Cohen v. Commissioner, 85 T. C. 787 (1985)

Section 6659's addition to tax for valuation overstatements applies to underpayments resulting from carrybacks, even if the original return was filed before the effective date of the statute.

Summary

In Cohen v. Commissioner, the court determined that Section 6659's penalty for valuation overstatements applies to underpayments in tax years prior to the statute's effective date, when those underpayments result from carrybacks claimed on returns filed after the effective date. The petitioners had filed returns for 1978 and 1979 before the effective date of Section 6659, but later claimed refunds based on carrybacks from 1981 and 1982. The court held that the penalty applied to the underpayments for 1978 and 1979, as the carrybacks were claimed on returns filed after December 31, 1981. This decision clarified that the timing of the carryback claim, rather than the original return, determines the applicability of Section 6659.

Facts

Petitioners filed their 1978 and 1979 Federal income tax returns before January 1, 1982. In April 1982, they filed amended returns for those years, claiming refunds based on carrybacks of unused investment tax credit from 1981. The IRS disallowed these credits, resulting in deficiencies for 1978, 1979, and 1981. In July 1983, petitioners filed another amended return for 1979, claiming a refund based on a carryback from 1982. The IRS sought to apply the Section 6659 penalty to the underpayments for 1978 and 1979, which were attributable to the disallowed carrybacks.

Procedural History

The case came before the Tax Court on petitioners' motion for partial summary judgment, seeking a ruling that Section 6659 did not apply to their 1978 and 1979 underpayments. The IRS argued that the penalty was applicable because the carrybacks were claimed on returns filed after the effective date of the statute.

Issue(s)

1. Whether Section 6659's addition to tax for valuation overstatements applies to underpayments in tax years prior to the statute's effective date, when those underpayments result from carrybacks claimed on returns filed after the effective date.

Holding

1. Yes, because the underpayments for 1978 and 1979 were attributable to carrybacks claimed on returns filed after December 31, 1981, and thus fell within

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the scope of Section 6659 as intended by Congress.

Court’s Reasoning

The court’s decision hinged on the interpretation of Section 6659 and its effective date. The statute applies to returns filed after December 31, 1981, and imposes a penalty on underpayments attributable to valuation overstatements. The court reasoned that if an underpayment results from a carryback claimed on a return filed after the effective date, the penalty applies, even if the original return for the year of the underpayment was filed before the effective date. The court cited the legislative history, which indicated that Congress intended the penalty to apply in situations where overvaluations in one year result in tax benefits in future years through carryovers or carrybacks. The court also referenced its prior holding in Herman Bennett Co. v. Commissioner, which established that carrybacks are attributable to the adjustment in the later year. The court concluded that applying the penalty to carrybacks was consistent with the deterrent purpose of Section 6659.

Practical Implications

This decision significantly impacts how tax practitioners should approach valuation overstatements and carrybacks. Attorneys must advise clients that the Section 6659 penalty can apply to underpayments in years prior to the statute’s effective date if those underpayments result from carrybacks claimed on returns filed after the effective date. This ruling emphasizes the importance of accurate valuation reporting, as any overstatement could lead to penalties on carrybacks in subsequent years. Taxpayers engaging in transactions that may result in carrybacks should be cautious about the potential for Section 6659 penalties. The decision also influences how the IRS assesses penalties, potentially leading to more scrutiny of carryback claims. Subsequent cases, such as those involving the application of Section 6659 to other types of carrybacks or carryovers, have cited Cohen as precedent for the broad applicability of the statute.

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