

UNITED STATES TAX COURT
WASHINGTON, DC 20217

PA

JASON CHAI,)
)
Petitioner(s),)
)
v.) Docket No. 28152-14.
)
COMMISSIONER OF INTERNAL REVENUE,)
)
Respondent)
)

ORDER OF DISMISSAL FOR LACK OF JURISDICTION

The petition in this case was filed in response to a notice of deficiency that respondent issued to petitioner on August 27, 2014, for petitioner’s 2003 tax year. This case is a parallel proceeding to related cases already heard by this Court. See Chai v. Commissioner, Docket No. 18330-09 (Chai I); Mercato Global Opportunities Fund, LP, v. Commissioner, Docket No. 26268-09 (Mercato).

Before the Court are petitioner’s motion for summary judgment and respondent’s motion to dismiss for lack of jurisdiction. In his motion for summary judgment, petitioner contends that this Court lacks jurisdiction over this case consistent with the opinion of the U.S. Court of Appeals for the Second Circuit in Chai v. Commissioner, 851 F.3d 190 (2d Cir. 2017), aff’g in part, rev’g in part, T.C. Memo 2015-42. Respondent agrees that the Court lacks jurisdiction but contends that summary judgment is not appropriate because the jurisdictional question is not intertwined with the merits of the case. Instead, respondent argues that the Court should dismiss for lack of jurisdiction because the notice of deficiency underlying this case was an invalid second notice of deficiency barred by section 6212(c).¹ As an alternative to his motion for summary judgment,

¹Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986 (Code) as amended and in effect at the relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

petitioner agrees with respondent's motion to dismiss, but petitioner contends that the Court should grant the motion to dismiss on grounds of res judicata.

For the reasons set out below, this Court lacks jurisdiction in this case because the underlying notice of deficiency was an invalid second notice of deficiency. We therefore dismiss.

Background

This case is related to two other cases that focus on a tax shelter scheme in which petitioner participated. At issue in this case is \$2 million in income that petitioner received in 2003 but failed to report. A brief review of the material facts and procedural history of the cases provides context for the motions before us.²

Starting in 2000, petitioner engaged in a tax shelter scheme involving multiple entities. Petitioner was part of the group facilitating the tax shelter scheme and received compensation for his services. He also received distributive shares of the losses allegedly generated by the tax shelter entities. The losses allegedly generated in 2003 offset petitioner's income for that year.

In 2003, petitioner received a \$2 million payment from one of the tax shelter entities. The entity reported this payment as nonemployee compensation, but petitioner failed to report the payment as taxable income on his Federal income tax return for 2003. On May 5, 2009, respondent issued to petitioner a notice of deficiency for 2003 asserting that petitioner owed self-employment tax on the \$2 million payment. Respondent did not assert in the notice of deficiency that petitioner owed income tax on the payment because it was fully offset by tax shelter losses.

On June 17, 2009, respondent issued a notice of final partnership administrative adjustment (FPAA) to the tax shelter limited partnership challenging, at the partnership level, the losses generated by the various tax shelter transactions. Petitioner then filed two timely petitions with this Court: a petition

²We summarize the facts material to our disposition of the motions. For a detailed statement of the facts underlying petitioner's case, see Chai v. Commissioner, T.C. Memo. 2015-42, at *1-*5.

disputing the initial notice of deficiency and, in his capacity as a partner other than the tax matters partner, a petition disputing the FPAA.

On October 30, 2009, respondent filed an amendment to answer in Chai I asserting an increased income tax deficiency, which was the result of respondent disregarding the tax shelter losses pursuant to Munro v. Commissioner, 92 T.C. 71 (1989).

On June 3, 2013, the Court entered a stipulated decision in Mercato, disallowing substantially all claimed tax shelter losses including those addressed in respondent's amended answer in Chai I.

On December 17, 2013, at the trial in Chai I, petitioner moved to dismiss the increased deficiency asserted in respondent's amended answer for lack of subject matter jurisdiction. Although respondent conceded that this Court did not have deficiency jurisdiction, respondent asserted that the Court had affected items jurisdiction pursuant to section 6230(a)(2)(B).

While petitioner's motion was pending, respondent issued a protective second notice of deficiency—the notice underlying this case—on August 27, 2014. Respondent alleged that the notice was an affected items notice of deficiency. The second notice determined the same increased deficiency asserted in respondent's amended answer in Chai I. In response, petitioner timely petitioned this Court to review the second notice, giving rise to this proceeding.

On February 13, 2015, in Chai I, this Court granted petitioner's motion to dismiss for lack of subject matter jurisdiction as to respondent's claim for the increased deficiency. On appeal, the U.S. Court of Appeals for the Second Circuit held that the Court did have subject matter jurisdiction over the increased deficiency, reversing the decision below. Chai, 851 F.3d at 206. It also held that neither the increased deficiency nor the items underlying the increased deficiency were affected items under section 6230 and remanded for further proceedings consistent with the opinion. Id. On remand, this Court entered a stipulated decision in Chai I determining petitioner's income tax liability for tax year 2003 on September 8, 2017.

Discussion

This Court is a court of limited jurisdiction, and it exercises that jurisdiction only as expressly authorized by statute. Breman v. Commissioner, 66 T.C. 61, 66

(1976). The Court's jurisdiction requires both a valid notice of deficiency and a timely petition. Sec. 6213(a); Savage v. Commissioner, 112 T.C. 46, 48 (1999). Generally, the Internal Revenue Service (IRS) may only issue one notice of deficiency for any year and a second notice is invalid. Sec. 6212(c)(1); Ron Lykins, Inc. v. Commissioner, 133 T.C. 87, 108 (2009). There are exceptions to this rule, however, and section 6230(a)(2)(C) carves out one such exception for an affected items notice of deficiency issued under section 6230(a)(2)(B). Rawls Trading, L.P., v. Commissioner, 138 T.C. 271, 291 (2012).

The U.S. Court of Appeals for the Second Circuit, which would review an appeal from this case, has already held that both the increased deficiency in Chai I and the payment underlying the increased deficiency are not affected items. Chai, 851 F.3d at 206-207. The second notice of deficiency, which respondent contends is an affected items notice of deficiency, asserts the same increased deficiency and deals with the same adjustments as those involved in Chai I. The Court of Appeal's opinion in Chai, which established the law of this case by holding that the adjustments in question and the resulting tax liability are not affected items, controls the analysis. See Bedrosian v. Commissioner, 143 T.C. 83, 112-113 (2014)

Because this notice of deficiency is not an affected items notice of deficiency within the meaning of section 6230, the exception to the general rule barring a second notice of deficiency is not applicable. At the time the second notice was issued, respondent had already issued a notice of deficiency for tax year 2003 and petitioner had filed a timely petition with respect to that notice. The notice underlying this case, therefore, was invalid at the time of issuance. Sec. 6212(c). Without a valid notice of deficiency, this Court lacks jurisdiction and must dismiss.

Petitioner contends that this Court should dismiss this case on res judicata grounds. To do so, however, would require this Court to assert jurisdiction it does not have. A court must have jurisdiction before it can decide whether an affirmative defense applies because the party asserting it must carry the burden of persuasion as to the issue. See Genesis Oil & Gas, Ltd. v. Commissioner, 93 T.C. 562, 564 (1989); see also Wright, Miller & Cooper, 18 Fed. Prac. & Proc. Juris. § 4405 (3d ed. 2018); Restatement, Judgments 2d, sec. 17 (1982). Because the

second notice of deficiency is not valid, this Court lacks the jurisdiction necessary to consider whether the affirmative defense of res judicata applies.

It is therefore

ORDERED that respondent's motion to dismiss for lack of jurisdiction, filed November 7, 2017, is granted, and this case is dismissed for lack of jurisdiction. It is further

ORDERED that petitioner's motion for summary judgment, filed March 28, 2017, is denied as moot.

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

ENTERED: **NOV 02 2018**