

# TAX PROCEDURE: THE TAX COURT HOLDS THAT A PARTNER-LEVEL DEFENSE TO AN ACCURACY-RELATED PENALTY CAN BE CONSIDERED IN A COLLECTION DUE PROCESS HEARING

Posted on **June 27, 2017** by **Jim Malone**



Taxpayers who are the subject of collection action by the IRS have the option of requesting a collection due process hearing before the IRS either files a tax lien or pursues a levy against the taxpayer's property. I.R.C. §§ 6320; 6330. The Tax Court then has jurisdiction to review the administrative disposition. I.R.C. § 6330(d). Typically, these hearings (and the court's subsequent review) focus on issues concerning the propriety of the proposed collection action, as well as potential collection alternatives.

The underlying merits of the tax assessment are usually not at issue because, in most cases, the taxpayer will have had a prior opportunity to seek Tax Court review of the assessment. Specifically, a taxpayer can only challenge the underlying merits of a tax assessment through a collection due process hearing "if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." I.R.C. § 6330(c)(2)(B). The Tax Court has read this exception narrowly, upholding an IRS regulation which provides that an opportunity for an appeals conference qualifies as "an opportunity to dispute" a tax liability. *Lewis v. Comm'r*, 128 T.C. 48, 55-61 (2007) (addressing Treas. Reg. § 301.6330-1(e)(3) Q&A-E2).

Last week, the Tax Court ruled that a partner could use a collection due process hearing to challenge an accuracy-related penalty assessed in a TEFRA partnership audit, making the court a potential forum for partner-level defenses in TEFRA cases. *McNeill v. Comm'r*, No. 14340-10L, 2017 U.S. Tax Ct. LEXIS 25 (June 19, 2017).

*McNeill* arose from a distressed asset/debt transaction, known as a DAD shelter. In May of 2003, Mr. McNeill purchased an 89.1% interest in Guisan LLC, an entity that held Brazilian consumer debt with a high basis and a low market value. *McNeill*, 2017 U.S. Tax Ct. LEXIS 25 at \*2. Guisan then contributed that debt to Labaite, LLC. *Id.* Mr. McNeill was the manager and the tax matters partner of Guisan, but not

of Labaite. *Id.* Labaite's manager then sold the relevant debt in December, generating a substantial loss. *Id.*

In August of 2007, the IRS issued a final partnership administrative adjustment under TEFRA to the partners of Labaite, which included an adjustment of over \$11 million to Labaite's partnership items and an accuracy-related penalty in connection with the DAD loss. *Id.* at \*3. Mr. McNeill, as Guisan's tax matters partner, filed a complaint in the District of Connecticut seeking review of the final partnership administrative adjustment. *Id.* Guisan's deposit was sufficient to cover the deficiency and the interest associated with its loss, but it did not cover the accuracy-related penalty. *Id.* at \*3-\*4.

The IRS then sent the McNeills an assessment for a \$1.5 million penalty, and a notice and demand for payment followed in June of 2008. *Id.* at \*4. In April of 2009, the IRS sent the McNeills a levy notice concerning their right to a collection due process hearing, as well as a similar notice in connection with the filing of a notice of federal tax lien filing. *Id.* The McNeills filed a request for a collection due process hearing in response to the levy notice; they later amended their request to include the lien filing as well. *Id.*

While the collection due process hearing was pending, Mr. McNeill, as tax matters partner of Guisan, filed a motion to voluntarily dismiss the pending district court case with prejudice. *Id.* The district court entered an order on July 22, 2009 granting the motion to dismiss; this order provided that the final partnership administrative adjustment was deemed to be correct, and it indicated that the court declined to adjudicate any partner-level defenses of the McNeills. *Id.* at \*5.

In the collection due process hearing, the settlement officer refused to consider the McNeill's partner-level defenses to the penalty, despite the language of the district court's order. Accordingly, the settlement officer sustained the collection activity, indicating that the penalty assessment was valid. *Id.*

Before the Tax Court, the IRS conceded that the McNeills had not had an opportunity to contest the applicability of the penalty based upon their partner-level defenses. *Id.* at \*5, n.7. In light of that concession, the court addressed whether it had jurisdiction to review the merits, notwithstanding some contraindications derived from TEFRA.

The court commenced its analysis by noting that TEFRA provided for the tax treatment of partnership items (including any penalty tied to an adjustment of a partnership item) to be determined in a centralized audit of the partnership. *Id.* at \*6-\*7. Further, the court observed that TEFRA removed "penalties . . . that relate to adjustments to partnership items" from the category of items subject to deficiency procedures. *Id.* at \*7 (quoting I.R.C. § 6230(a)(2)(A)(i)). The court also noted that a regulation that the court had previously upheld indicated that partner level defenses were to be addressed "through separate refund actions following assessment and payment." *Id.* (quoting Treas. Reg. § 301.6221-1(d)).

Next, the Tax Court addressed the scope of its jurisdiction over collection due process cases, which historically had not attached if the underlying liabilities were not also subject to its jurisdiction. *Id.* at \*8-\*9. The court then noted that its jurisdiction had been expanded to reach all collection determinations "regardless of the type of underlying liability" when section 6330(d) was amended in 2006. *Id.* at \*9. The court cited three cases as support; each case involved the question whether the court could review the merits of liabilities that normally would fall outside its jurisdiction:

- In *Yari v. Commissioner*, 143 T.C. 157, 161-63 (2014), *aff'd*, 669 Fed. Appx. 489 (9th Cir. 2016), the court held that it could reach the merits of a promoter penalty imposed under section 6707A.

- In *Mason v. Commissioner*, 132 T.C. 301, 318-20 (2009), it held that the merits of a trust fund recovery penalty could be challenged if the taxpayer did not receive notice under section 6672(b) of the Code.
- In *Callahan v. Commissioner*, 130 T.C. 44, 47-49 (2008), the court held that it could review the merits of a frivolous return penalty in a collection due process case.

In light of these cases, the Tax Court had little difficulty determining that it had jurisdiction to consider the merits of the taxpayers' partner-level defenses: "With respect to petitioners' section 6662(a) accuracy-related penalty, this penalty is another example of an item not subject to the Court's deficiency jurisdiction . . . , but nonetheless reviewable by the Court in the context of its section 6330 jurisdiction." *Id.* at \*11.

Accuracy-related penalties associated with partnership audits can be quite substantial. The Tax Court's ruling in *McNeill* offers taxpayers an alternative for cases in which they simply cannot pay the full amount of the penalty and seek a refund.



By: [Jim Malone](#)

Jim Malone is a tax attorney in Philadelphia. A Principal at Post & Schell, he focuses his practice on federal, state and local tax controversies. [Learn more about Post & Schell's Tax Controversy Practice >>](#)

This entry was posted in [Blog](#) and tagged [accuracy-related penalties](#), [collection due process](#), [partner-level defenses](#), [partnership audits](#), [TEFRA](#) by [Jim Malone](#). Bookmark the [permalink](#) [<http://taxcontroversyposts.postschell.com/tax-procedure-tax-court-holds-partner-level-defense-accuracy-related-penalty-can-considered-collection-due-process-hearing/>].