Malone v. Commissioner, 148 T. C. 16 (2017)

In Malone v. Comm'r, the U. S. Tax Court ruled that deficiency procedures apply to a negligence penalty asserted against taxpayers Bernard and Mary Ellen Malone for failing to report partnership items, even though the penalty was related to partnership items. The court clarified that such penalties are subject to deficiency procedures when no adjustments are made to the partnership items themselves. This decision underscores the procedural nuances of the Tax Equity and Fiscal Responsibility Act (TEFRA) and its impact on the assessment of penalties linked to partnership tax reporting.

Parties

Bernard P. Malone and Mary Ellen Malone, Petitioners, v. Commissioner of Internal Revenue, Respondent. The Malones were the taxpayers and petitioners at both the trial and appeal levels, while the Commissioner of Internal Revenue was the respondent throughout the litigation.

Facts

Bernard Malone was a partner in MBJ Mortgage Services America, Ltd. , a partnership subject to the unified audit and litigation procedures of the Tax Equity and Fiscal Responsibility Act (TEFRA). In 2005, MBJ reported installment sales of partnership assets, with Malone's distributive share being $3,200,748 of ordinary income and $3,547,326 of net long-term capital gain. However, on their joint 2005 Form 1040, the Malones did not report these partnership items but instead reported $4,526,897 of long-term capital gain from the sale of Malone's partnership interest in MBJ, which did not occur in 2005. The Malones did not file a notice of inconsistent treatment with the IRS. The Commissioner subsequently adjusted the Malones' return to include the partnership items as reported by MBJ and asserted a negligence penalty under IRC section 6662(a) for the Malones' failure to report these items.

Procedural History

The Commissioner issued a notice of deficiency to the Malones, leading them to file a petition with the U. S. Tax Court. The Commissioner moved to dismiss for lack of jurisdiction over partnership items, which the court granted on June 5, 2012, but explicitly reserved the jurisdictional issue regarding the applicability of the section 6662(a) penalty. The Commissioner later clarified that the penalty was asserted solely due to the Malones' failure to report their distributive share of partnership items. The court then ordered supplemental briefing on this jurisdictional question.

Issue(s)

Whether the deficiency procedures apply to a negligence penalty under IRC section 6662(a) when the penalty is asserted due to a partner's failure to report partnership

© 2025 SCOTUSreports.com. All rights reserved.

items consistently with the partnership's return, and no adjustments are made to the partnership items themselves?

Rule(s) of Law

IRC section 6221 states that the tax treatment of partnership items and the applicability of penalties related to adjustments to those items are determined at the partnership level. IRC section 6230(a)(2)(A)(i) excludes from deficiency procedures penalties related to adjustments to partnership items. IRC section 6222(a) requires partners to report partnership items consistently with the partnership's return, and section 6222(d) references penalties for disregard of this requirement, including the negligence penalty under section 6662(a) and (b)(1).

Holding

The U. S. Tax Court held that deficiency procedures apply to the negligence penalty asserted against the Malones under IRC section 6662(a) because no adjustments were made to the partnership items reported by MBJ. The court determined that the penalty was not related to any adjustments to partnership items but rather to the Malones' failure to report those items consistently.

Reasoning

The court's reasoning focused on the procedural implications of TEFRA and the specific circumstances of the case. It noted that penalties are generally factual affected items subject to deficiency procedures unless they relate to adjustments to partnership items, as per the 1997 Taxpayer Relief Act amendments to IRC sections 6221 and 6230. The court emphasized that the adjustments made to the Malones' tax liability were computational adjustments reflecting the partnership items as originally reported by MBJ, not adjustments to the partnership items themselves. Therefore, the exclusion from deficiency procedures under section 6230(a)(2)(A)(i) did not apply, and the court retained jurisdiction over the penalty determination. The court also addressed the Malones' argument that their inconsistently reported partnership items were "adjusted," concluding that no such adjustments occurred since the items were accepted as reported by MBJ.

Disposition

The court denied the Malones' motion to dismiss for lack of jurisdiction over the section 6662(a) penalty, affirming that deficiency procedures apply to the determination of the penalty in question.

Significance/Impact

The Malone decision clarifies the application of deficiency procedures to penalties related to partnership items under TEFRA when no adjustments are made to those items. It highlights the importance of distinguishing between adjustments to

© 2025 SCOTUSreports.com. All rights reserved.

partnership items and computational adjustments to a partner's tax liability based on those items. This ruling has practical implications for taxpayers and the IRS in handling penalties for inconsistent reporting of partnership items, ensuring that such penalties are subject to the procedural protections of deficiency procedures when no partnership-level adjustments are at issue. The decision also reaffirms the court's jurisdiction over penalties that are not directly tied to adjustments to partnership items, providing guidance on the scope of TEFRA's procedural framework.

© 2025 SCOTUSreports.com. All rights reserved.