No. 11-657

In the Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EQUIPMENT HOLDING COMPANY, L.L.C.;
RONALD J. ADAMS, TAX MATTERS PARTNER

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

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

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

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

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

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EQUIPMENT HOLDING CO., L.L.C.;
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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 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 this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-2a) is not reported but is available at 2011 WL 3821061. The opinion of the Tax Court (App., *infra*, 3a-5a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 29, 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*, 6a-31a.

STATEMENT

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

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

This case involves a particular kind of tax shelter, known as a Son-of-BOSS (Bond and Option Sales Strategy) transaction. In a Son-of-BOSS transaction, a taxpayer uses some mechanism, often a short sale, to artificially increase his basis in an asset before the asset is sold. A short sale is a sale of a security that the seller does not own or has not contracted for at the time of the sale. To close the short sale, the seller is obligated to purchase and deliver the security at some point in the future, often by using the proceeds from the short sale itself. 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. *Commissioner*, 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, respondent Ronald J. Adams and his wife, Shirley M. Adams (collectively, the taxpayers), owned respondent Equipment Holding Company, L.L.C. (EHC).[2] They wanted to downsize EHC by selling its commercial and industrial equipment, while minimizing their resulting tax liability. The taxpayers therefore engaged in two short sales, receiving total cash proceeds of more than $4 million. See 18737-07, Pet'r's Statement of Undisputed Material Facts 4-5 (T.C. July 3, 2008) (Statement). The taxpayers transferred that entire amount, along with the obligation to close out the short positions, to EHC. *Id.* at 5. EHC then closed the short sales by purchasing and delivering Treasury Notes for

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

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

approximately $4 million. *Ibid*. In calculating their outside bases in EHC, the taxpayers included the amount of the short-sale proceeds (more than $4 million) that had been contributed to the company, without reducing that amount to reflect EHC's offsetting obligation to close the short positions. See 18737-07, Mem. Supp. Resp't Opp'n to Pet'r's Mot. for Summ. J. 4 (T.C. Sept. 22, 2008) (Gov't Mem.).

The taxpayers then contributed additional assets to EHC through two other companies that they owned, Ronald Adams Contractors, Inc., and the newly-formed Adams Family Partnership. See Gov't Mem. 3-4. Those contributions triggered the termination of the existing EHC partnership and the formation of a new partnership. See *id*. at 4; see also 26 U.S.C. 708(b)(1)(B). The formation of that new partnership, in turn, permitted EHC to adjust, or "step up," its inside basis to equal the taxpayers' outside bases. See 26 U.S.C. 743(b)(1), 754. Because the taxpayers had inflated their outside bases (by including the short-sale proceeds contributed to EHC, without decreasing that amount by the offsetting obligation to close the short sales), EHC's new inside basis was similarly inflated by approximately $3.77 million. See Gov't Mem. 4-5. In August 1999, the taxpayers sold EHC's commercial and industrial equipment for slightly more than $4 million. See *id*. at 4.

In June 2000, the taxpayers and EHC filed their federal income-tax returns for 1999. EHC's inflated inside basis of $3.77 million enabled it to report only a modest gain of $238,498 on the $4 million sale of its assets. See Gov't Mem. 4. And because EHC's partners were required to report their respective shares of any gain, the taxpayers reported income amounts from the asset sale that were dramatically lower than they would have been if the Son-of-BOSS transactions had not been utilized. See *id*. at 4-5.[3]

2. On May 31, 2007, the IRS issued a Final Partnership Administrative Adjustment (FPAA), decreasing EHC's basis in its assets and thereby substantially increasing the taxpayers' taxable income for 1999. Respondent challenged the FPAA, arguing that it was barred because it was issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). The IRS contended that the assessments 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 therein which is in excess of 25 percent of the amount of gross income stated in the return."[4]

The Tax Court granted summary judgment to respondent. App., *infra*, 3a-5a. The court relied on its earlier holding in *Bakersfield Energy Partners, LP* v. *Commissioner*, 128 T.C. 207 (2007), aff'd, 568 F.3d 767 (9th Cir. 2009), that an understatement of gross income attributable to an overstatement of basis does not trig-

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[3] Partnerships do not pay federal income tax, but they are required to file annual information returns reporting the partners' distributive shares of income, gain, deductions, or credits. See 26 U.S.C. 701, 6031; *Randell* v. *United States*, 64 F.3d 101, 103 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996). The individual partners also report their respective distributive shares on their federal income tax returns. See 26 U.S.C. 701-704. Unpaid taxes are assessed against the individual partners.

[4] Although the FPAA was issued in May 2007, more than six years after the taxpayers filed their returns on June 23, 2000, the taxpayers executed a Form 872-I on June 15, 2006, in which they consented to extend the six-year assessment period until June 2007. See 18737-07, Mem. Supp. Pet'r's Mot. for Summ. J. 6 n.5 (T.C. July 3, 2008); Gov't Mem. 5.

ger the extended assessment period in Section 6501(e)(1)(A). The Tax Court stated that "*Bakersfield* has now been affirmed by the Court of Appeals for the Ninth Circuit," and it "decline[d] to reconsider [its] conclusion in that case." App., *infra*, 4a.

3. The court of appeals affirmed. App., *infra*, 1a-2a. The government conceded that the case was controlled, as a matter of circuit precedent, by the court of appeals' prior decision in *Burks* v. *United States*, 633 F.3d 347 (5th Cir. 2011), petition for cert. pending, No. 11-178 (filed Aug. 11, 2011). The court summarily affirmed on that basis.

REASONS FOR GRANTING THE PETITION

This case presents the question whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). On September 27, 2011, this Court granted the petition for a writ of certiorari in *United States* v. *Home Concrete & Supply, LLC*, No. 11-139 (*Home Concrete*), which presents the same issue. If the Court concludes in *Home Concrete* that an overstatement of basis in sold property can trigger the extended six-year assessment period, then the administrative adjustment at issue in this case was timely and the court of appeals erred in holding otherwise. Accordingly, the Court should hold this petition pending its decision in *Home Concrete*, and then dispose of the petition as appropriate in light of that decision.

CONCLUSION

The petition for a writ of certiorari should be held pending the Court's decision in *United States* v. *Home Concrete & Supply, LLC*, cert. granted, No. 11-139 (Sept. 27, 2011), and then disposed of as appropriate.

Respectfully submitted.

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NOVEMBER 2011

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 09-60866

EQUIPMENT HOLDING COMPANY, L.L.C.;
RONALD J. ADAMS, PETITIONERS-APPELLEES

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLANT

Filed: Aug. 29, 2011

Appeal from the Decision of the United States
Tax Court, No. 18737-07

Before: BENAVIDES, STEWART, and CLEMENT, Circuit Judges.

PER CURIAM:*

Appellant Commissioner of Internal Revenue appeals from a final order of the Tax Court. The sole issue presented is whether an understatement of income resulting from an overstatement of the tax basis of sold property can qualify as an omission from gross income

* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

giving rise to the extended, six-year period for tax assessment. A panel of this Court has decided this question on facts materially identical to the facts in the instant case and concluded that such an overstatement does not trigger the extended six-year assessment period in the Tax Code, 26 U.S.C. § 6501(e)(1)(A). *Burks v. United States,* 633 F.3d 347 (5th Cir.), *petition for cert. filed,* (Aug 11, 2011) (NO. 11-178, 11A9). The argument presented by the Commissioner is foreclosed by our circuit precedent, and the Commissioner recognizes the binding precedent, but nevertheless argues that *Burks* was wrongly decided to preserve the issue in the event the Supreme Court grants certiorari and reverses, vacates, or otherwise disturbs our decision in *Burks.* This panel is bound by our precedent.

The judgment of the Tax Court is AFFIRMED.

APPENDIX B

UNITED STATES TAX COURT
Washington, DC 20217

No. 18737-07

EQUIPMENT HOLDING COMPANY, LLC; RONALD J. ADAMS, TAX MATTERS PARTNER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

[Filed: Aug. 12, 2009]

ORDER AND DECISION

This case is before the Court on petitioner's motion for summary judgment filed July 7, 2008, as supplemented April 1, 2009. 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 turns on 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*, No. 2008-5053, ___ F.3d ___ (Fed. Cir. July 30, 2009), revg. and remanding 79 Fed. Cl. 189 (2007).

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. Accordingly, it is

ORDERED that petitioner's motion for summary judgment filed July 7, 2008, as supplemented April 1, 2009, is granted. 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 pursuant to Internal Revenue Code section 6501(a).

(Signed) Michael B. Thornton
Judge

ENTERED: [Aug. 12 2009]

APPENDIX C

1. 26 U.S.C. 275 (1940) 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.

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 with-

out 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 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.