

87 T.C. 779 (1986)

Section 6659 penalty for valuation overstatements applies to underpayments in tax years with returns filed before January 1, 1982, if those underpayments are attributable to valuation overstatements on returns filed after December 31, 1981, including situations involving carrybacks.

Summary

Petitioners claimed investment tax credits in 1981 and 1982 returns filed after December 31, 1981. They then filed amended returns for 1978 and 1979, claiming carrybacks of these credits, resulting in refunds. The IRS disallowed the credits and sought penalties under Section 6659 for valuation overstatements for tax years 1978 and 1979. The Tax Court addressed whether Section 6659, effective for returns filed after 1981, applies to underpayments in earlier years due to carrybacks from later returns with valuation overstatements. The court held that the penalty applies, reasoning that the underpayment was attributable to valuation overstatements on returns filed after the effective date of Section 6659.

Facts

Petitioners filed their 1978 and 1979 income tax returns before January 1, 1982.

In April 1982, they filed amended returns (Forms 1040X) for 1978 and 1979, claiming refunds based on carrybacks of investment tax credits from their 1981 return.

The IRS paid these refunds.

The IRS later determined deficiencies for 1978, 1979, and 1981, disallowing the investment tax credit and a loss from a tax shelter in 1981.

The deficiencies for 1978 and 1979 were due to disallowance of the investment tax credit carrybacks from 1981.

Petitioners filed another amended return for 1979 claiming additional refund based on carryback from 1982.

The IRS sought additions to tax under Section 6659 for valuation overstatements for 1978, 1979, and 1981, and the increased deficiency for 1979.

Procedural History

Petitioners moved for partial summary judgment in the Tax Court, arguing that Section 6659 was not applicable to their 1978 and 1979 tax years.

The Tax Court considered the motion to determine if the penalty applied to prior

year returns based on carrybacks from returns filed after the effective date of Section 6659.

Issue(s)

1. Whether section 6659 applies to underpayments for taxable years for which returns were filed prior to January 1, 1982, where such underpayments result from disallowance of carrybacks from taxable years for which returns were filed after December 31, 1981.

Holding

1. Yes, because the underpayment of tax for 1978 and 1979 is attributable to a valuation overstatement on the 1981 and 1982 returns, which were filed after December 31, 1981, making Section 6659 applicable.

Court's Reasoning

The court interpreted the effective date provision of Section 6659, which states it applies to “returns filed after December 31, 1981.”

The court noted that Section 6659(a) applies to “an underpayment of the tax imposed by chapter 1 for the taxable year which is attributable to a valuation overstatement.” and Section 6659(c) defines valuation overstatement as a value “claimed on any return”.

The court reasoned that the statute’s language indicates that if an underpayment is attributable to an overvaluation on *any* return filed after Dec 31, 1981, the penalty applies, regardless of when the return for the underpayment year was filed.

The court referenced the legislative history, particularly the General Explanation by the Staff of the Joint Committee on Taxation, which indicated that the penalty could apply to overvaluations on returns filed before the effective date if they cause underpayments on returns filed after the effective date, including carryovers.

The court found that carrybacks were logically included in the intent of the statute, stating, “It is inconceivable to us, however, that Congress intended to leave a gap for those who would place a valuation overstatement on a return for a year after the effective date of section 6659, carry back the claimed benefit of the overstatement to prior years, and obtain a refund of taxes for the prior years free of the risk of the sanction...”

The court cited *Herman Bennett Co. v. Commissioner*, 65 T.C. 506 (1975) for the principle that an item carried back from a later year is “attributable to” the adjustment in the later year.

Practical Implications

This case clarifies that the effective date of Section 6659 is determined by the return containing the valuation overstatement, not the return for the year of the underpayment.

Taxpayers cannot avoid the valuation overstatement penalty by carrying back benefits from returns filed after December 31, 1981, to prior years with returns filed before that date.

This decision emphasizes that the penalty's deterrent purpose extends to situations where valuation overstatements in later returns trigger tax benefits in earlier years through carryback provisions.

Legal practitioners should analyze the filing dates of returns with valuation overstatements, not just the returns for the underpayment years, when considering the application of Section 6659 penalties in carryback scenarios. This case demonstrates a broad interpretation of "returns filed after December 31, 1981" to encompass situations that exploit carryback rules to circumvent the penalty's intent.