ORAL ARGUMENT NOT YET RESCHEDULED

NO. 12-1364

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETALUMA FX PARTNERS, LLC and
RONALD SCOTT VANDERBEEK,
A Partner Other than the
Tax Matters Partner,

Petitioner-Appellee

v.

COMMISSIONER OF INTERNAL REVENUE SERVICE,

Respondent-Appellant

ON APPEAL FROM THE ORDER AND DECISION
OF THE UNITED STATES TAX COURT

REPLACEMENT BRIEF FOR THE APPELLEE

EDWARD M. ROBBINS, JR.
HOCHMAN, SALKIN, RETTIG,
TOSCHER & PEREZ, P.C.
9150 Wilshire Boulevard, Suite 300
Beverly Hills, CA 90212-3414
Telephone: (310) 281-3200
Fax: (310) 859-1430
Counsel for Petitioner-Appellee

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

(A) Parties and Amici

All parties, intervenors, and amici appearing below and in this Court are listed in the Replacement Brief for the Appellant.

(B) Rulings Under Review

All rulings under review are listed in the Replacement Brief for the Appellant.

(C) Related Cases

1. Petaluma

Petaluma FX Partners, LLC v. Commissioner, 134 T.C. 84 (2008) (*Petaluma I*);

Petaluma FX Partners, LLC v. Commissioner, 591 F.3d 649 (D.C. Cir. 2010) (*Petaluma II*);

Petaluma FX Partners, LLC v. Commissioner, 135 T.C. 29 (Dec. 15, 2010) (*Petaluma III*);

Petaluma FX Partners, LLC v. Commissioner, No. 11–1084, 2012 WL 2335993 (D.C. Cir., February 27, 2012) (*Petaluma IV*);

Petaluma FX Partners, LLC v. Commissioner, T.C. Memo 2012-142

(*Petaluma V*).

This case (*Petaluma VI*).

3. Logan Trust (Tigers Eye)

Tigers Eye Trading, LLC v. Commissioner, T.C. Memo 2009-121 (*Tigers Eye I*)

Tigers Eye Trading, LLC v. Commissioner, 138 T.C. 67 (2012) (*Tigers Eye II*)

Logan Trust v. Commissioner (Tigers Eye Trading, LLC), No. 12-1148 (D.C. Cir.) (*Tigers Eye III*)

4. Jade Trading

Jade Trading LLC v. United States, 80 Fed. Cl. 11 (2007) (*Jade I*);

Jade Trading LLC v. United States, 598 F.3d 1372 (Fed. Cir. 2010) (*Jade II*);

Jade Trading, LLC v. United States, 98 Fed. Cl. 453 (2011) (*Jade III*);

Jade Trading, LLC v. United States, 451 Fed. App'x. 954, No. 2011-5103, 2012 WL 178382 (Fed. Cir., January 12, 2012) (*Jade IV*).

Sentinel Advisors, LLC formed, managed, and handled the foreign

currency trading for both Tigers Eye Trading, LLC and Jade Trading, LLC. The United States Court of Appeals for the Federal Circuit has twice considered the same partnership jurisdictional issue in the context of virtually identical trading by Sentinel. That partnership proceeding is now closed with no penalties imposed by the Court, though the three affected partners anticipate litigating previously asserted penalties at the partner-level.

5. Other Sentinel Related Partnership Tax Court Cases.

Until the Tax Court issued Tigers Eye II, the petitioners in a number of Tax Court cases were in the process of resolving their partnership proceedings so that they could proceed to the partner-level defense against the penalties. While the IRS would have a more complete list, Appellee is aware of the following cases in that category:

Sapphire Traders, LLC v. Commissioner, Docket No. 019067-09

New Millennium Trading, LLC v. Commissioner, Docket No. 003439-06

Both cases are appealable to this Circuit.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES:

** Cases or authorities chiefly relief upon are marked by asterisks.*

STATUTES:

Administrative Procedure Act (APA) (5 U.S.C.):

In* *Cases or authorities chiefly relief upon are marked by asterisks.*

** Cases or authorities chiefly relief upon are marked by asterisks.*

* *Cases or authorities chiefly relief upon are marked by asterisks.*

GLOSSARY OF ABBREVIATIONS

We adopt the Glossary listed in the Appellant's Replacement Brief.

INTRODUCTION

We agree with the government that the Supreme Court's decision *United States v. Woods*, ___ U.S. ___, 134 S. Ct. 557 (2013) disposes of the Section 6226(f)[1] jurisdictional issue in favor of the government to the extent the Tax Court otherwise has jurisdiction. However, *Woods* does not dispose of, nor does it address, additional jurisdictional arguments that came to our attention at the end of last year.[2] We raise those arguments here, for the first time in this case.

JURISDICTIONAL STATEMENT

The jurisdictional statement in the Appellant's Replacement Brief in Petaluma VI is correct, except we disagree that the Tax Court had jurisdiction pursuant to Sections 6226(b)(1), (f), and 6233.

STATEMENT OF ISSUES

1. The Internal Revenue Code provides that TEFRA applies to sham partnerships, such as the one here, only to the extent that the IRS issues regulations extending TEFRA to sham partnerships. Here the

---

[1] All Code citations are to the Internal Revenue Code of 1986 (26 U.S.C.) unless otherwise stated.

[2] *See* Professor Andy S. Grewal, *The Missed Jurisdictional Argument in 'United States v. Woods,'* BNA Tax Insights (Dec. 18, 2013), available at http://tinyurl.com/WoodsJurisdiction.

IRS enacted invalid temporary regulations in 1987 purporting to apply TEFRA to sham partnerships, and ultimately issued valid final regulations that applied only to partnership taxable years commencing after October 3, 2001. Did the Tax Court correctly hold that it lacked jurisdiction over the penalties in this TEFRA case where the transactions occurred in 2000 and the IRS failed to enact valid regulations extending TEFRA to sham partnerships for that year?

2. The Internal Revenue Code provides a 40% addition to tax if the adjusted basis of any property claimed on any return of tax is 400% or more of the amount determined to be the correct amount of such adjusted basis. Here the IRS enacted a treasury regulation stating that the adjusted basis claimed on a return of any property with a correct adjusted basis of zero is "considered" to be 400 percent or more of the correct amount. Did the Tax Court correctly hold that it lacked jurisdiction over the 40% penalties in this case where the adjusted basis claimed on the return cannot be shown to be 400 percent or more of the correct amount?

STATUTES AND REGULATIONS

Pertinent statutes and regulations are set forth in the addendum

to this brief.

STATEMENT OF THE CASE

The Statement of the case in the Appellant's Replacement Brief in *Petaluma VI* is correct.

STATEMENT OF THE FACTS

The facts of this case are fairly stated by the Tax Court in its opinion in *Petaluma FX Partners, LLC. v. Commissioner,* 135 T.C. 581 (2010) (*Petaluma III*). They will not be repeated here.

SUMMARY OF ARGUMENT

TEFRA applies to the sham partnership in this case, only through regulations promulgated under Section 6233.[3] One such regulations is

---

[3] Sec. 6233. Extension to entities filing partnership returns, etc.
(a) General rule
If a partnership return is filed by an entity for a taxable year but it is determined that the entity is not a partnership for such year, then, to the extent provided in regulations, the provisions of this subchapter are hereby extended in respect of such year to such entity and its items and to persons holding an interest in such entity.
(b) Similar rules in certain cases
If a partnership return is filed for any taxable year but it is determined that there is no entity for such taxable year, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply.

(continued...)

Temp. Treas. Reg. Section 301.6231(a)(6)-1T(a)(1), the temporary regulation in effect during the period at issue in our case (herein after sometimes "The Temporary Regulation").[4] The Temporary Regulation is invalid due to the government's failure to invite written comments and requests for a public hearing as the Administrative Procedure Act requires, and the government's concomitant failure to make any statement of good cause for skipping the required notice and comment process. Elimination of The Temporary Regulation renders this entire case (not just the penalties) outside the jurisdiction of the Tax Court.

Turnning to the gross valuation misstatement penalty, the regulation there attempts to make some finite number 400% more than zero. That is impossible. The treasury regulations attempt to finesse this "divide by zero" problem by stating that zero basis circumstances are "considered" as satisfying the 400 percent or more threshold. The IRS may consider all it wants, but it cannot make the impossible, possible. The regulation fails and the gross valuation misstatement

---

[3](...continued)
See also Temp. Treas. Reg. § 301.6233-1T.

[4] Note that the "T" in the Treasury Regulation name indicates a temporary regulation.

penalty fails

ARGUMENT

I. THE TEMPORARY REGULATION IS PROCEDURALLY INVALID UNDER THE ADMINISTRATIVE PROCEDURE ACT (APA); THEREFORE, THE TAX COURT LACKS JURISDICTION OVER THIS ENTIRE CASE AND ACTION.

A. In General

For the first two years of its life, TEFRA applied only to real partnerships and real Sub-S corporations, not to nonpartnership entities or to sham partnerships. Administrative difficulties with this approach,[5] prompted Congress to eliminate these difficulties by granting the IRS the discretionary authority to issue regulations extending TEFRA to nonpartnership entities.[6] Section 6233 provides that if a partnership return is filed for a taxable year but it is

---

[5] For example, when a nonpartnership entity filed a partnership return the IRS would likely observe TEFRA procedures until it actually determined that a partnership tax return should not have been filed, in which case it would then realize that TEFRA procedures did not apply. By then it could well be too late to make a proper tax assessment under the non-TEFRA provisions of Chapter 63.

[6] *See* Section 6233(b)(1). Section 6233 was added to the tax code by Pub. L. 98-369, Section 714(p)(1), 98 Stat. 494, 964 (1984), a little short of two years after TEFRA's enactment.

determined that no partnership exists, the TEFRA procedures still apply to the entity, its items, and persons holding an interest in the entity, to the extent provided in the regulations. In such a case, the TEFRA temporary regulations applicable to Petaluma's 2000 taxable year provide that the Court may make determinations with respect to all items of the entity (entity items) that "would be partnership items, as defined in section 6231(a)(3) and the regulations thereunder, if * * * [it] had been a partnership". Sec. 301.6233-1T(a). Further, the TEFRA temporary regulations provide:

> Paragraph (a) of this section shall apply where a partnership return is filed for a taxable year but it is determined that there is no entity for such taxable year. For purposes of applying paragraph (a) of this section, the partnership return shall be treated as if is was filed by an entity.

Section 301.6233-1T(c)*; see also* Section 301.6233-1(a), (d) (applicable for taxable years beginning on or after October 4, 2001).

Under Section 6233(a), if a nonpartnership entity files a partnership return, then, "to the extent provided in regulations," the TEFRA procedures will apply to the nonpartnership entity. Under Section 6233(b), a similar rule applies when an sham partnership files a

partnership return, again "to the extent provided in regulations."

Regulations issued under Section 6233(b) purportedly established the Tax Court's jurisdiction over the TEFRA proceeding in our case. On April 18, 1986, the Federal Register published a notice of proposed rulemaking containing proposed amendments to the Regulations on Procedure and Administration under sections 6221-6233 of the Code. These amendments were proposed to conform the regulations to section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324) and section 714 (p)(1) of the Tax Reform Act of 1984 (98 Stat. 494). The notice instructed that written comments and requests for a public hearing were to be delivered to the IRS or mailed by June 17, 1986. Several comments on the proposed regulations were received. No public hearing was held because none was requested.[7]

Those regulations were issued in temporary form in 1987,[8] about a

---

[7] *See Miscellaneous Provisions Related to the Tax Treatment of Partnership Items*," 51 Fed. Reg. 13231 (April 18, 1986) (proposing various TEFRA-related regulations, including regulations under Section 6233).

[8] *See Miscellaneous Provisions Related to the Tax Treatment of Partnership Items*," 52 Fed. Reg. 6779, 6781 (March 5, 1987); Temp. Reg. Section 301.6233-1T(c).

year after Treasury had first issued proposed regulations under Section 6233(b). Although the proposed regulations received comments from the public,[9] the 1987 temporary regulations did not respond to those comments, nor did the IRS invite written comments and requests for a public hearing. Rather, the IRS stated that:

> Although the rules contained in the temporary regulations are the same as those contained in the notice of proposed rulemaking published on April 18, 1986 (51 FR 13231), the temporary regulations will have no impact on that notice. Therefore, the proposed regulations will be finalized in due course with any changes that may be made as a result of comments received.[10]

Also, the IRS did not make any statement of good cause for skipping the notice and comment process for the Temporary Regulation, as the Administrative Procedure Act requires. Instead, the IRS merely stated that the Temporary Regulation was issued to provide:

---

[9] *See supra* note 7 at 6780 ("Several comments on the proposed regulations were received.").

[10] *Supra* note 7 at 6780.

> [I]mmediate guidance to partners and partnerships affected and to the Internal Revenue Service in the conduct of partnership examinations.[11]

The IRS also noted a general proposition: "No general notice of proposed rulemaking is required by 5 U.S.C. 553 (b) for temporary regulations."[12] The IRS stated that the Temporary Regulation was issued under Section 7805 and also issued under Sections 6230 (k) and 6233.[13]

In 2001, the Treasury issued final regulations under Section 6233(b), but those regulations did not apply to our case.[14] The final regulations apply only for partnership taxable years commencing after Oct. 3, 2001. The transaction in our case occurred in 2000. Thus, the extension of TEFRA to our case rests on temporary regulations issued in 1987, which had sat on the shelf for 13 years at the time of the

---

[11] *Supra*, note 7 at 6780.

[12] *Supra,* note 7 at 6780.

[13] *Supra,* note 7 at 6780-81.

[14] *See Unified Partnerships Audit Procedures*," T.D. 8965, 66 Fed. Reg. 50541 (Oct. 4, 2001) (prescribing TEFRA regulations for partnership taxable years beginning on or after October 4, 2001).

taxpayers' transaction.[15]

The APA requires agencies, including the IRS, to publish contemplated rules to allow the public to make comments on their content and effect. 5 U.S.C. Section 553(b) and (c). To ensure measured, informed rulemaking, the agency is then required to take those comments into consideration before promulgating a final rule. *Id.* Section 553(c). The publication of the rule must occur "not less than 30 days before its effective date". *Id.* Section 553(d). The agency must also provide "reference to the legal authority under which the rule is proposed". *Id.* Section 553(b)(2). And these minimum requirements

---

[15] It is worth noting that with respect to the final regulations, a notice of proposed rulemaking and notice of public hearing appeared in the Federal Register on Tuesday, January 26, 1999 (64 Fed. Reg 3886), announcing that a public hearing was scheduled for Wednesday, April 14, 1999, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. The subject of the public hearing is proposed regulations under sections 6221 through 6233 of the Internal Revenue Code. The public comment period for these proposed regulations expired on Monday, April 26, 1999. The outlines of topics to be addressed at the hearing were due on Wednesday, March 24, 1999. The notice of proposed rulemaking and notice of public hearing, instructed those interested in testifying at the public hearing to submit a request to speak and an outline of the topics to be addressed. 64 Fed. Reg. 16640.

may be modified or superseded only if Congress does so expressly. *Id.* Section 559. If the agency action is challenged, "[t]he reviewing court shall . . . hold unlawful and set aside agency action . . . found to be . . . arbitrary, capricious, an abuse of discretion, or not in accordance with law." *Id.* Section 706(2)(D).

In the case of the Temporary Regulation at issue here, the IRS stated its legal authority for the Temporary Regulation -- the Temporary Regulation was issued under sections 7805, 6230(k) and 6233. The IRS Secretary did not publish the Temporary Regulation 30 days before its effective date, and the IRS did not seek comments before publishing the Temporary Regulation, nor did the IRS claim good cause for skipping this step.[16]

The IRS may attempt to excuse its failure to put the Temporary

---

[16] When Treasury regulation drafters find good cause to skip notice and comment, Internal Revenue Manual section 32.1.5.4.7.5.1(4) (Aug. 11, 2004), directs them to include the following text in the regulations: "'These regulations are necessary to provide taxpayers with immediate guidance. Accordingly, good cause is found for dispensing with notice and public comment pursuant to 5 U.S.C. 553(b) and (c)'".. This thin a justification might or might not work, but it is absent from these regulations or the related Treasury Decision. *See* T.D. 9466, 74 Fed. Reg. 49321 (Sept. 28, 2009).

Regulation through notice and comment. The Administrative Procedure Act, 5 U.S.C. section 553(b), provides:

> this subsection does not apply --
>
> (A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice * *

The APA provides similar exemptions from the prepublication requirement. *Id*. sec. 553(d).

The Temporary Regulation is not a mere statements of policy or rules of Treasury's organization, procedure, or practice. For The Temporary Regulation to be valid, then, it must be an interpretive rule unless the Court accepts the IRS alternative argument that Congress waived the APA's notice-and-comment requirement for temporary tax regulations.

B. The Interpretive Exception Does Not Apply Here

Historically, the judicial deference accorded to a Treasury regulation depended upon on whether the regulation was classified as "legislative" or "interpretive." A regulation was considered "legislative" if it was authorized pursuant to a specific section of the Code and "interpretative" if it was promulgated under the Treasury's general

rulemaking authority of section 7805(a). Legislative regulations were given much greater deference than interpretive regulations and were accorded the force and effect of law unless they exceeded the scope of the Treasury's authority, *Panama Ref. Co. v. Ryan*, 293 U.S. 388 (1935), were contrary to law, *Homes v. United States*, 868 F. Supp. 42 (W.D.N.Y. 1994), *M.E. Blatt Co. v. United States*, 305 U.S. 267 (1938), or were unreasonable *Joseph Weidenhoff, Inc. v. Commissioner*, 32 T.C. 1222 (1959). Interpretive regulations, by contrast, were merely persuasive, *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) and could be invalidated for any number of reasons, such as being inconsistent with the statute's legislative history. *See, e.g., United States v. Fogel Fertilizer Co.*, 455 U.S. 24 (1982). The 2011 Supreme Court decision in *Mayo Clinic Foundation v. United States*, 562 U.S. ___; 131 S. Ct. 704, 178 L. Ed. 2d 588 (2011) abolished this traditional distinction between legislative and interpretative rules. However, the classic "legislative" or "interpretive" distinction should still guide our analysis of the 5 U.S.C. Section 553(b) exception for interpretive regulations.[17]

---

[17] Although, we suppose that after *Mayo*, you could argue that

(continued...)

Unlike interpretive regulations issued under a general grant of authority such as Sections 7805 and/or 6230(k), legislative regulations are issued under a specific grant of authority such as Section 6233, the Code section present in our case. *See Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843-844, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984); *United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24, 102 S. Ct. 821, 70 L. Ed. 2d 792 (1982). We therefore conclude that the interpretive exception to the APA does not apply here. We note that the IRS attempted to avoid this unhappy result by saying that The Temporary Regulation was issued under Sections 7805 and 6230(k). However, the IRS could not avoid identifying the specific grant of authority stated in Section 6233. We do not think that the IRS can now avoid the requirements of the APA simply by waiving its bureaucratic hands and saying that the specific grant of authority in Section 6233 can be ignored.

Courts have applied various tests to distinguish between legislative and interpretive rules, but the this Circuit's test in *American*

---

[17](...continued)
interpretive regulations no longer exist.

Mining Cong. v. Mine Safety & Health Admin., 995 F.2d 1106 (D.C. Cir. 1993), appears to be the leading case. In short, *American Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d at 1109, relying on both case law and the Attorney General's Manual, held that a rule is legislative if Congress has given the agency authority to issue rules with the force of law and the agency intended to use that authority. Without saying more, it is apparent that the answer here is that Congress, in the expressed language of Section 6233, gave the IRS the authority to issue rules with the force of law and the IRS intended to and did use that authority.

C. The Temporary Regulation is Invalid

We have not found any case where a court has invalidated a temporary regulation for the IRS's failure to follow the dictates of the APA,[18] but some cases have come close in dicta. In *Tedori v. United*

---

[18] We have found a case where a court has invalidated an IRS tax refund procedure for the IRS's failure to follow the notice and comment procedures of the APA. *See, e.g., In re Long-Distance Telephone Service Federal Excise Tax Refund Litigation*, 853 F. Supp. 2d 138 (D.D.C. 2012). When notice-and-comment is absent, this Circuit has regularly opted for eliminating the offending procedure. *Sprint Corp. v. Fed. Communications Commission*, 315 F.3d 369, 354 U.S. App. D.C. 288

(continued...)

States, for example, the Ninth Circuit stated that the government could offer "[n]o explanation . . . as to why such a 'temporary regulation,' issued in 1987 shortly after enactment of the Tax Reform Act of 1986, should remain 'temporary' well over a decade later."[19] However, the court ultimately held against the government on different grounds and thus didn't set aside the regulation.

Along similar lines, the Seventh Circuit in *Kikalos v. Commissioner* stated that without any evidence that a temporary regulation has "undergone the scrutiny that typifies a pre-adoption notice and comment period,"[20] the regulation should be treated as a mere proposed regulation. And the Sixth Circuit, in *Hosp. Corp. of Am. v. Commissioner*, acknowledged that the temporary regulations may be invalid for the failure to comply with notice and comment requirements, but the court ultimately declined to address that issue, given the

---

[18](...continued)
(D.C. Cir. 2003) (noting that this Circuit has "opted for vacatur recently with some regularity" when notice-and-comment is absent).

[19] *Tedori v. United States*, 211 F.3d 488, 491 n. 9 (9th Cir. 2000) (discussing Temp. Reg. Section 1.163-9T(b)(2)(I)).

[20] *Kikalos v. Commissioner*, 190 F.3d 791, 796 (7th Cir. 1999).

taxpayer's failure to raise it.[21]

More recently, in *Intermountain Ins. Serv. of Vail LLC v. Commissioner*, a case involving temporary regulations addressing tax shelters and the Section 6501 statute of limitations rules, two concurring Tax Court judges concluded that those regulations were invalid for failure to comply with notice and comment requirements. (The majority in that case held against the government on different grounds.)[22]

If The Temporary Regulation is invalid, the Tax Court would have no jurisdiction to address the applicability of the 40% basis overstatement penalty. In fact, the Tax Court would have no jurisdiction to do anything in this case. Section 6233(b), by its terms,

---

[21] *Hosp. Corp. of Am. v. Commissioner*, 348 F.3d 136, 144-45 and n. 3 (6th Cir. 2003).

[22] *Intermountain Ins. Serv. of Vail LLC v. Commissioner*, 134 T.C. 211, 230 (2010). In *United States v. Home Concrete & Supply LLC*, 132 S. Ct. 1836 (2012), the court addressed the same statute of limitations issue presented in *Intermountain* and held against the government without addressing the procedural irregularities associated with temporary regulations.

applies "to the extent of regulations,"[23] and if The Temporary Regulation were set aside, no regulation would extend TEFRA to sham partnerships for any issue is a sham partnership case, at least for the taxable year involved here.[24]

Under general administrative law doctrines, it would seem unimaginable that the IRS could bypass notice-and-comment procedures, offer no required "good cause" explanation, promise to take comments into account but ignore them and then, more than a decade

---

[23] A minority of courts have held that a tax statute that calls for regulations can operate without them, but the D.C. Circuit has expressly declined to adopt that approach. See *Francisco v. Commissioner*, 370 F.3d 1228, 1230 n.1 (D.C. Cir. 2004) (noting that Tax Court had applied statute without regulations but declining to address that issue). The Supreme Court itself has repeatedly rejected the application of "phantom" regulations, and in any event, *Mayo* vitiates whatever force phantom tax regulations might have once had. *See* Amandeep S. Grewal, *Mixing Management Fee Waivers with Mayo*, 16 Fla. Tax. Rev. 1, 27-38 (2014), available at http://tinyurl.com/GrewalMayo, and Amandeep S. Grewal, "*Substance Over Form? Phantom Regulations and the Internal Revenue Code*," 7 Hous. Bus. & Tax. L. J. 42 (2006). So, without properly implemented regulations, Section 6233(b) has no effect and TEFRA does not apply to sham partnerships.

[24] This argument would be moot for partnership taxable years on or after Oct. 4, 2001, assuming that the final regulations under Section 6233 complied with the Administrative Procedure Act.

later, adversely invoke its temporary regulation against a taxpayer.[25]

Although some previously questioned whether general administrative law doctrines apply to the tax law, the Supreme Court flatly rejected any claims of tax exceptionalism in *Mayo*.[26]

II. THE ADJUSTED BASIS CLAIMED ON THE RETURN IN THIS CASE CANNOT BE SHOWN TO BE 400 PERCENT OR MORE OF THE CORRECT AMOUNT WITHOUT DIVIDING BY ZERO, AN IMPOSSIBLE SITUATION, AND THE TREASURY REGULATION'S ATTEMPT TO FIX THIS PROBLEM IS IMPROPER.[27]

Assuming other requirements are met, the gross valuation misstatement penalty, as in effect during the taxable year at issue,

---

[25] *See, e.g., Chrysler Corp. v. Brown*, 441 U.S. 281, 315 (1979) ("In enacting the APA, Congress made a judgment that notions of fairness and informed administrative decision making require that agency decisions be made only after affording interested persons notice and an opportunity to comment.")

[26] One might argue that Section 7805(e), which provides a three-year expiration period for temporary regulations issued after Nov. 20, 1988, effectively provides an unlimited shelf life for any temporary regulation issued on or before that date. But that position is impossible to reconcile with the Administrative Procedure Act's express statement rule. *See* Amandeep S. Grewal, *"Legislative Entrenchment Rules in the Tax Law*," 62 Admin. L. Rev. 1011, 1051-1058 (2010).

[27] Consider the statement: "Ten is 400% more than zero." That statement is always false.

applies when the claimed adjusted basis of property is 400 percent or more (than 400%) of the property's true basis. See Sections 6662(b)(3), (e)(1)(A) & (h) (2000) and Treasury Regulation Section 1.6662-5 (Substantial and gross valuation misstatements under chapter 1). In note 4 of *Woods*, the Supreme Court noted the argument of Prof. Grewal as *amicus curiae* that the regulation is in tension with the mathematical rule forbidding division by zero, but the Court declined to further address this issue because "Woods has not challenged the regulation before this Court, so we assume its validity for purposes of deciding this case." *Woods*, n.4 (citing *"Lee's Summit v. Surface Transp. Bd.*, 231 F. 3d 39, 41–42 (D.C. Cir. 2000) [discussing "problems posed by applying [a] 100% increase standard to a baseline of zero"].). We will challenge the 400% penalty regulation, because, in a case like this, where the IRS argues that a taxpayer has a zero basis in property, the penalty statute does not apply. If a taxpayer claims a positive basis in property, but the property's basis is really zero, then the percent by which the claimed basis exceeds the true basis is undefined. And "undefined" is not equal to 400 percent or more, nor is it infinite – it's simply undefined. *See Free Math Help, Division By Zero*,

http://www.freemathhelp.com/division-by-zero.html (last visited May 31, 2013); Professor Peter Alfeld, *Why Can't We Divide by Zero?*, http://www.math.utah.edu/~pa/math/0by0.html (last visited May 31, 2013). The 400% treasury regulations attempt to finesse this problem by stating that zero basis circumstances are "considered" as satisfying the 400 percent or more threshold. *See* Treasury Regulations Section 1.6662-5(g).

But this regulation, as a mathematical matter, misinterprets the statute and also contradicts its plain meaning – the statutory phrase "400 percent or more" does not include things that are undefined. (How can something be defined as "400 percent or more" if it cannot be defined?) We submit that the regulation is invalid. Although the Treasury enjoys the authority to define ambiguous statutory language, it does not enjoy the power to define an unambiguously undefined mathematical concept. *See also* Charles Seife, Zero: *The Biography of a Dangerous Idea 23* (2000) ("[D]ividing by zero destroys the entire framework of mathematics.").

The 400% gross valuation misstatement penalty thus does not apply here, because the IRS reduced the partners' outside basis from a

positive number down to zero. This conclusion flows directly from this Court's opinion in *Lee's Summit*, which should not be overruled. In that case, the government defended the Surface Transportation Board's decision not to conduct a formal environmental review where a corporation acquired an unused railroad line and planned to run two trains a day on that line. The relevant regulation required an environmental review whenever the acquisition of a railroad line would cause "an increase in rail traffic of at least 100 percent." 49 C.F.R. Section 1105.7(e)(5)(i)(A). The government successfully argued that the 100 percent standard did not apply when the baseline was zero, and the Surface Transportation Board thus could look to an alternate rule to determine whether to conduct an environmental review. See 231 F.3d at 42. *Lee's Summit* thus shows why Treas. Reg. 1.6662-5(b) is invalid - a percentage-based penalty cannot apply to a baseline of zero.

Aside from its embrace of mathematical impossibilities, the treasury regulation also creates significant policy problems. Under the regulation, whenever the true basis in property is zero, then any claimed basis, no matter how tiny, is considered to satisfy the 400 percent threshold. The Court rejected that argument in *Lee's Summit*,

and it should reject that argument here. See 231 F.2d at 42 ("If the cities' argument were credited, any increase in traffic above zero would trigger an assessment."). According to the treasury regulation, if a taxpayer claims a basis of even one penny in property whose basis is really zero, he automatically meets the 400 percent threshold. That makes no sense. Although this hypothetical taxpayer might be saved from a penalty because of Section 6662(e)(2)'s dollar limitations, the presence or absence of a statutory dollar limitation should not determine whether the IRS can bend the natural laws of mathematics and divide by zero.

Also, the treasury regulation arbitrarily treats zero basis circumstances as satisfying the 400% threshold for the gross valuation misstatement penalty, as opposed to merely satisfying the 200% threshold for the regular valuation misstatement penalty. If the government really has the power to make the impossible, possible, and to apply a percentage-based penalty to a baseline of zero, then simple fairness requires that the least severe percentage-based penalty apply.

CONCLUSION STATING RELIEF SOUGHT

This case and action should be dismissed entirely for lack of

jurisdiction.

Respectfully submitted,

Dated: June 10, 2014

/s/ Edward M. Robbins, Jr.

EDWARD M. ROBBINS, JR.
Hochman, Salkin, Rettig,
Toscher & Perez, P.C.
9150 Wilshire Boulevard,
Suite 300
Beverly Hills, California 90212
Telephone: (310) 281-3200
Fax: (310) 859-1430

Counsel for Petitioner-Appellee

3466021

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 4,670 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using WordPerfect 11 in 14-point Century Schoolbook.

Respectfully submitted,

Dated: June 10, 2014

/s/ Edward M. Robbins, Jr.

EDWARD M. ROBBINS, JR.
Hochman, Salkin, Rettig,
Toscher & Perez, P.C.
9150 Wilshire Boulevard,
Suite 300
Beverly Hills, California 90212
Telephone: (310) 281-3200
Fax: (310) 859-1430

Counsel for Petitioner-Appellee

3466021

CERTIFICATE OF SERVICE

I hereby certify that on June 10, 2014, I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit by using the appellate CM/ECF system.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

/s/ Edward M. Robbins, Jr.
EDWARD M. ROBBINS, JR.
Attorney for Appellee

3466021

ADDENDUM

Internal Revenue Code of 1986 (26 U.S.C.):

Sec. 6233. Extension to entities filing partnership returns, etc.

(a) General rule

If a partnership return is filed by an entity for a taxable year but it is determined that the entity is not a partnership for such year, then, to the extent provided in regulations, the provisions of this subchapter are hereby extended in respect of such year to such entity and its items and to persons holding an interest in such entity.

(b) Similar rules in certain cases

If a partnership return is filed for any taxable year but it is determined that there is no entity for such taxable year, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply.

Sec. 6662. Imposition of Accuracy-related Penalty.

See Addendum of Appellant's Replacement Brief.

Title 26 of the Code of Federal Regulations (Treasury Regulations):

Sec. 301.6233-1 Extension to entities filing partnership

returns.

(a) Entities filing a partnership return.

Except as provided in paragraph (c)(1) of this section, the provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C) and the regulations thereunder shall apply with respect to any taxable year of an entity for which such entity files a partnership return as well as to such entity's items for that taxable year and to any person holding an interest in such entity at any time during that taxable year. Any final partnership administrative adjustment or judicial determination resulting from a proceeding under subchapter C with respect to such taxable year may include a determination that the entity is not a partnership for such taxable year as well as determinations with respect to all items of the entity that would be partnership items, as defined in section 6231(a)(3) and the regulations thereunder, if such entity had been a partnership in such taxable year (including, for example, any amounts taxable to an entity determined to be an association taxable as a corporation). For example, a final determination under subchapter C that an entity that filed a partnership return is an association taxable as a corporation will serve as a basis for a computational adjustment reflecting the disallowance of

any loss or credit claimed by a purported partner with respect to that entity.

(b) Partnership return filed but no entity found to exist

Paragraph (a) of this section shall apply where a partnership return is filed for a taxable year but it is determined that there is no entity for such taxable year. For purposes of applying paragraph (a) of this section, the partnership return shall be treated as if it were filed by an entity. However, any final partnership administrative adjustment or judicial determination resulting from a proceeding under subchapter C with respect to such taxable year may also include a determination that there is no entity for such taxable year.

(c) Exceptions.

Paragraph (a) of this section shall not apply to --

(1) Entities for any taxable year in which such entity would be excepted from the provisions of subchapter C of the Internal Revenue Code under section 6231(a)(1)(B) and the regulations thereunder (relating to the exception for small partnerships) if such entity were a partnership for such taxable year; and

(2) Entities for any taxable year for which a partnership

return was filed for the sole purpose of making the election described in section 761(a).

(d) Effective dates.

This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see section 301.6233-1T contained in 26 CFR part 1, revised April 1, 2001.

[Added by T.D. 8965, 66 FR 50541-50564, Oct. 4, 2001.]

Sec. 1.6662-5 Substantial and gross valuation misstatements under chapter 1.

(a) In general.

If any portion of an underpayment, as defined in section 6664(a) and section 1.6664-2, of any income tax imposed under chapter 1 of subtitle A of the Code that is required to be shown on a return is attributable to a substantial valuation misstatement under chapter 1 ("substantial valuation misstatement"), there is added to the tax an amount equal to 20 percent of such portion. Section 6662(h) increases the penalty to 40 percent in the case of a gross valuation misstatement under chapter 1 ("gross valuation misstatement").

*****

(e) Definitions

(1) Substantial valuation misstatement.

There is a substantial valuation misstatement if the value or adjusted basis of any property claimed on a return of tax imposed under chapter 1 is 200 percent or more of the correct amount.

(2) Gross valuation misstatement.

There is a gross valuation misstatement if the value or adjusted basis of any property claimed on a return of tax imposed under chapter 1 is 400 percent or more of the correct amount.

*****

(g) Property with a value or adjusted basis of zero.

The value or adjusted basis claimed on a return of any property with a correct value or adjusted basis of zero is considered to be 400 percent or more of the correct amount. There is a gross valuation misstatement with respect to such property, therefore, and the applicable penalty rate is 40 percent.