No. 11-178

In the Supreme Court of the United States

UNITED STATES OF AMERICA AND
COMMISSIONER OF INTERNAL REVENUE, PETITIONERS

v.

DANIEL S. BURKS, ET AL.

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

PETITION FOR A WRIT OF CERTIORARI

DONALD B. VERRILLI, JR.
Solicitor General
Counsel of Record
JOHN A. DICICCO
Principal Deputy Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
JEFFREY B. WALL
Assistant to the Solicitor General
MICHAEL J. HAUNGS
JOAN I. OPPENHEIMER
Attorneys

Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

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

Petitioners are the United States of America and the Commissioner of Internal Revenue.

Respondents are Daniel S. Burks; MITA, a general partnership; and John F. Lynch.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

In the Supreme Court of the United States

No. 11-178

UNITED STATES OF AMERICA AND
COMMISSIONER OF INTERNAL REVENUE, PETITIONERS

v.

DANIEL S. BURKS, ET AL.

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

PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States of America and the Commissioner of Internal Revenue, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in these consolidated cases.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-28a) in the consolidated cases is reported at 633 F.3d 347. In the case of respondent Daniel S. Burks, the opinion of the district court (App., *infra*, 34a-43a) is not published in the *Federal Supplement* but is available at 2009 WL 2600358. In the case of respondents MITA and John F. Lynch, the opinion of the Tax Court (App., *infra*, 46a-48a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 9, 2011. A petition for rehearing was denied on April 15, 2011 (App., *infra*, 29a-33a). On June 29, 2011, Justice Scalia extended the time within which to file a petition for a writ of certiorari to and including August 13, 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*, 49a-79a.

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 these consolidated cases 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.

That issue arises in these consolidated cases in the context of 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. 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 Daniel S. Burks and John F. Lynch (along with their spouses and some of their trusts) owned stock that had appreciated in value. Respondents wanted to sell that stock while minimizing their taxable gains from the sales. Respondents therefore engaged in various short sales of United States Treasury Notes. In late 1999, respondents transferred the proceeds of the short sales as capital contributions to various pass-through partnerships that they had created (one of which was respondent MITA, a general

---

[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.

partnership formed by respondent Lynch). Those partnerships then closed the short sales by purchasing and delivering the requisite Treasury Notes. App., *infra*, 2a-3a; see Gov't C.A. Br. 6-7 (No. 09-11061); Gov't C.A. Br. 4-5 (No. 09-60827).

In 2000, respondents filed their tax returns for the previous year. In computing their outside bases, respondents Burks and Lynch included the amount of the short-sale proceeds that they had contributed to the partnerships, without reducing those amounts to reflect the partnerships' offsetting obligations to close the short positions. As a result, respondent Burks turned what would have been a large capital gain into a much smaller one, and respondent Lynch turned what would have been a large capital gain into a capital loss. See Gov't C.A. Br. 8 (No. 09-11061); Gov't C.A. Br. 5-7 (No. 09-60827).

2. In 2006 and 2007, the IRS issued Final Partnership Administrative Adjustments (FPAAs), reducing respondents' outside bases in their partnerships and thereby substantially increasing their taxable income for 1999.[2] App., *infra*, 3a-4a. Respondents challenged the FPAAs, arguing that they were barred because they were issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). The government contended that the FPAAs were 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

---

[2] Although the FPAA for respondent Lynch was issued in March 2007, more than six years after he had filed his return in October 2000, Lynch had consented to extending the assessment period until March 31, 2007. See Gov't C.A. Br. 8 (No. 09-60827).

therein which is in excess of 25 percent of the amount of gross income stated in the return."

In the case of respondent Burks, the district court denied his motion for summary judgment, holding that an overstatement of basis in sold assets can give rise to an omission from gross income for purposes of Section 6501(e)(1)(A). App., *infra*, 34a-43a. The court of appeals then granted Burks leave to file an interlocutory appeal. *Id.* at 4a. In the case of respondents Lynch and MITA, the Tax Court held that, under this Court's decision in *The Colony, Inc.* v. *CIR*, 357 U.S. 28 (1958) (*Colony*), an overstatement of basis in sold assets does not give rise to an omission from gross income for purposes of Section 6501(e)(1)(A). App., *infra*, 46a-48a. The Tax Court therefore granted respondents' motion for summary judgment, and the government timely appealed. *Id.* at 5a.

3. The court of appeals consolidated the cases and held that an overstatement of basis in sold assets does not give rise to an omission from gross income. App., *infra*, 1a-28a. The court therefore concluded that the three-year period in Section 6501(a), not the six-year period in Section 6501(e)(1)(A), applied to the IRS's assessments. *Id.* at 14a. The court declined to apply a regulation promulgated in temporary form by the IRS in September 2009, which became final in December 2010 while the appeals were pending, and which construes the phrase "omits from gross income" to encompass situations in which a taxpayer understates his income by overstating his basis in property. *Id.* at 25a. The court of appeals read this Court's decision in *Colony* to hold that the relevant statutory language is unambiguous and therefore precludes any contrary agency interpretation. *Ibid.*

REASONS FOR GRANTING THE PETITION

These consolidated cases present 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 these cases 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 these cases 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.

DONALD B. VERRILLI, JR.
Solicitor General
JOHN A. DICICCO
Principal Deputy Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
JEFFREY B. WALL
Assistant to the Solicitor General
MICHAEL J. HAUNGS
JOAN I. OPPENHEIMER
Attorneys

AUGUST 2011

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Nos. 09-11061, 09-60827

DANIEL S. BURKS, TAX MATTERS PARTNER OF KEY HARBOR INVESTMENT PARTNERS, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

DANIEL S. BURKS, TAX MATTERS PARTNER OF DJB INVESTMENT PARTNERS, PLAINTIFF-APPELLANT

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MITA, PARTNER; JOHN F. LYNCH, A PARTNER OTHER THAN THE TAX MATTERS PARTNER, RESPONDENTS

Filed: Feb. 9, 2011

Before: DEMOSS, BENAVIDES and ELROD, Circuit Judges.

DEMOSS, Circuit Judge:

This consolidated appeal requires us to determine whether an overstatement of basis constitutes an omission from gross income for purposes of the Tax Code, 26 U.S.C. § 6501(e)(1)(A), which extends the tax assessment period from three to six years. Because we conclude that an overstatement of basis is not an omission from gross income for purpose of the relevant statute, the Commissioner was limited to three years to pursue unpaid tax claims against the taxpayers. We further find that the recently promulgated Treasury Regulations do not apply to the taxpayers. We thus affirm the tax court's judgment in favor of the taxpayer, and reverse the district court's judgment in favor of the government.

I.

Appellee United States of America and Petitioner Commissioner of the Internal Revenue Service (IRS) (collectively "the government") assert that Appellants Daniel Burks, M.I.T.A., and John E. Lynch (collectively "taxpayers" or "the taxpayers") utilized the "Son of BOSS"[1] tax shelter to create artificial tax losses in order to offset capital gains. In a Son of BOSS scheme, partners engage in various long and short sale transactions and transfer the resulting obligations to the partnership thereby improperly inflating the basis in the partnership assets. *See e.g., Coltec Indus., Inc. v. United States,* 454 F.3d 1340, 1343 (Fed. Cir. 2006) (outlining steps of transactions used to inflate basis in assets). The partners do not reduce the basis by the liabilities assumed

---

[1] "'BOSS' is an acronym for 'Bond and Option Sales Strategy.'" *Kornman & Assocs., Inc.* v. *United States,* 527 F.3d 443, 446 n.2 (5th Cir. 2008). Son of BOSS is an abusive tax shelter that is a "variation of the slightly older BOSS tax shelter." *Id.* (citation omitted).

by the partnership. *See id;* I.R.S. Notice 2000-44, 2000-2 C.B. 255 (describing prohibited transactions used to create an artificial basis). When basis is overstated, "gross income is affected to the same degree as when a gross-receipt item of the same amount is completely omitted from a tax return." *Colony, Inc. v. Comm'r,* 357 U.S. 28, 32, 78 S. Ct. 1033, 2 L. Ed. 2d 1119 (1958).

The Tax Equity and Fiscal Responsibility Act of 1982 "established 'a single unified procedure for determining the tax treatment of all partnership items at the partnership level, rather than separately at the partner level.'" *Kornman & Assocs., Inc. v. United States,* 527 F .3d 443, 446 n.1 (5th Cir. 2008) (quoting *Callaway v. Comm'r,* 231 F.3d 106, 108 (2d Cir. 2000)). Generally, taxes must be assessed and collected within three years of the filing of the tax return. *See* 26 U.S.C. §§ 6501(a), 6229(a). The limitations period is extended to six years when the taxpayer "omits from gross income an amount properly includible therein . . . in excess of 25 percent of the amount of gross income stated in the return." 26 U.S.C. § 6501(e)(1)(A).

In the present cases, the IRS issued Final Partnership Administrative Adjustments (FPPAs) adjusting the partnership tax returns filed by the taxpayers on the grounds that the challenged transactions lacked economic substance.[2] *See Klamath Strategic Inv. Fund ex rel. St. Croix Ventures v. United States,* 568 F.3d 537,

---

[2] The issue before this court is a purely legal one—whether an overstatement of basis constitutes an omission from gross income for purposes of § 6501(e)(J)(A). The merits of the underlying transactions are not before this court on appeal. The district court and tax court have not yet determined that the taxpayers' reporting positions are unsupportable.

543 (5th Cir. 2009) ("The economic substance doctrine allows courts to enforce the legislative purpose of the [Tax] Code by preventing taxpayers from reaping tax bene fits from transactions lacking in economic reality."). The FPPAs were filed more than three years but less than six years after the taxpayers' individual tax returns were filed with the IRS. The taxpayers moved for summary judgment before the district court and tax court on the grounds that the government had issued the FPAAs after the expiration of the general three year limitations period for assessing tax against the various partners. In both matters, the government conceded that the three year limitations period had expired but asserted that an extended six year limitations period applied because the partners had omitted gross income in excess of 25% from their tax returns in violation of § 6501(e)(1)(A) when they overstated their basis.

In *United States v. Burks* (09-11061), the district court held that this court's decision in *Phinney v. Chambers*, 392 F.2d 680 (5th Cir. 1968), established that an overstatement of basis was an omission from gross income for purposes of § 6501(e)(1)(A). The district court thus denied Burks's motion for summary judgment. This court granted Burks permission to me an interlocutory appeal.

In *Commissioner v. M.I.T.A.* (09-60827), the tax court relied on the Supreme Court's decision in *Colony, Inc. v. Commissioner*, 357 U.S. 28, 32, 78 S. Ct. 1033, 2 L. Ed. 2d 1119 (1958), and cases construing that decision to support its finding that an overstatement of basis did not constitute an omission from gross income for purposes of § 6501(e)(1)(A). The tax court further found that *Phinney* did not directly address the issue facing the court. Because the tax court held that the three year limitations period applied, it granted the taxpayers' motion for summary judgment. The government timely appealed.

II.

On appeal, the taxpayers argue that an overstatement of basis does not constitute an omission from gross income as established by the Supreme Court in *Colony v. Commissioner* and thus the three year limitations period applies. The government argues that this court's decision in *Phinney v. Chambers* established that the six year limitations period applies to an overstatement of basis for purposes of § 6501(e)(1)(A). The government contends that *Colony* applies only in the context of a trade or business engaged in the sale of goods or services. The government also argues that application of *Colony* to the revised statute renders § 6501(e)(1)(A) subsections (i) and (ii) superfluous.[3] Finally, the government asserts that recently enacted Treasury Regulations purporting to define "omission from gross income" as encompassing an overstatement of basis are determinative and apply retroactively to the present matters. We consider each in turn.

A.

This court reviews de novo a court's determination on a motion for summary judgment. *See Staff IT, Inc. v. United States,* 482 F.3d 792, 797 (5th Cir. 2007); *Ford*

[3] 26 U.S.C. § 6501(e)(1)(A)(I), (ii) has since been amended such that subsections (i) and (li) now appear at § 6501(e)(1)(B)(I), (ii). There have been no amendments to the text of the subsections and thus the amendments do not affect our analysis. All references to subsections (i) and (ii) are as to the text of the statute prior to the recent amendments in effect at the time of this appeal.

Motor Co. v. Tex. Dept of Transp., 264 F.3d 493, 498 (5th Cir. 2001). Summary judgment is proper when "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a).

B.

The taxpayers argue that the Supreme Court's decision in *Colony v. Commissioner,* holding that an overstatement of basis was not an omission from gross income such that the extended limitations period applied, is controlling in the present matters.

In *Colony,* the Court held that an overstatement of basis did not constitute an omission from gross income for purposes of § 275(c) of the 1939 Tax Code, the predecessor to § 6501(e)(A)(1). 357 U.S. at 36, 78 S. Ct. 1033. Section 275(c) stated that a five year (now six year) statute of limitations applied when a 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." *Id.* at 29, 78 S. Ct. 1033.[4] The taxpayer in *Colony* had understated

---

[4] 26 U.S.C. 275 stated in relevant part:

> (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.
>
> (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.

gross income by overstating the basis in land the taxpayer had sold. *Id*. at 30, 78 S. Ct. 1033. The Court began its analysis by focusing on the plain language of the statute. "In determining the correct interpretation of § 275(c) we start with the critical statutory language, omits from gross income an amount properly includible therein.'" *Id.* at 32, 78 S. Ct. 1033.

The taxpayers argued that the term "omits" was commonly defined as "to leave out or unmentioned; not to insert, include, or name" and thus by the plain language of the statute only the complete omission of an item of income triggered application of the extended limitations period. *Id.* at 32- 33, 78 S. Ct. 1033. The Court stated it was "inclined" to agree with the taxpayers' argument, however it held that "it cannot be said that [§ 275(c)] is unambiguous" and turned to the legislative history of the statute. *Id.* at 33,78 S. Ct. 1033.

The court found "in that 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.* The Court thus found that the extended limitations period did not apply where gross receipts had been reported, despite gross income having been under-reported. *Id*. The Court concluded:

> We 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 omis-

---

Colony, Inc. v. Comm'r, 357 U.S. 28, 29 n.1, 78 S. Ct. 1033, 2 L. Ed. 2d 1119 (1958).

> sion 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. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting "gross income" or one, such as overstated deductions, affecting other parts of the return.

Id. at 36, 78 S. Ct. 1033.

The government asserts that this court's decision in *Phinney v. Chambers* limited *Colony's* holding requiring an actual omission of income pursuant to the plain meaning of the term "omits," because the revised statute § 6501(e)(1)(A)(ii) established adequate disclosure as the critical factor when determining whether there was an omission from gross income. *See Grapevine Imps., Ltd. v. United States,* 77 Fed. C1. 505, 509 (2007) ("In the wake of *Colony*, a judicial debate erupted over whether the 1954 version of [S]ection 6501(e)(1)(A) is triggered only where an item of income is entirely omitted from a return.").

In *Phinney,* this court was tasked with determining whether misreporting the nature of an item on a tax return constituted an omission from gross income for the purposes of § 6501(e)(1)(A). 392 F.2d at 681-83. The transaction at issue in *Phinney* involved the sale of community property owned by the taxpayer and her deceased spouse. *Id.* at 681. The taxpayer and her spouse each owned a 50% share in a note for stock, which had been sold under an installment plan. *Id.* at 681. The taxpayer and the fiduciary of the deceased taxpayer's spouse each filed tax returns. *Id.* at 681-82. The spouse's tax return reported a gain from the sale of the stock and correctly listed the transaction as an installment sale. *Id.* The taxpayer's tax return incorrectly listed the installment sale transaction as the sale of a stock and reported no gain or loss. *Id.* at 682.

The question before the court was whether the taxpayer omitted 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." *Id.* at 683 (citation omitted). Focusing on the item reported, *Phinney* found that the nature of the item was misrepresented such that there was no adequate disclosure of the transaction. *Id.* at 684. "The basic difficulty with the taxpayer's position here is that [the] taxpayer simply didn't give the government a chance to make a 'challenge' to the taxpayer's contention, because the taxpayer made no such contention on the return it filed." *Id.* The taxpayer's return reported an installment sale "under a different heading and under an incorrect designation." *Id.*

Citing to *Colony,* the court held that there was "[n]o better illustration" for the need for adequate disclosure as required in § 6501(e)(1)(A)(ii). *Id.* at 685.

> [T]he enactment of [§ 6501] subsection (ii) . . . makes it apparent that the six year statute is intended to apply 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.

Id. (internal marks omitted). The court concluded that "if an item of income is shown on the face of the return or an attached statement that is not shown in a manner sufficient to enable the [S]ecretary by reasonable inspection of the return to detect the errors then it is the omission of 'an amount' properly includable in the return." *Id.*

We do not read *Phinney* as limiting *Colony*'s holding.[5] In *Colony,* the court noted that its conclusion was "in harmony with the unambiguous language of § 6501(e)(1)(A)." 357 U.S. at 37, 78 S. Ct. 1033. A fair reading of *Colony* and *Phinney* supports our finding that both an actual omission of an amount from the tax return or a fundamental misstatement of the nature of an item reported in a tax return that places the Commissioner at a disadvantage in detecting the error may result in application of the extended limitations period. See *id.*; *Phinney*, 392 F.2d at 685 ("[T]he six year statute is intended to apply where there is either a complete *omission of an item* of income . . . or *misstating of the nature of an item* of income which places the [C]ommissioner at a special disadvantage in detecting errors.") (internal mark omitted) (emphasis added). The holdings in both cases support the underlying purpose of the Code: to provide the IRS with additional time to detect errors or omissions when the nature of the omis-

[5] The Seventh Circuit in *Beard* incorrectly read our decision in *Phinney* as limiting *Colony's holding. See Beard v. Comm'r*, 633 F.3d 616, 620-22, No. 09-3741, 2011 WL 222249, at *4-5. (7th Cir. Jan. 26, 2011). *As discussed above, the Seventh Circuit failed to note the distinct factual pattern presented in* Phinney, *where the taxpayers had misstated the very nature of the item so that the IRS would not have had any reasonable way of detecting the error on the tax return. That is not the case here*.

sion places the "government at a special disadvantage." *See Taylor v. United States,* 417 F.2d 991, 993 (5th Cir. 1969) ("[Section 6501(e)(1)(A)] provides that an item of income is 'omitted' if the item is not shown in a manner sufficient to enable the Government, upon a reasonable inspection, to detect the error. . . . [T]he Government is not to be penalized by a taxpayer's failure to reveal the facts.").

The facts in *Phinney* demonstrate that the taxpayer's return did not merely misstate an amount but rather misrepresented the very nature of the item reported such that the IRS could not have reasonably known what was actually being reported, an almost direct omission. *Phinney*, 392 F.2d at 684. We hesitate to read *Phinney* as applicable to a misstatement of an amount of income when the nature of the item is correctly reported because the error arguably qualifies as an "omission" in that it omits the truth or accuracy of the amount reported. Such a result renders the general three year limitations period meaningless.

Phinney involved a distinct fact pattern not presented in this appeal. The taxpayers in the present matters did not misstate the nature of an item such that the IRS was at a disadvantage in detecting the error because it could not reasonably know what was actually being reported. Rather, the nature of the item—the basis—was included in the tax return, albeit in an incorrect amount. This circumstance provides the IRS with sufficient notice to inquire into the correctness and validity of the item being reported. *See Colony*, 357 U.S. at 36, 78 S. Ct. 1033 (finding that the extended limitations period applies when "the return on its face provides no clue to the existence of the omitted item"). Absent a fundamental alteration to the nature of the item reported, disclosure of the item, despite the correctness of the amount, provides the IRS with reasonable notice of the item being reported and the general limitations period should apply pursuant to *Colony*.

Our holding is consistent with other courts' analysis regarding the applicability of *Colony* in the context of Son of BOSS tax shelters. These courts have generally found that an overstatement of basis does not constitute an omission from gross income for purposes of § 6501(e)(1)(A) such that the extended limitations period applied, because of the similarity of the language and meaning of § 275(c) and § 6501(e)(I)(A). *See, e.g., Home Concrete & Supply, LLC v. United States (Home Concrete II),* 634 F.3d 249, 255, No. 09-2353, 2011 WL 361495, *5 (4th Cir. Feb. 7, 2011) (finding that because the legislative history of § 275(c) is "equally compelling" with respect to § 6501(e)(I)(A) and that because there are no material differences in the language of the statutes, "we are not free to construe an omission from gross income as something other than a failure to report 'some income receipt or accrual' ") (quotations omitted); *Salman Ranch Ltd v. United States (Salman Ranch II),* 573 F.3d 1362, 1373-74, 1377 (Fed. Cir. 2009) (finding that "[t]he meaning of 'omits' in today's parlance appears to be no different than its meaning at the time of the *Colony* decision" and further noting that in the years since *Colony* had been decided Congress had not indicated that its holding was inapplicable to the revised statute despite ongoing debate surrounding the decision); *Bakersfield Energy Partners, LP v. Comm'r,* 568 F.3d 767, 771-72 (9th Cir. 2009) (finding that the 1939 Code was so substantially similar to the 1954 Code that *Colony* was controlling); *UTAM, Ltd. v. Comm'r,* 98

T.C.M. (CCH) 422, at *3 (2009) (rejecting the government's reliance on *Phinney* because under the facts before it the Commissioner was not at a disadvantage in "identifying the error in the reporting of the transaction" when the return adequately identified the nature of the item at issue); *Intermountain Ins. Servo of Vail v. Comm'r (Intermountain I),* 98 T.C.M. (CCH) 144, at *2-3 (2009) (applying *Colony* and holding that an overstatement of basis was not an omission from gross income); *cf Benson v. Comm'r,* 560 F .3d 1133, 1136 (9th Cir. 2009) (finding six year limitations period applied when failure to report "did not result from an overstatement of basis or other technical miscalculation"); *Grapevine Imports,* 77 Fed. Cl. at 510 (holding that "the meaning of the word 'omits,' has as much application to the 1954 version of the statute, as it did the 1934 version, for, in both, that word is pivotal," and further finding no compelling reason to hold that the common understanding of the term "omits" had "shifted" since *Colony* and revisions to the Code); *but see Beard v. Comm'r,* 633 F.3d 616, at 620, No. 09-3741, 2011 WL 222249, at *3 (7th Cir. Jan. 26, 2011) (creating a circuit split by finding that *Colony* was not controlling and holding that "an overstatement of basis can be treated as an omission from gross income"); *Home Concrete & Supply, LLC v. United States* (*Home Concrete l*), 599 F. Supp. 2d 678, 687 (E.D.N.C. 2008) (finding that an overstatement of basis was an omission from gross income for purposes of § 6501(e)(I)(A)), *rev'd,* 634 F.3d 249, 2011 WL 361495 (2011); *Brandon Ridge Pariners v. United States,* No. 8:06-cv-1340, 2007 WL 2209129, at *8 (M.D. Fla. July 30, 2007) (unpublished) (finding that *Phinney* compelled application of the extended limitations period because the taxpayers' tax returns did not adequately disclose the relevant transactions); *Salman Ranch Ltd. v. United States (Salman Ranch I),* 79 Fed. Cl. 189, 201-02 (2007), *rev'd,* 573 F .3d 1362 (Fed. Cir. 2009). *Salman Ranch (I)* and *Home Concrete (I)* have subsequently been overturned by the Federal Circuit and Fourth Circuit, respectively.

The government does not argue that these cases are distinguishable from the present matters, but rather asserts that they were wrongly decided. We disagree and find that *Colony*'s holding with respect to the definition of "omits gross income" remains applicable in light of the revisions to the Code. As such, an overstatement of basis that adequately appraises the Commissioner of the nature of the item being reported does not constitute an "omission from gross income" for purposes of § 6501(e)(1)(A). The taxpayers in the present matters disclosed the nature of the items on their tax returns sufficient to notify the Commissioner of the item being reported. We join the Fourth, Ninth, and Federal Circuits by finding that *Colony's* holding with respect to the definition of "omits from gross income" remains applicable in light of the revisions to the Code.

C.

The government alternatively argues that *Colony* does not control the present matters because application of *Colony* to § 6501(e)(1)(A) subsections (i) and (ii) would render these subsections superfluous. The government argues that *Colony's* finding that the ambiguous language found in § 275(c) was "in harmony" with the unambiguous language found in § 6501(e)(1)(A) was necessarily tied to these subsections.

Section 6501(e)(1)(A) was first enacted as § 275(c) of the Revenue Act of 1934, 48 Stat. 745. *See Badaracco v.*

Comm'r, 464 U.S. 386, 392, 104 S. Ct. 756, 78 L. Ed. 2d 549 (19S4). Congress amended the statute in 1954, renumbering it as § 6501(e)(1)(A) and adding two subsections. *See* H.R. Rep. No. 83-1337, 4561 (1954), U.S. Code Congo & Admin. News 1954, pp. 4017.[6] Although courts have held that the language in the two statutes is

---

[6] At the time of the appeal the revised statute read:

(e) Substantial omission of items

(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 and 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 of the collection of such a tax may be begun without assessment, at any time within 6 years after the return was filed. For the purpose 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.

26 U.S.C. § 6501(e).

virtually identical,[7] there is disagreement over the validity of *Colony* in light of the revisions.

Subsection (i) provides: "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).

Some courts have held that subsection (i) limits application of *Colony* to cases involving a trade or business. *See, e.g., Beard,* 633 F .3d at 620-21, 2011 WL 222249, at *4 (finding that subsection (i) applies only when there is an omission of a receipt or accrual from a trade or business); *Salman Ranch (I),* 79 Fed. Cl. at 200 (finding *Colony* applicable only in the case of business and trade income); *Home Concrete (I),* 599 F. Supp. 2d at 684 ("Subsection (i) redefines gross income for purposes of § 6501(e)(1)(A) in cases involving a trade or business."); *Brandon Ridge Partners,* 2007 WL 2209129, at *7 (finding that application of *Colony* outside the context of a trade or business "would render § 6501(e)(1)(A) superfluous"); *see also* CC *& FW Operations Ltd. P'ship v. Comm'r,* 273 F.3d 402, 406 n.2 (1st Cir. 2001) (declining to reach the issue but noting that whether *Colony*'s "main holding" applies in light of subsection (i) "is at least doubtful" because the

---

[7] *See, e.g., Badaracco v. Comm'r*, 464 U.S. 386, 392, 104 S. Ct. 756, 78 L. Ed. 2d 549 (1984) (noting that § 6501 was "first introduced" as § 275(c)); *Salman Ranch Ltd v. United States (Salman Ranch II),* 573 F.3d 1362, 1379 (Fed. Cir. 2009) (describing § 275(c) as the predecessor to § 6501); *Home Concrete & Supply, LLC v. United States*, 599 F. Supp. 2d 678. 684 (E.D.N.C. 2008) ("It is correct to say that the language of § 275(c) is virtually identical to a portion of § 6501(e)(1)(A).").

implication is that *Colony* does not apply to other types of income).

Other courts have found *Colony* applicable to all taxpayers in light of the revised statute. *See, e.g., Home Concrete (II)*, 634 F.3d at 255, 2011 WL 361495, at *4 (finding that *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"); *Salman Ranch (II),* 573 F.3d at 1372-73 ("*Colony* "interpreted the language of § 275(c) based upon what it viewed as congressional intent and purpose, without ever mentioning the taxpayer's trade or business."); *Bakersfield,* 568 F.3d at 778 (finding that *Colony* "did not even hint that its interpretation of § 275(c) was limited to cases in which the taxpayer was engaged in a 'trade or business' "); *UTAM,* 98 T.C.M. (CCH) 442, at *3 ("Neither the language nor the rationale of *Colony* can be limited to the sale of goods or services by a trade or business."); *Intermountain (I),* 98 T.C.M. (CCH) 144, at *3 n.5 (declining to "diminish" *Colony's* holding); *Grapevine Imports,* 77 Fed. Cl. at 511 (declining to find that application of *Colony* was limited to transactions involving the sale of goods or services by a trade or business).

The government argues that Congress would not have included the phrase "in the case of a trade of business" and "amounts received or accrued from the sale of goods or services" if it had not intended for the definition of gross income for purposes of § 6501(e)(1)(A)(i) to apply outside the context of trade or business engaged in the sale of goods or services. The government further asserts that taxpayers' construction of the term "omits" without reference to the term "gross income" focuses only on one component of the calculation, thus excluding consideration of one of the two figures that result in gain (the calculation of basis) and therefore renders the gross receipts provision meaningless.

Bakersfield offered a comprehensive analysis when disagreeing with the government's argument. 568 F.3d at 776. The court held that when comparing the two amounts needed to calculate gross income for purposes of § 6501(e)(1)(A), the gross income omitted with the gross income as stated in the return, the court found that whether an amount was omitted was a separate issue from whether the amount omitted exceeded 25% of the taxpayer's gross income. *Id.* at 776.

> Because § 6501(e)(1)(A)(i) changes the definition of "gross income" for taxpayers in a trade or business, it potentially affects both the numerator (the omission from gross income) and the denominator (the total gross income stated in the return). *Colony's* holding, however, affects only the numerator, by defining what constitutes an omission from gross income.
>
> When there is no dispute about the amount of gross income omitted, the denominator, the total amount of gross income stated in the return, determines whether the omission meets the 25% threshold that triggers the six-year limitations period. For taxpayers not in a trade or business, the denominator is the amount of gross income (gross receipts minus basis); for taxpayers in a trade or business, the denominator is the total amount of money received without any reduction for basis (gross receipts).

Id. at 776-77. Thus, when the amount omitted (the numerator) is not in dispute, applicability of the extended limitations period turns on whether the court was obliged to apply subsection (i)'s definition of "gross income" for a trade or business when determining the amount of gross income stated in the return (the denominator). *Id.* at 777 (citing *Hoffman v. Comm'r,* 119 T.C. 140, 150 (2002)). However, when the circumstances involve the sale of goods or services by a trade or business, whether subsection (i) applies is the dispositive issue "because it determine[s] whether the omitted amount of gross income constitute[s] more than 25% of the gross income stated in the return, wholly aside from *Colony*'s holding regarding what constitutes an omission from gross income." *Id.*

The court further noted that Congress did not alter the language in § 6501(e)(I)(A). *Id.* at 775. "Although the IRS would have us infer that Congress's addition of subparagraph (i) casts the language in the body of § 6501(e)(I)(A) in a different light, we can equally infer that Congress in 1954 intended to clarify, rather than rewrite, the existing law." *Id.* at 776. The court concluded:

> [Congress] could have expressly added a definition of "omits" if it wanted to overrule the cases that concluded, as the Supreme Court later did in *Colony,* that "omits" does not include an overstatement of basis. Instead, Congress allowed the preexisting general definition of "omits" to carry forward into the successor provision, and additionally provided for a special definition of "gross income" in the case of a "trade or business."

Id. "[T]he fact remains that *Colony* represents an interpretation of the very same language that is now found in § 6501(e)(I)(A), and in the years since *Colony,* Congress has not indicated that the Court's interpretation of the language of § 275(c) should not apply to § 6501(e)(I)(A)." *Salman Ranch (II)*, 573 F.3d at 1373.

Salman Ranch (II) held that, by its terms, the language of subsection (i) states how gross income is calculated for purposes of § 6501(e)(I)(A) when the income arises from a trade or business engaged in the sale of goods or services. 573 F.3d at 1373. Colony "did not speak to the calculation of 'gross income' . . . [r]ather, it identified the situations in which a taxpayer 'omits from gross income an amount properly includible therein.'" *Id.* at 1375. The court held that subparagraph (i), ''which explains how 'gross income' is calculated when a trade or business is involved," is not made superfluous simply by finding that an overstatement of basis is not an omission from gross income. *Id.*

Salman Ranch further held that the legislative history of § 6501(e)(I)(A) supported a finding that subsection (i) was not rendered superfluous by application of *Colony. Id.* at 1375-76. "Congress added subparagraph (i) to resolve a conflict between the IRS and taxpayers about how to calculate gross income in the case of a trade or business." *Id.* (citing *Hearings Before the Senate Comm. on Finance on H.R. 8300 (part* 2), 83rd Cong. 984 (1954) (letter of Harry N. Wyatt)) (discussing "disagreement evidenced by the case law between the [IRS] and some of the courts as to whether . . . [i]n the case of a business, the term 'gross income' should be construed as gross receipts and gross sales, or as net receipts and net sales"). *Salman Ranch* held that, "[i]n light of this conflict, we believe that Congress enacted subparagraph (i) . . . to assist the IRS in its calculation of whether any omitted gross income exceeded 25% of the gross income stated in the return." *Id.* at 1376.

We agree with the analysis presented in *Bakersfield* and *Salman Ranch (II)* and hold that a fair reading of § 6501(e)(1)(A)(i) supports our finding that subsection (i) was intended to define gross income for the sale of goods or services by a trade or business as gross receipts from those sales. Under the Code, gross income of a trade or business is usually calculated by subtracting the cost of goods sold from the gross receipts of the sale. 26 U.S.C. § 61(a). Subsection (i) provides an alternative to this customary definition in the context of sales of goods or services by a trade or business by defining "gross income" as gross receipts rather than gross receipts less the cost of goods sold. *See* § 6501(e)(1)(A)(i). Thus, pursuant to § 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, the return must omit a receipt. As such, subsection (i) is not rendered superfluous by application of *Colony* outside of the context of a trade or business.

D.

The government further argues that in enacting § 6501(e)(1)(A)(ii), Congress intended that an item could be omitted from gross income without it having been entirely omitted from the face of the return. *See Phinney,* 392 F.2d at 685. Subsection (ii) states:

> 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). Subsection (ii) thus provides a "safe harbor" for omissions of amounts which, though not included in the gross income as stated in the tax return, are adequately disclosed such that the IRS has sufficient notice.

> [F]rom 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.

Home Concrete (I), 599 F. Supp. 2d at 686; *see also Salman Ranch (II),* 573 F.3d at 1376 (finding that the adequate disclosure provision is related to *Colony*'s expression that Congress's intent in enacting § 275(c) was to afford the Commissioner additional time to investigate returns where an item has been omitted such that *Colony* has not been rendered moot) (citing *Colony,* 357 U.S. at 36, 78 S. Ct. 1033). As discussed *infra,* subsection (ii) is in harmony with both this court's decision in *Phinney* and the Supreme Court's decision in *Colony.* Thus, it is proper for this court to apply *Colony* in light of the revised statute. The government does not assert that the taxpayers failed to report any receipt or accrual in its computation of gross income. Rather, the government contends only that the taxpayers overstated their basis in the sale of assets. As such, the taxpayers' errors do not trigger the extended limitations period.

III.

Finally, the government argues that recently promulgated Treasury Regulations clarify that the definition of "omits from gross income" as found in § 6501(e)(I)(A) includes an overstatement of basis, thus the regulations are determinative.

On September 28, 2009, the Treasury issued Temporary Regulations §§ 301.6501(e))-1T(b) and 301.6229(c)(2)-1T(b), pursuant to 26 U.S.C. § 7805(a). Section 7805(a) of the Tax Code authorizes the Treasury Department to promulgate "all needful rules and regulations for the enforcement of this title." 26 U.S.C. § 7805(a). The Temporary Regulations were simultaneously issued as proposed regulations and were issued as final regulations effective December 14, 2010 (the Regulations). *See* Treas. Reg. §§ 301.6501(e)-1, 301.6229(c)(2)-1.[8] The Regulations define "omission from gross income" as including "an understated amount of gross income resulting from an overstatement . . . of basis for purposes of sections 6501(e)(1)(A) and

---

[8] Although the Temporary Regulations were in effect at the time the government and taxpayers sought appellate review, because any difference between the Temporary and final Regulations are not material to our review, this opinion cites to the final version of the Regulations.

6229(c)(2)." *Id.* at §§ 301.6501(e)-1(a)(iii) and 301.6229(c)(2)-1(a)(iii). The Regulations provide:

> In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1I)(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).

Treas. Reg. § 301.6501(e)-1(a)(iii). The Regulations limit *Colony's* applicability to circumstances where the taxpayer is a trade or business engaged in the sale of goods or services. *Id.* at § 301.6501(e)-(1)(a)(ii), (iii); T.D. 9511, 75 Fed. Reg. 78897, 78897 (Dec. 17, 2010). The Regulations also expressly disagree with the recent decisions in *Bakersfield* and *Salman Ranch (II)* applying *Colony* to the revised statute. *See* 75 Fed. Reg. 78897.

The government asserts that this court must afford the Regulations force of law deference and because the Regulations purport to apply retroactively they control the outcome of the present matters. *See Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council, Inc.,* 467 U.S. 837, 843-44, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984) (setting forth the standard for force of law deference, which affords agency regulations controlling weight, unless they are arbitrary, capricious, or contrary to the underlying statute). The taxpayers argue that the Regulations are an unreasonable interpretation of an unambiguous statute and contrary to Congressional intent. *See Nat'l Muffler Dealers Ass'n, Inc. v. United States,* 440 U.S. 472, 47&-77, 99 S. Ct. 1304, 59 L. Ed. 2d 519 (1979) *(pre-Chevron* case applying a more limited standard of reasonableness to a treasury regulation). Finally, the taxpayers assert that the Regulations cannot apply retroactively because such action would re-open previously time-barred claims.

Because we hold that § 6501(e)(1)(A) is unambiguous and its meaning is controlled by the Supreme Court's decision in *Colony,* we need not determine the level of deference owed to the Regulations. The Regulations attempt to define "omits from gross income" for purposes of the revised statute. However, the government cites to no authority refuting prior case law that has held § 6501(e)(1)(A) to be unambiguous with respect to the definition of "omits." *See Colony,* 357 U.S. at 37, 78 S. Ct. 1033 (finding that "without doing more than noting the speculative debate between the parties as to whether Congress manifested an intention to clarify or to change the 1939 Code" when Congress enacted § 6501 of the 1954 Tax Code, "we observe that the conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A)"); *Salman Ranch (II),* 573 F.3d at 1374 (finding the phrase "omits from gross income" identical in both statutes); *Bakersfield,* 568 F.3d at 775-76 (applying *Colony*'s definition of "omits from gross income" because it had construed language identical to the revised statute). The Regulations attempt to "trump" what is established precedent on what constitutes an "omission from gross income" for purposes of § 6501(e)(1)(A). *See Home Concrete (II),* 634 F .3d at 257, 2011 WL 361495, at *7 (declining to apply the Regulations retroactively because "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").

Moreover, the Regulations state that they "apply to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009." T.D. 9511, 75 Fed. Reg. 78897, 78897 (Dec. 17, 2010). The government argues that this provision applies to taxable years for which the limitations period did not expire with respect to the tax year at issue before September 24, 2009. The Regulations state that "'the applicable period' is not the 'general' three-year limitation period . . . [because] the three-year period does not 'close' a taxable year if a longer period applies." *Id.* at 78898. The government thus makes a circular argument that the Regulations apply to the taxpayers because the statute of limitations remains open under the language of the newly promulgated Regulations. *See Home Concrete (II),* 634 F.3d at 256, 2011 WL 361495, at *6 (finding that such argument "attempts to re-draft [] § 6501" because Congress specifically set forth the circumstances under which the extended limitations period applies and thus "the IRS's argument that the period for assessing tax is open—or indeed may be re-opened . . . so long as litigation is pending is contrary to the clearly and unambiguously expressed intent of Congress and must fail") (citations omitted); *Intermountain Ins. Serv. of Vail, LLC. v. Comm'r (Intermountain II),* 134 T.C. No. 11, at *1 (2010) (declining to engage in a "hypothetical" inquiry to determine the applicable limitations period because when urging the same argument, the government's interpretation was "irreparably marred by circular, result-driven logic").[9]

---

[9] Although we hold that § 6501(e)(1)(A) is unambiguous and its meaning is controlled by the Supreme Court's decision in *Colony,* we note that even if the statute was ambiguous and *Colony* was inapplicable, it is unclear whether the Regulations would be entitled to *Chevron* deference under *Mayo Foundation for Medical Research v. United States,* — U.S. ----, 131 S. Ct. 704, 711, 178 L. Ed. 2d 588 (2011). *See, e.g.*, *Home Concrete & Supply, LLC v. United States,* 634 F.3d 249, 257-58, (No. 09-2353) 2011 WL 361495, *7 (4th Cir. Feb. 7, 2011) (declining to afford the Regulations *Chevron* deference because the statute is unambiguous as recognized by the Supreme Court in *Colony).* In *Mayo,* the Court held that the principles underlying its decision in *Chevron* "apply with full force in the tax context" and applied *Chevron* to treasury regulations issued pursuant to 26 U.S.C. § 7805(a). *Id*. at 707. Significantly, in *Mayo* the Supreme Court was not faced with a situation where, during the pendency of the suit, the treasury promulgated determinative, retroactive regulations following prior adverse judicial decisions on the identical legal issue. "Deference to what appears to be nothing more than an agency's convenient litigating position" is "entirely inappropriate." *Bowen* v. *Georgetown Univ. Hosp.,* 488 U.S. 204, 213, 109 S. Ct. 468, 102 L. Ed. 2d 493 (1988). The Commissioner "may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations." *Chock Full O' Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971).

Moreover, *Mayo* emphasized that the regulations at issue had been promulgated following notice and comment procedures, "a consideration identified . . . as a significant sign that a rule merits *Chevron* deference." 131 S. Ct. at 714. Legislative regulations are generally subject to notice and comment procedure pursuant to the Administrative Procedure Act. *See* 5 U.S.C. § 553(b)(A). Here, the government issued the Temporary Regulations without subjecting them to notice and comment procedures. This is a practice that the Treasury apparently employs regularly. *See* Kristin E. Hickman, *A Problem of Remedy: Responding to Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 76 Geo. Wash. L.

Because the Regulations are an unreasonable interpretation of settled law, we find that they are not applicable to the taxpayers in the present matters. As such, we need not determine whether the Regulations may apply retroactively.

IV.

For the foregoing reasons, we affirm the tax court's judgment in favor of the taxpayers in matter 09-60827, *Commissioner v. M.I.T.A.* We reverse the district court's grant of summary judgment in favor of the government in matter 09-11061, *United States v. Burks,* and remand for further proceedings consistent with this opinion.

Rev. 1153, 1158-60 (2008) (noting that the treasury frequently issues purportedly binding temporary regulations open to notice and comment only after promulgation and often denies the applicability of the notice and comment procedure when issuing its regulations because that requirement does not apply to regulations that are not a significant regulatory action, while continuing to assert that the regulations are entitled to legislative regulations level deference before the courts). That the government allowed for notice and comment after the final Regulations were enacted is not an acceptable substitute for pre-promulgation notice and comment. *See U.S. Steel Corp. v. U.S. EPA*, 595 F.2d 207, 214-15 (5th Cir. 1979).

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 09-11061

DANIEL S. BURKS, TAX MATTERS PARTNER OF KEY HARBOR INVESTMENT PARTNERS, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

DANIEL S. BURKS, TAX MATTERS PARTNER OF DJB INVESTMENT PARTNERS, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Cons w/09-60827

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MITA, PARTNER; JOHN F. LYNCH, A PARTNER OTHER THAN THE TAX MATTERS PARTNER, RESPONDENTS

(Opinion February 9, 2011, 5 Cir., _____, F.3d _____)

Appeal from the United States District Court for the
Northern District of Texas, Dallas

ON PETITION FOR REHEARING EN BANC

Before: DEMOSS, BENAVIDES, and ELROD, Circuit Judges,

PER CURIAM:

(X) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. No member of the panel nor judge in regular active service of the court having requested that the court be polled on Rehearing En Banc (FED. R. APP. P., and 5th CIR. R. 35), the Petition for Rehearing En Banc is DENIED.

(   ) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. The court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor (FED. R. APP. P. and 5th CIR, R. 35); the Petition for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ HAROLD R. DEMOSS
United States Circuit Judge

* Judge Smith did not participate in the consideration of the rehearing en banc.

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT OFFICE OF THE CLERK

LYLE W. CAYCE
CLERK

TEL. 504-310-7700
600 S. MAESTRI PLACE
NEW ORLEANS, LA 70130

Apr. 15, 2011

MEMORANDUM TO COUNSEL OR PARTIES LISTED BELOW:

No. 09-11061 Daniel Burks v. USA
USDC No. 3:06-CV-1747
USDC No. 3:06-CV-1749
USDC No. 3:06-CV-1750
USDC No. 17832-07

Enclosed is an order entered in this case.

Sincerely,

LYLE W. CAYCE, Clerk

By: SEAN D. HENDERSON
SHAWN D. HENDERSON,
Deputy Clerk
504-310-7668

Ms. Kim Marie Kozaczek Boylan
Mr. David E. Colmenero
Mr. Joel N Crouch
Mr. Thomas A Cullinan
Mr. Robert R Di Trolio

Mr. John DiCicco
Ms. Laura L. Gavioli
Mr. Michael J Haungs
Mr. Kent Jones
Mr. Roger J. Jones
Mr. Jeffrey W. Koonce
Ms. Karen S. Mitchell
Ms. Joan I. Oppenheimer
Ms. Clarissa C Potter
Mr. Eddy Manuel Quijano
Mr. Andrew R. Roberson
Mr. Gilbert Steven Rothenberg
Mr. Michael Todd Welty
Ms. Cherish D. van Mullem

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

No. 3:06-CV-1747-N

DANIEL S. BURKS, AS TAX MATTERS PARTNER OF KEY HARBOR INVESTMENT PARTNERS AND AS DJM INVESTMENT PARTNERS, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 13, 2008]

ORDER

This Order addresses Plaintiff Daniel S. Burks's partial motion for summary judgment [20]. For the reasons explained below, the Court grants in part and denies in part the motion.

I. BACKGROUND

The Government argues that Daniel S. Burks, Janet Eileen Burks, 1996 Janet Eileen Burks Exempt Trust A, and 1996 Janet Eileen Burks Exempt Trust B—the partners of Key Harbor Investment Partners ("Key Harbor") and DJB Investment Partners ("DJB") (collectively, the "Partnerships")—have underreported their gross income due to the Partnerships' employment of a Son of BOSS tax shelter.[1] In his motion for partial summary judgment, Burks argues that the statute of limitations for assessing taxes against the partners of the Partnerships for the Partnerships' tax years ending in 1999 expired before the Government issued Notices of Final Partnership Administrative Adjustments ("FPAAs"). Specifically, Burks argues that 26 U.S.C. § 6229(a) establishes an exclusive three year period in which the Government must assess taxes or otherwise toll the limitations period for assessing a tax attributable to a partnership item. One such method of tolling the limitations period is by sending an FPAA. 26 U.S.C. § 6229(d). Although the Government did send FPAAs to the Partnerships, they did so almost six years after the limitations period had begun to run. Burks argues that this is the end of the story: section 6229's exclusive three-year period of limitations expired before the Government took any relevant action, and therefore the Government improperly assessed taxes against the individual partners.

The Government argues otherwise. According to the Government, section 6229 establishes only a *minimum* period of limitations, and the more general limitations period of 26 U.S.C. § 6501 is still applicable. The Government argues that the FPAAs were timely and sufficient to toll the limitations period with respect to two of the Partnerships' partners, 1996 Janet Eileen Burks

---

[1] For an description of Son of BOSS tax shelters see IRL Chief Counsel Notice 2003-020, IRS CCN CC-2003-020, available at 2003 WL 24016805 (June 25, 2003).

Exempt Trust A and 1996 Janet Eileen Burks Exempt Trust B (collectively, the "Trusts").[2]

Section 6229 was enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 648-671 ("TEFRA"). TEFRA "created a single unified procedure for determining the tax treatment of all partnership items at the partnership level, rather than separately at the partner level." *In re Crowell,* 305 F.3d 474, 478 (6th Cir. 2002). After the partnership level proceeding is complete, each individual partner's tax liability is adjusted accordingly. *See* 26 U.S.C. § 6230(a). Under typical circumstances, the status of section 6229 as a minimum or exclusive limitations period is irrelevant because either the Government will have appropriately acted before expiration of section 6229(a)'s three year period as possibly extended by section 6229(c), or the Government will have failed to act within either the three year period provided by section 6229(a) (as possibly extended by section 6229(c)) or the three year period provided by section 6501(a) (as possibly extended by section 6501(c) or (e)). Nonetheless, either because section 6501(a)'s period began to run at a later date than section 6229(a)'s period, or because an extension is available under section 6501 that is not available under section 6229, there are circumstances when the Government would be foreclosed from assessing taxes if section 6229 were deemed an exclusive limi-

[2] The Government concedes that the limitations period has expired with respect to Daniel and Janet Eileen Burks, the other two partners. For this reason alone, the Court grants in part Burks's motion. Thus, the Court need not address whether the statute of limitations would have been extended with respect to the Burkses—at least with respect to Key Harbor's alleged omission of gross income—by operation of section 6229(c)(2).

tations period. The Government concedes that this is such a case.

II. SECTION 6229(A)'S PLAIN LANGUAGE ESTABLISHES A MINIMUM PERIOD OF LIMITATIONS

Section 6229(a) provides:

> Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year *shall not expire before* the date which is 3 years after the later of—(1) the date on which the *partnership return* for such taxable year was filed, or (2) the last day for filing such return for such year.

26 U.S.C. § 6229(a) (emphasis added). It is undisputed that the assessments at issue involve "partnership items." Nonetheless, the Government argues that it may still rely on the limitations period in section 6501. That section provides:

> Except as otherwise provided by this section, the amount of *any tax* imposed by this title *shall be assessed* within 3 years after the return was filed . . . [T]he term "return" means the *return required to be filed by the taxpayer* (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).

26 U.S.C. § 6501(a).

By its plain language, Section 6229(a) is a minimum period that does not preclude the Government from relying on the general limitations period provided by section 6501. *See Andantech, L.L.C. v. C.I.R.*, 331 F.3d 972, 976 (D.C. Cir. 2003); *AD Global Fund, LLC v. United States*, 481 F.3d 1351 (Fed. Cir. March 2, 2007). Comparison of section 6229(a)'s "shall not expire" text with the text of section 6248(a) supports this conclusion. Section 6248 addresses the limitations period for certain partnerships consisting of more than 100 partners and provides:

> Except as otherwise provided in this section, *no adjustment* under this subpart to any partnership item for any partnership taxable year *may be made after* the date which is 3 years after the later of [the filing of the partnership return or the last day for filing such return].

26 U.S.C. § 6248 (emphasis added).[3] Congress evidently knows how to create an exclusive limitations period if it intends to do so. Section 6229 plainly establishes a minimum limitations period.

Burks's arguments otherwise are not persuasive. He relies heavily on the premise that the Court has jurisdiction over only "partnership items." *See* 26 U.S.C. § 6226(f) ("A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items."). Although it is true that individualized limitations issues are not partnership items, section 6226 also expressly grants the Court jurisdiction to consider individualized limitations issues. See 26 U.S.C. § 6226(d)(1) ("[A]ny person treated . . .

[3] One reason certain large partnerships are provided an exclusive limitations period under section 6248 rather than a minimum period under section 6229 may be so that the proceedings involving large partnerships are not overrun by the individualized limitations issues involved under section 6501—a concern not as relevant with a smaller partnership.

as a party to an action shall be permitted to participate in such action . . . for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired with respect to such person, and the court having jurisdiction of such action *shall have jurisdiction to consider such assertion*.") (emphasis added).

Burks's reliance on the Fifth Circuit's decision in *Weiner v. United States*, 389 F.3d 152 (5th Cir. 2004), is similarly misplaced. There, the Fifth Circuit held that a court conducting individual partner level proceedings could not exercise jurisdiction over partnership items such as limitations issues affecting "the partnership as a whole." *Id.* at 156-57. The Court did not address whether a court conducting partnership level proceedings could exercise jurisdiction over nonpartnership items such as limitations issues applicable to individual partners, and the Court did not address the relationship between sections 6229 and 6501.[4]

---

[4] There is also some dispute as to whether section 6501's limitations period is tolled by mailing an FPAA under section 6229(d). Although the language of section 6229(d) can reasonably accommodate either result, practical considerations compel the conclusion that mailing an FPAA will toll section 6501's limitations period. *See Rhone-Poulenc Surfactants and Specialties, L.P. v. C.I.R.*, 114 T.C. 533, 551-57 (2000) ("Were we to interpret section 6229(d) as only suspending the minimum period, i.e., 3 years from the later of the due date or filing date of the partnership return, the issuance of an FPAA would not suspend the running of the applicable period of limitations under section 6501. This would result in the running and expiration of the applicable period of limitations during the course of proceedings to resolve the underlying dispute."); *AD Global Fund, LLC v. United States*, 67 Fed. Cl. 657, 694 (2005).

IV. 6501'S SIX-YEAR LIMITATION PERIOD MAY APPLY

Section 6501(e)(1)(A) provides in part:

> 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 six years after the return was filed.

26 U.S.C. § 6501(e)(1)(A). Burks argues that the six-year limitation period is not in effect for three reasons. First, he argues that the Trusts did not *omit* gross income. Rather, according to Burks, their overstatement of basis served only to *understate* their gross income. Second, he argues that the six-year period does not apply because the Trusts qualify for section 6501(e)(1)(A)(ii)'s adequate disclosure exception. Third, Burks argues that, even if overstatement of basis constitutes an omission from gross income, the amount omitted did not exceed 25 percent. None of the arguments warrants summary judgment.

A. "Omission of Gross Income" Includes Overstatement of Basis

In the Fifth Circuit, overstatement of basis may result in an omission from gross income. Arguing otherwise, Burks' cites the Supreme Court's decision in *Colony, Inc. v. C.I.R.*, 357 U.S. 28 (1958). The Court held that 26 U.S.C. § 275—the predecessor to section 6501(e)(1)(A) and employing almost identical language as the current statute—dictates that an overstatement of basis is not an omission from gross income. There has been significant debate as to whether and how broadly the Court's holding affects application of 6501(e)(1)(A). *See Grapevine Imports, Ltd. v. United States*, 77 Fed. Cl. 505, 509 (Fed. Cl. 2007) ("In the wake of *Colony*, a judicial debate erupted over whether the 1954 version of Section 6501(e)(1)(A) is triggered only where an item of income is entirely omitted from a return."); *see also Salman Ranch Ltd. v. United States*, 79 Fed. Cl. 189, 200 (Fed. Cl. 2007) (finding that the holding in Colony is applicable only in the case of business and trade income). But because of the Fifth Circuit's decision in *Phinney v. Chambers*, 392 F.2d 680 (5th Cir. 1968), this Court need not take part in the debate. Despite the taxpayer's invocation of *Colony*, the *Phinney* Court held that the taxpayer's overstatement of basis resulted in an omission of gross income under section 6501(e)(1)(A). *Id*. at 685. Although the Court did not explain its decision with great detail, it referenced the "subsequent enactment of the 1954 Internal Revenue Code" in deciding that an overstatement of basis could result in an omission of gross income despite *Colony's* contrary holding. *Id*. According to the *Phinney* Court, an omission of gross income could arise from either an overstatement of basis and/or a pure omission of gross proceeds as long as the "item of income . . . is not shown in a manner sufficient to enable the secretary by reasonable inspection of the return to detect the errors." *Id*. Accordingly, the Trusts' overstatements of basis result in omissions from gross income provided that the Trusts did not adequately disclose the overstatement.[5]

---

[5] The Court is not convinced by Burks's contention that the holding in *Phinney* applies only to circumstances in which the taxpayer has made factual misrepresentations. Even if Burks's proposed distinction between "factual misrepresentations" and definitional disagreements

B. Burks Has Not Demonstrated Adequate Disclosure

Burks has not shown that the Trusts qualify for 6501(e)(1)(A)(ii)'s adequate disclosure exception. Section 6501(e)(1)(A)(ii) provides:

> 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). The Fifth Circuit interpreted the provision to say that "if an item of income . . . is not shown in a manner sufficient to enable the secretary by reasonable inspection of the return to detect the errors then it is the omission of 'an amount' properly includible in the return." *Phinney*, 392 F.2d at 685. Burks has not offered summary judgment proof establishing adequate disclosure and, therefore, is not entitled to summary judgment on this ground.

C. The Amounts of Gross Income Omitted May Have Exceeded the Trusts' Stated Gross by More than 25%

Burks argues for the first time in his reply brief that the Trusts' omitted gross income, even under the Government's theory, did not exceed their stated gross income by more than 25%. Because the Court generally

---

has merit, the Court in *Phinney* did not rely on the presence of "factual misrepresentations." Instead, the Court held that the overstatement of basis resulted in an omission of gross income where "an item of income . . . is not shown in a manner sufficient to enable the secretary by reasonable inspection of the return to detect the errors." 392 F.2d at 685.

does not consider issues raised for the first time in a reply brief, *Whitehurst v. United States*, 2008 WL 1874574, at *2 (5th Cir. Apr. 28, 2008), the Court does not grant Burks's motion for summary judgment on this ground.

CONCLUSION

Because the Government concedes that the statute of limitations is not open with respect to the Burkses' 1999 joint income tax return, the Court grants in part Burks's motion for partial summary judgment. But because section 6501(e)'s six-year period of limitations may apply to the Trusts, the Court denies in part the motion. The Court vacates the current scheduling order. The parties are directed to confer regarding an amended scheduling order and report back to the Court by July 7, 2008.

Signed June 13, 2008.

/s/ DAVID C. GODBEY
DAVID C. GODBEY
United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

No. 06-CV-1747-N

DANIEL S. BURKS, AS TAX MATTERS PARTNER OF KEY HARBOR INVESTMENT PARTNERS AND AS TAX MATTERS PARTNER OF DJM INVESTMENT PARTNERS, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Sept. 21, 2009]

ORDER

Before the Court is Plaintiff's Unopposed Motion To Amend Order To Certify Under 28 U.S.C. § 1292(b). It is hereby ORDERED that the Plaintiff's Unopposed Motion To Amend Order To Certify Under 28 U.S.C. § 1292(b) should be GRANTED.

The Court therefore amends its Order of June 13, 2008 to include the following:

> "Pursuant to 28 U.S.C. § 1292(b), the Court certifies that the issue of whether the overstatement of basis, as alleged under the facts of this case, may constitute the omission of income for purposes of the extended

6-year statute of limitations under I.R.C. § 6501(e)(1)(A):

i) involves a controlling question of law

ii) as to which there is substantial ground for difference of opinion, and

iii) that an immediate appeal from this Order may materially advance the ultimate termination of the litigation."

Signed September 21, 2009.

/s/ DAVID C.GODBEY
DAVID C. GODBEY
United States District Judge

APPENDIX E

UNITED STATES TAX COURT

Docket No. 17832-07

M.I.T.A. PARTNERS, JOHN F. LYNCH, A PARTNER OTHER THAN THE TAX MATTERS PARTNER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

[Served: Aug. 6, 2009]

ORDER AND DECISION

This case is before the Court on petitioner's motion for summary judgment filed August 18, 2008, and respondent's cross-motion for partial summary judgment filed October 21, 2008. The issue for decision is whether the Notice of Final Partnership Administrative Adjustment (FPAA) challenged in the petition was untimely because it was sent more than 3 years after the due date of the return for the year in issue or was timely because it was sent within the 6-year extended period of limitations provided by Internal Revenue Code section 6501(e)(1)(A). The issue is presented in terms of whether this Court, in *Bakersfield Energy Partners v. Commissioner*, 128 T.C. 207 (2007), affd. 568 F.3d 767

(9th Cir. 2009), correctly followed the United States Supreme Court opinion in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958).

There is no dispute that the issue is one of law that may properly be disposed of by summary judgment pursuant to Rule 121, Tax Court Rules of Practice and Procedure.

Respondent does not argue that this case is distinguishable from *Bakersfield*, *supra*, but argues that *Bakersfield* was wrongly decided and that, in any event, the opinion of the Court of Appeals for the Fifth Circuit in *Phinney v. Chambers*, 392 F.2d 680 (5th Cir. 1968), is controlling here because this case is appealable to the Court of Appeals for the Fifth Circuit.

Bakersfield has now been affirmed by the Court of Appeals for the Ninth Circuit, and we decline to reconsider our conclusion in that case. Moreover, the same result has been reached in factual circumstances more similar to those in this case than in *Bakersfield*. *Salman Ranch LTD v. United States*, 79 Fed. Cl. 189 (2007), rev. and remanded ___F.3d___ (Fed. Cir. July 30, 2009).

We conclude that *Phinney v. Chambers*, *supra*, is not squarely in point with respect to the issue dividing the parties in this case, *i.e.*, whether an overstatement of basis claimed on a return is an "omission" for purposes of section 6501(e). See *Golsen v. Commissioner*, 54 T.C. 742 (1970). Contrary to respondent's position, nothing in *Phinney* indicates that the Supreme Court opinion in *Colony, Inc.*, *supra*, was limited to sales of goods or services or was rendered obsolete in its reasoning by the language of section 6501 that was not in effect for the year before the Supreme Court. The Court of Appeals in *Phinney* focused on the term "omission" rather than on the term "gross income", as we did in *Bakersfield*.

Much has now been written on the issue, and we see no reason to repeat or elaborate by a formal opinion in this case. Upon due consideration and for cause, it is hereby

ORDERED that petitioner's motion for summary judgment filed August 18, 2008, and petitioner's supplement to motion for summary judgment filed July 16, 2009, is granted. It is further

ORDERED that respondent's cross-motion for partial summary judgment filed October 21, 2008, is denied. It is further

ORDERED AND DECIDED that the adjustments set forth in the notice that is the basis of this case are barred by the 3-year period of limitations in Internal Revenue Code section 6501(a).

/s/ MARY ANN COHEN
MARY ANN COHEN
Judge

ENTERED: [AUG 6 2009]

APPENDIX F

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(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.

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 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.

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 language 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 regulation 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 position 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 recordkeeping 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 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 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 re-

turn 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.