FEDERAL TAXATION

William D. Elliott[*]

I. INTRODUCTION

During the reporting period of July 1, 2012, to June 30, 2013, the Fifth Circuit decided several dozen cases concerning federal tax issues, but only four tax cases were selected on which to report.[1] These four cases, discussed below, stand out from the other cases decided by the court. The case of *Woods v. United States* is discussed because the case is now before the Supreme Court.[2]

One should take note of several cases not selected for discussion that warrant brief acknowledgment. *United States v. Renda*[3] slightly expanded the meaning of "claim" under the federal priority statute of 31 U.S.C. § 3713 to include the decision of a contracting officer under the Contract Disputes Act of 1978.[4] This broader interpretation of a claim is of interest to tax lawyers because tax claims are often brought under the priority statute.[5]

In *United States v. Coney*, the Fifth Circuit decided for the first time that the plain language of the "willfully attempted" exception of 11 U.S.C. § 523(a)(1)(C) "contains a conduct requirement (that the debtor 'attempted in any manner to evade or defeat [a] tax'), and a mental state requirement (that the

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* Attorney, Elliott, Thomason & Gibson, LLP, Dallas, Texas. Southern Methodist University School of Law (J.D. 1973); New York University School of Law (LL.M. in Taxation, May 1974). Fellow, American College of Tax Counsel. Thanks to Thomas E. Redding and Sallie W. Gladney of Houston for guidance on the issues in *Rigas v. United States*, 486 F. App'x 491 (5th Cir. Aug. 2012) (per curiam), discussed *infra* Part V. Mr. Redding and Ms. Gladney are noted experts on the Tax Equity and Fiscal Responsibility Act partnership proceedings.

1. *See generally* U.S. COURT OF APPEALS, FIFTH CIRCUIT, JUDICIAL WORKLOAD STATISTICS: CLERK'S ANNUAL REPORT JULY 2012 – JUNE 2013, *available at* http://www.ca5.uscourts.gov/clerk/docs/arstats.pdf (last visited Feb. 7, 2014) (outlining the Fifth Circuit's case load for the months between July 2012 and June 2013).
2. *See* Woods v. United States, 471 F. App'x 320 (5th Cir. June 2012) (per curiam), *rev'd*, 134 S. Ct. 557 (2013), *and rev'd and remanded by* 2014 WL 68879 (5th Cir. Jan. 9, 2014).
3. United States v. Renda, 709 F.3d 472, 476 (5th Cir. Feb. 2013).
4. *See* 31 U.S.C. § 7101 (2006).
5. *See, e.g.*, *Renda*, 709 F.3d at 476.

attempt was done 'willfully')."[6] The Fifth Circuit is now in line with other circuits on this point.[7]

II. *KELLER V. UNITED STATES*

Keller v. United States has been widely noted among estate planners because of the taxpayer victory under circumstances that suggested the case could have gone the other way.[8] The Fifth Circuit affirmed the district court decision allowing a family limited partnership (FLP) to be treated as having existed at the time of the decedent's death despite a failure to have funded the partnership before death.[9] Also, the court upheld the estate tax deduction of accrued interest on a form of Graegin loan from the FLP.[10]

The Texas decedent left a substantial estate and incomplete estate planning documents.[11] She was the trustee of trusts created upon the earlier death of her husband.[12] She decided to form an FLP with the trusts as limited partners.[13] The general partner, as is often the case, was a limited liability company (LLC).[14]

During the planning phase, the decedent's health began to decline.[15] In her hospital room, the decedent signed the partnership agreements and related LLC general partner documents, but the funding process remained incomplete until after her death.[16] Schedule A of the partnership agreement, detailing the funding for the partnership, was left blank.[17] Her executors funded the FLP according to the agreed-upon estate plan.[18]

Initially, the estate took the position that the FLP remained incomplete upon the decedent's death and paid the estate taxes without any valuation discounting.[19] Later, the estate had second thoughts and funded the partnership, then had the estate borrow sizeable funds from the FLP with which to pay estate taxes and other obligations.[20]

The estate filed a claim for a refund because it viewed the FLP as having been formed and funded as of death and, thus, valuation of FLP assets would

6. United States v. Coney, 689 F.3d 365, 371 (5th Cir. July 2012) (alteration in original) (quoting United States v. Fretz (*In re* Fretz), 244 F.3d 1323, 1327 (11th Cir. 2001)) (internal quotation marks omitted).
7. *See Fretz*, 244 F.3d at 1326–27 (quoting Grogan v. Garner, 498 U.S. 279, 286–87 (1991)); *see also* Bruner v. United States (*In re* Bruner), 55 F.3d 195, 197 (5th Cir. 1995).
8. *See* Keller v. United States, 697 F.3d 238, 239–40 (5th Cir. Sept. 2012).
9. *Id.* at 248.
10. *Id.*
11. *Id.* at 239.
12. *Id.* at 240.
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.* at 240–41.
17. *Id.*
18. *Id.* at 241.
19. *Id.*
20. *Id.*

take advantage of available valuation discounts arising from the FLP.[21] Also, the estate could take the accrual of interest on the loan from the FLP as a deduction for estate tax purposes.[22] In the subsequent refund lawsuit, the district court upheld the estate's argument that the decedent intended to transfer assets to the FLP—a transfer that should have been treated as having occurred for tax purposes.[23]

The Fifth Circuit affirmed the district court in holding that the decedent, by signing the formation documents, had incurred a binding obligation to fund the partnership, fund the LLC, and sell the LLC interests to her children.[24] The Fifth Circuit relied upon controlling Texas case law that held that whether newly acquired property belonged to a partner or a partnership depended upon the partners' intent.[25] This precedent concerned property acquired or used by an already-formed partnership, but the court extended the principle of the *Logan v. Logan* progeny to include the newly formed partnership in the instant case.[26] Therefore, at death, the decedent owned a limited partnership interest, rather than the assets, thus entitling the estate to valuation discounts.[27]

The court also upheld the deduction of the accrued interest from the FLP.[28] This loan and the resulting deduction for accrued interest resembled a "Graegin loan" based on controlling Tax Court precedent that allowed interest deductions for loans incurred to prevent financial loss to an estate resulting from forced sales of property to pay estate taxes.[29] The key fact in Graegin loans is that an estate takes out loans in lieu of liquidating estate assets.[30] These facts were found in *Keller*, and thus, the Fifth Circuit affirmed the holding of the lower court, allowing the interest deduction.[31]

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21. *Id.*

22. *Id.*

23. *Id.* at 248.

24. *Id.*

25. Logan v. Logan, 156 S.W.2d 507, 511–12 (Tex. 1941); *accord* Siller v. LLP Mortg., Ltd., 264 S.W.3d 324, 329 (Tex. App.—San Antonio 2008, no pet.); Foust v. Old Am. Cnty. Mut. Fire Ins. Co., 977 S.W.2d 783, 786 (Tex. App.—Fort Worth 1988, no writ).

26. *Keller*, 697 F.3d at 248.

27. *Id.*

28. *Id.*

29. Estate of Graegin v. Comm'r, 56 T.C.M. (CCH) 387 (1988).

30. *E.g.*, Estate of Bahr v. Comm'r, 68 T.C. 74 (1977) (approving an interest deduction on a loan taken in lieu of selling "essentially non-income-producing land" at "substantial financial loss" after the estate promptly sold all liquid assets); Estate of Todd v. Comm'r, 57 T.C. 288 (1971) (approving an interest deduction on a loan taken to avoid "estate liquidat[ion] [of] some of its nonliquid assets . . . at reduced prices"); *see also* McKee v. Comm'r, 72 T.C.M. (CCH) 324 (1996) (securing approval of a loan in lieu of the sale of stock in light of the loan's origination allowed company to "tak[e] advantage of the increasing value of the stock").

31. *Keller*, 697 F.3d at 248.

III. *UNITED STATES V. IRBY*

United States v. Irby is a modest case, but contains a point of first impression.[32] The taxpayer was convicted of multiple counts of tax evasion under three major tax criminal statutes: (1) attempting to evade or defeat a tax in violation of § 7201;[33] (2) willful failure to file a tax return in violation of § 7203;[34] and (3) attempting to interfere with the administration of internal revenue laws in violation of § 7212(a).[35]

The trial evidence showed that the taxpayer failed to pay taxes from 1998–2001.[36] In 2006, the taxpayer engaged in affirmative actions of concealment of assets by using nominee trusts to conceal assets.[37] The indictment for criminal tax evasion occurred in 2011, within five years of the affirmative actions of concealment.[38]

The general rule for the statute of limitations for tax crimes is three years.[39] Section 6531 contains exceptions to the general rule and extends the limitations period for these exceptions to six years.[40] The relevant statutory

32. *See* United States v. Irby, 703 F.3d 280, 282 (5th Cir. Dec. 2012) (per curiam), *cert. denied*, 133 S. Ct. 2810 (2013). The defendant in the case represented pro se. *Id.*

33. 26 U.S.C. § 7201 (2006) (entitled "Attempt to evade or defeat tax").

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

Id.

34. 26 U.S.C. § 7203 (2006) (entitled "Willful failure to file return, supply information, or pay tax").

> Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $25,000 . . . or imprisoned not more than 1 year, or both, together with the costs of prosecution.

Id.

35. 26 U.S.C. § 7212 (2006) (entitled "Corrupt or forcible interference").

> Whoever corruptly or by force or threats of force (including any threatening letter or communication) endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than 3 years, or both, except that if the offense is committed only by threats of force, the person convicted thereof shall be fined not more than $3,000, or imprisoned not more than 1 year, or both. The term "threats of force", as used in this subsection, means threats of bodily harm to the officer or employee of the United States or to a member of his family.

Id.

36. *Irby*, 703 F.3d at 282.

37. *Id.*

38. *See* Brief of Appellee at 27, *Irby*, 703 F.3d 280 (No. 11-60800), 2012 WL 1650272.

39. 26 U.S.C. § 6531 (2006).

40. *Id.*

language provides for the six-year statute of limitations for the crime of tax evasion under § 7201, thus:

> No person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal revenue laws unless the indictment is found or the information instituted within 3 years next after the commission of the offense, except that the period of limitation shall be 6 years . . . (2) for the offense of willfully attempting in any manner to evade or defeat any tax or the payment thereof . . . .[41]

The issue of interest in *Irby* was when the limitations period commences for purposes of tax evasion. The issue of limitations, though, is best understood after considering some basic aspects of the crime of tax evasion.

To prove a § 7201 violation of tax evasion, the government must prove three elements: (1) the existence of a tax deficiency; (2) an affirmative act constituting an evasion or attempted evasion of the tax; and (3) willfulness.[42] The government bears the burden of proving each element beyond a reasonable doubt.[43]

The Supreme Court and Fifth Circuit have long interpreted § 7201 to require a positive attempt to evade or defeat any tax—an affirmative act—rather than mere "passive neglect."[44] Thus, an act to evade a tax must have occurred by commission, rather than by omission.[45] The phrase "affirmative act" has been interpreted broadly to involve the concealment of a taxpayer's ability to pay taxes or remove assets from the reach of the Service.[46] Filing a false tax return is the most common method of attempting to evade the tax assessment, but the Supreme Court made clear in the seminal *Spies v. United States* decision that the element of attempting to evade is satisfied by any affirmative act with a tax-evasion motive.[47] Filing a false W-4 form is an act that represents an attempt to mislead the government by concealing the correct

41. *Id.* § 6531(2).

42. 26 U.S.C. § 7201 (2006); *see also* Sansone v. United States, 380 U.S. 343, 351 (1965) (discussing three elements of tax evasion); United States v. Barrow, 118 F.3d 482, 489 (6th Cir. 1997) (same); United States v. Townsend, 31 F.3d 262, 269 (5th Cir. 1994) (same); United States v. Eaken, 17 F.3d 203, 205–06 (7th Cir. 1994) (same); United States v. Huebner, 48 F.3d 376, 378 (9th Cir. 1994) (per curiam) (same).

43. United States v. Conaway, 11 F.3d 40, 44 (5th Cir. 1993); United States v. Alt, 996 F.2d 827, 828 (6th Cir. 1993); United States v. Marashi, 913 F.2d 724, 735 (9th Cir. 1990); United States v. Williams, 875 F.2d 846, 849 (11th Cir. 1989); *see generally* Keith J. Benes, David Gallai, Louisa J. McGruder & Anne M. Petersen, *Tax Violations*, 35 AM. CRIM. L. REV. 1219, 1229–39 (1998) (discussing violations of 26 U.S.C. § 7201).

44. Spies v. United States, 317 U.S. 492, 499 (1943); *see also* United States v. Doyle, 956 F.2d 73, 74–75 (5th Cir. 1992) (explaining the difference between felony and misdemeanor tax evasion).

45. United States v. Masat, 896 F.2d 88, 97 (5th Cir. 1990) (prohibiting conviction if tax evasion was based on willful omission alone).

46. *See* United States v. Robinson, 974 F.2d 575, 577–78 (5th Cir. 1992) (internal quotation marks omitted) (finding that filing unsigned tax returns constitutes an affirmative act); *see also Townsend*, 31 F.3d at 267 (stating that fraudulently preparing Form 637 with forged signatures fulfills the affirmative act requirement).

47. *Spies*, 317 U.S. at 495.

amount of the taxpayer's income.[48] By maintaining, rather than correcting, the false W-4 form, the taxpayer perpetuates the attempted deception.[49]

Generally, limitations for tax evasion run from the date of the filing of a tax return or, if a tax return is not filed, the date on which the return was due.[50] Circuits other than the Fifth Circuit have found in cases in which no return is filed during the relevant period, the statute of limitations properly began to run on the date the last affirmative act took place or the statutory due date of the return, whichever is later.[51] The Sixth Circuit decision in *United States v. Dandy* involved facts similar to the instant case, in which there was no tax return filed for 1982 and 1983, but the acts of tax evasion occurred in 1985.[52] The *Dandy* court found that the statute of limitations runs from the last evasive act "because it is these evasive acts . . . which form the basis of the crimes alleged in . . . [the] indictment."[53]

The most comparable Fifth Circuit case involving the limitations issue was *United States v. Williams*, in which the Fifth Circuit affirmed the taxpayer's felony conviction for tax evasion on account of the taxpayer's failure to file returns or pay taxes for three years, his submission of a fraudulent Form W-4 to his employer, as well as his continuing failure to correct the false Form W-4.[54]

These constituted affirmative acts sufficient for conviction under § 7201.[55] Moreover, the court determined that even though the act of filing a false W-4 occurred in only one year, the failure to correct the form in subsequent years constituted an act for prosecution purposes.[56]

The statute of limitations issue for tax evasion was also addressed in *Williams* as it related to the filing of the false Form W-4.[57] The taxpayer

48. *Doyle*, 956 F.2d at 74–75.

49. *Id.*; United States v. Williams, 928 F.2d 145, 149 (5th Cir. 1991); *see also* I. COMISKY, L. FELD & S. HARRIS, TAX FRAUD & EVASION ¶ 2.03 (Thompson/RIA 2012).

50. United States v. Habig, 390 U.S. 222, 223 (1968); United States v. Ferris, 807 F.2d 269, 271 (1st Cir. 1986) ("If all that defendant had done was to fail to file his 1977 income tax return, then the last act of evasion would have been April 15, 1978, the date the return and tax were due."); United States v. Crocker, 753 F. Supp. 1209, 1214 (D. Del. 1991); United States v. Sloan, 704 F. Supp. 880, 883 (N.D. Ind. 1989); United States v. Sherman, 426 F. Supp. 85, 89–90 (S.D.N.Y. 1976).

51. *See* United States v. Carlson, 235 F.3d 466, 470 (9th Cir. 2000); United States v. Dandy, 998 F.2d 1344, 1355–56 (6th Cir. 1993) ("To hold that the statute of limitations for income tax evasion . . . began to run on the date the returns were filed would reward defendant for successfully evading discovery of his tax fraud for a period of six years subsequent to the date the returns were filed."); United States v. Payne, 978 F.2d 1177, 1179 (10th Cir. 1992); United States v. Winfield, 960 F.2d 970, 974 (11th Cir. 1992) (per curiam); United States v. DiPetto, 936 F.2d 96, 98 (2d Cir. 1991) (per curiam); United States v. DeTar, 832 F.2d 1110, 1113 (9th Cir. 1987) (holding affirmative acts of placing assets in names of nominees and conducting business in cash within six years prior to the indictment made the indictment timely, even though taxes evaded were due and payable more than six years before the indictment).

52. *Dandy*, 998 F.2d at 1355–56.

53. *Id.* at 1356.

54. *Williams*, 928 F.2d at 146–47; *see also* Marilyn E. Phelan, *Federal Income Taxation*, 23 TEX. TECH L. REV. 307, 333–34 (1992) (mentioning *Williams* briefly).

55. *Williams*, 928 F.2d at 147.

56. *Id.* at 149.

57. *Id.* at 149–50.

contended that because the Form W-4 was filed more than six years prior to the indictment, the prosecution was time-barred.[58] The court followed the cases that held that the statute of limitations for prosecution under § 7201 begins to run on the date that the return is due.[59]

In *Williams*, however, the Fifth Circuit declined to take a position on the last affirmative act of evasion occurring after the due date of the tax return.[60] The court followed the numerous other circuit decisions that have concluded that the statute of limitations for § 7201 offenses runs from the later date of either the tax return's due date or the defendant's last affirmative act of tax evasion.[61]

IV. *WOODS V. UNITED STATES*

The Fifth Circuit decided *Woods v. United States* on June 6, 2012, slightly outside the reporting period of July 1, 2012, to June 30, 2013.[62] This case is briefly mentioned not because the Fifth Circuit decision was noteworthy—it was not—but because of the fact that the Supreme Court accepted certiorari and heard oral arguments on October 9, 2012.[63] The issue in the case was whether the overstatement penalty applied to an underpayment resulting from a determination that a transaction lacked economic substance because the sole purpose of the transaction was to generate a tax loss by artificially inflating the taxpayer's basis in property.[64] Section 6662 prescribes a penalty for an underpayment of federal income tax that is attributable to an overstatement of basis in property.[65]

The circuits appear to conflict. The Fifth Circuit has held that the penalty does not apply to situations in which the Service concludes that a transaction is a sham that lacks economic substance and, therefore, treats it as a nullity in calculating a participant's tax liability, even if the taxpayer has claimed an unjustified tax benefit by artificially inflating the value or basis of property.[66] As three members of the Fifth Circuit have acknowledged, there is nearly unanimous opposition to that position among the other courts of appeals, with only the Ninth Circuit adopting the Fifth Circuit's approach.[67] Nevertheless,

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58. *Id.* at 149.

59. *Id.*

60. *See id.* at 148.

61. *See* cases cited *supra* note 51 and accompanying text.

62. Woods v. United States, 471 F. App'x 320, 320 (5th Cir. June 2012) (per curiam), *rev'd*, 134 S. Ct. 557 (2013), *and rev'd and remanded by* No. 11-50487, 2014 WL 68879 (5th Cir. Jan. 9, 2014).

63. United States v. Woods, 133 S. Ct. 1632, 1632 (2013).

64. Woods v. United States, 794 F. Supp. 2d 714, 716 (W.D. Tex. 2011), *rev'd sub nom*. United States v. Woods, 134 S. Ct. 557 (2013).

65. 26 U.S.C. § 6662(a), (b)(3), (e)(1)(A), (h)(1) (2006).

66. Bemont Invs., L.L.C. *ex rel.* Tax Matter Partner v. United States, 679 F.3d 339, 347–48 (5th Cir. 2012) (Prado, J., concurring), *abrogated by Woods*, 134 S. Ct. 557.

67. *Id.* at 354; *see generally* William D. Elliott, *Federal Taxation*, 45 TEX. TECH L. REV. 811, 823 (2013) (discussing *Bemont Investments*).

the Fifth Circuit has deemed the issue "well settled" and has declined to reconsider its position.[68]

Numerous other circuits have rejected the Fifth Circuit's view and have concluded "when an underpayment stems from deductions that are disallowed due to a lack of economic substance, the deficiency is attributable to an overstatement of value and is subject to the penalty of § [6662]."[69]

V. *RIGAS V. UNITED STATES*

The decision in *Rigas v. United States* is a jurisdictional case for the 2004 tax year that arose out of a tax refund involving the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) partnership-level proceeding rules and that appears to resist easy understanding, unless one is a TEFRA expert.[70] A district court case discussing TEFRA partnership proceedings is relevant to this point:

> But the considerations that identify the applicable limitation reside discretely among the forbidding arcana of partnership taxation, a subject intractably muddled by archaically and chaotically composed—and, therefore, nearly inscrutable—statutes and regulations and by the bold proliferation and proud maintenance of abstruse distinctions and obscure jargon.[71]

The Fifth Circuit's opinion in *Rigas* is an extended and unpublished per curiam decision.[72] A partner brought a refund claim in district court to gain the right to report partnership income as capital gain instead of ordinary income.[73] The partner wanted to report the partnership income on a basis consistent with how other partners reported it.[74] A brief roadmap of the Fifth Circuit's *Rigas* decision is helpful. The points the court decided were:

(1) The amended partnership tax returns did not substantially comply with the regulatory requirements for an administrative adjustment request (AAR) for partnership items and thus prevented the district court from having jurisdiction to hear the refund action.[75]

68. *See, e.g.*, Woods v. United States, 471 F. App'x 320, 320 (5th Cir. June 2012) (per curiam), *rev'd*, 134 S. Ct. 557 (2013), *and rev'd and remanded by* No. 11-50487, 2014 WL 68879 (5th Cir. Jan. 9, 2014).

69. Merino v. Comm'r, 196 F.3d 147, 155 (3d Cir. 1999) (quoting Zfass v. Comm'r, 118 F.3d 184, 190 (4th Cir. 1997)) (internal quotation marks omitted); *e.g.*, Gilman v. Comm'r, 933 F.2d 143, 151 (2d Cir. 1991) (quoting Massengill v. Comm'r, 876 F.2d 616 (8th Cir. 1989)).

70. *See* Rigas v. United States, 486 F. App'x 491, 496 (5th Cir. Aug. 2012) (per curiam). Because *Rigas* is unpublished, it is not precedent. *See id.*

71. United States v. Steinbrenner, 949 F. Supp. 2d 1210, 1212 (M.D. Fla. 2013).

72. *Rigas*, 486 F. App'x at 502.

73. *See id.* at 496.

74. *Id.*

75. *Id.* at 497–500. Before 1982, partners were generally required to file a separate amended return to correct a partnership item. Samueli v. Comm'r, 132 T.C. 336, 340 (2009). TEFRA allows a "tax matter partner" (as defined in 26 U.S.C. § 6231(a)(7) (2006)) to file an AAR on behalf of the entire partnership (partnership AAR). *See* 26 U.S.C. § 6227 (2006). TEFRA also allows each partner to file a partnership AAR

(2) The claim by taxpayers that they were entitled to tax treatment consistent with other partners was an individual, not partnership, item.[76]
(3) Affirming the district court's dismissal of a partner's refund claim, the Fifth Circuit held that the district court lacked jurisdiction over the partnership item.[77]
(4) On the merits, the taxpayers' substantive individual claim was incorrect as a matter of law, and the refund should have been denied.[78]

The case concerned taxation as ordinary income or capital gain of a profits payment. Taxpayers, husband and wife, were one of five limited partners in Odyssey Energy Capital I, LP (Odyssey), which had contracted with Hydrocarbon Capital, LLC to manage and sell Hydrocarbon's portfolio (treating husband and wife as one partner).[79] In this contract, the parties disclaimed a partnership.[80] Odyssey's fee for its services to Hydrocarbon equaled 20% of profits after the return to Hydrocarbon of its expenses, capital, and a preferred return.[81] In 2004, the portfolio was sold and Odyssey was paid $20 million as its performance fee.[82]

Odyssey originally reported the performance fee as ordinary income in 2004.[83] In 2007, Odyssey amended its tax return to reflect the taxation of the performance fee as capital gain.[84] The five individual partners of Odyssey duly amended their individual returns as well.[85] Only one of the individual partners, the Rigas couple, the taxpayer in the instant case, had its refund claim denied.[86] The other four partners had their refunds approved.[87] The Rigas couple, feeling aggrieved, brought the refund action.[88]

The district court decided the case on summary judgment and upheld the Service's position that the performance fee should be taxed as ordinary income.[89] The district court confirmed that its jurisdiction to consider the refund claim was based on TEFRA, and that the taxpayers' amended return was

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solely on behalf of that partner. *See id.* An AAR must be filed in accordance with 26 U.S.C. § 6227 for a partner to change the treatment of a partnership item on the partner's return. *See* Phillips v. Comm'r, 106 T.C. 176, 180–81 (1995).

76. *Rigas*, 486 F. App'x at 501.
77. *Id.* at 502.
78. *Id.*
79. *Id.* at 493–94.
80. *Id.* at 494.
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.* at 495.
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.*

a partner's Administrative Adjustment Request (AAR).[90] Although the taxpayers did not file a Form 8082—a "Notice of Inconsistent Treatment or Administrative Adjustment Request," which is the form normally used to file an AAR—on a timely basis, the district court nevertheless found that the amended tax return substantially complied with the requirements of the regulations for an AAR.[91]

Normally, district court jurisdiction is grounded in 28 U.S.C. § 1346(a), which grants a district court jurisdiction over all civil actions seeking tax refunds from the federal government.[92] In this case, however, jurisdiction was sourced in the special jurisdictional rule of § 7422(h), which briefly states that "[n]o action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)."[93]

Thus, a district court has jurisdiction to consider a refund claim by a partner that is attributable to partnership items, with some exceptions, as provided in § 6228(b) or § 6230(c).[94] The purpose of this special jurisdictional rule of § 7422(h) is to require partnership items to be determined at the partnership—not the partner—level.[95] Stated another way, § 7422(h) cannot bar access to refund jurisdiction if the refund is attributable to either a non-partnership item (as defined in § 6231(a)(4)) or an affected item (as defined in § 6231(a)(5)).[96] If the refund is attributable to a partnership item, then § 7422(h) still cannot bar jurisdiction if the refund ground falls within either the § 6228(b) or § 6230(c) exceptions.[97]

The first exception, § 6228(b), allows a refund suit attributable to partnership items if a partner files an AAR, as provided in § 6227(d).[98] The Service is required to respond by mailing a notice indicating that partnership items will be treated as non-partnership items, or, if the Service fails to allow the AAR, no notice is mailed.[99] The second exception, § 6230(c), concerns refunds arising from erroneous computations and is not pertinent in *Rigas*.[100]

Even for experienced tax lawyers who are generally well-versed in partnership tax matters and specifically in TEFRA matters, the Fifth Circuit opinion in *Rigas* is difficult to absorb. An inquiry into the fabric of the

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90. Rigas v. United States, No. H-09-3770, 2011 WL 1655579, at *7, *11 (S.D. Tex. May 2, 2011).

91. *Id.* at *11. "A request for an administrative adjustment on behalf of a partner shall be filed on the form prescribed by the Internal Revenue Service for that purpose *in accordance with that form's instructions*." Treas. Reg. § 301.6227(d)-1(a) (2013) (emphasis added).

92. 28 U.S.C. § 1346(a) (2006).

93. 26 U.S.C. § 7422(h) (2006).

94. *Rigas*, 2011 WL 1655579, at *7.

95. Rigas v. United States, 486 F. App'x 491, 496 (5th Cir. Aug. 2012) (per curiam).

96. *See* 26 U.S.C. § 6231(a)(3)–(5) (2006) (distinguishing "partnership item[s]" from "nonpartnership item[s]" and "affected item[s]").

97. *Rigas*, 486 F. App'x at 496.

98. 26 U.S.C. § 6228 (2006).

99. *Id.*

100. *See* 26 U.S.C. § 6230(c) (2006).

statutory scheme of TEFRA partnership-level proceedings is challenging to understand.

The first point to be considered about *Rigas* is the substantial compliance issue. The Fifth Circuit reversed the district court on its finding that the amended tax return substantially complied with the AAR requirement.[101] Those requirements are outlined in Regulations § 301.6227(d)-1:

> (a) *In general*. A request for an administrative adjustment on behalf of a partner shall be filed on the form prescribed by the Internal Revenue Service for that purpose in accordance with that form's instructions. Except as otherwise provided in that form's instructions, the request shall—
> (1) Be filed in duplicate, the original copy filed with the partner's amended income tax return . . . and the other copy filed with [as applicable here] the service center where the partnership return is filed . . . ;
> (2) Identify the partner and the partnership by name, address, and taxpayer identification number;
> (3) Specify the partnership taxable year to which the administrative adjustment request applies;
> (4) Relate only to partnership items; and
> (5) Relate only to one partnership and one partnership taxable year.[102]

The Service has prescribed Form 8082 as the form to be used by a partner requesting an administrative adjustment.[103] The instructions require that taxpayers file Form 8082 as an AAR to adjust pass-through items and that taxpayers explain in detail the reasons for any adjustment reported on the form.[104] The instructions require that a partner filing Form 8082 as an AAR file the form in duplicate, the original filed with the partner's amended income tax return and the copy filed with the service center where the pass-through entity return is filed.[105] The face of Form 8082 requires that the partner list on the form the name, address, and identifying number of the pass-through entity to which the form relates and that entity's taxable year.[106]

The substantial compliance doctrine, while viewed as a narrow equitable doctrine, nevertheless enables courts to avoid hardship when a party establishes that it intended to comply with a provision, did everything reasonably possible to comply, but did not because of a failure to meet the provision's specific

101. *Rigas*, 486 F. App'x at 499.
102. Treas. Reg. § 301.6227(d)-1 (2013).
103. See *Instructions for Form 8082 (Rev. December 2011)*, DEP'T OF THE TREASURY: INTERNAL REVENUE SERV., http://www.irs.gov/pub/irs-pdf/i8082.pdf (last visited Feb. 8, 2014).
104. *See id.* at 2.
105. *See id.*
106. *See id.* at 1–3.

requirements.[107] The substantial compliance rule focuses on equitable-type issues of fairness and avoidance of hardship.[108]

The district court found that the Form 8082 was not timely filed and also refused to consider a first amended return.[109] The Odyssey second amended return failed to strictly comply with the § 301.6227(d)-1 regulatory requirement for an AAR in several respects: it was not filed at the Ogden Service Center, where the original Odyssey partnership return was filed, and it pertained to more than one partnership.[110] Also, the narrative explanation in the amended tax return arguably did not explain sufficiently the reasons for the refund.[111] The explanatory language contained in the amended return stated:

> Taxpayers received Amended K-1s from Odyssey Energy Capital I LP and from Odyssey Energy Capital LLC after their original return was filed. This amended return reflects the amended information. All documentation to support the calculations is enclosed. The information includes the amended K-1s and the effected forms and schedules which include Form 1040 pages 1 and 2, Forms 4797, 6251, and 8582 and Schedules D, E and SE.[112]

Despite all of these defects, the district court found that the amended return substantially complied with the regulatory requirements for four specific reasons:

- The amended return conveyed essential information to the Service to enable the Service to realize that Rigas was requesting an adjustment of a partnership item;
- "It provided information about Odyssey, the tax year to be adjusted, and the partnership item to be adjusted";
- "The inclusion of a request for adjustment relating to another partnership was clearly described in the document so that the [Service] would understand that two different partnership K-1s were at issue"; and
- The taxpayer filed the amended return with the requisite intent; the intent was that the amended return adjust a partnership item.[113]

The Fifth Circuit disagreed with the district court and found the amended return insufficient and not in substantial compliance with the AAR

107. *See also* Credit Life Ins. Co. v. United States, 948 F.2d 723, 726–27 (Fed. Cir. 1991) (explaining the benefit to the court of using the substantial compliance doctrine in determining compliance with the AAR requirement); Prussner v. United States, 896 F.2d 218, 224 (7th Cir. 1990) (en banc); *see* Sawyer v. Cnty. of Sonoma, 719 F.2d 1001, 1007–08 (9th Cir. 1983); Fischer Indus., Inc. v. Comm'r, 87 T.C. 116, 122 (1986), *aff'd*, 843 F.2d 224 (6th Cir. 1988); Estate of Chamberlain v. Comm'r, T.C.M. 1999-181, *aff'd*, 9 F. App'x 713 (9th Cir. 2001).

108. *See Credit Life Ins. Co.*, 948 F.2d at 726–27.

109. Rigas v. United States, No. H-09-3770, 2011 WL 1655579, at *8 (S.D. Tex. May 2, 2011).

110. *Id.* at *10–*11.

111. *Id.*

112. *Id.* at *11.

113. *Id.*

requirements.[114] The court reviewed the lower court's decision on a de novo basis.[115] Prior Fifth Circuit cases concerning substantial compliance are mostly based upon special use valuation elections, which the Fifth Circuit distinguished.[116] The Fifth Circuit particularly relied on the Tax Court's decision in *Samueli v. Commissioner*, similarly involving whether an amended tax return was an AAR.[117] The Tax Court held that the amended return failed to substantially comply with the regulatory requirements for an AAR because the amended return was filed in the wrong service center and not in the service center in which the partnership tax return was filed.[118] Further, the amended return did not explain in detail the reasons for the requested adjustments, as required by the regulations.[119] Accordingly, the outcome of *Samueli* was that jurisdiction in the district court could not be based on the § 6228(b) exception for § 7422(h).[120] The Tax Court decision in *Samueli* was not appealed.[121] There are numerous precedents supporting *Samueli* and the proposition that an amended return cannot support an AAR claim.[122] Other cases, to the opposite effect of *Samueli*, treat a taxpayer's amended return as a partner AAR even though no Form 8082 accompanied the amended return.[123]

In *Rigas*, the Fifth Circuit followed *Samueli* and found that the taxpayers' amended tax return failed for the same two reasons as in *Samueli*; therefore, the amended return did not substantially comply with the regulatory requirements for an AAR.[124]

After the Fifth Circuit rejected the taxpayers' substantial compliance argument, it proceeded to the heart of the case.[125] The Rigases sought refunds on two grounds. The first ground was the "settlement theory," which is also known as a "consistent-treatment claim." The taxpayers claimed on their amended refund claim that they were entitled to treatment consistent with other partners who received refunds based on the adjustment theory both before and after the Rigases' original refund claim was disallowed; the jurisdiction

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114. Rigas v. United States, 486 F. App'x 491, 499 (5th Cir. Aug. 2012) (per curiam).

115. *Id.* at 496.

116. *Id.* at 499.

117. Samueli v. Comm'r, 132 T.C. 336, 343 (2009).

118. *Id.*

119. *Id.*

120. *Id.*

121. *See id.* Though there were numerous decisions in a long-running dispute in *Samueli*, the substantial compliance decision was not appealed. *See* Samueli v. Comm'r, 661 F.3d 399 (9th Cir. 2011); Samueli v. Comm'r, 658 F.3d 992 (9th Cir. 2011) (depublished), *amended and superseded on rehearing by Samueli*, 661 F.3d 399.

122. *See* Schell v. United States, 84 Fed. Cl. 159 (2008) (noting that there was no jurisdiction to determine whether the Service failed to make a refund of an overpayment attributable to an application to a partner of a settlement; the settlement did not resolve validity of losses such that they converted to non-partnership items); Rothstein v. United States, 81 A.F.T.R.2d 98-2132 (Fed. Cl. 1998) (noting that there was no jurisdiction to consider a claim made using Form 1040X instead of RAA).

123. *See* Wall v. United States, 133 F.3d 1188, 1190 (9th Cir. 1998).

124. Rigas v. United States, 486 F. App'x 491, 499 (5th Cir. Aug. 2012) (per curiam).

125. *See id.* at 500.

argument was that the settlement theory was not a partnership item, but a claim of an individual partner and the taxpayer was not required to satisfy the jurisdictional requirement of § 7422(h).[126] The second ground was the "adjustment theory." The taxpayers claimed on their original refund claim that their share of a "performance payment" to the partnership, which they and the partnership had originally treated as ordinary income, should instead have been taxed as a capital gain. This would bring them into compliance with the partnership's amended characterization of that payment as shown on the Rigases' amended K-1. The taxpayer's jurisdiction argument under the adjustment theory was that, despite being a partnership item, it came within the exception provided by § 6228(b).[127]

As the Fifth Circuit opinion considers the settlement and adjustment theories, the opinion seems to turn opaque. The impression is left that the court considered both arguments as disjunctive, or alternative, grounds for a claim of consistent treatment.[128] The two arguments seem conjunctive, or two independent grounds of the same theory—but perhaps this criticism of the opinion is theoretical and without any practical consequence. As stated earlier in this discussion, the court rejected the adjustment theory.[129] In the court's words, "Because the Second Amended Rigas Return does not qualify as an AAR filed pursuant to 26 U.S.C. § 6227(d), jurisdiction to hear the Rigases' tax-refund lawsuit cannot be based upon the § 6228(b) exception to § 7422(h)."[130]

The handling of the partnership tax return could have been pursued analytically to determine if the taxpayers complied with § 6222(a), which provides that, "A partner shall, on the partner's return, treat a partnership item in a manner which is consistent with the treatment of such partnership item on the partnership return."[131]

The court's opinion references the fact that the partnership return was "accepted" and "processed," but the opinion does not describe the procedures followed by the Service.[132] The district court concluded that the partnership return and the accompanying Form K-1 provided to the taxpayers informed them of the partnership treatment of the performance fee as capital gain.[133] Whether the taxpayers filed their return consistently with the partnership return and thus complied with § 6222(a) would be a non-partnership item and would not need jurisdiction based on § 6228(b) to avoid the proscription of § 7422(h).[134] The district court could have based its refund jurisdiction on the

126. *See id.*
127. *See id.*
128. *See id.* "The Rigases' consistent-treatment claim is based on two alternative theories." *Id.*
129. *Id.* at 500–02.
130. *Id.* at 500.
131. 26 U.S.C. § 6222(a) (2006).
132. *Rigas*, 486 F. App'x at 495.
133. *Id.*
134. *Id.* at 496.

court's ability to decide whether there had been a prior determination of a partnership item (in the manner in which the Service accepted the amendment to the partnership return) and enforce that partnership-level characterization of the payment as capital gain.[135]

The Fifth Circuit held that the consistency argument depends upon whether the partner in question has been properly offered consistent settlement terms, and thus, the claim is not a partnership item.[136] Not being a partnership item, the court would allow the argument to be raised as an individual claim.[137] Jurisdiction would exist to consider an individual claim.[138] Relying on the analysis of two earlier decisions of other circuits, the court held that § 7422(h) could not bar jurisdiction of the taxpayers' claim based on the settlement theory.[139] On the merits, the Fifth Circuit affirmed the district court's grant of summary judgment to the Service on the settlement theory.[140] The payments of refunds to the other partners were not settlement agreements under § 6224(c).[141]

The taxpayers also argued that the character of income was adjusted in the partnership tax return and in a partnership-level proceeding, and therefore, the taxpayers claimed entitlement to consistent tax treatment with the other partners.[142] The Fifth Circuit refused to find district court jurisdiction for this argument under § 7422(h); the taxpayers' claim that they were entitled to the refund on the same basis of a similar characterization at the partner level for all partners is a claim attributable to a partnership item.[143] The court's conclusion that the claim is a partnership item is grounded on the idea that the tax characterization of the performance fee at the partnership level has the effect of impacting both the partnership and the partners' reporting.[144] Being a partnership item, there was no jurisdiction because the statutory and regulatory requirements essential for jurisdiction were not satisfied.[145] Hence, the claim on the adjustment theory was dismissed for want of jurisdiction.[146]

Ultimately, the *Rigas* decision leaves a sour taste. What the taxpayers sought in their refund claim was consistent treatment with the other partners in the same partnership.[147] All of the other partners, according to the Fifth Circuit, received capital gain treatment on the performance fee, while the taxpayers

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135. *See* Duffie v. United States, 600 F.3d 362 (5th Cir. 2010). The Fifth Circuit in *Rigas* did not cite *Duffie*. *See Rigas*, 486 F. App'x 491.
136. *Rigas*, 486 F. App'x at 501.
137. *Id.*
138. *Id.*
139. *Id.*; Prochorenko v. United States, 243 F.3d 1359, 1361 (Fed. Cir. 2001); Monti v. United States, 223 F.3d 76, 78 (2d Cir. 2000).
140. *Rigas*, 486 F. App'x at 502.
141. *Id.*
142. *Id.* at 500.
143. *Id.* at 501.
144. *Id.*
145. *Id.* at 502.
146. *Id.*
147. *Id.* at 496.

received ordinary income treatment.[148] When the flurry of words concluded, the Fifth Circuit denied the taxpayers' relief on the ground that the taxpayers' claim for a refund was based on a denial of a consistent settlement.[149] As acknowledged by the district court and the Fifth Circuit, the partnership tax return could very well have constituted an AAR, which was accepted by the Service, but application of the important § 6227 was left unanswered.[150] Under § 6227(c)(2)(A), if a tax matters partner files an AAR, the Service has three options, the first of which is to treat all partners consistently.[151] The statutory words of § 6227(c)(2)(A) become important:

> (2) Requests not treated as substituted returns
> (A) In general
> If the tax matters partner files an administrative adjustment request on behalf of the partnership which is not treated as a substituted return under paragraph (1), the Secretary may, with respect to all or any part of the requested adjustments—
> (i) without conducting any proceeding, allow or make to all partners the credits or refunds arising from the requested adjustments,
> (ii) conduct a partnership proceeding under this subchapter, or
> (iii) take no action on the request.[152]

If the Service elects option (i), then treatment must be consistent for "all partners," and the Service must, "without conducting any proceeding, allow or make to all partners the credits or refunds arising from the requested adjustments."[153]

In *Rigas*, the Service seems to have adopted option (i).[154] It conducted no partnership proceeding under option (ii) and did not take any action under option (iii).[155] The Service responded consistently with option (i), except that the Service inconsistently denied the taxpayers' claim.[156] On the face of the statute, the Service appears to have violated the § 6227(c)(2)(A)(i) requirement for consistent treatment for all partners.[157] Another approach that arguably would have been more appropriate for the Fifth Circuit, and an approach more appropriate for circuit court review, would have been to remand the case back to the district court for consideration of the amended tax return as an AAR combined with an instruction to consider the consistency mandates of

148. *Id.*
149. *Id.* at 500.
150. *Id.* at 498–99.
151. 26 U.S.C. § 6227(c)(2)(A) (2006).
152. *Id.* § 6227(c)(2)(A)(i)–(iii).
153. *Id.* § 6227(c)(2)(A)(i).
154. *Rigas*, 486 F. App'x at 495–96.
155. *Id.*
156. *Id.*
157. *See* 26 U.S.C. § 6227(c)(2)(A)(i).

§ 6227(c)(2)(A)(i).[158] The merits of any adjustments arising out of the amended return should be individual items outside of the refund court's jurisdiction.[159]

The temptation is compelling to continue a discussion of *Rigas* into the broader debate over aspects of TEFRA partnership-level jurisdiction, but this Article is not a TEFRA analysis. Numerous cases are currently before circuits other than the Fifth Circuit and additional Fifth Circuit cases were decided during the reporting period for this Article.[160] These matters await further discussion.

158. *Id.*; *Rigas*, 486 F. App'x at 498–500.

159. *Rigas*, 486 F. App'x at 498–500.

160. *E.g.*, Thompson v. Comm'r, 729 F.3d 869 (8th Cir. 2013); Irvine v. United States, 729 F.3d 455 (5th Cir. Sept. 2013); Kercher v. United States, Nos. 12-40483, 12-20359, 2013 U.S. App. LEXIS 18506 (5th Cir. Sept. 5, 2013); Jade Trading, LLC *ex rel.* Ervin v. United States, 598 F.3d 1372 (Fed. Cir. 2010), *abrogated by* United States v. Woods, 134 S. Ct. 557 (2013); Petaluma FX Partners, LLC v. Comm'r, 591 F.3d 649 (D.C. Cir. 2010), *abrogated by Woods*, 134 S. Ct. 557; Dial, USA, Inc. v. Comm'r, 95 T.C. 1 (1990).