Jenkins v. Commissioner, 102 T. C. 550 (1994)

A partner's inconsistent treatment of a partnership item as an affected item allows the Tax Court jurisdiction over the affected item without requiring a partnership-level proceeding.

Summary

Debra Lappin received a $75,000 payment from her former law firm partnership, reported as a guaranteed payment by the partnership. Lappin claimed it as tax-exempt under Section 104(a) for disability, filing a notice of inconsistent treatment. The IRS issued a deficiency notice disallowing the exemption. The Tax Court held that Lappin's treatment was an affected item, not a partnership item, thus not requiring a partnership-level proceeding. The court had jurisdiction to consider the affected item in a partner-level proceeding, denying Lappin's motion to dismiss.

Facts

Debra R. Lappin was a partner at Mayer, Brown & Platt (MBP) from 1983 to 1988. Due to her disability, her relationship with MBP terminated in December 1988. MBP paid Lappin $75,000 in exchange for her agreement not to exercise her rights under the waiver of premium provision of her life insurance policy. MBP reported this payment as a guaranteed payment under Section 707(c) on its partnership return. Lappin, on her 1989 tax return, claimed the $75,000 as tax-exempt disability compensation under Section 104(a)(3) and filed a notice of inconsistent treatment with the IRS.

Procedural History

The IRS examined Lappin's 1989 return and issued a notice of deficiency, disallowing the tax-exempt treatment of the $75,000 payment. Lappin filed a petition in the Tax Court and moved to dismiss, arguing the notice was invalid because the IRS did not conduct a partnership-level proceeding or convert partnership items to nonpartnership items. The Tax Court considered whether the payment was an affected item, thus within its jurisdiction in a partner-level proceeding.

Issue(s)

1. Whether the Tax Court has jurisdiction over the $75,000 payment as an affected item in a partner-level proceeding.
2. Whether Lappin's treatment of the $75,000 payment was inconsistent with the partnership's treatment under Section 6222.

Holding

1. Yes, because the $75,000 payment was an affected item, which is within the Tax Court's jurisdiction in a partner-level proceeding without a prerequisite partnership-

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level proceeding.
2. No, because Lappin’s treatment of the payment as tax-exempt under Section 104(a) was not inconsistent with the partnership’s treatment of the payment as a guaranteed payment under Section 707(c).

Court’s Reasoning

The court determined that Lappin’s claim of the $75,000 as tax-exempt under Section 104(a) was an affected item, not a partnership item, because it required a factual determination at the partner level regarding the applicability of Section 104(a). The court emphasized that the partnership’s reporting of the payment as a guaranteed payment under Section 707(c) was not disputed by Lappin, and thus, her inconsistent treatment notice did not trigger the need for a partnership-level proceeding. The court also noted that the IRS was not questioning the partnership’s treatment of the item but was addressing the tax-exempt status at the partner level. The court rejected Lappin’s argument that the absence of self-employment tax indicated a reclassification at the partnership level, stating that the notice of deficiency clearly addressed only the Section 104(a) exemption.

Practical Implications

This decision clarifies that the Tax Court has jurisdiction over affected items in partner-level proceedings without requiring a partnership-level proceeding, even when a partner files a notice of inconsistent treatment. Practitioners should be aware that a partner’s claim under a statutory relief provision like Section 104(a) is an affected item, allowing the IRS to issue a notice of deficiency without a partnership-level proceeding. This case also highlights the importance of clearly stating the basis for any inconsistent treatment to avoid unnecessary procedural disputes. Subsequent cases have relied on Jenkins to distinguish between partnership and affected items in tax disputes.

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