Durovic v. Commissioner, 54 T. C. 1364 (1970)

Filing a partnership return does not initiate the statute of limitations for assessing individual tax liability when no individual return is filed.

Summary

Marko Durovic, a partner in Duga Laboratories, failed to file individual income tax returns for the years 1954-1958, relying on partnership returns filed by Duga. The IRS assessed deficiencies and penalties, arguing that the statute of limitations had not started due to the absence of individual returns. The court agreed, ruling that partnership returns alone do not suffice to start the statute of limitations for individual tax assessments. It also addressed issues regarding currency conversion, the presumption of correctness in IRS determinations, and the calculation of cost of goods sold for Krebiozen, a drug distributed by Duga. The decision emphasized the necessity of individual returns and the implications for future tax assessments in similar cases.

Facts

Marko Durovic and his brother Stevan emigrated to Argentina in 1942, where Stevan conducted research leading to the discovery of Krebiozen, a substance with potential cancer-fighting properties. In 1950, Marko purchased the Krebiozen raw material and formed a partnership, Duga Laboratories, to distribute it in the U. S. Duga filed partnership returns for 1954-1958, but Marko did not file individual returns, relying on the partnership's losses to negate any tax liability. The IRS assessed deficiencies and penalties for those years, leading to a dispute over the statute of limitations, currency conversion rates, and the accuracy of Duga's cost of goods sold.

Procedural History

The IRS issued a notice of deficiency in December 1964 for the years 1954-1958. Marko contested the assessment, filing a petition with the U. S. Tax Court. The court heard arguments on the statute of limitations, the use of currency exchange rates, the presumption of correctness in the IRS's determinations, and the calculation of cost of goods sold. The court ultimately ruled in favor of the IRS on the statute of limitations issue, while adjusting the cost of goods sold calculations and rejecting fraud penalties.

Issue(s)

1. Whether the good-faith filing of a Form 1065 partnership return, reflecting the taxpayer's only source of income, starts the running of the statute of limitations where the taxpayer has failed to file an individual return.
2. Whether the taxpayer should have used the commercial rate of exchange, as opposed to the official rate, in converting Argentinian expenditures into dollars.

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3. Whether the IRS's determination was arbitrary and unreasonable so as to negate the presumption of correctness.
4. Whether the IRS erred in disallowing the partnership's cost of goods sold and assessing the taxpayer with his distributive share of the partnership income.
5. Whether the taxpayer acted fraudulently in failing to pay income tax for the years in issue.
6. Whether the IRS properly determined additions to tax for failure to file a timely declaration of estimated tax and for underpayment of estimated tax.
7. Whether the taxpayer and his wife could elect to file joint returns for the years in question after the IRS had already employed individual taxpayer rates in determining the deficiency.

Holding

1. No, because a partnership return, even if complete and disclosing the only income source, does not satisfy the requirement for an individual return under section 6012(a).
2. Yes, because the commercial rate more accurately reflects the actual dollar cost of the expenditures.
3. No, because the taxpayer's refusal to provide requested records justified the IRS's determination.
4. Yes, the IRS erred in disallowing cost of goods sold; the court determined an appropriate amount based on the evidence.
5. No, because the taxpayer's reliance on professional advice and lack of intent to evade taxes negated fraud.
6. No, for 1954, as the taxpayer had reasonable cause for not filing a timely declaration; Yes, for 1955-1958, as the underpayment penalties were mandatory.
7. No, because the IRS's prior use of individual rates precluded a later election for joint returns.

Court's Reasoning

The court reasoned that under section 6501(c)(3), the statute of limitations does not start without an individual return, as partnership returns are informational and do not contain all data needed to compute individual tax liability. For currency conversion, the court favored the commercial rate, citing its reflection of market conditions and actual economic cost. The court upheld the presumption of correctness in the IRS's determinations, noting that the taxpayer's refusal to provide records contributed to the IRS's actions. Regarding cost of goods sold, the court adjusted the figures to reflect a more accurate allocation of costs. The court found no fraud, emphasizing the taxpayer's good-faith reliance on advisors. The decision on estimated tax penalties was based on statutory requirements, with reasonable cause found for 1954 but not for subsequent years. Finally, the court rejected the joint return election due to the IRS's prior use of individual rates, citing administrative considerations and the need for voluntary disclosure in the tax system.

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Practical Implications

This decision clarifies that filing a partnership return does not start the statute of limitations for individual tax liability, emphasizing the need for individual returns. Taxpayers involved in partnerships must file individual returns to avoid indefinite exposure to IRS assessments. The ruling on currency conversion underscores the importance of using rates that reflect economic reality, which may influence future cases involving international transactions. The court's stance on the presumption of correctness and the necessity of providing records to the IRS highlights the importance of cooperation in audits. The adjustments to cost of goods sold calculations provide guidance on how to allocate costs in similar situations. The rejection of fraud penalties due to reliance on professional advice may encourage taxpayers to seek competent tax advice. Finally, the decision on joint returns reinforces the IRS's authority to use individual rates when no returns are filed, affecting how taxpayers plan their tax filings.

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