No. 13-343

In the Supreme Court of the United States

UNITED STATES OF AMERICA,
Petitioner,

v.

NEVADA PARTNERS FUND, LLC, BY AND THROUGH SAPPHIRE II, INC., TAX MATTERS PARTNER, et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

W. Whitaker Rayner
Kaytie M. Pickett
Jones Walker LLP
190 East Capitol Street
Suite 800
Jackson, MS 39201
(601) 949-4900
wrayner@joneswalker.com
kpickett@joneswalker.com

David D. Aughtry
Counsel of Record
Chamberlain, Hrdlicka, White, Williams & Aughtry
191 Peachtree Street, N.E.
34th Floor
Atlanta, GA 30303
(404) 659-1410
david.aughtry@chamberlainlaw.com

Counsel for Respondents

Becker Gallagher · Cincinnati, OH · Washington, D.C. · 800.890.5001

QUESTION PRESENTED

Section 6662 of the Internal Revenue Code imposes a 40% penalty for underpayment of taxes attributable to a gross valuation misstatement. When the IRS disallows a partnership's loss deduction because the loss-generating transaction lacked economic substance, is the partnership's resulting underpayment of tax attributable to a gross valuation misstatement?

RULE 29.6 STATEMENT

The nongovernmental corporate party Sapphire II, Inc., Tax Matters Partner to Nevada Partners Fund, LLC and Carson Partners Fund, LLC, has been dissolved and thus does not have any parent corporation or publicly held corporation that owns 10% or more of its stock. At the time of the transactions at issue, Sapphire II, Inc. was wholly owned by Sapphire Management, LLC, which is privately owned.

The nongovernmental corporate party Delta Currency Management Co., Tax Matters Partner to Reno Partners Fund, LLC, does not have any parent corporation or publicly held corporation that owns 10% or more of its stock.

The nongovernmental corporate party Bricolage Capital Management Co., Tax Matters Partner to Carson Partners Fund, LLC and Nevada Partners Fund, LLC, does not have any parent corporation or publicly held corporation that owns 10% or more of its stock.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTORY PROVISIONS

REGULATIONS

STATUTORY PROVISION INVOLVED

Petitioner included in its petition 26 U.S.C. § 6662 as it appears in the 2000 edition of the United States Code. Petitioner omitted the current version of Section 6662 of the Internal Revenue Code and Section 1409 of the Health Care and Education Reconciliation Act of 2010, Pub. Law No. 111-152, 124 Stat. 1029, 1067, which are both reprinted here in Appendix 1.

STATEMENT OF THE CASE

In 2001, Bricolage Capital, LLC created a three-tiered investment program called "FOCus" (Family Office Customized). *Pet. App.* 6a-7a. Bricolage carried out this program by forming three limited liability companies: Nevada Partners Fund, LLC, Carson Partners Fund, LLC, and Reno Partners Fund, LLC. *Pet. App.* 9a. Nevada owned 99% of Carson, and Carson owned interests in Reno and another hedge fund, Bricolage. *Pet. App.* 7a, 9a.

In October through December 2001, Reno engaged in foreign currency trades that resulted in roughly $18,000,000 in gains and $17,000,000 in losses. *Pet. App.* 9a-10a, n.10. On December 4, 2001, Kelley Williams, through the JKW 1991 Revocable Trust, purchased a 99% interest in Nevada. *Pet. App.* 12a. Carson then sold Reno on December 21, 2001, and reported a loss of approximately $17,000,000 on its partnership return. *Pet. App.* 13a. Carson reinvested the proceeds of the Reno sale into highly leveraged Japanese Yen transactions, which generated earnings of over $8,000,000 in 2002. *Pet. App.* 16a.

In 2006, the Internal Revenue Service issued Final Partnership Administrative Adjustments (FPAAs) to

Nevada, Carson, and Reno. *Pet. App.* 20a. The FPAAs stated that the IRS disallowed the partnership's losses on their 2001 partnership tax returns, asserting that the FOCus transactions lacked economic substance. *Pet. App.* 20a-21a. The FPAAs also stated that the IRS assessed penalties under Section 6662(a) of the Internal Revenue Code, including the 40% gross valuation misstatement penalty at issue. *Pet. App.* 21a.

On July 13, 2006, each of the partnerships sued to challenge the FPAAs' determination that the FOCus transactions lacked economic substance and to dispute the penalties. *Pet. App.* 21a. The district court found that although the 2002 FOCus investment activities generated profits, the 2001 transactions lacked economic substance. *Pet. App.* 22a, 97a. The court upheld negligence and substantial understatement of income tax penalties levied against the partners. *Pet. App.* 22a. But the court, relying on *Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988), and *Heasley v. Commissioner*, 902 F.2d 380 (5th Cir. 1990), held that the 40% gross valuation misstatement penalty was inapplicable. *Pet. App.* 40a.

The partnerships appealed the economic substance ruling and understatement of income tax penalties, and the Government cross-appealed the disallowance of the gross valuation misstatement penalty. *Pet. App.* 22a-23a. The court of appeals affirmed the economic substance determination and understatement of income tax penalties but affirmed the district court's holding that the gross valuation misstatement penalty is inapplicable. *Pet. App.* 51a. The court of appeals observed that this Court granted certiorari in *United*

States v. Woods, No. 12-562, which presents the same issue of whether a gross valuation misstatement penalty is appropriate when an underpayment of tax results from partnership-level transactions lacking economic substance. *Pet. App*. 39a-40a, n.42.

This Court *sua sponte* ordered the *Woods* parties to address whether the district court in that case had jurisdiction under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) to consider the substantial valuation misstatement penalty. *United States v. Woods*, 133 S. Ct. 1632 (2013). TEFRA sets up a two-tiered approach to the review of a partner's taxes. 26 U.S.C. §§ 6221, 6230(a)(1). First, in a partnership-level proceeding, a court reviews matters that affect the partnership as a whole. 26 U.S.C. § 6221. Then, in a separate deficiency proceeding against an individual partner, a court reviews items affecting only that partner. 26 U.S.C. § 6230(a)(1). Even though penalties are imposed on partners, not the partnership, a court can determine penalties in a partnership-level proceeding if the penalty "relates to an adjustment to a partnership item." 26 U.S.C. § 6221.

In *Woods*, the IRS contends that the partnership-level transactions' lack of economic substance caused the individual partner to misstate his adjusted basis in his partnership interest (the partner's "outside basis"). Brief for the United States at 41, *United States v. Woods*, No. 12-562 (U.S. May 30, 2013). The extent of this alleged basis misstatement would only be apparent upon a review of the partner's individual return. 26 C.F.R. §§ 301.6231(a)(3)-1, (a)(5)-1(b). Although a partnership return contains information on a partner's capital account, that is not necessarily the same as the partner's outside basis in his partnership interest. Thus, the partnership's return would not reflect the individual partner's outside basis. *Id.* The question in *Woods* is whether a court in a partnership-level proceeding can determine penalties based on a partner-level adjustment.

By contrast, here the IRS petition focuses upon the partnership-level gains and losses reported on the partnership's returns. *Pet.* 10. Because there is no dispute that the penalty at issue is based on a partnership-item adjustment to a partner-level asset, the jurisdictional question of *Woods* is not raised.

ARGUMENT

Respondents acknowledge that this Court ordinarily grants certiorari when a petition for writ of certiorari presents an issue identical with an issue already pending before the Supreme Court. *See, e.g., General American Investors Co. v. C.I.R.*, 348 U.S. 434, 435 (1955) ("We granted certiorari, 348 U.S. 812, 75 S. Ct. 35, because of an apparent similarity of issues here to those involved in *Commissioner v. Glenshaw Glass Co.*, 3 Cir., 211 F.2d 928, and the possible conflict between that case and this."). But the issue that this petition shares in common with *United States v. Woods*, No. 12-562, is not the primary issue presented by *Woods*. Rather, the issue worthy of certiorari in *Woods* was the question of jurisdiction raised by this Court. The Government acknowledges that the *Woods* jurisdictional question is not present in this case (*Pet.* 10-11); therefore, certiorari is not warranted.

The jurisdictional question present in *Woods* (but not here) is an important question of federal law that has not been, but should be, settled by this Court. The amici curiae briefs filed in support of the respondents in *Woods* reflect this. Of the five amici briefs submitted, only two focus exclusively on the merits of *Woods*. Brief of *Amicus Curiae* Professor David J. Shakow in Support of Respondents, *United States v. Woods*, No. 12-562 (U.S. Jul. 25, 2013); Brief of Scott and Audrey Blum as *Amici Curiae* in Support of Respondents, *Woods*, No. 12-562 (Jul. 26, 2013). The rest recognize that the jurisdictional issue is of far greater importance. Brief of *Amici Curiae* Gordon W. Bush, et al. in Support of Respondent, *Woods*, No. 12-562 (Jul. 26, 2013); Brief of New Millennium Trading, LLC, AHG Investments, LLC, NPR Investments, LLC, Alpha I, L.P., and West Ventures, L.P. as *Amici Curiae*, *Woods*, No. 12-562 (Jul. 26, 2013); Brief of *Amici Curiae* Partners in Jade Trading, LLC, Petaluma FX Partners, LLC, and Tigers Eye Trading, LLC in Support of Respondents and Jurisdictional Reversal, *Woods*, No. 12-562 (Jul. 26, 2013).

It is of greater importance for three reasons. First, the jurisdictional question requires that the Court determine as a threshold matter whether 26 U.S.C. § 6226 is even a jurisdictional statute, a point upon which the circuits are split. *See* Brief of *Amici Curiae* Gordon W. Bush, et al. in Support of Respondent at 7-8, *United States v. Woods*, No. 12-562 (U.S. Jul. 26, 2013) (*comparing A.I.M. Controls, L.L.C. v. Commissioner*, 672 F.3d 390, 395 (5th Cir. 2012), *with Prati v. United States*, 603 F.3d 1301, 1307-08 and n.4 (Fed. Cir. 2010)). This determination will affect whether parties will have an unwaivable right to raise a subject matter jurisdiction defense at any partnership-level proceeding.

Second, the jurisdictional question raises potential Article III concerns. "It is a fundamental precept that federal courts are courts of limited jurisdiction. The limits upon federal jurisdiction, whether imposed by the Constitution or by Congress, must be neither disregarded nor evaded." *See Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365, 374, 98 S. Ct. 2396, 2403 (1978) (limiting the doctrine of ancillary jurisdiction). If federal courts are improperly adjudicating partner issues at partnership-level proceedings, then they are reaching beyond their properly limited role. If jurisdiction is indeed lacking in *Woods*, this Court has a duty to put an end to future jurisdictional overreaching.

Third, the jurisdictional question raises potential due process concerns for taxpayers. If the penalty issue raised in *Woods* can be adjudicated in a partnership-level proceeding, then the IRS can sidestep the deficiency procedure usually used to adjudicate an individual partner's liability. As Justice Sotomayor alluded to at the *Woods* oral argument, under the Government's jurisdictional argument, the taxpayer would have to pay the penalty first and then seek a refund within six months before it could effectively dispute the penalty. *See* Transcript of Oral Argument at 4-5, *United States v. Woods*, No. 12-562 (U.S. Oct. 9, 2013).

By contrast, the common issue between this case and *Woods* is of little importance. The Court's resolution of this question will have no effect on future cases, because Congress amended the penalty statute in 2010 to resolve the circuit split on the question presented here and, absent a waiver, the statute of limitations has run on any claims not brought under the prior version of the statute. 26 U.S.C. § 6662(b)(6), *App.* 1-2; *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012). Thus this issue affects only a finite and small number of taxpayers whose cases arose under the prior version of the statute and that remain pending. The Government argued in *Woods* that those pending cases involve significant basis misstatements, but the total amount of basis misstatements is not what is at issue; rather, the only issue is whether a 40%, rather than a 20%, penalty should apply. Reply Brief for the United States at 2-3, *United States v. Woods*, No. 12-562 (U.S. Feb. 20, 2013). A 20% difference is not significant enough to warrant the devotion of the Court's valuable resources.

Even if the Court reaches the merits in *Woods* and decides the merits in the Government's favor, the potential conflict between this case and *Woods* is not of significant concern. There are several cases that have been decided over the last twenty years in which the Government did not seek certiorari on this issue, and so there already exists a potential conflict between cases resolved before *Woods* and *Woods* itself. *See, e.g.*, *Bemont Investments, L.L.C. ex rel. Tax Matters Partner v. United States*, 679 F.3d 339 (5th Cir. 2012); *Keller v. C.I.R.*, 556 F.3d 1056 (9th Cir. 2009); *Weiner v. United States*, 389 F.3d 152 (2004); *Gainer v. C.I.R.*, 893 F.2d 225 (9th Cir. 1990). There is no reason why the potential conflict between this case and *Woods* should be of any more importance than the potential conflict with those cases that have been already decided. Again, this issue does not raise Constitutional concerns. It is only a question of how much money can the Government recover. Given the limited importance of the only issue presented in this case, the taxpayers' interest in finality in this suit, which has been pending for seven years, should counsel against the grant of certiorari.

CONCLUSION

This Court was correct to hear *Woods*, but only because of the significant jurisdictional issue presented. Because the 2010 statutory changes render the merits of *Woods* obsolete, no reason remains to hold this case until *Woods* is decided. The petition for writ of certiorari should therefore be denied.

Respectfully submitted,

David D. Aughtry
Counsel of Record
Chamberlain, Hrdlicka,
White, Williams & Aughtry
191 Peachtree Street, N.E., 34th Floor
Atlanta, Georgia 30303
(404) 659-1410
david.aughtry@chamberlainlaw.com

W. Whitaker Rayner
Kaytie M. Pickett
Jones Walker LLP
190 East Capitol Street
Suite 800
Jackson, MS 39201
(601) 949-4900
wrayner@joneswalker.com
kpickett@joneswalker.com

Counsel for Respondents