106 Ltd. v. Commissioner of Internal Revenue, 136 T. C. 67 (2011)

In 106 Ltd. v. Commissioner, the U. S. Tax Court ruled that it had jurisdiction over a partnership-level penalty dispute related to a Son-of-BOSS tax shelter transaction. The court held that the partnership could assert a reasonable cause and good faith defense at the partnership level, but found that the partnership could not rely on advice from promoters involved in structuring the transaction. This decision underscores the limits of relying on professional advice to avoid penalties in tax shelter cases and clarifies the Tax Court's jurisdiction over partnership-level penalties.

Parties

106 Ltd. was the petitioner in this case, with David Palmlund serving as the tax matters partner. The respondent was the Commissioner of Internal Revenue. The case was heard in the United States Tax Court.

Facts

David Palmlund, the tax matters partner for 106 Ltd. , engaged in a Son-of-BOSS transaction in 2001, which generated over $1 million in artificial losses claimed on the partners' tax returns. The transaction involved the formation of several entities, including 32 LLC, 7612 LLC, and 106 Ltd. , and the purchase and subsequent distribution of foreign currency options and Canadian dollars. Palmlund relied on the advice of Joe Garza, his attorney, and the accounting firm Turner & Stone. The IRS issued a Final Partnership Administrative Adjustment (FPAA) that adjusted various partnership items to zero and asserted a gross-valuation misstatement penalty under section 6662(h) of the Internal Revenue Code. Palmlund conceded the tax due but contested the penalty, arguing that he relied in good faith on professional advice.

Procedural History

The IRS issued an FPAA to 106 Ltd. , which adjusted various partnership items and asserted penalties. Palmlund, as the tax matters partner, timely petitioned the U. S. Tax Court. The court granted partial summary judgment to the Commissioner on two issues: (1) that the 2001 asset distribution from 106 Ltd. was nonliquidating, and (2) that there was a gross-valuation misstatement in excess of 400% on the partnership return. The remaining issue was whether the partnership had a reasonable cause and good faith defense to the penalty.

Issue(s)

Whether the U. S. Tax Court has jurisdiction over the gross-valuation misstatement penalty in this partnership-level proceeding?

Whether a partnership can assert a reasonable cause and good faith defense in a

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partnership-level proceeding?

Whether the partnership can reasonably rely in good faith on the tax advice given by a promoter?

Rule(s) of Law

The Tax Court has jurisdiction over penalties in partnership-level proceedings if the penalty relates to an adjustment to a partnership item that can be assessed without a partner-level affected items proceeding. See *Petaluma FX Partners v. Commissioner*, 135 T. C. 29 (2010). A partnership can assert its own reasonable cause and good faith defense in a partnership-level proceeding. See *American Boat Co. LLC v. United States*, 583 F. 3d 471 (7th Cir. 2009). A taxpayer cannot reasonably rely in good faith on the advice of a promoter, defined as an adviser who participates in structuring the transaction or has an interest in, or profits from, the transaction. See *Tigers Eye Trading, LLC v. Commissioner*, T. C. Memo 2009-121.

Holding

The U. S. Tax Court held that it had jurisdiction over the gross-valuation misstatement penalty in this partnership-level proceeding because the penalty related to an adjustment to the partnership's inside basis, a partnership item. The court also held that the partnership could assert a reasonable cause and good faith defense at the partnership level but found that the partnership could not reasonably rely in good faith on the advice of Joe Garza and Turner & Stone, who were deemed promoters of the transaction.

Reasoning

The court's reasoning focused on three main points. First, it distinguished the case from *Petaluma FX Partners*, which held that the Tax Court lacked jurisdiction over penalties related to adjustments to a partner's outside basis. Here, the penalty related to the partnership's inside basis, which is a partnership item under the regulations, and thus within the court's jurisdiction. Second, the court followed the Seventh Circuit's decision in *American Boat Co.* in holding that a partnership can assert a reasonable cause and good faith defense in a partnership-level proceeding, rejecting the contrary view in *Clearmeadow Investments, LLC v. United States*. Finally, the court found that Palmlund could not rely on the advice of Garza and Turner & Stone because they were promoters of the transaction. The court adopted the definition of promoter from *Tigers Eye Trading* and found that both advisers participated in structuring the transaction and profited from its implementation. Additionally, the court noted Palmlund's business sophistication and the inaccuracies in Garza's opinion letter as further evidence of a lack of good faith reliance.

Disposition

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The court entered its decision for the respondent, upholding the gross-valuation misstatement penalty against 106 Ltd.

Significance/Impact

This case is significant for clarifying the Tax Court's jurisdiction over penalties in partnership-level proceedings and affirming that partnerships can assert a reasonable cause and good faith defense at that level. It also underscores the importance of the nature of the professional advice received, particularly from advisers who are promoters of the transaction in question. The decision impacts the ability of taxpayers to rely on professional advice to avoid penalties in tax shelter cases and highlights the need for independent, non-conflicted advice to establish a reasonable cause defense. The case has been cited in subsequent decisions addressing similar issues in the context of partnership-level proceedings and the application of penalties.

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