Sente Investment Club Partnership of Utah, Warren Roy Tolsen, Tax Matters Partner, Petitioner v. Commissioner of Internal Revenue, Respondent, 95 T. C. 243 (1990)

Partnership items of lower-tier partnerships must be determined in separate proceedings and cannot be contested in proceedings related to upper-tier partnerships.

Summary

Sente Investment Club Partnership (Sente) was a limited partner in two partnerships, Union Energy Drilling Fund 1983 (Drilling) and Sente Equipment Ltd. (Equipment). The IRS issued notices of final partnership administrative adjustment (FPAA) to Drilling and Equipment, disallowing losses and credits. Sente, in turn, reported its distributive share of these items on its own partnership returns. When the IRS issued an FPAA to Sente, it included adjustments related to the flowthrough items from Drilling and Equipment. The Tax Court held that it lacked jurisdiction to consider adjustments to partnership items of Drilling and Equipment in the Sente proceeding, as these must be determined in separate partnership proceedings. The court granted the IRS's motion to dismiss for lack of jurisdiction over these items and denied Sente's motion to strike the IRS's answer.

Facts

Sente Investment Club Partnership was a limited partner in Union Energy Drilling Fund 1983 (Drilling) and Sente Equipment Ltd. (Equipment). Drilling reported an ordinary loss of $3,506,733 for 1983 and income of $37,000 for 1984. Equipment reported ordinary losses of $1,944,684 and $2,522,264 for 1983 and 1984, respectively, and also claimed investment credits. Sente reported its distributive share of these losses and credits on its own partnership returns. The IRS issued FPAAs to Drilling and Equipment, disallowing their reported losses and credits. Sente filed a petition in response to the Drilling FPAA but failed to prosecute it, leading to dismissal. No petition was filed for the Equipment FPAA. The IRS then issued an FPAA to Sente, disallowing the losses and credits flowing from Drilling and Equipment, as well as other deductions claimed by Sente.

Procedural History

The IRS issued FPAAs to Drilling and Equipment in 1987, disallowing their reported losses and credits. Sente filed a petition in response to the Drilling FPAA, but it was dismissed for failure to prosecute in 1990. No petition was filed in response to the Equipment FPAA. In 1987, the IRS issued an FPAA to Sente, which included adjustments related to the flowthrough items from Drilling and Equipment. Sente filed a petition disputing these adjustments. The IRS moved to dismiss for lack of jurisdiction over the flowthrough items and to strike parts of Sente's petition. Sente moved to strike the IRS's answer as untimely. The Tax Court heard the case and

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issued its opinion in 1990.

Issue(s)

1. Whether the Tax Court has jurisdiction to consider adjustments to partnership items of Drilling and Equipment in the proceeding related to Sente.
2. Whether the IRS's answer was timely filed.

Holding

1. No, because the partnership items of Drilling and Equipment must be determined in separate partnership proceedings, not in the proceeding related to Sente, a pass-through partner.
2. Yes, because the IRS's answer was filed within the 60-day period allowed by the Tax Court Rules of Practice and Procedure.

Court's Reasoning

The court applied the unified audit and litigation procedures under the Internal Revenue Code, specifically Section 6221, which mandates that partnership items be determined at the partnership level. The court noted that the losses and credits reported by Drilling and Equipment were partnership items that must be resolved in separate proceedings for those partnerships. The court cited Section 6231(a)(3) and the regulations, which define partnership items as those more appropriately determined at the partnership level. The court also considered the definitions of pass-through and indirect partners under Section 6231(a)(9) and (10), emphasizing that changes in the tax liability of partners resulting from partnership proceedings are treated as computational adjustments. The court rejected Sente's attempt to dispute adjustments to Drilling and Equipment's items in its own proceeding, as this would undermine the statutory scheme designed to handle partnership items in a single proceeding per partnership. The court also found the IRS's answer to be timely filed under Rule 36, as it was submitted within the 60-day period from the date of service of Sente's amended petition.

Practical Implications

This decision clarifies that adjustments to partnership items of lower-tier partnerships cannot be contested in proceedings related to upper-tier partnerships. Practitioners must ensure that disputes over partnership items are raised in the correct partnership proceedings to avoid jurisdictional issues. The ruling emphasizes the importance of timely prosecution of partnership proceedings, as failure to do so can result in the inability to contest adjustments. The decision also reinforces the IRS's authority to make computational adjustments to the tax liability of partners based on the outcomes of partnership proceedings. Subsequent cases, such as Maxwell v. Commissioner and N. C. F. Energy Partners v. Commissioner, have followed this principle, further solidifying the jurisdictional boundaries in

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partnership tax disputes.

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