3K Investment Partners v. Commissioner, 137 T. C. 77 (2011)

In a significant ruling on tax court discovery procedures, the U. S. Tax Court denied 3K Investment Partners' motions to compel production of tax opinion letters and a list of firms issuing such letters related to Son-of-BOSS transactions. The court held that the requested materials were not relevant to the partnership's defense against accuracy-related penalties and constituted confidential return information protected by section 6103 of the Internal Revenue Code. This decision underscores the limits of discovery in tax cases and the stringent protection of taxpayer privacy.

Parties

3K Investment Partners, the petitioner, sought to compel the production of documents from the Commissioner of Internal Revenue, the respondent, in a partnership-level proceeding before the United States Tax Court.

Facts

The case involved the Commissioner's determination that 3K Investment Partners engaged in a Son-of-BOSS transaction, a type of tax shelter. James Menighan, through his limited liability company 3K Investments, LLC, allegedly purchased a prepackaged tax shelter from Jenkens & Gilchrist, P. C. , involving offsetting digital options on foreign currency. The Commissioner adjusted the partnership's tax items and imposed accuracy-related penalties under section 6662 of the Internal Revenue Code. 3K Investment Partners sought to defend against these penalties by requesting production of tax opinion letters issued by various law and accounting firms regarding Son-of-BOSS transactions, as well as a list of firms known to have issued such opinions.

Procedural History

3K Investment Partners timely petitioned the Tax Court following the Commissioner's notice of final partnership administrative adjustment for the tax year ended December 13, 2000. The partnership served two discovery requests on the Commissioner: one for redacted copies of tax opinion letters and another for a list of firms issuing such letters. The Commissioner objected to these requests, citing irrelevance and confidentiality concerns. After a hearing, the Tax Court denied the partnership's motions to compel production of the requested documents.

Issue(s)

Whether the requested tax opinion letters and the list of firms issuing such letters were relevant to the partnership's defense against accuracy-related penalties under section 6662 of the Internal Revenue Code?

Whether the requested tax opinion letters and the list of firms issuing such letters constituted confidential return information protected by section 6103 of the Internal

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Revenue Code?

Rule(s) of Law

Rule 70(b)(1) of the Tax Court Rules of Practice and Procedure governs the scope of discovery, allowing discovery of information relevant to the subject matter involved in the pending case, even if inadmissible at trial, if it appears reasonably calculated to lead to the discovery of admissible evidence.

Section 6662 of the Internal Revenue Code imposes accuracy-related penalties on underpayments of tax, with exceptions for underpayments attributable to reasonable cause and good faith under section 6664(c).

Section 6103(a) of the Internal Revenue Code mandates that returns and return information shall be confidential, with exceptions as authorized by the title. Section 6103(b)(2)(A) defines "return information" expansively.

Holding

The Tax Court held that the requested tax opinion letters and the list of firms issuing such letters were not relevant to the partnership's defense against accuracy-related penalties under section 6662. The court further held that these materials constituted confidential return information protected by section 6103 of the Internal Revenue Code.

Reasoning

The court reasoned that the requested materials were not relevant to the partnership's defense of reasonable cause and good faith under section 6664(c). The court rejected the partnership's argument that the existence of similar opinion letters from other firms would demonstrate a "general consensus" supporting the partnership's tax position, stating that each taxpayer must rest on the validity of their own position. The court found that the requested materials had no bearing on whether Jenkens & Gilchrist was provided necessary and accurate information or whether the partnership actually relied in good faith on Jenkens & Gilchrist's advice.

The court further reasoned that the requested materials constituted confidential return information under section 6103(b)(2)(A), as they were data collected by the Secretary in determining other taxpayers' tax liabilities. The court rejected the partnership's argument that redaction of taxpayer-specific information would remove the confidential nature of the opinion letters, citing Church of Scientology of Cal. v. IRS, 484 U. S. 9 (1987). The court distinguished Tax Analysts v. IRS, 117 F. 3d 607 (D. C. Cir. 1997), which involved legal analyses in field service advice memoranda, as inapplicable to the opinion letters and firm list.

Disposition

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The Tax Court denied the partnership's motions to compel production of the requested documents.

Significance/Impact

This decision clarifies the limits of discovery in tax court proceedings, particularly regarding the relevance of third-party tax opinion letters and the confidentiality of return information under section 6103. The ruling underscores the importance of assessing the reasonableness of a taxpayer's position based on their own facts and circumstances, rather than relying on the actions of others. It also reinforces the stringent protection of taxpayer privacy, even in the context of tax litigation. The decision may impact future tax court cases involving similar discovery requests and the application of accuracy-related penalties.

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