Phillips v. Commissioner, 106 T. C. 176 (1996)

A partner cannot unilaterally revoke an investment credit claimed on a partnership item through an amended return without following specific TEFRA procedures.

Summary

In Phillips v. Commissioner, the taxpayers attempted to avoid recapture of an investment credit by filing amended returns revoking the credit after disposing of partnership property. The Tax Court ruled that these amended returns were ineffective because they did not comply with the required procedures under TEFRA for changing the treatment of partnership items. The court emphasized that a partner's distributive share of investment credit is a partnership item that must be addressed through specific administrative adjustment requests, not through individual amended returns. This decision clarifies the procedural limitations partners face when attempting to alter partnership items on their personal tax returns.

Facts

Michael W. and Charlotte S. Phillips were partners in Ethanol Partners, Ltd. I and claimed an investment credit on their 1985 tax return based on partnership property. In 1986, after disposing of the property, they filed amended returns for 1985 and 1986 attempting to revoke the credit to avoid recapture liability. These amended returns were not accompanied by Form 8082, Notice of Inconsistent Treatment or Amended Return, and were filed after the IRS had initiated a partnership audit. The Phillips filed for bankruptcy in 1992, but the IRS continued with the partnership proceedings and issued a notice of deficiency based on a prospective settlement with Ethanol Partners.

Procedural History

The Phillips petitioned the Tax Court for a redetermination of deficiencies determined by the IRS for their 1984 and 1986 tax years. They conceded the deficiency for 1984, leaving the issue of recapture liability for 1986. The IRS had mailed a notice of final partnership administrative adjustment (FPAA) to the tax matters partner of Ethanol Partners in 1991, leading to a petition for readjustment filed in 1992. The Phillips' amended returns were assessed in 1992, and after their bankruptcy discharge in 1993, the IRS issued a notice of deficiency in 1993 based on a prospective settlement finalized in 1994.

Issue(s)

1. Whether the Phillips' amended returns for 1985 and 1986 were effective in revoking the investment credit claimed on partnership property to avoid recapture liability.

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Holding

1. No, because the amended returns did not conform to the requirements of an administrative adjustment request under section 6227 of the Internal Revenue Code, which is necessary for changing the treatment of partnership items.

Court’s Reasoning

The court reasoned that the Phillips’ attempt to revoke the investment credit via amended returns was procedurally invalid under TEFRA’s unified audit procedures. The court emphasized that a partner’s distributive share of investment credit is a partnership item, and changes must be requested through Form 8082, which was not filed. The court cited previous cases supporting the IRS’s authority to disregard amended returns upon subsequent audit and highlighted the policy of maintaining consistency in partnership items across all partners. The court also noted that the conversion of partnership items to nonpartnership items due to bankruptcy did not substantively alter the Phillips’ tax liability, as the prospective settlement with Ethanol Partners was still relevant to determining their distributive share and recapture liability.

Practical Implications

This decision underscores the importance of adhering to TEFRA procedures when attempting to change the treatment of partnership items on personal tax returns. Practitioners should advise clients that individual amended returns are insufficient to alter partnership items without the proper administrative adjustment requests. The ruling also illustrates that bankruptcy proceedings do not automatically nullify partnership-level determinations, affecting how attorneys should advise clients on the interplay between bankruptcy and partnership tax issues. Subsequent cases have reinforced the need for strict compliance with TEFRA procedures, impacting how partnership audits and individual tax liabilities are managed.

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