***Highwood Partners, B & A Highwoods Investments, LLC, Tax Matters Partner v. Commissioner of Internal Revenue, 133 T. C. 1 (2009)***

The U. S. Tax Court ruled in Highwood Partners v. Commissioner that the IRS could apply a six-year statute of limitations for tax assessments due to the partnership's failure to separately report gains from foreign currency options, as required by Section 988 of the Internal Revenue Code. This decision underscores the importance of detailed reporting in complex financial transactions and affects how tax avoidance schemes involving foreign currency options are treated.

**Parties**

Highwood Partners (Petitioner) was the plaintiff, represented by B & A Highwoods Investments, LLC as the Tax Matters Partner. The Commissioner of Internal Revenue (Respondent) was the defendant. Highwood Partners was the initial party at the trial level, and the case was appealed to the U. S. Tax Court.

**Facts**

Highwood Partners, a partnership, was formed by three entities controlled by Mrs. Adams, Mrs. Fowlkes, and the Booth and Adams Irrevocable Family Trust, respectively. These entities entered into foreign exchange digital option transactions (FXDOTs) with Deutsche Bank, involving long and short options on the U. S. dollar/Japanese yen exchange rate. The partnership reported a net loss from these transactions on its tax return but did not separately report the gains from the short options and the losses from the long options as required by Section 988 of the Internal Revenue Code. The IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA) after the three-year statute of limitations had expired, asserting that the failure to separately report these gains constituted a substantial omission of gross income, thereby triggering a six-year statute of limitations under Section 6501(e)(1).

**Procedural History**

Highwood Partners filed a motion for summary judgment in the U. S. Tax Court, arguing that the IRS's FPAA was untimely because it was issued after the three-year statute of limitations under Section 6501(a) had expired. The IRS opposed this motion and filed a cross-motion for partial summary judgment, contending that the six-year statute of limitations under Section 6501(e)(1) applied due to the substantial omission of gross income. The U. S. Tax Court denied both motions, finding that the IRS was not precluded from asserting the six-year statute of limitations despite the FPAA's explanations.

**Issue(s)**

Whether the failure to separately report gains from the short options and losses from the long options under Section 988 constitutes an omission from gross income sufficient to trigger the six-year statute of limitations under Section 6501(e)(1)?

Whether the partnership's and partners' returns adequately disclosed the nature and amount of the omitted gross income?

## Rule(s) of Law

Section 6501(a) of the Internal Revenue Code establishes a three-year statute of limitations for the IRS to assess taxes. Section 6501(e)(1) extends this period to six years if there is a substantial omission of gross income, defined as more than 25% of the amount of gross income stated in the return. Section 988 requires separate computation and reporting of gains and losses from foreign currency transactions. Section 6501(e)(1)(A)(ii) provides a safe harbor if the omitted income is disclosed in a manner adequate to apprise the IRS of its nature and amount.

## Holding

The U. S. Tax Court held that the failure to separately report gains from the short options and losses from the long options under Section 988 constituted an omission from gross income, triggering the six-year statute of limitations under Section 6501(e)(1). The Court further held that the partnership's and partners' returns did not adequately disclose the nature and amount of the omitted gross income.

## Reasoning

The Court's reasoning focused on the interpretation of Section 988 and Section 6501(e)(1). It determined that the long and short options were separate Section 988 transactions, and thus, the gains and losses from these transactions should have been reported separately. The Court rejected the petitioner's argument that the options constituted a single transaction, noting that the partnership treated them as separate for tax purposes. The Court also found that the partnership's and partners' returns did not adequately disclose the nature and amount of the omitted income, as they did not reveal the contributions of the options or how the partners calculated their bases in the redistributed stock. The Court emphasized that the omission was substantial and that the netting of gains and losses was misleading, failing to meet the disclosure requirements under Section 6501(e)(1)(A)(ii).

## Disposition

The U. S. Tax Court denied Highwood Partners' motion for summary judgment and the IRS's cross-motion for partial summary judgment, allowing the case to proceed to trial on the merits.

## Significance/Impact

This case is significant for its interpretation of the statute of limitations in the context of complex financial transactions involving foreign currency options. It clarifies that the failure to separately report gains and losses as required by Section 988 can trigger the six-year statute of limitations under Section 6501(e)(1). The decision underscores the importance of detailed and accurate reporting of financial transactions to the IRS, particularly in cases involving tax avoidance schemes. It also impacts how partnerships and their partners must report transactions to avoid triggering extended statute of limitations periods.

 