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# Know Thy TMP (Tax Matters Partner)

BY JOHN BONN, ESQ. AND FRANK POLEK, ESQ.

**Y**our tax matters partner's behavior can affect you. Recently, the Ninth Circuit Court of Appeals decided a case involving an investigation of a tax matters partner (TMP) by the IRS' Criminal Investigation Division (CID), and how such an investigation may affect other partners. The lesson to be learned for partners is that a TMP can still be a TMP despite a criminal investigation, and can still take action which binds or otherwise affects the other partners or LLC members.

In *Phillips v. Commissioner*, the taxpayers were limited partners in three partnerships. Through the partnerships, the taxpayers claimed losses for various tax years. All three partnerships were organized and marketed by the same individual general partner, who was also the TMP for all three partnerships. On the side, the TMP was preparing tax returns for others (but not the taxpayers). The TMP came under investigation by the CID in connection with those individual returns. The CID recommended to the Department of Justice (DOJ) that the TMP be prosecuted, but the DOJ declined. The TMP was aware of the investigation and of DOJ's decision not to prosecute, but he was never given written notice of the investigation.

The TMP was later investigated by CID for yet another criminal tax fraud. At about the same time, the Office of the United States Attorney in Portland, Oregon asked CID to join in an ongoing grand jury investigation of the TMP. At first, the decision was made not to prosecute. Later, the TMP was indicted, tried and convicted of mail fraud, conspiracy, money laundering, etc. (but not tax fraud). Each criminal investigation was unrelated to the taxpayers and to the partnerships in which they were partners.

Despite the taxpayers' arguments and, eventually, appeal, the IRS continued to treat the TMP as a TMP even when it believed that he had committed tax fraud.

The IRS also rejected the taxpayers' argument that the TMP was terminated as a TMP by operation of IRS regulations (26 C.F.R. § 301.6231), that a criminal investigation of a TMP imposes a mandatory obligation on the IRS to cease treating the TMP as a TMP. The regulation vests the Secretary with discretion to notify a partner if he is under criminal investigation. Only after notice is given (if it is given at all), will partnership treatment cease. Because written notice was never given to the TMP, partnership items remained partnership items and the TMP remained a TMP.

Finally, the taxpayers argued the Commissioner abused his discretion in not terminating the TMP. Again, the taxpayer lost. The Court found that no abuse of discretion has been shown.

Phillips is an extreme example of how a TMP's powers can be used, even unintentionally, to the detriment of those who entrust themselves to them. Tax Matters Partners Can Protect Themselves

How might a partner or LLC member protect themselves from a TMP who could take action against the interests of the partners or members? Here are some possibilities:

- ◆ Partners or members of an LLC can name themselves "notice partner" under the partnership administrative proceeding rules (26 U.S.C. § 6221 et seq.). This can be done on a case-by-case basis or for all matters involving the partnership or LLC, including extending statutes of limitation. Notice partners receive notice of the beginning and completion of IRS administrative proceedings. Having partners other than just the TMP receive such notices helps ensure that a TMP not hide or mishandle interaction with the IRS.

- ◆ Consider creating an entity which will be a general partner or an LLC member-manager. That entity will be named the TMP. The entity would be governed by a board of directors or similar body

with two or more unrelated persons who control it. Corporate actions could require the signature of at least two of the directors.

For example, the TMP could be an LLC, a

member-manager with a tiny economic interest, a board of directors, or a manager who is a partner in an independent public

accounting firm (or other trustworthy person) who handles all interaction with the IRS.

- ◆ Alternate TMPs from year to year between or among unrelated persons.

While not foolproof, taking steps such as these should help ensure that the TMP is less likely to be the subject of a criminal investigation or that he will take action detrimental to the partners or members.

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