No. 21-____

In the Supreme Court of the United States

WEST VENTURES L.P., FKA SLEIMAN VENTURES, L.P.; ANTHONY T. SLEIMAN, TAX MATTERS PARTNER

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

A partnership does not pay income tax to the U.S. Treasury. Unlike a corporation, which is subject to tax on its earnings, partnerships report items of income, deduction, gain, loss, and other tax attributes on a partnership income tax return, but these tax items flow through to the partners of the partnership. The partners report their allocable share of the partnership items and are ultimately responsible for the payment of any tax arising from the activities of the partnership.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 26 U.S.C. §§ 6221-6234 (2000) provides for a unified partnership proceeding, meaning, the IRS can examine the items of income, deduction, gain, loss, and other tax attributes reported on a partnership tax return by conducting an examination of the partnership itself, rather than having to examine each and every partners' income tax return separately. At the conclusion of the partnership examination, the partners are notified of any changes made by the IRS that flow from the partnership return through to the partners' income tax returns.

There are generally three types of adjustments that the IRS makes during the examination of the partnership. First, adjustments are made to items of income, deduction, gain, loss, and other tax attributes on the partnership return, these are referred to as "partnership items." Once adjustments to partnership items are made at the partnership level, these items are next reflected on each partners' income tax return.

The tax items at the partner level are considered to be either "computational adjustments," which are purely mathematical changes to each partner's return reflecting the partnership item changes, or "affected items," which are items that appear on each partner's income tax return that are impacted or "affected" by changes made to a partnership item, but require more than a simple mathematical adjustment at the partner level to determine the appropriate amount of tax liability owed by the partner.

A partner's outside basis, which represents the partner's investment in the partnership adjusted yearly to reflect activity of the partnership, has been held to be an "affected item." Accordingly, a partner's outside basis in a partnership is only adjusted if there is a change to a "partnership item" that flows through to the partner. If there is no change to the partnership income tax return, there is no flow through adjustment impacting outside basis, thus the partner's affected item remains unchanged.

Notwithstanding the Ninth Circuit's acknowledgement that the U.S. Tax Court determined that outside basis is an affected item, it did not concur. Rather, it held that because the partner here was itself a partnership, outside basis was a "partnership item" of the partner and not an "affected item." This is contrary to *U.S. v. Woods*, 571 U.S. 31 (2013), and the other Circuits addressing this issue.

Further, one of the partners in the partnership agreed to extend the statute of limitations for assessing tax against it. The extension was limited to that partner's items of income, deduction, gain, loss, and other tax attributes, but did not extend the statute of limitations for any of the partner's "affected items."

The question presented is whether a partner's outside basis is a "partnership item" of the partner or (and thus covered by the parties' extension agreement) as held by the Ninth Circuit or whether the partner's outside basis is properly characterized as an "affected item" (and thus outside the extension agreement) consistent with *Woods* and every other circuit to have considered the issue.

PARTIES TO THE PROCEEDINGS

Petitioner-appellant below was West Ventures, L.P., FKA Sleiman Ventures, L.P.; Anthony T. Sleiman, Tax Matters Partner.

Respondent-appellee below was the Commissioner of Internal Revenue.

CORPORATE DISCLOSURE STATEMENT

Petitioners hereby state that there exists no parent corporation or any publicly held corporation that owns a 10% or more ownership interest in Petitioners.

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PETITION FOR A WRIT OF CERTIORARI

This case presents the Court with the opportunity to resolve a split of authority central to cases under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 26 U.S.C. §§ 6221-6234 (2000), namely, whether a partner's outside basis in a partnership is properly characterized as an "affected item." Consistent with this Court's statement in *United States v. Woods*, 571 U.S. 31 (2013), what the Federal and Eighth Circuits have held, and what a judge of the Tenth Circuit has said, outside basis is an "affected item." In the decision below, the Ninth Circuit declined to characterize the partner's outside basis as an "affected item" thereby allowing a change to the income tax liability of the partner.

The parties had agreed to extend the statute of limitations for assessing additional taxes against the partner, but such extension did not include any of the partner's "affected items."

How this conflict is resolved affects not only the substantive treatment of outside basis under the tax code but the IRS's ability to effectively administer the tax code. A statute of limitation extension ensures that the IRS has sufficient time to perform its administrative functions. Taxpayers grant statute extensions, often with limitations, because it helps resolve disputes in an efficient manner. The Ninth Circuit's decision would interject an unacceptable ambiguity into this good faith administrative process.

OPINIONS BELOW

The Ninth Circuit's opinion (Pet. App. A) is reported at 817 Fed. Appx. 428. The U.S. Tax Court's opinion (Pet. App. B) is by Order of the Court, Docket entry 44, Docket No. 24683-10. The U.S. Tax Court's opinion (Pet. App. C) is an Order and Decision of the Court, Docket entry 120, Docket No. 24683-10.

JURISDICTION

The Ninth Circuit entered judgment on July 14, 2020, and denied rehearing on September 22, 2020. This petition is timely under this Court's March 19, 2020 order extending the time in which to file to "150 days from the date of the * * * order denying a timely petition for rehearing." *Cf.* Rule 30.1.

This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 26 U.S.C. §§ 6221-6234 (2000). *See citation Appendix D.* Bipartisan Budget Act of 2015, 26 U.S.C. §§ 6226 and 6235. *See citation in Appendix E.*

STATEMENT OF THE CASE

A. Statutory and Regulatory Background

A partnership does not pay income tax to the U.S. Treasury. Instead, the items of income, deduction, gain, loss, and other tax attributes that are incurred within the partnership flow through to each partner who owns the partnership. Each partner reports their allocable share of the partnership's items on their own tax return.

Prior to the enactment of The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 26 U.S.C. §§ 6221-6234 (2000), if the IRS wanted to adjust the income or expense items of the partnership, the IRS would have to conduct an examination of each partner's income tax return. This could result in numerous examinations of the same item of income or expense.

As explained by this Court, "[h]aving to use deficiency proceedings for partnership-related tax matters led to duplicative proceedings and the potential for inconsistent treatment of partners in the same partnership. Congress addressed those difficulties by enacting the Tax Treatment of Partnership Items Act of 1982." *United States v. Woods*, 571 U.S. 31, 38 (2013).

TEFRA provides a unified partnership proceeding, meaning, the IRS can examine the items of income, deduction, gain, loss, and other tax attributes reported on a partnership tax return by conducting an examination of the partnership itself, rather than having to examine each and every partners' income tax return separately. At the conclusion of the partnership examination, the partners are notified of any changes made by the IRS to the partnership return that flow through to the partners' income tax returns.

There are generally three types of adjustments that the IRS makes during the examination of the partnership. First, adjustments are made to items of income, deduction, gain, loss, and other tax attributes on the partnership return, these are referred to as "partnership items." Once adjustments to partnership items are made at the partnership level, these items are next reflected on each partners' income tax return.

The tax items at the partner level are considered to be either "computational adjustments," which are purely mathematical changes to each partner's return reflecting the partnership item changes, or "affected items," which are items that appear on each partner's income tax return that are impacted or "affected" by changes made to a partnership item, but require more than a simple mathematical adjustment at the partner level to determine the appropriate amount of tax liability owed by the partner.

A partner's outside basis in a partnership represents the amount the partner invested in the partnership, modified each year by both the amount of any distributions paid to the partner during the year and the partner's share of any income or loss sustained by the partnership. Because a partner's outside basis in a partnership is impacted by changes made to the items of income and expense of a partnership, outside basis has been characterized as an "affected item" by this Court and several Circuit Courts. *Id.*, at 41.

At the conclusion of an examination of the partnership, if there are no adjustments to the items of income or expense at the partnership level, there is no change to outside basis. Stated another way, affected items remain unchanged.

A partner can extend the statute of limitations for items appearing on the partner's return and for items impacting the partner's return from flow through items arising from a partnership examination (e.g., "affected items)." That extension is made on IRS Form 872-P. By signing the form, both the taxpayer and the IRS allow sufficient time for the IRS to complete its examination of the partner's income tax return at the conclusion of the partnership audit. The partner and the IRS can agree to limit which items are subject to the statute extension, depending on the circumstances of any particular case.

B. Facts of the Case

At issue in this case is the 1999 tax return of petitioner West Ventures L.P. (West Ventures).

West Ventures was a partner in Sleiman Two during 1999. West Ventures is itself a partnership. During the IRS's examination of West Ventures' 1999 income tax return, the parties signed Form 872-P, which extended the time the IRS had to make changes to West Ventures' income tax items in certain defined respects. The agreement extended the period of limitations for the items of income and expense appearing on West Ventures' income tax return, but it did not extend the statute of limitations for items appearing on the Sleiman Two partnership or for any of West Ventures' "affected items." (Pet. App. 6a-11a).

Sleiman Two filed its partnership return for 1999, reporting a capital loss of $700,000. (Pet.

App. 6a-11a). West Ventures' held a 90% partnership interest in Sleiman Two and reported its allocable capital loss of $630,000 that flowed through to it from Sleiman Two. (Pet. App. 6a-11a).

West Ventures' outside basis in Sleiman Two was $63,000,000 prior to the capital loss incurred by Sleiman Two. (Pet. App. 6a-11a). When Sleiman Two's 1999 partnership return was filed with the IRS, West Ventures' outside basis in Sleiman Two was reduced to $62,370,000, to account for the $630,000 capital loss realized by Sleiman Two and passed through to West Ventures. (Pet. App. 6a-11a).

The IRS never examined Sleiman Two's 1999 partnership return and no changes to Sleiman Two's 1999 partnership return or the capital loss were ever made. Thus, the capital loss reported on Sleiman Two's partnership return is the accepted amount of partnership activities for that year and each partner was required to report its allocable share of Sleiman Two's capital loss.

Sleiman Two dissolved at the end of 1999. At the time of the dissolution, Sleiman Two had no assets. Since West Ventures received no consideration for its interest in Sleiman Two on dissolution, it realized a further capital loss equal to its outside basis in Sleiman Two, which was $62,370,000 at the time of the dissolution, less the proceeds received in dissolution, which was zero. (Pet. App. 6a-11a).

Subsequently, the IRS examined the 1999 income tax return of West Ventures, as a partner in the Sleiman Two partnership. It denied West

Ventures' $62,370,000 short-term capital loss that arose from the dissolution of Sleiman Two. To achieve this result, the IRS reduced West Ventures' outside basis in Sleiman Two to zero, claiming that the IRS disagreed with the options transaction that gave rise to West Ventures outside basis in Sleiman Two. (Pet. App. 105a-106a).

Because the IRS never examined Sleiman Two's partnership return, the IRS accepted the options transaction reported by Sleiman Two. Nevertheless, the IRS attempted to reach the transaction by reducing West Ventures' outside basis in Sleiman Two to zero based on the same legal theory it would have used at Sleiman Two had it examined Sleiman Two's partnership return. (Pet. App. 105a-106a).

The issue here is whether West Ventures' outside basis could be adjusted in this manner. The IRS and West Ventures executed Form 872-P, extending the statute of limitations for partnership items of West Ventures, but it did not extend the statute for partnership items of Sleiman Two or any affected items of West Ventures.

This Court, as well as several Circuit Courts, have held that a partner's outside basis in a partnership is properly characterized as an "affected item." Since "affected items" were not subject to the parties' extension agreement, the IRS was barred from adjusting West Ventures' outside basis in Sleiman Two. It is undisputed that without a valid statute extension, the statute of limitations had run at the time the IRS made the adjustment to West Ventures' outside basis, and the IRS was barred from adjusting West Ventures' affected items.

REASON FOR GRANTING THE PETITION

The Ninth Circuit's decision warrants this Court's review because its misinterpretation of TEFRA creates a circuit split and undermines the efficient and fair administration of the tax code as it applies to partnership income. Whether a partner's outside basis in a partnership is properly characterized as an "affected item" impacts the type of income that can be adjusted during an IRS examination.

In addition to the circuit split regarding the substantive tax treatment of outside basis under the tax code, this case deserves review because it also impacts the IRS's ability to effectively administer tax examinations. A statute of limitation extension ensures that the IRS has sufficient time to perform its administrative functions. Taxpayers grant statute extensions, often with limitations, because it helps resolve disputes in an efficient manner.

The decision of the Ninth Circuit undercuts the trust both parties have in the statute extension policy and process, and the impact of the decision very well may cause taxpayers to be confused as to what income tax items are being extended for statute of limitations purposes, thereby dampening a taxpayer's willingness to grant extensions and negatively impacting the IRS examination function.

A. The Ninth Circuit's failure to properly characterize West Ventures' outside basis as an "affected item" is contrary to this Court's acknowledgement in *U.S. v. Woods* and creates a circuit split.

The holding of the Ninth Circuit represents a dramatic departure from all other Circuits that have considered the characterization of a partner's outside basis in a partnership. Other than the Ninth Circuit, every Circuit that has considered the matter has characterized a partner's outside basis in a partnership is an "affected item." Because of the Ninth Circuit's contrary holding, there is now a split between the Ninth Circuit on the one hand and the Eighth Circuit, Tenth Circuit and Federal Circuit. Each of these courts have stated that a partner's outside basis in a partnership is properly characterized as an "affected item."

The decision of the Ninth Circuit is also contrary to the acknowledgement by this Court in *United States v. Woods*, 571 U.S. 31 (2013), that a partner's outside basis in its interest in a partnership is characterized as an "affected item." Had the Ninth Circuit adopted this correct characterization of outside basis as an affected item, the IRS would be barred from adjusting West Ventures' basis in its partnership interest in Sleiman Two given the statute extension specifically excluded "affected items."

B. *U.S. v. Woods* and Circuit Courts recognize that a partner's outside basis in a partnership is properly characterized as an "affected item."

At issue in *Woods* was whether an overvaluation penalty should be addressed by the IRS during the partnership audit or later when a partner's income tax return is adjusted for changes made at partner level. Woods argued that because outside basis is not a partnership item, but an affected item of the partner, a penalty that would rest on a misstatement of outside basis cannot be considered by the IRS during the audit of the partnership. The Commissioner argued that it could determine the penalty at the partnership level, despite such characterization.

In *Woods*, this Court acknowledged that a partner's outside basis in a partnership is an "affected item." Specifically, this Court stated:

> We hold that TEFRA gives courts in partnership-level proceedings jurisdiction to determine the applicability of any penalty that could result from an adjustment to a partnership item, even if imposing the penalty would also require determining <u>affected or non-partnership items such as outside basis</u>. The partnership-level applicability determination, we stress, is provisional: the court may decide only whether adjustments properly made at the partnership level have the potential to trigger the penalty. Each partner remains free to raise, in subsequent, partner-level proceedings, any reasons why the penalty may not be imposed on him specifically."

Supra. at 41-42 (emphasis added).

C. Circuit Courts have characterized a partner's outside basis as an "affected item."

In *Schell v. United States*, 589 F.3d 1378 (Fed. Cir. 2009), the issue before the court was whether a closing agreement reached between a partner and the IRS changed the characterization of partnership items and non-partnership items. In its analysis, the court acknowledged that a partner's outside basis in a partnership is an "affected item." The court stated:

> "Partnership item" generally encompasses items "required to be taken into account for the partnership's taxable year," and those "more appropriately determined at the partnership level than at the partner level." I.R.C. § 6231(a)(3). Such items include the income, gains, losses, deductions, and credits of a partnership. Treas. Reg. § 301.6231(a)(3)–1(a) (2009). . . .
>
> [A]n "<u>affected item</u>" is defined as "any item to the extent such item is affected by a partnership item." I.R.C. § 6231(a)(4)-(5). <u>An example of an "affected item" is a partner's tax basis in his</u>

> partnership interest, which is affected by partnership items such as partnership income or loss.

Id. at 1381-1382 (emphasis added).

Likewise, in *Thompson v. Comm'r*, 729 F.3d 869, 873 (8th Cir. 2013), the issue before the court was whether a notice of deficiency issued by the IRS was the proper procedure for making adjustments to the partner's income tax return at the conclusion of a partnership audit. The IRS claimed the notice of deficiency was improperly issued and, thus the U.S. Tax Court lacked jurisdiction to consider the matter.

The taxpayer argued that the partnership audit was not conclusive and that a statutory notice of deficiency was the proper procedural step where Thompson's outside basis in the partnership was at issue. Thompson claimed the statutory notice impacted his outside basis in the partnership and, as such, outside basis was an "affected item" requiring the notice of deficiency. The court agreed with the taxpayer. "We agree with the other circuits to have addressed the issue that outside basis is an affected item that must be determined at the partner level." *Id.*

We also bring to the Court's attention the dissent in *Katz v. Commissioner of Internal Revenue*, 335 F.3d 1121 (10th Cir. 2003) (J. Robinson dissent on other grounds). The issue before the court was whether a bankruptcy filing by a partner to a partnership impacted the procedural mechanism for reviewing changes to an individual partner's return and whether the bankruptcy itself caused the individual partner's share of partnership losses to be converted into non-partnership items. While the holding of the case is not directly on point, in Judge Robinson' dissent, the following remarks were made:

> [A]ffected items' are items that require adjustment after and as a consequence of a determination that is necessarily made in a partnership-level proceeding. Affected items include computational adjustments to a partner's tax liability, after a partnership proceeding results in a change in a partnership item. <u>Examples of affected items include a partner's basis in the partnership</u> and penalty, addition to tax or additional amount. Treas. Reg. § 301.6231(a)(5)–1(b) and (e).")

Id. at 1130, fn. 1 (emphasis added).

D. The Conflict in the lower courts implicates an important and recurring issue.

TEFRA was repealed for partnership tax returns filed after January 1, 2018 and was replaced by the Bipartisan Budget Act of 2015, Public Law No 114-74 (BBA). The BBA enacted a new IRS examination regime, allowing the IRS to not only examine the partnership items of income and expenses, as occurred under TEFRA, but also allowing the IRS to collect taxes at the partnership level if the partnership agrees. If the partnership does not agree, the partnership notifies each partner of the IRS adjustments and the individual partners make payment directly to the IRS. 26 U.S.C. § 6226(a).

Despite these changes, the calculation of a partner's outside basis in a partnership remains a critical component of determining the proper amount of income tax owed by a partner. Without that calculation, and identification of the items affecting a partner's outside basis in the partnership, a partner's tax liability cannot be determined. For these reasons, the BBA makes clear that despite a new regime for examining partnership tax returns, determining a partner's outside basis in the partnership remains a critical step in determining a partner's income tax liability. *See* 26 U.S.C. § 6226(b)(3) (tax attributes affected by adjustments at the partnership level).

Further, the rules regarding statute of limitation extensions were not changed by the BBA. 26 U.S.C. § 6501(c). Taxpayers and the IRS can still enter into statute extensions, and can continue to limit those statute extensions, for both the partnership and partner level adjustments beyond the three-year statute of limitations set-forth in the BBA. *See* 26 U.S.C. § 6235 (a). Certainty regarding the terms and conditions of statute extensions are of paramount importance for partners, partnerships and the IRS under both TEFRA and the BBA.

CONCLUSION

For the foregoing reasons, the Court should grant certiorari to realign the Ninth Circuit's jurisprudence with its sister circuits and this Court's holding in *U.S. v. Woods*.

Respectfully submitted,

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