DeMartino v. Commissioner, 88 T. C. 583 (1987)

Amendments to tax laws can be constitutionally applied retroactively to pending cases before a final decision is reached.

Summary

In DeMartino v. Commissioner, the U. S. Tax Court initially ruled that the increased interest rate under section 6621(d) did not apply to the petitioners' underpayments due to their involvement in a sham transaction. However, following the amendment to section 6621(d) by the Tax Reform Act of 1986, the court reconsidered its position. The amendment explicitly included sham or fraudulent transactions under the higher interest rate. The court determined that, as no final decision had been entered, the amendment could be retroactively applied to the petitioners' case. The court emphasized that such retroactive application was constitutionally permissible and aligned with congressional intent to reverse the original holding.

Facts

The petitioners engaged in a Crude Oil Straddle, which was found to be a sham transaction due to market manipulation. Initially, the Tax Court held that the increased interest rate under section 6621(d) did not apply to the petitioners' underpayments because the transaction did not meet the statutory definition of a "straddle. " After the Tax Reform Act of 1986 amended section 6621(d) to include sham transactions, the Commissioner moved for reconsideration. The court had not yet entered a final decision in the case when the amendment was enacted.

Procedural History

The Tax Court initially ruled in T. C. Memo 1986-263 that section 6621(d) did not apply to the petitioners' underpayments. Following the amendment by the Tax Reform Act of 1986, the Commissioner filed a motion for reconsideration on November 12, 1986. The court granted this motion on March 4, 1987, and subsequently issued a supplemental opinion on March 12, 1987, modifying its earlier decision.

Issue(s)

1. Whether the amendment to section 6621(d) by the Tax Reform Act of 1986, which added sham or fraudulent transactions to the list of transactions subject to the higher interest rate, can be applied retroactively to the petitioners' case.

Holding

1. Yes, because the amendment to section 6621(d) can be constitutionally applied retroactively to the petitioners' case as no final decision had been entered.

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Court’s Reasoning

The court reasoned that the amendment to section 6621(d) was intended to reverse its earlier holding and explicitly include sham transactions under the higher interest rate. The court found that the amendment’s effective date covered the petitioners’ underpayments, as it applied to interest accruing after December 31, 1984, and no final decision had been entered in the case. The court relied on established case law, such as Brushaber v. Union Pacific R. Co. and Chase Securities Corp. v. Donaldson, to conclude that retroactive application of tax laws is constitutionally permissible, especially when no final decision has been reached. The court also noted that the petitioners had no vested right in the original opinion and had been given a full opportunity to litigate the underlying underpayment.

Practical Implications

This decision underscores the principle that tax law amendments can be applied retroactively to pending cases, provided no final decision has been reached. Practitioners should be aware that legislative changes can impact ongoing litigation, even after initial rulings. The case also highlights the importance of understanding the effective dates and exceptions in tax law amendments. For businesses and taxpayers, this ruling emphasizes the risk of engaging in sham transactions, as they may be subject to higher interest rates on underpayments. Subsequent cases, such as LaBelle v. Commissioner, have followed this precedent in applying retroactive amendments to tax laws.

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