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Ninth Circuit: Partnership losses claimed on unsigned, unfiled tax returns disallowed; Tax Court reversed

The U.S. Court of Appeals for the Ninth Circuit this week reversed the Tax Court's determination that taxpayers owed neither deficiencies nor penalties for prior tax years because partnership losses allegedly claimed on unsigned, unfiled tax returns for those years exceeded the IRS's adjusted non-partnership deficiencies.

The case is: *Stevens et al. v. Commissioner*, No. 21-71082 (9th Cir. July 3, 2023). Read the Ninth Circuit's [decision](#) [PDF 231 KB]

Summary

The taxpayers did not file tax returns for 2007 and 2012. For 2008 through 2011, the taxpayers reported no tax liability because of large net operating losses (NOLs) stemming from losses flowing from TEFRA partnerships.

After an audit, the IRS issued notices of federal income tax deficiencies and associated penalties under section 6212 for 2005 through 2012, and the taxpayers subsequently petitioned the Tax Court to review and redetermine the deficiencies and penalties.

After a trial, the Tax Court upheld the IRS' recomputed deficiencies for 2006 and 2008, but concluded that the taxpayers owed no deficiencies or penalties for 2007 and 2012 because the partnership losses claimed on unsigned, unfiled tax forms for those years were larger than the IRS' adjusted non-partnership deficiencies.

The Tax Court further concluded that the taxpayers owed no deficiencies or penalties for 2009, 2010, and 2011 because the taxpayers' NOL carryforward deductions were sufficient to offset the IRS adjustments to non-partnership items for each of those years. The Tax Court determined that the declaratory judgment provisions of section 6234(c) (as in effect for the relevant tax years) were

inapplicable because the taxpayers' 2009, 2010, and 2011 returns failed to satisfy section 6234(a)(3): namely, that the IRS' adjustments to the non-partnership items on those returns "do not give rise to a deficiency . . . but would give rise to a deficiency if there were no net loss from partnership items." In other words, the Tax Court held that even without the net partnership losses that the taxpayers claimed on their 2009, 2010, and 2011 returns, their taxpayers' adjusted taxable income was not enough to create a deficiency.

The taxpayers subsequently appealed to the Ninth Circuit, and the IRS cross-appealed. The taxpayers' appeal as to the 2006 and 2008 years was dismissed for lack of prosecution, leaving the Ninth Circuit to rule on the 2007 and 2009 through 2012 tax years.

As for 2007 and 2012, the Ninth Circuit concluded that the Tax Court erred when it concluded that partnership losses claimed on unfiled, unsigned tax returns for those years could be used to offset non-partnership income in an individual deficiency proceeding. The Ninth Circuit found that the taxpayers' 2007 and 2012 "returns" claiming such partnership losses were not valid tax returns with legal effect because the taxpayers' returns were neither filed with the IRS nor executed under penalty of perjury. (The partnership from which the majority of losses purportedly flowed also did not file returns for the years at issue.)

The Ninth Circuit further concluded that, as to tax years 2009-2011, the Tax court erred when it excluded from its calculations of "net loss from partnership items" the portions of the NOL carryforward deductions that were composed of TEFRA partnership losses in prior years. The Ninth Circuit explained that, when carried forward as deductions, NOLs composed of TEFRA partnership losses are partnership items that are part of the calculation of "net loss from partnership items" under section 6234(a)(3) (as it was then in effect). Because the Tax Court instead included those NOLs in its calculations of the taxpayers' non-partnership income tax liability, the Ninth Circuit held the Tax Court erroneously determined that the taxpayers did not owe deficiencies.

The Ninth Circuit thus reversed the Tax Court's conclusion that the taxpayers owed neither deficiencies nor penalties for 2007 and 2009 through 2012 and remanded for a recalculation of the taxpayers' deficiencies and penalties for those years.

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