

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

GRAMERCY FINANCIAL GROUP LLC,)	
CERRO NEGRO CAPITAL MANAGEMENT,)	
LLC, TAX MATTERS PARTNER,)	
)	
Petitioner(s),)	
)	
v.)	Docket No. 25760-17.
)	
COMMISSIONER OF INTERNAL REVENUE,)	
)	
Respondent)	

ORDER

This is a TEFRA partnership case based on a Final Partnership Administrative Adjustment (“FPAA”) for the 2009 tax year of Gramercy Financial Group LLC (“Gramercy”). Now pending before the Court are (1) the Commissioner’s motion for entry of decision (Doc. 16), and (2) the motion (Doc. 18) by Fereneze Capital Management, LLC (“Fereneze Capital”), requesting leave to file a notice of election to participate (Doc. 19) in this TEFRA suit. We will deny the Commissioner’s motion for entry of decision and will grant Fereneze Capital’s motion for leave.

Background

During 2009 Gramercy had four members: (1) Cerro Negro Capital Management, LLC (“Cerro Capital”), which is also the tax matters partner (“TMP”) and the petitioner in this case; (2) Scott Seaman, who on March 1, 2018, timely filed a notice of election to participate in this case (Doc. 5); (3) Tall Oaks Capital Management LLC (“Oaks Capital”), which joined in Mr. Seaman’s timely notice of election to participate (Doc. 5); and (4) Fereneze Capital, which on June 24, 2019, filed the now-pending motion requesting leave to participate in this case

in response to the Court's order regarding a proposed settlement reached by the Commissioner, Cerro Capital, Oaks Capital and Mr. Seaman.

For the 2009 tax year, Gramercy Filed a Form 1065, "U.S. Return of Partnership Income" (the "Form 1065"), reporting items of ordinary income, deductions (including a \$16 million termination fee), and partnership distributions. (Doc. 1, Ex. A.) The IRS examined the Form 1065 and ultimately disallowed various items and made adjustments as shown in the FPAA issued on September 13, 2017. (Doc. 1, Ex. A.) The adjustments included: disallowing various deductions (including the termination fee) and increasing ordinary income by \$38.7 million (part of the increase stemmed from a deemed \$15.5 million increase in gross receipts attributable to shares of Arco Capital Corporation, Ltd. ("ACC")); increasing partnership distributions of money by \$19.9 million; increasing partnership distributions of other property by \$26.4 million (including recharacterizing a \$9.2 million guaranteed payment as a \$10.9 million distribution of property to Fereneze Capital); and applying accuracy-related penalties to the resulting underpayment. (Doc. 1, Ex. A.)

On December 11, 2017, Cerro Capital timely filed a petition (Doc. 1) for readjustment of partnership items alleging six errors in the FPAA's adjustments including the increase in income from stock and options in ACC; the disallowance of a deduction for the termination fee; the \$10.9 million increase in distributions of other property to Fereneze Capital; the failure to adjust income in light of \$10.8 million in bad debt deductions from 2008; and the imposition of penalties. On March 1, 2018, Mr. Seaman and Oaks Capital timely filed a notice of election to participate under 245(b) (Doc. 5). Fereneze Capital, however, did not file a notice of election to participate within the 90-day period prescribed under Rule 245(b).

After the filing of the petition, Cerro Capital, Mr. Seaman, Oaks Capital, and the Commissioner were able to reach a proposed settlement agreement. The agreement would resolve each assignment of error raised in the petition but would concede to a \$2.7 million increase in partnership distributions to non-participating partner Fereneze Capital.

The Commissioner filed a motion for entry of decision on May 21, 2019, under Tax Court Rule 248(b), in accordance with the proposed settlement agreement. On May 28, 2019, the Court ordered (Doc. 17) that any party objecting to an entry of the proposed decision should within 60 days file motion for leave to participate in the suit.

On June 24, 2019, Fereneze Capital timely filed its motion for leave to file a notice of election to participate (Doc. 18) in this TEFRA suit. Fereneze Capital's motion asks for leave to file "out of time", presumably because the time for electing to participate pursuant to Rule 245(b) had expired. However, Rule 248(b)(4) creates its own deadline for the filing of the motion for leave (i.e., 60 days after the filing of the Commissioner's motion for entry of decision), and Fereneze Capital's motion was timely under that rule. But Rule 248(d) does not allow simply a "notice of election to participate" (as in Rule 245(b)) but rather requires a "motion for leave", and the rule therefore does require us to make a decision whether or not to grant such leave.

Fereneze Capital's motion indicated its objection to the Commissioner's motion for entry of decision and alleged, among other things, that: the \$2.7 million amount was part of an "Investment Sub-Advisory" fee agreement between Gramercy and Arco Capital Management LLC ("ACM"), a Puerto Rican company, for services rendered to Gramercy in 2008; ACM and Fereneze Capital have common ownership; Gramercy reported the amount on its 2008 Form 1065 as an expense allocated entirely to Fereneze Capital; ACM reported the amount as earned income on its 2008 Puerto Rican income tax return; the amount was not actually distributed to ACM until 2009 despite being reported as paid in 2008; the proposed settlement and decision reclassifies the amount as a distribution to Fereneze Capital in 2009; Cerro Capital was not impacted by the amount being reclassified as a distribution to Fereneze Capital; Cerro Capital may have failed to represent Fereneze Capital's interests in any fashion and as the TMP was in a unique position to offer concessions in the settlement that would negatively affect Fereneze Capital but would benefit Cerro Capital; and Fereneze Capital should now be allowed to participate in this TEFRA suit to protect its interests. (See Doc. 18.)

On July 15, 2019, the Commissioner (Doc. 21), Cerro Capital (Doc. 22), and Mr. Seaman (joined by Oaks Capital) (Doc. 23) each responded in opposition to Fereneze Capital's motion for leave and argued that Fereneze Capital failed to establish cause to allow its "untimely" participation in this suit. Furthermore, the oppositions argue that allowing the late participation would prejudice the Commissioner, Cerro Capital, Oaks Capital, and Mr. Seaman, who had exerted great efforts to reach an agreed upon settlement. On August 9, 2019, Fereneze Capital filed a reply that alleged, among other things, that Cerro Capital and Mr. Seaman had purposely excluded Fereneze Capital from settlement negotiations because they were aware that, during the initial examination, Fereneze Capital had

challenged the IRS's characterization of the \$2.7 million as a distribution and would not be willing to concede on that item. (See Doc. 25.)

Discussion

Each partner in a TEFRA partnership is a party to a suit filed on behalf of the partnership. See sec. 6226(c)(1). Many such suits are commenced (as this one was) by the TMP of the partnership. In such an instance, Tax Court Rule 245(b) permits other partners to file a notice of election to participate in the suit within 90 days from the time the Clerk of the Court serves the petition on the Commissioner. Rule 245(c) provides: “[t]he Court may grant leave to file * * * a notice of election to participate out of time upon a showing of sufficient cause.”

The rules make other provision for the participation of a partner later in the lawsuit. When a settlement of the case has been reached, the Commissioner may file a motion for entry of decision consistent with that settlement, and Tax Court Rule 248(b)(4) provides:

If any party objects to the granting of the Commissioner's motion for entry of decision, then that party shall, within 60 days from the date on which the Commissioner's motion was filed with the Court, file a motion for leave to file a notice of election to intervene or to participate, accompanied by a separate notice of election to intervene or a separate notice of election to participate, as the case may be.

This Court has held that a partner who did not have sufficient opportunity to participate in procedures leading to a proposed settlement and motion for decision under Rule 248(b) was allowed to participate pursuant to Rule 248(c) after the filing of the Commissioner's motion for entry of decision. See Peking Inv. Fund, LLC v. Commissioner, T.C. Memo. 2013-288 at *13-*16. We think that such participation is further warranted when the proposed settlement--negotiated and agreed upon by the other partners--includes recharacterizing a \$9.2 million partnership expense as a \$10.9 million distribution to be allocated to the previously nonparticipating partner. See id. at *14. We think sufficient cause has thus been established.

With regard to such participation resulting in prejudice to the other parties, Fereneze Capital points out that it does not intend to challenge the remaining six items the parties have agreed on in the proposed settlement, so the efforts exerted towards settling those items would not be wasted by allowing Fereneze Capital to

participate. This may be true, though the Court notes the possibility that one or more of the parties' willingness to settle those six items may have depended on the resolution of this \$9.2 (or \$10.9) million issue. However, the other parties do retain their option to settle the case under Rule 248(c) even if Fereneze Capital does not wish to enter into the settlement. It is

ORDERED that Fereneze Capital's motion (Doc. 18) for leave to file a notice of election to participate in this suit is granted and the Clerk of the Court shall file as of the date of this order the notice of election to participate lodged by Fereneze Capital. It is further

ORDERED that the Commissioner's motion (Doc. 16) for entry of decision is denied. It is further

ORDERED that, no later than November 29, 2019, Fereneze Capital shall file an amendment to the petition in accordance with the provisions of Rule 241 as to any issue to be raised that has not been raised in the petition. It is further

ORDERED that the Commissioner shall file an answer or shall move with respect to Fereneze Capital's amendment to the petition within the periods specified in and in accordance with the provisions of Rule 36(a) (sent. 2). It is further

ORDERED that, no later than February 28, 2020, the parties shall file a joint status report (or, if that is not expedient, then separate status reports) recommending a schedule for further proceedings, including the filing of any stipulation of settled issues as to which all the parties do agree, the filing of any agreement pursuant to Rule 248(c) reflecting agreement of fewer than all of the partners, and any discovery that the parties intend to conduct.

**(Signed) David Gustafson
Judge**

Dated: Washington, D.C.
November 6, 2019