FIFTH CIRCUIT 2009-2010 REVIEW: TAXATION

William D. Elliott†

I. INTRODUCTION

The Fifth Circuit decided three federal taxation cases during the review period of June 1, 2009, to June 30, 2010. Of these three cases, two involved tax collection circumstances. In *Evans*, a pro se taxpayer argued for use of the Texas fraudulent transfer limitations period instead of the federal tax collection limitations period arising in § 6502 of the Internal Revenue Code (I.R.C.).[1] The second case, *Davis*, involved a convicted tax-return preparer who argued that the taxpayer's addition of the phrase "without prejudice" to his Form 1040 meant that there was no tax return for which the preparer could be convicted of fraudulently preparing.[2] The third case, *Duffie*, concerned TEFRA partnership proceedings.[3] The taxpayers lost all three cases.

II. *UNITED STATES V. EVANS*

The principal issue in *United States v. Evans* was the applicable statute of limitations arising from a fraudulent conveyance.[4] The case arose in an action brought by the United States against a widow, in her individual capacity and as executrix of her deceased husband's estate, after the widow lost her challenge to proposed tax deficiencies in the Tax Court.[5] The Tax Court held against Mrs. Evans and in favor of the Internal Revenue Service

---

† Attorney at Law, Dallas, Texas. J.D., SMU School of Law; L.L.M. (in Taxation), New York University School of Law. For background on the topics covered by these three cases, see WILLIAM D. ELLIOTT, FEDERAL TAX COLLECTION, LIENS & LEVIES (Warren, Gorham & Lamont 2d ed. 2010).

1. *See infra* Part II. Unless otherwise noted, all references to the "Code" or section listed refer to the Internal Revenue Code of 1986 as amended.

2. *See infra* Part III.

3. *See infra* Part IV.

4. United States v. Evans, 340 F. App'x 990, 991-92 (5th Cir. Aug. 2009) (per curiam).

5. *Id.*

(the Service).[6] The joint income tax liability for Mr. and Mrs. Evans was $519,124.23 for tax years 1989, 1990, and 1993; Mrs. Evans's fiduciary liability amounted to $299,184.83 for the tax, interest, and penalties due by the estate.[7]

Facing such large tax deficiencies, Mrs. Evans transferred her individual assets and the estate's assets to a limited partnership.[8] Presumably, Mrs. Evans believed that she was placing her and the estate's assets beyond the reach of creditors by transferring the assets to a limited partnership.

The United States, as would be expected, took action to set aside Mrs. Evans's transfer to the limited partnership.[9]

> The United States sought to: (1) reduce to judgment federal tax assessments made against Evans and the [e]state; (2) hold Evans personally liable as a fiduciary under the federal insolvency statute [31 U.S.C. § 3713] for transferring assets out of the [e]state without having satisfied her husband's outstanding tax liabilities; (3) set aside as fraudulent the transfers of assets to the limited partnership or, alternatively, to have the partnership declared Evans's nominee; (4) foreclose upon the federal tax liens against Evans'[s] property; and (5) sell the property [transferred to the partnership].[10]

On summary judgment, the district court held for the United States.[11] The district court held that the transfer of assets belonging to Evans and the estate to the limited partnership constituted a fraudulent transfer under the Texas Uniform Fraudulent Transfer Act (TUFTA).[12]

Mrs. Evans appealed to the Fifth Circuit challenging, on a procedural ground, application of TUFTA to her partnership transfers.[13] She did not quarrel with the conclusion that her transfers were fraudulent under TUFTA but argued that the TUFTA statute of limitations of four years was violated; therefore, the government's claims were untimely.[14] The Fifth Circuit rejected Mrs. Evans's argument and held that the issue of limitations for transferee liability claims was to be controlled by the general ten-year limitations period applicable to federal tax collection actions.[15] The court

---

6. *Id.*
7. *Id.* at 992 n.1.
8. *Id.* at 992.
9. *See id.*
10. *Id.*
11. *Id.*
12. *Id.* (citing TEX. BUS. & COM. CODE ANN. § 24.006(a) (West 2009)).
13. *Id.* at 992-93. The other procedural arguments by Mrs. Evans are not discussed here.
14. *See id.* (citing TEX. BUS. & COM. CODE ANN. § 24.010(a)(2)).
15. *Id.* at 992. I.R.C. § 6502(a)(1) provides the following: "Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding

believed that the Supreme Court's decision in *United States v. Summerlin* controlled the case.[16] Also, earlier Fifth Circuit precedent followed *Summerlin* and concluded that the Service could bring fraudulent conveyance arguments within the § 6502 limitations period, instead of the four-year state limitations period under TUFTA.[17]

In holding that the United States has ten years to bring a fraudulent transfer claim based on a state's fraudulent conveyance statute, the Fifth Circuit decision in *Evans* remained within the mainstream of federal courts that have considered this issue.[18]

III. *UNITED STATES V. DAVIS*

The *United States v. Davis* case presented the issue of whether a tax-return preparer could be convicted of aiding and assisting in the filing of false returns for a taxpayer if the taxpayer modified the jurat to Form 1040.[19] In other words, does language added by the taxpayer when signing the tax return negate the existence of tax returns, removing an underpinning of the criminal conviction? The taxpayer had added the phrase "without prejudice" near his signature on the return.[20] The Fifth Circuit did not find the jurat impaired and thus upheld the validity of the tax return and the conviction, despite the additional inserted phrase.[21]

An individual's tax return, Form 1040, contains a jurat that states, in part: "[U]nder the penalties of perjury, I declare that I [the taxpayer] have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete."[22] This is an important provision for the self-assessment system used in this country. By signing a tax return, the taxpayer attests to the accuracy of the

---

begun . . . within ten years after the assessment of the tax . . . ." *Id.* at 993 n.2 (quoting I.R.C. § 6502(a)(1) (2006)).

16. *Id.* at 992-93; *see also* United States v. Summerlin, 310 U.S. 414, 416 (1940) (holding that the United States is not bound by statute of limitations for fraudulent conveyance actions).

17. *See* United States v. Fernon, 640 F.2d 609, 611-12 (5th Cir. 1981) ("'[I]t is well settled that the United States is not bound by state statutes of limitation or subject to the defense of laches in enforcing its rights. . . . The same rule applies whether the United States brings its suit in its own courts or in a state court.'") (quoting *Summerlin*, 310 U.S. at 416). Rather, the United States is subject to the statute of limitations found in I.R.C. § 6502(a)(1). *See id.* at 611-12 & n.7 (interpreting a prior version of I.R.C. § 6502, which set a six-year, rather than a ten-year, statute of limitations).

18. *See* United States v. Spence 242 F.3d 392 (10th Cir. 2000), *cert. denied*, 149 L. Ed. 2d 759 (2001); Bresson v. Comm'r, 213 F.3d 1173 (9th Cir. 2000); United States v. Sherlock, 134 F.3d 369 (5th Cir. 1997); United States v. Isaac, 968 F.2d 1216 (6th Cir. 1992); United States v. Wurdemann, 663 F.2d 50 (8th Cir. 1981); *see generally* WILLIAM D. ELLIOTT, FEDERAL TAX COLLECTION, LIENS & LEVIES Ch. 18 (Warren, Gorham & Lamont 2d ed. 2010) (discussing relevant cases from other circuits).

19. United States v. Davis, 603 F.3d 303, 305 (5th Cir. Apr. 2010). The taxpayer testified that the preparer suggested the addition of the "without prejudice" language when signing the return, telling the taxpayer that use of this language was "good practice." *Id.* at 307.

20. *Id.* at 305.

21. *Id.* at 307.

22. *Id.* at 306.

reported data, which enables the Service to "assess the substantial correctness of [the taxpayer's] self-assessment."[23]

The pertinent precedent for this case was found in those situations involving fraudulent tax returns when a taxpayer deleted portions of the jurat or failed to sign the return.[24] The court found tax returns invalid in those situations.[25] In the present case, the taxpayer added the phrase "without prejudice" to the jurat and was trying to come within the earlier precedent.[26]

In *Todd v. United States*, a tax return was considered complete even though the taxpayer added the phrase "signed involuntarily under penalty of statutory punishment" under the jurat.[27] In contrast, a tax return was invalidated when the taxpayer attached a specific disclaimer of liability.[28] The taxpayer's disclaimer "den[ied] that [he] [was] liable or made liable for any 1040 income tax for the above stated year" and "disclaim[ed] liability for any tax shown on the form."[29] The specific disclaimer of liability has been cited as a distinct fact in later cases.[30]

Tax protestors who have added protest language to their tax return have been found nevertheless to have filed valid tax returns. For example, the addition of the phrase "under protest" to a Form 1040, without more, has not been held to significantly alter the jurat; courts have characterized the additional wording as an exercise of the taxpayer's First Amendment rights.[31]

The court adopted the rule that the Service "should be entitled to construe alterations of the jurat against the taxpayer, at least when there is any doubt."[32] The logical outcome, therefore, was for the Fifth Circuit to find that the added phrase did not disturb the validity of the filed tax return, which it did so hold.[33]

23. Mosher v. I.R.S., 775 F.2d 1292, 1294 (5th Cir. 1985) (per curiam); *see* Borgeson v. United States, 757 F.2d 1071, 1072-73 (10th Cir. 1985) (per curiam); *see also* Buck v. United States, 967 F.2d 1060, 1061 (5th Cir. 1992) (per curiam) (explaining that failure to sign a Form 1040 precludes the I.R.S. from assessing the form for substantial correctness).

24. *See Buck*, 967 F.2d at 1060-61; Ledbetter v. Comm'r, 837 F.2d 708, 709-10 (5th Cir. 1988) (deletion of the phrase "under penalty of perjury" invalidated the tax return); United States v. Moore, 627 F.2d 830, 834 (7th Cir. 1980) (obliteration of the jurat invalidated the return).

25. *See Buck*, 967 F.2d at 1062; *Ledbetter*, 837 F.2d at 710.

26. *Davis*, 603 F.3d at 305.

27. Todd v. United States, 849 F.2d 365, 367 (9th Cir. 1988).

28. Sloan v. Comm'r, 53 F.3d 799, 800 (7th Cir. 1995).

29. *Id.*

30. *Id.*

31. *See* McCormick v. Peterson, No. CV93-2157, 1993 WL 566334, at *1 (E.D.N.Y. Dec. 1, 1993).

32. United States v. Davis, 603 F.3d 303, 307 (5th Cir. Apr. 2010); *Sloan*, 53 F.3d at 800.

33. *Davis*, 603 F.3d at 307.

IV. *DUFFIE V. UNITED STATES*

The Fifth Circuit decision in *Duffie v. United States* arose out of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) unified partnership examination procedures.[34] The case involved AMCOR-type tax shelters.[35] The Fifth Circuit adopted the lower court's opinion as its own—an unusual step—and affirmed the district court.[36] The *Duffie* case involved the following issues: (1) whether the district court had jurisdiction over suits brought by partners to recover penalty interest under former § 6621(c), and (2) whether the shortened statute of limitations for a refund claim of § 6230(c)(1)(A)(i) applies for a refund claim for § 6621(c) penalty interest.[37]

The penalty interest provision of § 6621(c), at issue in *Duffie*, is applicable to interest accruing after 1984 on underpayments relating to returns due prior to 1990 and imposes an increased rate of interest (120% of the normal rate) on substantial underpayments of tax (greater than $1,000) attributable to tax-motivated transactions.[38] Among the statutorily-defined tax-motivated transactions were, (iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period, and (v) any sham or fraudulent transaction.[39] Thus, one of the issues in *Duffie* was an interest provision that was repealed in 1990.[40]

The statutory scheme involved in *Duffie*, the TEFRA, was enacted to "improve the auditing and adjustments of income tax items attributable to partnerships."[41] TEFRA requires partnerships to file informational returns reflecting the distributive shares of income, gains, deductions, and credits

34. Duffie v. United States, 600 F.3d 362, 365 (5th Cir. Mar. 2010). Partnership procedures are codified at 26 U.S.C. §§ 6221-6233 by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (TEFRA) and effective for tax years after September 3, 1982. *See* Maxwell v. Comm'r, 87 T.C. 783 (1986).

35. *Duffie*, 600 F.3d at 367-68.

36. *See generally id.* at 364 (affirming the lower court's decision). Perhaps the complexity or arcaneness of TEFRA partnership law is so great that the Fifth Circuit just did not have it in them to write their own opinion. After considering *Duffie*, the Fifth Circuit might not be wrong.

37. *Id.* at 371-73.

38. I.R.C. § 6621(c)(1)-(2) (2006); *see* Tax Reform Act of 1984, Pub. L. No. 98-369, § 144, 98 Stat. 494, 682 (enacting legislation); Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721(b), 103 Stat. 2106, 2399 (repealing legislation); *see also* Copeland v. Comm'r, 290 F.3d 326, 330 n.10 (5th Cir. 2002) (noting that the provision was enacted as I.R.C. § 6621(d) and redesignated as I.R.C. § 6621(c) in 1986).

39. I.R.C. § 6621(c)(3)(A)(iv)-(v).

40. *See Duffie*, 600 F.3d at 380 n.20.

41. I.R.C. §§ 6221-6233 (2006 & Supp. III 2009); Alexander v. United States, 44 F.3d 328, 330 (5th Cir. 1995).

attributable to its partners.[42] Accordingly, the individual partners are responsible for reporting their pro rata share of tax on their income tax returns.[43]

TEFRA requires the treatment of all partnership items to be determined at the partnership level.[44] While TEFRA defines a "partnership item" in technical terms, the provision generally encompasses items "more appropriately determined at the partnership level than at the partner level."[45] All other items are defined as non-partnership items.[46]

If the Service decides to adjust any partnership items reflected on the partnership's return, it must notify the individual partners of the adjustment through a Notice of a Final Partnership Administrative Adjustment (FPAA).[47] The Service has three years from the later of (1) the date a partnership return is due, or (2) the date the partnership return is filed, to issue an FPAA.[48] The three-year period may be extended by agreement (1) between the Secretary and the partnership's tax matters partner (TMP) (which binds all partners), or (2) between the Secretary and an individual partner (which binds only that partner).[49] In addition, if the Service mails an FPAA to the TMP, the three-year period is tolled.[50] This three-year limitations period was at issue in *Duffie*.[51]

For ninety days following issuance of an FPAA, the TMP has the exclusive right to file a petition for readjustment of the partnership items in tax court, the Court of Federal Claims, or a United States district court.[52] After expiration of the ninety-day period, other partners are given sixty days to file a petition for readjustment.[53] If a partner's tax liability might be affected by the outcome of the litigation of partnership items, that partner may participate in the proceeding.[54] The Service may assess additional tax liability against individual partners within one year of the conclusion of the partnership's tax determination.[55] The partner may contest the tax liability by paying the assessment and filing a refund action in a United States district court; however, "[n]o action may be brought [in district court] for a refund attributable to partnership items."[56]

---

42. Kaplan v. United States, 133 F.3d 469, 471 (7th Cir. 1998).
43. *Duffie*, 600 F.3d at 365.
44. § 6221.
45. § 6231(a)(3).
46. § 6231(a)(4).
47. *Kaplan*, 133 F.3d at 471.
48. I.R.C. § 6229(a).
49. *Id.* § 6229(b)(1).
50. *Id.* § 6229(d).
51. *See* Duffie v. United States, 600 F.3d 362, 385 (5th Cir. Mar. 2010).
52. I.R.C. § 6226(a).
53. *Id.* § 6226(b)(1).
54. *Id.* § 6224(a), (c).
55. § 6229(d).
56. *Id.* § 7422(h).

But, if a partner settles his partnership tax liability with the Service, the partner will no longer be able to participate in the partnership-level litigation and will be bound instead by the terms of the settlement agreement.[57] In addition, partnership items convert to non-partnership items when the Service enters into a settlement agreement with the partner with respect to such items.[58] Thus, if a partner files an action for a refund attributable to partnership items, but those items have been converted through a settlement agreement, the jurisdictional bar of § 7422(h) no longer applies.[59]

In the early 1980s, the taxpayers, all high-income professionals, invested in limited partnerships organized by American Agri-Corp (AMCOR).[60] AMCOR organized and managed over 200 limited partnerships to contract with farmers to grow and sell crops and to then buy land on which it would itself grow crops and later sell the land for profit.[61] Each limited partner had a first-year, farming-related tax loss averaging roughly twice his investment.[62] An investor's loss in excess of his cash invested would be recaptured and taxed in later years after the first-year crops were sold.[63] The partnership's first-year crop costs were paid by the partners' capital contributions and loans from the farmers.[64]

In 1984, appellant John Duffie contributed $22,500 to Texas Farm Venturers (TFV), a registered tax-shelter partnership organized and promoted by AMCOR, in exchange for a 0.5966% limited partnership interest in TFV.[65] On its 1984 Form 1065, U.S. Partnership Return of Income, TFV reported an ordinary, i.e., noncapital, loss of $9,698,031, comprised primarily of a reported "net farm loss" of $9,515,989 ($9,515,989 of "farm deductions" against $0 of "farm income").[66] Duffie reported his pro rata share of the overall loss ($57,859) on taxpayers' 1984 joint tax return.[67]

In 1990 and 1991, the Service sent the partnership a Notice of FPAA that disallowed farming expenses and other deductions for a number of reasons, including that the partnership's transactions were "shams" and "lacked economic substance."[68] Partners filed partnership-level tax court suits contesting the proposed adjustments.[69] Duffie was a party to the

57. *Id.* §§ 6228(a)(4), 6224(c)(1).
58. *Id.* § 6231(b)(1)(C).
59. Alexander v. United States, 44 F.3d 328, 331 (5th Cir. 1995).
60. Duffie v. United States, 600 F.3d 362, 365-67 (5th Cir. Mar. 2010).
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*
65. *See id.* at 367-68.
66. *Id.* at 368.
67. *Id.*
68. *Id.*
69. *Id.*

partnership suit.[70] By 2001, the Tax Matters Partners (acting for the partnership) had intervened in the suits and reached a settlement with the Service in the various cases.[71] The agreed settlements were reached pursuant to a Motion for Entry of Decisions pursuant to Tax Court Rule 248(b).[72] The critical language in the agreed decision was as follows:

> [T]hat the [1984] adjustments to partnership income and expense . . . are attributable to transactions which lacked economic substance, as described in former I.R.C. § 6621(c)(3)(A)(v), so as to result in a substantial distortion of income and expense, as described in I.R.C. § 6621(c)(3)(A)(iv), when computed under the partnership's cash receipts and disbursements method of accounting[; and that liabilities in the amount of $5,802,914 lack economic substance].[73]

The phrase "lack economic substance" gave rise to one of the issues in the case.[74] The penalty interest statute used the word "sham," not the phrase "lack of economic substance."[75] The taxpayers argued that the tax court's characterization (per the agreed decision) of TFV's transactions as "lack[ing] economic substance, as described in former I.R.C. § 6621(c)(3)(A)(v)" did not equate to a finding that those transactions were shams.[76]

The Service later assessed tax including interest, computed at the higher § 6621(c) penalty rate.[77] The Duffies' tax liability resulted from a partnership-level tax court settlement reflected in an agreed decision.[78] The taxpayers paid the assessment and filed a claim for refund on the ground that the tax court decision finding a "lack of economic substance" did not support a § 6621(c) penalty interest rate, which required a "sham" finding.[79] The Service denied the Duffies' claim for refund, and the taxpayers filed suit in district court.[80]

70. *Id.*
71. *Id.* at 368-69.
72. *Id.* at 368.
73. *Id.* at 373.
74. *See id.*
75. *See id.* at 374.
76. *Id.* at 373.
77. *Id.* at 364.
78. *Id.* at 365. In *Weiner v. United States*, 389 F.3d 152 (5th Cir. 2004), a case involving AMCOR partners who had entered into individual settlement agreements with the Service, the Fifth Circuit held that, when settlement agreements entered into by the Service with individual AMCOR partners did not specify the ground or grounds for the partial disallowance of partnership deductions reflected in the agreements, and the underlying FPAAs listed multiple grounds for disallowance—some "tax-motivated" and some not—no § 6621(c) interest could be imposed, as it was impossible for the Court to determine whether the disallowance (and each resulting partner underpayment) was attributable to a tax-motivated ground. *See Weiner*, 389 F.3d at 159-63. Duffie involves similar arguments, but arising from an agreed judgment in the tax court, not an individual settlement agreement. *Duffie*, 600 F.3d at 365.
79. *Duffie*, 600 F.3d at 365-69.
80. *Id.* at 364-65.

The district court granted the government's motion for summary judgment and held that transactions lacking economic substance are per se "sham transactions" for purposes of imposing § 6621(c) and that characterization of a partnership's transactions is a partnership item that cannot be re-litigated in a partner-level refund suit.[81] As a consequence, the court determined that (1) res judicata barred the taxpayers from challenging whether the adjustments were attributable to sham transactions, (2) § 7422(h) barred jurisdiction because the § 6621(c) claims were "attributable to partnership items," and (3) § 6621(c) claims are "computational adjustments" and, therefore, untimely under § 6230(c)(2)(A) (providing a shortened limitations period for a refund claim).[82]

A principal argument in the case was that the wording of the agreed tax court decision in the TFV case did not establish the partnership-level determination necessary to support the imposition of § 6621(c) interest against them, that is, that TFV engaged in a sham transaction.[83] The issue before the Fifth Circuit was, therefore, whether the agreed judgment in the tax court foreclosed imposition of penalty interest under § 6621.[84] The Service argued res judicata barred the taxpayer's assertion that the tax court agreed decision in the TFV case did not establish the partnership-level determination necessary to impose § 6621(c) penalty interest.[85]

The government presented a defense based on a variation of res judicata called claim preclusion, which traditionally applies where four conditions are present: (1) the parties in the subsequent action are identical to, or in privity with, the parties in the prior action; (2) the judgment in the prior action was rendered by a court of competent jurisdiction; (3) the prior action concluded with a final judgment on the merits; and (4) the same claim or cause of action is involved in both suits.[86]

The district court held all four requirements of claim preclusion were present in the case: (1) there was an identity of parties between the TFV case and the refund case; (2) the agreed decision in the TFV case was entered by a court of competent jurisdiction (the tax court); (3) the agreed decision was a final judgment on the merits; and (4) the same claim or cause of action is involved in the TFV case and in the *Duffie* refund case.[87]

---

81. *Id.* at 365-67.
82. *Id.* at 386-87.
83. *See id.* at 365-88.
84. *See id.* at 364.
85. *Id.* at 379-80.
86. *Id.* (citing United States v. Shanbaum, 10 F.3d 305, 310 (5th Cir. 1994)) (In *Shanbaum*, the Fifth Circuit stated that "[t]he doctrine of res judicata, read in the broad sense of the term, embraces two distinct preclusion concepts: claim preclusion (often termed 'res judicata') and issue preclusion (often referred to as 'collateral estoppel.'")).
87. *Id.* at 372-83.

In a TEFRA partnership proceeding, adjustments to partnership items are adjudicated in a single, partnership-wide judicial proceeding, rather than in separate proceedings with respect to each partner.[88] All partners are treated as parties to, and are entitled to participate in, the unified judicial proceeding, the results of which are then applied to each partner.[89] Although partners may, in certain circumstances, challenge the application of those results to their individual returns, they may not seek to re-determine the underlying partnership items.[90] Thus, TEFRA partnership proceedings introduce a variation on common law res judicata situations. Individual partners are bound by the determinations made in the partnership-level proceedings, at least to the extent of matters decided in partnership-level proceedings, and will not be allowed to re-litigate those determinations. Duffie claimed that the agreed tax court decision, setting the partnership-level tax court proceeding, was not res judicata as to him.[91]

The district court held that the intent of the parties in the tax court case, in which the agreed decision was entered, was to conclude a partnership-level proceeding.[92] The settlement resolved the question of whether the Service could apply § 6621(c) penalty interest.[93] Accordingly, the Fifth Circuit held that res judicata (or claim preclusion, more precisely) prevented the court from having jurisdiction to review the interest assessment attributable to a partnership item because the tax court, in the agreed decision, had already found the item to be a sham transaction.[94]

The taxpayers in *Duffie* secondarily argued that the district court had jurisdiction to hear their refund claim for penalty interest under § 6621, despite the bar present in § 7422(h).[95] The Duffies argued that penalty interest is not an issue that can be resolved in a partnership-level proceeding (called an "affected item").[96]

Generally, § 7422 bars suits against the government, but subsection (h) provides two exceptions relevant to the instant case:

---

88. *See* I.R.C. § 6226 (2006); *see also* Staff of the Joint Comm. on Taxation, 97th Cong., General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, at 268 (Comm. Print 1982) (referencing the "[d]uplication of . . . judicial effort" under the prior, partner-by-partner approach).

89. § 6226(c).

90. *See id.* §§ 6230(a)(2)(A)(i), (c)(1), (c)(4); Blonien v. Comm'r, 118 T.C. 541, 551-52 (2002) (holding that the tax courts lack jurisdiction to consider partnership items in a partner-level deficiency proceeding); *see also* I.R.C. § 7422(h).

91. *Duffie*, 600 F.3d at 372.

92. *Id.* at 372-82.

93. *Id.*

94. *Id.* at 386. The district court also concluded that the refund claim was out of time, and therefore, the court did not have jurisdiction in the case. *Id.*

95. *Id.* at 382-85.

96. *Id.*

1. "No action may be brought for a refund attributable to partnership items (as defined in [§] 6231(a)(3)) except as provided in [§] 6228(b) or [§] 6230(c)."[97]

2. "No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously assessed or collected . . . until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard . . . ."[98]

The district court held that it lacked subject-matter jurisdiction due to the bar of § 7422(h).[99] The Fifth Circuit affirmed.[100]

The *Duffie* decision concerns a second issue: whether interest is a partnership item or an affected item.[101] Under TEFRA, the uniformity of adjustments and the scope of administrative and judicial review is limited to the determination of partnership items.[102] Section 6231(a)(3) defines a partnership item as:

> [A]ny 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, for purposes of this subtitle [subtitle F], such item is more appropriately determined at the partnership level than at the partner level.[103]

This is a strict definition; "partnership items" are items (i) included under subtitle A, and (ii) designated by regulation as being more appropriately determined at the partnership-level.[104] Subtitle A, §§ 1-1563 of the Revenue Code, address how income, deductions, credits, etc., should be calculated and reported on tax returns.[105] By regulation, items "more appropriately determined at the partnership level" include the gains, losses, deductions, and credits of a partnership.[106] If something is not a partnership item, then it is a non-partnership item.[107]

The Duffies argued that interest arises under subtitle F—not subtitle A—and is not of the same nature as income, deductions, credits, etc;

97. I.R.C. § 7422(h) (2006).
98. *Id.* § 7422(a).
99. *Duffie*, 600 F.3d at 383-86.
100. *Id.*
101. *Id.*
102. I.R.C. § 6221 (2006).
103. *Id.* § 6231(a)(3).
104. *Id.*
105. I.R.C. §§ 1-1563 (2006 & Supp. III 2009).
106. Treas. Reg. § 301.6231(a)(3)-1.
107. I.R.C. § 6231(a)(4) (2006).

interest has not been designated a partnership item by regulation.[108] Also, there was some precedent to support the taxpayers.[109] The Second Circuit in *Field* previously held that § 6621(c) interest is not a partnership item.[110]

The timeliness of the refund claim was at issue.[111] Taxpayers filed their refund claims with the Service on August 11, 2004, which is more than six months after when the Service mailed the notice of computational adjustment (July 19, 2002) and more than two years after the date on which the decision entered in the TFV tax court case became final (October 17, 1991).[112]

A jurisdictional prerequisite of filing an administrative refund claim "according to the provisions of law in that regard" is that a taxpayer must file that claim within the applicable statute of limitations.[113] The normal time limit for refund claims is the later of three years after the filing date of the applicable return or two years after payment of the tax.[114]

For claims described in § 6230(c)(1), special rules apply. Section 6230 concerns claims that, although attributable to partnership items, are otherwise permissible because they fall under the § 6230(c) exception to the § 7422(h) bar.[115] In the case of claims described in § 6230(c)(1)(A) (computational claims) or § 6230(c)(1)(C) (claims relating to penalties), the claim must be filed within six months after the date the Service mails the notice of computational adjustment applying the results of the partnership proceeding to the partner's return.[116]

The district court held that it did not have jurisdiction to consider any arguments concerning § 6621(c) interest because taxpayers failed to file a timely administrative refund claim.[117] The Fifth Circuit agreed.[118]

The limitations period at issue in *Duffie* was the six-month limitations period of § 6230(c)(2)(A), which applies only to claims based on erroneous computations of "computational adjustments," defined as "the change in the tax liability of a partner which properly reflects the treatment under this subchapter [C of Chapter 63] of a partnership item."[119] The taxpayers argued that § 6621(c) interest should not have been asserted at all, not that the Service made an erroneous computation.[120] A determination that an underpayment of tax is attributable to a tax-motivated transaction does not

108. Duffie v. United States, 600 F.3d 362, 375 (5th Cir. Mar. 2010).
109. *Id.*
110. Field v. United States, 328 F.2d 58, 59-60 (2d Cir. 2003).
111. *Duffie*, 600 F.3d at 382-86.
112. *Id.*
113. I.R.C. § 7422(a) (2006).
114. *Id.* § 6511(a).
115. *Id.* § 6230.
116. § 6230(c)(2)(A).
117. *Duffie*, 600 F.3d at 382-87.
118. *Id.*
119. I.R.C. §§ 6230(c)(1)(A), 6231(a)(6).
120. *Duffie*, 600 F.3d at 382-86.

seem to be a computation item, but a substantive determination. To this end, the Fifth Circuit decision in *Duffie* seems lacking.

The Fifth Circuit obviously did not accept the taxpayers' argument that interest, and even § 6621(c) penalty interest, is not a partnership item and therefore within the court's jurisdiction. But the technical argument on why interest is not a partnership item seems sound.

The taxpayers in the case have been involved in the tax system for twenty-five years.[121] They started off by investing in a tax shelter—and an aggressive one at that.[122] Time changes and the permissive tolerance of tax-shelter investing back in the 1980s is now viewed critically. The hind-sight that is now available inevitably colors the lens through which judges view the legal arguments presented by long-running litigants and make the taxpayers appear on the order of tax protestors. The arguments made by the Duffies before the Fifth Circuit appear grounded on relevant statutory law.[123] Nevertheless, the Fifth Circuit rejected all of their claims.[124]

V. CONCLUSION

The Fifth Circuit inventory of federal tax cases for this review period is small, and all of the cases were government victories. Perhaps a way of looking at these cases is that they represent a marker of the outer boundary—the taxpayers presented arguments that the court rejected. Future taxpayers at least now know how far they should not go.

121. *Id.* at 367-70.
122. *See id.*
123. *See id.* at 382-86.
124. *Id.*