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Court of Federal Claims Splits on the Computation of the TEFRA "Jurisdictional Deposit"

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Since the enactment of TEFRA in 1982, the tax treatment of the partnership items of certain partnerships has been determined at the partnership level. [1] Partners may choose to dispute adjustments asserted by the IRS in a "notice of final partnership administrative adjustment" (FPAA) in the Tax Court, or they may select a U.S. district court or the Court of Federal Claims as the forum for litigation. [2]

When litigation takes place in the Tax Court, any tax arising from adjustments asserted in an FPAA generally is not required to be paid until the decision of the Tax Court has become final. [3] When litigation takes place in a district court or in the Court of Federal Claims, however, the tax can be assessed and collected once 150 days have elapsed from issuance of the FPAA. Indeed, Section 6226(e) requires that the partner filing a petition for review of an FPAA in a district court or in the Court of Federal Claims must "deposit[] with the Secretary, on or before the day the petition is filed, the amount by which the tax liability of the partner would be increased if the treatment of partnership items on the partner's return were made consistent with the treatment of partnership items on the partnership return, as adjusted by the final partnership administrative adjustment."

Two judges of the Court of Federal Claims, in cases decided in 2008 and 2009, interpreted the required "deposit" to include increases to the petitioning partner's taxes, arising from adjustments made in an FPAA, but payable with respect to years subsequent to the year for which the FPAA was issued. Recently, in *Prestop Holdings, LLC*, 106 AFTR 2d 2010-7246 (Fed. Cl. Ct., 2010), a third judge took a contrary position and limited the deposit to taxes payable with respect to only a single year. We explore below who has the better side of this dispute, and how it relates to other questions that arise under the partnership audit rules. The answer may be that there really is not quite as much at stake as the volume of spilled ink would lead a casual observer to think.

CHOICE OF FORUM AND THE 'JURISDICTIONAL' DEPOSIT

Section 6226 , in providing a choice of forums in which partners can petition for readjustment of partnership items, parallels the choice of forums available for income tax litigation outside of the TEFRA partnership context—Tax Court for those who prefer to litigate before they pay, and a district court or the Court of Federal Claims for those who are willing to pay first and seek a refund thereafter. [4] We focus in this article on those who choose the latter route.

In the nonpartnership context, it has long been established that the taxpayer's payment in full of the asserted tax liability, prior to filing of a refund action, is a jurisdictional prerequisite to the taxpayer's bringing a suit for refund in a district court or in the Court of Federal Claims. [5] In the partnership context, things are more complicated, for several reasons.

First, a typical FPAA merely proposes adjustments to individual items of income or deduction of the partnership (or, in some cases, of the partners), but does not usually compute each partner's actual tax liability arising from the adjustments proposed by the Service. Accordingly, it can be difficult to know whether a prelitigation payment made by a partner of tax liability arising from an FPAA will, in fact, be payment in full.

Second, Section 6226 contemplates that a petition for readjustment of partnership items will be filed by one partner, even though all partners may then become parties to the action commenced by that petition. [6] It would be unreasonable to require the one filing partner to cause all of the other partners to pay their taxes before suit. On the other hand, failure to require payment of the asserted tax in the context of partnership tax disputes would give taxpayers litigating such disputes a significantly broader choice of forums than that available outside the partnership context.

In order to accommodate these conflicting policies, Section 6226(e) imposes a "jurisdictional requirement" for filing a petition in a district court or in the Court of Federal Claims, on only the filing partner. As noted above, that partner must deposit, "on or before the day the petition is filed, the amount by which the tax liability of the partner would be increased if the treatment of partnership items on the partner's return were made consistent with the treatment of partnership items on the partnership return, as adjusted by the final partnership administrative adjustment." Moreover, a failure to comply with this "jurisdictional requirement" is not necessarily fatal; the statute provides that a district court or the Court of Federal Claims may consider the requirement to have been satisfied "where there has been a good faith attempt to satisfy such requirements and any shortfall in the amount required to be deposited is timely corrected." [7]

There is no *jurisdictional* requirement that any partner, other than the partner who files the petition for readjustment, must deposit any amount of tax liability in connection with commencement of a partnership proceeding in a district court or in the Court of Federal Claims. [8] Nevertheless, Section 6225(a) provides that, if an FPAA has been issued and a petition for readjustment is not timely filed in the Tax Court, "assessment of a deficiency attributable to any partnership item may be made." [9]

There is no requirement, however, to deposit the amount of any asserted penalties, and such penalties generally cannot be assessed and collected until completion of the partnership proceeding. [10]

THE DEPOSIT: ONE YEAR'S LIABILITY OR MULTIPLE YEARS'?

The “taxable year” is the crucial unit of time by means of which a taxpayer’s income tax liability is computed. Taxable year concepts infuse both the substantive tax law rules governing the taxation of partners and the procedural regime created by TEFRA to adjudicate disputes about the application of those substantive rules.

As a matter of substantive tax law, Section 702(a) requires each partner to take into account its distributive share of various partnership items in determining the partner’s income tax. Section 706(a) provides that the inclusions required by Section 702 “shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.”

In what is perhaps the simplest example, a partnership using the calendar year as its taxable year may be composed exclusively of partners each of whom also uses the calendar year as its taxable year. In this case, each partner would take into account on the partner’s individual income tax return for 2010 that partner’s share of the partnership’s income for 2010, and so on.

On the procedural side, the TEFRA rules clearly contemplate that an FPAA will be issued with respect to a particular taxable year of the partnership. [11] Nevertheless, adjustments made in an FPAA issued with respect to one partnership taxable year can increase a partner’s tax liability in more than one of the partner’s taxable years. We have identified two broad classes of cases in which this can occur:

1. The adjustments made in the FPAA can reduce the losses (or credits) that the partner can carry to other years.

Example: Mary Doe was a partner in Partnership A during 2007 and 2008. Her distributive share of Partnership A’s loss for 2007 was reported as $1 million. Mary had (and reported) no distributive share of Partnership A income or loss for 2008. Apart from her distributive share of Partnership A’s loss, Mary reported income of $200,000 in 2007 and income of $2 million in 2008. Accordingly, Mary’s individual income tax return for 2007 reflected an NOL of $800,000 (equal to the excess of the reported $1 million partnership loss over her other income of $200,000), which she carried over to 2008. [12] Mary’s individual income tax return for 2008 would reflect taxable income of $1.2 million (the excess of her $2 million of income over her NOL carryover of $800,000).

If the IRS were to audit Partnership A’s 2007 return and to disallow the loss in its entirety, Mary’s income for 2007 would increase from a reported loss of $800,000 to positive taxable income of $200,000. The audit also would result, as a mere “computational adjustment” arising from the 2007 adjustment, in disallowance of Mary’s $800,000 NOL carryover from 2007 to 2008, and her taxable income for 2008 thus would increase from $1.2 million to $2 million. [13]

A partner’s claiming of partnership losses in a taxable year after the year in which the losses are incurred by the partnership does not necessarily result from the application of loss carryover rules such as Section 172 (relating to NOLs) and Section 469 (relating to passive activity losses). Such a deferral, at the partner level, of the deductibility of losses that have been allocated to the partner by the partnership can also result under Section 704(d) from the partner's lack of sufficient basis in its partnership interest, or under Section 465 from the partner's lack of a sufficient amount "at risk" in the activity in which the losses are incurred. Under those provisions, the losses become allowable to the partner in the year in which the partner's basis or amount at risk increases.

2. In many instances, the Service has adopted the practice of issuing an FPAA with respect to a particular year that determines the tax consequences of a transaction in a way that will not have an actual impact on the income or loss of the partners until a later year.

An example of this sort of situation is provided by *Kligfeld Holdings,* 128 TC 192 (2007). Simplifying the facts of *Kligfeld* somewhat, during 1999 a partner contributed property that had a basis of approximately $300,000 to a partnership. Later in that year, the partnership and the partners engaged in a complex series of transactions that they reported as having caused the partner's basis in his interest in the partnership to increase to almost $10 million, without the partner's having made any additional contributions or recognizing any income. During 2000, the partnership distributed $10 million of cash to the partner. The partner reported no gain on the distribution, on the theory that it did not exceed his basis in his partnership interest.

The IRS issued an FPAA with respect to the partnership's 1999 taxable year, one of the adjustments in which was a reversal of the increase that was claimed to have arisen during that year to the partner's basis in his partnership interest. The claimed basis increase had not had any impact on the computation of gain or loss arising from any transaction occurring during 1999, but did affect the computation of gain on the cash distribution made during 2000. The Tax Court's opinion supports the conclusion that, since the basis adjustments, which were partnership items, were reflected on the partnership's return for 1999, it was proper for the Service to challenge them in an FPAA issued with respect to that year. [14]

A similar circumstance arose in *Prestop,* where the FPAA adjusted the tax treatment of certain tax-free distributions of property made during 1997 by the partnership to a partner. The adjustments made in the FPAA with respect to the partnership's 1997 taxable year did not have the effect of making the 1997 tax-free distributions taxable, but they did reduce the partner's basis in the property distributed. Thus, when the partner sold the property distributed during 1998, [15] the amount of loss recognized by the partner on the sale and offset against the partner's other gains was reduced as a result of the adjustments made in the 1997 FPAA.

When these circumstances arise and a petition for readjustment of partnership items is filed in a district court or in the Court of Federal Claims, how is the "jurisdictional deposit" required by Section 6226(e)(1) to be computed? The statute describes that deposit as being "the amount by which the tax liability of the partner would be increased if the treatment of the partnership items on the partner's return were made consistent with the treatment of the partnership items on the partnership return," as adjusted by the FPAA. Does the reference to the "partner's return" encompass only the return for the partner's taxable year in computing the taxable income of which, under Section 706(a) , the partner includes the income or loss of the partnership for the partnership's taxable year with respect to which the FPAA is issued? Or does the "partner's return" include all of the partner's returns for all years that may be affected by the adjustments made in the FPAA?

CASE LAW: MAKING A FORTRESS OUT OF THE DICTIONARY (ACT)?

The first Court of Federal Claims case that addressed—in 2008, 26 years after the enactment of TEFRA!—the computation of the jurisdictional deposit appears to be *Kislev Partners, L.P.*, 102 AFTR 2d 2008-5780 , 84 Fed Cl 385 (Fed. Cl. Ct., 2008), *motion for reconsideration denied* 102 AFTR 2d 2008-6600 , 84 Fed Cl 378 (Fed. Cl. Ct., 2008).

During 2002, Kislev Partners disposed of foreign currency (euros) by converting the foreign currency to dollars at its FMV of approximately $1.3 million. On its return for 2002, the partnership claimed that it had a basis of over $142 million in the foreign currency and that it had thus incurred a loss of approximately $140 million on its disposition.

The court stated that "Kislev attempted to defer most of these losses, reporting a loss of $6,551,884 on its 2002 Schedule K while reporting a 'deferred [loss] due to basis limit' in the amount of $134,084,225 on its Form 1065, which it included in its capital accounts." [16] The opinion does not state explicitly when or whether Kislev Partners reported the deferred loss as having become allowed. Nevertheless, from the opinion's description of the tax reporting by one of the partners, it appears that additional losses, constituting all or a portion of the deferred loss, were in fact claimed by the partners in 2003, 2004, and 2005. The Service sent an FPAA with respect to Kislev Partners' 2002 taxable year that disallowed both the $6,551,884 loss that was claimed on the partnership's return for that year and the entire deferred loss.

A partner, Nesim Bahar, filed a petition for redetermination in the Court of Federal Claims. Bahar's tax liability for his 2002 taxable year had not been reduced to any extent by his distributive share of Kislev Partners' claimed foreign currency loss for that year, but his total tax liability for the years 2002-2005 had been reduced by an aggregate of $2.9 million by his share of Kislev Partners' losses for all those years. Bahar preceded his petition with payment of a $9,500 jurisdictional deposit, computed as the sum of his 2002 tax liability attributable to the adjustments made by the FPAA (zero), plus a small additional amount deposited "out of an abundance of caution." The government moved to dismiss Bahar's petition on the grounds that his jurisdictional deposit had been inadequate.

The Court of Federal Claims, in an opinion by Judge Williams, concluded that the deposit was inadequate. The opinion relied on a number of different arguments to reach this conclusion and to reject Bahar's argument that the use of the singular noun "return" in Section 6226(e) meant that only the tax liability of a single year could be taken into account in computing the amount of the required deposit.

The court first relied on the very first provision of the United States Code—1 U.S.C. section 1, sometimes called the "Dictionary Act." This rule of construction states that, "[i]n determining the meaning of any Act of Congress, unless the context indicates otherwise[,] words importing the singular include and apply to several persons, parties, or things...." [17]

Second, the court accepted, without citation of authority, the government's conclusory assertion that "the overarching statutory requirement is that the total 'tax liability' be deposited as a jurisdictional prerequisite to maintaining suit in this forum," even if reaching that result might require going beyond the "literal terms" or "plain language" of the statute. The court declined to permit what it called "Bahar's election to defer his tax losses to future years and thus incur no FPAA-related tax liability for 2002" [18] either to dictate the amount of the required deposit or to "undermine the primary statutory purpose of §6226(e)(1) which equates the amount of that deposit with total tax liability."

Third, the court noted that its reading of "tax liability" in Section 6226(e) as potentially encompassing liability for more than one taxable year of a partner that may be affected by an FPAA for a single year of a partnership is consistent with the case law holding that the "computational adjustment" that may be collected from a partner on conclusion of a TEFRA partnership proceeding, without need for the issuance of a further notice of deficiency to the partner, can include the partner's liability for all years that are affected by the FPAA. In this context, the Court of Federal Claims cited to one of its earlier decisions, *Grapevine Imports, Ltd.*, 100 AFTR 2d 2007-5228 , 77 Fed Cl 505 (Fed. Cl. Ct., 2007), which had considered the application of the statute of limitations in a context analogous to that present in *Kislev Partners.*

In *Grapevine*, the Service issued an FPAA with respect to the partnership's 1999 taxable year on 12/17/04, more than three years after all relevant returns for 1999 taxable years had been filed, but less than three years after the partnership and its partners had filed their returns for 2000. The adjustments made in the FPAA for 1999 had the effects of eliminating a loss claimed by certain partners (the Tigues) on the their individual income tax return for 1999 and of causing the Tigues to have a significant amount of positive taxable income in that year. Accordingly, the Tigues' NOL carryover that had arisen in 1998 was absorbed in 1999 and was not available to be carried to 2000. This increased the Tigues' taxable income and tax liability for their 2000 taxable year.

The Court of Federal Claims held that the FPAA was timely with respect to the potential adjustments that it caused to the Tigues' liability for their 2000 taxable year, arising from the unavailability of the loss carryover, even though that unavailability was attributable to increased partnership income during their 1999 taxable year, asserted in the FPAA, and even though the period of limitations had expired with respect to the Tigues' 1999 taxable year itself. [19]

The court in *Kislev Partners* considered *Grapevine*'s rule, that an FPAA with respect to a particular taxable year, "closed" by the statute of limitations when the FPAA was issued, nevertheless could be effective as to a later year that was not "closed," to be support for an analogous rule that treated the tax liability of a later year as arising from an FPAA for an earlier year for purposes of computing the required jurisdictional deposit. Accordingly, the court concluded that Bahar's deposit had been inadequate. Because he had made a "good faith" effort to comply with the deposit requirement, however, the court gave him 60 days within which to remedy the $2.9 million shortfall in his deposit.

The court denied Bahar's motion for reconsideration in an opinion that added little to its original decision, except for the observation that "the requirement that a partner make a deposit equal to the tax liability parallels Congress' general prerequisite to filing a refund suit that a taxpayer must fully pay the tax liability resulting from an IRS adjustment [sic] he seeks to challenge."

Russian Recovery Fund. In late 2009, another Court of Federal Claims decision, *Russian Recovery Fund Ltd.*, 105 AFTR 2d 2010-310 , 90 Fed Cl 698 (Fed. Cl. Ct., 2009), [20] revisited the question of how to compute the jurisdictional deposit.

The facts in *Russian Recovery Fund* were very similar to those in *Kislev Partners*, including the purported incurrence by the partnership of losses in one year (2000), followed by the claiming of a portion of those losses by partners partially on their returns for that year and partially on their returns for a later year (2001). An FPAA with respect to 2000 disallowed all of the losses, and the deposit made by the partner who filed a petition in the Court of Federal Claims included only the increased tax liability for 2000 that would arise from applying the adjustments in the FPAA. The government moved to dismiss the petition on the grounds of inadequacy of the jurisdictional deposit.

Judge Bruggink found Judge Williams's decision in *Kislev Partners* to be persuasive and concluded that the jurisdictional deposit must include the petitioning partner's tax liability for all years and amounts by which that partner's returns are affected by the FPAA. [21]

THIRD TIME'S THE CHARM?

The Court of Federal Claims addressed the question of the proper computation of the jurisdictional deposit for a third time in Judge Allegra's very recent opinion in *Prestop Holdings.*

We described the facts in *Prestop* above: An FPAA issued in 2005 [22] adjusted the tax treatment of certain tax-free distributions of property made during 1997 by a partnership to a partner. The adjustments made in the FPAA with respect to the partnership's 1997 taxable year did not have the effect of making the tax-free distributions taxable, but they did reduce the partner's basis in the property distributed. The partner sold the property distributed during 1998. The amount of loss claimed to have been recognized by the partner on the sale and available to offset other gains was reduced as a result of the adjustments made in the 1997 FPAA. The partner had not had sufficient gains in 1998 to absorb the entire claimed loss, so a portion of the loss claimed by the partner on his 1998 return was carried over and offset gains on the partner's 1999, 2000, and 2001 returns.

Prestop thus exemplifies both types of situations described above in which adjustments made in an FPAA can affect tax liability in later years—the actual taxable event took place after the year with respect to which the FPAA was issued, and portions of the loss claimed by the partner in the year of the taxable event were carried to even later years.

One of the partners filed a petition in the Court of Federal Claims for readjustment of the items set out in the FPAA. As the FPAA was issued with respect to the partnership's 1997 taxable year, and the adjustments made in the FPAA had no income tax effect during the partner's 1997 taxable year, the partner made only a nominal $100 jurisdictional deposit. The government moved to dismiss, asserting that the proper deposit, including amounts payable with respect to 1998, 1999, 2000, and 2001, would have exceeded $800,000.

The government, of course, relied on both *Kislev Partners* and *Russian Recovery Fund* to support its motion. Judge Allegra, "[w]ith all due respect to the distinguished jurists who penned [those] opinions," concluded that they were mistaken and failed "to give proper account to the statutory language of section 6226, the structure of the TEFRA provisions, and, to the extent relevant, the legislative history of TEFRA."

Judge Allegra began by dismissing the prior opinions' reliance on the Dictionary Act's equation of singular and plural terms as an independent source of statutory interpretation. The Act, by its own terms, does not apply if the "context indicates otherwise." Accordingly, Judge Allegra found it necessary to conduct an independent examination of the "context," including the surrounding language and purpose of the TEFRA provisions. He determined, in effect, that the results of that examination would be dispositive of whether the Dictionary Act applied.

Turning then to the TEFRA provisions themselves, Judge Allegra demonstrated that many of the rules governing FPAAs clearly contemplate that an FPAA will be issued with respect to a single partnership taxable year, and that these rules would not work well in a multi-year context. The opinion also contains a lengthy list of questions highlighting the difficult mechanics that can arise when adjustments relating to multiple taxable years—the period of limitations with respect to some of which, for example, may be closed by the time an FPAA is issued—must all be taken into account in computing the jurisdictional deposit. And the opinion takes the court's prior opinions to task for what he calls the "venturous claim" that "tax liability is typically computed on a multi-year basis," a claim that is contrary to decades of precedent applying an annual accounting concept to federal income tax matters.

Accordingly, the $100 deposit in *Prestop* was found to be adequate, and the government's motion to dismiss was denied.

CAN WE MAKE ANY SENSE OF THIS?

At a superficial level, perhaps the most surprising thing to many readers about this controversy is that it exists at all. In the Tax Court, all judges are ordinarily considered to be bound by prior "regular" decisions of the court, and the "court review" process exists to resolve conflicts and to determine when to overrule existing precedent. [23] In the Court of Federal Claims, such deference is apparently not expected, and judges are bound only by decisions of the Court of Appeals for the Federal Circuit and of the Supreme Court. [24] This difference in approach can be one important factor in deciding where to litigate a tax case, whether or not arising under the TEFRA procedures.

More confusing at a substantive level is an inconsistency between an indisputable proposition advanced by Judge Allegra and a practice followed by the IRS. The judge stated that it "makes no sense" to believe that "Congress truly thought that the review of a single FPAA would encompass all the partners' liabilities for all the taxable years affected by the partnership adjustment." On the other hand, Judge Allegra acknowledges and accepts the Service's practice of issuing an "FPAA that makes no adjustments to income in the partnership taxable year referenced,"[25] but that adjust the partnership's basis in an asset that may be disposed of only in a later year, if at all.

There does not seem to be any good reason to restrict to the context of computing the jurisdictional deposit the concept that an FPAA should relate only to a single taxable year. If that concept were applied consistently throughout the TEFRA partnership audit procedures, much more attention would have to be paid to whether a particular proposed adjustment was made in an FPAA for the proper year.

Perhaps some of the difficulty in this area is attributable to the fact that the circumstances giving rise to multi-year adjustments springing from an FPAA with respect to a single year are not all of one kind. In some cases, an FPAA clearly relates to an item of partnership income or loss reported (or reportable) in the year for which the FPAA is issued, and it is only a loss carryover rule at the partner level that causes multiple taxable years of the partner to be in issue. In that event, all of the adjustments at the partner level clearly arise from a taxable event of the partnership that occurred during the taxable year of the FPAA.

Those situations arguably lend themselves well to the analysis in *Kislev Partners* and in *Russian Recovery Fund,* at least to the extent that the petitioning partner has actually enjoyed a reduction in tax liability in any year not "closed" by the statute of limitations at the time that the petition is filed.[26] Indeed, when considering the analogous question of how to apply the statute of limitations when partner-level loss carryover rules cause an adjustment made in an FPAA to affect a partner's tax liability in later years, the Court of Federal Claims (in *Grapevine,* a decision written by Judge Allegra!) and the Tax Court have agreed that the later years are "fair game" in a proceeding for readjustment.[27]

In other cases, however, the ultimate taxable event will occur only in a future year. In those circumstances, perhaps we are asking the wrong question when we try to figure out what the amount of the jurisdictional deposit should be; the more pertinent question might be whether the FPAA has been issued with respect to the proper year, or whether the adjustment should have been proposed in an FPAA for a different year (or a different partnership), or even in an ordinary notice of deficiency issued directly to a partner.

Unfortunately, the definition of "partnership item" in Reg. 301.6231(a)(3)-1 encompasses not only the "partnership aggregate and each partner's share" of various items of income and deduction, but also many matters that often will not give rise to an income adjustment at either the partnership or the partner level in the year in which they arise, such as the amount and sharing of partnership liabilities, optional basis adjustments under Section 754 , and many "items relating" to various contribution and distribution transactions.[28] Some combination of a narrower definition of "partnership items" and clear regulatory guidance concerning the taxable year with respect to which some of these "non-income" adjustments should be asserted would go a long way towards reducing the number of situations in which difficult issues relating to computation of the jurisdictional deposit arise.

AND WHY ARE WE BOTHERING?

The statutory formula for computation of the Section 6226(e) jurisdictional deposit keys off of the "treatment of the items on the partner's return." The dispute between the judges of the Court of Federal Claims hinges on whether the reference to the "partner's return," a phrase that, as a literal matter, encompasses only a single return for a single taxable year of the partner, can be read to refer to the returns for all of the partner's taxable years that may be affected by the adjustments made in the FPAA. *Kislev Partners* and *Russian Recovery Fund* adopt this broader reading, while *Prestop* insists on reading the noun "return" in the singular.

Let us suppose that *Prestop*'s narrower reading of the statute prevails. How great is the benefit of that conclusion to a partner who has filed a petition for redetermination in a district court or in the Court of Federal Claims? The partner will be required to make a jurisdictional deposit consisting of the tax liability for only one taxable year. But, if the adjustments made in the FPAA would have the effect of increasing the partner's tax for other years as well, this relief may be short-lived.

Section 6225(a) permits assessment of "a deficiency attributable to any partnership item" and levy or proceeding in court to collect the deficiency at any time after the close of the 150th day on which the FPAA was mailed to the TMP, unless a petition for redetermination is filed in the Tax Court. Section 6225(a) 's broad reference to "deficiency attributable" does not contain any comforting words in the grammatical singular that could be read to restrict the permitted assessment to only one taxable year of the partner.

In a very closely related area, the Federal Circuit (whose precedent binds all judges of the Court of Federal Claims) has held that issuance of a partner-level notice of deficiency is not a prerequisite to collection of tax arising in years to which partners had carried tax credits that were subsequently disallowed in a partnership proceeding. [29] If a petition for readjustment is filed in a district court or in the Court of Federal Claims, rather than in the Tax Court, it is difficult to articulate a credible statutory argument that would prohibit the Service from assessing and seeking to collect asserted deficiencies for all affected years of all the partners, including the partner who filed the petition for readjustment, attributable to partnership items, once the 150-day period specified in Section 6225(a) has expired. [30]

Granted, some partners will view the Service's right to assess and to attempt to collect tax as a far less serious burden than a requirement to make a cash deposit as a jurisdictional prerequisite to filing suit. (Perhaps we should call this the "Catch Me If You Can" theory of life.[31]) Many other partners, however, certainly will promptly pay any properly assessed liability. For them, the ability to defer payment by a few weeks or months by jumping out of Section 6226(e)'s frying pan into Section 6225(a)'s fire will be a hollow victory indeed.

Practice Notes

A partner with a valid tactical reason for choosing to litigate in a refund forum instead of the Tax Court may appreciate *Prestop*'s narrow reading of the jurisdictional prerequisite of a deposit. Whether that approach will be taken in a district court, or whether it will be approved by the Federal Circuit with respect to the Court of Federal Claims, remains to be seen. The ultimate benefit, however, may be negligible if the government prevails.

[1] Section 6221 . "Small partnerships" described in Section 6231(a)(1)(B) are not subject to the rules added by TEFRA. "Electing large partnerships" are subject to a different regime, pursuant to Sections 6240-6255 .

[2] Sections 6226(a) and (b)(1) .

[3] Section 6225(a)(2) . If the taxpayer loses in the Tax Court, Section 7485 permits the tax to be assessed and collected immediately, notwithstanding that, under Section 7481(a) , the Tax Court's decision will not become final until completion of the appeal process. Immediate assessment and collection can be avoided, however, if the taxpayer posts a bond.

[4] If the tax matters partner (TMP) files the petition for readjustment, the TMP gets to choose the forum; see Section 6226(a) . If the TMP does not file a petition in any court, a petition filed by a partner in the Tax Court takes priority over a petition filed by any other partner in a district court or in the Court of Federal Claims; see Section 6226(b)(2) . If the TMP does not file a petition in any court and no petition is filed in the Tax Court by any partner, the first filed petition in a district court or in the Court of Federal Claims takes priority; see Section 6226(b)(3) .

[5] Flora, 5 AFTR 2d 1046 , 362 US 145 , 4 L Ed 2d 623 , 1960-1 CB 660 (1960).

[6] Section 6226(c) .

[7] Indeed, in Kislev Partners, L.P., 102 AFTR 2d 2008-5780 , 84 Fed Cl 385 (Fed. Cl. Ct., 2008), *motion for reconsideration denied* 102 AFTR 2d 2008-6600 , 84 Fed Cl 378 (Fed. Cl. Ct., 2008), the first case in which the Court of Federal Claims found a "deposit" by a partner to be inadequate because it had not been computed to take into account the partner's tax liability for later years, the court granted the partner 60 days from the date of the court's decision to make an additional deposit that would remedy the shortfall.

[8] In contrast, each taxpayer seeking to litigate a nonpartnership matter (or a "small partnership" matter that is not subject to the TEFRA procedures, see note 1, *supra*) in a district court or in the Court of Federal Claims must first make full payment of the assessed tax.

[9] Although the Code does not state so explicitly, it seems clear that this assessment is computed on the assumption that the adjustments made in the FPAA are all correct. See Staff of the Joint Committee on Taxation, *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982*, page 272; Mather, 624-2nd T.M. (BNA), *Audit Procedures for Pass-Through Entities*, page A-65 (2009). Reg. 301.6226(e)-1(d) provides that the amount deposited by the petitioning partner may be applied against the assessment of that partner's tax. Section 6230(c) provides procedures that apply if the district court or the Court of Federal Claims finds for the taxpayers, but Treasury fails to refund the amount of the overpayment attributable to the court's decision.

[10] See Pisem, "What Happened to My Prepayment Forum? The Penalty Problem in TEFRA Partnership Audit Cases," 108 JTAX 269 (May 2008) . For a discussion of the difficulties in raising partner-level defenses to an asserted penalty on a prepayment basis, see *id.* and Pisem, "The Uncertain Boundary Between 'Partner-Level' and 'Partnership-Level' Defenses," 111 JTAX 151 (September 2009) .

[11] See, e.g., Section 6223(f) (rules that apply if "the Secretary mails a notice of final administrative adjustment for a partnership taxable year"), Section 6226(a) (rules for filing "a petition for a readjustment of the partnership items for such taxable year" within 90 days after the "day on which a notice of final partnership administrative adjustment is mailed"), Section 6226(f) (determination of "all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates").

[12] Assume Mary's distributive share of Partnership A's loss was not limited by the passive loss rules of Section 469 or by similar provisions, and that the entire loss constituted a "business" loss fully includable under Sections 172(c) and (d) in computing Mary's NOL carryover. For the sake of simplicity, the possibility of loss carrybacks to earlier years is ignored. See Section 172(b)(3) (election to waive NOL carrybacks).

[13] Similar results can follow when the taxpayer's loss carryovers are attributable to nonpartnership items, but the FPAA, by increasing the taxpayer's distributive share of partnership income, decreases the amount of such nonpartnership losses that are available to be carried to other years.

[14] The opinion in Kligfeld Holdings, 128 TC 192 (2007) was issued in response to the partnership's motion for summary judgment on statute of limitations grounds, and the argument was apparently not made to the court (at least in an explicit manner) that even a *timely* FPAA with respect to the partnership's 1999 year would have been an incorrect vehicle by means of which to raise issues that affected the computation of gain or loss only on a subsequent transaction between the partnership and the partner occurring during 2000.

When a similar issue was more clearly presented to the Tax Court in an earlier memorandum decision—Santa Monica Pictures, LLC, TC Memo 2005-104 , RIA TC Memo ¶2005-104 (issue X), not cited in Kligfeld, the court held that a proposed adjustment that did not affect income in the year of the FPAA was improper and declined to exercise jurisdiction over the proposed adjustment. Similarly, in Wilmington Partners L.P., TC Memo 2009-193 , RIA TC Memo ¶2009-193 , issued after Kligfeld, a partner contributed property to a partnership during 1993, but no taxable transaction affected by the basis of that property occurred until 1999. The Service issued an FPAA with respect to the partnership's 1999 taxable year, asserting that the partnership had overstated the basis arising from the 1993 contribution. The partnership argued that an FPAA adjusting the basis of the note contributed to the partnership in 1993 could properly be issued *only* for the partnership's *1993* taxable year. The Tax Court held that an FPAA for 1999 that adjusted the basis of an asset contributed to the partnership in 1993 was valid. In footnote 4 of the Wilmington opinion, the Tax Court stated that, even if the IRS could have issued the FPAA for 1993 (citing Kligfeld), it was not required to do so.

It is hard to reconcile Kligfeld, Santa Monica Pictures, and Wilmington with a coherent and consistent system for issuing FPAAs and litigating the issues that those FPAAs raise.

[15] This description simplifies the facts a bit. In reality, the partner transferred to a corporation, in a transaction apparently governed by Section 351 and in exchange for stock issued by the corporation, the property that had been distributed to the partner by the partnership, and the partner then sold the corporate stock during 1998.

[16] The Kislev Partners opinion does not tell us explicitly what section of the Code required or permitted the partnership to defer its reporting of the bulk of the losses purportedly incurred during 2002. The use of "basis limit" hints that Section 704(d) may have applied at the partner level to prohibit the partners from claiming losses that were properly allocated to them, but were nevertheless in excess of their bases in their partnership interests. The opinion's references to the partnership's "attempt to defer" and the partner's "election to defer" the losses, however, suggest some impropriety on the part of the partnership and its partners, as though they were seeking arbitrarily to elect the year in which losses would be allowed, rather than simply applying Section 704(d) . If the mandatory and mechanical rule of Section 704(d) in fact applied, this suggestion of impropriety is unfortunate. (The question of whether, as a matter of the mechanics of tax reporting, partner-level Section 704(d) limitations should properly be reflected on the partnership's return or only on the partner's return is beyond the scope of this article, but there is no doubt that such limitations are not elective.) The court's visceral discomfort with what it seemed to perceive as an arbitrary assignment of losses among taxable years is even more evident in Russian Recovery Fund Ltd., 105 AFTR 2d 2010-310 , 90 Fed Cl 698 (Fed. Cl. Ct., 2009), discussed in the text below.

[17] Later, in ruling on Bahar's motion for reconsideration, the Court of Federal Claims said in fn. 4 that it did "not deem its invocation of 1 U.S.C. §1 to be the sole or driving legal underpinning of its decision," thereby paying at least lip service to Judge Learned Hand's observation that "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary." Cabell v. Markham, 148 F.2d 737 (CA-2, 1945), *aff'd* 326 U.S. 404 (1945). Is it merely coincidental that the Tax Court in Driscoll, 135 TC No 27 , Tax Ct Rep Dec (RIA) 135.27, 2010 WL 5173156 , a recent decision interpreting Section 107 's exclusion from gross income for "parsonage allowances," relied in part on the same portion of the Dictionary Act that was cited by Judge Williams in Kislev Partners?

[18] As observed in note 16, *supra*, the court's focus on the impropriety of giving effect to a taxpayer "election"—whether an election explicitly provided by the Code or simply a taxpayer decision to report losses in one year rather than another—appears, as far as can be ascertained from the published opinion in Kislev Partners, to be misplaced. Rather, the partnership and its partners, including Bahar, seem simply to have applied mandatory provisions of the Code to the facts as they existed from year to year, in order to determine when losses should cease to be deferred. Perhaps the court meant to suggest that the facts relevant to the computation of Bahar's basis in his interest in Kislev Partners were not really as Bahar asserted or that Bahar's ability to undertake transactions that could affect that basis, such as the contribution of money to the capital of Kislev Partners, should be considered the equivalent of an improper "election" with respect to the amount of the required deposit, but a fuller exposition of these issues would have helped to avoid some of the confusion engendered by the opinion.

[19] For a discussion of this issue, see Pisem and Binder, "*BLAK* Affirms the Necessity of Raising S/L Defense Early in TEFRA Partnership Proceedings," 112 JTAX 222 (April 2010) .

[20] The bulk of the opinion is devoted to discussing the proper method of computing the jurisdictional deposit when the partner filing the petition for readjustment is itself a pass-through entity, a fascinating subject that is beyond the scope of this article.

[21] Judge Bruggink devoted only three paragraphs in the opinion to the amount of the jurisdictional deposit and stated that he found the more extensive opinion in Kislev Partners "to be persuasive," so it is perhaps unfair to read the later opinion too closely on that issue. Nevertheless, there are in the Russian Recovery Fund opinion a number of troubling points that one wishes had been smoothed away in editing, lest they cause trouble in future cases.

First among these is Judge Bruggink's statement that Kislev Partners had "reasoned that 'tax liability is typically calculated on a multi-year basis,'" an assertion that seems contrary to the annual accounting principle so fundamental to our income tax law. (This point is made with some vehemence by Judge Allegra in his opinion in Prestop Holdings, LLC, 106 AFTR 2d 2010-7246 (Fed. Cl. Ct., 2010), discussed in the text, below.) In actuality, the Kislev Partners opinion describes the quoted proposition merely as a conclusion that the government, in its argument, sought to draw from "precedent." Judge Williams's own conclusion in Kislev Partners is the far less categorical statement, in terms of scope and in terms of the certainty with which it is asserted, that "the term 'return' in §6226(e)(1) ... permits the term 'tax liability' to be construed as encompassing multiple returns spanning multiple years."

Judge Bruggink also stated: "Moreover, a voluntary election to defer losses to subsequent years should not control the deposit amount. Allowing an entity to do so would permit it to assure itself of a deposit-free chance to litigate by allocating the loss entirely to other years." It is even less clear in Russian Recovery Fund than it is in Kislev Partners why deduction of a portion of the losses was deferred from the year in which they were incurred, but the most likely cause seems to be again the basis limitation of Section 704(d) . Application by the partners of an unambiguous rule of law that limits their ability to claim losses in a particular year is scarcely an abusive "voluntary election." While there may be arguments to support the "election" argument made in Kislev Partners and in Russian Recovery Fund (see notes 16 and 18, *supra*), the subject deserves far more attention than it was given in the two opinions.

[22] The FPAAs at issue in Kislev Partners and in Russian Recovery Fund were issued after the Prestop FPAA, leading to the question of why the jurisdictional deposit issue in those cases was decided years earlier. The answer is that the Prestop litigation in the Court of Federal Claims was stayed for over three years "pending the resolution of a related criminal case."

[23] A "regular" Tax Court decision by any one judge is normally treated as precedent binding on all the judges of the Tax Court unless and until it is "reviewed by the court" and overruled. See, e.g., Sunoco, Inc., 118 TC 181 (2002), overruling Bowater Inc., 101 TC 207 (1993). An exception to this generalization is the Golsen rule, under which a Tax Court judge will follow the precedential decisions of the Court of Appeals to which a matter under adjudication is appealable, even in the presence of Tax Court precedent to the contrary. See Golsen, 54 TC 742 (1970).

[24] See, e.g., Shore, 72 AFTR 2d 93-6615 , 9 F3d 1524 (CA-F.C., 1993), in which the Federal Circuit was called on to resolve a disagreement among judges of the Court of Federal Claims regarding the precise contours of the Flora "full payment" rule that provides one of the jurisprudential underpinnings for the requirement of a "jurisdictional deposit." See Kafka and Cavanagh, *Litigation of Federal Civil Tax Controversies,* Second Edition (Thomson Reuters/WG&L, 1997 and Supp. Nov. 2010), ¶15.03[5], page 15-17.

[25] Such as the FPAAs at issue in Kligfeld and in Prestop itself. But the cases discussed in note 14, *supra*, demonstrate that this practice has not been universally adopted by judges who have confronted this issue.

[26] The possibility that the partner may enjoy, but has not yet enjoyed, a tax reduction in future years (after the filing of the petition) from positions that are challenged in an FPAA seems irrelevant to the amount of jurisdictional deposit that should be required in what is, in effect, a refund suit. While there are hard questions regarding whether additional deposits should be required if, as, and when a partner files returns for future years claiming such tax reductions after a petition has been filed, and regarding how to read Section 6226(e) to deal properly with years that may be "closed" by the statute of limitations, those seem like little reason not to reach the correct result in run of the mill situations.

[27] See the discussion in Pisem and Binder, *supra* note 19, and the accompanying text; BLAK Investments, 133 TC 431 (2009) (reviewed).

[28] Where an FPAA adjusts the basis of property distributed by a partnership to a partner, the year of the distribution may be the "last clear chance" for determination of that basis under the TEFRA rules, as there is no way of knowing whether the partnership will even be in existence when the partner ultimately disposes of the property. It is not clear, though, that this unusual situation should drive the analysis of more common situations in which an actual taxable event may take place in a future year at the partnership level. (Yet a third pattern arises when an item of partnership loss that has been incurred in the current year is deferred by a partner to a future year because of application of a

Section 704(d) basis limitation; again, the need to answer that hard question as best we can should not stand in the way of trying to determine the most appropriate response to more common questions.)

[29] Olson, 83 AFTR 2d 99-759 , 172 F3d 1311 (CA-F.C., 1999). Section 6230(a)(1) provides that Sections 6211-6216 , including Section 6213(a) 's prohibition on assessment and collection prior to issuance of a notice of deficiency, do not apply to the assessment and collection of "any computational adjustment." Section 6231(a)(6) defines "computational adjustment" as the "change in the tax liability of a partner which properly reflects the treatment under this subchapter of a partnership item."

[30] See note 9, *supra*, and the accompanying text. These issues can, of course, be side-stepped by filing a petition for readjustment in the Tax Court, so that no payment will become due until the decision of the Tax Court has become final (see note 3, *supra*), but there are sometimes valid tactical reasons for choosing to litigate in another forum.

[31] The Section 6651(a)(3) failure to pay penalty, however, provides some disincentive to such conduct.