

**UNITED STATES TAX COURT
WASHINGTON, DC 20217**

BENYAMIN AVRAHAMI & ORNA)
AVRAHAMI,)
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Petitioners,)
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v.) Docket No. 16792-16.
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COMMISSIONER OF INTERNAL REVENUE,)
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Respondent)
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ORDER

This is a redetermination case involving deficiencies in income tax and accuracy-related penalties for the taxable (calendar) years 2012 and 2013 as determined by respondent in a notice of deficiency dated May 19, 2016. Pending before the Court is petitioners’ Motion To Strike, filed November 3, 2016. In their motion petitioners move to strike from respondent’s Amendment To Answer, filed October 4, 2016, paragraphs 10 through 14 in their entirety. Respondent filed a Notice Of Objection to petitioner’s motion on November 28, 2016. Thereafter, petitioners filed a Reply in rebuttal on February 15, 2017.

Other than what appears to be mechanical adjustments, the deficiencies in income tax for 2012 and 2013 are attributable to adjustments made by respondent in the notice of deficiency in the amounts of \$1,199,000 and \$887,683, respectively, for “Other income from Form 5471 * * * reflecting Subpart F Income from foreign activities.”¹ In their Petition, petitioners allege that respondent erred in making such determination and assert that they “are not required to report Other Income from Form 5471”, that they “are not required to file Forms 5471”, and that

¹ IRS Form 5471 is entitled “Information Return of U.S. Persons With Respect To Certain Foreign Corporations”.

they “did not fail to report Other Income from Form 5471 (i.e., Subpart F Income from foreign activities)”, on their income tax returns for 2012 and 2013. In his Answer respondent denies that he erred in making the \$1,199,000 and \$887,683 adjustments for those years.

Within three weeks of filing his Answer respondent filed a First Amendment To Answer, which adds paragraphs 10 through 14 to his pleading and asserts an increased deficiency and penalty against petitioners. The introductory sentences of paragraphs 10 through 12 of respondent’s First Amendment To Answer provide as follows:

10. FURTHER ANSWERING the Petition, Respondent alleges that Petitioners’ correct share of ordinary income from American Findings Corporation for the taxable years 2012 and 2013 is \$1,165,622 and \$1,149,197, respectively, rather than the \$144,622 and \$98,197 reported on their tax returns. Respondent alleges that the adjustments to Petitioners’ correct share of ordinary income from American Findings Corporation for taxable years 2012 and 2013 is based on the following: [subparagraphs (a) through (k) omitted]

11. FURTHER ANSWERING the Petition, Respondent alleges that Petitioners’ correct share of ordinary income from Chandler One LLC for the taxable year 2012 is \$205,755 rather than the \$129,755 reported on their tax return. Respondent alleges that the adjustments to Petitioners’ correct share of ordinary income from Chandler One LLC for taxable year 2012 is based on the following: [subparagraphs (a) through (k) omitted]

12. FURTHER ANSWERING the Petition, Respondent alleges that Petitioners’ correct share of ordinary income/(loss) from White Knight Investment ACC for the taxable years 2012 and 2013 is \$(588,560) and \$54,031, respectively, rather than the \$(637,560) and \$5,031 reported on their tax returns. Respondent alleges that the adjustments to Petitioners’ correct share of ordinary income/(loss) from White Knight Investment ACC for taxable years 2012 and 2013 is based on the following: [subparagraphs (a) through (k) omitted]

[Emphasis added.]

Subparagraphs (a) through (k) of paragraphs 10 through 12 consist of allegations relating to certain reported expenses not constituting payments for insurance, captive insurance arrangements, transactions lacking economic substance, and the like. Paragraph 13 of respondent's First Amendment To Answer then asserts an increased deficiency in income tax against petitioners for 2013, while paragraph 14 asserts an increased accuracy-related penalty for that year.²

According to respondent,³ American Findings Corporation, Chandler One LLC, and White Knight Investment ACC (referenced in paragraphs 10, 11, and 12, respectively, of respondents' First Amendment To Answer) are non-TEFRA pass-through entities, with Chandler One LLC being a small partnership owned equally by petitioners as individuals and the other two being S corporations. Petitioners do not challenge these assertions.⁴

In their Motion To Strike, petitioners do not challenge the validity of respondent's May 19, 2016 notice of deficiency, but rather invoke Scar v. Commissioner, 814 F.2d 1363 (9th Cir. 1987), alleging that respondent "failed to consider any information with respect to taxpayers, American Findings Corporation, Chandler One LLC, or White Knight Investment before issuing its Notice of Deficiency to Petitioners." Admittedly, the notice of deficiency is silent regarding any flow-through adjustment from any of the foregoing entities, but in the Court's view that does not mean that Scar precludes respondent from asserting an increased deficiency and penalty pursuant to I.R.C. section 6214(a) in respect of a flow-through adjustment.⁵

² In his Notice Of Objection to petitioners' Motion To Strike, respondent states that he "made no allegation of an increased deficiency for taxable year 2012 because, even with the new matters alleged, no increased deficiency exists."

³ See respondent's Notice Of Objection.

⁴ See petitioners' Reply To Notice Of Objection.

⁵ I.R.C. sec. 6214(a), which petitioners acknowledge but fail to come to grips with, provides in relevant part as follows:

SEC. 6214. DETERMINATIONS BY TAX COURT.

(a) JURISDICTION AS TO INCREASE OF DEFICIENCY, ADDITIONAL AMOUNTS, OR ADDITIONS TO THE TAX.-- * * * the Tax Court shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine [continued on next page]

In Scar v. Commissioner, 814 F.2d 1363 (9th Cir. 1987), rev'g 81 T.C. 855 (1983), the taxpayers, after receiving a notice of deficiency that disallowed a deduction from a partnership with which the taxpayers had no connection, argued that the Commissioner failed to determine a deficiency as contemplated under I.R.C. section 6212(a). A review of various statements attached to the notice of deficiency revealed that the Commissioner had issued the notice without reviewing the taxpayers' tax return, which admittedly had been filed. Further, the Commissioner admitted to having done so "to protect the government's interest". Scar v. Commissioner, 814 F.2d at 1365.

After invoking this Court's jurisdiction, the taxpayers filed a motion to dismiss for lack of jurisdiction. This Court held the notice of deficiency to be valid and denied the taxpayers' motion to dismiss. Scar v. Commissioner, 81 T.C. 855 (1983).

In analyzing the issue on appeal, the Court of Appeals for the Ninth Circuit concluded that the Commissioner must consider information relating to a particular taxpayer before it can be said that the Commissioner determined a deficiency with respect to that taxpayer. Scar v. Commissioner, 814 F.2d at 1368. With this standard in mind, the Court of Appeals found the notice of deficiency to be invalid under section 6212(a) because the notice on its face revealed that the Commissioner had not reviewed the taxpayers' return or otherwise made a determination respecting the taxpayers' liability for the particular taxable year. Id., at 1370.

Courts applying Scar, including both this Court and the Court of Appeals for the Ninth Circuit, have limited the rule established in that case to its facts. See Sealy Power, Ltd. v. Commissioner, 46 F.3d 382, 387-388 (5th Cir. 1995); Kantor v. Commissioner, 998 F.2d 1514, 1521-1522 (9th Cir. 1993); Campbell v. Commissioner, 90 T.C. 110, 114-115 (1988); Green Gas Delaware Statutory Trust v. Commissioner, T.C. Memo. 2015-168. Simply stated, the rule set forth in Scar

whether any additional amount, or any addition to the tax should be assessed, if claim therefor is asserted by the Secretary at or before the hearing or a rehearing.

Typically, a claim for an increased deficiency is made by the Commissioner in an answer, an amended answer, or an amendment to an answer. See generally Tax Court Rule 41, regarding Amended and Supplemental Pleadings; see also Tax Court Rule 142(a)(1), placing the burden of proof on the Commissioner in respect of, inter alia, any new matter and increases in deficiency, pleaded in the answer.

v. Commissioner, applies in the narrow set of circumstances where the notice of deficiency on its face reveals that respondent failed to make a determination, thereby invalidating the notice and thus depriving this Court of jurisdiction to proceed on the merits.

In the instant case, petitioners do not allege that the May 19, 2016 notice of deficiency is invalid; to the contrary, they appear to acknowledge its validity. That being so, it is clear that the prerequisites to this Court's redetermination jurisdiction, i.e., a valid notice of deficiency and a timely-filed petition, are present. This makes Scar inapposite, as that case focused on this Court's jurisdiction.

But even if one were to read Scar more broadly, petitioners' reliance on it is still misplaced. After all, respondent's allegations in paragraphs 10 through 12 of his First Amendment To Answer demonstrate that petitioners' share of ordinary income (or loss) from the three entities in question is either greater than (insofar as income is concerned) or less than (insofar as loss is concerned) the specific amounts of income or loss reported on petitioners' returns. Obviously, therefore, respondent looked at relevant returns. Moreover, respondent represents that all three entities are non-TEFRA flow-through entities, that one of them is a small partnership owned equally by petitioners as individuals, and that the other two are S corporations, presumably also owned (in whole or in part) by petitioners. Notably, petitioners have not challenged these representations, nor have petitioners challenged respondent's allegations regarding the amounts of income (or loss) from these three entities that were reported by petitioners on their 2012 and 2013 income tax returns. Under these circumstances, Scar does not support petitioners' motion.

Finally, mention should be made of the fact that motions to strike are not favored by the federal courts. See Estate of Jephson v. Commissioner, 81 T.C. 999, 1000-1001 (1983). A matter will not be stricken from a pleading unless it can have no possible bearing upon the subject matter of the litigation. In addition, a motion to strike will usually not be granted unless there is a showing of prejudice to the moving party. Id., at 1001. Given the provisions of I.R.C. section 6214(a), as well as Tax Court Rule 142(a) regarding the burden of proof in respect of new matters and increases in deficiency, and further given the fact that the instant case has not yet been calendared for trial, petitioners' Motion To Strike does not overcome these restrictions or satisfy these standards. In short, petitioners have not shown that the allegations in respondent's First Amendment To Answer are not justiciable in the instant case.

Premises considered, it is hereby

ORDERED that petitioners' Motion To Strike, filed November 3, 2016, is denied. I.R.C. sec. 6214(a).

(Signed) Robert N. Armen
Special Trial Judge

Dated: Washington, D.C.
May 31, 2017