Initially, Prudential was interested in Mr. Schnitzer's offer. Mr. Schnitzer was invited to Prudential's Newark, New Jersey, corporate headquarters for further meetings and discussions with Prudential's management. Mr. Schnitzer met with Prudential's senior executives and corporate headquarters staff, including Prudential's chairman, and with Donald Knab (who headed Prudential's real estate department). Prudential was particularly interested in standardizing the reports it received on the operating results of its various commercial real properties around the country. However, Prudential ultimately declined Mr. Schnitzer's offer, because of the substantial number of pension plans whose real estate investment accounts Prudential managed. Prudential believed that having an ownership interest in PMS might be a potential conflict of interest and might present problems under the pension laws.

Although Prudential declined Mr. Schnitzer's offer, from 1974 through late 1977, PMS's property management business increased substantially, with Prudential being PMS's biggest customer. Pursuant to Mr. Schnitzer's discussions with Prudential's management and corporate headquarters staff in 1974, PMS standardized its reports on the Prudential commercial real properties that PMS managed. By 1977, PMS had expanded its property management operations to other cities around the country, including Atlanta, Georgia, Los Angeles and San Francisco, California, Newark, New Jersey, and Portland, Oregon.

In 1977, Mr. Schnitzer and Kanter discussed Century, Inc.'s possible sale of a 47.5-percent stock interest in PMS to IRA. Kanter indicated that, through Kanter's business contacts, Kanter and/or IRA could obtain additional property management business for PMS with other parties, including possibly with the Pritzker family.

In November 1977, Century, Inc., sold a 47.5-percent stock interest in PMS to IRA for $150,000. The sale was made subject to Century, Inc.'s right to apply PMS profits first to servicing the $1.1 million debt Century, Inc., had incurred to purchase PMS in 1974.

By 1979, Mr. Schnitzer concluded that Kanter and/or IRA had failed to produce the additional property management business for PMS that had been expected. He decided that Century, Inc., should repurchase IRA's 47.5-percent PMS stock interest from IRA.

Mr. Schnitzer and Kanter negotiated the price that Century, Inc., would pay IRA for the 47.5-percent PMS stock interest. In July 1979, Century, Inc., purchased from IRA the 47.5-percent PMS stock interest for a price of $3.1 million, to be paid to IRA over a 10-year period with interest.

5. Payments From the Essex Partnership to IRA and THC From 1982 Through 1989. John Eulich was a real estate developer of office buildings, shopping malls, and warehouses in Houston and Dallas, Texas. In connection with his real estate development work, Mr. Eulich had known Ballard and Lisle since at least 1965, when Ballard and Lisle worked in Prudential's Houston regional

office. Mr. Eulich's real estate development activities were primarily conducted through Vantage, Inc., a corporation that he owned. In addition to owning Vantage, Inc., Mr. Eulich later became a majority shareholder in Motor Hotels Management, Inc. (MHM). During some of the years at issue, MHM, IRA, THC, and Gateway Hotel Management Corp. were partners in the Essex Partnership, which partnership is discussed more fully infra.

In 1968, Mr. Eulich acquired Rodeway Inns, a company that owned a small chain of garden court motels. Over the years, Rodeway Inns increased the number of its motels. In acquiring many of Rodeway Inn's additional motels, Rodeway Inns and Mr. Eulich obtained financing from Prudential. From 1968 through about 1973, in securing this financing for Rodeway Inns, Mr. Eulich dealt with Ballard. In about 1974, Mr. Eulich and Prudential became dissatisfied with the performance of the hotel management company that was managing and operating some 16 Rodeway Inns motels that had been financed by Prudential.

Mr. Eulich decided to establish his own hotel management company, MHM, to operate the motels. Mr. Eulich arranged to have another individual possessing substantial hotel management experience serve as MHM's president and manage MHM's day-to-day operations. MHM was incorporated on January 1, 1975. MHM's three shareholders eventually included Mr. Eulich (who was the majority shareholder), the individual who Mr. Eulich had arranged to be MHM's president, and another longtime business associate of Mr. Eulich.

In persuading the individual who became MHM's president to participate in the ownership and operation of MHM, it was agreed that MHM's hotel management business would be expanded. After MHM commenced its operations, although he generally was not involved in conducting MHM's day-to-day business operations, Mr. Eulich helped arrange financing for MHM and was actively engaged in marketing MHM's services to various outside parties in an effort to obtain additional hotel management business.

By the middle to late 1970's, MHM had acquired a good reputation for the hotel management services it offered. Prudential's real estate department staff generally were very satisfied with MHM's management of a number of hotel properties in which Prudential was involved. However, until about the early 1980's, MHM generally only managed smaller-size hotel properties, not large hotels. By about the early 1980's, MHM managed hotel properties nationwide in about 20 to 25 States, although to a more limited and lesser extent than it wished in the northeastern region of the country.

In about 1976, Allen Ostroff became a Prudential real estate department employee and served as Prudential's in-house consultant on hotels and hotel operations. Prior to joining Prudential, Mr. Ostroff had worked for a number of years for Hilton Hotels as a hotel manager and executive. Ballard was instrumental in Prudential's hiring of Mr. Ostroff, as Ballard had concluded that Prudential's real estate department needed to employ an individual possessing substantial expertise in hotels and hotel operations.

Previously, the real estate department staff in Prudential's regional offices negotiated hotel management contracts for Prudential's hotel properties on an ad hoc basis. By 1979, Mr. Ostroff had devised a model hotel management contract that Prudential's real estate department staff could use in negotiating such management contracts. Mr. Ostroff also worked on various hotel projects for Donald Knab, Ballard, and/or Lisle.

At some point during the 1970's, the hotel management industry began to offer owners of large hotels relatively short-term management contracts for hotels, typically for terms ranging from 5 to 10 years. It was sometimes not desirable for a hotel owner to enter into a long-term management contract, particularly if the owner contemplated selling the hotel within the next 5 to 10 years, as an outstanding long-term management contract could make the hotel more difficult to sell. Rather than entering into a long-term management contract with a national hotel company, like Hilton Hotels, Hyatt Corp., or Marriott Hotels, an owner of a large hotel frequently had its hotel operated under a franchise with a national hotel company like Hilton Hotels or Marriott Hotels.[18] For instance, under a franchise agreement with Hilton Hotels, the hotel owner could obtain the right to use the Hilton name as well as the services of the Hilton national hotel

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[18] During the period relevant to these cases, Hyatt Corp. did not offer such franchise arrangements.

reservation system. The hotel owner then could have its Hilton-franchised hotel managed and operated under a short-term management contract with either Hilton Hotels (the franchisor) or another hotel management company.[19]

One of Mr. Ostroff's first assignments at Prudential was to improve the operating condition of the Gateway Hotel at Newark, New Jersey. The Gateway Hotel was located a few blocks from Prudential's corporate headquarters. The hotel was in shabby condition, as Prudential had recently acquired it through foreclosure. Moreover, the class or type of customers that prior operators of the hotel catered to was not the type of clientele Prudential was comfortable with because other Prudential executives and individuals transacting business at Prudential's headquarters office frequently stayed at the hotel.

Mr. Ostroff first obtained a Hilton franchise for the Gateway Hotel. Although Hilton Hotels had been reluctant to grant Prudential a franchise, Mr. Ostroff obtained the franchise by pointing out to Hilton Hotels the other profitable business dealings it had with Prudential.

Mr. Ostroff next hired another hotel management company to take over the Gateway Hotel's management and operation. This management company was owned by an experienced hotel manager Mr. Ostroff had known during Mr. Ostroff's prior employment with

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[19] A hotel management executive testified that a national hotel company, like Hilton Hotels, could not grant a hotel franchise to a hotel owner conditioned upon the owner also entering into a management contract with it for the franchised hotel, as such action might violate the anti-trust laws.

Hilton Hotels. This individual, at some point, assigned John Connolly to be the Gateway Hotel's on-site manager.

Mr. Ostroff was extremely successful in turning around and substantially improving the Gateway Hotel's operating condition. Prudential corporate headquarters executives eventually were proud to have other Prudential executives and business visitors stay at the hotel. Prudential executives also made significant use of the hotel facilities for meetings and entertainment and were very pleased with the service that they and their guests received at the hotel.

The individual who owned the hotel management company that operated the Gateway Hotel did not spend much of his own time in actually running the Gateway Hotel. Over the years, he had delegated more and more duties in the hotel's operation to Mr. Connolly. In 1981, Mr. Connolly informed Mr. Ostroff that he was considering leaving his position as on-site manager of the Gateway Hotel, because he felt he was not being adequately compensated for his services. Mr. Ostroff attempted unsuccessfully to have Mr. Connolly's employer increase Mr. Connolly's pay. Mr. Ostroff and his superiors at Prudential then decided to terminate Prudential's management contract with Mr. Connolly's employer and awarded the management contract to a hotel management company owned by Mr. Connolly.

Mr. Ostroff advised Mr. Connolly of Prudential's desire to have him manage the Gateway Hotel; however, Mr. Ostroff advised Mr. Connolly that he would have to establish a management company of his own because Prudential did not want to have its employees involved in operating the hotel and did not want any of the hotel's employees to be Prudential employees. All hotel employees would have to be employees of Mr. Connolly's hotel management company. However, establishing such a hotel management company presented a problem for Mr. Connolly, as Mr. Connolly's management company, among other things, would be required to employ a financial manager and an accounting staff to prepare and issue the financial reports on the Gateway Hotel's operations that Prudential expected. Moreover, its full-time employment of such personnel to perform these and other required services could well be uneconomical, as Mr. Connolly's company would be managing only one or at most two hotels.

Mr. Connolly, nevertheless, proceeded to organize a hotel management company and incorporated Gateway Hotel Management Corp. (GHM) some time in 1981. In about late 1981, GHM received from Prudential a management contract to operate the Gateway Hotel and a management contract to operate another Hilton-franchised hotel that Prudential owned at Midland, Texas.[20]

Kanter and Mr. Eulich were aware Mr. Connolly would need assistance for the hotel management company he established. Mr. Eulich also wanted MHM's hotel management business eventually to include MHM's management of a number of large hotels. Mr. Eulich

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[20] Although Mr. Ostroff and Prudential ultimately awarded the Midland, Texas, hotel's management contract to GHM, GHM and MHM had each submitted bids on the Midland hotel's management contract. During this time, Prudential usually obtained bids from at least three hotel management companies for a particular hotel's management contract.

previously knew Kanter from being involved in certain prior business ventures in which Kanter had helped raise capital. He believed that Kanter's business contacts, particularly those contacts attributable to Kanter's association with the Pritzker family, could be beneficial to MHM, as Kanter knew many people in the hotel industry, including individuals who owned the large hotels that MHM wanted to manage.

Mr. Eulich, Kanter, and Mr. Connolly decided to form the Essex partnership (Essex), which was organized in about late 1981. The partners of Essex and their partnership interests were as follows:

Partner	Partnership Interest
MHM	47.500%
IRA	26.125%
THC	21.375%
Mr. Connolly (and/or GHM)	5.000%

One of the Essex partnership's stated purposes was to provide consulting and liaison services to its partners. Although the partnership agreement required its partners to contribute the capital needed to operate the partnership, very little, if any, actual capital contributions were ever required from them. Essex had no office, equipment, or employees because employees of MHM performed many of the consulting services that GHM needed. GHM was not billed by MHM for these services because GHM entered into consulting and fee participation agreements with Essex wherein GHM agreed to pay to Essex a specified percentage of its fees on GHM's management contracts on the Gateway and Midland hotels.

MHM also entered into similar consulting and fee participation agreements with Essex with respect to MHM's management contracts on two or three specific hotels that MHM managed.

From 1982 through 1986, the specified percentage of fees Essex received under the various consulting and fee participation agreements it had with GHM and MHM varied and, at times, was adjusted. In operating Essex, the partners agreed that the fees GHM paid Essex generally would equal the fees MHM paid to the partnership. The partnership's specified percentage of fees under each consulting and fee participation agreement could easily be adjusted and modified, as each consulting and participation agreement was cancelable by a 30- to 90- day notice. As a result, if a significant change occurred with respect to the compensation that GHM or MHM received under a particular hotel management contract, an offsetting change then could be effectuated in the other consulting and fee participation agreements GHM and MHM had with Essex.

Initially, in about early 1982, GHM entered into the consulting and fee participation agreement with Essex in connection with GHM's management contracts on the Gateway Hotel and the Hilton-franchised hotel at Midland, Texas. MHM entered into similar agreements with Essex in connection with MHM's management contracts on a Hilton-franchised hotel at Allentown, Pennsylvania, and another Hilton-franchised hotel, the Madison Hotel, at Morristown, New Jersey. Although Prudential had helped finance the latter two hotels' construction, Prudential apparently had no involvement in awarding the Allentown Hilton and Madison Hilton hotel management contracts to MHM, as the two hotels were owned by third parties. In late 1983, MHM received a hotel management contract for Prudential's Hilton-franchised Twin 60's Hotel at Dallas, Texas. Shortly thereafter, MHM and Essex entered into a consulting and fee participation agreement, pursuant to which Essex received a percentage of MHM's fees under the Twin 60's management contract.[21]

As the total fees that MHM paid to Essex generally equaled the total fees that GHM (Mr. Connolly's hotel management company) paid to Essex, the total fees MHM paid to the partnership roughly approximated MHM's distributive share of partnership income as a 47.5-percent partner in the Essex partnership. However, as indicated previously, MHM was not paid directly for the substantial services its employees rendered to GHM. Rather, as a partner in Essex, MHM received 47.5 percent of the partnership's income. Although IRA and THC, as partners, also received a combined 47.5 percent of the income of Essex, IRA and THC, in contrast to MHM, provided no similar substantial services to GHM.[22]

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[21] Robert James, MHM's president, related that the consulting and participation agreement for the Twin 60's hotel was entered into to replace the income that Essex would lose following the expected termination of MHM's management contract for the Allentown Hilton, as the Allentown Hilton was then in the process of being sold.

[22] An MHM employee testified that, in managing GHM, Mr. Connolly was essentially a "one-man show". A number of MHM's management personnel were instructed by MHM's management to do whatever they could to help Mr. Connolly with GHM's operations. For instance, MHM employees helped perform the financial and accounting services that GHM required in connection with its

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Mr. Eulich and MHM's top management essentially viewed MHM's involvement in Essex as a marketing and sales device, whereby MHM eventually might obtain more management contracts for large hotels. By having MHM participate in Essex, Mr. Eulich hoped to have Kanter help MHM obtain additional hotel management contracts. Mr. Eulich realized that this would take some time, as owners of large hotels did not frequently change hotel management companies with which they did business. In addition, MHM needed to increase its level of experience and expertise in managing and operating large hotels. The arrangement thus described involving Essex and its partners was apparently satisfactory to all who were involved with Essex irrespective of the disparate contributors among its partners.

In 1986, MHM was sold by Mr. Eulich to an unrelated company called Aircoa. Aircoa continued to allow MHM to participate as a partner in Essex until about 1990.

B. Certain Loans, Payments, and Other Benefits that Ballard and Lisle and/or Their Family Members Received. Ballard and Lisle established respective grantor trusts (the CMB and the CMB II Trusts for Ballard and the RWL and the RWL II Trusts for Lisle). As grantor trusts, the income (or losses) of the trusts

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[22](...continued)
Gateway and Midland hotel management contracts. In yet another instance, an MHM employee helped Mr. Connolly with union negotiations. Also, after Prudential awarded the Midland, Texas, hotel's management contract to GHM, MHM's employees helped Mr. Connolly find an on-site manager for that hotel. Although Mr. Connolly did give MHM some occasional help and advice, such as sales presentations to hotel owners, the volume of services that MHM employees furnished to GHM greatly exceeded the volume of services that MHM received from GHM and Mr. Connolly.

was taxable to Ballard and Lisle pursuant to sections 671 through 678. The CMB, CMB II, RWL, and RWL II Trusts each made investments, as limited partners, in certain movie shelter partnerships. Kanter or Solomon Weisgal (the trustee of the Bea Ritch Trusts that owned all of IRA's common shares) was the trustee of these trusts. Each Ballard and Lisle trust held no assets other than its respective movie partnership interest. Each trust financed the acquisition of its movie partnership interest through a loan from IRA and International Films, Inc. (IFI), a corporation in which IRA, at one time, was a majority shareholder.[23] In making loans to the trusts, IRA originally provided the loan funds and received promissory notes from each of the trusts; IRA then transferred these trust notes to IFI, in exchange for IFI's notes. The trust notes that IFI held, from a practical standpoint, were only collectible if the movie ventures in which the trusts had invested proved successful, because the trusts had no other assets available to creditors. IFI had no recourse against Ballard and Lisle, individually, because the

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[23] The parties disagree as to whether these and other loans to Ballard and Lisle, various trusts of Ballard and Lisle, and to Mrs. Ballard were bona fide loans, and whether the parties to these transactions actually intended the funds to be repaid. The terms "loan", "promissory note", and other similar terms are used herein for convenience and are not intended as ultimate findings or conclusions concerning whether a bona fide indebtedness actually existed. Similarly, the parties are in dispute over whether certain consulting payments that were made to Ballard and Lisle's children from 1983 through 1989, which are more fully discussed infra, were in fact, compensation paid for the children's consulting work. The use of terms indicating that consulting payments were made to the children should not be construed as conveying any legal conclusion as to whether such payments constituted compensation for services rendered.

trusts, not Ballard and Lisle, had borrowed the funds and issued the promissory notes.[24]

Ultimately, the movie ventures in which the trusts invested proved unsuccessful and were not profitable. Additionally, the Internal Revenue Service later disallowed the deductions that Ballard claimed on his tax returns with respect to these movie investments, which resulted in the Ballards being required to pay additional taxes to the Internal Revenue Service. In July 1985, Mrs. Ballard borrowed about $160,000 from either IFI or IRA to pay this income tax liability that she and Mr. Ballard owned.

In 1987, IFI owed IRA in excess of $1 million and did not have sufficient resources to repay IRA. To "clean up" IFI's liability to IRA, Lawrence Freeman (IRA's president) and Linda Gallenberger (a TACI employee and an officer of convenience for IRA) had IFI (of whom IRA was now sole shareholder) transfer all of its assets to IRA in satisfaction of IFI's liability to IRA. Substantially all of the assets IFI transferred consisted of promissory notes that had been issued by various third parties, including the above promissory notes of Ballard and Lisle's grantor trusts, as well as other notes that Ballard and Lisle had issued individually. On its books, IRA reduced IFI's liability

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24 Kanter explained that, although, for Federal income tax purposes, the taxable income or taxable loss of each grantor trust was required to be reported on Ballard or Lisle's tax returns, the trusts were otherwise still separate legal entities for State law purposes. Ballard and Lisle thus were not personally liable upon the loans of their trusts, as Ballard and Lisle had not personally guaranteed the loans. Kanter claimed that he had helped the trusts obtain the loans because the movie investments originally looked very promising.

to it by an amount equal to the full face amount of the notes IFI transferred.

As reflected by a memorandum dated July 17, 1987, Lawrence Freeman (IRA's president) and Linda Gallenberger agreed that the loans that IRA was holding that had been made to Ballard and Lisle, individually, and to their respective grantor trusts would be "forgiven", in view of the difficulty of collection.

In 1987, IRA "sold" for a stated price of $1 each to MAF, Inc. (MAF), a wholly owned subsidiary of Computer Placement Services, Inc., the promissory notes of Ballard and Lisle's grantor trusts that IRA obtained above from IFI. MAF had a relatively insubstantial amount of assets and operated out of the accounting firm offices of Albert Morrison (MAF's president). Mr. Freeman (who was then IRA's president) had asked Mr. Morrison (a certified public accountant and longtime friend of Kanter) to be MAF's president. Mr. Morrison received no salary for being MAF's president. As MAF's president, he approved the "purchase" by MAF of the trust notes as a "favor" to Kanter.

IRA subsequently also sold 100 percent of IFI's outstanding shares of stock to Linda Gallenberger for $1 in September 1988. Shortly thereafter, Ms. Gallenberger placed IFI into bankruptcy.

On its 1987 tax return, IRA claimed losses with respect to its "sale" of the trust notes to MAF. IRA also claimed bad debt deductions with respect to the individual notes of Ballard and Lisle that it obtained from IFI. It further claimed a $65,000 worthless security deduction with respect to the IFI shares that were later sold to Ms. Gallenberger.

For substantially all of the period from about 1983 to 1989, KWJ Corp. (an IRA subsidiary) and later the KWJ partnership (whose partners were IRA's subsidiaries BWK, Carlco, and TMT) paid monthly "consulting fees" of $1,000 each to Ballard's two daughters and to Lisle's son and daughter. After the Internal Revenue Service commenced examinations of many of Ballard, Kanter, and Lisle's respective returns for the years at issue, Kanter, in February 1990, sent letters to the children terminating the KWJ partnership's "consulting arrangement" with them.[25] In two of these termination letters, Kanter apprised the children that he had recently assumed IRA's presidency. He noted that their consulting arrangement had begun when Lawrence Freeman was IRA's president. In the letters, Kanter stated that the children had done nothing for a number of years, and he blamed Mr. Freeman for having the KWJ partnership continue to make monthly payments to them.

After becoming IRA's acting president in 1989, Kanter also discussed with Ballard and with Lisle the payment of their individual promissory notes that IRA held but had previously deducted as bad debts on IRA's 1987 return. Since at least 1987, Ballard had claimed that neither he nor his wife were liable on the promissory notes that they had previously executed. In late

[25] Melinda Ballard's consulting arrangement had been terminated earlier in late 1988.

1992, Ballard agreed to pay IRA $120,000 in settlement of his $196,000 debt to IRA on his promissory notes. Ballard also entered into an arrangement, at about this time, to repay the $160,000 loan his wife had received from IRA in July 1985.

Kanter reached a similar agreement with Lisle to discharge his debt to IRA. Originally, pursuant to certain payment negotiations Kanter and Lisle had in 1989, Lisle agreed to pay the debt in 2 years. He failed to do so, and he and Kanter discussed the matter again, until Lisle, at some point, agreed to pay the debt by the end of 1993. However, Lisle died before making any payment, and Kanter, acting on behalf of IRA, filed a claim against Lisle's estate.

Beginning in about 1990, Ballard was paid a salary by TMT and Lisle was paid a salary by Carlco. Kanter, who was now IRA's president, agreed to have each of these IRA subsidiaries pay a salary to Ballard and Lisle. Ballard had requested that TMT pay him a salary. At various times during the period from 1987 through 1989, various of Ballard's family trusts had also received loans from TMT in order to make certain real estate investments.

Discussion

There are certain facts that the parties do not dispute: (1) Moneys were paid by "The Five"; (2) such moneys constituted gross income for Federal income tax purposes; and (3) such moneys (or income) were in fact reported for Federal income tax purposes. What is in dispute, and in support of the determination that these facts constitute fraud, is respondent's contention that the moneys paid by "The Five" were not paid to the true earners of the income; therefore, the true earners of that income did not report such income on their Federal income tax returns; the true earners of that income were Kanter, Ballard, and Lisle; the payments by "The Five" were exacted or conditioned upon the business that "The Five" received through the efforts and assistance of Kanter, Ballard, and Lisle; and the failure of Kanter, Ballard, and Lisle to report such income on their individual Federal income tax returns constitutes fraud.

A. The Assignment of Income Doctrine.

Generally, a corporate entity will be recognized for tax purposes. In Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 438-439 (1943), the Supreme Court established the following test for determining whether a corporation will be recognized as a separate taxable entity:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. * * * [Fn. refs. omitted.]

The principle that income is taxed to the person who earned it is basic to our system of income tax law. Commissioner v. Culbertson, 337 U.S. 733, 739-740 (1949); Lucas v. Earl, 281 U.S. 111, 115 (1930). However, in the corporate context, particularly in those cases involving closely held personal service corporations, this actual earner test may be inadequate. Johnson v. Commissioner, 78 T.C. 882, 890-891 (1982), affd. without published opinion 734 F.2d 20 (9th Cir. 1984).

In Johnson v. Commissioner, supra, a professional athlete, who had conveyed the exclusive rights to his personal services to a corporation, contended that the corporation, rather than he, was taxable on the amounts paid directly to it by his employer. Recognizing that a corporation can act only through its employees and agents, this Court set forth two requirements that must be met before a corporation, rather than the service-performing individual, can be considered to control the earning of the income. These requirements are: (1) The corporation must have had the right to direct or control the individual's activities in some meaningful manner, and (2) there must exist between the corporation and the person or entity using the services a contract or similar indicium recognizing the corporation's controlling position. Johnson v. Commissioner, 78 T.C. at 890-891.

The U.S. Court of Appeals for the Seventh Circuit and the Federal Circuit rejected the two-part Johnson test in favor of a more flexible facts and circumstances approach. Schuster v. Commissioner, 800 F.2d 672, 677-678 (7th Cir. 1986), affg. 84 T.C. 764 (1985); Fogarty v. United States, 780 F.2d 1005, 1012 (Fed. Cir. 1986), affg. 6 Cl. Ct. 612 (1984).

B. Fraud.

In asserting that a taxpayer is liable for the addition to tax for fraud under section 6653(b), respondent has the burden of proving, by clear and convincing evidence, that some part of the underpayment for each year at issue was due to fraud. Sec. 7454(a); Rule 142(b). Consequently, respondent must establish (1) an underpayment, and (2) that some part of the underpayment is due to fraud. King's Court Mobile Home Park v. Commissioner, 98 T.C. 511, 515-516 (1992); Truesdell v. Commissioner, 89 T.C. 1280, 1301 (1987).

Fraud is an intentional wrongdoing by the taxpayer with the specific purpose of evading a tax known or believed to be owing. Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968); McGee v. Commissioner, 61 T.C. 249, 256 (1973), affd. 519 F.2d 1121 (5th Cir. 1975). Respondent's burden of proving fraud is met if it is shown that the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes. Stoltzfus v. United States, supra at 1004; Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983).

The existence of fraud is a question of fact to be resolved from the entire record. DiLeo v. Commissioner, 96 T.C. 858, 874 (1991), affd. 959 F.2d 16 (2d Cir. 1992); Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). The taxpayer's entire course of conduct can be indicative of fraud. Stone v.

Commissioner, 56 T.C. 213, 224 (1971). Because fraud can rarely be established by direct proof of the taxpayer's intention, fraud may be established by circumstantial evidence and reasonable inferences drawn from the record. DiLeo v. Commissioner, supra at 874-875; Rowlee v. Commissioner, supra at 1123. However, the mere suspicion of fraud is insufficient because fraud is not to be inferred or presumed. Carter v. Campbell, 264 F.2d 930, 935 (5th Cir. 1959).

In Bradford v. Commissioner, 796 F.2d 303, 307 (9th Cir. 1986), affg. T.C. Memo. 1984-601, the U.S. Court of Appeals for the Ninth Circuit set forth a nonexclusive list of circumstantial evidence that may give rise to a finding of fraudulent intent. Such "badges of fraud" include: (1) Understatement of income; (2) maintenance of inadequate records; (3) failure to file income tax returns; (4) implausible or inconsistent explanations of behavior; (5) concealment of assets; and (6) failure to cooperate with tax authorities.

In addition, substantial understatements of income for successive years are strong evidence of fraudulent intent. Rogers v. Commissioner, 111 F.2d 987, 989 (6th Cir. 1940), affg. 38 B.T.A. 16 (1938); Conforte v. Commissioner, 74 T.C. 1160, 1201 (1980), affd. in part, revd. on another issue 692 F.2d 587 (9th Cir. 1982); Otsuki v. Commissioner, 53 T.C. 96, 107-108 (1969); see also Baumgardner v. Commissioner, 251 F.2d 311, 316 (9th Cir. 1957), affg. T.C. Memo. 1956-112.

C. The Parties' Arguments.

Respondent contends that Kanter, Ballard, and/or Lisle were involved in three separate schemes that resulted in their receiving kickbacks from "The Five" for assistance provided by Kanter, Ballard, and/or Lisle to "The Five" or individuals or entities associated with "The Five" in obtaining business, principally with Prudential or Travelers. Respondent alleges that these three schemes were: (1) The Prudential scheme in which Ballard, Lisle, and Kanter agreed to divide and share the kickbacks among themselves, respectively, in a 45-percent, 45-percent, and 10-percent split; (2) the Travelers scheme in which Lisle and Kanter agreed to divide and share the kickbacks among themselves, respectively, in a 90-percent and 10-percent split; and (3) the Kanter transaction in which Kanter received 100 percent of the kickbacks. On brief, respondent asserts that, during the years at issue, Ballard, Kanter, and/or Lisle received substantial amounts totaling in the millions of unreported kickback income from the Prudential scheme, Travelers scheme, and Kanter transaction.

Respondent maintains that Kanter, in carrying out the Prudential and Travelers schemes, routed the kickback payments through IRA and THC, two entities that he controlled, to conceal from Prudential and Travelers (Ballard and/or Lisle's employers) the fact that Ballard and Lisle were receiving kickbacks. As a further part of the Prudential kickback scheme, respondent argues, Kanter later directed and allocated much of the kickbacks

IRA received from "The Five" to IRA's subsidiaries Carlco, TMT, and BWK, roughly in accordance with the respective 45-percent, 45-percent, and 10-percent split agreed to by Ballard, Lisle, and Kanter. In doing this, respondent claims Ballard, Lisle, and Kanter each then controlled and managed their respective share of the kickbacks from the Prudential scheme, as, beginning in about 1984, Ballard managed TMT, Lisle managed Carlco, and Kanter managed BWK. Although Ballard and Lisle's purported shares of the kickbacks were not immediately paid to them, respondent asserts that substantial funds eventually were either paid out or provided to them and their families through "loans" and "consulting payments" to their children.

Although, as indicated in this Court's findings, the payments at issue from "The Five" were made to IRA, THC, or subsidiaries of IRA and THC, respondent heavily relies on the assignment of income doctrine in contending that the payments represented kickback income of Ballard, Lisle, and Kanter. Respondent cites DeVaughn v. Commissioner, T.C. Memo. 1983-712, as an example of a similar situation in which the assignment of income doctrine was applied to tax kickback payments to an individual taxpayer who had earned the payments but sought to redirect them to that taxpayer's corporation. Respondent lastly asserts that Ballard, Lisle, and Kanter's failure to report this kickback income on their individual returns constitutes fraud.

Alternatively, respondent asserts that, if the Court should determine that these payments did not constitute income to

Ballard, Lisle, and Kanter, under the assignment of income doctrine, such income should be reallocated to Kanter pursuant to section 482.

Petitioners, on the other hand, while not disputing that IRA, THC, and various subsidiaries of IRA and THC received payments from "The Five" during the years at issue, strongly dispute respondent's characterization of such payments as kickbacks. Petitioners deny that any kickback schemes existed. They note that, at trial, all of the various witnesses associated with "The Five" explicitly denied that these payments were "kickbacks" or "payoffs" for Ballard and/or Lisle's help in steering business to them. Petitioners further point out that all of the payments were reported on the respective tax returns of IRA and THC during the years at issue, which is not denied by respondent. They contend that the assignment of income doctrine is inapplicable and that such income is properly taxable to IRA, THC, and/or IRA and THC's subsidiaries, not to Ballard, Lisle, and/or Kanter, as respondent asserts. They lastly maintain that respondent failed to establish, by clear and convincing evidence, that Ballard, Lisle, and Kanter are liable for additions to tax for fraud under section 6653(b).

Petitioners further argue that respondent, at this late date, should not be permitted alternatively to argue that much of the alleged kickback income should be reallocated and taxed to Kanter under section 482. As noted earlier, respondent did not determine fraud in the notices of deficiencies but claimed fraud through amended pleadings filed at trial.

D. Analysis.

1. Determination With Respect to Alleged Kickback Schemes. On the record presented, the Court cannot find or conclude that respondent's claimed kickback schemes existed or, if such schemes did exist, that there was fraud in connection with the reporting and payment of Federal income taxes on the income generated through the purported schemes. None of the witnesses who appeared at trial testified that there were any such schemes. Most, if not all, of these witnesses were called by respondent. Indeed, various witnesses associated with "The Five" expressly denied making kickback payments in return for Ballard and/or Lisle's help in directing business to them.[26]

[26] The word "kickback" has several meanings. Webster's Third New International Dictionary defines "kickback", as pertinent to the facts of this case, as follows:

> Kickback: (2) to pay a kickback (forced to kick back out of every paycheck) 2: to give back (money) as a kickback (asked to kick a dollar back each week). 2: Refund: as a: a percentage of a payment exacted as a condition for granting assistance by one in a position to open up or control a source of income or gain. b: a usu. secret rebate of part of a purchase price by the seller to the buyer or to the one who directed or influenced the purchaser to buy from such seller.

The definitions of kickback relate to situations that are generally considered sinister. It is evident from the record of this case that respondent viewed the transactions involving "The Five", Kanter, Ballard, and Lisle, as sinister. Counsel for respondent throughout the trial referred to the transactions as "schemes" and described the TACI special E account as a "black box" through which illegally obtained moneys were laundered to Kanter, Ballard, and Lisle and the Ballad and Lisle children, as part of the process that respondent contends constituted fraud. The Court makes no judgment as to whether payments by "The Five" were sinister or whether they were generally accepted methods of doing business. Even if the transactions or schemes were sinister, that fact alone does not establish fraud since the ultimate question is whether there was an intentional wrongdoing by the taxpayer with the specific purpose of evading a tax known or believed to be owing. Representatives of "The Five" who testified as respondent's witnesses at trial, readily admitted paying fees to Kanter and/or IRA or THC for the

(continued...)

For instance, Kenneth Schnitzer testified that PMS did not need to obtain Ballard and/or Lisle's help in obtaining property management business with Prudential, as PMS had already established a strong working relationship with Prudential, due to PMS's prior standardization of the operational reports it issued to Prudential, which reports saved Prudential many thousands of dollars. Mr. Schnitzer elaborated that a 47.5-percent stock interest in PMS was sold to IRA in late 1977, solely because Kanter had convinced him that Kanter and/or IRA could assist PMS in obtaining substantial property management business with other parties besides Prudential.[27] Other evidence of record confirms and corroborates this testimony of Mr. Schnitzer. By 1977, Prudential was using PMS's property management services extensively in a number of major cities around the country and had entered into many additional property management contracts

[26](...continued) assistance they received from Kanter and by no means considered their actions in paying such fees as being sinister or as kickbacks in the context of the dictionary definitions above.

[27] Respondent contends that IRA was allowed to purchase the 47.5-percent PMS stock interest for a bargain price of $150,000 in late 1977, because Mr. Schnitzer wanted Ballard and Lisle's help in obtaining for PMS even more property management business with Prudential. Respondent notes that Mr. Schnitzer's company originally, in 1974, acquired PMS for a price of $1.3 million, whereas, by 1977, PMS's volume of business had greatly increased. However, IRA's $150,000 purchase price is not so disparately low a price as respondent maintains. In acquiring the stock interest, IRA agreed to allow PMS's profits first to be applied to servicing the $1.1 million loan Mr. Schnitzer's company had previously taken out to acquire PMS. In effect, the $1.3 million price paid for PMS was encumbered with an indebtedness of $1.1 million, leaving PMS with a net worth of approximately $200,000. Additionally, Mr. Schnitzer testified that the $150,000 IRA paid was a relatively unimportant part of the transaction, as Mr. Schnitzer was primarily interested in Kanter and/or IRA's procurement for PMS of substantial additional property management business with other parties.

with PMS. At that point, PMS thus had a significant advantage over its competitors in obtaining additional further property management business with Prudential, due to its already having established a solid, existing business relationship with Prudential and Prudential's satisfaction with the past property management services PMS had rendered.

Similarly, John Eulich testified that he caused MHM to participate in the Essex partnership that was formed in late 1981, because he expected that Kanter and/or IRA and THC eventually might help MHM in obtaining management contracts for larger-sized hotels. Most significantly, the Court notes that Aircoa (an unrelated third party that acquired MHM sometime in 1986, on a date well after both Ballard and Lisle had left Prudential) continued to have MHM as a partner in Essex until about 1990. Additionally, Allan Ostroff, Prudential's in-house consultant on hotels and hotel operations, confirmed that Prudential's real estate department personnel, by the late 1970's, had a very good opinion of the hotel management services MHM offered.

With respect to Bruce Frey and the BJF Development partnership, the record reflects that, following Mr. Frey's success with the Village of Kings Creek condominium conversion project, the Miami regional office Prudential real estate department executive Mr. Frey had previously dealt with in purchasing that apartment complex, approached Mr. Frey inquiring whether Mr. Frey would be interested in purchasing other

Prudential apartment complexes. Mr. Frey was then able to persuade Prudential to engage with him in a number of subsequent condominium conversion projects on a joint venture basis. The Prudential real estate department executive originally had been somewhat surprised at Mr. Frey's $20 million offer price for the Village of Kings Creek complex, as his offer exceeded the property's apparent market value, which he discussed with Ballard.

With respect to Hyatt Corp.'s payments to KWJ Corp., and later the KWJ partnership, the record reflects that the payments were a finder's fee to J.D. Weaver for Mr. Weaver's efforts in persuading Lisle to allow Hyatt Corp. to bid on the Embarcadero Hotel's management contract. Kanter was not even involved with this transaction and knew nothing about it until later. It was Mr. Weaver's efforts that allowed Hyatt Corp. to be awarded the Embarcadero Hotel's management contract in about 1972. Kanter first learned of Mr. Weaver's right to receive this finder's fee during 1973, when A.N. Pritzker asked Kanter to review Hyatt Corp.'s "commission" agreement with KWJ Corp., Mr. Weaver's wholly owned subchapter S corporation. Later, in about 1976, Kanter negotiated IRA's purchase of KWJ Corp. from Mr. Weaver, which purchase was concluded in 1979.[28] Although Mr. Pritzker

[28] Respondent contends that Mr. Weaver in essence was Ballard, Lisle, and Kanter's agent, to whom were funneled Hyatt Corp.'s kickback payments for Lisle's help in obtaining the Embarcadero Hotel's management contract. In advancing this theory, respondent argued that Mr. Weaver, in 1979, essentially sold KWJ Corp. to IRA for only a nominal net amount of $1,000. Although IRA paid Mr. Weaver $150,000 for 100-percent of KWJ Corp's outstanding shares of stock, respondent asserts that KWJ Corp. then possessed about $149,000 in (continued...)

had also, at some earlier point, advised Ballard and Lisle of Mr. Weaver's finder's fee with respect to the Embarcadero Hotel's management contract, Mr. Pritzker told Ballard and Lisle that Hyatt Corp.'s payment of this finder's fee was a unique, one-time occurrence. Mr. Pritzker assured them that no similar finder's fees would be paid with respect to future management contracts Hyatt Corp. and Prudential would be negotiating for other Prudential hotels.[29]

With respect to the payments IRA, and later THC, received from William Schaffel, the payments were attributable to Kanter

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[28](...continued)
accumulated cash. However, as petitioners point out, the 1979 financial statement of KWJ Corp., which respondent relied upon, does not specify whether all of the payments KWJ Corp. received from Hyatt, prior to Mr. Weaver's sale of KWJ Corp., were accumulated and held by KWJ Corp. or, instead, were distributed to Mr. Weaver. Petitioners maintain that the payments may well have been distributed to Mr. Weaver shortly after they were received, as 100 percent of KWJ Corp.'s income as a subchapter S corporation was taxable to Mr. Weaver. Moreover, the Court notes that Mr. Weaver had previously agreed in 1976 to sell KWJ Corp. for $150,000 to IRA, as Mr. Weaver then had been disappointed with the amount of Hyatt's payments to KWJ Corp. In that regard, Hyatt executives testified that initially only relatively small payments were made to KWJ Corp., as these payments were based on a percentage of the management fees Hyatt itself earned. They explained that Hyatt's management fees under the Embarcadero Hotel's management contract were relatively low during the initial years of the hotel's operation because a period of time elapsed before Hyatt was able to operate the hotel on a more profitable basis. They also noted that Hyatt financed about $1 million in additional hotel improvements following the hotel's opening, which improvements eventually contributed significantly to the hotel's later profitability.

[29] Over the period from about 1972 through the time of trial, Prudential eventually built a total of about 10 large, major-convention-size hotels that Hyatt Corp. managed for it. During their discussions about Hyatt Corp.'s obtaining the management contract on one of the first of these other hotels built after the Embarcadero Hotel, A.N. Pritzker first informed Ballard and Lisle of J.D. Weaver's finder's fee with respect to the Embarcadero Hotel's management contract. According to Ballard, his and Lisle's response was that, if Hyatt Corp. earned such large profits on its prior hotel management contracts and could afford to pay similar finder's fees to other third parties on a regular basis, Prudential then would want to reduce Hyatt Corp.'s compensation under any future hotel management contracts the two companies entered. Such testimony dispels the notion that there was collusion between Ballard, Lisle, Kanter, and Weaver with respect to these fees.

and/or IRA's introduction of Mr. Schaffel to Ballard and Lisle at the dinner meeting in New York City that Kanter arranged with Mr. Schaffel in the summer of 1979. Kanter's later August 28, 1984, letter to Mr. Schaffel confirms this. Although Mr. Schaffel originally agreed to pay IRA half of his fees on any business deals where IRA and its associates were "instrumental or helpful", the Court cannot conclude that Ballard and/or Lisle directed business with Prudential or Travelers to Mr. Schaffel in exchange for or conditioned upon Ballard, Lisle, and/or Kanter's receiving payments from Mr. Schaffel. In his testimony, Ballard denied ever participating in any such arrangement, pursuant to which he and/or Lisle directed business from Prudential to Mr. Schaffel or to parties whom Mr. Schaffel represented.[30] Similarly, Mr. Schaffel, in his testimony, denied that he had ever compensated Ballard and/or Lisle for their help in directing business with Prudential and Travelers to him. Moreover, the record fails to support a finding that any of the payments Mr. Schaffel made to Kanter was intended to inure in whole or in part to Ballard and/or Lisle.

To be sure, Ballard and Lisle knew that Kanter and/or an entity associated with Kanter had some arrangement with Mr. Schaffel to share in the fees Mr. Schaffel earned on certain business deals. Kanter initially had proposed and discussed such

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30 In his interview by Internal Revenue Service agents, Lisle also denied taking any such actions when he was employed by either Prudential or Travelers.

an arrangement with Mr. Schaffel during the 1979 New York City dinner meeting that Ballard and Lisle attended. The Court further notes that, during 1984, when Kanter and Mr. Schaffel had their dispute over whether IRA was entitled to a share of Mr. Schaffel's fees on business deals with Travelers, Lisle told Mr. Schaffel that he didn't care about whatever arrangement Mr. Schaffel and Kanter had between them. Lisle, instead, expressed concern that a lawsuit between the two might cause problems for Lisle with Travelers. According to Kanter, he previously advised Lisle not to become involved in Kanter and Mr. Schaffel's dispute. Nevertheless, this falls short of establishing, as respondent asserts, that Ballard and/or Lisle participated with Kanter in schemes to receive kickback payments from Mr. Schaffel.[31]

Respondent further notes various "loan arrangements" involving IRA that were highly favorable to Ballard and Lisle and/or their family members, including certain "loans" made to Ballard or Lisle's grantor trusts. The Court agrees that the loans that financed certain movie partnership investments by Ballard and Lisle's grantor trusts were exceptionally favorable and generous financing arrangements for Ballard and Lisle. In

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[31] In his testimony, Mr. Schaffel related that, in 1979, he had been very eager to meet Ballard and Lisle because he was then just starting to become more actively involved in the real estate development business. However, by about 1983, he felt strongly that the original written agreement he had with IRA (whose language was somewhat ambiguous and open-ended) should not apply to his business deals with Travelers. He stated that he subsequently agreed to share his fees on business deals with Travelers after successfully negotiating to limit the potential scope of the original agreement more favorably to himself. He added that he insisted that his future payments be made to an entity other than IRA.

connection with these loans to their grantor trusts, Ballard and Lisle received potential tax benefits from the trusts' movie investments and assumed no personal liability to repay the loans.[32]

However, the Court cannot conclude that, in actuality, the loan arrangements, including the essentially nonrecourse loans to the grantor trusts, were a disguised means by which Ballard and Lisle's respective shares of purported kickback proceeds were passed out to them. The Court considers this evidence to be equivocal and less than conclusive in establishing the existence of kickback schemes respondent alleges. To be sure, Ballard and Lisle were extremely valuable business contacts of Kanter. The record reflects a number of instances where Kanter traded upon and utilized his contacts and personal relationships with prominent business people, including Ballard, Lisle, and the Pritzker family, to obtain certain business arrangements with other third parties for entities associated with him.[33] He thus

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[32] These loans essentially amounted to nonrecourse loans to Ballard and Lisle because the trusts had no other assets and could only repay the loans if the movie investments proved profitable. As the movie investments were highly speculative ventures, the Court does not accept Kanter's claim that IFI originally had been willing to loan the money to the trusts on this entirely nonrecourse basis to Ballard and Lisle because the movie investments, Kanter maintained, were particularly promising and had considerable profit potential. Indeed, the record reflects that IRA, not IFI, was the source of the loan funds. The Court believes that a lender operating at arm's-length with a prospective borrower, like these grantor trusts, would have insisted on receiving better security for the repayment of its loan. At minimum, before issuing a loan to one of these grantor trusts, such a lender would first have required the grantor (i.e., Ballard or Lisle, each of whom had substantial financial resources) to guarantee the loan's repayment.

[33] For example, as indicated previously, Kanter was able to persuade William Schaffel to share his fees with IRA following Kanter's introduction of Mr. Schaffel to Ballard and Lisle at the summer of 1979 dinner meeting Kanter (continued...)

may have helped to arrange favorable loans for Ballard and Lisle out of gratitude for their friendship and the business advantages that friendship conferred upon him and the entities associated with him.[34]

Similarly, the Court also finds the "consulting payments" Kanter arranged to have KWJ Corp., and later the KWJ partnership, to Ballard's and Lisle's children from about 1983 through 1989 to be inconclusive in establishing the kickback scheme respondent alleges. Kanter may well have considered these consulting arrangements with the children as being favors to Ballard and Lisle but to say that such payments constituted fraud is indeed stretching. The Court notes, however, that, beginning in about 1984, Ballard managed TMT's real estate investments and Lisle managed Carlco's investments in tax-exempt bonds, and neither

[33](...continued)
had arranged in New York City. Mr. Schaffel was very impressed when Kanter introduced him to Ballard and Lisle, as Mr. Schaffel felt this introduction to be beneficial to him in any future business dealings he might have with Prudential. Undoubtedly, Mr. Schaffel's acquaintance with Ballard and Lisle also made it easier for him to market his services to other parties he sought to represent.

[34] In the same category is Kanter's financing of FPC Subventures' acquisition of limited partnership interests in One River Associates and Four Ponds Associates, each of which limited partnerships had been established by Mr. Schaffel and Benedict Torcivia to engage in a real estate project. Although Lisle held a 90-percent interest in FPC Subventures and a family trust of Kanter held the remaining 10-percent interest, the evidence of record does not disclose whether Kanter was repaid by Lisle for the funds Kanter advanced to FPC Subventures. The record, however, reflects that these limited partnership interests were acquired at arm's-length prices. Kanter paid the same price for the limited partnership interests that other unrelated third parties paid for their limited partnership interests in One River Associates and Four Ponds Associates.

Ballard nor Lisle received any compensation for their services until about 1990.[35]

In conclusion, the Court cannot conclude that the kickback schemes respondent alleges existed.

2. Assignment of Income Doctrine. In the instant cases, respondent, on brief, acknowledges that IRA and THC were not sham entities. However, this does not preclude application of the assignment of income doctrine, as a taxpayer may assign income to a corporation that conducts real and substantial business in an attempt to avoid tax. Haag v. Commissioner, 88 T.C. 604, 611 (1987), affd. without published opinion 855 F.2d 855 (8th Cir. 1988).

The Court's holding that there were no kickback schemes involving Kanter, Ballard, and/or Lisle, also essentially disposes of respondent's assignment of income argument with respect to the payments received from three members of "The Five". These include the payments that: (1) IRA received from PMS; (2) IRA and THC received from Essex; and (3) IRA and certain

[35] As part of its Prudential kickback scheme theory, respondent argues that Ballard was the actual beneficial owner of TMT's assets, and that Lisle was the actual beneficial owner of Carlco's assets. Respondent points out that Carlco and TMT issued preferred stock so that each corporation, beginning with 1984, would no longer be included in IRA's consolidated group for income tax purposes. Respondent suggests that Carlco and TMT's deconsolidation from IRA were initial steps taken in implementing Kanter, Ballard, and Lisle's ultimate plan to distribute out, to Ballard and Lisle, Carlco and TMT's assets (which assets supposedly arose from kickback payments "The Five" made to Ballard and Lisle). As previously discussed, the Court rejects respondent's Prudential kickback scheme theory as being unsupported by the evidence. Further, Kanter testified that a major reason for the deconsolidation was his concern that Carlco's investment in tax-exempt bonds could cause the disallowance of IRA's and its other subsidiaries' interest deductions. See sec. 265(a)(2), which provides for the disallowance of deductions for interest expenses incurred with respect to purchasing or carrying tax-exempt obligations.

of IRA's subsidiaries received from Hyatt Corp. through their ownership of KWJ Corp. and later the KWJ partnership.

The payments IRA received from PMS were attributable to IRA's ownership of a 47.5-percent stock interest in PMS. Similarly, the payments of IRA and THC received from Essex were attributable to their respective interests as partners in Essex. Lastly, the payments IRA and its subsidiaries received from Hyatt were attributable to IRA's purchase of KWJ Corp's outstanding stock in 1979. As a result of its purchase of KWJ Corp., IRA secured KWJ Corp.'s right to receive the finder's fee payments that Hyatt had earlier granted to J.D. Weaver in connection with Hyatt's Embarcadero Hotel management contract.

In each of these three instances, IRA and/or THC owned the property interests or property rights that generated the income in question. Thus, there was no assignment to them of income that Ballard, Lisle, and/or Kanter, in fact, earned. The Court holds that, in these instances, the assignment of income doctrine is not applicable because there was no improper shifting of income to "a different tree from that on which * * * [such income] grew." See <u>Lucas v. Earl</u>, 281 U.S. 111 (1930).

As to the payments IRA and/or THC received from (1) Bruce Frey and the BJF partnership, and (2) William Schaffel, the Court also holds that there was no impermissible assignment of income to IRA and THC of such income from Mr. Frey and/or Mr. Schaffel.

More specifically, with respect to the claimed kickback payments Kanter received from the purported Prudential, Travelers, and Kanter transactions, Kanter served as an adviser, attorney, consultant, and/or officer to both IRA and THC during the years at issue. Notwithstanding the fact that Kanter had no formal employment contracts with IRA and THC, both corporations exercised significant control over Kanter's activities. The record reflects that Kanter's law firm earned substantial legal fees for the legal work it performed for IRA and/or THC.[36] Further, in the two remaining instances in question, the party receiving the services (Bruce Frey/the BJF partnership or William Schaffel) recognized IRA and/or THC's controlling position by entering into an agreement to obtain the services from IRA and/or THC.[37] Indeed, with respect to the payments from Mr. Frey and the BJF partnership, IRA and THC did invest in a number of Mr. Frey's condominium conversion projects. Irrespective of whether this Court applies its own two-part Johnson test or a more flexible facts and circumstances approach, the Court holds that the assignment of income doctrine is not applicable. See Haeri v. Commissioner, T.C. Memo. 1989-20.

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[36] Kanter testified that he recommended to Lawrence Freeman (IRA's president) and Solomon Weisgal (the trustee of the Bea Ritch trusts that owned all of IRA's outstanding common shares) that IRA make certain investments or participate in certain undertakings. He stated that his advice and recommendations, as an adviser, attorney, and consultant to IRA, were in no way binding upon IRA. Although Mr. Freeman and Mr. Weisgal often accepted his advice and recommendations, Kanter related that they, not he, made the final decision on whether to invest or not to invest.

[37] Respondent has not argued that the payments THC received from Mr. Schaffel should be taxed to IRA under the assignment of income doctrine.

The Court further agrees with petitioners that the section 482 issue that respondent seeks to raise is not properly before the Court, as respondent first attempted to raise this new issue in its post-trial briefs.[38]

3. Additions to Tax for Fraud. The Court concludes that respondent has not met the burden of proving, by clear and concise evidence, that Kanter, Ballard, and Lisle are liable for the addition to tax for fraud under section 6653(b) for any of the years at issue. Respondent has not established that there was an underpayment of tax by any of the petitioners arising out of what respondent derisively described throughout the trial of this case as "kickback schemes" wherein moneys were exacted as a condition for doing business, and that such moneys constituted income that was nor reported by petitioners. Even if the so-called "schemes" were sinister or were not generally acceptable business practices, or even if such schemes were illegal, such facts, standing alone, would not constitute fraud. As noted earlier, fraud is an intentional wrongdoing with the specific purpose of evading a tax known or believed to be owing by conduct intended to concede, mislead, or otherwise prevent the collection of taxes. There is not showing that taxes were evaded or avoided on any of the payments made by "The Five". Quite the contrary, respondent's witnesses, including its own agents, testified that

[38] This Court will not consider issues raised for the first time on brief, when to do so deprives the opposing party of the opportunity to present evidence addressing that issue had the issue been timely raised. Estate of Gillespie v. Commissioner, 75 T.c. 374, 381 (1980).

all of the payments by "The Five" had been reported on Federal income tax returns, and the taxes due thereon had been paid. The evidence does not establish that the parties reporting such income were not the proper earners of that income. The Court finds it of significance that not one of the examining agents recommended that the fraud penalty be asserted against petitioners, even thought the examination process extended over several years, thus affording respondent ample opportunity to establish a case for fraud. No evidence was offered at trial that was not available to respondent's agents during the examination process, nor was any new evidence offered by respondent that was not available or not known during the audit process. As noted earlier, there were no "kickback schemes", and none of the alleged "kickback schemes" payments by "The Five" represented unreported taxable income of Kanter, Ballard, and Lisle. There was, therefore, no underpayment of tax. Moreover, in the Court's view, certain transactions that respondent cited (e.g., the essentially nonrecourse loans made to Ballard and Lisle's grantor trusts and the "consulting payments" received by Ballard and Lisle's children) in asserting petitioners are liable for these additions to tax for fraud, at best, amount to only respondent's suspicious of fraud. The Court, however, does not consider these transactions as even rising to the level of suspicion of fraud. Consequently, the Court holds that petitioners are not liable for additions to tax for fraud under section 6653(b). Sec. 7454(a); Rule 142(b).[39]

ISSUE II. KANTER'S 1981, 1982, 1983, 1984, AND 1986 CENTURY INDUSTRIES ADJUSTMENTS.

At issue is whether certain entities that were claimed partners in Century Industries should be disregarded as partners of the partnership for Federal income tax purposes and whether 50 percent of the partnership's income, for 1981, 1982, 1983, 1984, and 1986, instead, constitutes Kanter's taxable income for those years.

Century Industries was a partnership organized in 1979, and its partners were the Bea Ritch trusts, Solomon Weisgal (individually and for his own account, rather than as trustee of the Bea Ritch trusts), and a third individual. The 25 trusts (collectively), Mr. Weisgal, and the other individual each held one-third interests in the partnership. The partnership's objective was to engage in highly leveraged investments in which the partners would contribute relatively minimal amounts of their own capital. The partnership was ultimately unsuccessful in such investments.

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[39] In the amended pleadings alleging fraud, respondent alleged, alternatively, that, in the event the court held against respondent on the fraud issue, petitioners were liable, under sec. 6653(a), for the addition to tax for negligence or intentional disregard of rules and regulations, and that, in come of the cases, petitioners were also liable for the sec. 6659(a) addition to tax for valuation overstatements and under sec. 6621(c) for increased interest. Since the Court holds that there was no underpayment of taxes, such holding precludes any liability by petitioners or these alternative claims.

In early 1980, the partnership was reconstituted. The third individual referred to above, withdrew from the partnership, new partners were admitted, and the partnership's investment focus was changed. The reconstituted partnership would engage in investments in which its partners would be required to contribute larger amounts of capital. The new partners included four family trusts for the benefit of Mr. Weisgal's family members (the James Children's Trust, the Lawrence Children's Trust, the Lee Children's Trust, and the Richard Children's Trust); Atlay Valley Investments General Partnership (Atlay partnership), another investment partnership composed of irrevocable trusts for the benefit of Mr. Weisgal's family; and Kanter. During 1980 and 1981, the partners in Century Industries, their capital interests, and their initial capital contributions were as follows:

Partners	Partnership Int.	Capital Contrib.
Atlay partnership	29 percent	$290
Bea Ritch trusts	49 percent	490
James Children's Trust	5 percent	50
Lawrence Children's Trust	5 percent	50
Lee Children's Trust	5 percent	50
Richard Children's Trust	5 percent	50
Kanter	1 percent	10
Weisgal	1 percent	10

In 1984, Cypress Lane Investment (a general partnership comprised of 30 irrevocable trusts for the benefit of Mr. Weisgal's family) replaced Atlay partnership as a 29-percent partner in Century Industries.

Century Industries had no office or employees of its own and operated out of the accounting firm offices of Mr. Weisgal. Although Century Industries considered and evaluated a number of potential investments from 1981 through about 1988, it made only a relatively small number of investments until about 1987. After 1981, its partners were not required to make additional capital contributions until 1986. During 1986 and 1987, its partners made the following additional capital contributions:

Partner	1986 Capital Contrib.	1987 Capital Contrib.
Bea Ritch trusts	$29,900	$53,400
Cypress Lane Inv.	17,900	31,900
James Children's Trust	3,000	5,500
Lawrence Children's Trust	3,000	5,500
Lee Children's Trust	3,000	5,500
Richard Children's Trust	3,000	5,500
Kanter	6,100	3,600
Weisgal Revocable Trust	6,100	3,600

Kanter and Weisgal generally received and analyzed investment proposals submitted to Century Industries by other entities and persons. In evaluating potential investments, they frequently solicited and obtained advice from business acquaintances and contacts. On occasion, if Kanter or Weisgal believed that outside professional consulting services, such as accounting or legal services, were necessary to evaluate a possible investment, such outside services would be obtained.

From about 1981 through 1986, Century Industries earned standby commitment fees for its consideration of investment proposals submitted to it. These standby commitment fees were paid by a number of entities, including IRA, THC, Zion Ventures, Inc., and Computer Placement Services, Inc., regarding proposed investment ventures. Century Industries required payment to it of the standby commitment fee prior to its consideration of any investment proposal. In addition, a party submitting an investment proposal was also required to pay for outside consulting services needed to evaluate or structure the proposed venture.

From 1981 through 1986, Century Industries received standby commitment fees from the following entities in the amounts indicated:

Payer	1981	1982	1983	1984	1985	1986
Bayshore Marina	--	--	--	--	--	$50,000
Century Capital	--	$ 3,000	--	--	--	--
City & Suburban Dist.	--	--	--	--	$ 3,000	--
Computer Placement Services	$13,500	7,000	--	--	--	--
CPS Inv.	--	--	$ 500	$ 2,000	3,500	--
Delphi Indus.	--	--	--	--	3,000	--
IRA	4,000	3,000	--	--	4,000	--
James Ins. Tr.	--	--	5,000	--	--	--
Ry. Placement Services	--	--	4,500	--	--	--
Satcorp	--	--	--	75,000	--	--
Silite	17,500	7,000	18,000	13,000	11,000	12,000
Stockholder	--	--	--	3,000	--	--
TAC	--	--	--	--	4,500	--
THC	--	--	1,000	--	--	--
Waco Capital	--	--	--	--	1,000	--
Zion	--	--	4,000	--	--	--
	$35,500	$20,000	$33,000	$93,000	$30,000	$62,000

From 1983 through 1986, Kanter and Weisgal received the following guaranteed payments from Century Industries:

Year	Kanter	Weisgal
1983	$ 2,000	$2,000
1984	12,000	--
1985	7,500	--
1986	6,000	6,000

Beginning in about 1987, Century Industries made certain investments that required significant additional capital contributions from its partners. Some of these investments proved to be unsuccessful. Ultimately, in 1988 or 1989, the partnership was dissolved. Its affairs were wound up and its remaining investments with any value were distributed to the partners.

During the period of its existence, Century Industries filed Forms 1065 (U.S. Partnership Returns) for each of its taxable years, including the years 1980 through 1986. On these returns, the partnership reported the following items of income and expenses:

	1980	1981	1982	1983	1984	1985	1986
Income							
Unspecified	--	--	--	--	--	--	$62,000
Flankin Ltd.	--	--	$ 3,026	$ 5,186	$ 5,198	$ 7,047	6,056
Real Est. Loan Assn.	--	--	--	--	--	2,107	897
Dividends	--	$ 2,526	--	--	--	--	--
Interest	--	7	--	--	--	--	--
Dividends & int.	--	--	3,314	2,812	6,898	7,113	4,347
Form 4684	--	--	--	(4,100)	--	--	--
Other income/ fees	$1,000	35,000	20,000	33,000	93,000	30,000	--
Total income	$1,000	$37,533	$26,340	$36,898	$105,096	$46,267	$73,300
Deductions							
Bank charges	--	$ 5	--	--	--	--	$ 613
Legal fees	--	--	$ 625	--	--	--	1,825
Admin. services	--	--	3,000	--	--	--	--
Advertising exp.	--	--	2,652	--	--	--	--
Guaranteed pmts.	--	--	--	$ 4,000	$12,000	$ 7,500	12,000
Bus. & tax consulting serv.	--	--	--	--	12,345	7,500	25,000
Telephone	--	--	--	--	376	300	5
Copying	--	--	--	--	19	764	10
Messenger service	--	--	--	--	15	9	14
Travel	--	--	--	--	2,134	726	--
Printing	--	--	--	--	92	--	--
Air fare	$ 30	--	--	--	928	--	--
Miscellaneous	--	--	--	--	330	249	11
Office services	--	--	--	--	--	--	--
Total Deducs.	$ 970	$37,528	$20,063	$32,898	$76,857	$29,144	$33,822

The $62,000 "unspecified income" shown above for 1986 consisted of standby commitment fees.

In notices of deficiency issued to the Kanters for 1981, 1982, 1983, 1984, and 1986, respondent determined that 50 percent of Century Industries' income constituted Kanter's distributive share of the partnership's income for those years. Respondent issued a notice of final partnership administrative adjustment (FPAA) to Century Industries reallocating some of the partnership's 1986 income to Kanter. No FPAA was issued to Century Industries for 1983 and 1984. The effect of respondent's determinations is to disregard all of the other partners in Century Industries except Kanter and Weisgal. The question before the Court is whether respondent's determination should be decided at the partnership level or at the individual partner level.[40]

Discussion

A. Whether for Federal Income Tax Purposes a Person is to be Respected as a Partner in a Partnership.

In Commissioner v. Culbertson, 337 U.S. 733 (1949), the U.S. Supreme Court addressed whether a person is to be respected as a partner in a particular partnership for Federal income tax purposes. In doing so, the Court first recognized that, in order for a person to be treated as a partner of a partnership for tax purposes, that person must have either contributed capital or services. The Court reasoned that the mere intention that a person provide capital or services at some time in the future would not suffice because that would sanction violation of the assignment of income doctrine. Id. at 738-740. However, in Culbertson, the Court declined to impose rigid standards prescribing the type of capital or services a partner must contribute. The Court expressly rejected a proposed test that

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[40] As a lead-in to the discussion that follows, the issue boils down to whether Century Industries, for the years at issue, was subject to the TEFRA partnership provisions (TEFRA). If the partnership was subject to TEFRA, the Court has no jurisdiction in this proceeding. As the ensuing discussion reveals, respondent acknowledged that issuance of the FPAA for 1986 was an inconsistent position. Respondent takes the position that, for all years at issue, Century Industries was a "small partnership" under sec. 6231(a)(1)(B) and, therefore, was not subject to TEFRA, thus this Court has jurisdiction. Kanter takes the opposite position, that Century Industries was not a "small partnership" and was subject to TEFRA, therefore, this Court has no jurisdiction over the years at issue.

required a partner to have contributed either "vital services" or "original capital". Id. at 741-742. The Court, instead, held that the governing test is "whether, considering all the facts * * * the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." Id. at 742-743.

Subsequent to Commissioner v. Culbertson, supra, statutory provisions were enacted to deal with family partnerships in which capital is a material income-producing factor. These provisions are now found in section 704(e). As a result, section 704(e) and the regulations thereunder have largely supplanted the Culbertson test for partnerships in which capital is a material income-producing factor.[41] See discussion in Stanback v. Commissioner, 271 F.2d 514, 517-519 (4th Cir. 1959), vacating and remanding 27 T.C. 1 (1956); Smith v. Commissioner, 32 T.C. 1261, 1266-1267 (1959).

Section 704(e)(1) provides that, as to partnerships in which capital is a material income-producing factor, a person owning a capital interest in such a partnership must be recognized as a partner, regardless of whether or not that person's capital interest was acquired by purchase or gift. However, if appropriate, partnership income can be reallocated to ensure that the donor of a partnership interest receives reasonable

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[41] Although sec. 704(e) is directed primarily towards "family partnerships", it applies even to those partnerships that are not family partnerships. Carriage Square, Inc. v. Commissioner, 69 T.C. 119, 126 n. 4 (1977), app. dismissed (9th Cir. 1979); Evans v. Commissioner, 54 T.C. 40, 51 (1970), affd. 447 F.2d 547 (7th Cir. 1971).

compensation for services the donor renders to the partnership. Sec. 704(e)(2); sec. 1.704-1(e)(3), Income Tax Regs.

For purposes of section 704(e)(1), the determination of whether capital is a material income-producing factor must be made with reference to all of the facts presented in the particular case. In general, capital is considered a material income-producing factor if a substantial portion of the gross income of the partnership's business is attributable to the use of capital. Further, capital will not usually be considered a material income-producing factor where the income of the business consists principally of fees, commissions, or compensation for personal services performed by the partnership's members or employees. On the other hand, capital is ordinarily a material income-producing factor if the operation of the business requires substantial inventories or substantial investment in plant, machinery, or other equipment. Sec. 1.704-1(e)(1)(iv), Income Tax Regs.; Carriage Square, Inc. v. Commissioner, 69 T.C. 119, 126-127 (1977), app. dismissed (9th Cir. 1979).

Nevertheless, the Culbertson test remains operative with respect to partnerships in which capital is not a material income-producing factor. Persons are to be recognized as partners in such partnerships if they and the partnership's other partners intend, in good faith and acting with a business purpose, to join together as partners. Poggetto v. United States, 306 F.2d 76, 79-80 (9th Cir. 1962); Carriage Square, Inc. v. Commissioner, 69 T.C. at 128.

B. <u>TEFRA Partnership Provisions.</u>

The partnership audit and litigation provisions found in subchapter C of chapter 63 of subtitle F of the Internal Revenue Code were enacted as part of the Tax Equity and Fiscal Responsibility Tax Act of 1982. These provisions, sections 6221 through 6233 (collectively referred to for convenience as the TEFRA partnership provisions), are generally applicable to specified partnerships and other entities filing partnership returns for taxable years beginning after September 4, 1982. Pub. L. 97-248, sec. 407(a)(1), (3).

In <u>Maxwell v. Commissioner</u>, 87 T.C. 783 (1986), this Court held that Congress enacted the TEFRA partnership provisions to uniformly adjust items of partnership income, loss, deduction, or credit that affect each partner in a proceeding at the partnership level. Thus, disputes that arise from "partnership items" are to be resolved in a partnership proceeding, whereas disputes relating to "nonpartnership items" continue to be resolved at the individual partner level. The TEFRA partnership provisions include detailed provisions applicable to partnership proceedings. For our purposes here, any portion of a deficiency that is attributable to a "partnership item" cannot be considered in the partner's personal or individual case. Partnership items must be separated from the partner's personal case and must be considered solely in the partnership proceeding.

As is pertinent here for the years 1983, 1984, and 1986, "small partnerships" are specifically excepted from, and are not subject to, the TEFRA partnership provisions. In defining the term "partnership", section 6231(a)(1)(A) prescribes those partnerships that are subject to the TEFRA partnership provisions. These partnerships have sometimes been referred to for convenience as "TEFRA partnerships". Section 6231(a)(1)(B), in general, excludes "small partnerships" from the section 6231(a)(1)(A) definition of "partnership".[42] A small partnership generally is a partnership (1) that has ten or fewer partners, (2) all of whose partners are either estates or natural persons who are U.S. citizens or resident aliens, and (3) where each partner's share of each partnership item is the same as the share of every other partnership item. Sec. 6231(a)(1)(B)(I); sec. 301.6231(a)(1)-1T(a)(1) through -1T(a)(3), Temp. Proced. & Admin. Regs. A determination of whether a partnership qualifies as a small partnership is to be made for each of the partnership's taxable years. Sec. 6231(a)(1)-1T(a)(4), Temp. Proced. & Admin. Regs.[43]

For purposes of the TEFRA partnership provisions, a "partnership item" is defined to include, among other things, the partnership's aggregate and each partner's share of items of income, gain, loss, deduction, or credit of the partnership.

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42 A small partnership may elect to have the TEFRA partnership provisions apply. Sec. 6231(a)(1)(B)(ii). However, the parties agree that Century Industries made no such election for 1983 through 1986.

43 Since there are 25 Bea Ritch trusts, that number alone suffices to exclude Century Industries as a small partnership.

Sec. 6231(a)(3); sec. 301.6231(a)(3)-(1)(a)(1)(I), Proced. & Admin. Regs.

Section 6233(a) authorizes the Treasury, by regulation, to extend the TEFRA partnership provisions to certain entities that have filed partnership returns (and to those entities' income tax items and to persons holding interests in such entities), even where those entities are ultimately determined not to be partnerships.[44] However, section 6233(a) has not been used to subject small partnerships to the TEFRA partnership provisions. As noted above, small partnerships are specifically excepted from the TEFRA partnership provisions under section 6231(a)(1)(B). See Sec. 301.6233-1T(d)(1)(I), Temp. Proced. & Admin. Regs.

C. <u>The Parties' Arguments.</u>

Petitioners contend that all of Century Industries' partners are to be respected as partners for tax purposes, and that no additional income of the partnership should be attributed as Kanter's taxable income. They further maintain that the Court, in the instant cases, has no subject-matter jurisdiction to decide the allocation of Century Industries' income, for 1983, 1984, and 1986, because (1) Century Industries is subject to the TEFRA partnership provisions for those years, and (2) respondent

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[44] Sec. 301.6233-1T(a), Temp. Proced. & Admin. Regs., generally extends the TEFRA partnership provisions to certain specified entities for taxable years for which such an entity has filed a partnership return, to any of such entity's items for such taxable years, and to any person holding an interest in such entity during such taxable years. As a result, in the event the entity is ultimately determined to not be a partnership, corresponding computational adjustments may still yet be made with respect to a purported partner's tax liability, as special statutes of limitation under sec. 6229 are applicable with respect to the purported partner.

issued no notice of final partnership administrative adjustment to Century Industries for 1983 and 1984.

Respondent, on the other hand, contends that, for tax purposes, Kanter and Solomon Weisgal are the only two persons to be recognized as partners in Century Industries and are each to be treated as having a 50-percent interest in Century Industries. Respondent asserts that, until 1987, the other purported partners' membership in the partnership was a sham, as the ostensible partnership between them and Kanter and Weisgal existed only to shift away income to those purported partners (i.e., the standby commitment fees) that Kanter and Mr. Weisgal earned in performing personal services for various third parties. Respondent argues that capital was not a material income-producing factor in the partnership for 1981, 1982, 1983, 1984, and 1986. Citing further the Culbertson test, respondent claims that the purported partners are not to be recognized as partners during those years, as no present intention existed between them, Kanter, and Mr. Weisgal to conduct a business enterprise. According to respondent, these purported partners rendered no services and contributed only insignificant amounts of capital.

Respondent further maintains that the Court does have subject-matter jurisdiction over the 1983, 1984, and 1986 adjustments to Kanter's taxable income from Century Industries, because the only persons to be recognized as partners for tax purposes in that partnership are Kanter and Mr. Weisgal, two natural persons and U.S. citizens having equal 50-percent interests in the partnership, for each of those years, and, therefore, the partnership is a small partnership that is specifically excepted from the TEFRA partnership provisions. Respondent acknowledges that its issuance of an FPAA to Century Industries for 1986 is inconsistent with respondent's position in this proceeding but asserts that the FPAA was issued by respondent to the partnership in order to take a protective position as to 1986. Respondent does not address why a similar protective position was not taken for the years 1983 and 1984.

On brief, respondent further argues that a total of 50 percent of Century Industries' income for 1981, 1982, 1983, 1984, and 1986 is allocable to Kanter for each of those years, under either of the following alternative theories: (1) Section 482; (2) section 671 (as respondent asserts that the Bea Ritch trusts are grantor trusts whose income are taxable to Kanter); or (3) section 704(e)(2).

Petitioners contend that (1) respondent's arguments above are not properly before the Court, and (2) in any event, the Court still lacks subject-matter jurisdiction over these income adjustments to Kanter from Century Industries for 1983, 1984, and 1986. Petitioners further maintain that the TEFRA partnership provisions should still be operative as to Century Industries, even if Century Industries comes within the small partnership exception for 1983, 1984, and 1986. To allow respondent to litigate here, in the instant cases, the 1983, 1984, and 1986 adjustments to Kanter's taxable income from Century Industries, petitioners claim, would undermine the purpose of the TEFRA partnership provisions. They note that the TEFRA partnership provisions, where applicable, require a partnership-level proceeding first to be commenced, in an effort to prevent such piecemeal litigation of partnership items in a partners' personal tax proceeding. As part of their TEFRA policy argument, petitioners point out that section 6233(a) allows the TEFRA partnership provisions to be extended to certain entities that have filed partnership returns. Thus, petitioners contend, the TEFRA partnership provisions should apply to preclude litigation of the 1983, 1984, and 1986 adjustments in the instant cases.

D. Analysis.

1. Subject-matter jurisdiction. Preliminarily, the Court must consider whether it has subject-matter jurisdiction with respect to the 1983, 1984, and 1986 taxable income adjustments respondent determined against Kanter. This jurisdictional question depends upon whether Century Industries, during each of those years, comes within the small partnership exception to the TEFRA partnership provisions. If Century Industries was a small partnership, then this Court has jurisdiction to consider this case at the partner level because small partnerships, as noted earlier, are excepted from TEFRA. The Court notes that it does have jurisdiction to determine its jurisdiction. United Cancer Council, Inc. v. Commissioner, 101 T.C. 162, 167 (1993).

As noted earlier, respondent issued an FPAA to Century Industries for 1986 as a protective measure. However,