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The Uncertain Boundary Between "Partner-Level" and "Partnership-Level" Defenses Under the Partnership Audit Rules

By: Elliot Pisem

In the May 2008 issue of the *Journal*,[1] we discussed a procedural problem -- the absence of a "prepayment forum" in which to have adjudicated "partner-level" defenses to penalties asserted by the IRS -- that arises frequently under the provisions of the Internal Revenue Code that govern the "Tax Treatment of Partnership Items."[2]

BACKGROUND

The governing statutory and regulatory provisions giving rise to this problem are analyzed at length in our prior article, so they can be summarized in an over-simplified fashion, without all their definitions, exceptions, and special rules, very briefly here.

Under statutory provisions added by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") and amended by the Taxpayer Relief Act of 1997 ("TRA '97"), the tax treatment of "partnership items" of certain partnerships, including the application of penalties asserted by the IRS, is determined in partnership-level administrative and judicial proceedings. "Partnership-level" defenses to application of an asserted penalty attributable to adjustment of a partnership's partnership items may be raised in the partnership administrative and judicial proceedings.

If a partnership files a petition with the Tax Court, the Court of Federal Claims, or a U.S. District Court with respect to a notice of final partnership administrative adjustment ("FPAA") asserting a penalty, the penalty may not be assessed or collected until the partnership litigation is concluded. Once partnership-level litigation is concluded, however, penalties may be assessed and collected immediately. As the statutory provisions are interpreted in the Treasury Regulations, there is no opportunity to raise "partner-level" defenses to application of a penalty prior to payment. In order to raise any "partner-level" defenses to an asserted penalty, a partner must bring a separate refund action after assessment and payment of the penalty.[3]

Our prior article discussed cases, in the District Court for the Eastern District of Texas and in the Court of Federal Claims, in which taxpayers had challenged the validity of the Treasury Regulations and attempted to raise "partner-level" defenses in a partnership-level judicial proceeding. We noted that the taxpayers had had only very limited success and concluded:

> [E]ven in the most friendly forum, the ability to raise partner-level defenses in the partnership proceeding may have to be viewed as an exception, rather than a general rule. The words of the Code, Regulations, and legislative history may be so clear that no court will ordinarily allow the raising of such defenses in a partnership proceeding. The advocate's job will be to convince the court, as frequently as possible, that special factors are present to justify permitting a taxpayer to raise partner-level defenses in a partnership proceeding, prior to payment of the asserted penalties.

Over the last year, these observations have proved largely correct. The Tax Court and the Court of Appeals for the Fifth Circuit have joined the Court of Federal Claims in sustaining the validity of the Treasury Regulations and their bar on the raising of "partner-level" defenses to asserted penalties in partnership proceedings. And, at the same time, those same courts, perhaps out of a sense of discomfort with depriving taxpayers of a prepayment forum in which to raise those defenses, have applied expansive definitions of the "partnership-level" defenses to penalties that *may* be raised in a partnership proceeding.[4] However, unfortunately for taxpayers, the Tax Court's most recent foray in this area raises other questions that may eviscerate certain defenses when they are raised in the partnership proceeding.

VALIDITY OF THE REGULATIONS

In *New Millennium Trading, L.L.C.*, 131 TC No. 18 (Dec. 22, 2008), a partnership proceeding, the tax matters partner (the petitioner in the case and a former owner of a 79.04% interest in the partnership) moved for partial summary judgment to declare that the Regulations barring the raising of partner-level defenses were invalid or, alternatively, that they did not apply in the case before the court, because the asserted penalties themselves were based on "partner conduct." The Tax Court held that "the statutory scheme does not allow partners to raise partner-level defenses to the determination that penalties apply to adjustments to partnership items during a partnership-level proceeding."

Moreover, since it was "clear" to the court that "Congress did not wish the Court to decide all issues associated with a partnership in a single proceeding, even if it has the information available to do so," the tax matters partner's arguments relating to "partner conduct" were rejected and the partners would not be permitted to raise "partner-level" defenses; "partnership" defenses could be considered later in the partnership proceeding. The Tax Court had no occasion in resolving the summary judgment motion to consider the extent to which any particular factual defenses fell into the "partner-level," as distinguished from the "partnership," category.[5]

More recently, in *Klamath Strategic Investment Fund*, 103 AFTR2d 2009-2220 (May 21, 2009), the Court of Appeals for the Fifth Circuit was faced with "partner-level" defenses to a penalty on appeal from one of the cases discussed in our prior article.[6] In the District Court, the taxpayers had argued that they were permitted to raise "partner-level" defenses in the partnership proceeding, notwithstanding the explicit Treasury Regulations to the contrary. Unlike the District Court, which was ambiguous in its opinion regarding whether or

not the Regulations were valid, the Court of Appeals clearly purported to apply the Regulations to the facts before it. The Court of Appeals also cited *New Millennium Trading* with apparent approval.

Accordingly, it seems fair to say that the validity of the Regulations has now been accepted in a variety of courts, and that they have not been found to be invalid in any case in which the issue was squarely presented.

SCOPE OF THE REGULATIONS

With the validity of the Regulations having been broadly accepted, attention turns to question of just how one distinguishes between "partnership-level" defenses, which a taxpayer is permitted to raise in the partnership proceeding, prior to paying an asserted penalty, and "partner-level" defenses that can only be raised by means of a refund suit.

The Regulatory Text

The Regulations provide some limited guidance regarding the meaning of "partner-level" and "partnership-level" defenses. "Partnership-level determinations include all the legal and factual determinations that underlie the determination of any penalty, ... other than partner-level defenses specified in [Reg. 301.6221-1(d)]."[7] "Partner-level defenses are limited to those that are personal to the partner or are dependent upon the partner's separate return and cannot be determined at the partnership level. Examples of these determinations are ... whether the partner has met the criteria of ... section 6664(c)(1) (reasonable cause exception) subject to partnership-level determinations as to the applicability of section 6664(c)(2)."[8]

The Regulations contain no guidance defining the crucial terms "personal to the partner" and "cannot be determined at the partnership level."[9] The Regulations also do not make clear whether the "cannot be determined" requirement applies only to defenses that are "dependent upon the partner's separate return" or whether the "cannot be determined" requirement applies as well to defenses that are "personal to the partner."[10]

Prior Cases

In the partnership proceeding *Santa Monica Pictures, LLC*, TCM 2005-104, the Tax Court treated as a "partnership-level" defense asserted reliance by a partner on professional advice received in the course of preparation by that partner of the partnership's tax return. The fact that the individual receiving the advice happened to be a partner did not cause the determination to be a "partner-level" determination, where the individual's actions were taken on behalf of the partnership and were related to preparation of the partnership return.

The District Court in *Klamath* took this approach a long step farther. In that case, one important aspect of the tax structure of the transaction before the court involved a purported borrowing by one of the partners in the partnership, Cary Patterson. The tax benefits claimed by Patterson had arisen from his sale, after his withdrawal from being a partner in the partnership, of property distributed to him by the partnership in liquidation of his interest.

Patterson had consulted with tax counsel regarding the allowability and proper reporting of the purported losses to claimed on the sale of that property and had received a written opinion apparently concluding that the losses would be allowable. The opinion was created when Patterson was no longer a partner in the partnership and was provided to Patterson as an individual (and not as a partner in the partnership).

The District Court analogized its need, in determining whether or not to impose a penalty, to look at the economic substance of the borrowing transaction in which Patterson individually had participated to the focus in *Santa Monica Pictures* on actions taken by a partner on behalf of the partnership. The Court concluded that Patterson's individual "reasonable cause and good faith," raised by him as a defense to a penalty asserted by the IRS, was not an item "personal to the partner or dependent on the partner's separate return" or an item that "cannot be determined at the partnership level." A similar analysis was applied in a companion case having similar facts and involving another partnership, Kinabalu Strategic Investment Fund, and its former partner, Harold Nix.

Recent Developments

The IRS in *Klamath* had asserted an accuracy-related penalty under Section 6662. The District Court concluded that the partnership met the requirements for a "partnership-level" exception to that penalty, *i.e.*, that there was "substantial authority" for the partnership's position and the partnership reasonably believed that its position was more likely than not correct. Application of any one exception -- either the "substantial authority and reasonable belief that more likely than not" exception or the "reasonable cause and good faith" exception -- would have been sufficient to eliminate the penalty, and there was, accordingly, no apparent reason for the District Court to have considered the "reasonable cause and good faith" exception. Nevertheless, as described above, the District Court did consider that exception and concluded that it applied.

Before the Court of Appeals, the IRS made two arguments: (1) that the District Court had erred in its conclusion that the "substantial authority and reasonable belief that more likely than not" exception applied; and (2) that the District Court lacked jurisdiction to consider the "reasonable cause and good faith" exception. The IRS did not argue that the District Court's conclusion that the *substantive*, as distinguished from the *jurisdictional*, requisites for application of the "reasonable cause and good faith" exception were present was incorrect. Thus, when the Court of Appeals, for the reasons described below, concluded that the District Court had not erred in its jurisdictional finding, the accuracy-related penalty could not be applied.[11]

The Court of Appeals devotes only one paragraph of its opinion to a direct discussion of the jurisdictional issue, writing:

> The TEFRA structure enacted by Congress does not permit a partner to raise an individual defense during a partnership-level proceeding, but when considering the determination of penalties at the partnership level the court may consider the defenses of the partnership. *See New Millennium Trading, LLC v. Comm'r,* 131

> T.C. No. 18, 2008 WL 5330940 at * 7 (2008). Though Temp. Treas. Reg. § 301.6221-1T(d) lists the reasonable cause exception as an example of a partner-level defense, it does not indicate that reasonable cause and good faith may never be considered at the partnership level. Several courts have found that a reasonable cause and good faith defense may be considered during partnership-level proceedings if the defense is presented on behalf of the partnership. *See Santa Monica Pictures v. Comm'r*, 89 T.C.M. 1157, 1229–30 (2005) (considering the reasonable cause and good faith defense asserted by the partnership to determine whether accuracy-related penalties should apply); *See also Stobie Creek Investments, LLC v. United States*, 82 Fed. Cl. 636, 703–04, 717–21 (2008) (considering the reasonable cause defense at the partnership level). Here, reasonable cause and good faith were asserted on behalf of Klamath and Kinabalu, by the current managing partners. Accordingly, we hold that the district court did not err in considering the defenses.

The reasoning of the Court of Appeals seems extremely questionable. As explained above, *Santa Monica Pictures* involved facts significantly different from those in *Klamath*, as the actions evidencing "reasonable cause and good faith" in *Santa Monica Pictures* were taken on behalf of the partnership, rather than on behalf of any particular partner. Similarly, the Court of Appeals seems to have missed entirely the point of the opinion of the Court of Federal Claims in *Stobie Creek*, which states explicitly, "[J]urisdiction of this partnership-level proceeding does not extend to issuing binding judgments on the partner level defenses for the not-yet-filed partner-level proceedings.... Partners may raise any particular defenses at the partner level, including the reasonable cause and good faith exception to the imposition of penalties. Jurisdiction of the Court of Federal Claims extends to determining whether penalties are applicable to the partnership items at issue and whether reasonable cause and good faith *on behalf of the partnership, acting through its managing partner,* and in turn through Jeffrey Welles [the manager of the managing partner], serves as a defense to the imposition of those penalties" (emphasis added).[12] What was relevant to the Court of Federal Claims in *Stobie Creek* was not the identity of the partner whose counsel was seeking to introduce evidence, but, rather, the identity of the person to whose actions in seeking professional advice that evidence related.[13]

Tigers Eye

The Tax Court's opinion in the partnership proceeding *Tigers Eye Trading LLC*, TC Memo 2009-121 (May 27, 2009), relating to a "Son-of-BOSS" transaction effected on behalf of an individual, A. Scott Logan, evidences an attempt at a more expansive analysis of the issues. Mr. Logan was defending, on the grounds of "reasonable cause and good faith," against penalties asserted by the IRS and asserted that, in preparing his income tax returns, he reasonably relied on the opinions of his personal attorneys and accountants, as well as on an opinion letter and memorandum prepared by the law firm Curtis, Mallet-Prevost, Colt & Mosle LLC ("Curtis Mallet"). The circumstances surrounding the issuance of the Curtis Mallet opinion are not set out in detail in the Tax Court's opinion,[14] but we are told that the IRS asserted that Curtis Mallet was a "promoter" of the transactions in issue and that no partner could reasonably rely on an opinion issued by a "promoter."

Mr. Logan sought partial summary judgment, asking the court to declare that the Treasury Regulation barring the Tax Court from considering his "partner-level" defenses was invalid. Mr. Logan's motion was of course opposed by the IRS, and the Tax Court had no trouble denying the motion on the basis of its holding in *New Millennium Trading*. At the same time, the IRS made a motion *in limine*, one aspect of which sought confirmation that Curtis Mallet's status as a "promoter" should be determined in the partnership proceeding; the IRS's motion was opposed by Mr. Logan.

The Tax Court began its analysis of the motion *in limine* by reviewing case law that has held that "reasonable cause and good faith" can be demonstrated only by relying on the advice from a "competent and independent advisor unburdened with a conflict of interest and not from promoters of the investment," since a "promoter's self-interest makes such 'advice' inherently unreliable." The Court therefore needed to determine whether it had jurisdiction in the partnership proceeding to determine whether or not Curtis Mallet was a promoter.[15]

In connection with its disallowance of the deductions arising from the Son-of-BOSS transaction, the IRS asserted that Tigers Eye "had no business purpose other than tax avoidance, lacked economic substance, and constitutes an economic sham for Federal income tax purposes." The analysis of whether or not Tigers Eye actually had a profit objective, as distinguished from solely a tax avoidance objective, must be made at the partnership level, by reference to the activities and intent of the managers and promoters who effectively organize and operate the partnership. This analysis will look to evidence concerning "Son-of-BOSS" transactions that those managers and promoters may have organized for other investors -- including, potentially, other Son-of-BOSS transactions promoted by the organizers of Tigers Eye in connection with which Curtis Mallet had provided tax opinions. Accordingly, the determination of whether Curtis Mallet was or was not a "promoter" would require factual findings similar to those necessary to determine whether or not Tigers Eye was a sham or lacked economic substance, and that determination was properly made at the partnership level.

The Court then applied this conclusion to the three factors relevant under the Regulations to determining whether a defense is a "partner-level" defense -- "personal to the partner," "depends on the partner's separate return," and "cannot be determined at the partnership level."

- ***Personal to the Partner*** -- The Court defined "personal" defenses as those that "require factual findings that are generally unrelated to the promotion of the transaction or the formation of the partnership that would be relevant to all partners."[16] Thus, issues of "reliance on materials and opinions provided to all participating partners" are not "personal." If Curtis Mallet were held, in a determination made at the partnership level, to be a "promoter," it would then follow that, as a "defense that relates to all ... partners and is an integral part of the investment program," the defense of reliance on Curtis Mallet's opinion would not be "personal to a particular partner," and the "Court [would have] jurisdiction in a partnership-level proceeding to decide the applicability of that defense."[17]

- ***Depends on Partner's Separate Return*** -- The Court stated, "A defense depends on the partner's separate return if relevant facts can be established only by examination of or reference to the partner's separate return," and then noted, "[D]eciding whether a particular partner reasonably relied on the advice of a competent tax adviser generally would not require the Court to examine that partner's return." We would observe that this statement appears to be equally true regardless of whether the advisor provided advice to the partnership, to all the partners, to some of the partners, or only to one particular partner, so that this factor must always weigh in favor of the "partnership-level" status of a reasonable cause defense grounded in reliance on the advice of counsel. In any event, the Court reasoned, "Deciding whether Mr. Logan ... [was] entitled to rely on the Curtis Mallet opinion would not require an examination of [his] separate returns; the facts necessary to prove [he was] entitled to rely on the Curtis Mallet opinion and that such reliance was reasonable to support a reasonable cause defense to partnership-item penalties would not depend on [his] separate returns."

- ***Cannot Be Determined at Partner Level*** -- The Court seemed to view this factor as somehow conclusory or cumulative of the prior two factors: "Defenses that are personal to the partner or depend on the partner's separate return cannot be decided at the partnership level because the Court is unable to decide on the basis of the evidence necessary and relevant to deciding the underlying adjustments in the FPAA whether the defense applies." In this case, Curtis Mallet's status as a promoter was relevant to issues raised by the FPAA concerning the creation and operation of the partnership and the manner in which partnership interests were sold. Accordingly, the Court had jurisdiction to make findings concerning the relationship of Curtis Mallet to the partnership. "Whether the adviser upon whose opinion the partner claims to have relied is a promoter of the transactions and, if so, whether the adviser's opinion is inherently unreliable can be decided on the basis of the evidence necessary and relevant to deciding the underlying adjustments in the FPAA; they would be more appropriately determined at the partnership level."

In light of this analysis, the Court left open the possibility that it might conclude, after a trial on the merits at which the facts relating to Curtis Mallet's role in the implementation of the transactions were developed, that the defense of reliance on the Curtis Mallet opinion was a partnership-level defense -- but only if it also concluded that Curtis Mallet was a "promoter" and that the defense would therefore not be allowed. (This explains the odd procedural alignment in this case, where the IRS argued that the taxpayer's reasonable cause defense should be adjudicated in the Tax Court, a "prepayment forum.") On the other hand, if the Court concluded that Curtis Mallet was not a promoter, the defense would be a partner-level defense that Mr. Logan might assert in a subsequent partner-level suit for refund, but only after he had paid the penalty (assuming that the IRS prevailed on the substantive issues in the *Tigers Eye* Tax Court litigation).

Just a few weeks after issuance of the Tax Court's opinion in *Tigers Eye*, the Court of Federal Claims released Judge Allegra's opinion in *Clearmeadow Investments, LLC v.*

United States,[18] another "Son-of-BOSS" case. In that opinion, the Court explicitly disagrees with the contention in *Klamath* that a "reasonable cause and good faith" defense can *ever* be considered a partnership-level defense, *i.e.*, a defense that can be litigated on a pre-payment basis. The Court relied on the "plain meaning" of the words of the Regulations that distinguish between partner- and partnership-level defenses, and it read them to categorize the "reasonable cause and good faith" defense as *per se* partner-level.[19] Accordingly, the Court concluded that the prior decisions on which the taxpayers had relied in attempting to get the Court to consider their defense in the course of the partnership proceeding -- the Fifth Circuit's decision in *Klamath* and the Court of Federal Claims's own decision in *Stobie Creek Investments, LLC v. United States*[20] -- were incorrect.[21]

Can the Needle Be Threaded?

If *Clearmeadow* is now the law in the Court of Federal Claims, it will likely be impossible in a partnership proceeding in that Court to raise a "reasonable cause and good faith" defense based on the advice of counsel. Although the transaction before the Court in *Clearmeadow* was a "promoted tax shelter," the breadth of the Court's opinion and the Court's apparent indifference to the question of whether the actions assertedly giving rise to the defense were taken by (or on behalf) of the partnership, as distinguished from by (or on behalf of) one or more of the partners, may leave little room for drawing factual distinctions in subsequent cases.

In the Tax Court, things may be a bit different. The IRS succeeded in convincing the Tax Court that the taxpayer in *Tigers Eye* could not prevail on its defense of reliance on the Curtis Mallet opinion in a prepayment forum -- either Curtis Mallet was a promoter, in which case the taxpayer could not prevail at all, or Curtis Mallet was not a promoter, in which case the taxpayer's defense could be raised only by means of a partner-level refund suit after the Tax Court litigation had been lost and the penalty had been paid. The Tax Court's analysis highlights a tactical dilemma that now faces taxpayers in "promoted" tax shelter transactions as they attempt to have defenses of reliance on counsel (or other qualified tax advisors) heard in a partnership-level prepayment proceeding; if they succeed in convincing the Court that the tax advice in question was given to a sufficiently large group of partners (or to the managers of the partnership), the IRS may retort that that very fact demonstrates the sort of "conflict of interest" and lack of independence that may render an advisor a "promoter" on whose advice reliance is inherently impermissible![22]

Not every case, though, involves circumstances similar to those at issue in *Tigers Eye*. Indeed, in cases arising outside of the "promoted tax shelter" context, *Tigers Eye*'s acknowledgement that "reasonable cause and good faith" defenses may sometimes be adjudicated in the (prepayment) partnership proceeding may prove to be very helpful. At the same time, Curtis Mallet's involvement in the implementation of the *Tigers Eye* transaction and the courts' increasing antipathy to law firms that are perceived to have made large profits selling opinions that encouraged abusive transactions,[23] such as "Son-of-BOSS," should provide a basis for distinguishing the portion of the *Tigers Eye* decision holding that reliance on the Curtis Mallet opinion may have been inherently unreasonable.

Indeed, in the very recent case of *Canterbury Holdings, LLC v. Commissioner*, T.C. Memo 2009-175 (July 27, 2009), a partnership proceeding that did not involve a "promoted" transaction, the Court considered -- without apparent objection on the jurisdictional issue from the Internal Revenue Service -- and upheld a "reasonable cause and good faith" defense based on the partnership's consultation with a qualified tax professional, citing (in footnote 8 to the Tax Court's opinion) *New Millenium* and *Tigers Eye* for the proposition that "TEFRA tells us that we should usually examine any accuracy-related penalties or additions to tax related to adjustments to partnership items at the partnership level." Nevertheless, at least until some future cases in which the jurisdictional issue is explicitly thrashed out provide some additional guidance, one is left with a worried feeling that there may be a declining possibility, in the prepayment phase of a TEFRA partnership proceeding, of prevailing even in the Tax Court on a reliance on counsel defense.[24]

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1 Pisem, "What Happened to My Prepayment Forum? The Penalty Problem in TEFRA Partnership Audit Cases," 108 JTAX 269 (May 2008).

2 Internal Revenue Code sections 6221-6234.

3 Amendments to the Treasury Regulations were proposed earlier this year under which the IRS would have the power, if it wished to do so in a particular case, to remove partnership items that relate to "listed transactions," as defined in Treasury Regulation section 1.6011-4(b)(2), from the TEFRA partnership audit procedures, with the effect that such items (and, presumably, penalties asserted with respect to such items) would be governed by the ordinary deficiency procedures. Notice of Proposed Rulemaking REG-138326-07, 2009-9 I.R.B. 638. The amendments are proposed to be effective for taxable years ending on or after February 13, 2009. The amendments, even if adopted, would not apply to any transactions that are not "listed" and, even in the case of a listed transaction, could not be "proactively" invoked by a taxpayer.

4 The Court of Federal Claims, as we will discuss below, has held firmly to a narrower definition of "partnership-level" defenses.

5 The Tax Court's Memorandum Opinion in *Tigers Eye Trading LLC*, T.C. Memo 2009-121 (May 27, 2009), discussed below, contains an extensive "Afterword" decrying the complex litigation structure created by the Code and Regulations and their denial of a prepayment forum in which to challenge asserted penalties.

6 *Klamath Strategic Investment Fund, LLC*, 472 F. Supp. 2d 885, 99 AFTR2d 2007-850 (DC Tex., 2007).

7 Reg. 301.6221-1(c).

8 Reg. 301.6221-1(d). Section 6664(c)(2) contains special rules requiring that a taxpayer have obtained a "qualified appraisal" by a "qualified appraiser" *and* made a further "good faith investigation" of the value of contributed property before a court can even consider whether a taxpayer may take advantage of the reasonable cause exception in the case of a valuation overstatement with respect to charitable contribution property. The Tax Court in the partnership proceeding *Whitehouse Hotel Limited Partnership*, 131 TC No. 10 (Oct. 30, 2008), determined that a partnership (which the IRS conceded had obtained a "qualified appraisal" from a "qualified appraiser") had not made the requisite "investigation" and imposed a penalty for valuation overstatement.

9 If "cannot be determined at the partnership level" refers to *legal* impossibility -- impossibility arising because the scope of the partnership proceeding is defined as not including a particular defense -- the definitions become circular, as there then seems to be no meaningful difference between defenses that *may not* be asserted in the partnership proceeding and those that *cannot* be asserted in the partnership proceeding. On the other hand, if "cannot be determined at the partnership level" is intended to refer to *factual* impossibility, it is difficult to imagine what circumstances would make such a determination impossible if a particular partner chose to introduce evidence in the partnership proceeding relevant to his own partner-level defense.

10 As a matter of grammar, the Regulations could be read to say either, "Partner-level defenses are limited to those that (a) are personal to the partner or are dependent upon the partner's separate return and (b) cannot be determined at the partnership level," or "Partner-level defenses are limited to those that (a) are personal to the partner or (b) (1) are dependent upon the partner's separate return and (2) cannot be determined at the partnership level." In its consideration of these issues, *Tigers Eye Trading LLC*, TC Memo 2009-12, discussed

below, uses several different paraphrases (conjunctive and disjunctive, affirmative and negative) of the regulatory definition, not always consistent with each other, without distinction or analysis; as the Court ultimately concluded in that case that none of the three tests for "partner-level" status may be met, it was not necessary for it to parse the words of the Regulations more closely.

[11] The Court of Appeals expressly declined to express an opinion on whether the District Court had correctly resolved the "substantial authority and reasonable belief that more likely than not" issue.

[12] 102 AFTR 2d at 2008-5496 (emphasis added). This passage appears on the precise pages in the official Court of Federal Claims Reports that are cited by the Court of Appeals in *Klamath*!

[13] When the Court of Federal Claims in *Stobie Creek* says, "Whether the partnership can assert this exception through the actions of its managing partner, Jeffrey Welles, will be considered below," 102 AFTR2d at 2008-5497, the "actions" to which the court refers are actions by Jeffrey Welles that assertedly *gave rise to (or evidence)* reasonable cause and good faith, actions that presumably occurred during or shortly after the years in issue; those "actions" are not actions taken by Mr. Welles before the Court of Federal Claims in *asserting the existence of* reasonable cause and good faith.

The confusion in the reasoning of the Court of Appeals is highlighted by an intriguing grammatical ambiguity in a passage from the very next paragraph of its opinion: "The district court found that Patterson and Nix sought legal advice from qualified accountants and tax attorneys concerning the legal implications of their investments and the resulting tax deductions. They hired attorneys to write a detailed tax opinion, providing the attorneys with access to all relevant transactional documents. This tax opinion concluded that the tax treatment at issue complied with reasonable interpretations of the tax laws. At trial, the Partnerships' tax expert concluded that the opinion complied with standards established by Treasury Circular 230, which addresses conduct of practitioners who provide tax opinions. Overall, the district court found that the Partnerships proved by a preponderance of the evidence that *they* relied in good faith on the advice of qualified accountants and tax lawyers." (Emphasis added.) What is the antecedent of the highlighted pronoun "they"? The District Court could not have found that "the Partnerships" (Klamath and Kinabalu) had relied on "qualified accountants and tax attorneys," since those advisors gave their advice only to Patterson and Nix after their withdrawal from the partnerships. But if it was only Patterson and Nix who relied on that advice, on what rational basis can it be said that their defense to the asserted penalty was a "partnership-level" defense?

[14] The Court does state, in explaining why it *might* ultimately find that Curtis Mallet was a "promoter," that Curtis Mallet "may have provided" substantially identical tax opinions to investors in other Son-of-BOSS transactions promoted by Sentinel (the promoter of the *Tigers Eye* transaction), that each such investor was required to pay $100,000 to obtain a Curtis Mallet opinion, that the Government was arguing in its appeal of *Jade Trading, LLC v. United States*, 80 Fed. Cl. 11, 100 AFTR 2d 2007-7123 (2007), that Curtis Mallet understood that prospective clients would retain the firm only if it rendered a favorable opinion, and that "there are indications in the Exhibits to the Second Stipulation of Facts" that Curtis Mallet attorneys "may have played a role" in preparing the transaction documents at issue in *Tigers Eye* and other cases.

[15] The term "promoter" appears in section 7422(i) of the Internal Revenue Code, and related terms, such as "promotion," appear in a wide variety of Code sections, and not always with a single, consistent meaning. For example, in *Countryside Limited Partnership v. Commissioner*, 132 T.C. No. 17 (June 8, 2009), the Tax Court declined to use the definition of "promoter" in former Code section 6111(d), as in effect prior to its repeal by the American Jobs Creation Act of 2004, in parsing the meaning of the term "promotion of the ... participation of such corporation in any tax shelter" in Code section 7525(b), as in effect prior to its amendment by the 2004 Act. Thus, one should certainly not assume that the definition of "promoter" used in the judge-made rule of law articulated in *Tigers Eye* (to the effect that reliance on an opinion rendered by a promoter may not provide "reasonable cause" for an underpayment) will be identical to the definitions to be applied when the term is found in the Code. Indeed, caution should be exercised even when there seems to be a close affinity between that judge-made rule and a particular Code provision, such as Code section 6664(d)(3) (which provides that, in case of "reportable transaction understatement" for taxable year ending after October 22, 2004, reasonable cause cannot be based on reliance on the opinion of a "material advisor" who participated in "promotion" of the transaction).

[16] In another sentence in this portion of the opinion, the Court refers to "defenses that require factual findings that are generally relevant to all partners *or a class of partners* and not unique to any particular partners." (Emphasis added.) How broad a "class of partners" must be in order for facts relevant to it to become "partnership-level," rather than "partner-level," facts is not discussed in the opinion.

[17] The *Tigers Eye* opinion states quite explicitly, "[R]eliance on the Curtis Mallet opinion by Mr. Logan ... would be assertable and decided in this partnership-level proceeding only if the Court should decide that Curtis Mallet was a promoter and that the Curtis Mallet opinion was inherently unreliable." One should therefore not place much stock in apparent ambivalence at other points in the opinion about whether a partnership-level determination would *necessarily* be adverse to the taxpayer.

[18] 103 AFTR 2d 2009-2786 (June 17, 2009).

[19] In the words of section 301.6221-1(d), "Partner-level defenses are limited to those that are personal to the partner or are dependent upon the partner's separate return and cannot be determined at the partnership level. Examples of these determinations are ... whether the partner has met the criteria of ... section 6664(c)(1) (reasonable cause exception) subject to partnership-level determinations as to the applicability of section 6664(c)(2)." The Court of Federal Claims also noted that the Regulations providing substantive guidance with respect to application of the "reasonable cause and good faith" exception distinguish between a "pass-through entity" and a "taxpayer" holding an interest in such entity, Treasury Regulation section 1.6664-4(e), and also state "that 'the most important factor' in determining 'reasonable cause' is 'the extent of the *taxpayer's* effort to assess the proper tax liability.'" Treasury Regulation section 1.6664-4(b)(1) (emphasis added). From this juxtaposition, the Court reasoned that the Regulation's emphasis on the "taxpayer," as distinguished from the "pass-through entity," suggested partner-level treatment.

However, section 1.6664-4(e), in its entirety, reads, "The determination of whether a taxpayer acted with reasonable cause and in good faith with respect to an underpayment that is related to an item reflected on the return of a pass-through entity is made on the basis of all pertinent facts and circumstances, including the taxpayer's own actions, as well as the actions of the pass-through entity." This language suggests to your author that "reasonable cause and good faith" defenses can also properly be grounded in actions taken on behalf of the partnership (for example, in the partnership's seeking of competent professional advice in connection with the preparation of its return). If that is indeed the case, *Clearmeadow*'s reading of section 301.6221-1(d), that makes that section's reference to the "reasonable cause and good faith" defense an absolute bar to partnership-level adjudication, rather than a mere example of a defense that would frequently be a partner-level defense, seems harsh and over-literal.

[20] 82 Fed. Cl. 636, 102 AFTR 2d 2008-5442 (2008).

[21] It is interesting to note that the Court of Federal Claims in *Clearmeadow* cites to *Tigers Eye* for that case's assertion that "[b]ecause the statutory scheme provides that a partner may raise his partner-level defenses only in a later refund action, the regulation is entitled to deference by [the Tax Court]." At the same time, the Court of Federal Claims neglects to mention that *Tigers Eye*, contrary to the approach taken in *Clearmeadow*, in fact held that the court in a partnership proceeding might, in some cases, have jurisdiction to determine at least the *invalidity* of a "reasonable cause and good faith" defense.

[22] See also the discussion of Code section 6664(d)(3) in footnote 15, above.

[23] See footnote 14, above.

[24] Of course, in cases appealable to the Fifth Circuit, the more favorable rule in *Klamath* may apply.