

INVESTMENT LOSS DISALLOWED

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A panel of the Commonwealth Court disallowed a claimed business loss of over \$21 million on the grounds that a settlement with the Internal Revenue Service regarding the same loss amounted to an admission that the investment was not made with the intention of making a profit. *Hvizdak v. Commonwealth*, No. 739 F.R. 2006 (Pa. Cmwlth., Nov. 19, 2009).

The taxpayer filed a nonresident Pennsylvania Personal Income Tax (PIT) return, claiming a loss of over \$21 million passed through from Brown Fox Partners Fund LLC, in which taxpayer owned an interest. Brown Fox evidently was an investment partnership. It did not file a Pennsylvania partnership information return. The PIT statute provides that a nonresident is subject to PIT on income from sources within Pennsylvania, including his or her distributive share of the income of an unincorporated business apportioned to Pennsylvania and income from intangible personal property employed in a trade, profession, occupation or business carried on in Pennsylvania. The opinion did not discuss under which provisions of the PIT statute the taxpayer's share of the business loss from the partnership was sourced to Pennsylvania. In any event, the taxpayer claimed the loss for both PIT and federal income tax

purposes. The Internal Revenue Service disallowed the loss on the basis of IRS Notice 2002-50 (June 25, 2002), which stated the Service's intention to disallow losses from what the Service believed were partnership straddle tax shelters designed to generate tax losses. The taxpayer entered into a settlement agreement with the Service that disallowed all but about \$11,000 of the claimed loss. The Pennsylvania court held that the settlement agreement amounted to an admission by the taxpayer that the transaction was not entered into for gain, profit or income as required by 61 Pa. Code § 103.13(a). It is not clear, however, why the \$11,000 loss was permitted. The entire loss was generated by the Brown Fox partnership. If the purchase of the partnership interest was not motivated by an intention to generate profit, it is not clear why even a small portion of the loss was allowed.

Although the assessment was sustained, the Court granted relief from a 25% penalty for omitting from income an amount properly included therein. The Court stated that while the taxpayer incorrectly claimed a substantial loss, that did not constitute the omission of income. Therefore the statutory penalty did not apply.

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