

UNITED STATES TAX COURT
WASHINGTON, DC 20217

PA

LORI J. MANROE,)
)
Petitioner,)
)
v.) Docket No. 21590-17.
)
COMMISSIONER OF INTERNAL REVENUE,)
)
Respondent.)

ORDER

The petition in this case was filed on October 16, 2017. On November 3, 2017, petitioner filed an amendment to petition. Petitioner seeks review of (1) the notice of deficiency dated July 12, 2017, issued to her for taxable year 2001, and (2) the notice of deficiency dated July 12, 2017, issued to her for taxable year 2002.¹ On December 12, 2017, respondent filed an Answer to Petition, as Amended.

On December 14, 2017, petitioner filed a Motion To Restrain Assessment or Collection or To Order Refund of Amount Collected. On February 1, 2018, respondent filed a Response to petitioner's motion to restrain. Among other things, in his Response respondent acknowledges that the deficiencies determined in the deficiency notices are attributable to affected items that require partner-level determinations. On March 26, 2018, petitioner filed a Response to respondent's response.

On February 1, 2018, respondent filed a Motion To Dismiss for Lack of Jurisdiction as to Penalties. On March 26, 2018, petitioner filed an Objection to respondent's motion to dismiss as to penalties.

It is well settled that this Court has no jurisdiction to consider partnership items in an

¹In those deficiency notices respondent determined the following deficiencies in Federal income tax and penalties against petitioner:

<u>Year</u>	<u>Deficiency</u>	<u>Penalty</u> <u>I.R.C. sec. 6662(h)</u>
2001	\$1,630,592	\$652,265.60
2002	96,943	36,770.20

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affected item deficiency proceeding. Saso v. Commissioner, 93 T.C. 730 (1989). An affected item is any item to the extent such item is affected by a partnership item. I.R.C. sec. 6231(a)(5). Of the two types of affected items, the first type is a computational adjustment made to record the change in a partner's tax liability resulting from adjustments reflecting the proper treatment of partnership items. Sec. 6231(a)(6). This Court has no jurisdiction in a partner-level deficiency case as to computational adjustments flowing through from a TEFRA partnership to a partner. Once partnership level proceedings are completed, the Commissioner is permitted to assess a computational adjustment against a partner without issuing a deficiency notice. Sec. 6230(a)(1); Crowell v. Commissioner, 102 T.C. 683, 689 (1994). The second type of affected item requires a partner-level determination. Section 6230(a)(2)(A)(i) provides that the normal deficiency procedures apply to those affected items which require partner-level determinations.

Outside basis may be an affected item required to be properly determined in a partner level deficiency proceeding. Thompson v. Commissioner, 729 F.3d 869, 873 (8th Cir. 2013); Jade Trading, LLC ex rel. Ervin v. United States, 598 F.3d 1372, 1380 (Fed. Cir. 2010); Petaluma FX Partners, LLC v. Commissioner, 591 F.3d 649, 655 (D.C. Cir. 2010); Greenwald v. Commissioner, 142 T.C. 308, 314-317 (2014); see I.R.C. secs. 6213(a), 6230(a)(2) (A)(I). Cf. United States v. Woods, 571 U.S. ___, 134 S.Ct. 557 (2013); see also Thompson v. Commissioner, T.C. Memo. 2014-154, at *2 n. 4, aff'd 821 F.3d 1008 (8th Cir. 2016).

Petitioner's motion to restrain and respondent's motion to dismiss as to penalties in the instant case raise certain issues substantially similar to those in Thompson v. Commissioner, 137 T.C. 220 (2011), rev'd and remanded 729 F.3d 869 (8th Cir. 2013).² In our supplemental memorandum opinion on remand in Thompson (T.C. Memo. 2014-154, at *2 n. 4), we explained, in pertinent part:

This case constitutes a partner-level proceeding under the unified partnership audit and litigation procedures of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) * * *. In this Supplemental Memorandum Opinion, we respond to the Court of Appeals' mandate and respondent's motion for entry of decision. We incorporate our factual findings in Thompson v. Commissioner, 137 T.C. 220 * * * .

In our previous Opinion, we held that we lacked jurisdiction to consider * * * Mr. Thompson's income tax deficiency and related accuracy penalty. *Id.* at 236, 239. That holding rested on our 2006 decision in the partnership-level proceeding. RJT Inys. X, LLC v. Commissioner, docket No. 11769-05 (June 6, 2006), aff'd 491 F.3d 732 (8th Cir. 2007), that: (1) the partnership was a sham and lacked economic substance; (2) the partnership had been "formed and/or availed to overstate artificially the basis of the interest of * * * [Mr. Thompson] in * * * [the partnership] in the amount of \$22,006,759 for purposes of tax avoidance"; and (3) the 40 percent gross valuation misstatement penalty under section 6662 would apply. * * *

²In their first appeal the taxpayers conceded the accuracy penalty issue. See 729 F.3d 872 n. 3.

We thought that these determinations in a decision that had become final, led inexorably to the conclusion that any flowthrough income, loss, or deduction from the partnership, as well as any loss claimed by Mr. Thompson on liquidation of his partnership interest, must be disallowed. See Thompson v. Commissioner, 137 T.C. at 231-235. No further, partner-level determination within the meaning of section 6230(a)(2) and section 301.6231(a)(6)-1(a)(2), Proced. & Admin. Regs., was necessary. Id. at 231. Hence, section 6230(a)(1) left this Court without jurisdiction over the petition. See id. at 236, 239. * * * [the Commissioner's erroneous issuance of a notice of deficiency to * * * [the taxpayers] could not confer jurisdiction absent the need for a partner-level determination. See id. at 225-226.

The Court of Appeals reached a somewhat different conclusion. It noted * * * [the taxpayers'] concession that our 2006 decision as to the penalties' applicability was res judicata. See Thompson v. Commissioner, 729 F.3d at 872 n. 3. As to the underlying deficiency, however, the Court of Appeals agreed with other Courts of Appeals that have addressed the issue and held that "outside basis is an affected item that must be determined at the partner level." Id. at 873 (citing Jade Trading, LLC v. United States, * * *, and Petaluma FX Partners, LLC v. United States, * * *). It read this Court's 2006 decision in the partnership-level proceeding to say Mr. Thompson's outside basis was overstated, but not that it was overstated in its entirety - in other words, that he had a zero basis. * * * See Thompson v. Commissioner, 729 F.3d at 872-873. The Court of Appeals reasoned that because Mr. Thompson's exact outside basis remained to be determined, this Court could and should have made that partner-level determination. See id. at 874 (Gruender, J., concurring in the judgment) (opining that the "tax court clearly determined Thompson's outside basis to be zero", but that the Court nevertheless had jurisdiction over the petition).⁴

The Court of Appeals found that we have jurisdiction to determine Mr. Thompson's outside basis in his partnership interest. We need not make such a determination, however, because the parties have stipulated the deficiency. See Thompson v. Commissioner, 137 T.C. at 223-224. Our task on remand is, therefore, limited to entry of a decision formalizing that agreement.

⁴After the Court of Appeals issued its opinion, the Supreme Court decided another TEFRA case, United States v. Woods, 571 U.S. ___, 134 S.Ct 557 * * *.

* * * * *

Woods thus confirms that we properly exercised jurisdiction in applying the valuation misstatement penalty in the partnership-level proceeding here. Before the penalty can be imposed, Woods cautions, "[e]ach partner's outside basis still must be adjusted at the partner level. Id. But once the court handling the partnership-level proceeding has concluded that the partnership is a sham, such that each partner must have a zero outside basis, these partner-level

adjustments of outside_basis incident to imposition of the penalty should be merely computational. See id. at __, 134 S.Ct. at 566 & n. 2.

As to whether partner-level adjustment of outside basis incident to a deficiency determination should also be merely computational, Woods provides no direct answer. In dicta, however, the Court addresses the amici's suggestion that its decision will permit the Internal Revenue Service to directly assess a penalty on a tax underpayment that cannot itself be assessed without deficiency procedures. See id. Noting that "an underpayment attributable to an affected item [such as outside basis] is exempt" from deficiency procedures where partner-level determinations are unnecessary, the Court observes that "it is not readily apparent why additional partner-level determinations would be required before adjusting outside basis in a sham partnership." Id.

In the sham partnership at issue here, the Court of Appeals concluded that such additional determinations were required, and we proceed in accordance with that mandate.

Upon due consideration, it is

ORDERED that, on or before April 25, 2018, petitioner and respondent each shall file a Response to this order. In such Response petitioner/respondent shall set forth and discuss fully her/his position as to: (1) whether additional partner-level determinations of outside basis and/or other partner-level determinations are required in this case; (2) if so, what specifically are those additional partner-level determinations of outside basis and/or other partner-level determinations; and (3) to what extent, if any, this Court has jurisdiction in this partner-level proceeding as to the income tax deficiencies and/or penalties for 2001 and 2002 determined in the notice of deficiency.

**(Signed) L. Paige Marvel
Chief Judge**

Dated: Washington, D.C.
March 27, 2018