No. 11-139

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

HOME CONCRETE & SUPPLY, LLC, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, if the taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The questions presented are as follows:

1. Whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the extended six-year assessment period.

2. Whether a final regulation promulgated by the Department of the Treasury, which reflects the IRS's view that an understatement of gross income attributable to an overstatement of basis can trigger the extended six-year assessment period, is entitled to judicial deference.

PARTIES TO THE PROCEEDINGS

Petitioner is the United States of America.

Respondents are Home Concrete & Supply, LLC; Robert L. Pierce; Susanne D. Pierce; Stephen R. Chandler; Rebecca R. Chandler; and Home Oil and Coal Company, Inc.

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PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States of America, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-21a) is reported at 634 F.3d 249. The opinion of the district court (App., *infra*, 23a-46a) is reported at 599 F. Supp. 2d 678.

JURISDICTION

The judgment of the court of appeals was entered on February 7, 2011. A petition for rehearing was denied on April 5, 2011 (App., *infra*, 22a). On June 22, 2011, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including August

3, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

The relevant statutory and regulatory provisions are reproduced in the appendix to this petition. App., *infra*, 47a-72a.

STATEMENT

1. As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, if the taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The question presented in this case is whether that six-year assessment period applies to a tax-avoidance scheme that operated by overstating a taxpayer's basis in property.

a. When a taxpayer sells property, any "[g]ain[]" that he realizes from the sale contributes to his "gross income." 26 U.S.C. 61(a)(3). The taxpayer's gain, however, is not the sale price of his property. Rather, it is the sale price minus the taxpayer's capital stake in the sold asset, which is generally the amount paid to obtain the property, as adjusted by various other factors. 26 U.S.C. 1012. For tax purposes, that capital stake is commonly referred to as the taxpayer's "basis" in property. 26 U.S.C. 1011(a). Because the taxable income from a property sale is generally determined by subtracting the taxpayer's basis from the property's sale price, an overstatement of basis will typically decrease

the amount of the taxpayer's gain (and thus the amount of federal income-tax liability) that is attributable to the sale.

This case involves a particular kind of tax shelter, known as a Son-of-BOSS (Bond and Option Sales Strategy) transaction. In a Son-of-BOSS transaction, a taxpayer uses some mechanism, often a short sale, to artificially increase his basis in an asset before the asset is sold. A short sale is a sale of a security that the seller does not own or has not contracted for at the time of the sale. To close the short sale, the seller is obligated to purchase and deliver the security at some point in the future, often by using the proceeds from the short sale itself. App., *infra*, 3a n.1. Typically in a Son-of-BOSS transaction, a taxpayer enters into a short sale and transfers the proceeds as a capital contribution to a partnership. The partnership then closes the short sale by purchasing and delivering the relevant security on the open market. See *Beard* v. *CIR*, 633 F.3d 616, 617-618 (7th Cir. 2011), petition for cert. pending, No. 10-1553 (filed June 23, 2011).

When the taxpayer and partnership file their tax returns for the year in which a transaction of the kind described above occurs, they are required under 26 U.S.C. 722, 723, and 752 to report their taxable bases in the partnership. The taxpayer's basis in the partnership is called an "outside basis," while the partnership's basis in its own assets is called an "inside basis." See *Kornman & Assocs., Inc.* v. *United States*, 527 F.3d 443, 456 n.12 (5th Cir. 2008). In a Son-of-BOSS transaction, when computing both "outside" and "inside" basis, the taxpayer and the partnership include the short-sale proceeds contributed to the partnership, without decreasing that amount by the corresponding obligation (*i.e.*, to

close the short sale by purchasing and delivering the relevant security) that the partnership has assumed. As a result, the taxpayer either generates a large paper loss that can be used to offset capital gains on other unrelated investments, or turns what would otherwise have been a sizeable capital gain into a smaller taxable gain or even a capital loss.[1] See *Beard*, 633 F.3d at 618.

b. In this case, respondents Stephen R. Chandler and Robert L. Pierce were the sole shareholders of respondent Home Oil and Coal Company, Inc. (Home Oil), which they planned to sell. In order to minimize their tax liability, they formed a pass-through entity in April 1999 called Home Concrete & Supply, LLC (Home Concrete).[2] In May 1999, the taxpayers participated in a short sale of United States Treasury Notes, receiving cash proceeds of more than $7.4 million. They then transferred that entire amount, along with the obligation to close out the short position, to Home Concrete.

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[1] In 2000, the IRS issued a notice informing taxpayers that Son-of-BOSS transactions were invalid under the tax laws. See Notice 2000-44, 2000-36 I.R.B. 255 (describing arrangements that unlawfully "purport to give taxpayers artificially high basis in partnership interests"). In the wake of that notice, courts largely have invalidated Son-of-BOSS transactions as lacking in economic substance. See, *e.g.*, *Jade Trading, LLC* v. *United States*, 80 Fed. Cl. 11, 45-46 (2007), aff'd in relevant part, 598 F.3d 1372, 1376-1377 (Fed. Cir. 2010). In 2004, the IRS offered a settlement to approximately 1200 taxpayers. Many taxpayers who had engaged in Son-of-BOSS transactions, however, either did not qualify, chose not to participate in the settlement, or had not yet been identified. See *Beard*, 633 F.3d at 618.

[2] Home Concrete was a limited liability corporation, which for present tax purposes is treated in the same manner as a partnership. See 26 U.S.C. 752; 26 C.F.R. 301.7701-3(b)(1)(i). This brief therefore refers to the ownership interests in Home Concrete as partnership interests.

The following day, Home Concrete closed the short sale by purchasing and delivering Treasury Notes for slightly less than $7.4 million. The taxpayers later executed a series of transactions through which they transferred virtually all of Home Oil's assets to Home Concrete, and they then sold Home Concrete for approximately $10.6 million. App., *infra*, 2a-3a.

In April 2000, Chandler and his wife, respondent Rebecca R. Chandler; Pierce and his wife, respondent Susanne D. Pierce; and Home Concrete filed their federal income-tax returns for 1999. In computing both their inside and outside bases, the taxpayers and Home Concrete included the amount of the short-sale proceeds (more than $7.4 million) that had been contributed to Home Concrete, without reducing that amount to reflect Home Concrete's offsetting obligation to close the short position. As a result, Home Concrete reported only a modest gain of $69,125 on the $10.6 million sale of its assets. App., *infra*, 4a.

2. In September 2006, the IRS issued a Final Partnership Administrative Adjustment (FPAA), decreasing to zero the taxpayers' outside bases in Home Concrete and thereby substantially increasing their taxable income for 1999. Respondents challenged the FPAA, arguing that it was barred because it was issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). The government contended that the FPAA was governed instead by the extended six-year assessment period in 26 U.S.C. 6501(e)(1)(A), which applies when a taxpayer "omits from gross income an amount properly includible therein which is in excess

of 25 percent of the amount of gross income stated in the return."[3]

The district court granted partial summary judgment to the United States. App., *infra*, 23a-46a. It ruled that "where a taxpayer overstates basis and, as a result, leaves an amount out of gross income, the taxpayer 'omits from gross income an amount properly includible therein' for purposes of [Section] 6501(e)(1)(A)." *Id.* at 39a. The court therefore concluded that the six-year period in Section 6501(e)(1)(A), and not the three-year period in Section 6501(a), applied to the IRS's assessment. *Ibid*. The court rejected respondents' argument that this Court's decision in *The Colony, Inc.* v. *CIR*, 357 U.S. 28 (1958) (*Colony*), required a different result. The court explained that *Colony* had involved an earlier provision of the Internal Revenue Code, and that subsequent statutory amendments make clear that *Colony*'s holding does not apply to the current Section 6501(e)(1)(A). App., *infra*, 32a-38a.

3. The court of appeals reversed. App., *infra*, 1a-21a. The court concluded that "*Colony* forecloses the argument that Home Concrete's overstated basis in its reporting of the short sale proceeds resulted in an omission from its reported gross income." *Id.* at 11a. The court declined to apply a regulation promulgated in temporary form by the IRS in September 2009, which became final while the appeal was pending, and which con-

[3] Although the FPAA was issued in September 2006, more than six years after the taxpayers filed their returns in April 2000, the assessment period was suspended for approximately five months (between December 2003 and May 2004) due to a third-party recordkeeper's tardy compliance with an IRS summons. See C.A. App. 326 n.5; see also 26 U.S.C. 7609(e)(2). Respondents do not dispute that if the six-year assessment period applies, the FPAA in this case was timely.

strues the phrase "omits from gross income" to encompass situations in which a taxpayer understates his income by overstating his basis in property. *Id.* at 16a. The court held that the regulation was inapplicable by its terms, and that this Court's decision in *Colony* had found the relevant statutory language unambiguous and thus precluded any contrary agency interpretation. *Id.* at 12a-16a.

REASONS FOR GRANTING THE PETITION

This case presents the question whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). That question is presented in a petition for a writ of certiorari currently pending before the Court. See *Beard* v. *CIR*, 633 F.3d 616 (7th Cir. 2011), petition for cert. pending, No. 10-1553 (filed June 23, 2011). The government agrees with the petitioners in *Beard* that this Court should grant review in that case in order to resolve a conflict among the circuits. See Gov't Br., *Beard*, *supra*, at 19-20 (filed July 27, 2011).

Beard is the earlier-filed petition, and the government is not aware of any reason why this case would present a more suitable opportunity than *Beard* for resolving the circuit conflict. If the Court grants the petition in *Beard* and concludes that an overstatement of basis in sold property does trigger the extended six-year assessment period, then the assessments at issue in this case were timely and the court of appeals erred in holding otherwise. Accordingly, the Court should hold this petition pending the disposition of *Beard*, including any

subsequent proceedings on the merits, and then dispose of the petition as appropriate in light of those decisions.

CONCLUSION

The petition for a writ of certiorari should be held pending the Court's final disposition of *Beard* v. *CIR*, petition for cert. pending, No. 10-1553 (filed June 23, 2011), and then disposed of as appropriate.

Respectfully submitted.

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AUGUST 2011

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 09-2353

HOME CONCRETE & SUPPLY, LLC; ROBERT L. PIERCE; STEPHEN R. CHANDLER; REBECCA R. CHANDLER; HOME OIL AND COAL COMPANY, INCORPORATED; SUSANNE D. PIERCE, PLAINTIFFS-APPELLANTS

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

BAUSCH & LOMB, INC., AMICUS SUPPORTING APPELLANTS

Argued: Oct. 27, 2010
Decided: Feb. 7, 2011

OPINION

Before: WILKINSON, GREGORY, and WYNN, Circuit Judges.

WYNN, Circuit Judge:

In *Colony, Inc. v. Commissioner of Internal Revenue,* the United States Supreme Court held that an

overstatement of basis in assets resulting in an understatement of reported gross income does not constitute an "omission" from gross income for purposes of extending the general three-year statute of limitations for tax assessments. 357 U.S. 28, 78 S. Ct. 1033, 2 L. Ed. 2d 1119 (1958). Because *Colony* squarely applies to this case, and because we will not defer to Treasury Regulation § 301.6501(e)-1(e), which was promulgated during this litigation and, by its own terms, does not apply to the tax year at issue, we reverse and hold that the tax assessments at issue here were untimely.

I.

In 1999, plaintiffs Stephen R. Chandler and Robert L. Pierce were the sole shareholders of plaintiff Home Oil and Coal Company, Incorporated ("Home Oil"). Mr. Pierce contemplated selling his interest in Home Oil and sought professional financial planning advice in anticipation of the transaction. This financial advice, rendered by several financial planning firms, included proposals to minimize the tax liability generated by Mr. Pierce's sale of his interest in Home Oil. The ensuing transactions form the grounds of this dispute.

Plaintiff Home Concrete & Supply, LLC ("Home Concrete"), a pass-through entity for tax purposes, was formed on April 15, 1999. Its partners were Mr. Chandler, Mr. Pierce, Home Oil, and two trusts established for the benefit of Mr. Pierce's children (collectively "the taxpayers").

On May 13, 1999, each of the taxpayers initiated short sales[1] of United States Treasury Bonds. In the

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[1] A "short sale" is a "sale of a security that the seller does not own or has not contracted for at the time of sale, and that the seller must bor-

aggregate, the taxpayers received $7,472,405 in short sale proceeds. Four days later, the taxpayers transferred the short sale proceeds and margin cash to Home Concrete as capital contributions. By transferring the short sale proceeds to Home Concrete as capital contributions, the taxpayers created "outside basis" equal to the amount of the proceeds contributed.[2] The next day, May 18, 1999, Home Concrete closed the short sales by purchasing and returning essentially identical Treasury Bonds on the open market at an aggregate purchase price of $7,359,043.

On June 11, 1999, Home Oil transferred substantially all of its business assets to Home Concrete as a capital contribution. Three days later, the taxpayers (except Home Oil) transferred percentages of their respective partnership interests in Home Concrete to Home Oil as capital contributions to Home Oil. On August 31, 1999, Home Concrete sold substantially all of its assets to a third-party purchaser for $10,623,348.

In April 2000, Home Concrete and the taxpayers timely filed their tax returns for the 1999 tax year. Home Concrete elected to adjust, or "step-up," its inside basis under 26 U.S.C. ("I.R.C.") § 754 to equal the tax-

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row to make delivery." BLACK'S LAW DICTIONARY 1456 (9th ed. 2009). To close the short sale, "'[t]he short seller is obligated . . . to buy an equivalent number of shares [or substantially identical security] in order to return the borrowed [property].'" In theory, the short seller makes this covering purchase using the funds he received from selling the borrowed [property].'" *Kornman & Assocs., Inc. v. United States,* 527 F.3d 443, 450 (5th Cir. 2008) (quoting *Zlotnick v. TIE Commc'ns,* 836 F.2d 818, 820 (3d Cir. 1988)).

[2] A partner's basis in her partnership interest is called "outside basis," and a partnership's basis in its assets is referred to as its "inside basis." *Kornman,* 527 F.3d at 456 n.12; *see also* 26 U.S.C. §§ 722-23.

payers' outside bases. *See* I.R.C. § 743(b)(1). Home Concrete then adjusted its inside basis to $10,527,350.53, including the amount of short sale proceeds earlier contributed by the taxpayers. As a result, Home Concrete reported a modest $69,125.08 gain from the sale of its assets.

Home Concrete's 1999 tax return reported the basic components of the transactions. Its § 754 election form gave, for each partnership asset, an itemized accounting of the partnership's inside basis, the amount of the basis adjustment, and the post-election basis. The sum of the post-election bases is indicated at the end of the form. On its face, Home Concrete's return also showed a "Sale of U.S. Treasury Bonds" acquired on May 18, 1999 at a cost of $7,359,043, and a sale of those Bonds on May 19, 1999 for $7,472,405. The return also reported the resulting gain of $113,362. Similarly, the taxpayers' individual returns showed that "during the year the proceeds of a short sale not closed by the taxpayer in this tax year were received."

Notwithstanding these disclosures, the Internal Revenue Service ("IRS") did not investigate the taxpayers' transactions until June 2003. The IRS issued a summons to Jenkins & Gilchrist, P.C., the law firm that assisted the taxpayers with the transactions, on June 19, 2003. The parties agree that substantial compliance with the IRS summons did not occur until at least May 17, 2004.

As a result of the investigation, on September 7, 2006 the IRS issued a Final Partnership Administrative Adjustment ("FPAA"), decreasing to zero the taxpayers' reported outside bases in Home Concrete and thereby

substantially increasing the taxpayers' taxable income. Specifically, the IRS reasoned that

> the purported partnership was formed and availed of solely for purposes of tax avoidance by artificially overstating basis in the partnership interests of its purported partners. . . . [T]he acquisition of any interest in the purported partnership by the purported partner, short sales of Treasury Notes, the transfer of proceeds from short sales of Treasury Notes or other assets to a partnership in return for a partnership interest, the purchase or disposition of assets by the partnership, and the distribution of those assets or proceeds from the disposition of those assets to the purported partners, and the subsequent sale of those assets to generate a loss, all within a period of 8 months, had no business purpose other than tax avoidance, lacked economic substance, and, in fact and substance, constitutes an economic sham for federal income tax purposes. Accordingly, the partnership and the transactions described above shall be disregarded in full and (1) any purported losses resulting from these transactions are not allowable as deductions; and (2) increases in basis of assets are not allowed to eliminate gain for federal income tax purposes.

Accordingly, Home Concrete deposited $1,392,118 with the IRS and sued in the District Court for the Eastern District of North Carolina to recover that amount, alleging that the FPAA was barred by the general three-year limitations period in I.R.C. § 6501(a).

In response, the IRS contended that the FPAA was timely under the six-year limitations period in

§ 6501(e)(1)(A). The IRS invoked the extended statute of limitations arguing that Home Concrete "omit[ted] from gross income an amount properly includable therein" and which exceeded 25% of the amount of gross income stated in Home Concrete's 1999 tax return. *Home Concrete & Supply, LLC v. United States*, 599 F. Supp. 2d 678, 683 (E.D.N.C. 2008). There was no dispute that if an amount had been omitted from Home Concrete's return, that amount exceeded the 25% threshold. Likewise, there was no dispute that the FPAA would have been timely under the six-year statute of limitations, which would have been tolled beginning six months after the date the summons issued to the date of compliance. *Id.* at 681 n.5; *see also* I.R.C. § 7609(e)(2). By the district court's calculation, "the limitations period for the 1999 tax returns was suspended from December 20, 2003, until May 17, 2004. . . . Thus, a six-year statute, tolled, would not have run even under this most restrictive interpretation of the record until" September 14, 2006. *Home Concrete & Supply*, 599 F. Supp. 2d at 681 n.5.

On the other hand, the taxpayers argued that the six-year statute of limitations was inapplicable because Home Concrete's allegedly overstated basis did not constitute an omission from gross income. And even if it had been an omission, the taxpayers argued, their tax returns collectively made adequate disclosure of the transactions such that they were entitled to the safe harbor of the three-year statute of limitations under § 6501(e)(1)(B)(ii) (hereafter "safe harbor provision"). *Id*. at 683.

Thereafter, the district court granted partial summary judgment in the IRS's favor, ruling that "where a

taxpayer overstates basis and, as a result, leaves an amount out of gross income, the taxpayer 'omits from gross income an amount properly includible therein' for purposes of § 6501(e)(1)(A)." *Id.* at 687. The court ordered further briefing on, among other issues, whether the taxpayers adequately disclosed any omitted amount such that the safe harbor provision applied. After considering the supplemental briefs,[3] the district court ruled that the taxpayers failed to make adequate disclosure and therefore could not invoke the safe harbor provision. Accordingly, the district court concluded that the FPAA was timely under the six-year statute of limitations in § 6501(e)(1)(A). Home Concrete and the taxpayers appealed.

II.

On appeal, Home Concrete and the taxpayers argue that *Colony* establishes that an overstated tax basis does not constitute an omission from gross income for purposes of extending the limitations period for assessments. We review this question of law de novo. *Blaustein & Reich, Inc. v. Buckles,* 365 F.3d 281, 286 (4th Cir. 2004)

In *Colony,* the IRS alleged that a taxpayer "understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the 'basis' of such lots by erroneously including in their cost certain unallowable items of development expense." 357 U.S. at 30, 78 S. Ct. 1033. The IRS fur-

[3] In their supplemental brief to the district court, the taxpayers stipulated "for purposes of resolving the [cross-motions for summary judgment] only, that 'they overstated the tax basis of the assets that [Home Concrete] sold in 1999 resulting in an omission [ ] from gross income in excess of 25 percent of the stated gross income amount.' "

ther contended that the amount left out of gross income because of the overstated basis exceeded 25% of the amount of gross income stated in the relevant tax returns. The IRS argued that its assessments were therefore timely under the extended five-year statute of limitations in former I.R.C. § 275(c). *Id.* at 30-31, 78 S. Ct. 1033. That section stated that:

> If the taxpayer omits from gross income an amount properly includable therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

26 U.S.C. § 275(c) (1939).

The Supreme Court in *Colony* acknowledged that former § 275(c) was ambiguous and did not clearly answer whether Congress intended an overstated basis to constitute an omission from gross income stated in the return. The Court found in the legislative history "persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes." *Id.* at 33, 78 S. Ct. 1033. According to the Court, "in enacting [former §] 275(c) Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors." *Id.* at 37, 78 S. Ct. 1033. The Court therefore

refused to construe "omits" broadly and instead restricted its applicability to situations where taxpayers actually fail to report income.

Notably, in dicta, the Supreme Court also stated that its conclusion was "in harmony with the *unambiguous* language of section 6501(e)(1)(A)"—the section at issue in this case. *Id.* (emphasis added). In 1954, Congress recodified former § 275(c) at § 6501(e)(1)(A). Congress extended the limitations period from five years to six, and added the following additional subsections:

> (i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and
>
> (ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

Section 6501(e)(1)(A) and former § 275(c) are otherwise essentially identical.

In this case, the district court distinguished *Colony* on the ground that its holding is limited to cases in which the taxpayer is a trade or business selling goods or services. *Home Concrete & Supply,* 599 F. Supp. 2d at 685-86; *accord, e.g., Beard v. Comm'r,* 633 F.3d 616, 620 (7th Cir. 2011) (holding that *Colony* only applies in

the trade or business context); CC & *F W. Operations Ltd. P'ship v. Comm'r*, 273 F.3d 402, 406 n.2 (1st Cir. 2001) (noting, in dicta, the "arguable implication" that the holding of *Colony* applies only to sales of goods or services by a trade or business). In doing so, the district court relied heavily upon the Court of Federal Claims' decision in *Salman Ranch, Ltd. v. United States,* 79 Fed. Cl. 189 (2007), which has since been reversed by the Federal Circuit. 573 F.3d 1362 (Fed. Cir. 2009). The Federal Circuit expressly refused to limit *Colony's* application to sales of goods or services by a trade or business because nothing in *Colony* suggests such a limitation. *Salman Ranch,* 573 F.3d at 1373; *see also Bakersfield Energy Partners, L.P. v. Comm'r,* 568 F.3d 767, 778 (9th Cir. 2009) ("There is no ground for suggesting that the [*Colony*] Court intended the same language in § 275(c) to apply differently to taxpayers in a trade or business than to other taxpayers."); *Grapevine Imports, Ltd. v. United States,* 77 Fed. Cl. 505, 511 (2007) ("[T]his court sees no basis for limiting the Supreme Court's decision [in *Colony*] to sales of goods or services by a trade or business."); *UTAM, Ltd. v. Comm'r,* 98 T.C.M. (CCH) 422, 2009 WL 3739456, at *3 (2009) (same).

Like the Ninth and Federal Circuits, we hold that the Supreme Court in *Colony* straightforwardly construed the phrase "omits from gross income," unhinged from any dependency on the taxpayer's identity as a trade or business selling goods or services. There is, therefore, no ground to conclude that the holding in *Colony* is limited to cases involving a trade or business selling goods or services. *See Salman Ranch,* 573 F.3d at 1373 ("We are not prepared to conclude—based simply upon the Court's reference to ambiguity in § 275(c)

and the lack thereof in § 6501(e)(1)(A)—that the Court's facially unqualified holding nevertheless carries with it a qualification.").

Further, the Supreme Court's discussion of the legislative history behind former § 275(c) is equally compelling with regard to current § 6501(e)(1)(A). The language the Court construed in former § 275(c)—"omits from gross income an amount properly includable therein"—is identical to the language at issue in § 6501(e)(1)(A). Because there has been no material change between former § 275(c) and current § 6501(e)(1)(A), and no change at all to the most pertinent language, we are not free to construe an omission from gross income as something other than a failure to report "some income receipt or accrual." *Colony,* 357 U.S. at 33, 78 S. Ct. 1033; *see also Bakersfield Energy Partners, L.P.*, 568 F.3d at 778 (concluding that *Colony* forecloses the argument that an overstated basis can constitute an omission from gross income for purposes of extending the statute of limitations under § 6501(e)(1)(A)); *Salman Ranch,* 573 F.3d at 1377 (same). Thus, we join the Ninth and Federal Circuits and conclude that *Colony* forecloses the argument that Home Concrete's overstated basis in its reporting of the short sale proceeds resulted in an omission from its reported gross income.

III.

The IRS presses another path around *Colony.* After concluding that the IRS's position regarding the meaning of "omits" was barred by *Colony,* the Ninth Circuit commented that the "IRS may have the authority to promulgate a reasonable reinterpretation of an ambiguous provision of the tax code, even if its interpretation runs contrary to the Supreme Court's 'opinion as to the best reading' of the provision." *Bakersfield Energy Partners,* 568 F.3d at 778 (quoting *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.,* 545 U.S. 967, 982-83, 125 S. Ct. 2688, 162 L. Ed. 2d 820 (2005)).

Perhaps in response to the Ninth Circuit's cue, the IRS promulgated a temporary regulation on September 28, 2009, which became final during the pendency of this appeal. Treas. Reg. § 301.6501(e)-1. The IRS claims that this regulation is entitled to controlling deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984).

The regulation states that:

> (iii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income,* as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, *gross income* means the excess of the amount realized from the disposi-

> tion of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A).
>
> . . .
>
> (e) *Effective/applicability date—(1) Income Taxes.* Paragraph (a) of this section applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009.

Treas. Reg. § 301.6501(e)-1(a)(1)(iii)(1)(e)(1) (2010). The IRS asks us to apply the regulation retroactively to produce the result it desires in this case. We decline to do so for several reasons.

First, the 1999 tax year at issue in this case, for which tax returns were due by April 2000, is well beyond the reach of the regulation's express period of applicability. Even assuming *arguendo* that the six-year statute of limitations applied, pursuant to the regulation, the "period for assessing tax" would have expired, according to the district court's unchallenged finding, on September 14, 2006. Thus, the period for assessing tax for the 1999 tax year expired long before September 24, 2009. By its own terms, the regulation does not apply here.[4]

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[4] In *UTAM*, the Tax Court noted that the IRS (curiously) did not rely on the temporary regulation, even though it had been promulgated while that case was still pending. 98 T.C.M. (CCH) at * 1 n.2. We observe that the timeline in this case is virtually identical to the timeline in *UTAM:* The IRS issued an FPAA on October 13, 2006, alleging that the taxpayer had omitted gross income by overstating basis in its tax

The IRS urges a different interpretation of the regulation's applicability clause in the preamble to Treasury Decision 9511. The preamble suggests that the "six-year period for assessing tax" in § 6501(e)(1) remains open for "all taxable years . . . that are the subject of any case pending before any court of competent jurisdiction (including the United States Tax Court and Court of Federal Claims) in which a decision had not become final (within the meaning of [26 U.S.C. §] 7481)." Because this case was not finally resolved as of September 24, 2009, the IRS argues that § 6501(e)(1)'s six-year period for assessing tax remains open and Treasury Regulation § 301.6501(e)-1(e) applies. We cannot agree.

With this logic, the IRS attempts to re-draft I.R.C. § 6501. In the statute, Congress made clear that the window for tax assessments, barring special circumstances, closes after three years. I.R.C. § 6501(a). In the event of an omission, the window closes after six years. I.R.C. § 6501(e). And Congress specifically listed circumstances, such as fraud, in which the assessment window remains open without limitation. *Id.* § 6501(c). Congress unambiguously stated its intent to close the period for assessing tax within six years after a return is filed, except in cases of fraud. Accordingly, the IRS's argument that the period for assessing tax is open—or indeed may be re-opened, as would be the case here—so long as litigation is pending is contrary to the clearly and unambiguously expressed intent of Congress and must fail. *United States v. Mead,* 533 U.S. 218, 227, 121

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return for the 1999 tax year. *Id.* at *1-2. The IRS did not ask the Tax Court to apply the temporary regulation retroactively in *UTAM* yet asks this Court to do so in this factually analogous case.

S. Ct. 2164, 150 L. Ed. 2d 292 (2001) (stating that an agency's interpretation is not binding on courts if it is "manifestly contrary to the statute"). Not surprisingly, the Tax Court rejected the same argument as to the substantially identical applicability clause in the temporary regulation. *Intermountain Ins. Servs. of Vail, LLC v. Comm'r*, 134 T.C. No. 11, 2010 WL 1838297, at *4-6 (2010) (rejecting the IRS's argument as circular and contrary to the plain language of the regulations).

Second, even putting the applicability clause aside, *Chevron* deference is warranted only when a treasury regulation interprets an ambiguous statute. *Mayo Found. for Med. Educ. & Research v. United States,* 562 U.S. —, — - —, 131 S. Ct. 704, 711, 178 L. Ed. 2d 588 (2011); *see also Brand X Internet Servs.,* 545 U.S. at 980, 125 S. Ct. 2688; *Chevron,* 467 U.S. at 842-43, 104 S. Ct. 2778. While we are aware that lower courts are divided regarding whether an overstated basis constitutes an omission from gross income, the Supreme Court's reference to "the *unambiguous* language of section 6501(e)(1)(A)" cannot be ignored. *Colony,* 357 U.S. at 37, 78 S. Ct. 1033 (emphasis added). Because the regulation here interprets "omits from gross income" under § 6501(e)(1)(A), and the Supreme Court declared that statute unambiguous, we do not believe that the regulation is entitled to controlling deference. *See Chevron,* 467 U.S. at 842-43, 104 S. Ct. 2778 ("If the intent of Congress is clear, that is the end of the matter; for the courts, as well as the agency, must give effect to the unambiguously expressed intent of Congress.").

Finally, we are not persuaded by the IRS's argument that the regulation should apply retroactively to this case as a clarification of law established in *Colony* and

other cases. The Supreme Court has acknowledged that a subsequent agency interpretation of an ambiguous statute may displace an earlier judicial construction of the same provision. *Brand X Internet Servs.,* 545 U.S. at 982-83, 125 S. Ct. 2688. But again, the Supreme Court stated in *Colony* that § 6501(e)(1)(A) is unambiguous as to the very issue to which the regulation purports to speak. The regulation is not, therefore, a mere clarification. Rather, if applied, the regulation would change the law governing the taxpayers' 1999 tax returns and thereby subject the taxpayers to liability to which they would not have been subject under pre-regulation law. *See United States v. Capers,* 61 F.3d 1100, 1110 (4th Cir. 1995) (declining to apply an amendment to the United States Sentencing Guidelines retroactively because the amendment changed Fourth Circuit law so as to deprive the defendant of a benefit to which he would have been entitled under pre-amendment law).

Because *Colony* was established law when the taxpayers filed their returns in April 2000, we refuse to apply Treasury Regulation § 301.6501(e)-1(e), which purports to establish a rule contrary to *Colony* to subject the taxpayers to the extended limitations period ten years later. *See Levy v. Sterling Holding Co.,* 544 F.3d 493, 506 (3d Cir. 2008) ("[W]here a new rule constitutes a clarification—rather than a substantive change—of the law as it existed beforehand, the application of that new rule to pre-promulgation conduct necessarily does *not* have an impermissible retroactive effect"); *cf. Smiley v. Citibank (South Dakota), N.A.,* 517 U.S. 735, 744 n.3, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996) (stating that an agency interpretation does not have an impermissible retroactive effect where there was previously no clear agency guidance).

IV.

In sum, we conclude that the Supreme Court's holding in *Colony* applies to § 6501(e)(1)(A). An overstated basis in property is not an omission from gross income that extends the limitations period in § 6501(e)(1)(A). Accordingly, Home Concrete's overstated basis in the short sale proceeds did not trigger the six-year statute of limitations. Moreover, Treasury Regulation § 301.6501(e)-1(e), by the plain terms of its applicability clause, does not apply to the tax year at issue in this case and is furthermore not entitled to deference. The general three-year statute of limitations in § 6501(a) applies, making the FPAA here untimely. We reverse the district court's judgment to the contrary.[5]

REVERSED.

WILKINSON, Circuit Judge, concurring:

I am happy to concur in Judge Wynn's fine opinion in this case. The *Chevron* test is straightforward enough when it comes to post-*Chevron* cases. But it is sometimes difficult to determine whether pre-*Chevron* decisions are based upon "*Chevron* step one" (the plain command of the statute) or upon "*Chevron* step two" (a permissible construction of the statute). *Mayo Found. for Med. Educ. & Research v. United States,* 562 U.S. —, — - —, 131 S. Ct. 704, 711, 178 L. Ed. 2d 588 (2011). Certainly Justice Harlan in *Colony, Inc. v. Commissioner,* 357 U.S. 28, 78 S. Ct. 1033, 2 L. Ed. 2d 1119 (1958), had no occasion to ponder the permutations of the *Chevron* test, which came down in 1984.

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[5] In light of this holding, we need not reach the parties' arguments regarding the safe harbor provision.

Here, however, I am persuaded that the Supreme Court rested its judgment in *Colony* on the plain language of the statute, which then, as now, stated that the extended statute of limitations for assessing tax liability applies "[i]f the taxpayer *omits* from gross income an amount properly includible therein." 26 U.S.C. § 275(c) (1939) (emphasis added); *see* 26 U.S.C. § 6501(e)(1)(A) (current version). In other words, I believe that *Colony* was decided under *Chevron* step one.

Lawyers of course are adept at finding ambiguity, and language of course is by its nature imprecise. One need not consult a dictionary, however, to understand that the plain meaning of "omit" is "to leave out" or "to fail to mention." The taxpayers here did not omit, leave out, or fail to mention their transaction. Instead, they provided the details on their returns. *See* Majority Op. at 252. To be sure, the IRS asserts that the returns overstated Home Concrete's basis and thus understated the overall tax liability resulting from the sale of its assets. But as the Court noted in *Colony,* if Congress had been concerned with that problem, "it could have chosen another verb such as 'reduces' or 'understates,' either of which would have pointed significantly in the Commissioner's direction." *Colony,* 357 U.S. at 32, 78 S. Ct. 1033.

I recognize there is some language in *Colony* suggesting that the Court looked at legislative history or thought that § 275(c) was ambiguous. *See Colony,* 357 U.S. at 33, 78 S. Ct. 1033 ("Although we are inclined to think that the statute on its face lends itself more plausibly to the taxpayer's interpretation, it cannot be said that the language is unambiguous. In these circumstances we turn to the legislative history of § 275(c).").

But that language seems to me secondary in importance to the thrust of the opinion and to the Court's argument that "in enacting § 275(c) Congress manifested no broader purpose than to give the Commissioner [additional time] to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors." *Id.* at 36, 78 S. Ct. 1033. More importantly, as Judge Wynn notes, the Court observed that its decision was "in harmony with the *unambiguous* language of" 26 U.S.C. § 6501(e)(1)(A), the successor provision to § 275(c) and the provision at issue here. *See id*. at 37, 78 S. Ct. 1033 (emphasis added).

I appreciate that *Chevron* and *National Cable & Telecommunications Ass'n v. Brand X Internet Services,* 545 U.S. 967, 125 S. Ct. 2688, 162 L. Ed. 2d 820 (2005), afford agencies considerable discretion in their areas of expertise. As *Brand X* put it, "*Chevron* established a presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, . . . desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows." *Brand X,* 545 U.S. at 982, 125 S. Ct. 2688 (internal quotations and citation omitted). The Supreme Court's recent decision in *Mayo Foundation* likewise affords full *Chevron* deference to Treasury Regulations, concluding that the Treasury Department's interpretations of ambiguous statutes will stand if they are "a 'reasonable interpretation' of the enacted text." *Mayo Found.,* 562 U.S. at —, 131 S. Ct. at 714 (quoting *Chevron,* 467 U.S. at 844, 104 S. Ct. 2778). Given the fact that government today is an enterprise of unprecedented complexity, this makes perfect sense. Nor do judges

harbor any desire to impair the mission of the IRS in a day of staggering budget deficits.

Yet it remains the case that agencies are not a law unto themselves. No less than any other organ of government, they operate in a system in which the last words in law belong to Congress and the Supreme Court. What the IRS seeks to do in extending the statutory limitations period goes against what I believe are the plain instructions of Congress, which have not been changed, and the plain words of the Court, which have not been retracted. *See Colony,* 357 U.S. at 37, 78 S. Ct. 1033.

This seems to me something of an inversion of the universe and to pass the point where the beneficial application of agency expertise gives way to a lack of accountability and a risk of arbitrariness. We do not stand alone in reaching this determination; other courts have similarly rebuffed the IRS's repeated attempts to adopt the six-year statute of limitations for omissions of gross income so as to cover misleading statements in tax returns that would result in tax deficiencies. *See Salman Ranch Ltd. v. United States,* 573 F.3d 1362, 1372-74 (Fed. Cir. 2009); *Bakersfield Energy Partners, L.P. v. Comm'r,* 568 F.3d 767, 778 (9th Cir. 2009); *Grapevine Imports, Ltd. v. United States,* 77 Fed. Cl. 505, 511-12 (2007); *Intermountain Ins. Serv. of Vail, LLC v. Comm'r,* 134 T.C. No. 11, 2010 WL 1838297, at *6-8 (2010). These courts have recognized that regardless of whether the IRS's position is sound as a matter of policy, it is simply not the law.

We have been told many times to leave to the Court "the prerogative of overruling its own decisions." *See Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490

U.S. 477, 484, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989). If that injunction has been issued to the circuit courts, it assuredly applies to agencies in situations where the Court has interpreted the plain language of a statutory command. Maybe Congress will conclude at some point that the six-year period should apply to declarations that fall short of omissions or the Court may decide that *Colony* was somehow, after all, a *Chevron* step two case. But those decisions are neither ours nor the agency's to make. *Chevron, Brand X,* and more recently, *Mayo Foundation* rightly leave agencies with a large and beneficial role, but they do not leave courts with no role where the very language of the law is palpably at stake. There is a balance to be struck here, and courts still must play a part in determining where "here" is. The disruption of that balance in this case seems clear and evident.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 09-2353
(7:06-cv-00181-FL)

HOME CONCRETE & SUPPLY, LLC; ROBERT L. PIERCE; STEPHEN R. CHANDLER; REBECCA R. CHANDLER; HOME OIL AND COAL COMPANY, INCORPORATED; SUSANNE D. PIERCE, PLAINTIFFS-APPELLANTS

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

BAUSCH & LOMB, INC., AMICUS SUPPORTING APPELLANT

Filed: Apr. 5, 2011

ORDER

The petition for rehearing en banc was circulated to the full court. No judge requested a poll under Fed. R. App. P. 35. The court denies the petition for rehearing en banc.

For the Court

/s/ PATRICIA S. CONNOR, CLERK
PATRICIA S. CONNOR

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH
CAROLINA, SOUTHERN DIVISION

No. 7:06-CV-181-FL

HOME CONCRETE & SUPPLY, LLC, A DELAWARE LIMITED LIABILITY COMPANY; ROBERT L. PIERCE, AS TAX MATTERS PARTNER; SUSANNE D. PIERCE; STEPHEN R. CHANDLER; REBECCA R. CHANDLER; AND HOME OIL AND COAL COMPANY, INC., A NORTH CAROLINA CORPORATION, PLAINTIFFS/PETITIONERS

v.

UNITED STATES OF AMERICA, DEFENDANT/RESPONDENT

Filed: Nov. 21, 2008

ORDER

LOUISE W. FLANAGAN, Chief Judge.

Plaintiffs/petitioners ("plaintiffs") initiated this action by filing "Complaint and Petition for Readjustment of Partnerships Items Under 26 U.S.C. § 6226," wherein they seek a determination that any tax assessment for the 1999 tax year is time barred and that no adjustment of their taxes is warranted for the 1999 tax year. Plaintiffs include Home Concrete & Supply, LLC, ("Home

Concrete"), a Delaware limited liability company which is deemed a partnership, and its owners who are deemed partners, for federal income tax purposes.[1] Plaintiffs also include Robert L. Pierce ("Pierce"), the tax matters partner for Home Concrete, who seeks reimbursement of the sum of $1,392,118.00[2] he deposited with the IRS, together with his wife, plaintiff Susanne D. Pierce, with whom he filed jointly for the 1999 tax year. Pierce owned Home Oil & Coal Company, Inc. ("Home Oil") at the time of its 1999 sale together with plaintiff Stephen R. Chandler ("Chandler"), who proceeds here also with his wife, Rebecca R. Chandler, with whom he filed jointly for that tax year. Home Oil also is a plaintiff in this action.

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[1] While the government denied in its first amended answer treatment as a partnership to Home Concrete for tax purposes, (Def.'s First Am. Answer, ¶ 2), this denial appears to have no basis in fact or law, and, moreover, to have been discounted by defendant in subsequent filings. Pursuant to 26 C.F.R. §§ 301.7701-2 and 301.7701-3, a limited liability company such as Home Concrete by default receives pass-through partnership tax treatment unless it elects to change its tax status by filing a Form 8832 "Entity Classification Election" with the Internal Revenue Service ("IRS"). *See* 26 C.F.R. §§ 301.7701-2 and 301.7701-3. None of the numerous exhibits proffered by the government includes a Form 8832 for Home Concrete electing to receive federal corporate tax treatment. Indeed, all of the documents offered by both parties indicate that plaintiff Home Concrete did, in fact, receive pass-through partnership tax treatment from the IRS. This, of course, would include the Notice of Final Partnership Administrative Adjustment ("FPAA"), underlying the instant action.

[2] This amount represents the amount by which the partnership's tax liability would be increased if the treatment of partnership items on Home Concrete's return were made consistent with the treatment of partnership items on the partnership return as defined by the FPAA issued by the Internal Revenue Service ("IRS") September 7, 2006.

The case comes now before the court on plaintiffs' motion for summary judgment and defendant's motion for partial summary judgment, presenting for decision the question of whether a three year or a six year limitations period applies for any IRS assessments relating to the transactions at issue.

STATEMENT OF THE CASE

Plaintiffs filed the instant action pursuant to 26 U.S.C. § 6226(e)(1), seeking refund of deposit made for the 1999 tax year in response to the 2006 FPAA. Plaintiffs allege that the 2006 FPAA was time barred by the three year statute of limitations in §§ 6229[3] and 6501. Plaintiffs allege further that the IRS assessments are erroneous and disclaim any liability. Defendant asserts in response that the six year limitations period prescribed in § 6501(e)(1)(A) applies and plaintiffs are not entitled to refund of the deposit. It is the government's position that the assessments are proper.

On February 23, 2007, plaintiffs moved for judgment on the pleadings, asserting, as they do now, that defendant's assessment of taxes for the 1999 tax year was time barred because the three year limitations period set forth in § 6501(a) applies to any action to recover taxes related to their 1999 tax returns. The six year statute of limitations provided by § 6501(e)(1)(A) in this case applies, the government argued then and argues now, because plaintiffs omitted a substantial amount of gross income from their returns. As set forth in prior order, after protracted briefing, the court denied, with-

[3] Plaintiffs seemingly discount applicability now of § 6229 as no mention is made in their briefing on the instant motions. The three year statute of limitations at issue is the one set forth in § 6501.

out prejudice, plaintiffs' motion for judgment on the pleadings and defendant's motion for partial summary judgment. An agreed to case schedule was implemented, including limited discovery, and on this basis the parties' cross-motions come now before the court.

In their motion for summary judgment, plaintiffs argue that the FPAA is time barred by 26 U.S.C. § 6501(a), which sets out a general three year statute of limitations for actions to assess taxes on partnerships and individuals. Defendant moves for partial summary judgment, on grounds that the six year statute of limitations provided by § 6501(e)(1)(A) applies to tax assessments based on the plaintiffs' 1999 tax returns under the circumstances presented, and the assessment therefore was timely.

STATEMENT OF UNDISPUTED FACTS

On the record presented, the specific date of filing of the partners' individual returns, which the parties agree, for purposes of beginning the §§ 6501(a) and (e) limitations periods, are the relevant ones, *see Bufferd v. C.I.R.*, 506 U.S. 523, 526, 113 S. Ct. 927, 122 L. Ed. 2d 306 (1993), is unclear. However, for purposes of calculating the § 6501 limitations periods, the actual date of filing of a return does not matter, as long as the return is filed before the deadline. *See* 26 U.S.C. § 6501(b)(1). The date used as the date of "filing" for returns filed before the deadline is the deadline date. There is no dispute that the returns at issue were filed before the April 17, 2000, deadline.

On the record before the court, there also is no issue that June 19, 2003, the IRS served summons pursuant to court order on Jenkens & Gilchrist, P.C. ("Jenkens"),

plaintiffs' attorneys, well within the six year statute of limitations asserted by the government.[4] Though the record is unclear as to the precise date that Jenkens responded to the summons related to Home Concrete, the parties agree that the earliest possible date of compliance was May 17, 2004. It is undisputed that the IRS issued the FPAA assessing the contested taxes on September 7, 2006, more than six years after the April 17, 2000 filing date.[5]

The FPAA assessing the taxes contested by plaintiffs was issued in response to a series of transactions undertaken by plaintiffs Pierce and Chandler in anticipation of the sale of the business, Home Oil. Following the advice of their accountants, Arthur Andersen LLP, and Jenkens, plaintiffs embarked on a series of transactions

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[4] There is reference in defendant's first amended answer to issuance of a summons on May 21, 2002; however, there is nothing in the record showing service of a summons issued on this date nor does any summons with this date play a part on the parties' arguments to the court.

[5] There appears no dispute, however, that the FPAA issued within a six year statute of limitations period running from April 17, 2000 to September 14, 2006 which accounts for tolling of the limitations period provided by 26 U.S.C. § 7609(e). Plaintiffs do not dispute that § 7609(e) provides a mechanism by which the applicable time limit is tolled where a party having "possession, custody, or care of books of account containing entries relating to the business of the person liable" for a given tax, 26 U.S.C. § 7602(a)(2), receives a summons from the IRS but fails to respond within six months of the summons. 26 U.S.C. § 7609(e)(2). As noted above, plaintiffs' attorneys received such a summons and failed to respond within six months. As a result it appears the limitations period for the 1999 tax returns was suspended from December 20, 2003, until May 17, 2004. Thus, a six year statute, tolled, would not have run even under this most restrictive interpretation of the record until a few days after the FPAA was issued.

including short sales[6] designed to increase basis in certain assets, thus decreasing income tax liability from the sale of the business.[7] Plaintiffs contend an increased basis for Pierce and Chandler in Home Concrete resulted equal to the amount of the proceeds from the short sales with no offset for the obligations to close the short sales. The IRS contends that the proper treatment of the capital contributions at issue would include

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[6] Short sales are transactions that provide a twist on "buy low, sell high" where the first step is to "sell high" and the last step is to "buy low." In a short sale transaction, an investor borrows shares, or in this case U.S. Treasury Notes from a brokerage house and sells them in the open market. The proceeds from this sale go into the investor's account with the brokerage house. At some point later, the investor must replace the borrowed shares or notes by purchasing new ones. If the short seller is successful, he will be able to purchase the shares at a lower price than those he sold, allowing him to take a profit on the transaction.

[7] It appears that on April 15, 1999, plaintiffs created three entities for purposes of carrying out their transactions: Home Concrete; Salisbury Investments LLC, ("Salisbury"), a single member Delaware limited liability company owned by Pierce; and Goodnight Investments LLC, ("Goodnight"), a single member Delaware limited liability company owned by Chandler. On May 13, 1999, using Salisbury, Goodnight and two trusts owned and controlled by Pierce, Pierce and Chandler initiated several short sales of U.S. Treasury Notes. Four days later, on May 17, 1999, Pierce and Chandler contributed the proceeds from all of the short sales, along with margin cash, to Home Concrete as a capital contribution. Critically, also on May 17, 1999, Pierce and Chandler contributed the obligations to close the short sales to Home Concrete. The next day, on May 18, 1999, Home Concrete covered the short sale positions. It appears that on June 11, 1999, Home Oil transferred all of its business assets to Home Concrete as a capital contribution. Then, on June 14, 1999, Pierce and Chandler each transferred substantially all of their respective ownership interests in Home Concrete to Home Oil as capital contributions. These transfers included the basis plaintiffs claim the May 17, 1999, transfers created in Home Concrete.

the obligations to close the short sales as a liability offsetting the contributions and, therefore, the contributions produced no increase in basis.

According to plaintiffs' calculation, because of the basis claimed by the plaintiffs from the short sales, Home Oil's basis in its partnership interest in Home Concrete exceeded the amount of its share of Home Concrete's basis in its assets by the amount of basis claimed from those transactions. Plaintiffs elected to take advantage of 26 U.S.C. § 754, which allows partnerships to increase the partnership's basis in its assets to equal the partners' basis in the partnership. The parties agree that, using this election, Home Oil claimed an increased basis in Home Concrete of $5,984,526.17. This apparently produced a total basis in Home Concrete's assets of approximately $10,527,350.00, though, again, the record does not appear particularly precise on this point.

On August 31, 1999, Home Concrete sold substantially all of its assets to a third party for $10,623,348.00. Plaintiffs claim this resulted in only a modest gain for Home Concrete. Defendant claims that, because the stepped up basis claimed by plaintiffs was impermissible, Home Concrete realized a substantially greater amount of taxable gain. Ultimately, defendant issued the September 7, 2006, FPAA assessing taxes on the amount plaintiffs allegedly omitted from gross income, and thereafter the instant dispute was presented to the court.

DISCUSSION

Summary judgment is appropriate, under Rule 56(c), "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c). A fact is material if it might affect the outcome of the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). In deciding a motion for summary judgment, the court construes evidence in the light most favorable to the nonmoving party and draws all reasonable inferences in the nonmovant's favor. *Anderson,* 477 U.S. at 255, 106 S. Ct. 2505.

A party seeking summary judgment "bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the [record] which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). Once the moving party has met its burden, the non-moving party must then "set forth specific facts showing that there is a genuine issue for trial." *Matsushita Elec. Indus. Co. Ltd. v. Zenith Radio Corp.,* 475 U.S. 574, 586-87, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986) (quoting FED. R. CIV. P. 56(e)).

While both sides frame the question presented as whether the three year statute of limitations in § 6501(a) or the six year statute of limitations in § 6501(e)(1)(A) applies to plaintiffs' situation, because plaintiffs contend that none of the assessments on their face are proper, consideration now of whether § 6501(e)(1)(A) applies is more complicated. Section 6501(e)(1)(A) provides that

if a taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return," the extended statute of limitations for assessments of tax by the IRS is triggered. 26 U.S.C. § 6501(e)(1)(A). So determining whether an item has been omitted in this case, where the alleged omission is an overstatement of basis, requires this court first to decide whether such an overstatement can constitute an omission under § 6501(e)(1)(A). Assuming that it does, the court then must determine whether the basis in question actually was overstated. *Id.* And if it was, before the court can decide finally whether the six year limitations period applies, it must decide whether plaintiffs adequately disclosed the omitted amount on the relevant tax returns where "[i]n determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item." 26 U.S.C. § 6501(e)(1)(A)(ii).

Plaintiffs bear the burden of initially showing that the IRS failed to assess the 1999 taxes within the three year statute of limitations asserted. *See Hoffman v. C.I.R.*, 119 T.C. 140, 146, 2002 WL 31113898 (T.C. 2002). Because it is undisputed in this case that the IRS did not assess the 1999 taxes within a three year limitations period, plaintiffs have established their prima facie case. The court's focus turns very quickly now to whether defendant can go forward under the six year limitations period, where the burden shifts to defendant to establish that § 6501(e)(1)(A)'s extended limitations period applies. *Id.*

Plaintiffs urge that *The Colony, Inc. v. Commissioner of Internal Revenue,* 357 U.S. 28, 78 S. Ct. 1033, 2 L. Ed. 2d 1119 (1958), controls this court's decision, and precludes application of the six year limitations period. Defendant contends with equal vigor that it does not. *Colony* applied an earlier version of the Internal Revenue Code (IRC), where the Court was interpreting 26 U.S.C. § 275(c), appearing in the 1939 IRC, to the case of a taxpayer who erroneously understated the gross profits from the sale of trade goods (undeveloped lots of land) by improperly increasing the basis it held in those goods. *Colony,* 357 U.S. at 31-32, 78 S. Ct. 1033. The Court began by noting that the question before it had been "resolved for future cases by Congress's adoption of § 6501(e)(1)(A)" in the 1954 IRC. *Id.* at 32, 78 S. Ct. 1033.

The Court looked at the language of § 275(c), noting the dictionary definition of "omit" as "'to leave out or unmentioned; not to insert, include, or name.'" *Id.* at 32-33, 78 S. Ct. 1033 (quoting Webster's New International Dictionary (2d ed. 1939)). However, after reviewing the text of the statute, the Court determined that "it cannot be said that the [subsection's] language is unambiguous." *Id.* at 33, 78 S. Ct. 1033. The Court reviewed the legislative history of 26 U.S.C. § 275 and found that "Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors." *Id.* at 36, 78 S. Ct. 1033. Thus, the Court held that the taxpayer's overstatement of basis did not trigger the extended statute of limitations provided by § 275(c), a result the Court

deemed "in harmony with the unambiguous language of § 6501(e)(A)(1)." *Id.* at 37, 78 S. Ct. 1033.

In the years since *Colony* was decided, a handful of courts have applied its holding regarding overstatements of basis to § 6501(e)(1)(A), with unharmonious results. At least four courts have found the holding of *Colony* limited to situations in which the taxpayer is a trade or business engaged in the sale of goods or services and has overstated basis in those goods or services on its return, thereby under-reporting gross income. *See Burks v. United States,* No. 3:06-CV-1747 (N.D. TX. June 13, 2008); *Brandon Ridge Partners v. United States,* 2007 WL 2209129 (M.D. Fla. 2007); *Salman Ranch, Ltd. v. United States,* 79 Fed. Cl. 189 (2007); *Phinney v. Chambers,* 392 F.2d 680 (5th Cir. 1968); *see also CC & F Western Operations Limited Partnership v. Comm'r,* 273 F.3d 402, 406 n.2 (1st Cir. 2001) (addressing a different situation but noting that § 6501(e)(1)(A)(i)'s definition of gross income for § 6501 arguably implies "that it does not apply under section 6501 to other types of income"). These courts have also held that, in non-trade and business sale of goods and services settings, a taxpayer can "omit" gross income by overstating basis.

At least three other courts have taken a more expansive view of the holding of Colony and found that the Court's interpretation of the predecessor to § 6501(e)(1)(A) applies equally to all taxpayers, regardless of whether they are a trade or business selling goods and services. *See Wilmington Partners L.P. et al. v. Comm'r,* No. 15098-06 (T.C. Apr. 30, 2008) (following *Bakersfield*); *Bakersfield Energy Partners, LP v. Comm'r,* 128 T.C. 207, 2007 WL 1712543 (2007); *Grape-*

vine Imports, Ltd. v. United States, 77 Fed. Cl. 505 (2007). Plaintiffs ask for this court to follow this line of reasoning and hold that *Colony*'s reach extends to all situations involving § 6501(e)(1)(A) so that if a taxpayer overstates basis and therefore under reports gross income, the three year statute of limitations for assessing deficiencies in tax payments still applies, regardless of whether the overstatement and omitted gross income are readily apparent on the face of the return. *See Bakersfield,* 128 T.C. at 214; *Grapevine,* 77 Fed. Cl. at 510-11. "Omit" means that § 6501(e)(1)(A) only applies when an item is completely left off of the face of a tax return, it is urged here. *See Bakersfield*, 128 T.C. at 215; *Grapevine,* 77 Fed. Cl. at 511-12. While these decisions are supportive of plaintiffs' position, the undersigned is compelled to conclude they are, in this regard, erroneous.

It is correct to say that the language of § 275(c) is virtually identical to a portion of § 6501(e)(1)(A). However, that language was found in *Colony* to be sufficiently ambiguous that the Court had to review legislative history to decide the meaning of the statute. *Colony*, 357 U.S. at 33-35, 78 S. Ct. 1033. A careful reading of the 1958 decision discloses that the word "omit" was discerned as part of the phrase "omits from gross income an amount properly includible therein" and in light of the legislative history of § 275(c). In *Colony,* the Court was applying the 1939 IRC then in effect to income tax returns for the years 1946 and 1947. The 1954 IRC effective at the time the opinion was rendered included the language of § 6501(e) as it appears today. For the Court's decision to be "in harmony" with § 6501(e)(1)(A), the transformation of the language of § 275(c)—the language that is repeated in

§ 6501(e)(1)(A)—from ambiguous to unambiguous must be tied to the two new subsections Congress added in § 6501(e)(1)(A). *See Salman Ranch,* 79 Fed. Cl. at 199 (finding that the "in harmony" language of *Colony* must be related to the two new subsections of § 6501(e)(1)(A)).

The two subsections Congress added to § 275(c) in drafting § 6501(e)(1)(A), acknowledged by the Court in *Colony,* make clear the limit of its holding. Subsection (i) redefines gross income for purposes of § 6501(e)(1)(A) in cases involving a trade or business. That subsection provides:

> (i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services.

26 U.S.C. § 6501(e)(1)(A)(i). The normal calculation for gross income for trade or business taxpayers involved in the sale of goods or services involves subtracting the cost of goods sold ("COGS") from the gross receipts of the sales. *See Salman Ranch*, 79 Fed. Cl. at 199 (quoting *In re Lilly,* 76 F.3d 568, 572 (4th Cir. 1996) (holding, in a different context, that overstatement of COGS was an "item omitted from gross income under I.R.C. § 6013(e)(1)(A)")). As the court in *Salman Ranch* cogently explained:

> [S]ection 6501(e)(1)(A)(i) provides an exception to the customary definition of gross income in the event of sales of goods or services by a trade or business, allowing that "gross income," as used in section 6501(e)(1)(A), will be defined as the "gross receipts"

> alone of those sales. Under I.R.C. § 6501(e)(1)(A), in order for an omission from gross income to arise in the context of sales of goods or services by a trade or business (which under the I.R.C. § 6501(e)(1)(A)(i) gross receipts provision actually should read "omits from gross 'receipts'"), an omission of a receipt must occur. The *Colony* Court's declaration that section 275(c) is "limited to situations in which specific receipts or accruals of income items are left out of the computation of gross income" makes eminent sense because The Colony, Inc. was a trade or business selling goods or services. *Colony*, 357 U.S. at 33, 78 S. Ct. 1033. The Court's conclusion that The Colony, Inc. had not omitted any gross income and thus was not liable under section 275(c) is "in harmony with the unambiguous language of § 6501(e)(1)(A)," in that the resolution would be the same under either provision. *Id.* at 37, 78 S. Ct. 1033.

Salman Ranch, 79 Fed. Cl. at 199.

Plaintiffs seemingly accept that for the Court's "in harmony" statement in *Colony* to make sense the "harmony" must come from somewhere in the new subsections of § 6501(e)(1)(A). However, plaintiffs urge that subsection (i) is not what creates "harmony" between the Court's holding and § 6501(e)(1)(A). Instead, plaintiffs urge this court to focus on subsection (ii) as "the obvious source of unambiguous language alluded to by the Supreme Court in *Colony.*" (Mem. in Supp. of Pls.' Mot. for Summ. J. (DE # 53) at 14.) That subsection provides:

> (ii) In determining the amount omitted from gross income, there shall not be taken into account any

> amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item.

26 U.S.C. § 6501(e)(1)(A)(ii). From this language, plaintiffs draw the conclusion that the Court was referencing subsection (ii) because it deals with what it means to "omit" something from a return. Therefore, *Colony* must stand for the proposition that "omit" only means to leave an item or amount off the face of a return.[8]

Plaintiffs misapprehend the import of subsection (ii). That subsection does speak to what it means to "omit" an amount from gross income on a return. However, nothing in the language of § 6501(e)(1)(A)(ii) supports the conclusion that the only way to "omit" an item is to leave it completely off of the face of a return. Quite to the contrary, the language of subsection (ii) indicates that Congress intended for it to be possible to "omit" an item from gross income under § 6501(e)(1)(A) without leaving it completely off the face of a return. *See Phinney,* 392 F.2d at 685 (holding that subsection (ii) "makes it apparent that the six year statute is intended to apply

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[8] Plaintiffs' focus on subsection (ii) and their reading of *Colony* would render subsection (i) superfluous. *See Salman Ranch,* 79 Fed. Cl. at 200 ("Plaintiffs' construction of this critical term 'omits' without reference to the term 'gross income' focuses only on one component of the calculation, thereby excluding consideration of one of the two figures that generates the gain—the calculation of basis—and in tandem rendering the gross receipts provision of I.R.C. § 6501(e)(1)(A)(i) superfluous."). Such a result violates a fundamental canon of statutory construction and should be avoided wherever possible. *Alaska Dept. of Envtl. Conservation v. E.P.A.,* 540 U.S. 461, 489 n.13, 124 S. Ct. 983, 157 L. Ed. 2d 967 (2004).

where there is either a complete omission of an item of income of the requisite amount or misstating the nature of an item of income which places the 'commissioner . . . at a special disadvantage in detecting errors'" (emphasis omitted)).

Subsection (ii) clearly directs that, when determining what has been omitted from gross income, no "amount which is omitted from gross income stated in the return" may be considered "if such amount is disclosed in the return . . . in a manner adequate to apprise the Secretary of the nature and amount of such item." 26 U.S.C. § 6501(e)(1)(A)(ii). Thus, from the plain language of (ii), it is possible for an amount to be "omitted from gross income" and disclosed on the face of the return. Subsection (ii) simply makes it possible for a taxpayer to be protected if the taxpayer discloses the amount in a way sufficient to alert the IRS to the substance and size of the item omitted. If a taxpayer omits an amount from gross income yet includes the item which causes the amount to be omitted on the taxpayer's return in such a way that the IRS is apprised of the "nature and amount" of the item, then that item is not considered "omitted" for purposes of § 6501(e)(1)(A). However, where a taxpayer includes an item on a return in such a way that the IRS is not apprised of the "nature and amount" of the item, then that item has been "omitted" from gross income for purposes of § 6501(e)(1)(A), even though it is included on the face of the return.

It is also instructive to consider § 6501(e)(1)(A)'s language and terms in light of the relevant statutory definitions provided by the IRC. These statutory definitions further undermine the overly broad reading of *Colony* urged by plaintiffs. "Gross income" is, broadly con-

strued,[9] "all income from whatever source derived, including . . . (3) gains derived from dealings in property." 26 U.S.C. § 61(a). Section 1001(a) fleshes out the meaning of "gains derived from dealings in property," defining gains from dealings in property as "the excess of the amount realized therefrom over the adjusted basis." 26 U.S.C. § 1001(a). Thus, "gross income" as related to dealings in property is defined with reference to the property's adjusted basis. Any overstatement in basis will necessarily decrease the amount of gross income that a taxpayer states on his return. In other words, by overstating basis in the gross income calculation, the taxpayer "leave[s] out" or fails to "include" "an amount properly includible therein." Therefore, where a taxpayer incorrectly states an overestimated basis in property, the taxpayer "omits" gross income by leaving the amount out of gross income stated on the taxpayer's return.

For all of these reasons, this court finds that where a taxpayer overstates basis and, as a result, leaves an amount out of gross income, the taxpayer "omits from gross income an amount properly includible therein" for purposes of § 6501(e)(1)(A). Therefore, the extended six year statute of limitations may apply to such a taxpayer if the taxpayer overstated basis on an item resulting in an omission from gross income of an amount properly includible therein which is in excess of the 25 percent threshold and the taxpayer does not qualify for the safe harbor provisions provided by § 6501(e)(1)(A)(ii). In this part, plaintiff's motion for summary judgment is denied,

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[9] Gross income as defined in 26 U.S.C. § 61(a) is always to be broadly construed. *See Comm'r v. Glenshaw Glass Co.,* 348 U.S. 426, 429-30, 75 S. Ct. 473, 99 L. Ed. 483 (1955).

and in corresponding part, defendant's motion is allowed.

The court next must determine whether the basis in question actually was overstated in order to decide whether the extended limitations period applies here. Section 6501(e)(1)(A), as set forth earlier, provides that if a taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return," the extended statute of limitations for assessments of tax by the IRS is triggered. 26 U.S.C. § 6501(e)(1)(A). So determining whether an item has been omitted in this case, where the alleged omission is an overstatement of basis, requires this court first to decide whether such an overstatement can constitute an omission under § 6501(e)(1)(A), which question the court has answered in the affirmative. Before the court can decide finally whether the six year limitations period applies, it must decide whether plaintiffs adequately disclosed the omitted amount on the relevant tax returns, where "[i]n determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item." 26 U.S.C. § 6501(e)(1)(A)(ii).

The parties have presented some arguments regarding plaintiffs' disclosures for purposes of § 6501(e)(1)(A)(ii)'s safe harbor provision. Plaintiffs would say they come within its protection, and also for this reason defendant's assessment action was untimely. Defendant would have the court find they do not and, for

this reason, the six year limitations period must be applied.

To get to this part of the analysis it must be found that an omission of gross income has actually occurred in this case. And this goes to the heart of this case, making, as alluded to earlier, consideration, as a preliminary matter, whether § 6501(e)(1)(A) applies a more complicated determination than how each side now explains it. In order for the safe harbor of § 6501(e)(1)(A)(ii) to apply, plaintiffs must have disclosed the amount omitted from gross income "in a manner adequate to apprise the Secretary of the nature and amount" of the omission. 26 U.S.C. § 6501(e)(1)(A)(ii).

The court has, for the reasons given, decided as a matter of law that the six year limitations period may apply; however, the court leaves open the remaining issues presented for decision bearing on applicability of the extended limitations period pending supplemental briefing expressly on: 1) whether plaintiffs overstated basis; and, if so, 2) can the court, on the record before it, now determine whether the resulting omission from gross income was or was not in excess of 25 percent of the stated gross income amount; and, if it was 3) whether the safe harbor of § 6501(e)(1)(A)(ii) applies here. The court specifies below parameters of the briefing requested to be provided, on the facts now a part of the record.

The issue of what tax returns may be considered by the court in determining what plaintiffs did or did not disclose need not wait to be decided, however. Another legal issue susceptible now to being decided at this juncture is what standard should be used in determining whether a disclosure is adequate for purposes of

§ 6501(e)(1)(A)(ii). Resolution of these issues now will result in more focused supplemental briefing. The court sets out below the answers to these question of law bearing on whether, in this instance, if the taxpayer omitted from gross income an amount properly includible therein which is in excess of the 25 percent threshold, there was adequate disclosure.

First, as to the issue of what tax returns may be considered, section 6501(a) defines what a "return" is for purposes of that section. The case law, before the 1997 amendment to this section, interpreting what tax returns could be considered in determining adequate disclosure under § 6501(e)(1)(A)(ii), allowed courts to consider the returns of pass-through entities such as a partnership. *See Brandon Ridge,* 2007 WL 2209129 at *8. The court reiterates its prior holding that the 1997 amendments to § 6501(a) were only intended to clarify when the statute of limitations begins to run. (*See* Order Den. Mots. for J. on the Pleadings, No. 7:06-cv-181 (DE # 38) at 9.) The case law regarding which tax returns are available for review has not been disturbed.

The two other courts which have addressed this issue similarly have concluded that the court should consider the individual tax returns at issue as well as the partnership returns, where necessary. *See Salman Ranch,* 79 Fed. Cl. at 202-03 (holding that the court would review both the individual and partnership returns to determine whether adequate disclosure was present); *Brandon Ridge,* 2007 WL 2209129 at *8-9 (holding that in cases where there are references in the taxpayer's return to income from a pass-through entity, the returns from the pass-through entity also can be considered). When the court considers plaintiffs' disclosures, it may

review both information contained in plaintiffs' individual returns and in the partnership return, as necessary to determine whether plaintiffs adequately disclosed any amount in question.

As to the question of what is the proper standard to use in determining whether disclosures are adequate for purposes of § 6501(e)(1)(A)(ii), the parties's briefing is more extensive. Plaintiffs argue that *Colony* controls the inquiry. There the Court stated "[w]e think that in enacting § 275(c) Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item." *Colony*, 357 U.S. at 36, 78 S. Ct. 1033.

As the court in *CC & F* found, several courts have continued to use the "clue" language from *Colony. CC & F Western Operations, Ltd.*, 273 F.3d at 407; *see also, White v. C.I.R.,* 991 F.2d 657, 661-62 (10th Cir. 1993) (citing *Colony* for the proposition that adequate disclosure requires returns to provide a "clue"); *Bishop v. United States,* 338 F. Supp. 1336, 1351 (N.D. Miss. 1970) (also citing *Colony* for the "clue" language). Plaintiffs do not articulate broadly what standard of disclosure constitutes a "clue." Instead, they assert that if an overstated basis may result in an omission of income, then a basis step-up and related sale disclosed on the same return provide an adequate "clue" for the IRS and thus adequate disclosure under § 6501(e)(1)(A)(ii). (*See* Mem. in Supp. of Pls.' Mot. for Summ. J. at 18.) The government, on the other hand, cites to a competing line of

cases that apply a more stringent standard. Specifically, the government cites *CC & F Western Operations, Ltd.*, 273 F.3d at 407, *Phinney,* 392 F.2d at 685, and *In re G-I Holdings,* 2006 WL 2595264, for the proposition that something more than a clue is required by § 6501(e)(1)(A)(ii).

Plaintiffs' reliance on *Colony* as establishing the test for adequate disclosure under § 6501(e)(1)(A)(ii) is misplaced. As noted above, *Colony* dealt with the predecessor provision to § 6501(e). The code section before the Court in *Colony* (§ 275(c)) contained no safe harbor provision. To the degree that *Colony* may have established any "clue" test,[10] it established it for § 275(c). The Court did not determine the meaning of § 6501(e)(1)(A)(ii) because that statute was not before the Court in that case. Accordingly, any suggestion by the Court that a "clue" is all that is needed to invoke adequate disclosure would simply be dicta that does little to enlighten the appropriate standard for disclosure as it relates to § 6501.[11]

This court concludes, after careful consideration, that the plain language of § 6501(e)(1)(A)(ii) requires some-

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[10] The First Circuit does not espouse even that *Colony* established such a test. As the court explained in *CC & F,* "[t]he only test adopted in Colony was that there be an omission of gross receipts exceeding 25 percent and not just an overstatement of basis that effectively reduced reportable gross income by that amount. The clue language was used merely to explain why Congress might have been more concerned about an omitted receipt than an overstated basis—specifically, because the omitted receipt will (ordinarily) provide no clue as to the error; by implicit contrast, an overstated basis provides something the IRS can check." *CC & F Western Operations, Ltd.,* 273 F.3d at 407.

[11] Even though the Court in *Colony* determined its holding to be in "harmony" with newly enacted § 6501(e), that harmony, as discussed *supra* does not come from subsection (ii) but rather from subsection (i).

thing "far more than a mere clue that might intrigue Sherlock Holmes." *CC & F Western Operations, Ltd.*, 273 F.3d at 407. This court, like the court in *CC & F*, finds that the language of this section requires the taxpayer's return provide more than a clue—it must disclose the nature and amount of the alleged omission from gross income where subsection (ii) explicitly requires that disclosure must be made "in a manner adequate to apprise the Secretary of the nature and amount of" any item omitted from gross income. 26 U.S.C. § 6501(e)(1)(A)(ii). This language indicates that Congress wanted more than a "clue" as to the omitted amount's existence before a taxpayer should be allowed to invoke safe harbor protection. The disclosure must be sufficient to indicate what type of item has been omitted and how large (or small) that item is on the face of the relevant returns. This does not mean that a taxpayer need include "a detailed disclosure of every precise fact that may underlie a transaction." *Salman Ranch*, 79 Fed. Cl. at 203. Rather, it means that the taxpayer must disclose the substance of a transaction in order to benefit from the shorter limitations period if the taxpayer omits income. *Id.* (citing *CC & F Western Operations, Ltd.*, 273 F.3d at 408).

The question whether an overstatement of basis can constitute an omission is, therefore, answered in the affirmative. Further, the court may, at the appropriate time, consider both the partnership and individual taxpayers' income tax returns in determining adequate disclosure under § 6501(e)(1)(A)(ii). And, the court will apply a disclosure standard that requires that the nature and amount of any potentially omitted amounts be disclosed on the face of those returns to qualify for the safe harbor provision. The court holds in abeyance decision

on the remaining issues presented bearing on applicability of the extended limitations period pending supplemental briefing expressly on: 1) whether plaintiffs overstated basis; and, if so, 2) can the court, on the record before it, now determine whether the resulting omission from gross income was or was not in excess of 25 percent of the stated gross income amount; and, if it was 3) whether the safe harbor of § 6501(e)(1)(A)(ii) applies here. These issues shall be the subject of the parties' supplemental briefing, in light of the decisions herein rendered, so that the court may more fully consider them. The parties' supplemental memoranda, not to exceed 30 pages in length, shall be filed and served on or before December 22, 2008. Responses, not to exceed 15 pages in length, shall be filed and served on or before January 19, 2009.

CONCLUSION

For the reasons given, plaintiff's motion for summary judgment is denied in part, and in corresponding part, defendant's motion is allowed. The court holds in abeyance decision on remaining parts pending receipt and review of supplemental briefing herein ordered.

APPENDIX D

1. 26 U.S.C. 275 (1934) provides:

Period of limitation upon assessment and collection. Except as provided in section 276—

(a) General rule. The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(b) Request for prompt assessment. In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within eighteen months after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of three years after the return was tiled. This subsection shall not apply in the case of a corporation unless—

(1) Such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such 18 months' period; and

(2) The dissolution is in good faith begun before the expiration of such 18 months' period; and

(3) The dissolution is completed.

(c) Omission from gross income. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may

be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

(d) Return filed before last day. For the purposes of subsections (a), (b), and (c), a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

(e) Corporation and shareholder. If a corporation makes no return of the tax imposed by this chapter, but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed. (May 10, 1934, 11:40 a.m., c. 277, § 275, 48 Stat. 745.)

2. 26 U.S.C. 6229(c)(2) (2000) provides:

Period of limitations for making assessments

(c) Special rule in case of fraud, etc.

(2) Substantial omission of income

If any partnership omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) shall be applied by substituting "6 years" for "3 years".

3. 26 U.S.C. 6501(e)(1)(A) (1954) provides:

Limitations on assessment and collection.

(e) Omission from gross income.

Except as otherwise provided in subsection (c)—

(1) Income taxes.

In the case of any tax imposed by subtitle A—

(A) General rule.

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

4. 26 U.S.C. 6501(e)(1)(A) (2000) provides:

Limitations on assessment and collection

(e) Substantial omission of items

Except as otherwise provided in subsection (c)—

(1) Income taxes

In the case of any tax imposed by subtitle A—

(A) General rule

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item.

5. 26 C.F.R. 301.6229(c)(2)-1 provides:

Substantial omission of income.

(a) *Partnership return*—(1) *General rule.* (i) If any partnership omits from the gross income stated in its return an amount properly includible therein and that amount is described in clause (i) of section 6501(e)(1)(A), subsection (a) of section 6229 shall be applied by substituting "6 years" for "3 years."

(ii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6229(c)(2).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

(b) *Effective/applicability date.* The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

(c) *Expiration date.* The applicability of this section expires on or before September 24, 2012.

6. 26 C.F.R. 301.6501(e)-1 provides:

Omission from return.

(a) *Income taxes*—(1) *General rule.* (i) If a taxpayer omits from the gross income stated in the return of a tax imposed by subtitle A of the Internal Revenue Code an amount properly includible therein that is in excess of 25 percent of the gross income so stated, the tax may be assessed, or a proceeding in court for the collection of that tax may be begun without assessment, at any time within 6 years after the return was filed.

(ii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to any income

other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A)(i).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

(2) [Reserved]

(b) *Effective/applicability date.* Estate and gift taxes—(1) If the taxpayer omits from the gross estate as stated in the estate tax return, or from the total amount of the gifts made during the period for which the gift tax return was filed (see § 25.6019-1 of this chapter) as stated in the gift tax return, an item or items properly includible therein the amount of which is in excess of 25 percent of the gross estate as stated in the estate tax return, or 25 percent of the total amount of the gifts as stated in the gift tax return, the tax may be assessed, or a proceeding in court for the collection thereof may be

begun without assessment, at any time within 6 years after the estate tax or gift tax return, as applicable, was filed.

(2) For purposes of this paragraph (b), an item disclosed in the return or in any schedule or statement attached to the return in a manner sufficient to apprise the Commissioner of the nature and amount thereof shall not be taken into account in determining items omitted from the gross estate or total gifts, as the case may be. Further, there shall not be taken into account in computing the 25 percent omission from the gross estate stated in the estate tax return or from the total gifts stated in the gift tax return, any increases in the valuation of assets disclosed on the return.

(c) *Excise taxes—(1) In general.* If the taxpayer omits from a return of a tax imposed under a provision of subtitle D an amount properly includible thereon, which amount is in excess of 25 percent of the amount of tax reported thereon, the tax may be assessed or a proceeding in court for the collection thereof may be begun without assessment, at any time within 6 years after the return was filed. For special rules relating to chapter 41, 42, 43 and 44 taxes, see paragraphs (c)(2), (3), (4), and (5) of this section.

(2) *Chapter 41 excise taxes.* If an organization discloses an expenditure in its return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the Commissioner of the existence and nature of the expenditure, the three-year limitation on assessment and collection described in section 6501(a) shall apply with respect to any tax under chapter 41 arising from the expenditure. If a taxpayer fails to so disclose an expenditure in its return (or in a schedule or statement

attached thereto), the tax arising from the expenditure not so disclosed may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed.

(3) *Chapter 42 excise taxes.* (i) If a private foundation omits from its annual return with respect to the tax imposed by section 4940 an amount of tax properly includible therein that is in excess of 25 percent of the amount of tax imposed by section 4940 that is reported on the return, the tax may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed. If a private foundation discloses in its return (or in a schedule or statement attached thereto) the nature, source, and amount of any income giving rise to any omitted tax, the tax arising from the income shall be counted as reported on the return in computing whether the foundation has omitted more than 25 percent of the tax reported on its return.

(ii) If a private foundation, trust, or other organization (as the case may be) discloses an item in its return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the Commissioner of the existence and nature of the item, the three-year limitation on assessment and collection described in section 6501(a) shall apply with respect to any tax imposed under sections 4941(a), 4942(a), 4943(a), 4944(a), 4945(a), 4951(a), 4952(a), 4953 and 4958, arising from any transaction disclosed by the item. If a private foundation, trust, or other organization (as the case may be) fails to so disclose an item in its return (or in a schedule or statement attached thereto), the tax arising from any

transaction not so disclosed may be assessed or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed.

(4) *Chapter 43 excise taxes*. If a taxpayer discloses an item in its return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the Commissioner of the existence and nature of the item, the three-year limitation on assessment and collection described in section 6501(a) shall apply with respect to any tax imposed under sections 4971(a), 4972, 4973, 4974 and 4975(a), arising from any transaction disclosed by the item. If a taxpayer fails to so disclose an item in its return (or in a schedule or statement attached thereto), the tax arising from any transaction not so disclosed may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed. The applicable return for the tax under sections 4971, 4972, 4973 and 4974, is the return designated by the Commissioner for reporting the respective tax. The applicable return for the tax under section 4975 is the return filed by the plan used to report the act giving rise to the tax.

(5) *Chapter 44 excise taxes*. If a real estate investment trust omits from its annual return with respect to the tax imposed by section 4981 an amount of tax properly includible therein that is in excess of 25 percent of the amount of tax imposed by section 4981 that is reported on the return, the tax may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed. If a real estate investment trust discloses in its return (or in a schedule or statement at-

tached thereto) the nature, source, and amount of any income giving rise to any omitted tax, the tax arising from the income shall be counted as reported on the return in computing whether the trust has omitted more than 25 percent of the tax reported on its return.

(d) *Exception*. The provisions of this section do not limit the application of section 6501©.

(e) *Effective/applicability date—(1) Income taxes*. Paragraph (a) of this section applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009.

(2) *Estate, gift and excise taxes*. Paragraphs (b) through (d) of this section continue to apply as they did prior to being removed inadvertently on September 28, 2009. Specifically, paragraph (b) of this section applies to returns filed on or after May 2, 1956, except for the amendment to paragraph (b)(1) of this section that applies to returns filed on or after December 29, 1972. Paragraph (c) of this section applies to returns filed on or after October 7, 1982, except for the amendment to paragraph (c)(3)(ii) of this section that applies to returns filed on or after January 10, 2001. Paragraph (d) of this section applies to returns filed on or after May 2, 1956.

7. 75 Federal Register 78,897 provides:

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 9511]

RIN 1545-BI44

Definition of Omission From Gross Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations defining an omission from gross income for purposes of the six-year minimum period for assessment of tax attributable to partnership items and the six-year period for assessing tax. The regulations resolve a continuing issue as to whether an overstatement of basis in a sold asset results in an omission from gross income. The regulations will affect any taxpayer who overstates basis in a sold asset creating an omission from gross income exceeding twenty-five percent of the income stated in the return. Additionally, provisions related to estate, gift and excise tax are reinstated from the prior final regulation.

DATES: *Effective Date*: These regulations are effective on December 14, 2010.

Applicability Date: The regulations relating to income taxes apply to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009, which is the date that the proposed and temporary regulations to which these regulations relate were filed with the **Federal Register**. For dates of applicability regarding the regulations relating to estate, gift and excise taxes, see § 301.6501(e)-1(e)(2).

FOR FURTHER INFORMATION CONTACT: William A. Heard, III at (202) 622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) under section 6229(c)(2) and section 6501(e) of the Internal Revenue Code. On September 28, 2009, temporary regulations (TD 9466) regarding the definition of an omission from gross income for purposes of the six-year period for assessment were published in the **Federal Register** (74 FR 49321). A notice of proposed rulemaking (REG-108045-08) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (74 FR 49354). One written comment was received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held. After consideration of the comment, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed.

Summary of Comments and Explanation of Revisions

These final regulations amend the Procedure and Administration Regulations (26 CFR part 301) relating to sections 6229(c)(2) and 6501(e). In addition to the revisions set forth in the proposed regulations cross-referencing the temporary regulations, the final regulations reflect structural amendments to sections 6229(c)(2) and 6501(e) in the Hiring Incentives To Restore Employment Act (Pub. L. 111-147, 124 Stat. 112) to accommodate an additional threshold triggering the six-year period of limitations for omissions from gross income attributable to assets subject to certain reporting requirements, which is not otherwise addressed in these final regulations. The final regulations also clarify the effective/applicability date provisions in the section

6229(c)(2) and section 6501(e) regulations to eliminate a perceived ambiguity in the temporary regulations, that was brought to light by the Tax Court in *Intermountain Insurance Service of Vail v. Commissioner*, 134 T.C. No. 11 (2010), appeal docketed, No. 10-1204 (DC Cir.).

As explained in the preamble to the temporary regulations, the United States Courts of Appeals for the Ninth Circuit and the Federal Circuit construed section 6501(e)(1) in cases outside the trade-or-business context contrary to the interpretation provided in these final regulations, holding that an overstatement of basis does not constitute an "omission." *Bakersfield Energy Partners v. Commissioner*, 568 F.3d 767 (9th Cir. 2009); *Salman Ranch Ltd v. United States*, 573 F.3d 1362 (Fed. Cir. 2009). Those courts relied on the Supreme Court's opinion in *Colony v. Commissioner*, 357 U.S. 28 (1958), which dealt with an omission from gross income in the context of a trade or business under the predecessor of section 6501(e). The Treasury Department and the Internal Revenue Service disagree with those courts that the Supreme Court's reading of the predecessor to section 6501(e) in *Colony* applies to sections 6501(e)(1) and 6229(c)(2), for the reasons set forth in the preamble to the temporary regulations.

After publication of the temporary regulations, the Tax Court declared the temporary regulations invalid, adhering to its prior opinion in *Bakersfield Energy Partners v. Commissioner*, 128 T.C. 207 (2007). *Intermountain Insurance Service of Vail v. Commissioner*, 134 T.C. No. 11 (2010), appeal docketed, No. 10-1204 (DC Cir.). In part, the Tax Court in *Intermountain* concluded that the Supreme Court's opinion in Colony was the only permissible interpretation of the statutory lan-

guage in question ("omits from gross income"). The Treasury Department and the Internal Revenue Service disagree with *Intermountain*. The Supreme Court stated in *Colony* that the statutory phrase "omits from gross income" is ambiguous, meaning that it is susceptible to more than one reasonable interpretation. The interpretation adopted by the Supreme Court in *Colony* represented that court's interpretation of the phrase but not the only permissible interpretation of it. Under the authority of *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982-83 (2005), the Treasury Department and the Internal Revenue Service are permitted to adopt another reasonable interpretation of "omits from gross income," particularly as it is used in a new statutory setting. *See Hernandez-Carrera v. Carlson*, 547 F.3d 1237 (10th Cir. 2008) (agencies are free to promulgate a reasonable construction of an ambiguous statute that contradicts any court's interpretation, even the Supreme Court's). The interpretation of the phrase "omits from gross income" as used in section 6501(e)(1) is currently pending before several United States Courts of Appeals.

Because these regulations are a clarification of the period of limitations provided in sections 6501(e)(1) and 6229(c)(2) and are consistent with the Secretary's application of those provisions both with respect to a trade or business (that is, gross income means gross receipts), as well as outside of the trade-or-business context (that is, the section 61 definition of gross income applies), they are applicable to all cases with respect to which the period for assessing tax was open on or after September 24, 2009, the date the temporary regulations were filed with the **Federal Register**.

1. Retroactivity

The sole written comment received in response to the notice of proposed rulemaking by cross-reference to the temporary regulations questioned the application of the regulations, characterizing them as retroactive, and recommended that they be applied only prospectively. The commentator stated that the temporary regulations apply with retroactive effect "in that taxable years which had closed are now reopened." The Treasury Department and the Internal Revenue Service disagree with the characterization of the regulations as retroactive. The final regulations have been clarified to emphasize that they only apply to open tax years, and do not reopen closed tax years as suggested by the commentator.

The commentator also relied on the 1996 amendments to section 7805(b) to argue that retroactively effective Treasury regulations are impermissible, with limited exceptions. The 1996 amendments to section 7805(b), however, do not apply to the regulations under sections 6229(c)(2) and 6501(e)(1). That is because those amendments are only effective for regulations that relate to statutory provisions enacted on or after July 30, 1996. Taxpayer Bill of Rights 2 (Pub. L. 104-168, section 1101(a), 110 Stat. 1469). Since section 6229(c)(2) was enacted in 1982 and section 6501(e)(1)(A) was enacted in 1954 (and redesignated as subparagraph (B) as part of the HIRE Act in 2010), the 1996 amendments to section 7805(b) are inapplicable to the regulations. Prior to the 1996 amendments, section 7805(b) provided, "The Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect." Although these regulations are not retroactive, a retroactive regu-

lation interpreting sections 6229(c)(2) and 6501(e)(1) is expressly permitted by the applicable version of section 7805(b), which presumes regulations to apply retroactively unless otherwise provided.

2. Intermountain

The Tax Court's majority in *Intermountain* erroneously interpreted the applicability provisions of the temporary and proposed regulations, which provided that the regulations applied to taxable years with respect to which "the applicable period for assessing tax did not expire before September 24, 2009." The Internal Revenue Service will continue to adhere to the position that "the applicable period" of limitations is not the "general" three-year limitations period. The three-year limitations period is one of several limitations periods in the Internal Revenue Code, including the six-year limitations period under sections 6229(c)(2) and 6501(e)(1). The expiration of the three-year period does not "close" a taxable year if a longer period applies. Consistent with that position, the final regulations apply to taxable years with respect to which the six-year period for assessing tax under section 6229(c)(2) or 6501(e)(1) was open on or after September 24, 2009. This includes, but is not limited to, all taxable years (1) for which six years had not elapsed from the later of the date that a tax return was due or actually filed, (2) that are the subject of any case pending before any court of competent jurisdiction (including the United States Tax Court and Court of Federal Claims) in which a decision had not become final (within the meaning of section 7481) or (3) with respect to which the liability at issue had not become fixed pursuant to a closing agreement entered into under section 7121. The Internal Revenue Service's posi-

tion is consistent with the effective/applicability date provisions of these final regulations.

3. Other Revisions

The final regulations are amended to reinstate estate, gift and excise tax provisions that were inadvertently removed by the temporary regulations.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the NPRM cross-referencing the temporary regulations preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is William A. Heard III of the Office of the Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and record-keeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

■ **Paragraph 1.** The authority citation for part 301 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.6229(c)(2)-1 is also issued under 26 U.S.C. 6230(k). * * *

■ **Par. 2**. Section 301.6229(c)(2)-1 is added to read as follows:

§ 301.6229(c)(2)-1 Substantial omission of income.

(a) *Partnership return*—(1) *General rule*. (i) If any partnership omits from the gross income stated in its return an amount properly includible therein and that amount is described in clause (i) of section 6501(e)(1)(A), subsection (a) of section 6229 shall be applied by substituting "6 years" for "3 years."

(ii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6229(c)(2).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

(b) *Effective/applicability date*. This section applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009.

§ 301.6229(c)(2)-1T [Removed]

■ Par. 3. Section 6229(c)(2)-1T is removed.

■ Par. 4. Section 301.6501(e)-1 is added to read as follows:

§ 301.6501(e)-1 Omission from return.

(a) *Income taxes*—(1) *General rule*. (i) If a taxpayer omits from the gross income stated in the return of a tax imposed by subtitle A of the Internal Revenue Code an amount properly includible therein that is in excess of 25 percent of the gross income so stated, the tax may be assessed, or a proceeding in court for the collection of that tax may be begun without assessment, at any time within 6 years after the return was filed.

(ii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, *gross income* means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A)(i).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

(2) [Reserved]

(b) *Estate and gift taxes*—(1) If the taxpayer omits from the gross estate as stated in the estate tax return, or from the total amount of the gifts made during the period for which the gift tax return was filed (see § 25.6019-1 of this chapter) as stated in the gift tax return, an item or items properly includible therein the amount of which is in excess of 25 percent of the gross estate as stated in the estate tax return, or 25 percent of the total amount of the gifts as stated in the gift tax return, the tax may be assessed, or a proceeding in court for the collection thereof may be begun without assessment, at any time within 6 years after the estate tax or gift tax return, as applicable, was filed.

(2) For purposes of this paragraph (b), an item disclosed in the return or in any schedule or statement attached to the return in a manner sufficient to apprise the Commissioner of the nature and amount thereof shall not be taken into account in determining items omitted from the gross estate or total gifts, as the case may be. Further, there shall not be taken into account in computing the 25 percent omission from the gross estate stated in the estate tax return or from the total gifts stated in the gift tax return, any increases in the valuation of assets disclosed on the return.

(c) *Excise taxes*—(1) *In general.* If the taxpayer omits from a return of a tax imposed under a provision

of subtitle D an amount properly includible thereon, which amount is in excess of 25 percent of the amount of tax reported thereon, the tax may be assessed or a proceeding in court for the collection thereof may be begun without assessment, at any time within 6 years after the return was filed. For special rules relating to chapter 41, 42, 43 and 44 taxes, see paragraphs (c)(2), (3), (4), and (5) of this section.

(2) *Chapter 41 excise taxes*. If an organization discloses an expenditure in its return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the Commissioner of the existence and nature of the expenditure, the three-year limitation on assessment and collection described in section 6501(a) shall apply with respect to any tax under chapter 41 arising from the expenditure. If a taxpayer fails to so disclose an expenditure in its return (or in a schedule or statement attached thereto), the tax arising from the expenditure not so disclosed may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed.

(3) *Chapter 42 excise taxes*. (i) If a private foundation omits from its annual return with respect to the tax imposed by section 4940 an amount of tax properly includible therein that is in excess of 25 percent of the amount of tax imposed by section 4940 that is reported on the return, the tax may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed. If a private foundation discloses in its return (or in a schedule or statement attached thereto) the nature, source, and amount of any income giving rise

to any omitted tax, the tax arising from the income shall be counted as reported on the return in computing whether the foundation has omitted more than 25 percent of the tax reported on its return.

(ii) If a private foundation, trust, or other organization (as the case may be) discloses an item in its return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the Commissioner of the existence and nature of the item, the three-year limitation on assessment and collection described in section 6501(a) shall apply with respect to any tax imposed under sections 4941(a), 4942(a), 4943(a), 4944(a), 4945(a), 4951(a), 4952(a), 4953 and 4958, arising from any transaction disclosed by the item. If a private foundation, trust, or other organization (as the case may be) fails to so disclose an item in its return (or in a schedule or statement attached thereto), the tax arising from any transaction not so disclosed may be assessed or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed.

(4) *Chapter 43 excise taxes*. If a taxpayer discloses an item in its return (or in a schedule or statement attached thereto) in a manner sufficient to apprise the Commissioner of the existence and nature of the item, the three-year limitation on assessment and collection described in section 6501(a) shall apply with respect to any tax imposed under sections 4971(a), 4972, 4973, 4974 and 4975(a), arising from any transaction disclosed by the item. If a taxpayer fails to so disclose an item in its return (or in a schedule or statement attached thereto), the tax arising from any transaction not so disclosed may be assessed, or a proceeding in court for the collec-

tion of the tax may be begun without assessment, at any time within 6 years after the return was filed. The applicable return for the tax under sections 4971, 4972, 4973 and 4974, is the return designated by the Commissioner for reporting the respective tax. The applicable return for the tax under section 4975 is the return filed by the plan used to report the act giving rise to the tax.

(5) *Chapter 44 excise taxes*. If a real estate investment trust omits from its annual return with respect to the tax imposed by section 4981 an amount of tax properly includible therein that is in excess of 25 percent of the amount of tax imposed by section 4981 that is reported on the return, the tax may be assessed, or a proceeding in court for the collection of the tax may be begun without assessment, at any time within 6 years after the return was filed. If a real estate investment trust discloses in its return (or in a schedule or statement attached thereto) the nature, source, and amount of any income giving rise to any omitted tax, the tax arising from the income shall be counted as reported on the return in computing whether the trust has omitted more than 25 percent of the tax reported on its return.

(d) *Exception*. The provisions of this section do not limit the application of section 6501(c).

(e) *Effective/applicability date*—(1) *Income taxes*. Paragraph (a) of this section applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009.

(2) *Estate, gift and excise taxes*. Paragraphs (b) through (d) of this section continue to apply as they did prior to being removed inadvertently on September 28, 2009. Specifically, paragraph (b) of this section applies

to returns filed on or after May 2, 1956, except for the amendment to paragraph (b)(1) of this section that applies to returns filed on or after December 29, 1972. Paragraph (c) of this section applies to returns filed on or after October 7, 1982, except for the amendment to paragraph (c)(3)(ii) of this section that applies to returns filed on or after January 10, 2001. Paragraph (d) of this section applies to returns filed on or after May 2, 1956.