

UNITED STATES TAX COURT
WASHINGTON, DC 20217

John C. Bedrosian & Judith D. Bedrosian,)	
)	
Petitioners,)	
)	
v.)	Docket No. 12341-05.
)	
COMMISSIONER OF INTERNAL REVENUE,)	
)	
Respondent)	

ORDER OF DISMISSAL

The Commissioner asks that we dismiss for lack of jurisdiction the only item remaining at issue in this case, the deductibility of certain professional fees. According to the Commissioner, we lack jurisdiction because the fees are attributable to a transaction that was determined to be a sham at the partnership level. Because that determination was already made in a partnership-level proceeding, the Commissioner argues that we lack jurisdiction in this partner-level proceeding. We will grant the Commissioner's motion.

Background

Except as is pertinent to this order, we will not recount the lengthy history of this case. For a thorough summary, see Bedrosian v. Commissioner, 143 T.C. 83 (2014) and 144 T.C. 152 (2015).

On June 30, 2006, the Commissioner filed a motion to dismiss for lack of jurisdiction, alleging that all of the determinations in the notice of deficiency relate to partnership items (or affected items) that were already addressed in a partnership-level proceeding involving Stone Canyon Partners. We granted that motion in part, but insofar as it related to the disallowance of legal, accounting, consulting, and advisory fees, we denied the motion. See Bedrosian v. Commissioner, T.C. Memo 2007-375. While the parties appeared to be in agreement that most of the items placed at issue in this case were partnership items or affected items, the parties did not agree as to the professional fees. Bedrosian v.

Commissioner, T.C. Memo 2007-375, 94 T.C.M. (CCH) 614, 616 (2007). We held that we had jurisdiction over the professional fees.

In January 2015, the Bedrosians sought reconsideration of that opinion. They stated in their written motion that “[t]he sole reason respondent disallowed the legal fees in our case is because they were incurred in connection with a transaction respondent determined to be a sham transaction.” The Bedrosians cited Domulewicz v. Commissioner, T.C. Memo. 2010-177 for the proposition “that disallowance of legal fees deducted on a partner’s return for the sole reason that the fees were nondeductible because they were incurred in connection with a sham transaction was an affected item, not a partnership item.”

We denied their motion. Bedrosian v. Commissioner, 144 T.C. 152 (2015). In doing so, we quoted at length the notice of deficiency underlying this case. Bedrosian v. Commissioner, 144 T.C. at 154. That notice of deficiency disallowed the deduction (at least in part) for lack of substantiation, stating that the Bedrosians “failed to establish that such expenditures were incurred”. On its face, the notice of deficiency did not appear to disallow the legal fees solely because they were incurred in connection with a sham transaction.

Now the Commissioner has renewed his motion to dismiss for lack of jurisdiction. He is aided by supplemental stipulation, in which the parties now agree that the only basis for the disallowance of the professional fees is that they were incurred in connection with the partnership. That stipulation provides:

The disallowance of the deduction claimed by Petitioners for professional fees in the amount of \$525,000.00 was based solely on the determination that the fees were incurred in connection with the partnership transactions described in the Notice of Final Partnership Administrative Adjustment (FPAA) issued to Stone Canyon Partners on April 8, 2005 for its tax year ended December 27, 1999.

The FPAA issued to Stone Canyon Partners, among other things, “determined that STONE CANYON PARTNERS was a sham [and] lacked economic substance”. No one filed a timely petition with respect to that FPAA. See Stone Canyon Partners v. Commissioner, T.C. Memo. 2007-377, aff’d sub nom. Bedrosian v. Commissioner, 358 F. App’x 868 (9th Cir. 2009). Thus, those items became final.

Discussion

The litigation of tax disputes involving income tax items of an entity that is treated as a partnership for tax purposes generally follows a two stage process. The Commissioner examines the partnership as an entity and makes determinations at the partnership level. The effect of those adjustments at the partner level is determined in a subsequent proceeding.

The first stage is a proceeding that is conducted at the partnership level. See secs. 6221 et seq. That partnership-level proceeding is for the purpose of determining partnership items. Id.; see also sec. 6231(a)(3). That examination may be concluded by the issuance of a notice of final partnership administrative adjustment (FPAA). Sec. 6223(a)(2). A partner who disagrees with the determinations in an FPAA may file a petition challenging the FPAA. Sec. 6226. Partnership items may not be challenged outside of the partnership level proceeding. Sec. 7422(h).

The second stage addresses affected items. Affected items are items that are affected by partnership items, but they are not themselves partnership items. Sec. 6231(a)(5). Those affected items can be assessed one of two ways. Computational affected items are items that don't require further fact-finding at the partner level, and they may be assessed following the partnership-level proceeding. Secs. 6230(a)(1), 6231(a)(6); see also N.C.F. Energy Partners v. Commissioner, 89 T.C. 741, 744 (1987) (citing Maxwell v. Commissioner, 87 T.C. 783, 792 n.7 (1986)). Factual affected items are those that require further fact finding at the partner level, and generally the Commissioner must issue a notice of deficiency to adjust factual affected items.

The question before us is the deductibility of certain professional fees that were paid by the Bedrosians. Fees for entering into a sham transaction are not deductible. New Phoenix Sunrise Corp. v. Commissioner, 132 T.C. 161, 186 (2009), aff'd, 408 F. App'x 908 (6th Cir. 2010). The parties stipulated that the disallowance of the fees was based solely on the determination that the fees were incurred in connection with Stone Canyon Partners, and the Stone Canyon Partners proceeding already established, conclusively, that the partnership was a sham and lacked economic substance. There is nothing left for us to decide in this case; the fees are not deductible. Because we can make no further determinations with respect to those fees, we lack jurisdiction over the sole item that had been remaining in this case. Accordingly, it is

ORDERED that the Commissioner's motion to dismiss for lack of jurisdiction filed April 28, 2017, is granted and this case is dismissed.

(Signed) Ronald L. Buch
Judge

ENTERED: **DEC 29 2017**