Nussdorf v. Commissioner, T.C. Memo. 2007-239

Determinations regarding the basis of property contributed to a partnership are partnership items, requiring resolution at the partnership level rather than in individual partner-level proceedings before the Tax Court.

Summary

In consolidated cases, the Tax Court addressed jurisdictional motions concerning notices of deficiency issued to partners of Evergreen Trading, LLC, related to a tax shelter scheme. The IRS issued a Final Partnership Administrative Adjustment (FPAA) to Evergreen Trading and notices of deficiency to its partners, disallowing losses from currency option transactions. The partners contested the Tax Court's jurisdiction, arguing the deficiencies involved partnership items resolvable only at the partnership level. The Tax Court agreed, holding that determinations of basis in contributed property are partnership items under TEFRA, thus it lacked jurisdiction over these items in the individual partner cases.

Facts

Petitioners were partners in Evergreen Trading, LLC during 1999 and 2000.
Petitioners purportedly contributed Euro options and cash to Evergreen Trading in exchange for partnership interests.
Evergreen Trading engaged in complex currency option transactions, reporting significant ordinary losses in 1999 and gains in 2000.
A portion of these losses and gains was allocated to the petitioners.
The IRS issued an FPAA to Evergreen Trading for 1999 and 2000, challenging the transactions as lacking economic substance and designed for tax avoidance.
Subsequently, the IRS issued notices of deficiency to the petitioners, disallowing losses and making related adjustments.

Procedural History

The IRS issued a Notice of Beginning of Administrative Proceeding and later an FPAA to Evergreen Trading for tax years 1999 and 2000.
The IRS also issued Notices of Deficiency to the individual partners (petitioners) for the same tax years.
Petitioners filed petitions in Tax Court, arguing the notices of deficiency were invalid as they concerned partnership items.
Respondent (Commissioner) also moved to dismiss for lack of jurisdiction, agreeing that the notices primarily addressed partnership items.
Petitioners initially argued that paragraph 8 of the notice of deficiency related to a nonpartnership item, but the court disagreed.

Issue(s)

1. Whether the determinations in the notices of deficiency issued to the individual

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partners constitute “partnership items” or “affected items” as defined under TEFRA (Tax Equity and Fiscal Responsibility Act of 1982), specifically sections 6221-6234 of the Internal Revenue Code?

2. Whether the determination of the basis of the Euro options contributed by the partners to Evergreen Trading is a “partnership item” that must be resolved at the partnership level?

Holding

1. Yes, the Tax Court held that the determinations in the notices of deficiency, including the determination of the basis of contributed options, are “partnership items” or “affected items” because they are intrinsically linked to partnership-level determinations.

2. Yes, the determination of the basis of the contributed Euro options is a “partnership item” because under Section 723, the partnership’s basis in contributed property is dependent on the contributing partner’s basis, requiring a partnership-level determination.

Court’s Reasoning

The court relied on the definition of “partnership item” in Section 6231(a)(3) of the Internal Revenue Code, which includes any item required to be taken into account for the partnership’s taxable year under Subtitle A to the extent regulations prescribe it is more appropriately determined at the partnership level.
Section 723 mandates that a partnership’s basis in contributed property is the same as the contributing partner’s adjusted basis at the time of contribution. The court stated, “*in order for a partnership to determine, as required by section 723, its basis in the property that a partner contributed to it, the partnership is required to determine the basis of such partner in such property.*”
Treasury Regulations Section 301.6231(a)(3)-1(a)(4) and (c)(2) explicitly list contributions to the partnership and the basis of contributed property as partnership items. Specifically, regulation 301.6231(a)(3)-1(c)(2)(iv) identifies as a partnership item “*[t]he basis to the partnership of contributed property (including necessary preliminary determinations, such as the partner’s basis in the contributed property).*”
The court reasoned that determining the basis of the contributed Euro options was essential for Evergreen Trading’s books and records and for furnishing information to partners, thus falling squarely within the definition of partnership items. The court rejected petitioners’ argument that the pre-contribution basis was a nonpartnership item, emphasizing that once the options were contributed, their basis became a partnership item to be determined in a partnership proceeding. The court concluded, “*We hold that the determination set forth in paragraph 8 of the respective notices of deficiency that respondent issued to petitioners in these cases relates to certain partnership items described above. We further hold that we do not*

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have jurisdiction over those items."

Practical Implications

This case reinforces the principle that under TEFRA, tax disputes involving partnership items must generally be resolved at the partnership level. It clarifies that issues related to the basis of contributed property, even if seemingly originating at the partner level, become partnership items once the property is contributed to the partnership.

For legal practitioners, this case serves as a reminder of the jurisdictional limitations of the Tax Court in partner-level proceedings when partnership items are at issue. It highlights the importance of understanding the definition of "partnership item" and "affected item" in the context of partnership tax audits and litigation.

This decision impacts how tax advisors approach partnership tax disputes, emphasizing the need to address partnership items within the framework of partnership-level administrative and judicial proceedings, such as FPAA litigation, rather than through individual partner deficiency cases.

Later cases have consistently cited Nussdorf for the proposition that basis determinations of contributed property are partnership items, solidifying its precedent in partnership tax law.

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