No. 99-815

In the Supreme Court of the United States

JOSEPHINE CHIMBLO, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the notice of deficiency determining "affected items" against petitioners was barred by the statute of limitations contained in Section 6229 of the Internal Revenue Code, 26 U.S.C. 6229.

2. Whether the negligence penalty was properly imposed under Section 6653(a) of the Internal Revenue Code, 26 U.S.C. 6653(a) (1982 & Supp. IV 1986).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 177 F.3d 119. The memorandum opinion of the Tax Court is unofficially reported at 74 T.C.M. (CCH) 1307 (Pet. App. 17a-28a).

JURISDICTION

The judgment of the court of appeals was entered on May 17, 1999. The petition for rehearing was denied on August 19, 1999 (Pet. App. 29a). The petition for a writ of certiorari was filed on November 12, 1999. The

jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1983 and 1984, petitioners invested in a partnership known as Barrister Equipment Associates Series 151 (Barrister). The "sole business [of the partnership] was printing and selling '49 different literary works and microcomputer disks aimed at a general public market, using leased films, plates and disks to produce said products'." Pet. App. 5a. On Barrister's federal partnership tax returns for 1983 and 1984, it reported significant losses and considerable amounts of qualified investment credit property. Petitioners claimed a distributive share of the ordinary loss deductions and investment tax credits on their individual federal income tax returns for 1983 and 1984, and they carried back an unused portion of the 1983 tax credit to reduce their 1980 and 1981 tax liabilities. *Ibid.*

On September 5, 1989, the Commissioner of Internal Revenue mailed to the Barrister partners, including petitioners, a notice of final partnership administrative adjustment (FPAA) determining adjustments to Barrister's 1983 and 1984 partnership returns. C.A. App. 28-31. A petition for readjustment was filed in the Tax Court on behalf of Barrister by its tax matters partner pursuant to 26 U.S.C. 6226. That case culminated in the entry of a stipulated decision on February 17, 1995, which provides (i) that none of the losses claimed by Barrister for 1983 and 1984 are allowable and (ii) that the amounts of its qualified investment credit property for 1983 and 1984 are zero. C.A. Supp. App. 93-96. In that partnership-level proceeding, Barrister did not assert that the statute of limitations barred the adjustment of its return.

As a result of the decision entered in the partnership-level proceeding, the Commissioner made "computational adjustments" to the partners' tax returns and assessed tax deficiencies against petitioners for 1980 and 1981 with respect to their erroneously asserted partnership items. See 26 U.S.C. 6225, 6230(a)(1), 6231(a)(6).

In addition, in a notice of deficiency mailed on April 29, 1996, the Commissioner determined that petitioners were liable in 1980 and 1981 for negligence penalties and substantial understatement penalties stemming from their erroneous treatment of their investments in Barrister. Penalties asserted against individuals because of their incorrect treatment of partnership items (which are themselves determined at the partnership level) are known as "affected items." See generally 26 U.S.C. 6221-6233. Petitioners petitioned to the Tax Court for a redetermination of these "affected items." [1]

2. Petitioners argued in the Tax Court that (i) the Commissioner's determination of the penalties at issue was barred by the limitations period provided at 26 U.S.C. 6229 and (ii) they had reasonably relied on the advice of their accountant with respect to their tax treatment of the Barrister partnership transactions and were therefore not subject to the negligence penalty. The Tax Court held that the Commissioner's determination of affected items was not barred by the statute of limitations and that petitioners had not shown

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[1] Their case was consolidated in both the Tax Court and the court of appeals with a related case involving taxpayers Catherine Chimblo and the Estate of Gus Chimblo, who also challenged the Commissioner's determination of affected items against them with respect to their tax treatment of investments in the Barrister partnership. Catherine Chimblo and the Estate of Gus Chimblo have not petitioned for a writ of certiorari.

that their reliance on their accountant respecting the tax treatment of their partnership items was reasonable. Pet. App. 27a-28a.

3. The court of appeals affirmed. Pet. App. 1a-16a. The court rejected petitioners' contention that the fact that the FPAA was issued after the limitations period provided in 26 U.S.C. 6229(a) had expired required a finding that the "affected items proceeding" involving the individual partners was barred by the statute. Pet. App. 10a-11a. The court explained that Section 6229(a) creates a limitation on the period for adjusting a partnership return which creates a defense for the partnership, not for the partners, and that the failure of the partnership to raise that defense in the partnership-level proceeding barred its assertion in the "affected items proceeding" involving the individual partners.

The court of appeals also upheld the Tax Court's finding that petitioners were liable for negligence penalties. The court concluded that the Tax Court had not clearly erred in finding that the partners' asserted reliance on their accountant's advice was unreasonable. The court noted that the partnership's "too-good-to-be-true" offering was a sufficient indication that the partnership was created only to generate tax benefits. Pet. App. 12a-13a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. The court of appeals correctly held that the Commissioner's notice of deficiency was not barred by limitations. The Commissioner's determination of federal taxes with respect to partnerships is governed by

provisions codified at 26 U.S.C. 6221-6233.[2] The limitations period for assessing any tax attributable to a partnership item (or an affected item for an individual partner) is generally three years after the later of (i) the date on which the partnership return is filed, or (ii) the last day for filing such return for such year. 26 U.S.C. 6229(a). If an FPAA is mailed to the tax matters partner with respect to any taxable year, however, the running of the limitations period is suspended under 26 U.S.C. 6229(d)—

> (1) for the period during which an action may be brought under section 6226 (and, if an action with respect to such administrative adjustment is brought during such period, until the decision of the court in such action becomes final), and
>
> (2) for 1 year thereafter.

In this case, the Commissioner issued an FPAA to the Barrister partners, and an action was brought in the Tax Court on their behalf under Section 6226. Under the express terms of 26 U.S.C. 6229(d), the limitations period was suspended until one year after the Tax Court decision became final. The stipulated decision of the Tax Court became final on May 18, 1995 (90 days after its entry on February 17, 1995). See 26 U.S.C. 7481(a)(1), 7483. The notice of deficiency in the "affected items" proceeding was mailed to petitioners

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[2] These provisions are known as the unified partnership audit examination and litigation provisions, which were enacted by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97- 248, § 402(a), 96 Stat. 648, effective (§ 407(a)(1), 96 Stat. 670) for partnership taxable years beginning after September 3, 1982.

on April 29, 1996, which was within the resulting limitations period for those items. Pet. App. 6a.

Petitioners contend that, because the FPAA was issued beyond the three-year period provided in 26 U.S.C. 6229(a), the limitations on the determination of affected items necessarily expired prior to the Commissioner's mailing of the notice of deficiency. That contention, however, ignores the fact that the FPAA was determined in the partnership proceeding to be valid and that a final decision upholding the FPAA was entered in that case. As the court of appeals correctly concluded (Pet. App. 12a), any affirmative statute of limitations defense that may have been available with respect to the timeliness of the FPAA was waived when it was not raised in the partnership-level proceeding. Accord, *Crowell* v. *Commissioner*, 102 T.C. 683, 693 (1994). See also *Kaplan* v. *United States*, 133 F.3d 469, 473 (7th Cir. 1998); *Thomas* v. *United States*, 967 F. Supp. 505, 506 (N.D. Ga. 1997); *Slovacek* v. *United States*, 36 Fed. Cl. 250, 254-256 (1996); *Barnes* v. *United States*, 97-2 Tax Cas. (CCH) ¶ 50,774 (M.D. Fla. 1997), aff'd, 158 F.3d 587 (11th Cir. 1998)(Table). Because the FPAA was determined to be valid in the partnership proceeding, and because the affected items were thereafter determined within the one-year period provided for that purpose in 26 U.S.C. 6229(d), the court of appeals correctly concluded (Pet. App. 11a-12a) that the notice of deficiency was timely for the affected items at issue in this case.

Petitioners err in asserting (Pet. 13) that the role given to the tax matters partner in the partnership proceeding to raise the statute of limitations defense deprives individual partners of due process of law. That contention has consistently been rejected in the courts of appeals because the statute "contemplates

that indirect partners will receive notice from [the tax matters partner or other] specified direct partners." *Walthall* v. *United States*, 131 F.3d 1289, 1294-1295 (9th Cir. 1997). See also *Transpac Drilling Venture 1983-63* v. *United States*, 16 F.3d 383, 390 (Fed. Cir.), cert. denied, 513 U.S. 819 (1994); *Brookes* v. *Commissioner*, 108 T.C. 1 (1997); *1983 Western Reserve Oil & Gas Co.* v. *Commissioner*, 95 T.C. 51, 64 (1990), aff'd without published opinion, 995 F.2d 235 (9th Cir. 1993) (Table). There is no conflict among the circuits or other reason to warrant further review of that contention in this case.

2. The court of appeals also correctly upheld the factual determination of the Tax Court that petitioners had not reasonably relied on their accountant and were liable for the negligence penalty imposed by Section 6653 of the Code. During the tax years involved in this case, Section 6653 of the Code imposed a penalty of five percent of an underpayment of tax required to be shown on a return which was found to be "due to negligence (or intentional disregard of rules or regulations)." 26 U.S.C. 6653(a) (Supp. IV 1986).[3] Negligence for this purpose is defined as the "lack of due care or [a] failure to do what a reasonable and prudent person would do under the circumstances." *Goldman* v. *Commissioner*, 39 F.3d 402, 407 (2d Cir. 1994); see *Zfass* v. *Commissioner*, 118 F.3d 184, 188 (4th Cir. 1997); *Chamberlain* v. *Commissioner*, 66 F.3d 729, 732 (5th Cir. 1995). A taxpayer's reliance on expert advice is not "rea-

[3] Section 6653 was repealed by the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721(c)(2), 103 Stat. 2399, for tax years after 1989. Section 6662 of the Code now imposes an "accuracy-related penalty" in various situations, one of which is "[n]egligence or disregard of rules or regulations." 26 U.S.C. 6662(a), (b)(1).

sonable and prudent" for this purpose when, as the Tax Court found in this case (Pet. App. 24a-25a), the purported "expert" lacks knowledge of the business in which the taxpayer invested, and there is no evidence that the "expert" or the taxpayer independently made a reasonable investigation of the business merits of the partnership. *David* v. *Commissioner*, 43 F.3d 788, 789-790 (2d Cir. 1995); *Goldman* v. *Commissioner*, 39 F.3d at 408. Moreover, a taxpayer's purported reliance on expert advice is not reasonable when, as here, the tax benefits offered by the advised investment are "too good to be true." *David* v. *Commissioner*, 43 F.3d at 789; *Goldman* v. *Commissioner*, 39 F.3d at 407-408. The Tax Court correctly determined, under these legal standards, that petitioners did not reasonably rely on expert advice in this case.

Petitioners err in asserting (Pet. 14) that the courts below looked only at the "single fact" that their reliance on the purported expert was unreasonable. The court of appeals emphasized that the negligence of petitioners was also demonstrated by their surprising failure to "voice a concern to their advisor over the absence of any generated income and the eventual complete loss of their original $25,000 investments" and by the fact that their cash investment was substantially less than the claimed deductible losses and credits. Pet. App. 13a. As the court noted, the negligence of petitioners was further borne out by the fact that the "partnership's 'too-good-to-be-true' offering was clear indication that [the] partnership was created only to generate tax deductions." *Ibid.* Further review of these findings "concurred in by two lower courts" (*Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982)) is not warranted. See *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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