Kyle W. Manroe Trust v. Commissioner, 132 T. C. 26 (2009)

In a significant tax case, the U. S. Tax Court ruled that the statute of limitations for assessing tax on a listed transaction remains open under I. R. C. § 6501(c)(10) if not disclosed, even if the transaction occurred before the section's enactment. The case involved the Manroes' short sale transaction, deemed a listed transaction under IRS Notice 2000-44. The court held that the effective date of § 6501(c)(10) applied to the Manroes' 2001 tax year, despite their argument that the transaction predated the disclosure requirements, emphasizing the importance of timely disclosure for tax avoidance schemes.

Parties

Plaintiff/Petitioner: Kyle W. Manroe Trust, with Robert and Lori Manroe as trustees, tax matters partner of BLAK Investments (the partnership). Defendant/Respondent: Commissioner of Internal Revenue.

Facts

In December 2001, Robert and Lori Manroe, as trustees of the Manroe Family Trust, engaged in a transaction involving the short sale of Treasury notes. They borrowed Treasury notes, sold them short, and contributed the proceeds along with the obligation to cover the short sale to BLAK Investments, a California general partnership. The Manroes claimed high bases in their partnership interests without reducing them for the obligation to cover the short sale. They then redeemed their partnership interests, claiming significant tax losses on their 2001 and 2002 tax returns. The transaction was identified as a listed transaction under IRS Notice 2000-44, which described similar tax avoidance schemes involving artificial basis inflation in partnership interests.

Procedural History

On October 13, 2006, the Commissioner issued a notice of final partnership administrative adjustment (FPAA) to BLAK Investments, determining that the partnership was a sham and lacked economic substance, thus disallowing the Manroes' claimed losses and imposing penalties. The tax matters partner timely petitioned the Tax Court for review, asserting that the statute of limitations barred the determination of liability for 2001. The Commissioner moved for partial summary judgment on the statute of limitations issue under I. R. C. § 6501(c)(10), while the Manroes filed a cross-motion arguing the inapplicability of this section to their transaction.

Issue(s)

Whether the effective date of I. R. C. § 6707A precludes the application of I. R. C. § 6501(c)(10) to the Manroes' transaction from 2001?

Whether the Manroes' transaction is a listed transaction under I. R. C. § 6707A(c)(2)?

Whether the period of limitations for assessing tax resulting from the adjustment of partnership items with respect to the Manroes' transaction is open for 2001 under I. R. C. § 6501(c)(10)?

Rule(s) of Law

I. R. C. § 6501(c)(10) provides that if a taxpayer fails to include information about a listed transaction on any return or statement for any taxable year as required under I. R. C. § 6011, the time for assessing any tax imposed by the Code with respect to such transaction does not expire before one year after the earlier of the date the Secretary is furnished the information or the date a material advisor meets the requirements of I. R. C. § 6112. I. R. C. § 6707A(c)(2) defines a "listed transaction" as a transaction that is substantially similar to one identified by the Secretary as a tax avoidance transaction under I. R. C. § 6011.

Holding

The Tax Court held that I. R. C. § 6501(c)(10) applied to the Manroes' 2001 tax year because the period for assessing a deficiency had not expired before the section's enactment on October 22, 2004. The court further held that the Manroes' transaction was a listed transaction under IRS Notice 2000-44, and thus subject to the disclosure requirements of I. R. C. § 6011. Consequently, the period of limitations for assessing tax for 2001 remained open under I. R. C. § 6501(c)(10) due to the Manroes' failure to disclose the transaction as required.

Reasoning

The court reasoned that the effective date of I. R. C. § 6501(c)(10) was distinct from that of I. R. C. § 6707A, and its application to tax years for which the period of limitations remained open as of its enactment date was consistent with statutory construction principles. The court rejected the Manroes' argument that the effective date of I. R. C. § 6707A should limit the application of I. R. C. § 6501(c)(10), noting that such an interpretation would render the latter's effective date meaningless. The court also found that the Manroes' transaction was substantially similar to the Son-of-BOSS transactions described in IRS Notice 2000-44, despite involving short sales rather than options, as both shared the common goal of inflating basis in partnership interests. The court emphasized that the legislative history of I. R. C. § 6501(c)(10) supported its application to transactions that became listed after they occurred but before the statute of limitations closed. The court further upheld the validity of the final regulation under I. R. C. § 6011, which required disclosure of the transaction on the Manroes' next-filed return after it became a listed transaction.

Disposition

The Tax Court granted the Commissioner's motion for partial summary judgment and denied the Manroes' cross-motion for partial summary judgment, holding that the period of limitations for assessing tax for 2001 remained open under I. R. C. § 6501(c)(10).

Significance/Impact

This decision underscores the importance of timely disclosure of participation in listed transactions under I. R. C. § 6011 to prevent the expiration of the statute of limitations under I. R. C. § 6501(c)(10). It clarifies that the effective date of I. R. C. § 6501(c)(10) applies to transactions that occurred before its enactment but for which the period of limitations remained open. The case also demonstrates the broad interpretation of what constitutes a "listed transaction," extending to transactions substantially similar to those identified by the IRS, even if they involve different financial instruments. This ruling has significant implications for taxpayers engaging in tax avoidance schemes, as it emphasizes the IRS's ability to challenge such transactions even years after they occur if not properly disclosed.

