



U.S. Department of Justice

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October 1, 2013

Lyle W. Cayce, Esquire
Clerk, U.S. Court of Appeals
for the Fifth Circuit
U.S. Court of Appeals Courthouse
600 S. Maestri Place
New Orleans, LA 70130-3408

Re: NPR Investments, L.L.C. v. United States
(5th Cir. - No. 10-41219)

Dear Mr. Cayce:

This is in response to your letter dated September 26, 2013, requesting the parties in the above-referenced case to file supplemental letter briefs by 5:00 P.M. on October 1, 2013. Regarding the first question posed by the Court, a comprehensive response – along the lines of the discussion of this issue in our briefs in *United States v. Woods* (S. Ct. No. 12-562) – would require several pages. Per the instructions of Mr. Connors of your office, we are providing an abridged response here. Of course, we would be happy to provide a more comprehensive answer upon request.

For ease of reference, this letter sets forth in bold the questions contained in your letter, followed by our responses.

(1) Did the district court have jurisdiction to decide, in a partnership-level proceeding, whether a basis-overstatement penalty applies as a result of the sham transactions? This question does not pertain to the district court’s jurisdiction to determine defenses.

Yes. A court presiding over a partnership-level proceeding has jurisdiction to determine, *inter alia*, “the applicability of any penalty...which relates to an adjustment to a partnership item.” I.R.C. § 6226(f). The

ordinary meaning of the word “relate” is “to bring into or establish association, connection, or relation.” *Random House Unabridged Dictionary* 1626 (2d ed. 1993); see *Commissioner v. Brown*, 380 U.S. 563, 570-571 (1965) (where common term “is used in the Code without limiting definition,” its ordinary meaning should be given effect). Accordingly, a penalty “relates to” an adjustment to a partnership item “if it has a connection with or reference to” the adjustment, at least where the connection is not too “tenuous” or “remote.” *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992).

An evident connection exists between the adjustments contained in the notice of final partnership administrative adjustment (FPAA) issued in this case – adjustments that NPR and its partners concede are correct – and any basis-overstatement penalty that could be assessed. As explained in our opening brief (Gov’t Br. 13-15, 16-20), the basis overstatements in this case are premised on the partners’ contributions of offsetting option positions to NPR and NPR’s liquidating distributions of foreign currency to the partners shortly thereafter. The FPAA, however, adjusted those partnership items to zero. (R44.) See Treas. Reg. § 301.6231(a)(3)-1(a)(4)(i), (ii) and (c)(1)-(3). In the absence of any contributions to, and distributions from, NPR, the partners could not have claimed the inflated basis in the foreign currency subsequently contributed to their law firm and reflected on the firm’s 2001-2003 returns. The basis-overstatement penalty in this case therefore “relates to” those partnership-item adjustments, and the district court accordingly had jurisdiction to determine the applicability of the penalty.¹

(2) For purposes of determining the district court’s jurisdiction to decide whether a basis-overstatement penalty applies (as distinguished from the district court’s jurisdiction to consider defenses), are there aspects of the present case that factually

¹ We note that a partner’s actual liability for any accuracy-related penalty whose “applicability” is determined in a partnership-level proceeding will depend on a number of partner-level inquiries to be undertaken following the conclusion of the partnership-level proceeding, such as whether the partner’s return reflects the erroneous tax treatment determined in the partnership proceeding, whether there is a resulting underpayment of tax by the partner, and whether the partner qualifies for the “reasonable cause” exception set forth in I.R.C. § 6664(c). Thus, the reviewing court in the partnership-level proceeding determines “applicability” by deciding whether the partnership-level error, if reflected on the returns of individual partners, could trigger the penalty.

distinguish it from the transactions at issue in *Petaluma FX Partners, LLC v. Commissioner*, 591 F.3d 649 (D.C. Cir. 2010) or *Jade Trading, LLC v. United States*, 598 F.3d 1372 (Fed. Cir. 2010)?

There are no material differences between the transactions at issue in *Petaluma* and *Jade Trading* and the transaction at issue in this case.

(3) To the extent that this question does not duplicate question (2) above, assuming that *Petaluma* and *Jade Trading* were correctly decided, is the present case distinguishable and if so, how?

This case does not appear to be distinguishable from *Petaluma* and *Jade Trading* in terms of the jurisdictional issue. We note that the issue whether *Petaluma* and *Jade Trading* were correctly decided is at the heart of the jurisdictional issue before the Supreme Court in *Woods*, scheduled for argument on October 9.

(4) Was any penalty at issue in the present case based on the partnership's inside basis, as distinguished from each partner's outside basis? Please explain in detail if your answer is "yes."

No.

* * * * *

This case is currently assigned to the undersigned attorney, who may be reached at (202) 514-2937.

Sincerely yours,

/s/ Arthur T. Catterall

ARTHUR T. CATTERALL
Attorney
Appellate Section

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CERTIFICATE OF SERVICE

I hereby certify that on October 1, 2013, I electronically filed the foregoing supplemental letter brief with the Clerk of the Court using the CM/ECF system, which will send notice of such filing to the following registered CM/ECF user:

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/s/ Arthur T. Catterall
ARTHUR T. CATTERALL
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