Refund Claims for Holders of Partnership Interests, a Cautionary Tale.

What would you do if you realized that a tax return filed in the past three years treated an item as ordinary income that qualified for capital gains treatment? Generally, if you decided that the amount was worth the trouble, you would file an amended return and seek a refund.

But there is one situation where that is not the right move: when the income came from a partnership covered by TEFRA. The Fifth Circuit recently issued an opinion that illustrates the point nicely. *Rigas v. United States*, 2012 U.S. App. LEXIS 17636 (5th Cir. Aug. 21, 2012).

In *Rigas*, the taxpayers had an interest in a limited liability company known as Odyssey Energy Capital, LLC ("Odyssey") that managed oil and gas assets and had elected to be taxed as a partnership. In 2004, when it successfully sold the portfolio of assets it was managing, Odyssey was paid a "performance fee" of 20 million dollars. When it filed its original return for 2004, it treated this as ordinary income. The taxpayers then received a K-1 and they treated their 4 million dollar share of the performance fee the same way.

In 2007, Odyssey filed an amended return, which now reported the performance fee as a long-term capital gain, but did not make a formal request for an administrative adjustment. Mr. and Mrs. Rigas then received an amended K-1 for 2004. As a consequence, the taxpayers filed an amended return, which treated their share of the performance fee as a long-term capital gain, and they sought a refund of $857,682. After a second amended return was filed, the refund filing was ultimately rejected, leading the taxpayers to file a refund action.

Unfortunately, Mr. and Mrs. Rigas stepped on a jurisdictional land mine: section 7644(h) of the Internal Revenue Code restricts refund claims that are based upon partnership items; jurisdiction only exists if the claim falls within either Section 6228(b) of the Code (dealing with items treated as non-partnership items and the rejection of an individual partner's request for an administrative adjustment) or within Section 6230(c) of the Code (which addresses computational errors or a failure to apply a final partnership administrative adjustment to a partner).

The district court concluded that it had jurisdiction over the refund action under Sections 6228(b) and 7644(h) of the Code, holding that the taxpayers had substantially complied with the requirement of filing a request for administrative adjustment. *See Rigas v. United States*, 2012 U.S. App. LEXIS 17636, *11-*12 (5th Cir. Aug. 21, 2012).

On appeal, the Fifth Circuit was satisfied that the doctrine of substantial compliance could be applied to the filing requirements for a request for administrative adjustment, since it viewed the filing requirements as a procedural rather than a substantive issue. *Id.* at *16-*17. The Fifth Circuit reversed, however, because it was not convinced that the relevant return did substantially comply with the filing requirements. Relying upon a very similar tax court opinion, *Samueli v. Commissioner*, 132 T.C. 336, 343 (2009), the Fifth Circuit ruled that the taxpayers' return did not meet the substantial compliance threshold because it was not filed in the same IRS service center as the partnership return and because it did not explain in detail the reasons for the requested adjustments. *Id.* at *17-*19. The simple statement that the return was being filed due to an amended K-1 was not enough.

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