEFRA proceedings with the individual partners' deficiency proceedings. Section 6230(a)(1) restricts sections 6211(a) and 6214 and provides that the subchapter B deficiency procedures only apply to two circumstances: (i) affected items that require a partner-level determination (factual affected items), or (ii) items that have become non-partnership items. See sec. 6230(a)(2)(A). If neither (i) nor (ii) are present, then the results of the TEFRA partnership-level proceeding are not subject to subchapter B deficiency procedures and the Commissioner is permitted to assess a computational adjustment against a partner without issuing a notice of deficiency. See secs. 6225, 6230(a)(1); N.C.F. Energy Partners v. Commissioner, 89 T.C. 741, 744 (1987). A computational adjustment is defined in the Code as "the change in the tax liability of a partner which properly reflects the treatment under this subchapter of a partnership item. All adjustments required to apply the results of a proceeding with respect to a partnership under this subchapter to an indirect partner shall be treated as computational adjustments." Sec. 6231(a)(6). The Commissioner accomplishes this by issuing the taxpayer a "Notice of Computational Adjustment" under section 6230(c)(2)(A).

For purposes of the Motion to Dismiss, the critical inquiry then is whether the increased deficiency is an affected item that requires a partner-level determination before it can be assessed. (We note that the second basis is inapplicable here because the partnership losses at issue did not become non-partnership items as defined in section 6231(b)). If the increased deficiency is an

affected item that requires a partner-level determination before it can be assessed then the results of the Mercato TEFRA partnership-level proceeding are properly applied to petitioner through the subchapter B deficiency procedures and the Motion to Dismiss should be denied. However, if the increased deficiency is not an affected item that requires a partner-level determination then the results of the Mercato TEFRA partnership-level proceeding can only be applied to petitioner through a Notice of Computational Adjustment.

The increased deficiency is not an affected item that requires a partner-level determination. There is no factual determination that must occur in the petitioner's deficiency proceeding before respondent can apply the results of the TEFRA partnership-level proceeding. The disallowed losses from the TEFRA partnership-level proceeding can be applied to petitioner's 2003 income taxes regardless of the outcome of this deficiency proceeding (whether the \$2 million at issue in this case is taxable non-employee compensation or a return of capital). Therefore, because the increased deficiency is not an affected item requiring a partner-level determination, section 6230(a)(1) requires that the results of the TEFRA partnership-level proceeding be applied to petitioner through a Notice of Computational Adjustment. As a result, the First Amendment to Answer did not cure the Court's lack of jurisdiction over the increased deficiency, and the Court will grant petitioner's Motion to Dismiss for Lack of Subject Matter Jurisdiction as to the increased deficiency.

Upon due consideration and for cause, it is hereby

ORDERED that petitioner's Motion to Dismiss for Lack of Subject Matter Jurisdiction filed December 17, 2013, is granted. It is further

ORDERED that respondent's claims for and increased deficiency and increased penalty are dismissed for lack of jurisdiction.

**(Signed) Mary Ann Cohen
Judge**

Dated: Washington, D.C.
February 13, 2015