

T.C. Memo. 2010-23

UNITED STATES TAX COURT

LEE E. AND KATHY H. NEWELL, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 26844-06.

Filed February 16, 2010.

Edward I. Kaplan, for petitioners.

Andrew R. Moore, for respondent.

MEMORANDUM OPINION

MARVEL, Judge: Respondent determined deficiencies in Federal income tax and an addition to tax under section 6651(a)(1)¹ as follows:

¹Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and

(continued...)

<u>Year</u>	<u>Deficiency</u> ¹	<u>Addition to tax</u> <u>sec. 6651(a)(1)</u>
1996	\$72,145	-0-
1997	846,531	-0-
2001	473,380	\$47,338
2002	229,565	-0-
2003	336,821	-0-

¹The years in dispute are 2001, 2002, and 2003. The deficiencies determined for 1996 and 1997 reflect solely the disallowance of net operating losses from the years in dispute.

The only issue for decision is whether the managing member interest of petitioner husband Lee E. Newell (petitioner husband) in a California limited liability company (L.L.C.) that is classified as a partnership for Federal income tax purposes is a limited partnership interest as a limited partner for purposes of applying the passive activity rules under section 469 and related regulations.² We hold that it is not.

Background

The parties submitted this case fully stipulated pursuant to Rule 122. We incorporate the stipulation of facts into our findings by this reference. On the date they petitioned this Court, petitioners resided in California.

¹(...continued)
all Rule references are to the Tax Court Rules of Practice and Procedure.

²The parties stipulated that the sec. 6651(a)(1) addition to tax applies to any deficiency determined for 2001. Because we conclude that petitioners are not liable for the deficiency determined for any of the years at issue, petitioners are not liable for the addition to tax.

Petitioner husband is an attorney licensed in Florida, but he does not practice law. His primary business activity involves the management of real estate investments. He spends more than 50 percent of his time and more than 750 hours annually in real property trade or business activities.

During 2001, 2002, and 2003 (years at issue) petitioner husband owned all of the stock in California Custom Millworks, Inc. (Millworks), an S corporation. Millworks' business included manufacturing and installing windows, cabinets, doors, trim, and other items of carpentry.

During the years at issue petitioner husband actively engaged in the conduct of the trade or business of Millworks as follows:

<u>Year</u>	<u>Hours</u>
2001	250
2002	300
2003	350

His participation in the trade or business of Millworks was a significant participation activity as defined by section 1.469-5T(c), Temporary Income Tax Regs., 53 Fed. Reg. 5726 (Feb. 25, 1988). During the years at issue Millworks incurred losses that were distributed to petitioner husband and deducted by petitioners on their Federal income tax returns.³ Respondent

³In 2005 Millworks filed for bankruptcy "in which all its assets were disposed, and then liquidated."

does not challenge the amount of the losses, which were as follows:

<u>Year</u>	<u>Loss</u>
2001	\$458,379
2002	1,270,452
2003	798,431

During the years at issue petitioner husband also owned 33 percent of the member interests in Pasadera Country Club, L.L.C. (Pasadera). Pasadera was formed in 1999 as an L.L.C. under California law to engage in the business of owning and operating a golf course, restaurant, and country club facility. Pasadera is classified as a partnership for Federal income tax purposes.

At all relevant times petitioner husband was the managing member of Pasadera⁴ and was responsible for hiring and firing all management personnel. As the managing member, he also oversaw the construction of Pasadera's 38,000-square-foot clubhouse; created and administered all membership programs, including advertising and reviewing and approving membership applications; and reviewed, approved, and signed all checks for expenses incurred in the construction and operation of Pasadera. He was

⁴The parties stipulated that petitioner husband was the managing member of Pasadera during the years at issue. The First Amended and Restated Limited Liability Company Operating Agreement of Pasadera in effect during the years at issue (operating agreement) stated that the managing member of Pasadera was NCDG Golf, L.L.C. (NCDG Golf). Petitioner husband, as president of NCDG Golf, signed the operating agreement as the managing member.

also responsible for annual filings with State and county agencies and for any liquor license, compliance, or other legal issues of Pasadera.

Petitioner husband negotiated all construction and permanent loans for Pasadera and was personally liable for those loans. As of the date on which the parties submitted the stipulation of facts, petitioner husband remained personally liable for Pasadera's outstanding loan obligations. If Pasadera experienced an operational cash shortfall, he, along with two other members of Pasadera, provided funding to cover the shortfall.

Petitioner husband actively engaged in the conduct of the trade or business of Pasadera as follows:

<u>Year</u>	<u>Hours</u>
2001	450
2002	400
2003	400

Pasadera incurred losses in each of the years at issue.

Petitioner husband's distributive shares of the losses, the amounts of which respondent does not dispute, were as follows:

<u>Year</u>	<u>Loss</u>
2001	\$1,882,125
2002	2,104,000
2003	2,034,394

Petitioners deducted the losses on their 2001-03 joint Federal income tax returns.

