assigned - Wherry 8/16/17 Chicago, TC Special

UNITED STATES TAX COURT

WASHINGTON, DC 20217

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DERRINGER TRADING, LLC, JETSTREAM BUSINESS LIMITED, TAX MATTERS PARTNER, ET AL.,	)	
Petitioners	)	Docket Nos. 20872-07, 6268-08
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

ORDER

This case is set for trial during the August 16, 2017, Chicago, Illinois, special trial session. This is a partnership-level proceeding under the TEFRA unified audit and litigation procedures of section 6621-6234.[1] The partnership that is the subject of the proceeding is Derringer Trading, LLC (Derringer), and the years at issue are Derringer's tax years during 2003 and 2004. Leila Verde, LLC (Leila Verde) was a partner of Derringer in the years at issue.

On February 7, 2013, respondent filed with this Court a motion seeking to show cause why this case should not be decided against petitioner on the basis of our decision in Superior Trading, LLC v. Commissioner, 137 T.C. 70 (2011), supplemented by T.C. Memo. 2012-110, aff'd, 728 F.3d 676 (7th Cir. 2013). On March 13, 2013, Michael Hartigan (Mr. Hartigan) filed with this Court an opposition to that motion, in which he represented that Susan Hartigan (Mrs. Hartigan) was the ultimate owner of Leila Verde, and therefore he as her designated representative of Leila Verde should be permitted to participate in this

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended, and in effect at the relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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case. On December 29, 2016, Mrs. Hartigan filed with the Court a motion for leave to file an out-of-time Notice of Election to Participate in this case. In this motion, Mrs. Hartigan claimed that she was never a member of Leila Verde, LLC. Petitioner and respondent filed notices of objection to Mrs. Hartigan's motion on January 11, 2017, and January 23, 2017, respectively.

On February 2, 2017, the Court held a conference call, during which it became clear that the parties disagreed as a factual matter as to whether Mrs. Hartigan was ever an indirect partner in Derringer through Leila Verde. On February 7, 2017, the Court issued an order asking each of the parties and Mrs. Hartigan to file a memorandum on their positions regarding the persons who held ownership interests in Derringer Trading, LLC and Leila Verde, LLC during all relevant periods. On February 17, respondent filed with the Court a memorandum supporting his position that Mrs. Hartigan was the 99% owner of Leila Verde during 2003 and 2004. On the same day, Mrs. Hartigan filed a memorandum in support of her position that she was not a partner of Leila Verde during 2003 and 2004. The Court conducted an evidentiary hearing on the issue on June 1 and 2, 2017.

Background

The parties' stipulation of facts, with accompanying exhibits, are incorporated here. This case is related to the facts and determinations found in Superior Trading, LLC v. Commissioner, 137 T.C. 70 (2011), supplemented by T.C. Memo. 2012-110, aff'd, 728 F.3d 676 (7th Cir. 2013). All of the cases consolidated therewith, and this case, involve tax shelter investment vehicles for so-called tax advantages. Generally speaking, our findings of fact regarding the investments in Superior Trading are all applicable here.

The story that led to the proceeding now before us seems to have begun with Mr. John E. Rogers' (Mr. Rogers) formation of Warwick Trading LLC (Warwick), a limited liability company, under the laws of the State of Illinois on December 17, 2001. On May 7, 2003, Warwick entered into a so-called contribution agreement with Lojas Arapua, S.A. (Arapua), a Brazilian retailer, under which Arapua transferred certain Brazilian consumer receivables to Warwick in exchange for a 99% interest in Warwick. On December 19, 2003, Mr. Rogers formed Derringer, another limited liability company, under the laws of the State of Illinois. When formed, 99% interest in Derringer was held by Warwick and the remaining 1% interest was held by Jetstream, a company originally formed under the laws of the British Virgin Islands. On the same day, Mr. Rogers formed yet another limited liability company under the laws of the State of Illinois, Leila Verde Fund LLC (Leila Verde).[2] On December 22, 2003, Warwick contributed a 98% interest in Derringer to Leila Verde in exchange for a 99% interest in Leila Verde.

I. The Leila Verde Purchase

Susan Hartigan (Mrs. Hartigan) is a U.S individual who resided in Massachusetts during the years at issue. She has a Master in Business Administration degree from Boston University and worked as a financial analyst at W.R. Grace, an American chemical conglomerate, from 1985 to 1993. She married Mr. Michael Hartigan (Mr. Hartigan), a tax attorney, in 1986, and has been a homemaker since 1993.

On December 22, 2003, Mrs. Hartigan allegedly bought a 99% interest in Leila Verde for $52,500, evidenced by a document entitled "Membership Interest Purchase Agreement" (Leila Verde Purchase Agreement), which is signed by both Mr. Rogers and Mrs. Hartigan. However, Mr. Hartigan testified at the hearing that the document was signed after the fact in 2013 in connection with a lawsuit against Mr. Rogers. In his deposition in a related Tax Court case, Kenna Trading, LLC v. Commissioner, 143 T.C. 322 (2014), Mr. Hartigan testified that Mr. Rogers directed him to make the $52,500 payment directly to Multicred Investment LLC (Multicred), a Brazilian company that had a business relationship with Mr. Rogers at that time. The record shows that Mr. Rogers sent instructions via email to Mr. Hartigan on transferring payments to Multicred.

On December 31, 2003, Mr. Hartigan's company, Monarch Strategies, LLC, paid $52,500 to Multicred for Mrs. Hartigan's 99% interest in Leila Verde. Mr. Rogers testified at the hearing that the payment to be made to Warwick was "stolen" by Multicred and was never received by him or Warwick. Consequently, Mrs. Hartigan never became a partner in Leila Verde. Initially when this case began, however, Mr. Rogers had represented to this Court that Mrs. Hartigan was

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[2] In 2011, a Florida limited liability company bearing the name "Leila Verde" was formed, into which all the assets of the Illinois entity were supposedly transferred. For purpose of this order, we will assume, as Leila Verde and Mr. Hartigan contend, that the Florida entity is a successor entity to the Illinois one.

a partner in the partnership. Mr. Rogers later changed his position and claimed that he had subsequently discovered neither he nor Warwick received the $52,500, and he contended that all purchase payments were to be made to him or Warwick, not Multicred. At the hearing, Mr. Hartigan admitted that since 2009 and until recently, he had been "fight[ing] tooth and nail" against Mr. Rogers' assertions. Now, however, he acknowledges that he has completely changed his position.

Mr. Rogers prepared and filed the Form 1065, U.S. Return of Partnership Income, for Derringer's tax year ending December 31, 2003, which indicates that Leila Verde held a 98% interest in Derringer, and Warwick and Jetstream each held a 1% interest in Derringer.[3] Consequently, the Schedule K-1, Partner's Share of Income, Deductions, Credits, etc., allocated an ordinary loss of $3,387,824 to Leila Verde. Mr. Rogers and/or Mr. Hartigan prepared Leila Verde's Form 1065 for its 2003 tax year, which Mr. Hartigan signed as a partner, describing it as "self-prepared." Leila Verde's 2003 return reported an ordinary pass-through loss of $3,387,824 from Derringer. Michael Hartigan prepared and signed Leila Verde's Form 1065 for the 2004 tax year. The 2004 return lists Mrs. Hartigan as Leila Verde's 99% owner, and Mr. Hartigan as the 1% owner.[4]

The ordinary losses from Leila Verde were also reflected in the Hartigans' joint Form 1040, U.S. Individual Income Tax Return, for 2003 and 2004. Both joint returns appear to be signed by Mrs. Hartigan, but Mrs. Hartigan testified at the hearing that Mr. Hartigan signed her name on the 2003 return. On May 5, 2014, Mrs. Hartigan filed a petition with this Court (Docket No. 9981-14) to contest a statutory notice of deficiency issued to the Hartigans for the tax years 2003, 2004, and 2008. In her petition, Mrs. Hartigan noted that the losses generated from Derringer were used overwhelmingly to offset Mr. Hartigan's income during 2003 and 2004.

II. <u>The Hartigans' Representations to this Court Regarding Leila Verde's Ownership</u>

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[3]According to the Schedule K-1, Leila Verde's profit and loss percentage in Derringer was 99.8% for 2003 and 2004. Jetstream and Warwick each had 0.1% profit and loss interest in Derringer.

[4]Appraently at that point, Mr. Hartigan believed that Jetstream no longer held any interest in Leila Verde.

In a Notice of Election to Participate filed on November 26, 2007, for the purpose of this case, Mr. Hartigan asserted that he was a partner of Leila Verde, thereby acknowledging the validity of his and his wife's purchase of Leila Verde.

In his filing of March 13, 2013, Mr. Hartigan represented that Mrs. Hartigan is the "ultimate owner investor" in Leila Verde and thus should be considered a partner of Derringer through her ownership interest in Leila Verde. He further represented that Mr. Rogers' statement that Mr. Rogers never received the $52,500 payment for Leila Verde was incorrect. On June 2, 2016, Mr. Hartigan represented that Leila Verde had appointed him as a representative, and reiterated his position that Mr. Rogers and Warwick had received the full payment for Leila Verde. In August 2016, Mr. Hartigan made yet another representation to this Court that the Hartigans made a payment to Multicred at Mr. Roger's behest, indicating that Mr. Rogers had directed the payment of the purchase price to Multicred.

In his deposition in Kenna Trading, LLC v. Commissioner, Mr. Hartigan identified his wife as an investor in the Warwick/Sugarloaf transactions and also identified a check as the payment for her interest in Leila Verde. He also confirmed that Mr. Rogers had directed him to pay Multicred directly.

Mrs. Hartigan, in a memorandum filed with this Court on November 26, 2008, asserted that she is the super-majority partner of Leila Verde: "Derringer Trading, LLC is owned ninety-eight (98%) percent by Leila Verde Fund, LLC, which is ninety-nine (99%) percent owned by me." Mr. Hartigan also jointly filed this memorandum as Leila Verde's tax matters partner. On May 5, 2014, in her petition to this Court in response to the statutory notice of deficiency issued to the Hartigans, Mrs. Hartigan asserted that she "used money and investment properties belonging to her" to invest in Leila Verde, and thus had been allocated the flow-through deductions from Derringer.

III. The Hartigans' Depositions in a Bankruptcy Proceeding Regarding Leila Verde's Ownership

In 2013, in a deposition in a bankruptcy proceeding, In re Michael Hartigan (Dkt. No. 13-14612, S.D.Fla.), Mr. Hartigan stated that Mrs. Hartigan purchased a 99% interest in Leila Verde during 2003. He testified that the ownership of Leila Verde was "99 percent Susan [Mrs. Hartigan] and one percent me" from 2004 until 2011, when Mr. Hartigan's ownership was reduced to zero.

Likewise, Mrs. Hartigan testified in her deposition in the same bankruptcy proceeding that she was the "manager" and the "member" of Leila Verde. She also testified that she paid Mr. Hartigan's living expenses out of the funds of Leila Verde.

IV. The Hartigans' Representations to the Massachusetts Superior Court Regarding Leila Verde's Ownership

Mr. and Mrs. Hartigan maintained their position that they purchased Leila Verde and Mrs. Hartigan was a 99% owner of Leila Verde, in two lawsuits filed against Mr. Rogers and his associated entities. Both lawsuits were filed in the Massachusetts Superior Court.

A. The Sugarloaf Lawsuit

On July 11, 2013, Mrs. Hartigan filed a lawsuit against Sugarloaf Fund, LLC (the Sugarloaf lawsuit), the successor entity of Warwick and Jetstream, in the Massachusetts Superior Court (Hartigan v. Sugarloaf Fund LLC, et al., Dkt. No. 13-586). In the amended complaint, Mrs. Hartigan stated that she agreed to enter into transactions with Warwick in 2003 and as a result owned a limited liability company (Leila Verde), which itself owned a second limited liability company (Derringer). Mrs. Hartigan also claimed that she had entered into "a valid and binding" contract with Warwick. Mrs. Hartigan attached the Leila Verde Purchase Agreement as an exhibit to her complaint, which appears to be signed by Mr. Rogers and by her.

B. The Seyfarth Shaw Lawsuit

On October 4, 2012, Mrs. Hartigan was listed as one of the petitioners in a lawsuit (the Seyfarth Shaw lawsuit) filed in the Massachusetts Superior Court (Demetriou et al v. Seyfarth Shaw LLP et al., Dkt. No. 12-01616). The defendants in this lawsuit were Mr. Rogers and the law firm that he worked at during the time of the Derringer transactions, Seyfarth Shaw, LLP.[5] Mrs. Hartigan was initially represented by Mr. Hartigan in this lawsuit. On August 15, 2014, now represented

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[5]Another defendant named in this case is not relevant for the purpose of the issue we decide here.

by other counsel, Mrs. Hartigan entered into a settlement agreement with the defendants, in which the defendants agreed to pay Mrs. Hartigan $30,000.

In June 2016, Mr. Hartigan represented to this Court that "Rogers and/or Seyfarth paid substantial funds to settle this case [the Seyfarth Shaw lawsuit] in the favor of all Plaintiffs, including Susan M. Hartigan." By contrast, in June 2017, Mr. Hartigan testified at the hearing that the defendants settled the Seyfarth Shaw lawsuit because "Seyfarth decided that it was cheaper to settle than to litigate." He further asserted that, in his opinion, Mrs. Hartigan's claim in the lawsuit was considered a "nuisance," and the settlement was for an immaterial amount.

V. Mrs. Hartigan's Relationship with Mr. Hartigan

Mrs. Hartigan has been married to Mr. Hartigan since 1986, and they have had four children together. Mrs. Hartigan testified that they have lived apart since 2004, when Mr. Hartigan moved to Miami, Florida, and adding that he only returns to Massachusetts for holidays and business. She further testified that Mr. Hartigan was "very demanding, very imperious" to her, and she was not allowed to review tax returns.

With respect to the Lelia Verde purchase, Mrs. Hartigan stated in an affidavit filed before the hearing that Mr. Hartigan caused or may have caused her, through deception, abuse, manipulation, exploitation and domination, to make the Leila Verde purchase in order to shelter his own income. She stated that Mr. Hartigan signed her name on the 2003 joint tax return, and she was "intimidated and coerced" by Mr. Hartigan into signing the 2004 joint tax return. At the hearing, she testified that she played no role in preparing the tax returns and did not know the meaning of terms such as K-1 or limited liability company until as late as 2014.

Mrs. Hartigan further testified that she was not "actively involved" in the Sugarloaf lawsuit or the Seyfarth Shaw lawsuit except for depositions.

Discussion

I. Statute of Frauds

Mrs. Hartigan contends that the Leila Verde Purchase Agreement is invalid under Illinois law because: (1) there was no mutual assent to enter into this agreement in the first place; and (2) Illinois' statute of frauds prevents the contract from being enforceable. To prove this, she provided to this Court a copy of the Leila Verde Purchase Agreement, emphasizing that although it includes Mrs. Hartigan's name in the signature block, it bears no actual signature of hers. She claims that the only copy with her signature was signed after the fact as demanded by Mr. Hartigan. We are not persuaded by this contention.

While we agree with Mrs. Hartigan that an essential element for the formation of a contract is the mutual assent by the parties, we note that actual signatures are not a necessary condition for the manifestation of a mutual assent. See Delcon Group, Inc. v. Northern Trust Corp., 543 N.E.2d 595, 600 (Ill. App. 1989) ("one of the elements essential to the formation of a contract is a manifestation of agreement or mutual assent by the parties to its terms"). A mutual agreement could be found even though it is inferred from conduct rather than from words. See Williston on Contracts, Section 4:2 (4th ed.) ("[A] bilateral agreement may be found even though one of the promises is inferred from conduct rather than from words.").

"Whether a writing constitutes a binding contract, even though it is not signed * * * usually depends upon the intention of the parties. * * * The object of a signature is to show mutuality or assent, but these facts may be shown in other ways, [such] as * * * by acts or conduct of the parties." Hedlund & Hanley, LLC v. Board of Trustees of Community College District No. 508, 376 Ill. App. 3d 200, 206 (2007) (Citations omitted.). As respondent pointed out, for 13 years, from the alleged purchase of Lelia Verde in 2003 until 2016, Mrs. Hartigan never challenged her true ownership of Lelia Verde; instead, she had consistently contended on multiple occasions, under oath, that she was a partner of Leila Verde. The absence of a signed agreement does not lead to a definitive lack of mutual agreement when entering into a purchase agreement.

Alternatively, Mrs. Hartigan asserts that the unsigned Leila Verde Purchase Agreement has violated Illinois' statute of frauds, thus it is not enforceable under Illinois law. Mrs. Hartigan's sweeping generalization that "the Illinois Frauds Act, 740 ILCS 80/1, generally requires that for a contract to be enforceable, it must be in writing and signed by the parties" is inaccurate. To prevent the enforcement of unfounded fraudulent claims, the state of Illinois, like most of the states in the United States, has adopted laws in the nature of the statute of frauds. Illinois' statute of frauds provides that two specific classes of contracts, among others, are within its scope: contracts for the sale of goods above $500; and contracts that cannot be performed within one year from their making. 810 ILCS 5/2-201, codifying U.C.C. section 2-201; 740 ILCS 80/1. The statute of frauds does not automatically apply when there is no signed agreement, as Mrs. Hartigan suggests.

We first note that the Leila Verde Purchase Agreement, although it specifies a purchase price exceeding $500, does not involve a sale of "goods" within the meaning of 810 ILCS 5/2-201. "Goods," as defined in U.C.C section 2-201, is limited to "all things * * * which are movable at the time of identification to the contract for sale." 810 ILCS 5/2-105. A partnership interest, not moveable in nature, is not a "good," the sale of which is required to be in writing by the Illinois statute of frauds. See also Hawkland UCC Series § 2-105:2 ("The exclusion of 'things in action' and the inclusion of 'things which are movable' suggests that Section 2-105 limits goods to tangible personal property.").

Furthermore, we agree with respondent that the contract at issue here could well be completed within one year; consummating a sale of partnership interests requires nothing more than a transfer of funds and acknowledgment of their receipt. Therefore, we reject Mrs. Hartigan's legal conclusion that the lack of her signature on the purchase agreement violates the statute of frauds on its face.

More importantly, we note that Mrs. Hartigan's statute of frauds argument is misplaced in the context of Federal income tax law. Even if the lack of Mrs. Hartigan's signature on the Leila Verde Purchase Agreement amounted to a violation of the Illinois statute of frauds, our analysis would not stop there. This Court has long recognized that "the purpose of the statute [of frauds] is to protect one party from the enforcement of an oral agreement," and when "[e]nforcement of the oral contract is not at issue * * * the statute of frauds is not applicable." Brauer v. Commissioner, 74 T.C. 1134 at 1142-1143 (1980). Therefore, even if Mrs. Hartigan had a defense, under the statute of frauds, against a potential lawsuit brought by Mr. Rogers to enforce the agreement, she cannot invoke it as a defense against respondent in the instant TEFRA case. Respondent has never been a party to this contract and has never sought to enforce performance of this contract against Mrs. Hartigan. In other words, even if the statute of frauds could prevent the Leila Verde Purchase Agreement from being judicially enforceable against Mrs. Hartigan, she may still be considered a partner of Leila Verde for Federal income tax purposes.

In sum, we conclude that the lack of Mrs. Hartigan's signature on the Leila Verde Purchase Agreement would not result in the unenforceability of this agreement against her. But even if the statute of frauds did apply to this purchase agreement, it only affords Mrs. Hartigan a defense against potential lawsuits raised by parties privy to this agreement; it does not accord her a defense against respondent for Federal income tax purposes. To decide whether Mrs. Hartigan is a partner for a TEFRA proceeding, we need to invoke other doctrines that are more germane to our purpose.

II. Duty of Consistency

Mrs. Hartigan is estopped by the duty of consistency from claiming that she is not a partner in Leila Verde for Federal income tax purposes. "The doctrine of the duty of consistency, also known as 'quasi-estoppel,' is among the equitable principles applicable in this Court." Arberg v. Commissioner, T.C. Memo. 2007-244. This doctrine rests upon the premise that a taxpayer has a duty to be consistent in the tax treatment of items and will not be permitted to benefit from the taxpayer's own prior error or omission. Id. We note that the Court of Appeals for the Seventh Circuit, to which an appeal in the instant TEFRA case would seem to lie absent a stipulation to the contrary, has identified three elements as conditions of the application of the duty of consistency: (1) a representation or report by the taxpayer; (2) on which the Commission has relied; and (3) an attempt by the taxpayer after the statute of limitations has run to change the previous representation or to recharacterize the situation in such a way as to harm the Commissioner. Kielmar v. Commissioner, 884 F.2d 959, 965 (7th Cir. 1989).

In this case, Mrs. Hartigan has maintained to several courts, including this Court, that she is a partner of Leila Verde. She also represented to the Commissioner, through the Hartigans' joint tax returns, that she is a partner of Leila Verde, and as a result took a deduction of over 3 million dollars. "For purposes of the duty of consistency, a taxpayer's treatment of an item on a return can be a representation that facts exist which are consistent with how the taxpayer reports the item on the return." Estate of Letts v. Commissioner, 109 T.C. 290, 299-300 (1997). The Commissioner has relied on her representation and never doubted its veracity, which is evidenced by his acceptance of the Hartigans' joint tax returns and earlier filings in this case.

Consequently, the only questions left for us are whether Mrs. Hartigan is attempting to change her previous representation after the statute of limitations has run, and/or whether such change could harm respondent. Mrs. Hartigan here seeks to change her position as reflected on the Hartigans' joint tax returns of 2003 and

2004 by asserting that she has never been a partner in Leila Verde. As discussed above, for 2003 and 2004, Mrs. Hartigan was able to claim deductions of over 3 million dollars due to her alleged status as a partner in Leila Verde, which would not have been allowed if she was not a partner of Leila Verde. However, the statute of limitations on assessment for the Hartigans' joint tax returns for 2003 and 2004 is normally three years from the date the return was filed.[6] Sec. 6501(a). Consequently, any attempt to make an assessment for the Hartigans' 2003 and 2004 individual income taxes and penalties will be barred by the statute of limitations absent computational adjustments from the instant TEFRA proceeding.

Since all three prongs of the test are met, the Commissioner may act as if the previous representation remains true, even if it is not, and the Hartigans are barred from asserting the contrary. E.g., Kielmar v. Commissioner, at 965 (citing Herrington v. Commissioner, 854 F.2d at 758); Arberg v. Commissioner. Thus, Mrs. Hartigan is barred from asserting here that she is not a partner of Leila Verde.

We also note that this is a TEFRA case, and the TEFRA provisions provide that a partner must treat a partnership item on the partner's return "in a manner which is consistent with the treatment of such partnership item on the partnership return." Sec. 6222(a). If a partner believes that the partnership's treatment of an item is erroneous, then this partner must file with the Secretary a statement identifying the inconsistency. Sec. 6662(b)(1)(B). This case bears striking similarities to Blonien v. Commissioner, 118 T.C. 541 (2002), where this Court held that the duty of consistency prevented that petitioner from claiming on his income tax returns that he was a partner and then later asserting, following the TEFRA partnership proceeding, that he never in fact became a partner.

Blonien held that the taxpayer was estopped by the duty of consistency from claiming that he was not a partner for Federal income tax purposes. Id. at 553.

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[6] As noted earlier, on February 7, 2014, respondent issued a notice of deficiency to the Hartigans for each of the tax years 2003, 2004 and 2008. Mrs. Hartigan timely petitioned this Court, and the case was dismissed for lack of jurisdiction on November 19, 2014. Even if we assume that the IRS and Mrs. Hartigan had entered into a written agreement to extend the assessment limitations period for her individual tax returns beyond the normal three-year period pursuant to section 6501(c)(4), the statute would generally have expired 150 days after the case's dismissal. Sec. 6503(a), sec. 7481(a), sec. 7483.

This Court noted that the taxpayer never filed a Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request, to notify the Internal Revenue Service that he was not a partner in accordance with section 6222, and he only notified the Service of his change of position after the period of limitations had expired for the assessment of a deficiency on his 1987 tax return. Id. at 554-556. Pointing out that "these are the elements for equitable estoppel under the duty of consistency," this Court held that the taxpayer was bound by his representation on his filed Form 1040 that he was a partner. Id. at 555.

Mrs. Hartigan similarly represented in her joint tax return that she was a partner of Leila Verde. Both Mr. and Mrs. Hartigan represented in a bankruptcy case that Mrs. Hartigan was a partner. They have never notified respondent that Mrs. Hartigan was not a partner in accordance with section 6222. Only after the period of limitations had expired for the assessment of a deficiency on their 2003 and 2004 tax returns did they inform respondent of their change in position. As in Blonien, Mrs. Hartigan is barred from asserting she is not a partner under the duty of consistency, notwithstanding her claim that there is no evidence that she actually signed the Leila Verde Purchase Agreement at the time of the alleged purchase.

III. Tax Benefit Rule

Mrs. Hartigan is also barred from asserting that she is not a partner in Leila Verde under the tax benefit rule. The tax benefit rule, a judicially created doctrine, provides that "an amount deducted from gross income in one year is included in income in a subsequent year if an event occurs in the subsequent year that is fundamentally inconsistent with the premise on which the deduction had previously been based." The Estate of Backemeyer v. Commissioner, 147 T.C. __, __ (slip op. at 20) (Dec. 8, 2016); Rojas v. Commissioner, 90 T.C. 1090, 1097 (1988), aff'd, 901 F.2d 810 (9th Cir. 1990). The Seventh Circuit "has long held that the tax benefit rule encompasses the recovery of previously deducted taxes and that refunds of such taxes are to be treated as income in the year received." First Trust and Savings Bank of Taylorville v. United States, 614 F.2d 1142, 1144 (7th Cir. 1980).

In First Trust, the Seventh Circuit concluded that "the occurrence of an event inconsistent with a prior deduction is * * * sufficient to invoke the tax benefit rule." Id. at 1146. It reasoned that to allow the bank a deduction without subjecting it to income tax when its payment is refunded "is to produce precisely the sort of windfall which the tax benefit rule is designed to preclude." Id. In this case, if we allow Mrs. Hartigan to change her position now and claim that she is not a partner in Leila Verde, it is "an event inconsistent with" her 2003 and 2004 deductions. And because the statute of limitation has run, respondent cannot, absent a TEFRA computational adjustment, assess a deficiency on her 2003 or 2004 Form 1040 tax returns. The effect would be allowing Mrs. Hartigan a deduction without subjecting it to income tax when she claims there should never have been a deduction, and "to produce precisely the sort of windfall which the tax benefit rule is designed to preclude." Therefore, the tax benefit rule bars allowing Mrs. Hartigan to change her position.

IV. Judicial Estoppel

Finally, Mrs. Hartigan is barred from asserting that she is not a partner of Leila Verde under the judicial estoppel doctrine. As discussed above, both Mr. and Mrs. Hartigan have represented to this Court numerous times that Mrs. Hartigan was a partner of Leila Verde. In addition, Mrs. Hartigan testified during a deposition in Mr. Hartigan's bankruptcy proceeding that she was "a member" of Leila Verde. Also, in the Sugarloaf lawsuit, she represented to the Massachusetts Superior Court that she agreed to enter into transactions with Warwick in 2003 and as a result owned Leila Verde. Finally, in the Seyfarth Shaw lawsuit, the defendants settled with Mrs. Hartigan, and paid her "substantial funds," as Mr. Hartigan represented. Only recently has Mrs. Hartigan veered away from her position and claimed that she never owned any interest in Leila Verde.

As explained by the Seventh Circuit, judicial estoppel applies when: (1) the later position held by the taxpayer is clearly inconsistent with his or her earlier position; (2) the facts at issue must be the same in both cases; and (3) the party to be estopped must have convinced the first court to adopt its position. Levinson v. U.S., 969 F.2d 260, 264-265 (7th Cir. 1992). Judicial estoppel rests within the court's discretion. Indeck Energy Servs., Inc. v. Commissioner, T.C. Memo. 2003-101. We note that the Seventh Circuit does not require a court to adopt a taxpayer's previous position in a judicial decision; a mere favorable settlement would satisfy the third prong of this test. See McNamara v. City of Chicago, 138 F.3d 1219 at 1225 (7th Cir. 1998) ("The doctrine of judicial estoppel requires, however, that the party sought to be estopped have obtained a favorable judgment or settlement * * * on the basis of a legal or factual contention that he wants to repudiate in the current litigation." (Citation omitted.)).

In this case, it is clear that Mrs. Hartigan's change of position satisfies the first two prongs of the test. When Mrs. Hartigan settled her case favorably in the Seyfarth Shaw lawsuit, she represented to the Massachusetts Superior Court that she was a partner of Leila Verde; she claims now that she has never been a partner of Leila Verde. The only hurdle remaining to apply judicial estoppel is to show that Mrs. Hartigan's favorable settlement with the defendants in the Seyfarth Shaw lawsuit satisfies the third prong of the requirement. We conclude that it does.

As we discussed above, under the Seventh Circuit's jurisprudence, a mere favorable settlement would satisfy the third prong. However, Mr. Hartigan asserted that Sugarloaf and Seyfarth Shaw settled this case only because "Seyfarth decided that it was cheaper to settle than to litigate." If this is an argument trying to prove Mrs. Hartigan did not get the "substantial" settlement on the merits of her case in the Seyfarth Shaw lawsuit, we find that it is not persuasive. First, Mr. Hartigan has not adduced any evidence indicating that Mr. Rogers and Seyfarth Shaw's settlement arose purely out of cost concerns; it is a mere unfounded speculation. Second, as the Seventh Circuit pointed out, "a settlement represents capitulation. Persons who triumph by inducing their opponents to surrender have 'prevailed' as surely as persons who induce the judge to grant summary judgment." <u>Kale v. Obuchowski</u>, 985 F.2d 360, 362 (7th Cir. 1993). Having won a favorable settlement in the Seyfarth Shaw lawsuit by insisting that she had partnership interest in Leila Verde, Mrs. Hartigan is "stuck" with that proposition in subsequent litigation. <u>Id.</u>

Further, we note that Mrs. Hartigan's admissions to this Court that she was a partner of Leila Verde, in her affidavit filed on May 5, 2014, constitute judicial admissions for the purposes of both Illiniois law and federal income tax law. <u>See</u> <u>Hartke v. Conn</u>, 102 Ill. App. 3d 96, 102 (1981) ("[Judicial admissions] may be: (1) those made in pleadings or other documents, or (2) testimonial." (Citation omitted.)). "Judicial admissions are conclusive and may not be contradicted * * * [they] are binding and conclusive and have the effect of withdrawing a fact or facts from issue and dispensing wholly with the need for proof of the admitted facts." <u>Id.</u> Therefore, Mrs. Hartigan is barred from contradicting her earlier judicial admissions to this Court that she was a partner.

IV. <u>Mrs. Hartigan's Potential Innocent Spouse Claim</u>

Mrs. Hartigan argues to this Court that Mr. Hartigan caused her to make the Leila Verde purchase through deception, abuse, manipulation, exploitation and domination in order to shelter his own income. She claims to have derived no benefit from the investment. She also alleges that she did not prepare or review the Hartigans' joint tax returns, nor did she sign the tax returns of her own will. Mrs. Hartigan further asserts that she was not "actively involved" in the Sugarloaf lawsuit or the Seyfarth Shaw lawsuit except for depositions; her husband was the one taking all actions.

These facts, however, are more relevant to an innocent spouse defense Mrs. Hartigan could potentially raise under section 6015 and section 6230 in a partner-level proceeding after the instant TEFRA proceeding has been resolved. In this TEFRA partnership case, we do not have jurisdiction to consider an innocent spouse defense. See Carmel v. Commissioner, 98 T.C. 265 (1992). Therefore, we consider the evidence introduced by Mrs. Hartigan indicating her husband had tricked or coerced her into making this investment irrelevant for our purpose.

Conclusion

After having reviewed all the relevant facts in this case, we conclude that Mrs. Hartigan was a partner of Leila Verde for Derringer's 2003 and 2004 tax years for Federal income tax purposes. We find Mrs. Hartigan's statue of frauds argument misplaced for the purpose of this TEFRA proceeding. Furthermore, we conclude that Mrs. Hartigan is barred from asserting that she is not a partner of Leila Verde under any of three doctrines: duty of consistency; tax benefit rule; and judicial estoppel.

Based on the foregoing, it is hereby

ORDERED that Mrs. Hartigan will be treated as a partner in Leila Verde for Derringer's 2003 and 2004 tax years and she or her representative will be permitted to participate in the August 16, 2017, trial of this case.

(Signed) Robert A. Wherry
Judge

Dated: Washington, D.C.
August 11, 2017