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Tax Court: Government does not bear burden of production for penalties in partnership-level proceedings

The U.S. Tax Court today in a “reviewed opinion” held that in a TEFRA partnership-level proceeding, the IRS does not bear the burden of production under section 7491(c) with respect to penalty assessments.

The Tax Court reached its conclusion because section 7491(c), by its terms, shifts the burden of production for penalties to the IRS only with respect to the liability of individuals. TEFRA partnership-level proceedings do not determine the liability of individuals, only adjustments to partnership items. Even when the applicability of a penalty with respect to an adjustment is determined at the partnership level, the penalty might not apply to a particular partner because of partner-level defenses or because the tax on a partner’s share of an adjustment did not cross a threshold for the penalty to apply. Consequently, because partnership-level proceedings do not determine the liability of an individual for any penalties, the burden of production does not shift under section 7491(c), and the partnership bears the burden of establishing defenses to the assertion of penalties at the partnership level.

The case is: *Dynamo Holdings Ltd Partnership v. Commissioner*, 150 T.C. No. 10 (May 7, 2018). Read the Tax Court’s [opinion](#) [PDF 94 KB]

Summary

A corporation and a partnership shared common ownership. During the years at issue, the corporation transferred property to the partnership.

The IRS asserted that the transfers were gifts among the ultimate beneficial owners, or alternatively that the transfers were for less than fair market value and that the amounts of the discount were subject to withholding tax. The IRS also determined that accuracy-related penalties under section 6662(a) applied to the adjustments in the

partnership-level proceedings as well as additions to tax and penalties against the corporation.

The Tax Court noted that in the past, it had questioned whether the IRS bears the burden of production with respect to penalties in a partnership-level proceeding but had never expressly ruled on the issue.

The Tax Court concluded that:

- Section 7491(c) imposes the burden of production on the IRS “in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount....”
- A partnership is not an individual, and a partnership-level proceeding is not a proceeding with respect to the liability of any individual.
- The IRS does not bear the burden of production with respect to penalties, additions to tax, or additional amounts in a partnership-level proceeding.

KPMG observation

It is worth noting that although none of the direct or indirect partners in the partnership in this case was an individual, the Tax Court’s rationale would apply even if one or more of the partners were individuals. The Tax Court focused on the nature of a TEFRA partnership-level proceeding as a proceeding to determine adjustments to partnership items, rather than a proceeding to determine liability of the partners with respect to tax or penalties. So the Tax Court’s rationale would reach the same result in a case in which one or more partners were individuals.

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