**Tax Shelters: The Ninth Circuit Reverses Grant of Summary Judgment in a Sham Partnership Case.**

Earlier this week, the Ninth Circuit issued a terse (under 600 words) unpublished decision reversing the grant of summary judgment in a tax shelter case. *Broadwood Inv. Fund LLC v. United States,* 2015 U.S. App. LEXIS 13501 (9th Cir. Aug. 3, 2015). The court briefly indicated that the district court had erred because the taxpayers had provided sufficient evidence to raise a genuine issue of material fact on the question of intent, which was relevant to a determination whether the relevant partnership was a sham. *Id.*, slip op. at *2-*3 (reversing *Broadwood Inv. Fund LLC v. United States*, 2012 U.S. Dist. LEXIS 148878 (C.D. Cal. Sept. 21, 2012)). Since this had to be the shortest opinion I have seen in a tax shelter case, I wondered what the district judge had done.

*Broadwood* was an action challenging final partnership administrative adjustments under Section 6226 of the Internal Revenue Code, which provides for judicial review of determinations by the IRS concerning the tax treatment of partnership items in a partnership level administrative proceeding. The partnership was between a group of entities controlled by Henry T. Nicholas and the Chenery Distressed Asset Fund ("Chenery"), and it was formed in December of 2001.

The taxpayers brought the action after the IRS had disallowed millions of dollars in investment losses based upon its determination that the relevant partnership was a sham. 2012 U.S. Dist. LEXIS 148878, slip op. at *5. In response, the government sought summary judgment, and the district court granted the motion.

To determine whether the partnership was a sham, the district court indicated that the taxpayers needed to show that the partnership was formed "in good faith" and with a business purpose of "carrying on the business and sharing in the profits and losses." *Id.*, slip op. at *15 (citations omitted).

One particular letter was pivotal to the district court: the letter stated that Chenery had arranged matters so that any of the investments that the fund was holding could be sold before December 31, 2001 "without risk of economic loss." *Id.*, slip op. at *18-*19. From this statement, the district court concluded that the government had established that the partnership was not formed with a business purpose of sharing profits and losses. This was a rather significant cognitive leap: a statement that existing assets could be sold for a limited period of time without any risk of loss says nothing about what the parties expected to transpire over the anticipated life of the partnership.

The district court also refused to consider expert reports that the taxpayers offered to show that the partnership's investments had a profit potential. In the court's view, that evidence was relevant to the economic substance doctrine but not to the question whether the partnership was a sham. *Id.*, slip op. at *24-*26. Again this seems problematic: the prospect for profits from the operation of the partnership would seem highly relevant to the question whether the taxpayers entered into the partnership with an intent to share in the profits and losses that it generated.

While the district court noted that other courts had determined that a partnership was a sham even though its investments had economic substance, *Id.*, slip op. at *25, the case that it relied upon, *Southgate Master Fund, LLC v. United States,* 659 F.3d 466 (5th Cir. 2011), was

distinguishable. In *Southgate,* the decision that the partnership was a sham rested upon factors that indicated that the purported partners never intended to operate the partnership jointly. One purported partner consistently worked at cross-purposes to the partnership's interests. 659 F.3d at 485-86. Another reserved all of the profits to be earned from specific transactions to himself. *Id.* at 486-88. Nothing in *Broadwood* remotely suggests that kind of circumstance existed.

Consequently, this simply appears to be one of those cases where the district court was completely wrong.

Jim Malone is a tax attorney in Philadelphia; he focuses his practice on federal, state and local tax controversies. This post is intended to provide background on a relevant issue; it is not intended as legal advice. 