In the United States Court of Federal Claims

NOT FOR PUBLICATION
No. 02-384T
(Filed March 9, 2009)

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KHALIL HAMDAN AND	*
LANA K. HAMDAN,	*
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Plaintiffs,	*
	*
v.	*
	*
THE UNITED STATES,	*
	*
Defendant.	*
	*

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MEMORANDUM OPINION AND ORDER

WOLSKI, Judge.

The defendant has moved to dismiss this case pursuant to Rule 12(b)(1) of the Rules of the United States Court of Federal Claims ("RCFC"). The government argues that the Court lacks subject matter jurisdiction over the Hamdans' remaining claim regarding developer fees for tax year 1990 because the developer fees at issue are partnership items relating to a partnership governed by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), and are thus only adjustable at the partnership level. Section 7422(h) of the Internal Revenue Code ("I.R.C.") deprives federal courts of subject matter jurisdiction over individual claims for refunds attributable to TEFRA partnership items except in two narrow circumstances. *See* I.R.C. § 7422(h). Since the TEFRA provisions govern the Hamdans' claim, and Section 7422(h) deprives the Court of subject matter jurisdiction to hear it, the government's motion to dismiss is **GRANTED.**

I. BACKGROUND

The Hamdans were the sole shareholders in two corporations -- Hamdan Project Development (HPD) and HPD-Latigo, an S Corporation. App. B to Mot. of the United States to Dismiss (Mar. 11, 2004) (App. B) at A146. In 1987, HPD-Latigo, an individual named Khodor I. Saab and Cambridge Financial, Inc. formed a partnership, Malibu Cedars, Ltd. ("Malibu Cedars"), to convert foreclosed rental properties into condominiums. *Id*. at A146-47. Malibu

Cedars entered into an "Agreement for Services" with Plaza-HPD -- a joint venture of Plaza Development, Inc., a corporation half owned by Mr. Saab, and HPD -- under which Plaza-HPD converted and sold the properties. *Id*. at A147.

On December 20, 1994, the Commissioner of the Internal Revenue Service ("Commissioner") sent HPD-Latigo, Malibu Cedars' tax matters partner ("TMP"), a Notice of Final Partnership Administrative Adjustment ("FPAA") which disallowed, among other things, developer fees deducted as accrued for tax year 1989. *Id*. at A150. Malibu Cedars contested the determinations in the FPAA, but eventually entered into a Closing Agreement with the Commissioner on May 20, 1997 regarding tax years 1989 and 1992. App. B at A198-99, A150-51. The partnership was not required to include, in its income for 1992, $432,600 in developer fees accrued and deducted in 1989 but never paid. *Id.* at A199. The partners were not required to include their allocable share of these fees in their partnership income for 1992. *Id.* On May 29, 1997, the Tax Court entered a stipulated decision reflecting the Closing Agreement. *See id.* at A132-33.

On January 18, 2000, the Tax Court issued an opinion regarding the Hamdans' individual tax returns for tax year 1989. *Id*. at A143-66. The Hamdans attempted to argue issues regarding the Malibu Cedars partnership, and the Tax Court found it had "no jurisdiction to redetermine any adjustment to Malibu Cedars' partnership return," as the claims at issue in the case were those of the Hamdans -- specifically their S-Corporation HPD-Latigo -- and not claims of the partnership. *Id*. at A151 n.2.

The Hamdans filed a complaint in this Court on April 23, 2002. Compl. The Court has issued two decisions in the case. In its September 30, 2004 Memorandum Opinion and Order, the Court dismissed all of the Hamdans' claims except for those encompassed within "Issue 1" of the Complaint, for tax years 1990 and 1992. Mem. Op. and Order (Sept. 30, 2004). Concerning the rest of the plaintiffs' first claim, the Court found it "ha[d] no jurisdiction to determine if refunds are due for taxable year 1991, as the plaintiffs have neither alleged that they timely filed a tax refund claim with the IRS for that taxable year, nor did they produce such a document in response to the defendant's discovery requests." *Id.* at 2. The Court found it had no jurisdiction over the plaintiffs' second claim regarding tax year 1989 due to the rule articulated in *Flora v. United States*, 362 U.S. 145 (1960). *Id* The Court found it lacked jurisdiction over the plaintiffs' third claim regarding tax years 1987, 1988, and 1990, "as this ground was not contained in the tax refund claims filed with the IRS for these years." *Id.* In the November 17, 2005 order, the Court dismissed the Hamdans' claim regarding tax year 1992.[1] Mem. Op. and Order (Nov. 17, 2005). The only claim remaining in the case is that raised in the

[1] In their response to the government's current motion to dismiss the plaintiffs raise an argument regarding their 1992 income tax. Resp. to the United States' Mot. to Dismiss at 3-5. This claim was already dismissed and is not before the court.

part of "Issue 1" of the Hamdans' complaint concerning tax year 1990.[2] The Court explained, "[i]f plaintiffs can prove that the partnership paid developer fees in tax year 1990 that it failed to deduct because these were already deducted as accrued in 1989, and that the deduction of these fees in 1990 would result in a reduction of their 1990 income taxes, the closing agreement does not foreclose their recovery. A claim has been stated." *Id.* at 2.

II. DISCUSSION

The government moved to dismiss on the ground that I.R.C. § 7422(h) precludes jurisdiction in this matter. That provision reads: "No action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)." Before addressing this argument the Court will discuss the applicable legal standards.

A. The Standard of Review

A court must have subject matter jurisdiction to consider any claim. *Ex parte McCardle*, 74 U.S. (7 Wall.) 506, 514 (1868); RCFC 12(h)(3). Subject matter jurisdiction may be challenged at any time by the parties, or by the court on its own initiative, or even for the first time on appeal. *Capron v. Van Noorden*, 6 U.S. (2 Cranch) 126, 127 (1804); *Folden v. United States*, 379 F.3d 1344, 1354 (Fed. Cir. 2004), *cert. denied*, 545 U.S. 1127 (2005). The plaintiff bears the burden of establishing jurisdiction. *McNutt v. General Motors Acceptance Corp.* 298 U.S. 178, 189 (1936). The plaintiff must establish jurisdiction by a preponderance of the evidence. *Reynolds v. Army & Air Force Exchange Service*, 846 F.2d 746, 748 (Fed. Cir. 1988).

The plaintiffs argue that the Court is barred from hearing this motion because the Court previously declined to grant a motion for summary judgment regarding this claim. Resp. to the United States' Mot. to Dismiss at 1-2. This view is erroneous. The current motion before the court is a motion to dismiss for lack of subject matter jurisdiction under Rule 12(b)(1). As noted above, subject matter jurisdiction may be raised at any point and by any party. *See United States v. Newport News Shipbuilding & Dry Dock* Co., 933 F.2d 966, 988 n.1 (Fed. Cir. 1991); *Pennhurst State School and Hosp. v. Halderman* 465 U.S. 89, 98 n.8 (1984). The plaintiffs also argue that because the motion relies on evidence outside of the complaint it should be treated as a motion for summary judgement. Resp. to the United States' Mot. to Dismiss at 2-3. This argument is also mistaken. Reliance on evidence does not change the nature of the motion to summary judgment, which is reserved for determining the *merits* of a case. *See Vink v. Hendrikus Johannes Schijf Rolkan N.V.*, 839 F.2d 676, 677 (Fed. Cir. 1988); *Forest Glen Properties, LLC* v. United States, 79 Fed. Cl. 669, 677 (2007). A motion to dismiss for failure to state a claim upon which relief may be granted -- which is a merits determination, *Spruill v. Merit Sys Prot. Bd.*, 978 F.2d 679, 686 (Fed. Cir. 1992), must, under our court's rules, be

[2] Unless citing a court opinion, all cites to the Internal Revenue Code or Treasury Regulations are to the language in force in 1990 when the Hamdans' claim arose.

converted to one for summary judgment when outside evidence is considered, and summary judgment procedures are accordingly followed. *Forest Glen*, 79 Fed. Cl. 669 at 677. This is not true for motions to dismiss for lack of subject matter jurisdiction. *Id.* When evidence is submitted challenging jurisdiction, a court is obligated to determine if it has jurisdiction, *see* RCFC 12(h)(3), and may consider this evidence without conversion. *Id.* at 676.

B. The TEFRA Partnership Provisions Apply

TEFRA creates a unified procedure for determining the tax treatment of partnership items at the partnership level, rather than the individual level. *Prati v. United States*, 81 Fed. Cl. 422, 427 (2008). The "statutory labyrinth," as Judge Block describes the TEFRA provisions, is contained in sections 6221-33 of the I.R.C. *Prati*, 81 Fed. Cl. 422 at 427. The Code requires partnerships to file a Form 1065 -- an informational tax return -- with the IRS, which identifies the distributive share of income, deductions, and credits attributable to each partner in the partnership. *See* I.R.C. § 6031(a). If the TEFRA provisions apply, controversies regarding partnership items are at a unified partnership proceeding -- not individual proceedings. *See* I.R.C. § 6221.

The plaintiffs do not dispute that Malibu Cedars is a TEFRA partnership, and indeed it was so treated by the Tax Court. App. B at A149.[3] In any event, the tax code provides two exceptions from the TEFRA provisions -- I.R.C. § 6231(a)(1)(B) and I.R.C. § 761. Neither of these exceptions apply to free the Hamdan's claim from the restrictions of the TEFRA provisions.

The first exception to the TEFRA provisions is the small partnership exception. *See* I.R.C. § 6231(a)(1)(B). This provision has two requirements: (1) there must be ten or fewer partners in the partnership, each of whom is a natural person or an estate; and (2) each partner's share in each partnership item must the same as his share in every other partnership item. *Id.*

The second exception to the partnership rules is I.R.C. § 761. Section 761 provides that a partnership may be excluded from the TEFRA provisions "if the income of the members of the organization may be adequately determined without the computation of partnership taxable income" and the partnership "is availed of--"

(1) for investment purposes only and not for the active conduct of a business,

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[3] The Court also notes that, although in its Form 1065 for the 1990 tax year Malibu Cedars checked a box claiming that it was not subject to the TEFRA procedures, *see* App.B at B23, it nevertheless designated a tax matters partner under the act. *Id.* at B24. And even if the "no" box is checked, the statute itself still determines whether TEFRA applies. *See* I.R.C. § 6231; *Rothstein v. United States*, 1998 WL 331582, 81 A.F.T.R.2d 98-2132 (Fed. Cl. May 15, 1998).

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or
(3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities[.]

I.R.C. § 761(a).

The small partnership exception in § 6231(a)(1)(B) does not apply because two of Malibu Cedars' partners -- HPD Latigo and Cambridge Financial -- were corporations, not natural persons or estates as required by the statute. App. B at A146-47. Malibu Cedars cannot qualify as a small partnership for the purposes of this exception because two of its members were not natural persons. Malibu Cedars also fails to meet the requirements of the exception contained in § 761. The plaintiffs make no argument nor offer any evidence to demonstrate that this exception should apply. The government's contention that Malibu Cedars does not qualify for this exception, due to its reported real estate business purpose, *see* Br. in Supp. of Mot. to Dismiss the Claim Remaining at 8-9, is therefore unopposed. *See also* App. B at 146-47.

A partnership item is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such an item is more appropriately determined at the partnership level than at the partner level." I.R.C. § 6231(a)(3); *see also Pochorenko v. United States*, 243 F.3d 1359, 1362-63 (Fed. Cir. 2001) (identifying partnership items). Items determined at the partnership level are "income, gains, losses, deductions, and credits of a partnership." Treas. Reg. § 301.6231(a)(3)-1. Non-partnership items are defined in the Code as "an item which is (or is treated as) not a partnership item." I.R.C. § 6231(a)(4).

Here, the developer fees are partnership items. This is evident from the fact that issues concerning them first arose in the FPAA for the 1989 tax year. *See* App. B at A150. The Hamdans are seeking a deduction for fees paid by the *partnership* to Hamdan Project Development Corp. and Plaza Development Corp. *See* App. B. at A97. These developer fees paid and deductible at the partnership level fall squarely under "partnership items" as defined by Treas. Reg. § 301.6231(a)(3)-1.

C. Section 7422(h) Deprives the Court of Subject Matter Jurisdiction Except in Narrow Circumstances Not Present Here

Having established that a matter is subject to TEFRA, "[i]n theory, a partner may contest the tax liability by paying the assessment and filing a refund action in the U.S. Court of Federal Claims." *Prati*, 81 Fed.Cl. at 429 (discussing I.R.C. § 6226(e)). However, section 7422(h) limits "a partner's ability to seek a refund based on adjustments made to the partnership's return by depriving all courts of jurisdiction to hear partner refund claims where the refund is 'attributable to partnership items.'" *Id*. (citing I.R.C. § 7422(h)).

Section 7422(h) states that "[n]o action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)," and thus contains two exceptions. *See* I.R.C. § 7422(h). One exception is section 6230(c). Section 6230(c)(1)(A) provides courts with jurisdiction when a partner brings an erroneous computation claim against the Commissioner. I.R.C. § 6230(c)(1)(A). Section 6230(c)(1)(B) applies when "the Secretary fail[s] to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a)." I.R.C. § 6230(c)(1)(B).

The Hamdans allege no erroneous computation, only that the Commissioner failed to allow deductions for tax year 1990. Compl. at 2-3 ("The Commissioner issued a Notice of Deficiency for the year 1989 [b]ut failed to reverse the assessment in the subsequent years . . . ."). Thus section 6230(c)(1)(A) does not apply. Section 6230(c)(1)(B) cannot apply to this claim as there has been no settlement, FPAA, or court decision addressing the developer fees issue for the 1990 tax year.

The other exception is in section 6228(b) and applies when an individual partner asks for judicial review of an administrative adjustment request ("AAR") he timely filed with the IRS. *See* I.R.C. § 6228(b). The TEFRA provisions allow an individual partner to file a request for an administrative adjustment of a partnership item within three years of either the date in which the partnership return is filed or the last day for filing of a partnership return for the tax year. I.R.C. § 6227(a)(1). The individual partner must also file the AAR before the IRS mails the tax matters partner an FPAA for the given tax year. I.R.C. § 6227(a)(2).

Section 6228(b) creates a process for judicial review if the IRS either does not allow or only partially allows an AAR filed under section 6227. *See* I.R.C. § 6228(b)(2)(A). Section 6228(b)(1) allows an individual partner to bring a suit for a credit or refund of an overpayment only if the IRS, after reviewing a timely AAR, had previously mailed the taxpayer a notice that the items in question would be treated as non-partnership items. I.R.C. § 6228(b)(1)(A). This action must be brought by the partner within two years of the IRS's notice regarding the treatment of the items in question. I.R.C. § 6228(b)(1)(B).

Section 6228(b)(2) allows for subject matter jurisdiction pursuant to section 7422(h), should the Secretary fail to allow any part of an AAR. I.R.C. § 6228(b)(2)(A). Should this occur, the partnership items in question are to be treated as non-partnership items. I.R.C. § 6228(b)(2)(A)(ii). The suit cannot be filed until after the expiration of six months from the date of filing the request as set forth in section 6227, discussed *supra*, but must be filed within two years of filing the AAR. I.R.C. § 6228(b)(2)(B). The partner and the Secretary can agree in writing to extend the period. I.RC. § 6228(b)(2)(B)(ii). Such actions cannot be brought if a partnership proceeding has already begun for that year. I.R.C. § 6228(b)(2)(C). If the Secretary fails to mail a notice of a partnership proceeding before the two years in which the partner has to file a case and fails to mail an FPAA within three years of the partnership return's filing or the last day of filing for the tax year, the period for filing a petition is extended. I.R.C. § 6228(b)(2)(D). The period is extended to six months after the three years in which the

Commissioner had to issue the FPAA, plus the time provided by any agreements to extend the time for assessment. *Id.*

The Hamdans never filed an AAR with the IRS. The record contains no Form 8082 for the 1990 tax year, nor do the Hamdans argue that a completed form exists. The plaintiffs, however, did file an amended 1990 tax year return. The Hamdans submitted an amended Form 1040X in an attempt to deduct the developer fees for their 1990 tax year. App. B at A131. In the section titled "Explanation of Changes to Income, Deductions and Credits," the Hamdans noted: "Decision of Tax Court, Exhibit 39 and Closing Agreement, Exhibit 40 of Docke[t] No 8669-97 accepted the disallowance of $1,467,331 to Malibu Cedars[;] and HPD-Latigo owns 25% or $366,833, an S Corp. passed thru to taxpayers per Exhibit 41-J. Amount must be reversed for 1990." *Id*. The Hamdans filed their 1040X on April 13, 1999. *Id*. at A20.

The filing of a Form 1040X does not meet the requirements for filing an AAR. The tax regulations require a partner to use the correct form when filing an AAR. Treas. Reg. § 301.6227(c)-1T ("A request for an administrative adjustment on behalf of partner shall be filed on the form prescribed by the service for that purpose . . . ."); *see Rothstein v. United States*, 1998 WL 331582, 81 A.F.T.R.2d 98-2132, *98-2135 (Fed. Cl. May 15, 1998); *see also Phillips v. Comm'r*, 106 T.C. 176, 180-181 (1995) (noting that the statute does not authorize the Secretary to consider a nonconforming AAR). The Form 1040X filed by the Hamdans for tax year 1990 is not an AAR, and thus the section 6228(b) exception does not apply.[4] Thus, neither of the statutory exceptions to section 7422(h) can provide the Court with subject matter jurisdiction over the Hamdans' claim concerning the 1990 tax year, and the case must be dismissed. *See* I.R.C. § 7422(h).

[4] Even if the Court were to consider the Form 1040X to be an AAR, the Hamdans' case was filed after the two year statute of limitation period would have run out. *See* § 6228(b)(2)(B). The Hamdans argue that the statute of limitations in their case was waived by the government. Resp. to the United States's Mot. to Dismiss at 5. But the agreement to which the plaintiffs refer neither mentions "partnership" nor does it mention the Malibu Cedars partnership. App. B at B50. Thus, it does not meet the section 6229 requirement that "the agreement expressly provides that such agreement applies to tax attributable to partnership items." I.R.C. § 6229(b)(2).

III. CONCLUSION

Section 7422(h) of the Internal Revenue Code deprives the Court of subject matter jurisdiction over the Hamdans' remaining claim in this case. The Court accordingly **GRANTS** the government's motion to dismiss the case for lack of subject matter jurisdiction. The Clerk of the Court is directed to close the case. No costs shall be awarded.

IT IS SO ORDERED.

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VICTOR J. WOLSKI
Judge