NO.

In The Supreme Court of the United States

RITCHIE N. STEVENS AND JULIE A. KEENE-STEVENS,

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

1. Whether a net operating loss carryover to a future year that is an "affected item" under the TEFRA Partnership audit regime can be included within the definition of a "net loss from partnership items" for purposes of former 26 U.S.C. §6234(a)(3), given that the definitions of "partnership items" and "affected items" are mutually exclusive.

2. Whether the submission of unsigned partnership tax returns and unsigned personal tax returns of the partners to the IRS and the Tax Court was sufficient for the Tax Court to acknowledge the asserted partnership losses reflected on those returns for purposes of resolving the partners' Tax Court case.

PARTIES TO THE PROCEEDING

Petitioners, Ritchie N. Stevens and Julie A. Keene-Stevens, were the petitioners-appellees in the Ninth Circuit Court of Appeals.

Respondent, Commissioner of Internal Revenue, was the respondent-appellant in the Ninth Circuit Court of Appeals.

STATEMENT OF RELATED PROCEEDINGS

This case arises from the following proceedings:

Julie A. Keene-Stevens and Ritchie N. Stevens v. Commissioner of Internal Revenue, No. 21-71082 (9th Cir. July 3, 2023) (reversing and remanding the judgment of the Tax Court, *rehearing denied*, Sept. 13, 2023); and

Ritchie A. Stevens and Julie A. Keen-Stevens v. Commissioner of Internal Revenue, Docket Nos. 29815-13, 9539-15 (Tax Court Memo No. 2020-118).

There are no other proceedings in state or federal trial or appellate courts, or in this Court, directly related to this case within the meaning of this Court's Rule 14.1(b)(iii).

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Ritchie A. Stevens and Julie N. Keene-Stevens respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this this case.

OPINIONS BELOW

The opinion of the court of appeals is available at 72 F.4th 1015 (9th Cir. 2023). Pet. App. 1a. The opinion of the Tax Court is available at T.C. Memo 2020-118 (2020), Pet. App. 32a.

JURISDICTION

The opinion of the Court of Appeals was entered on July 3, 2023. The court of appeals denied a request for rehearing on September 14, 2023. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Section 6234 of the Internal Revenue Code, 26 U.S.C. §6234 (2011), subsections (a) and (b), provide as follows:

> §6234. Declaratory judgment relating to treatment of items other than partnership items with respect to an oversheltered return
>
> (a) General rule
>
> If—
>
> (1) a taxpayer files an oversheltered return for a taxable year,
>
> (2) the Secretary makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and
>
> (3) the adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency if there were no net loss from partnership items,

the Secretary is authorized to send a notice of adjustment reflecting such determination to the taxpayer by certified or registered mail.

(b) Oversheltered return

For purposes of this section, the term "oversheltered return" means an income tax return which—

(1) shows no taxable income for the taxable year, and

(2) shows a net loss from partnership items

Section 6234 in its entirety is found at Pet. App. 115a.

STATEMENT

In this case, the Ninth Circuit ruled in a manner that is contrary to guidance previously provided by this Court and that is contrary to every Court of Appeals to address the definition of "partnership item" and "affected item" under the TEFRA Partnership Audit regime, former 26 U. S.C. §§ 6221-6232 (2006 ed. and Supp. V). The Ninth Circuit's opinion is also contrary to every decision of the Tax Court to address these definitional issues.

Even more problematically, the Ninth Circuit, at the urging of the IRS itself, ruled in a manner that is completely inconsistent with the instructions provided by the IRS to its own agents.

In addition, the Ninth Circuit improperly held that the petitioners' failure to file income tax returns for certain years rendered "inoperative" millions of dollars of asserted partnership losses, *i.e.,* partnership losses that appeared on partnership returns, and appeared as "flow through" losses on individual tax returns, that were given to, but not formally filed with, the IRS and the Tax Court. The sole reason the Ninth Circuit rendered these asserted losses "inoperative" was because tax returns were not formally filed with the IRS.

Such adverse consequences for a failure to formally file a partnership return are not contemplated by the Tax Code. The normal consequences of a partnership's failure to file a tax return are a) to indefinitely extend the ability of the IRS to propose adjustments to the partnership's income and expenses, and to increase taxes owed by the partnership's partners as the result of these adjustments, and b) to impose late filing penalties on the partnership. *See* 26 U.S.C. § 6229(c)(3) (2000) and 26 U.S.C. § 6698. These same consequences for a failure to formally file a tax return with the IRS also apply at the partner level.

By rendering these asserted partnership losses "inoperative" in the present case, the Ninth Circuit violated the statutory TEFRA Partnership audit scheme and created a risk that the petitioners will never be able to claim the benefit of all of the asserted partnership losses.

The Ninth Circuit's holding, if extended to other situations in which taxpayers fail to formally file tax returns with the IRS, could permanently deprive taxpayers of their ability to claim deductions and losses merely because they have not formally "filed" tax returns. That has never been the law.

Individual taxpayers who do not formally file their tax return(s) with the IRS and who find themselves litigating in Tax Court regarding the amounts of taxes they owe have always been able to argue that they are entitled to losses and deductions that are not reflected on a formal, filed return. Similarly, the IRS has always been able to argue that taxpayers who did not formally file a return must pay tax on taxable income not reflected on a formal, filed return. Losses and deductions, along with income, do not become legally inoperative because of a taxpayer's failure to formally file a return with the IRS.

The Ninth Circuit's holding also illustrates the potential mischief that can occur as the result of the holding of another recent Ninth Circuit opinion for which review is being sought in this Court. *See Seaview Trading, LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023) (en banc), *petition for certiorari pending*, No. 23-125. In that case, the petitioner challenges the Ninth Circuit's holding that the petitioner did not "file" its tax return because the tax return was not provided to a specific office within the IRS. The Ninth Circuit's opinion in the present case illustrates just one of the possible unusual results that can occur if the Ninth Circuit's holding in *Seaview Trading* is not reversed.

A. Statutory Background

The TEFRA Partnership Audit provisions were enacted in 1982 under the Tax Treatment of Partnership Items Act of 1982, as Title IV of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). 96 Stat. 648 (formerly codified as amended at 26 U.S.C. §§ 6221-6232 (2006 ed. and Supp. V)). The purpose of these provisions was to avoid duplicative proceedings and the potential for inconsistent treatment of partners in the same partnership. *See United States v. Woods*, 571 U.S. 31, 38 (2013).[1]

As explained by this Court in *Woods*, 571 U.S. at 39, TEFRA Partnership proceedings take place in two distinct phases. The first phase is called a "partnership level proceeding," the purpose of which is to resolve all "partnership items" relating to the partnership tax return at issue. A "partnership item" is defined as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that . . . such item

[1] The Bipartisan Budget Act of 2015, Pub. L. No. 114-74, 129 Stat. 584, replaced the TEFRA Partnership Audit regime with a new partnership audit regime, generally effective for tax years starting on January 1, 2018. All references to the Internal Revenue Code herein are to Code Sections as they existed during the tax years 2007 through 2012.

is more appropriately determined at the partnership level than at the partner level." 26 U.S.C. § 6231(a)(3) (2000).

After the conclusion of the partnership level proceeding, the IRS deals with the partners of the partnership in one of two ways. The IRS sends an "affected item" notice of deficiency to a partner if there are so-called “affected items” requiring a determination at the partner level. Affected items are non-partnership items that are affected by partnership items. *See* 26 U.S.C. § 6230(a)(2)(A)(i); 26 C.F.R. § 301.6231(a)(5)-1(a). *See also United States v. Woods, supra,* 571 U.S. at 39, *Napoliello v. Commissioner,* 655 F.3d 1060, 1064 (9th Cir. 2011).

If there are no affected items requiring a determination at the partner level, the IRS can compute and assess the additional taxes owed by the partner as the result of the adjustments in the partnership level proceeding without issuing a notice of deficiency. *See* 26 U.S.C. § 6230(a)(1); *United States v. Woods, supra,* 571 U.S. at 39; *Olson v. United States,* 172 F.3d 1311, 1317 (Fed. Cir. 1999).

The IRS is not obligated to conduct a partnership level proceeding before conducting a partner level audit. In such a situation, the "outcome of the partnership proceeding" is the acceptance of the partnership return as filed. *See Roberts v. Commissioner,* 94 T.C. 853, 860-61 (1990). This binds the IRS to all partnership items as reflected on the partnership books and records for purposes of determining affected items. *See* Internal Revenue

Manual. 8.19.1.6.9.3.1(2) (10-01-2013); *Meruelo v. Commissioner,* 691 F.3d 1108 (9th Cir. 2012).

In the partner level proceeding, only affected items and issues that require partner level determination may be considered. *See Roberts v. Commissioner, supra*, at 860-61. In an affected items proceeding where there was no partnership-level proceeding, the IRS and the courts may still analyze documents and records at the partnership level, but lack jurisdiction to redetermine any partnership item. *Id.* at 862. This principle applies in a partner level proceeding over any portion of a deficiency attributable to a partnership item even when, as is the situation here, the partnership has failed to file a partnership return. *See Jimastowlo Oil, LLC v. Commissioner*, T.C. Memo 2013-195, 24.

While disputes can arise about whether a particular issue is a "partnership item" or is an "affected item," *see Woods, supra,* 571 U.S. at 39-42, there is no dispute that an affected item is not, and cannot be, a partnership item. Affected items are dealt with only after the conclusion of all partnership level proceedings, *i.e.*, after all partnership items are resolved. *See id.* at 39; *Meruelo v. Commissioner*, *supra*.

This principle is starkly illustrated by cases in which the IRS issues a "regular" notice of deficiency under 26 U.S.C. § 6212 seeking to make adjustments to "partnership items" or to "affected item" before the conclusion of partnership level proceedings. In that situation, the Tax Court must dismiss for lack of jurisdiction the proposed adjustments to "partnership items" and/or "affected items." *See, e.g, Adkison v. Commissioner,* 592 F.3d 1050, 1052 (9th Cir. 2010); *see also Meruelo v. Commissioner, supra,* 691 F.3d at 1114-1117.

Sometimes the IRS proposes adjustments to a partner's individual tax liability that are completely unrelated to TEFRA partnership losses claimed by the partner, at a time when TEFRA partnership level proceedings have not been initiated or are ongoing but remain unresolved. If the claimed partnership losses are sufficiently large, that results in a situation where the IRS cannot assert, and the Tax Court cannot determine, any deficiency. That is because the non-partnership adjustments proposed by IRS, if sustained, would not result in a deficiency.

The claimed partnership losses cannot be adjusted through the normal deficiency process at the partner level unless and until the IRS successfully challenges the claimed partnership losses through the TEFRA procedures. For example, if a taxpayer has claimed partnership losses of $100,000.00 and had net non-partnership income of $50,000.00, and the IRS seeks to increase non-partnership income by $30,000.00, the Tax Court cannot determine that there is a deficiency in income taxes unless it is later determined that the claimed partnership losses must be reduced by more than $20,000.00.

Congress enacted former 26 U.S.C. § 6234 to deal with such "oversheltered" tax returns of partners in TEFRA partnerships. Section 6234 permits the Tax

Court to enter a declaratory judgment regarding proposed adjustments to non-partnership items where the Tax Court lacks deficiency jurisdiction.

Under § 6234, Congress permitted such declaratory judgments only if all of the following requirements are met:

> A) The taxpayer must have filed an "oversheltered return," *i.e.,* a return which shows no taxable income for the tax year in question, and which shows a net loss from partnership items;
>
> B) The IRS makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and
>
> C) The adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency *if there were no net loss from partnership items.* (emphasis added)

Thus, to determine whether the IRS can invoke the Tax Court's jurisdiction to enter a declaratory judgment under § 6234, it is necessary to consider whether a taxpayer/partner would be liable for a deficiency in income taxes for a particular year if 1) IRS proposed adjustment to non-partnership items reflected on the partner's income tax return, 2) those proposed adjustments were sustained, and 3) the entire "net loss from partnership items" claimed by the taxpayer/partner for the year in question is disregarded.

If the answer to this question is "yes," then the Tax Court has jurisdiction to enter a declaratory judgment regarding the proposed adjustments to the non-partnership items for that year. In the hypothetical discussed above at p. 9, the Tax Court would have jurisdiction to enter a declaratory judgment under § 6234 regarding the $30,000.00 in proposed adjustments to non-partnership items because the proposed adjustments to non-partnership items, if sustained, would result in a deficiency if the asserted partnership losses are disregarded.

If the answer to that question is "no," then the Tax Court does not have jurisdiction under § 6234 to issue a declaratory judgment regarding the proposed adjustments to the non-partnership items for that year.

Section 6234 was enacted as a response to the Tax Court's holding in *Munro v. Commissioner*, 92 T.C. 71 (1989). The taxpayers in *Munro* had timely filed their income tax return for the year in question (1983). The taxpayers had also invested in multiple TEFRA partnerships, the tax returns of which were being audited by the IRS at the time the Tax Court issued its opinion in *Munro*. 92 T.C. at 71-72.

In *Munro*, the Tax Court held that deficiency proceedings initiated before any proposed adjustments to partnership items become final must only consider non-partnership items in determining any deficiency. All partnership items (including income, losses, deductions and credits) included on a taxpayers' return were to be completely ignored to determine if a deficiency existed that is attributable to non-partnership items. 92 T.C. at 74.

This approach effectively deprived taxpayers of a pre-payment forum in which to litigate the validity of the claimed partnership losses. Taxpayers had to pay any "deficiency" determined by the Tax Court in the partner level proceeding and then seek a refund if the IRS's proposed adjustments to the partnership returns were not successful.

One reason the Tax Court took this approach was to avoid a situation where the IRS was time-barred from asserting deficiencies based on non-partnership items if the partnership-level proceedings lasted longer than the statute of limitations on the ability to assess deficiencies based on non-partnership items. That statute of limitations is normally three years after the date of the filing of the individual tax return. 26 U.S.C. § 6501(a).

There is no such concern where a taxpayer fails to formally file a return. The failure to formally file a return means that the IRS has an unlimited amount of time within which to assert a deficiency based on non-partnership items. 26 U.S.C. § 6501(c)(3).

Following the issuance of the *Munro* opinion, Congress enacted §6234 in part to ameliorate taxpayers' lack of a pre-payment remedy. *See* Staff of J. Comm. on Taxation, General Explanation of Tax

Legislation Enacted in 1997 (1997 Blue Book), at 369-70 (J. Comm. Print 1997).

Section 6234 contains a provision which permits the Tax Court to treat a notice of deficiency as a notice issued under § 6234 if it later is determined that § 6234 applies. 26 U.S.C. § 6234(h).

Section 6234 does not squarely address the situation where a taxpayer prepares and submits to IRS, but does not formally "file" individual "oversheltered" income tax returns and related TEFRA partnership returns. Those are the facts of the present case.

B. The Factual Background and Holdings of the Tax Court

Petitioners are husband and wife. The IRS audited their personal income taxes for the years 2004 through 2012. The IRS issued multiple notices of deficiency which, together, asserted income tax deficiencies against both petitioners for all of these years.

Petitioners filed timely Tax Court petitions for all years to challenge the asserted deficiencies. During the course of the Tax Court proceedings, the IRS filed a Motion to Dismiss for Lack of Jurisdiction to preclude consideration of all TEFRA partnership losses asserted by petitioners, whether asserted on filed returns or asserted on unfiled returns. The Tax Court granted this Motion. Pet. App. 36a. After this Motion was granted, the IRS "recomputed" the asserted deficiencies for most of the years before the

Tax Court, without adjusting the asserted partnership losses for purposes of computing the asserted recomputed deficiencies. Pet. App 36a-37a.

Not all of the tax years that were before the Tax Court are involved in the present appeal. The tax years involved in the present appeal fall into two different groups. The first group consists of tax years 2009, 2010 and 2011. These are the years affected by the first issue presented. The second group consists of tax years 2007 and 2012. These are the years affected by the second issue presented.

1. Tax Years 2009, 2010 and 2011

For the year 2009, petitioners filed both an original tax return and an amended tax return. The IRS accepted the amended return. Pet. App 43a-44a, 91a.

The amended return was an "oversheltered return" within the meaning of section 6234. It showed no taxable income and a net loss from TEFRA partnership items for 2009 of $990,360.00. It also reflected a net operating loss carryover from prior years of ($9,766,818.00). Pet. App. at 43a-44a, 92a-93a. Most of this loss carryover consisted of unused TEFRA partnership losses first claimed in prior tax years.

After comparing the recomputed asserted deficiency with petitioner's amended return for 2009, the Tax Court concluded that the IRS's proposed non-partnership adjustments, if sustained, would have increased petitioners' taxable income by only

$5,981.00. Pet. App. 93a. The Tax Court then determined that these asserted adjustments, if sustained, would not give rise to a deficiency for 2009 in the absence of the TEFRA partnership losses claimed in 2009 and therefore determined that the "oversheltered return" provisions of § 6234 did not apply. The Tax Court then determined that there was no deficiency due from petitioners for 2009. Pet. App. 92a-93a.

The Tax Court's ruling for 2010 was similar to its ruling for 2009. For the tax year 2010, petitioners filed a return reflecting adjusted gross income of a negative ($10,188,499.00). Pet. App. 45a-46a. Most of the negative income resulted from a net operating loss carryover from earlier years. Most of this loss carryover consisted of unused TEFRA partnership losses first claimed in prior tax years. There were modest 2010 TEFRA partnership losses claimed. *Id.*

The IRS's recomputed deficiency was based primarily on asserted unreported capital gain of $730,356.00 and disallowance of the net operating loss carryover. Pet. App. 47a.

The Tax Court ruled in a manner similar to its ruling for the 2009 tax year. Accordingly, the Tax Court held that the "oversheltered return" provisions of § 6234 did not apply, and further held that the petitioners were not liable for a deficiency for 2010. Pet. App. 104a.

In reaching these conclusions, the Tax Court treated the net operating loss carryover from prior years, which was primarily based on unused TEFRA partnership losses first claimed in prior years, as an "affected item" that had to be treated as valid for purposes of computing any deficiency. As an "affected item," it would be adjusted only after the completion of a TEFRA partnership-level proceeding for the year in which the partnership losses were first claimed. Pet. App. 100a.

The treatment of the net operating loss carryover as an "affected item," and not as a "partnership item," under TEFRA was consistent with the statutory definition of "affected item," the case law, and the instructions for IRS revenue agents contained in the Internal Revenue Manual. *See* 26 U.S.C. § 6230(a)(2)(A)(i); 26 C.F.R. § 301.6231(a)(5)-1(a), *Cummings v. Commissioner,* T.C. Memo 1996-282 (addressing whether a net operating loss carryover was the type of affected item requiring the issuance of a notice of deficiency) and cases cited therein, and Internal Revenue Manual ("IRM") at 8.19.1.6.9.3.1 (10-1-2013), IRM at 4.31.2.3.15 (5) (4-10-2023).

The Tax Court ruled in a similar manner for the year 2011. The petitioners filed a 2011 return reflecting 2011 TEFRA partnership losses of ($566,999.00) and reflecting a net operating loss carryover of ($10,750,110.00). Most of this loss carryover consisted of unused TEFRA partnership losses first claimed in prior tax years. Pet. App. 47a-49a.

The IRS's recomputed asserted deficiency proposed total non-partnership adjustments of approximately $310,000.00. Pet. App. 49a-50a. Because these proposed adjustments, if sustained, would not have resulted in a deficiency in the absence of the 2011 TEFRA partnership losses, due to the large "affected item" net operating loss carryovers from 2010, the Tax Court held that the "oversheltered return" provisions of §6234 did not apply and further held that petitioners were not liable for a deficiency for 2011. Pet. App. 105a-109a.

2. Tax Years 2007 and 2012

For the tax years 2007 and 2012, petitioners did not formally file income tax returns with the IRS. They did, however, submit unsigned returns to the IRS and to the Tax Court. Pet. App. 39a-40a, 50a.

Petitioner's unsigned return for 2007 reflected non-partnership income of roughly $255,000.00. Pet. App. 39a-40a. It also reflected TEFRA partnership income of $700,959.00 and TEFRA partnership losses of ($7,594,316.00). The IRS's recomputed deficiency proposed non-partnership adjustments totaling $167,658.00. Pet. App. 40a. The recomputed deficiency did not seek to adjust the TEFRA partnership losses, as the Court had previously dismissed for lack of jurisdiction any asserted changes to the claimed TEFRA partnership income or losses. *Id.*

The Tax Court then held that the "oversheltered return" provisions in 6234 did not apply because petitioners had not filed a return. Pet. App. 68a. The Tax Court then determined that there was no deficiency for the 2007 tax year. Pet. App. 75a-76a.

The Tax Court declined the IRS's invitation to follow its prior holding in *Munro*, instead holding that the inapplicability of § 6234 "does not resuscitate *Munro*." Pet. App. 68a-70a. The Court pointed out that, per the report issued by the Joint Committee on Taxation, Congress intended the IRS to "return to its prior practice of computing deficiencies by assuming that all TEFRA items whose treatment has not been finally determined [in a partnership-level proceeding] had been correctly reported on the taxpayer's return [in a partner-level proceeding]" *Id.*

The Tax Court explained that the IRS would not be prejudiced by the Tax Court's ruling because, following the conclusion of any partnership level proceedings, the IRS could make an "affected items" adjustment at the taxpayer/partner level and would be free to issue another notice of deficiency for 2007 to deal with non-partnership items, citing 26 U.S.C. § 6231(e)(1). Pet. App. 75a-76a.

The Tax Court ruled in a similar manner for the year 2012. The IRS proposed non-partnership increases in income of $389,326.00 in its reconstructed deficiency. The unfiled return for 2012 reflected current TEFRA partnership losses of $33,147.00, plus an affected item net operating loss carryforward from 2011 in the amount of ($11,463,228.00) that was based in large part on unused TEFRA partnership losses first claimed in prior tax years. Pet. App. 50a.

The Tax Court held that, because no return had been filed for 2012, the oversheltered return provisions of § 6234 did not apply. The Court rejected the IRS's request that the Court apply the holding announced in *Munro*, explaining that the IRS was protected for this year for the same reasons that the IRS was protected for the year 2007. The Court determined that there was no deficiency for the year 2012. Pet. App. 109a-110a.

C. The Holdings of the Ninth Circuit

The Ninth Circuit reversed the holdings of the Tax Court for both groups of years. As we explain below, both reversals were legal error.

1. Tax Years 2009, 2010 and 2011

With respect to the years 2009, 2010 and 2011, the Ninth Circuit held that the original partnership loss which generated the net operating loss was a "partnership item." Pet. App. 24a. This statement is correct, but it is also incomplete. The complete statement is that these original partnership losses can only be characterized as "partnership items" in the year in which these losses are generated by the partnership.

"Partnership items" are litigated at partnership-level proceedings. *United States v. Woods, supra*, 571 U.S. at 39. Thus only a partnership-level proceeding involving the year in which the losses were generated by the partnership will affect the partnership losses on which the net operating loss is based. Any reduction of a claimed partnership loss in a partnership-level proceeding involving the year in which the losses originated will affect the amount of the net operating loss carryforward that can be used in later tax years at the partner level. Hence the classification of the net operating loss carryover to a later year as an "affected item."

A partnership-level proceeding for a later year in which the net operating loss carryover is used by a partner on his or her own personal return will have no effect whatsoever on the partnership losses claimed in an earlier year. That is because the neither the net operating losses claimed by the partner nor the original partnership losses that generated the net operating loss appear on the partnership return for the later year.

It follows, then, that a net operating loss, even one based on partnership losses generated in an earlier year, that is used by a partner in a later year, cannot be a "partnership item." Rather, as is explained previously, it is an "affected item." *United States v. Woods, supra,* 571 U.S. at 39-42.

Notwithstanding these straightforward principles, the Ninth Circuit concluded that "a partnership item [such as the partnership loss at issue here] does not lose its character as a partnership item when carried over as an NOL deduction into a subsequent tax year." Pet. App. 24a. The Ninth

Circuit's conclusion is wrong; it is contrary to the statutory definition of "partnership item."

The Ninth Circuit, in response to petitioners' argument that the phrase "net loss from partnership items" necessarily refers to partnership losses originating in the year being examined for purposes of determining whether § 6234 applies, stated that "Taxpayers insert a time limit that is not found in the statute." Pet. App. 24a The Ninth Circuit, however, ignored the fact that "partnership" losses can only be "partnership items" for one year, namely the year in which the losses are generated by the partnership.

The Ninth Circuit also criticized the Tax Court for being "inconsistent" in discussing the nature of the net operating losses by classifying these losses as "affected items" while "ignoring those NOL partnership item components in its Section 6234(a)(3) calculations." Pet. App. 27a.

There was nothing inconsistent about the Tax Court's treatment of the net operating losses as "affected items." The amounts of net operating losses appear on a partner's return, not on a partnership return, and thus cannot be litigated in a partnership-level proceeding. The IRS's own instructions to its agents in the Internal Revenue Manual refer to net operating loss carryovers attributable to partnership losses generated by the partnership in earlier tax years as "affected items." So do the courts. *Cummings v. Commissioner, supra.*

In sum, the Ninth Circuit, in reversing the Tax Court, held that the net operating loss carryovers at issue in the present case were both "losses from partnership items" under §6234(a)(3) and "affected items." To the best of the petitioners' knowledge, no other appellate or trial court, anywhere, has ever held that an item appearing only on an individual partner's tax return and that is related to a partnership is a "partnership item" or that such an item appearing only on a partner's tax return can simultaneously be both a "partnership item" and an "affected item."

2. Tax Years 2007 and 2012

The Ninth Circuit, in reversing the Tax Court's holding regarding the years 2007 and 2012, agreed that the Tax Court had properly concluded that §6234 does not apply to these two years. Pet. App. 14a. But the Ninth Circuit held that petitioners' failure to formally file income tax returns reflecting the partnership losses shown on the unfiled returns provided to the IRS meant that normal rules of the TEFRA partnership audit regime did not apply. Per the Ninth Circuit, the Tax Court, rather than accepting the asserted partnership losses as accurate for purposes of determining whether a deficiency existed, should have proceeded as if the asserted partnership losses did not exist. Pet. App. 13a-22a.

The Ninth Circuit based its reversal solely on the fact that petitioners had not formally filed tax returns with the IRS, stating that "[t]he Tax Court erred by effectively accepting as accurate partnership losses that were not reported on valid tax returns and thus could not be adjudicated in the required, separate, partnership-level proceedings under TEFRA." Pet. App. 13a. The Ninth Circuit further stated as follows:

> The Tax Court erred by accepting as accurate Taxpayers' TEFRA-eligible claimed partnership losses because it had no jurisdiction in these proceedings to evaluate those losses at all. What's more, the TEFRA rules and statutes provide no process to evaluate partnership losses claimed on invalid tax returns.

Pet. App. 18a.

The Ninth Circuit's conclusions are legally erroneous in multiple respects. First, in partner-level proceedings, the determination of whether the partnership should be disregarded for tax purposes under a legal doctrine such as sham or economic substance cannot be litigated, because that issue is a partnership item that must be litigated in a partnership-level proceeding. *Petaluma FX Partners, LLC v. Commissioner*, 131 T.C. 84, 93, 97 (2008), *aff'd on this issue*, 591 F.3d 649, 653-654 (D.C. Cir. 2010), *see also RJT Invs. X v. Commissioner*, 491 F.3d 732, 737-738 (8th Cir. 2007).

The Tax Court did not "err in accepting as accurate" the asserted partnership losses for purposes of determining whether there was a deficiency in a partner level proceeding in the absence of any partnership-level proceeding. That is precisely the result contemplated by the TEFRA Partnership audit regime. The IRS remained free to challenge all partnership level issues in a partnership-level proceeding at a later date.

The Ninth Circuit egregiously erred in concluding that "the TEFRA rules and statutes provide no process to evaluate partnership losses claimed on invalid tax returns." This conclusion is contrary to § 6229(c)(3), which provides for an unlimited statute of limitations for the IRS to audit partnership tax years where the partnership fails to formally file a return. Given the fact that Congress has expressly contemplated the possibility of partnership-level proceedings where a partnership has failed to file a partnership return, the Ninth Circuit's holding is strange indeed.

The Ninth Circuit's holding in the present case is also contrary to the Ninth Circuit's recent en banc opinion in *Seaview Trading LLC v. Commissioner, supra, petition for certiorari pending*, No. 23-125. In *Seaview Trading*, a partnership-level proceeding, the issue presented is whether the partnership filed a tax return. The Ninth Circuit held that the partnership had not filed a return.

The holding that the partnership failed to file a return, if allowed to stand, will not render inoperative the pending TEFRA partnership-level proceedings.[2] The fact that the Ninth Circuit panel in the present case completely disregarded the Ninth Circuit's own recent en banc opinion in *Seaview Trading* is most unfortunate.

The Ninth Circuit's conclusions regarding the years 2007 and 2012 are wrong, and wrong in a way that jeopardizes the rights of other taxpayers.

REASONS FOR GRANTING THE PETITION

I. The Ninth Circuit's Opinion is at Odds With This Court's Holding in *United States v. Woods,* With the Holdings of Other Courts of Appeal and Prior Opinions of the Ninth Circuit Itself, and With the Holdings of Virtually All Trial Courts (Issue 1)

Had the Ninth Circuit followed the statutory definition of "partnership item" set forth in 26 U.S.C. § 6231(a)(3) (2000), *see* pp. 6-7, *supra*, and had the Ninth Circuit acknowledged that a net operating loss carryover on a partner's tax return is not a partnership item that can be adjudicated in a partnership level proceeding, the Ninth Circuit would have affirmed the ruling of the Tax Court. Instead, the Ninth Circuit issued an opinion that is inconsistent with the statutory definition of

[2] The Tax Court has held there can be a partnership-level proceeding where the partnership fails to file a return. *See Jimastowlo Oil, LLC v. Commissioner, supra.*

"partnership item." This creates a problem for lower courts, the IRS and taxpayers in the administration of the TEFRA Partnership provisions.

Had the Ninth Circuit followed the guidance offered by this Court in *United States v. Woods, supra,* the Ninth Circuit would have affirmed the ruling of the Tax Court. Instead, the Ninth Circuit issued an opinion disregarding this Court's guidance in *Woods*. This creates a problem for lower courts, the IRS and taxpayers in the administration of the TEFRA Partnership provisions.

Had the Ninth Circuit followed the logic of the rulings of its sister circuits, as well as the logic of the prior rulings of the Ninth Circuit itself, regarding the proper relationship between "partnership items" and affected items," *see, e.g., Adkison v. Commissioner, supra, Meruelo v. Commissioner, supra, Curr-Spec Partners., LP v. Commissioner,* 579 F.3d 391 (5th Cir. 2009), *Baxter v. United States,* 48 F.4th 358 (5th Cir. 2022), *Greenberg v. Commissioner*, 10 F.4th 1136 (11th Cir. 2021), the Ninth Circuit would have affirmed the ruling of the Tax Court and would have avoided a conflict between the logic of its holding here (that an item appearing on an individual partner's tax return is a "partnership" item that can be litigated in a partnership level proceeding) and the logic of the other Circuits regarding the relationship between "partnership items" and "affected items."

Now there is a conflict between the Courts of Appeal on the relationship between "partnership items" and "affected items." That should be resolved by this Court, and should be resolved in favor of petitioners.

Had the Ninth Circuit ruled in a manner consistent with the logic of lower courts on the relationship between "partnership items" and "affected items," s*ee, e.g., United States v. Steinbrenner,* 949 F. Supp. 2d 1210 (M.D. Fla. 2013). *Roberts v. Commissioner, supra,* this Circuit conflict would not exist.

The Ninth Circuit's ruling in the present case creates problems for trial and appellate courts administering the TEFRA Partnership audit regime. This Court should grant review to resolve these problems.

II. The TEFRA Partnership Audit Provisions Remain Administratively Important

TEFRA Partnership Audit provisions remain important to the administration of the tax laws, notwithstanding that the TEFRA provisions were replaced by the BBA Partnership Audit provisions effective for tax years starting January 1, 2018. See footnote 1, *supra,* at p. 7. TEFRA partnership proceedings, by their nature, take years to resolve, because there are often two separate rounds of litigation. In the first round, disputed "partnership items" are resolved. In the second round, disputed "affected items" are resolved.

A search on the Tax Court's website of Tax Court Orders issued during 2022 and 2023 reveals that the Tax Court issued about 140 Orders mentioning the word "TEFRA" during this period (89 during 2023). A search of Tax Court opinions issued during this same period reveals that the Tax Court issued 43 opinions referencing TEFRA.

There are also multiple opinions issued by the Courts of Appeal dealing with TEFRA during 2022 and 2023. *See, e.g., Goldberg v. Comm'r*, 73 F.4th 537 (7th Cir. 2023), *Estate of Keeter v. Comm'r*, 75 F.4th 1268 (11th Cir. 2023), *Baxter v. United States*, *supra*, *Sarma v. Comm'r,* 45 F.4th 1312 (11th Cir. 2022), *Seaview Trading LLC v. Commissioner, supra*, *Gluck v. Comm'r*, 2022 U.S. App. LEXIS 6913 (2d Cir. 2022), and *SNJ Ltd. v. Comm'r,* 28 F.4th 936 (9th Cir. 2022).

III. This Court Should Encourage Tax Compliance by Discouraging the IRS From Taking Litigation Positions That Are at Odds With the Statutory Scheme and at Odds With the Guidance the IRS Provides to Its Own Agents

It is disappointing and unfortunate when a Court of Appeals reaches a conclusion that is directly contradicted by the statutory scheme, the relevant case law, and the instructions provided by the IRS itself to its own employees. It is doubly disappointing and unfortunate when a Court of Appeals reaches such an improper conclusion at the urging of the IRS.

This Court recently highlighted public pronouncements made by the IRS that were at odds with the IRS's litigating position before this Court in

Bittner v. United States. 143 S.Ct. 713 (2023) The present case is more problematical for the IRS because the case law leading up to this Court's holding in *Bittner* was far less developed than the case law relevant to the resolution of the present case.

It is important that the IRS cut square corners, and that the public perceive that the IRS is cutting square corners. Granting review in this case to reverse the holdings of the Ninth Circuit will prevent the left hand of the IRS from acting inconsistently from the right hand of the IRS and will encourage tax compliance by promoting public perception that the IRS must live by its own rules.

IV. The Ninth Circuit's Holding is Squarely At Odds With the Statutory Scheme (Issue 2)

The premises underlying the Ninth Circuit's holding that the Tax Court was required to completely ignore the asserted partnership losses for 2007 and 2012 in determining whether petitioners are liable for deficiencies for those years are completely flawed. As is explained above, the TEFRA Partnership provisions clearly contemplate that, in any partner level proceeding, courts are required to accept asserted TEFRA partnership losses as valid for purposes of determining whether a deficiency exists in the partner-level proceeding in the absence of a concluded partnership-level proceeding that requires adjustments to the affected items on the partner's tax return. The statutory provisions governing TEFRA Partnerships discussed above, and the case law interpreting these provisions discussed above, demonstrate that the Ninth Circuit clearly erred in reversing the Tax Court and in holding that the Tax Court was required to completely ignore the existence of the asserted partnership losses for purposes of determining whether petitioners were liable for deficiencies for the years 2007 and 2012.

Such a clear, egregious error warrants this Court granting review. If the Ninth Circuit's holding is reversed, the IRS will remain free to adjust all partnership level items in a partnership level proceeding, even in the absence of a filed partnership return. The reversal of the Ninth Circuit's holding will not hamper such efforts by the IRS in any way.

V. The Ninth Circuit's Holding Threatens to Improperly Prevent Taxpayers Who Have Not Filed Tax Returns to Claim the Benefits of Losses and Deductions to Which They Are Entitled (Issue 2)

The Ninth Circuit's holding on issue 2 creates potential adverse consequences for two classes of taxpayers, a) the petitioners, and b) the taxpaying public at large. With respect to petitioners, the Ninth Circuit's opinion threatens to prevent them from ever obtaining the benefit of the claimed partnership losses or even from litigating whether they are entitled to the benefit of the claimed partnership losses.

Under the rationale relied up on by the Ninth Circuit, any partnership-level proceedings initiated by the IRS prior to the filing of partnership returns are void and of no effect. Per the Ninth Circuit, partnership returns must first be filed before any partnership-level proceedings can be commenced. Per the Ninth Circuit, if the IRS does not initiate partnership-level proceedings after petitioners file partnership returns, the petitioners can then pay the tax owed as the result of the partner-level proceeding and seek a refund. Pet. App. 20a.

The Ninth's Circuit's conclusion that petitioners here would be able to file a refund suit after the conclusion of the pending partner-level Tax Court proceedings is flawed. It completely ignores the restrictions on the ability of petitioners to file a refund suit based on claimed TEFRA Partnership losses, particularly after the conclusion of Tax Court proceedings. *See* 26 U.S.C. §§6512(a), and 7422(h).

The Ninth Circuit's conclusion also ignores important differences between the situation addressed by the Tax Court in *Munro* and the situation faced by petitioners here. In *Munro*, the IRS had commenced partnership-level proceedings as of the date of the start of the partner-level proceedings. It was a virtual certainty that the validity of the asserted partnership losses in *Munro* would be adjudicated and that any overpayments of tax by the Munros made between the date of the resolution of the partner level proceeding and the resolution of the partnership level proceedings would be refunded.

The situation faced by petitioners here is different. No partnership-level proceedings had apparently been commenced as of the date of the Tax Court's opinion. Furthermore, per the Ninth Circuit, it is not possible now for the IRS to initiate partnership-level proceedings unless and until partnership returns are filed. Even after partnership returns are filed, the IRS may choose to not initiate partnership level proceedings, and there are significant statutory limitations on the ability of petitioners to bring a refund suit if no partnership-level proceedings are started by the IRS. *See* 26 U.S.C. §§ 6512(a) and 7422(h). Thus, the petitioners here may not be able to ever obtain overpayments based on asserted losses under the Ninth Circuit's holding.

As regards the taxpaying public, the rationale relied on by the Ninth Circuit suggests that every taxpayer's failure to file a tax return prevents that taxpayer from claiming the benefit of deductions, losses and credits to which the taxpayer is entitled under the Tax Code. That has never been the law.

Taxpayers who have failed to properly file tax returns and who then end up litigating in Tax Court over the amount of taxes they owe for the year(s) for which they did not properly file tax return(s) have always been able *See, e.g., Naylor v. Commissioner,* Tax Court Memo 2013-19 (allowing deductions to a non-filer).

CONCLUSION

The Court should grant this Petition for Certiorari.

Respectfully submitted,

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