Estate of Quick v. Commissioner, 110 T. C. 172 (1998)

The characterization of a partner's distributive share of partnership losses as passive or nonpassive under section 469 requires partner-level factual determinations and is an affected item under TEFRA.

Summary

The Estate of Quick case involved the classification of partnership losses as passive or nonpassive under section 469. The partnership, Water Oaks, Ltd. , reported losses as arising from trade or business activity. The IRS recharacterized these losses as passive for the partners, leading to a dispute over the statute of limitations for assessment. The Tax Court held that determining whether losses are passive or nonpassive involves partner-level factual determinations regarding participation, making it an affected item under TEFRA. This ruling extended the statute of limitations, allowing the IRS to reassess deficiencies and penalties for the years in question.

Facts

Robert W. Quick was a limited partner in Water Oaks, Ltd. , a Florida partnership subject to TEFRA audit rules. The partnership owned and operated a mobile home park, reporting losses from its activities as arising from trade or business, not rental activity. Quick reported these losses as nonpassive on his 1989 and 1990 tax returns. The IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA) disallowing certain deductions, which was challenged and resulted in a favorable decision for the partnership for 1989 and 1990. Subsequently, the IRS recharacterized Quick's share of losses as passive, leading to computational adjustments and deficiency notices.

Procedural History

The IRS issued an FPAA to the partnership, which was challenged in Tax Court, resulting in a decision adjusting partnership losses. After this decision became final, the IRS issued computational adjustment notices to Quick for 1987-1990, recharacterizing the 1989 and 1990 losses as passive. Quick filed a petition in Tax Court, moving for summary judgment, arguing the statute of limitations had expired. The IRS moved to amend its answer to assert the recharacterization as an affected item, extending the statute of limitations.

Issue(s)

1. Whether the characterization of a partner's distributive share of partnership losses as passive or nonpassive under section 469 is a partnership item or an affected item.
2. Whether the statutory period of limitations bars the IRS from recharacterizing the partner's distributive share of partnership losses as passive losses subject to the

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limitations of section 469.

Holding

1. No, because the characterization of losses as passive or nonpassive requires partner-level factual determinations regarding participation, making it an affected item under TEFRA.
2. No, because the characterization of losses as an affected item extends the statute of limitations under sections 6229(a) and (d), allowing the IRS to recharacterize the losses and assess additional deficiencies and penalties.

Court's Reasoning

The court analyzed whether the characterization of losses as passive or nonpassive under section 469 is a partnership item or an affected item. The partnership reported its losses as arising from trade or business activity, not rental activity, meaning the passive or nonpassive classification required partner-level determinations of material participation. The court rejected the IRS's argument that the losses were from rental activity, citing the partnership's reporting and the need for factual determinations at the partner level. The court concluded that this classification is an affected item under TEFRA, extending the statute of limitations for assessment. The court also noted that the IRS's computational adjustments for 1987 and 1988 were proper because they were based on finalized partnership-level adjustments, not on recharacterizing losses as passive.

Practical Implications

This decision clarifies that the characterization of partnership losses as passive or nonpassive under section 469 is an affected item requiring partner-level factual determinations, thus extending the statute of limitations under TEFRA. Practitioners must be aware that the IRS can reassess deficiencies and penalties for such losses even after the general statute of limitations has expired, provided the FPAA is timely issued. This ruling impacts how similar cases should be analyzed, requiring careful consideration of the nature of partnership activities and the partner's level of participation. It also underscores the importance of accurate reporting by partnerships, as their classification of activities can affect the IRS's ability to make adjustments at the partner level.

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