October 11, 2013

INTRODUCTION

Two prominent San Antonio businessmen had their tax case heard by the US Supreme Court yesterday.

Reuters Featured Article of the Day

Tax penalty for two Texans? Supreme Court weighs partner problem

By Patrick Temple-West

WASHINGTON, Oct 9 (Reuters) - The U.S. Supreme Court on Wednesday grappled with a case about a steep penalty the Internal Revenue Service imposed on two Texas businessmen over a sham tax shelter, with legal arguments centered on whether their partnership shielded them or not.
The case involves Billy Joe "Red" McCombs, a Texas billionaire and former owner of the Minnesota Vikings football team, and his business partner Gary Woods.

Fourteen years ago, the two set up a partnership to run a tax shelter known as a, "current options bring reward alternatives," or COBRA. The shelter generated losses meant to offset a windfall gain that McCombs was expecting.

After an audit, the IRS in 2004 billed Woods and McCombs for unpaid taxes plus a 40 percent penalty. The taxpayers took the agency to court in 2005.

A Texas district court ruled the financial transactions were a sham, but disallowed the IRS's 40 percent penalty. The IRS appealed, but lost again in a June 2012 ruling by the 5th U.S. Circuit Court of Appeals. Lower courts have already ruled that COBRA shelters were a sham, so the shelter itself is not in dispute. The Supreme Court is trying to decide if the IRS penalty can be applied to McCombs and Woods. Its decision could affect hundreds of millions of dollars in penalties in similar cases, the IRS has said.
The nine justices, who rarely hear tax cases, asked both sides to argue whether the partnership entity they set up shielded McCombs and Woods from the tax penalty.

The oral argument was a rematch between two lawyers who argued a tax shelter case before the high court last year.

The court's 5-4 ruling in that case, United States v. Home Concrete & Supply LLC, went against the IRS and divided along an unusual ideological split for the justices.

Greg Garre, a Supreme Court lawyer representing the two Texans, argued that the tax penalty only applies to the partnership entity and cannot be extended to the individuals.

A partnership is a single business owned by two or more people. The entity must file tax documents, but only the individual partners pay income taxes on partnership gains.

The government's lawyer, Deputy Solicitor General Malcolm Stewart, argued that the tax penalty can be applied to individuals when each one files individual income taxes that are consistent with the partnership return.

Justice Stephen Breyer raised concerns that Garre was splitting hairs with his argument that the tax penalty applies to partnerships and not to individual partners.

"In common sense it doesn't seem to me to make much of a difference," Breyer said.

A decision in this case, United States v. Woods, is expected by June 2014. A ruling against the IRS on the partnership question could hurt its efforts to prosecute tax shelter cases, tax lawyers have said.
Woods and McCombs could not be reached for comment at McCombs Partners, a San Antonio-based investment management firm, which was founded by McCombs and where Woods is president.
Garre, a lawyer with Latham & Watkins LLP, said after the oral argument: "We look forward to the court's decision."

The IRS could not be reached for comment.

The case is United States v Woods No. 12-562 (Reporting by Patrick Temple-West. Editing by Kevin Drawbaugh and Andre Grenon)