No. ______

IN THE

Supreme Court of the United States

GRAPEVINE IMPORTS, LTD.,
and T-TECH, INC.,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the
United States Court of Appeals for the Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

As the Commissioner of Internal Revenue has acknowledged in response to a related petition, a "square circuit conflict" exists among seven federal circuits on an issue of importance to the IRS and taxpayers alike relating to the applicable statute of limitations for the assessment of income taxes. *See* Brief of Respondent at 8, 19-20, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011); *see also* Brief of Petitioner at 7, *United States* v. *Home Concrete & Supply, LLC*, No. 11-139 (U.S. Aug. 3, 2011) (likewise acknowledging a "conflict among the circuits"). The questions presented by this petition are as follows:

1. Whether the Internal Revenue Service may promulgate regulations providing that an overstatement of the tax basis of sold property constitutes an "omi[ssion] from gross income," thereby triggering an extended statute of limitations for the adjustment of that tax, *see* 26 U.S.C. § 6501(e)(1)(A) (2000), where this Court—in *Colony, Inc.* v. *Commissioner*, 357 U.S. 28 (1958)—has already held that such an interpretation is contrary to the text, legislative history, and purpose of the operative statutory language.

2. Whether a federal agency can use newly-promulgated regulations to compel an appellate court to reverse a judgment that had already been entered against that agency prior to the promulgation of the regulations.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6, undersigned counsel state that Grapevine Imports, Ltd. and T-Tech, Inc. have no parent corporations and no publicly held company owns 10% or more of the stock of either entity.

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Petitioners Grapevine Imports, Ltd. and T-Tech, Inc. (collectively, "Grapevine") respectfully petition this Court for a writ of certiorari to review the judgment entered in this case by the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-33a) is reported at 636 F.3d 1368. The opinion of the Court of Federal Claims (Pet. App. 34a-53a) is reported at 77 Fed. Cl. 505.

JURISDICTION

The judgment of the court of appeals was entered on March 11, 2011. A timely-filed petition for rehearing *en banc* was denied on June 6, 2011 (Pet. App. 54a-56a). 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. *See* Pet. App. 57a-64a.[1]

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[1] In 2010, Congress amended sections 6501(e)(1)(A) and 6229(c)(2) of the Internal Revenue Code, the statutory provisions at issue here. *See* Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71, 111-12 (2010). The appendix to this petition sets forth the version of those sections applicable to the 1999 tax year, the tax year at issue in this case.

INTRODUCTION

This case should have all the hallmarks of a routine tax appeal. The underlying question, though important, involves a straightforward issue of statutory interpretation—namely, whether a taxpayer who overstates the tax basis of sold property "omits from gross income an amount properly includible therein," and thereby triggers an extended statute of limitations under the Internal Revenue Code. *See* 26 U.S.C. §§ 6229(c)(2), 6501(e)(1)(A) (2000).

In fact, this Court has already confronted and interpreted the very same statutory language at issue here—"omits from gross income an amount properly includible therein"—albeit in an older version of the Code, *see* 26 U.S.C. § 275(c) (1938 ed., Supp. I). In *Colony, Inc.* v. *Commissioner*, this Court held that the government could not avail itself of the extended statute of limitations where a taxpayer had overstated its basis in sold property, because such an overstatement does not constitute an omission from gross income. 357 U.S. 28, 32-37 (1958). In rejecting the Commissioner's contrary interpretation, the Court explained that every indicia of congressional intent—from the text to the legislative history and purpose of the statute—favored the taxpayer. *Id.* In the end, the Court concluded that Congress "merely had in mind failures to report particular income receipts and accruals, and did not intend the [extended] limitation to apply whenever gross income was understated." *Id.* at 33-35.

In the more than 50 years since this Court decided *Colony*, the Internal Revenue Service has actively sought ways to limit its holding. Those efforts have proved largely unsuccessful. Congress has not seen fit to change the operative statutory language, even though the statute has been amended more than a dozen times. And the courts have largely rejected the IRS's efforts to limit *Colony*'s reach.

Denied the relief it sought in the legislative and judicial arenas, the IRS (acting through the Secretary of the Treasury) recently promulgated regulations that purport to redefine the phrase "omits from gross income" in a manner contrary to every indicia of congressional intent elucidated by this Court in *Colony*. Even more troubling, the IRS successfully argued below that it could use these regulations for the first time on appeal to obtain the reversal of the judgment that the Court of Federal Claims had already entered against the government in this very case.

As a result of the IRS's unprecedented actions, this case presents two questions of exceptional importance that are in need of resolution by this Court:

First, as Judge Wilkinson recognized in a related appeal, this petition presents the "sometimes difficult" question of whether a "pre-*Chevron* decision[]"—in this case, *Colony*—was "based upon '*Chevron* step one' (the plain command of the statute) or upon '*Chevron* step two' (a permissible construction of the statute)." *Home Concrete & Supply, LLC* v. *United States*, 634 F.3d 249, 258 (4th Cir. 2011) (Wilkinson, J., concurring), *petition for cert. filed*, 80 U.S.L.W. ---- (U.S. Aug. 3, 2011) (No. 11-139). Obviously, when the Court decided *Colony* in 1958, Justice Harlan "had no occasion to ponder the permutations of the *Chevron* test." *Id.*; *see also* 1 Richard J.

Pierce, Jr., *Administrative Law Treatise* § 3.6, at 232-34 (5th ed. 2010) (discussing some of the difficulty in determining whether "a pre-*Chevron* Supreme Court precedent" resolved a dispute at *Chevron*'s first step).

Second, because of the IRS's position in this case—that it can use newly promulgated regulations to compel an appellate court to reverse a judgment that a trial court had already entered against the government—this petition presents the equally important question of whether the judgment of a trial court is subject to revision by executive officers. In *National Cable & Telecommunications Association* v. *Brand X Internet Services*, this Court indicated that such authority lies beyond the power of the executive, *see* 545 U.S. 967, 983-84 (2005); *see also id.* at 1016-17 (Scalia, J., dissenting).

The government has recognized in a response to a related petition that "the courts of appeals are divided on the question whether an overstatement of basis in property can give rise to an 'omi[ssion] of gross income' for purposes of Section 6501(e)(1)(A)." Brief of Respondent at 19, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011). Because of the important and recurring nature of this and other questions presented herein, and because they are best presented in this case, this Court should grant the petition and review the judgment of the court below.

STATEMENT

1. Ordinarily, the government has only three years from the filing of a return in which to issue an adjusted tax assessment. 26 U.S.C. §§ 6229(a), 6501(a) (2000). The three-year period, however, is

extended to six years 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." *Id.* § 6501(e)(1)(A) (2000); *accord id.* § 6229(c)(2) (2000).

On December 17, 2004, more than three but less than six years after Grapevine and its limited partners, Joseph and Virginia Tigue, filed their 1999 tax returns, the Commissioner of Internal Revenue issued a Final Partnership Administrative Adjustment ("FPAA") for Grapevine's 1999 tax return. *See* Pet. App. 2a-3a, 6a. The FPAA alleged that Grapevine had overstated its basis in short-sale transactions involving Treasury Notes due to the Tigues' treatment of short-sale liabilities within the partnership. *See* Pet. App. 4a-5a. As a result, the Commissioner argued that he could avail himself of section 6501(e)(1)(A)'s extended, six-year statute of limitations. *See* Pet. App. 7a.[2]

The untimely FPAA proposed a $10,000,000 negative adjustment to Grapevine's outside basis and a $21,884 increase in capital gain. Pet. App. 6a. The FPAA also reduced Grapevine's loss from the short-sale transaction from $21,884 to zero and reduced

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[2] The treatment of short-sale liabilities was done on the advice of counsel, *see* Pet. App. 36a, and it was done *before* the IRS issued a notice informing taxpayers that it considered such a transaction "not properly allowable for federal income tax purposes," IRS Notice 2000-44, 2000-36 I.R.B. 255 (Sept. 4, 2000). As a result, there has been no allegation of an intent to defraud the government, and the Commissioner has never attempted to invoke the complete exception to the statute of limitations based on the filing of a false or fraudulent return, *see* 26 U.S.C. § 6501(c), *see also id.* § 6229(c)(1).

the Tigues' bases in their partnership interests by $10,000,003. Pet. App. 36a-37a. The effect of the Commissioner's proposed adjustments was to increase taxable income for the 1999 tax year through a reduction in Grapevine's outside basis and an increase to Grapevine's capital-gain income. *See* Pet. App. 6a.

2. Grapevine filed an action in the United States Court of Federal Claims challenging the FPAA as untimely. *See* Pet. App. 37a. Following the resolution of a separate challenge to an FPAA issued for Grapevine's 2000 tax return (a decision that was not contested on appeal),[3] the parties filed competing motions for summary judgment concerning the untimeliness of the FPAA for the 1999 tax return (the matter that is the subject of this petition). *See* Pet. App. 37a.

Grapevine argued that the FPAA for the 1999 tax year was untimely because it was not issued within the three-year period provided by the Internal Revenue Code's statute of limitations, 26 U.S.C. §§ 6229(a), 6501(a) (2000), and in any event, the nature and amount of the items in dispute—the understatement of gain resulting from an overstatement of basis—was adequately disclosed within the meaning of section 6501(e)(1)(A)(ii), which entitled Grapevine to the benefit of a safe harbor contained in that provision. *See* Pet. App. 6a-7a.

In contrast, the government argued that an overstatement of basis could constitute an omission from

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[3] *See Grapevine Imports, Ltd.* v. *United States*, 71 Fed. Cl. 324 (2006).

gross income, thereby triggering the extended, six-year limitations period set forth in section 6501(e)(1)(A), and that the transaction was not adequately disclosed within the meaning of the safe-harbor provision. *Id.* For purposes of the summary judgment motions only, Grapevine stipulated that the basis used to calculate losses with respect to the short-sale transaction was overstated. Pet. App. 37a.

The Court of Federal Claims granted Grapevine's motion and denied the government's cross-motion for summary judgment, holding that the assessment for the 1999 tax year was untimely. Pet. App. 34a-53a. Relying on this Court's decision in *Colony*, which construed the same statutory phrase at issue here, the Court of Federal Claims held that "an overstatement of basis that results in an understatement of income does not trigger the extended statute of limitations in section 6501(e)(1)(A)." Pet. App. 49a. In light of this holding, the court found it unnecessary to determine whether the disclosure in Grapevine's return triggered the safe-harbor provision contained in section 6501(e)(1)(A)(ii). Pet. App. 50a n.10.

On April 23, 2008, after the parties settled several remaining issues associated with the challenge to the FPAA for the 2000 tax year, the Court of Federal Claims entered a final judgment disposing of the case. *See* Pet. App. 10a.

3. On June 23, 2008, the government filed a timely notice of appeal to the United States Court of Appeals for the Federal Circuit. *Id.*

a. Shortly after the government's appeal was docketed, Grapevine moved to consolidate this case with a related appeal, *Salman Ranch, Ltd.* v. *United States*, No. 2008-5053 (Fed. Cir.). *See* Pet. App. 11a. Grapevine did so because the two cases presented the same dispositive issue—namely, whether an overstatement of the basis of sold property can constitute an omission from gross income within the meaning of sections 6501(e)(1)(A) and 6229(c)(2).

The government opposed Grapevine's motion. Pet. App. 11a. According to the government, because the Federal Circuit's "resolution of *Salman Ranch* may completely dispose of the issues in this case," there was no need for "additional briefing" in the instant action, "not to mention the time and expense of putting together an appendix and preparing a reply brief." Instead, the government argued that the court should "hold this appeal in abeyance until issuance of its decision in *Salman Ranch*." The parties might then be entitled to the benefit of that decision. *See* Pet. App. 11a.

After considering these motions, the court of appeals stayed the briefing in this case pending its decision in *Salman Ranch*. *Id.*

b. Thereafter, a panel of the court of appeals decided *Salman Ranch, Ltd.* v. *United States ("Salman Ranch I")*, 573 F.3d 1362 (Fed. Cir. 2009), in favor of the taxpayer. *See* Pet. 11a. Relying on *Colony*, the court held that an overstatement of basis does "not constitute an omission from gross income," and as a result, the Commissioner must proceed under the standard three-year limitations period rather than the six-year period provided under sections 6501(e)(1)(A) and 6229(c)(2). *Salman Ranch I*, 573 F.3d at 1377. Because the FPAA at issue in *Salman*

Ranch I—like the FPAA here—was issued more than three but less than six years after the challenged return was filed, the court of appeals instructed the Court of Federal Claims to enter a judgment in favor of the taxpayer on this point. *Id.*

c. Following the panel's decision against the government in *Salman Ranch I*, the IRS promulgated temporary Treasury regulations. Pet. App. 11a; *see also* Definition of Omission from Gross Income, 74 Fed. Reg. 49,321, 49,323 (Sept. 28, 2009) (codified at 26 C.F.R. §§ 301.6229(c)(2)-1T, 301.6501(e)-1T). The Temporary Regulations, issued without notice and comment, merely restated the government's litigating position—rejected by this Court in *Colony*, the court of appeals in *Salman Ranch I*, the Court of Federal Claims in the instant action, and a host of other courts—that an overstatement of basis constitutes an omission from gross income. 74 Fed. Reg. at 49,321-22. In fact, the IRS went so far as to expressly state its disagreement with those decisions. *See id.*

d. Within days of the Temporary Regulations' promulgation, the government filed a petition for panel rehearing in *Salman Ranch I*. It argued that the panel should reverse its prior opinion on the basis of the Temporary Regulations. The panel denied the petition without opinion. *See* 573 F.3d at 1362.

e. Following the issuance of the mandate in *Salman Ranch I*, the parties in this case filed competing status reports regarding the effect, if any, that *Salman Ranch I* had on this appeal. Grapevine argued that additional briefing was both unnecessary and unfair in light of the government's prior representation—that there was no need for additional briefing because *Salman Ranch I* may completely dispose of the issues in this case—and because the government had failed to notify the court of the IRS's rulemaking efforts at the time the government had requested the stay of proceedings. Accordingly, Grapevine argued that the court of appeals should summarily affirm the lower court's judgment in this case on the basis of *Salman Ranch I*. For its part, the government did not dispute that, under *Salman Ranch I*, its assessment of Grapevine's 1999 tax return was untimely. But the government argued that additional briefing was necessary because, under the Temporary Regulation's interpretation of sections 6501(e)(1)(A) and 6229(c)(2), the IRS's assessment was timely. *See* Pet. App. 11a.

The court of appeals lifted the stay and ordered the government to file its opening brief in this case.

f. On December 17, 2010, after briefing, but before oral argument, the IRS promulgated final Treasury regulations, which are substantially similar to the temporary ones. *See* Pet. App. 11a-12a; *see also* Definition of Omission from Gross Income, 75. Fed. Reg. 78,897, 78,898-900 (Dec. 17, 2010) (codified at 26 C.F.R. §§ 301.6229(c)(2)-1, 301.6501(e)-1). The government then filed a letter with the court, pursuant to Federal Rule of Appellate Procedure 28(j), arguing that the judgment of the Court of Federal Claims should be reversed on the basis of the Final Regulations.

4. The court of appeals agreed with the government. Even after recognizing the split among its sister circuits, *see* Pet. App. 19a n.5, the court applied

the newly-minted Final Regulations to reverse the final judgment that the Court of Federal Claims had entered against the government in this case, Pet. App. 32a-33a.

The court of appeals first acknowledged that, unless the regulations constitute intervening authority, it was bound by *Salman Ranch I*. Pet. App. 13a. The court then considered whether the regulations were binding under *Mayo Foundation for Education & Research* v. *United States*, 131 S. Ct. 704, 713-14 (2011), which extended to qualifying Treasury regulations the deference afforded under *Chevron, U.S.A., Inc.* v. *National Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Pet. App. 14a-22a.

Beginning at *Chevron*'s first step, the court stated that its task was to "determine whether Congress's intent in enacting [section 6501(e)(1)(A)] was so clear as to foreclose any other interpretation." Pet. App. 18a. In this way, the court purported to distinguish *Colony* and *Salman Ranch I* simply because, in those cases, the courts faced a different task—"to find the best (in each court's view) interpretation of the statute in light of the evidence." *Id.* Looking first at the statutory text, the court of appeals stated that *Colony* had declared the text of "the predecessor statute ambiguous." *Id.* At the same time, the court recognized that it could not stop its analysis there. Because *Chevron* requires a court to employ traditional tools of statutory construction, *see* Pet. App. 14a, the court of appeals went on to consider whether there were any other indicia of congressional intent "so clear that [they left] no room for [the] agency to add anything," Pet. App. 20a.

The court held that because the legislative history did not "explicitly discuss[] application of the limitations period to cases involving overstatement of basis," the IRS could issue regulations treating basis overstatement as an omission. Pet. App. 21a. In the process, however, the court of appeals did not acknowledge *Colony*'s ultimate conclusion—that "Congress manifested no broader purpose" than to extend the limitations period in situations where a taxpayer failed to "report particular income receipts and accruals." 357 U.S. at 35-36. As a result, at least according to the court of appeals, to implicate *Chevron*'s first step, Congress had to rule out "explicitly" the exact interpretation advanced by the agency, even if that interpretation was plainly beyond the scope of what Congress had intended. *See* Pet. App. 21a (refusing to follow *Colony* because none of the excerpts of legislative history cited by the Supreme Court "*explicitly discussed* application of the limitations period to cases involving overstatement of basis" (emphasis added)).

At *Chevron*'s second step, the court of appeals held that the regulations constituted "a reasonable policy choice for the agency to make." Pet. App. 22a. Though the court acknowledged that *Salman Ranch I* had found the IRS's justifications "non-persuasive," the court was "unable to say that [these justifications], or the policy they support, are ipso facto unreasonable." Pet. App. 23a.

Finally, the court dismissed out of hand Grapevine's argument that an agency abuses its discretion when, as a party to litigation, it seeks to apply new regulations in an attempt to have an adverse trial-court judgment reversed on appeal. Pet. App. 30a-31a. Instead, relying on *dicta* from *United States* v. *Morton*, 467 U.S. 822, 836 n.21 (1984), and unrelated statements from *Smiley* v. *Citibank (South Dakota), N.A.*, 517 U.S. 735, 741 (1996), the court of appeals held that agencies may use their regulatory authority to manipulate the judicial process "even if they are parties to the litigation in which new regulations are asserted as authority." Pet. App. 30a-31a.

REASONS FOR GRANTING THE PETITION

I. THE FEDERAL CIRCUIT'S DECISION IS CONTRARY TO THIS COURT'S DECISION IN *COLONY* AND FURTHER DEEPENED AN ACKNOWLEDGED CIRCUIT SPLIT.

The decision below conflicts dramatically with the decisions of other courts of appeals—so much so that the Federal Circuit expressly acknowledged the "varying results" reached by its sister circuits. Pet. App. 19a n.5. And the government has likewise acknowledged—in a response to a related petition—that there is a "square circuit conflict" over "the question whether an overstatement of basis in property can trigger an 'omi[ssion] from gross income' under Section 6501(e)(1)(A)." Brief of Respondent at 8, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011).

Beyond adding to this clear circuit split, however, the decision below also stands in direct conflict with this Court's decision in *Colony*. Although decided 26 years before *Chevron*, *Colony* could not have been more clear: Congress manifested a clear intent that an overstatement of basis does not constitute an omission from gross income.

In *Colony*, this Court considered whether an overstatement of the basis of sold property constituted an omission under the same statutory phrase at issue here—"omits from gross income an amount properly includible therein," 26 U.S.C. § 275(c) (1938 ed., Supp. I); *accord* 26 U.S.C. §§ 6229(c)(2), 6501(e)(1)(A) (2000). The taxpayer had argued that "the statute is limited to situations in which specific receipts or accruals of income items are left out of the computation of gross income." *Colony*, 357 U.S. at 33. Based on the statute's use of the word "omits," which means "'to leave out or unmentioned; not to insert, include, or name,'" the Court concluded that the text "on its face lends itself more plausibly to taxpayer's interpretation"—though it could "[]not be said that the language is unambiguous." *Id.* at 32-33.

Because the text favored the taxpayer, the Court could have ended its inquiry there, but it went on to examine the legislative history and purpose of the statute. Starting with the legislative history, the Court found "persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes." *Id.* at 33. Indeed, *Colony* found repeated instances in which Congress had stated that it "merely had in mind failures to report particular income receipts and accruals, and did not intend the [extended] limitation to apply whenever gross income was understated." *Id.* at 33-35. Conversely, the Court was "unable to find any solid support for the Government's theory in the legislative history." *Id.* at 36.

Critically, the Court rejected the government's argument that the statute's purpose was to provide "for a longer period of limitations where returns contained relatively large errors adversely affecting the Treasury." *Id.* at 36. The Court rejected this "broad construction" because, "if the mere size of the error had been the principal concern of Congress, one might have expected to find the statute cast in terms of errors in the total tax due or in total taxable net income." *Id.* Moreover, the Court explained that such an interpretation would create a "patent incongruity in the tax law," citing a Third Circuit opinion explaining one such incongruity associated with the IRS's interpretation. *Id.* at 28 (citing *Uptegrove Lumber Co.* v. *Comm'r*, 204 F.2d 570, 573 (3d Cir. 1953)). In that Third Circuit opinion, the court of appeals explained that "there are many places throughout an income tax return where a taxpayer may make arithmetical errors or claim improper deductions with the result that his tax liability is understated." *Uptegrove Lumber*, 204 F.3d at 573. Under the Commissioner's construction, however, only errors in the gross-income section of a return would be subject to the extended limitations period. *Id.*

At bottom, *Colony* held that "Congress manifested no broader purpose than to give the Commissioner [additional time] to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting the errors." *Id.* at 36. "In such instances," the Court continued, "the return on its face provides no clue to the existence of the missing item." *Id.* "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." *Id.*

By ignoring these clear indicia of congressional intent, the decision below stands in obvious conflict with this Court's decision in *Colony*. *Colony* did not merely choose as "more persuasive" the taxpayer's interpretation of the statute, but, instead, rejected the government's claim that the statute encompassed anything beyond the "specific situation" where an income receipt or accrual was left out of the computation of gross income. *See* 357 U.S. at 33. Moreover, *Colony* emphasized that adopting the government's expansive interpretation would mean reading the statutory language "more broadly than is justified by the evident reason for its enactment . . . [and would] create a patent incongruity in the tax law." *Id.* at 36-37. Thus, without invoking the words of *Chevron*, *Colony* unquestionably held that Congress did not intend for the statute to encompass anything more than a failure to report income receipts and accruals, and rejected the government's contrary interpretation of the statute.

Even ignoring the obvious conflict between the decision below and *Colony*, the Federal Circuit unquestionably—and admittedly—added to an entrenched split among the circuits.

A. Circuits Following *Colony*.

The Fourth, Fifth, and Ninth Circuits have all followed *Colony*. The Fourth and Fifth Circuits have followed *Colony* in ruling against the IRS, even after the issuance of the Temporary and Final Regulations. *See Home Concrete*, 634 F.3d at 250; *Burks* v.

United States, 633 F.3d 347, 360 (5th Cir. 2011). The Ninth Circuit, in contrast, considered and rejected the IRS's interpretation on the strength of *Colony*, but did so prior to the promulgation of either set of regulations and, thus, had no occasion to determine their validity. *See Bakersfield Energy Partners, LP* v. *Comm'r*, 568 F.3d 767, 778 (9th Cir. 2009).

In *Home Concrete & Supply, LLC* v. *United States*, the Fourth Circuit forcefully rejected the very same arguments that the government has advanced in this case. 634 F.3d at 253-58. Relying on the Federal Circuit's prior decision in *Salman Ranch I* and the Ninth Circuit's decision in *Bakersfield Energy Partners*, the Fourth Circuit held that, because *Colony* construed the same statutory language, there was no basis to ignore *Colony*'s interpretation of the text, history, and purpose of that language. *Home Concrete*, 634 F.3d at 255.

In addition, the Fourth Circuit held that the IRS's regulations were "foreclose[d]" by *Colony*. *Id.* Building on its prior analysis—that *Colony* resolved the meaning of the same statutory language—the Fourth Circuit concluded that the regulations were contrary to *Colony*'s finding of Congress's unambiguous intent. *See id.* at 255-57.

Judge Wilkinson joined in the court's "fine opinion" but wrote separately to emphasize that, while it is "sometimes difficult to determine" where a pre-*Chevron* decision sits on the continuum, he was persuaded that "*Colony* was decided under *Chevron* step one." *Id.* at 258 (Wilkinson, J., concurring). In the process, he acknowledged that "some language in *Colony*" suggests that the Court found Congress's intent ambiguous. *Id.* 259. In his opinion, however, "[o]ne need not consult a dictionary . . . to understand that the plain meaning of 'omit' is 'to leave out' or 'fail to mention.'" *Id.* In Judge Wilkinson's view, the taxpayers in the case before him "did not omit, leave out, or fail to mention their transaction." *Id.* "Instead, they provided the details on their returns." *Id.* And while the IRS asserted that the returns overstated the taxpayers' basis and thus understated their overall liability, Judge Wilkinson was not persuaded: "[A]s the Court noted in *Colony*, if Congress had been concerned with that problem, 'it could have chosen another verb such as "reduces" or "understates," either of which would have pointed significantly in the Commissioner's direction.'" *Id.* (quoting *Colony*, 357 U.S. at 32).

In reaching this conclusion, Judge Wilkinson acknowledged that *Chevron* and *Brand X* "afford agencies considerable discretion in their areas of expertise." *Id.* That said, "[agencies] operate in a system in which the last words in law belong to Congress and the Supreme Court." *Id.* "What the IRS seeks to do," Judge Wilkinson concluded, "goes against what I believe are the plain instructions of Congress, which have not changed, and the plain words of the Court, which have not been retracted." *Id.* (citing *Colony*, 357 U.S. at 37).

The Fifth Circuit reached the same conclusion in *Burks* v. *United States*, rebuffing each and every one of the government's arguments along the way. 633 F.3d at 350-61. Beginning with the government's argument that *Colony* was somehow not binding, the court of appeals held that subsequent amendments to the Internal Revenue Code—specifically, the addition of subsections (i) and (ii) to section 6501(e)(1)(A)—did not obviate "*Colony*'s holding with respect to the definition of 'omits from gross income.'" *Id.* at 354. Thus, "an overstatement of basis that adequately apprises 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)." *Id.* at 354-55.

The Fifth Circuit also rejected the government's argument that the application of *Colony* would render "superfluous" the addition of subsections (i) and (ii) to section 6501(e)(1)(A). *Id.* at 355. Relying in large part on the Federal Circuit's decision in *Salman Ranch I* and the Ninth Circuit's decision in *Bakersfield Energy Partners*, the Fifth Circuit explained that, not only did the addition of subsections (i) and (ii) not alter the operative language that *Colony* had interpreted, but also that the legislative history of these amendments explained how they were fully consistent with *Colony*'s interpretation of the phrase "omits from gross income." *Burks*, 633 F.3d at 356-57 (explaining that subsection (i) was added to resolve a conflict "about how to calculate gross income in the case of a trade or business," and was not intended to define what constitutes an omission); *see also Salman Ranch I*, 573 F.3d at 1375-76 (the phrase "omits from gross income" defines what qualifies as an omission, whereas the new provisions come into play only if there has been an omission).

In the end, the Fifth Circuit, like the Fourth, held that the regulations were "an unreasonable interpretation of settled law." *Burks*, 633 F.3d at 360.

As a result, they were "not applicable" and the taxpayers were entitled to judgment as a matter of law. *Id.*

Finally, in *Bakersfield Energy Partners, LP* v. *Commissioner*, the Ninth Circuit reached a similar conclusion—albeit prior to the IRS's promulgation of the Temporary and Final Regulations. *See* 568 F.3d at 568. The court concluded that it was "bound" by this Court's decision in *Colony*, rejecting the IRS's interpretation as "directly contrary to *Colony*'s construction of the same language in the predecessor statute, § 275(c)." *Id.* at 775. That said, the Ninth Circuit acknowledged that the "IRS *may* have the authority to promulgate a reasonable reinterpretation" of § 6501(e)(1)(A), but only if the court found that Congress's intent in enacting that provision was "ambiguous"—a question that the *Bakersfield* court declined to reach. *Id.* at 778 (emphasis added).

B. Circuits Declining to Follow *Colony*.

In addition to the Federal Circuit in this case, three other circuits—the Seventh, Tenth, and District of Columbia Circuits—have declined to follow *Colony*. And yet, even though these courts are in agreement as to the result—a victory for the government through application of the extended, six-year statute of limitations—they are divided over the proper approach for reaching that outcome.

In *Beard* v. *Commissioner*, the most notable outlier, the Seventh Circuit forged a novel path. Unlike its sister circuits, which up until that point had concluded that *Colony* was binding, the Seventh Circuit held that the addition of subsections (i) and (ii) to section 6501(e)(1)(A) "cast in a different light" the language that this Court had interpreted in *Colony*. 633 F.3d 616, 622 (7th Cir. 2011), *petition for cert. filed*, 80 U.S.L.W. 3004 (U.S. June 23, 2011) (No. 10-1553). In fact, the new amendments were so transformative and, in the Seventh Circuit's view, so clearly favored the IRS's construction, that the Commissioner did not even need to rely on the regulations in order to prevail in that case. *See id.* at 623. Thus, the Seventh Circuit held that the new amendments flipped the language that *Colony* had interpreted on its head.

At the same time, the Seventh Circuit ignored the fact that section 6229(c)(2) was meant to provide the same limitations period for partnership returns that section 6501(e)(1)(A) provides for general returns, *see* 26 U.S.C. § 6229 (2000), and yet, Congress did not make similar amendments to section 6229(c)(2). As a result, the Seventh Circuit's holding creates an incongruity under the Tax Code, because the amendments would only trigger the extended statute of limitations under section 6501(e)(1)(A), whereas the absence of those amendments in section 6229(c)(2) would mean that *Colony* would continue to apply to partnership returns. Nevertheless, the Seventh Circuit held that, under section 6501(e)(1)(A), a taxpayer who overstates his basis in sold property "omits from gross income an amount properly includible therein." *Beard*, 633 F.3d at 623.

Because the Seventh Circuit found "that *Colony* is not controlling," and because it held that the case could be resolved in favor of the Commissioner at *Chevron*'s first step, the court had no occasion to consider the validity of the regulations. *See id.* Therefore, its one-sentence treatment of those regulations is mere *dictum*. *Id.* Nevertheless, the court stated that, if it had occasion to reach this issue, it "would have been inclined to grant" the regulations *Chevron* deference. *Id.*

The Tenth Circuit weighed in on the validity of the regulations in *Salman Ranch, Ltd.* v. *Commissioner ("Salman Ranch II")*, upholding them from a challenge by Salman Ranch, Ltd.—the same entity that had prevailed before the Federal Circuit in *Salman Ranch I* with respect to a different tax year. *See* --- F.3d ---, ---, 2011 WL 2120044, at *3-4 (10th Cir. 2011). However, the Tenth Circuit stated that it was not "persuaded by the Seventh Circuit's determination in *Beard* v. *Commissioner* that Congress resolved all doubts about the meaning of 'omits from gross income'" in favor of the Commissioner. *Id.* at ---, 2011 WL 2120044, at *7 (citation omitted). Instead, the Tenth Circuit was persuaded by the Federal Circuit's analysis in the decision below; it held that the IRS's regulations were not foreclosed by *Colony*, and those regulations were entitled to deference under *Chevron*. *Id.*

Like the decision below, and also like the decision in *Beard*, the Tenth Circuit ignored the fact that the amendments—embodied in subsections (i) and (ii) of section 6501(e)(1)(A)—were not contained in that section's parallel provision, section 6229(c)(2). Thus, these courts failed to consider the incongruity that their decisions created.

Finally, in *Intermountain Insurance Services of Vail, LLC* v. *Commissioner*; the District of Columbia

Circuit also held that the regulations are entitled to *Chevron* deference. *See* --- F.3d ---, ---, 2011 WL 2451011, at *16 (D.C. Cir. 2011). The D.C. Circuit's analysis was similar to that of the court below; it held that the amendments to section 6501(e)(1)(A)—amendments that did not alter the operative language interpreted by this Court in *Colony*—nevertheless freed the IRS to promulgate a contrary interpretation. *Id.* at ---, 2011 WL 2451011, at *12. Unlike the circuits whose decisions it joined, the D.C. Circuit at least recognized the potential incongruity raised by attaching significance to amendments not repeated in section 6229(c)(2). *See id.* at ---, 2011 WL2451011, at *11. In the end, however, the court concluded that Congress intended for section 6229(c)(2) to have the same meaning as section 6501(e)(1)(A), even though the former section lacked the amendments added to the latter. *See id.*

II. THE FEDERAL CIRCUIT'S DECISION CROSSES A LINE THAT THIS COURT DREW IN *BRAND X* AND CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS.

In addition to holding that the regulations were not foreclosed by *Colony*, the decision below held that executive agencies may use their regulatory authority to alter a judgment "even if they are parties to the litigation in which new regulations are asserted as authority." Pet. App. 31a. It did so by deferring to regulations that had the effect of reversing an adverse judgment that a trial court had already entered against the government.

In reaching this troubling conclusion, the Federal Circuit crossed a line that this Court drew in *Brand X*, and it split from decisions of its sister circuits. The court below reached such a result by relying on *dicta* and other statements from this Court—*dicta* and statements that have confused the lower federal courts. As a result, this Court's review is likewise necessary to resolve this equally important issue.

A. *Brand X* Recognized that a Judicial Decision May Not be Reversed by Executive Officers.

In *Brand X*, this Court made clear that an agency may not invoke its rulemaking authority to manipulate the judicial process. Responding to Justice Scalia's criticism that the Court's holding effectively allowed the executive department to "revise[], overturn[], or refuse[]" to give full faith and credit to judgments of the judicial department, 545 U.S. at 1017 (Scalia, J., dissenting), the Court was adamant that its holding did not amount to such a troubling result. In particular, the Court emphasized that by requiring courts to give deference to an agency's *subsequent* "decision to construe a[n ambiguous] statute differently from a court," the Court was not announcing a rule that subjected *prior* judicial decisions to reversal by executive officers. *Id.* at 983.

The decision below has proved Justice Scalia prophetic. He warned that the lower courts might construe *Brand X* to reach a disturbing result: "Even when the agency itself is party to the case in which the Court construes a statute, the agency will be able to disregard that construction and seek *Chevron* deference for its contrary construction the next time around." *Id.* at 1017 (Scalia, J., dissenting). The result here is even more troubling: The agency did not wait until "the next time around." Rather, it invoked its regulatory authority to set aside the Court of Federal Claims' construction and sought *Chevron* deference from the court of appeals for a contrary construction, which the IRS promulgated *after* the trial court had entered a judgment against it *in this very case*. *See* Pet. App. 30a-31a.

By allowing the IRS to manipulate the outcome of this case, the decision below undermines the public's confidence in the courts and raises serious separation-of-powers concerns. If the IRS wanted the benefit of its rulemaking authority in this case, it could have sought a stay of these proceedings in the Court of Federal Claims while it exercised that authority. Instead, it submitted to a judgment unaided by whatever regulatory authority it purports to possess. Having elected to proceed in this fashion, the IRS should not be allowed to regulate its way out of that judgment. Indeed, a contrary rule would render the more than three years that the parties spent litigating before the Court of Federal Claims a complete waste of time and money. What private party would undertake such an expensive and time-consuming endeavor if the executive possesses the power to overrule, by regulatory fiat, any adverse judgment entered against it?

The decision below also renders impotent the authority that Congress vested in the Court of Federal Claims to serve as a "truly independent" tribunal with the power to "enter dispositive orders" and "final judgment[s]" against the United States. S. Rep.

No. 97-275, at 8, 22 (1981), *reprinted in* 1982 U.S.C.C.A.N. 11, 18, 32; *see also* 28 U.S.C. § 1491 (vesting the Court of Federal Claims with "jurisdiction to render judgment upon any claim against the United States"). Indeed, it is virtually impossible to imagine how the Court of Federal Claims—or the federal district courts, for that matter (*see, e.g.*, *Home Concrete*, 634 F.3d at 252-53 (appeal from district court judgment))—could exercise such authority if the executive is permitted to promulgate rules as a means of reversing that court's judgments. *Cf. Glidden Co.* v. *Zdanok*, 370 U.S. 530, 554-55 (1962) (explaining that final judgments that were issued by the predecessor of the Court of Federal Claims, the Court of Claims, were not subject to "executive revision").

B. A Number of Courts of Appeals Have Recognized that an Agency May Not Use Its Rulemaking Authority to Secure the Reversal of a Judgment Previously Entered Against that Agency.

In a series of decisions that pre-date the present dispute, several federal appellate courts have made clear that an agency "may not take advantage of [its] power to promulgate retroactive regulations during the course of a litigation for the purpose of providing [itself] 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); *accord Caterpillar Tractor Co.* v. *United States*, 589 F.2d 1040, 1043 (Ct. Cl. 1978); *see also Tallahassee Mem'l Reg'l Med. Ctr.* v. *Bowen*, 815 F.2d 1435, 1452, 1456 (11th Cir. 1987) (holding that the issuance of regulations in an attempt to moot an adverse trial-court judgment in a case where the agency is a party is an "abuse of the interaction between administrative agencies and the courts" and an "abuse [of] the litigation process"), *cert. denied*, 485 U.S. 1020 (1988).

More recently, the Fifth Circuit explained that, even if "*Colony* was inapplicable," it is not clear that deference is owed in a "situation where, during the pendency of suit, the [IRS] promulgated determinative retroactive regulations" displacing "prior adverse judicial decisions on the identical legal issue." *Burks*, 633 F.3d at 360 n.9 (citing *Chock Full 'O Nuts*). Similarly, in his separate opinion concurring in full with the Fourth Circuit's judgment, Judge Wilkinson explained that "agencies are not a law unto themselves," and warned that the IRS's present position threatens to "disrupt[]" the "balance" of power between courts and agencies. *Home Concrete*, 634 F.3d at 260 (Wilkinson, J., concurring).

C. This Court's Holdings in *Morton*, *Smiley*, and *Mayo Foundation* Do Not Allow an Agency to Regulate Its Way Out of a Judgment that a Court Has Entered Against that Agency.

The court below and the D.C. Circuit both held that *United States* v. *Morton*, 467 U.S. 822, 835 n.21 (1984), "for all practical purposes, superseded" decisions such as *Chock Full O' Nuts*. *Intermountain*, --- F.3d at ---, 2011 WL 2451011, at *12; *accord* Pet. App. 31a (relying on *Morton* for the proposition that "[a]gencies retain [their] authority [to issue binding regulations] even if they are parties to the litigation in which [the] new regulations are asserted as authority"). Their reliance on *Morton* is mistaken.

In *Morton*, this Court did not hold that an agency may reverse an adverse judgment by regulation. Instead, the opinion in *Morton* makes clear that this Court was compelled to reverse the lower courts' decisions—and rule in the government's favor—based on the "plain language of the statute." 467 U.S. at 826-29. After reaching that conclusion, the Court went on to observe that regulations, issued after the lower courts' decisions became final, provided *further support* for the Court's interpretation of "the plain language of the statute." *Id.* at 836. To be sure, the Court also noted, in *dicta*, that it found inconsequential the fact that the regulations at issue were not promulgated "until after [the] suit was brought." *Id.* at 835 n.21. But *Morton*'s *holding* falls well short of establishing that an agency may use new regulations to compel an appellate court to reverse an adverse judgment that a trial court had entered against that agency.[4]

In response to the petition in *Beard*, the IRS has attempted to defend its authority to manipulate the judicial process by quoting out of context certain statements that this Court made in *Smiley* and *Mayo*

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[4] As this Court recognized in *Chevron*, once a court determines that Congress's intent is unambiguous, there is no room for an agency to promulgate a contrary interpretation. 467 U.S. at 842-43. Thus, there was no need for *Morton* to consider the agency's interpretation embodied in the regulations. *See* 467 U.S. at 826-29. Moreover, *Morton* should not be read to conflict with this Court's decision 21 years later in *Brand X*, in which this Court recognized that a prior judicial decision may not be "'reversed' by [an] agency." *Brand X*, 545 U.S. at 983.

Foundation. *See* Brief of Respondent at 16-17, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011) (quoting from *Smiley* v. *Citibank (South Dakota), N.A.*, 517 U.S. 735, 741 (1996), and *Mayo Foundation*, 131 S. Ct. at 712). But neither of those cases held that an agency may use its rulemaking authority to have reversed on appeal a judgment previously entered against that agency.

In *Smiley*, the government was not even a party to the case, and as a result, this Court had no occasion to address the issue presented here. 517 U.S. at 737-38. Thus, at most, *Smiley* stands for a completely unrelated and far more limited proposition—that, in a case where an agency is *not* a party to litigation, a court must defer to a regulation even though it may have been prompted by a problem that was identified by that very litigation. *Id.* at 741. In such a situation, however, the agency is not using its rulemaking authority to snatch for itself victory from the jaws of judicial defeat; it is addressing a problem identified by private parties that Congress intended for the agency to resolve. *See id.* at 740-41.

Similarly, *Mayo Foundation* did not address the issue presented in this petition. As the Court in *Mayo Foundation* explained, the lawsuit underlying the Mayo Foundation's appeal was filed "[a]fter" the IRS promulgated the regulations at issue in that case. 131 S. Ct. at 710. As a result, *Mayo Foundation* could not have held that, if an agency is "'troubled by the consequences of [a court's] resolution of [a] case,'" 131 S.Ct. at 713 (quoting *United Dominion Indus., Inc.* v. *United States*, 532 U.S. 822, 838 (2001)), it may promulgate regulations overruling a judgment entered against the government in that very case. Instead, the decision that *Mayo Foundation* quoted, *United Dominion*, merely acknowledged that, if an agency is not satisfied with a court's interpretation of a regulation, the agency may amend the regulation and seek to apply its contrary interpretation in *subsequent* litigation. *United Dominion*, 532 U.S. at 838. Thus, contrary to the government's suggestion in a related response, *see* Brief of Respondent at 16, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011), nothing in *Mayo Foundation* provides that an agency may invoke its rulemaking authority to overturn an adverse judgment in the very case that it lost.

Nevertheless, the court below and the D.C. Circuit relied on these unrelated statements from *Smiley* and *Mayo Foundation* in an effort to bolster their troubling conclusions. *See* Pet. App. 30a-31a; *Intermountain*, --- F.3d at ---, 2011 WL 2451011, at *12. Conversely, this Court has held that "[d]eference to what appears to be nothing more than an agency's convenient litigation position" is "entirely inappropriate." *Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204, 213 (1988). Without question, *Morton*, *Smiley*, and *Mayo Foundation* have engendered confusion causing misapplication of the statements recounted above. Moreover, there is a tension between the misapplication of these statements and both this Court's holding in *Georgetown University Hospital* and its recognition in *Brand X* that a prior judicial determination may not be "'reversed' by [an] agency," 545 U.S. at 983. As a result, this Court's review is likewise necessary to clarify whether an agency may use its regulatory authority on appeal to overturn a judgment that had been entered against it by the trial court.

III. THE ISSUES IN CONFLICT ARE IMPORTANT, RECURRING, AND BEST-PRESENTED BY THIS CASE.

The tax consequences of this case are of paramount importance. Indeed, in its response to the petition filed with this Court in *Beard*, the government recognized that there is "a significant governmental and public interest in the uniform administration of federal tax law." Brief of Respondent at 20, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011). Besides that, the resolution of this case also will have "a significant impact on the United States Treasury," either by broadening or restricting the application of a provision allowing the IRS additional time to adjust taxes in situations where there is no suggestion of fraud. *See id.*

Above all, however, this petition presents two important and recurring questions that extend far beyond uniform administration of the Tax Code. Indeed, these questions implicate the very relationship between administrative agencies and the courts. *First*, as noted above, this petition presents the "sometimes difficult" question of whether a "pre-*Chevron* decision[]" was decided under *Chevron*'s first or second step. *Home Concrete*, 634 F.3d at 258 (Wilkinson, J., concurring). *Second*, this petition presents the equally important question whether an agency may use its rulemaking authority to manipulate the outcome of a case in which it is a party.

These two important questions are best presented in this case. Both were fairly raised below, and both were squarely addressed and decided by the Federal Circuit. *See* Pet. App. 14a-24a, 30a-31a.

By contrast, in *Beard* v. *Commissioner*—the other candidate for this Court's review (No. 10-1553)—the Seventh Circuit did not address the regulations' validity or the propriety of the IRS's actions. *See Beard*, 633 F.3d at 622-23. Instead, the Seventh Circuit's decision is an outlier; it is the only decision to hold that, even though the operative language of the statute has not changed, "*Colony* is not controlling" and, in fact, the statutory language so clearly favors the IRS's construction that the Commissioner does not even need to rely on the regulations in order to prevail. *Id.* Every other court to consider these issues has rejected the Seventh Circuit's analysis—even those courts that have, nonetheless, ruled in the government's favor. *See* Pet. App. 18a-19a & n.5 (expressly rejecting *Beard*'s analysis); *accord Intermountain*, --- F.3d at ---, ---, 2011 WL 2451011, at *7, *12; *Salman Ranch II*, --- F.3d at ---, 2011 WL 2120044, at *7; *Home Concrete*, 634 F.3d at 254-55; *Burks*, 633 F.3d at 353-54; *Bakersfield*, 568 F.3d at 768, 778. In addition, the Fifth Circuit expressly noted that the "Seventh Circuit in *Beard* incorrectly read" a prior decision of the Fifth Circuit, *Phinney* v. *Chambers*, 392 F.2d 680 (5th Cir. 1968), when *Beard* reached its erroneous conclusion that subsequent amendments to the Code effectively flipped the language that *Colony* interpreted on its head. *Burks*, 633 F.3d at 352 n.5 (criticizing *Beard*).

At bottom, there is no question that *Beard* was wrongly decided, but the Seventh Circuit reached that mistaken result by relying on statutory changes that no other federal appellate court has deemed dispositive of congressional intent. As a result, *Beard* is a less effective vehicle for resolving the issues presented at this level. This case, in contrast, is well within the mainstream of cases decided by the federal courts of appeals. As such, it is a more effective vehicle for this Court to address the issues in conflict.

Although the government acquiesced in the petition in *Beard*, and stated that its petition in *Home Concrete* should be held pending disposition of *Beard*, it did so without any discussion regarding whether *Beard* is the best vehicle for resolving the important issues presented by these cases. *See* Brief of Respondent at 19-21, *Beard* v. *Comm'r*, No. 10-1553 (U.S. July 27, 2011); *see also* Brief of Petitioner at 7, *United States* v. *Home Concrete & Supply, LLC*, No. 11-139 (U.S. Aug. 3, 2011). Instead, the government merely stated that it is "not aware of any reason why [*Home Concrete*] would present a more suitable opportunity than *Beard* for resolving the circuit conflict." Brief of Petitioner, *Home Concrete*, *supra*, at 7. But, as explained above, the issues in conflict are best presented in this case. As a result, the Court should grant this petition and hold the petitions in *Beard* and *Home Concrete* until the issues in conflict are resolved by the Court at the merits stage of this case. At the very least, the Court should grant the petitions in both this case and *Beard*—and hear them in tandem on the merits—because this case better presents the full panoply of issues for this Court's review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

GRAPEVINE IMPORTS, LTD., A TEXAS LIMITED PARTNERSHIP, T-TECH, INC., A TEXAS CORPORATION, AS TAX MATTERS PARTNER,
Plaintiffs-Appellees,

v.

UNITED STATES,
Defendant-Appellant.

2008-5090

Appeal from the United States Court of Federal Claims in 05-CV-296, Judge Francis M. Allegra.

Decided: March 11, 2011

HOWARD R. RUBIN, Katten Muchin Rosenman, of Washington, DC, argued for plaintiffs-appellees. With him on the brief was ROBERT T. SMITH. Of counsel on the brief were M. TODD WELTY and LAURA L. GAVIOLI, Sonnenschein, Nath & Rosenthal, of Dallas, Texas; and KENNETH J. PFAEHLER, of Washington, DC. Of counsel was William E. Copley, Sonnenschein, Nath & Rosenthal, of Washington, DC.

GILBERT S. ROTHENBERG, Acting Deputy Assistant Attorney General, Appellate Section, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellant. With him on the brief were JOHN A. DICICCO, Acting Assistant Attorney General, and MICHAEL J. HAUNGS and JOAN I. OPPENHEIMER, Attorneys.

ROGER J. JONES, Latham & Watkins LLP, of Chicago, Illinois, for amicus curiae Bausch & Lomb Incorporated. With him on the brief were ANDREW R. ROBERSON; and KIM M. BOYLAN, of Washington, DC.

Before LOURIE, BRYSON, and PROST, *Circuit Judges.*

PROST, *Circuit Judge.*

The government appeals the U.S. Court of Federal Claims' judgment that the Internal Revenue Service's ("IRS's") 2004 administrative adjustment of Plaintiffs' 1999 partnership return was time-barred. *Grapevine Imports, Ltd.* v. *United States*, 77 Fed. Cl. 505 (2007). The question is whether administrative adjustments in these circumstances are governed by the normal three-year statute of limitations, or whether they are controlled by a special six-year limitations period.

The Tax Code gives the IRS six years instead of three to adjust a return when the return "omits" some item that should have been included in "gross income." Here, the Plaintiffs are accused of overstating their basis in certain capital assets via a tax shelter, and thus understating income from those assets' sale. The government argues that basis overstatement is an "omission from gross income" sufficient to trigger the extended limitations period. Plaintiffs contend that it is not.

The Court of Federal Claims' judgment relied on the Supreme Court's opinion in *Colony, Inc.* v. *Commissioner of Internal Revenue*, 357 U.S. 28 (1958). In *Colony*, the Supreme Court reviewed the precursor limitations statute and held that overstatement of basis was not an "omission from gross income," and so did not trigger the extended limitations period. Following that precedent, the Court of Federal Claims granted judgment to Plaintiffs. In a separate case on similar facts, another panel of this court reached the same conclusion. *Salman Ranch Ltd.* v. *United States*, 573 F.3d 1362 (Fed. Cir. 2009).

In the months following, the U.S. Department of the Treasury issued new regulations disputing the reasoning applied by the Court of Federal Claims, stating that the *Colony* decision did not conclusively resolve the statute's interpretation, and holding that the limitations period—properly interpreted—gave the government six years to bring claims of this type.

Because we hold that the new Treasury regulations are entitled to deference in interpreting the statutory language, and because we hold that, under the regulations' interpretation, the government's case is not time-barred, we reverse the Court of Federal Claims' judgment.

I. BACKGROUND

A. Grapevine and the Tigues

This is a tax case. The story, for our purposes, begins in late 1999. Plaintiff Grapevine Imports, Ltd. ("Grape-vine") was a limited liability partnership with three partners. Taxpayers Joseph J. Tigue and Virginia B. Tigue, limited partners, each owned 49.5% partnership shares. Plaintiff T-Tech, Inc. ("T-Tech") owned the remaining 1% as a general partner, and was also the partnership's tax matters partner. T-Tech, in turn, was wholly owned by Mr. Tigue.

The Tigues purportedly arranged to sell Grapevine (which owned an auto dealership) for upwards of $10 million. The government contends that the Tigues' collective tax basis in Grapevine at that time was about $1 million, so the sale would have resulted in significant taxable capital gains for the Tigues. From that starting point, a series of transactions took place that changed the tax picture significantly.

On December 9, 1999, the Tigues each sold short $5 million in U.S. Treasury Notes.[1] In a short sale, the seller sells some security that he does not actually own, normally by working with a lender to borrow securities at a set fee or rate for some period of time. The seller sells the borrowed securities; time passes. Then, just before he is due to return the securities to the lender, the seller buys equivalent securities using funds received from the earlier sale.

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[1] That the Tigues ran these transactions through two wholly-owned limited liability corporations—one for Joseph Tigue and one for Virginia Tigue—is not relevant to this short summary.

He gives the equivalent securities to the lender, and the transaction is closed. *See Zlotnick* v. *TIE Commc'ns*, 836 F.2d 818, 820 (3rd Cir. 1988) (describing

In this case, the initial phase of the Tigues' short sales brought in $9,978,119. Before the sales were closed, the Tigues conveyed these proceeds and the obligation to close the short sales to Grapevine.

In order to close the sales, Grapevine purchased Treasury Notes on the open market having face value of $10,000,003. Grapevine then conveyed the notes to the lender, closing the short sale. Because Grapevine paid more for the Treasury Notes than it received from the Tigues, Grapevine recorded a $21,884 loss on the transaction.

Shortly thereafter, on December 31, 1999, the Tigues sold Grapevine for $11,017,147, and the proceeds were delivered to the Tigues and T-Tech according to their partnership interests.

Grapevine filed its 1999 partnership tax return on April 19, 2000, showing a net short-term loss of $21,884 (attributable to the short sale). On or about April 17, 2000, the Tigues filed a joint federal income tax return in which they reported a long term capital loss of $45,077 from their sale of Grapevine. The Tigues' return claimed a basis in Grapevine of $10,961,317.

The government contends that Grapevine and the Tigues' returns were improper. It contends that the Tigues' reported capital loss stemmed from an unlawful overstatement of the Tigues' basis in

Grapevine. By treating the conveyance of the short sale proceeds (the $9,978,119) as increasing basis, but failing to apply a corresponding basis reduction to account for Grapevine's new obligation to close the short sales, the Tigues managed to dramatically increase their basis in the partnership—and so reduce their capital gains—via economically meaningless transactions. In other words, the government accuses the Tigues, through Grapevine, of using a "Son of BOSS ['Basis and Options Sales Strategy']" tax shelter. *See Kornman & Assocs.* v. *United States*, 527 F.3d 443, 446 n.2 (5th Cir. 2008) (describing "Son of BOSS" tax shelters); I.R.S. Not. 2000-44, 2000-2 C.B. 255 (further describing such shelters, and identifying them as improper "listed transactions").

On December 17, 2004, the IRS issued a Final Partnership Administrative Adjustment ("FPAA") to T-Tech that administratively reduced the Tigues' basis in Grapevine by $10 million for 1999, thus requiring recomputation of the partners' tax liability.

B. Judgment of the Court of Federal Claims

Grapevine challenged the FPAA in the Court of Federal Claims as untimely.[2] It argued that the Internal Revenue Code's statute of limitations for such adjustments was three years, and the IRS's adjustment was two years too late. *See* I.R.C. § 6501(a) (2004) (setting forth a general rule that the IRS may not assess tax more than three years after the taxpayer's return); *id.* § 6229(a) (2004) (reflecting the

[2] For convenience, the remainder of this opinion uses the term "Grapevine" to mean both Grapevine and its tax matters partner T-Tech.

three-year rule for tax attributable to partnership items).[3] The government disagreed, contending that Grapevine's overstatement of basis—which led to understatement of gain, and so underpayment of tax—triggered an extended six-year statute of limitations. *See* I.R.C. §§ 6501(e)(1)(A), 6229(c)(2) (2004).

The Court of Federal Claims sided with Grapevine and ruled the government's attempt at adjustment time-barred. The court noted that the Supreme Court had analyzed the question of whether overstatement of basis would lead to an extended limitations period under the precursor statute. *See Colony, Inc.* v. *Comm'r of Internal Revenue*, 357 U.S. 28, 32–38 (1958).

Colony was a fairly straightforward statutory interpretation case. The taxpayer was a corporation in the business of land sales. *See Colony, Inc.* v. *Comm'r of Internal Revenue*, 26 T.C. 30, 31 (1956), *rev'd*, 357 U.S. 28 (1958). The corporation's 1946 and '47 tax returns over-stated basis in certain land sales, and

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[3] In 2010, during this appeal's pendency, Congress made certain amendments to the Tax Code's limitations statutes. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 513, 124 Stat. 71, 111 (2010). Congress stated that these amendments would affect returns for which the limitations period had not yet expired on the date of enactment, March 18, 2010, but noted that such limitations period was to be computed based on the pre-amendment statute. *Id.* § 513(d), 124 Stat. at 112. In this opinion, we therefore analyze the 2004 code to determine the limitations period for Grapevine's 1999 return. We make no holding as to the effect, if any, of the substantive amendments on Grapevine's case. We note, however, that neither Grapevine nor the government contends that these amendments should affect this appeal.

so understated the corporation's profits. The question was whether the IRS could assess deficiencies on those returns more than three but less than five years later (the extended limitations period was then five years). *Colony*, 357 U.S. at 30.

The limitations statute interpreted in *Colony* resembled the law at issue here:

> SEC. 275. 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.
>
> . . .
>
> (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 re-turn, 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.

Internal Revenue Code of 1939 § 275, 53 Stat. 1, 86–87 (1939).

In determining whether the phrase "omits from gross income" encompasses an overstated basis, the Supreme Court noted, "[I]t cannot be said that the language is unambiguous. In these circumstances we turn to the legislative history of § 275(c)." *Colony*, 357 U.S. at 33.

Turning to that history, Colony found in the legislative reports a number of statements indicating that "Congress merely had in mind failures to report particular income receipts and accruals, and did not intend the five-year limitation to apply whenever gross income was understated." *Id.* at 35. The Court concluded that the purpose of the extended limitations period was to give the government extra time to discover items that had been entirely omitted from returns—not to recover for items that, though included, were misstated. *Id.* at 36. On that basis, the Court held for the taxpayer and ruled that overstatement of basis was not an "omission from gross income."

Returning to this case's time before the Court of Federal Claims, Grapevine argued that *Colony* controlled, and the government's case was time-barred. The government tried to resist *Colony*'s application. It argued that *Colony* properly applied only to income from the sale of goods and services by a trade or business, and not other income.[4] The basis of this argument was that the modern Tax Code differs from the statute analyzed in *Colony*. Notably, the updated

[4] This argument had achieved some traction in certain judicial decisions. *See Grapevine*, 77 Fed. Cl. at 509–10 (recounting decisions questioning Colony's reach).

code sets forth a test similar to that in *Colony*—but explicitly limits that test to the "trade or business" context. I.R.C. § 6501(e)(1)(A)(i) (2004).

The government argued that *Colony* should be similarly limited to the "trade or business" context. It urged that this was Congress's intent, and pointed out that the taxpayer in *Colony* was in the business of land sales. The Court of Federal Claims disagreed, noting several reasons why *Colony* still controlled even outside the "trade or business" context. *See Grapevine*, 77 Fed. Cl. at 510–12. The court also noted that the Supreme Court had discussed—briefly—§ 6501(e)(1)(A) in the Colony opinion:

> And 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, we observe that the conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954.

Colony, 357 U.S. at 37. The 1954 revision to § 6501(e)(1)(A) brought the language to essentially its modern posture. Consistent with the Supreme Court's note, the Court of Federal Claims went on to determine that Congress's enactment of § 6501(e)(1)(A) did not operate to limit *Colony*'s holding.

Accordingly, on April 23, 2008, the court entered judgment dismissing the government's claims concerning the 1999 tax return as time-barred. The government timely appealed.

C. *Salman Ranch* and the New Regulations

Before briefing began, Grapevine moved to consolidate this appeal with another Son of BOSS case then pending before another panel, *Salman Ranch Ltd.* v. *United States*, 573 F.3d 1362 (Fed. Cir. 2009). The government opposed consolidation, but asked for this case to be held in abeyance until the *Salman Ranch* case was decided on the possibility that *Salman* Ranch would conclusively resolve the time bar question. We agreed with the government and stayed briefing in this case.

The *Salman Ranch* opinion ably sets forth that case's progress before the court. Briefly put, the government again argued that the *Colony* decision should be limited to the context of income from the sale of goods or services by a trade or business. Id. at 1371. The *Salman Ranch* panel disagreed. It concluded that the *Colony* decision did not turn on the taxpayer's trade or business, and that enactment of § 6501(e)(1)(A) did not mandate any different result. *Id.* at 1373–77. Thus, the panel held for the taxpayer and ruled the government's claims time-barred.

Shortly after *Salman Ranch* issued, the Treasury Department issued temporary regulations implementing the Department's own interpretation of the statute of limitations and the statute's interaction with *Colony*. Treas. Regs. §§ 301.6229(c)(2)-1T, .6501(e)-1T, 74 Fed. Reg. 49,321 (Sept. 28, 2009). The Department subsequently issued final regulations replacing the temporary regulations. Treas. Regs. §§ 301.6229(c)(2)-1, .6501(e)-1, 75 Fed. Reg. 78,897 (Dec. 17, 2010).

The preamble to the final regulations states: "The Treasury Department and the Internal Revenue Service disagree . . . 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) . . . ." 75 Fed. Reg. at 78,897. The regulations go on to set forth the Department's view that, outside the context of income from sale of goods or services by a trade or business, "an understatement of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of 6501(e)(1)(A)." Treas. Reg. § 301.6229(c)(2)-1(a)(1)(iii) (2010); *see also* Treas. Reg. § 301.6501(e)-1(a)(1) (2010). In other words, the new Treasury regulations set forth the view of *Colony* that the government urged before both the Court of Federal Claims in this case, and before the *Salman Ranch* panel. They state that *Colony* did not conclusively resolve the statutory interpretation issue, and that overstatement of basis (outside the trade or business context) can trigger the extended limitations period.

The government contends that the new Treasury regulations should control the outcome of the present appeal. Grapevine resists, arguing that the new regulations cannot change this court's interpretation of the limitations statutes, and, even if they can, they do not apply in this case.

II. DISCUSSION

A. Standard of Review

We have jurisdiction over this appeal from the Court of Federal Claims' final judgment pursuant to

28 U.S.C. § 1295(a)(3). We review that court's grant of summary judgment de novo. *Pennzoil-Quaker State Co.* v. *United States*, 511 F.3d 1365, 1369 (Fed. Cir. 2008). Summary judgment is appropriate where "there is no genuine issue as to any material fact and [the movant] is entitled to judgment as a matter of law." R. Ct. Fed. Cl. 56(c)(1).

In this case, the underlying facts are not in dispute. Our role is to resolve a question of pure statutory interpretation. This is an issue of law, which we review de novo. *AD Global Fund, LLC* v. *United States*, 481 F.3d 1351, 1353 (Fed. Cir. 2007).

B. Presence of Intervening Authority

The essential issue on appeal is whether this case is governed by our decision in *Salman Ranch*. A panel of this court is ordinarily bound to follow a prior precedential decision unless there are intervening circumstances, such as new controlling authority. *Tex. Am. Oil Corp.* v. *Dep't of Energy*, 44 F.3d 1557, 1561 (Fed. Cir. 1995) (en banc) ("This court applies the rule that earlier decisions prevail unless overruled by the court *en banc*, or by other controlling authority such as intervening statutory change or Supreme Court decision.").

The new Treasury regulations cannot, of course, change the Tax Code. But they may reflect the Treasury Department's exercise of authority granted by Congress to interpret an ambiguity in that code. Where an executive department, entrusted with interpretive authority, promulgates statutory interpretations that are reasonable within the circumstances established by Congress, then the courts must defer to that interpretation. *Chevron, U.S.A., Inc.* v. *Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843–44 (1984).

There is at this point little doubt that the Treasury Department has a Congressional mandate to interpret ambiguities in the Tax Code, and that Treasury regulations, when promulgated, are to be interpreted under the standards set forth in *Chevron*. *Mayo Found. for Med. Educ. & Research* v. *United States*, No. 09-837, slip op. at 11–12, 562 U.S. ___ (Jan. 11, 2011); *see also Mead* v. *United States*, 533 U.S. 218, 229 (2001). Our task, therefore, is to examine the statute and the regulations to determine the deference, if any, owed to the Treasury Department in this appeal. In other words, we undertake *Chevron* review of the new Treasury regulations. If the Treasury regulations are entitled to *Chevron* deference, then they are new intervening authority and may require us to depart from *Salman Ranch*.

C. Applying *Chevron*

The *Chevron* analysis has two steps. First, we must determine if there is an ambiguity in the statute such that an agency has room to interpret. Second, we must determine whether the agency's action is a reasonable interpretation of Congress's intent. *Chevron*, 467 U.S. at 842–43.

1. *Chevron* Step One: Congress's Intent Was Not So Clear as to Foreclose Reinterpretation

Where a court, applying the traditional tools of statutory construction, is unable to identify a "clear intent" by Congress as to how a given question should be resolved, that opens the door to an agency filling in the "gap" by regulation. *Chevron*, 467 U.S. at 843. The search for Congress's intent begins with the plain statutory text. *Id.* at 848–51; *Nat'l Cable & Telecomm. Ass'n* v. *Brand X Internet Servs.* (hereinafter "*Brand X*"), 545 U.S. 967, 986 (2005) ("At the first step, we ask whether the statute's plain terms directly address the precise question at issue.") (quotation marks omitted); *Torrington Co.* v. *United States*, 82 F.3d 1039, 1044 (Fed. Cir. 1996). If, even after consulting the plain text, there is still some question as to Congress's intent concerning the given question, we turn to the traditional tools of statutory construction, e.g., legislative history, to see if they show a clear intent that is unclear from the text alone. *Chevron*, 467 U.S. at 842–43; *see also Torrington*, 82 F.3d at 1044.

The Tax Code's provision for an extended limitations period when a return reflects a "[s]ubstantial omission of items" reads:

> (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 re-turn, 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.

I.R.C. § 6501(e)(1)(A) (2004).

The Tax Code includes similar language clarifying that, where the "substantial omission of income" is attributable to a partnership item, the limitations period for the taxpayer should not expire before six years after the relevant date for the partnership return:

> (a) General rule.—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 (determined without regard to extensions).
>
> . . .

(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 in-come stated in its return, subsection (a) shall be applied by substituting "6 years" for "3 years".

Id. § 6229(a)–(c)(2) (2004).

Grapevine contends that, under *Colony* and *Salman Ranch*, these statutes' meaning is clear: overstatement of basis does not constitute an "omission from gross income." The government disagrees and argues that those cases do not control this one. We think the government is correct. Those cases, while instructive, do not resolve the question for purposes of *Chevron* step one.

Both *Colony* and *Salman Ranch* preceded the issuance of Treasury regulations interpreting this statute. The task of those courts was therefore different from ours. Their task was to weigh the evidence of the statute's meaning and to determine whether that evidence better favored the taxpayer or the government. The goal was to find the best (in each court's view) interpretation of the statute in light of the evidence. And in that inquiry, both reached the same outcome—they held the taxpayers' arguments against including overstated basis as an "omission" stronger than the government's argument in favor, and interpreted the statute accordingly.

We face a different task in light of *Chevron* and *Brand X*. The objective of *Chevron* step one is not to interpret and apply the statute to resolve a claim, but to determine whether Congress's intent in enacting it was so clear as to foreclose any other interpretation. *See Brand X*, 545 U.S. at 982–83 ("Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction."). If room exists for more than one reasonable interpretation of Congress's intent, then the agency, not the judiciary, has the interpretive mandate. The courts' role is thereby reduced to ensuring that the agency takes no action that is unreasonably inconsistent with the statute. *Id.*; *see also Chevron*, 467 U.S. at 843–44.

Looking at the relevant text of § 6229 and § 6501, we find them ambiguous as to Congress's intent concerning treatment of a taxpayer's overstated basis. *Chevron*, 467 U.S. at 842–43; *see also Brand X*, 545 U.S. at 986. This is consistent with the analysis of both *Colony* and *Salman Ranch*. In *Colony*, as noted *supra*, the Supreme Court expressly found the predecessor statute ambiguous, and turned to the legislative history to resolve the question. 357 U.S. at 33

("[I]t cannot be said that the language [of the statute] is unambiguous."). And while it is true that the Court later referred to the updated § 6501(e)(1)(A) as "unambiguous," it did not rely or elaborate on that statement, nor was the updated statute at issue in that case. *Id.* at 37. Further, in *Colony* the taxpayer was in the business of land sales, so § 6501(e)(1)(A)(i)'s test for income "in the case of a trade or business" expressly applied. That is not the case here. The ambiguity concerns what to do outside the trade and business context, and the only language in § 6501(e)(1)(A) applicable out-side the trade or business context is the same language from the predecessor statute, "omits from gross income an amount." The Supreme Court previously noted that this term was ambiguous as to whether it encompassed an overstated basis. We therefore find *Colony* no bar to our finding that the text of the relevant statutes, standing alone, is ambiguous as to the disposition of this issue.[5]

Nor does *Salman Ranch* mandate any different

[5] In recent months, several of our sister circuit courts have addressed this issue and reached varying results. *Compare Burks* v. *United States*, No. 09-11061, slip op. at 21–22 (5th Cir. Feb. 9, 2011) (declining to grant *Chevron* deference because statute was unambiguous), and *Home Concrete & Supply, LLC* v. *United States*, No. 09-2353, slip op. at 13–14 (4th Cir. Feb. 7, 2011) (same), *with Beard* v. *Comm'r of Internal Revenue*, No. 09-3741, slip op. at 12 (7th Cir. Jan. 26, 2011) (holding *Colony* non-controlling in light of intervening statutory change and noting appropriateness of *Chevron* deference); *see also Bakersfield Energy Partners* v. *Comm'r of Internal Revenue*, 568 F.3d 767, 775–78 (9th Cir. 2009) (holding, prior to promulgation of regulations, that *Colony* controlled interpretation of limitations period).

conclusion. This court there closely analyzed both the up-dated statute and its legislative history to determine whether divergence from *Colony* was warranted. 573 F.3d at 1373–77. It made no separate holding that the statute was unambiguous for purposes of *Chevron* step one, and indeed the panel's resort to legislative history strongly suggests that the statutory interpretation could not be resolved on the statutory text alone.

We thus conclude that the plain statutory text of § 6501(e)(1)(A) and § 6229(c)(2), standing alone, is subject to multiple interpretations. As this court noted in *Salman Ranch*, the Tax Code's use of the term "omits" suggests that the section is primarily addressed to the return where the taxpayer has "fail[ed] to include or mention" or "le[ft] out" some item rather than misrepresenting it (as by an overstatement of basis). 573 F.3d at 1374 (quoting *Am. Heritage Dictionary of the English Language* 1227 (4th ed. 2000)). But without looking beyond the text itself, we cannot say that the statute forecloses the possibility that a taxpayer's overstated basis might constitute an omission from gross income.

Having concluded that the text, standing alone, does not resolve Congress's intended treatment of basis over-statement, we next must look to see if there are any other indications of Congressional intent so clear that we perceive no room for an agency to add anything. "If the intent of Congress is clear, that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 842–43; *Brand X*, 545 U.S. at 986.

Even incorporating the legislative history into our analysis of the statutory text, we do not think Congress's intent was so clear that no reasonable interpretation could differ. *Colony* reviewed much of the relevant Congressional debate and committee reports for the 1934 Revenue Act. 357 U.S. at 33–35. Of the excerpts analyzed by the Supreme Court, none explicitly discussed application of the limitations period to cases involving overstatement of basis. The cited excerpts discuss the situation of taxpayers who, whether "negligent," "forgetful," or "by honest mistake," omit—not overstate the basis of—items on their return. *Id.* The Court found these excerpts "persuasive" to support its holding. *Id.* at 35. The Court did not find that there was no other reasonable interpretation of the history than its own, and neither do we.

Salman Ranch's review of the more recent legislative history of § 6501 also cannot resolve the issue beyond question. 573 F.3d at 1375–76. This court concluded from the legislative history that Congress's 1954 amendments were primarily directed to the related issue of whether omitted gross income exceeded 25% of stated gross income, not whether basis overstatement was an omission. *Id.* at 1376. While persuasive support of *Salman Ranch*'s holding, the cited text cannot remove all reasonable dispute about Congress's meaning.

Accepting the soundness of the judicial reasoning in *Colony* and *Salman Ranch*, it is not judicial clarity that matters for step one of *Chevron*, but legislative clarity. If the Tax Code lacks legislative clarity, and we hold that it does, then there is room for agency interpretation. That the Supreme Court and this court have strongly reasoned for a certain interpretation of these statutes does not mean their inherent ambiguity has been wiped away. *Brand X*, 545 U.S. at 982 ("A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from *the unambiguous terms of the statute* and thus leaves no room for agency discretion.") (emphasis added).

We conclude that § 6501(e)(1)(A) and § 6229(c) are ambiguous as to Congress's intent for treatment of basis overstatement outside the trade or business context. We therefore conclude that the Treasury Department is entitled to promulgate its own interpretation of these statutes, and to have that interpretation given deference by the courts so long as it is within the bounds of reason.

2. *Chevron* Step Two: The Treasury Regulations Are a Reasonable Interpretation of the Limitations Period

The second step of the *Chevron* analysis asks whether the newly issued Treasury regulations constitute "a reasonable policy choice for the agency to make." *Chevron*, 467 U.S. at 845. Review of the Treasury regulations reveals that they are reasonable, even though they depart from the judicial interpretation of *Colony* and *Salman Ranch*.

As it did before this court in *Salman Ranch*, the Treasury Department justified its statutory interpretation with two basic arguments. First, the Department viewed Congress's addition of a special "gross receipts" definition in the 1954 Internal Revenue Code as a response to "disagreement among the courts that existed at the time regarding the proper scope of section 275(c) of the 1939 Internal Revenue Code." Preamble to Temp. Treas. Regs., 74 Fed. Reg. 49,321 (Sept. 28, 2009); *see also* Preamble to Treas. Regs., 75 Fed. Reg. 78,897 (Dec. 17, 2010) (adopting the reasons set forth in the preamble to the temporary regulations). By emphasizing the effect of the "gross receipts" definition, the regulations purport to better reflect Congress's intention when compared to *Colony*. Second, the Department argues that to apply *Colony* outside the trade or business context risks rendering the "gross receipts" definition meaningless. It asks, why would Congress enact a new definition for "gross receipts" in the trade or business context if it had already established (as *Colony* held) that that same definition would apply in all contexts? Preamble to Temp. Treas. Regs., 74 Fed. Reg. at 49,321–22.

Salman Ranch discussed these justifications and found them non-persuasive, 573 F.3d at 1374–76, but we are unable to say that they, or the policy they support, are ipso facto unreasonable. It is beyond question that in 1954 Congress added provisions for computing gross income in the trade and business context without expressly stating whether those provisions would also apply to other contexts. One could, and in this case the Treasury Department did, reasonably argue that this was evidence of an intent to treat non-trade or business in-come according to a different rule.

Grapevine opposes this conclusion, reasoning first that an interpretation that departs from *Colony* cannot be reasonable. Appellees' Br. 42–43. For the reasons already set forth, we disagree. *Colony*'s holding does not foreclose reasonable disagreement in agency rules under *Chevron*. Neither that case nor *Salman Ranch* found Congress's intent was so clear as to support no reasonable interpretation other than the taxpayer's.

In its response brief, Grapevine also argues that the temporary Treasury regulations should not receive *Chevron* deference because of purported procedural shortcomings in their issuance. Now that the regulations have issued in final form, these arguments are moot. There can be little doubt that the final regulations of the Treasury Department are entitled to *Chevron* review and, where appropriate, deference. *Mayo Found.*, slip op. at 9–10 ("We believe *Chevron* and *Mead*, rather than *National Muffler* and *Rowan*, provide the appropriate framework for evaluating the full-time employee rule [a Treasury regulation promulgated after notice-and-comment procedures]."); *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001); *cf. Fed. Nat'l Mortg. Ass'n* v. *United States*, 379 F.3d 1303, 1307–08 (Fed. Cir. 2004).

Because the Treasury regulations are a reasonable interpretation of § 6501(e)(1)(A), they must receive our deference. *Colony* and *Salman Ranch* notwithstanding, we will defer to the Treasury Department's interpretation in applying § 6501(e)(1)(A).

D. The Present Appeal

Grapevine contends that, even if the Treasury regulations control application of the limitations period prospectively, they should not control the present appeal. Grapevine presents three arguments, which we address in turn.

1. The New Treasury Regulations Apply to Previous Tax Years

Grapevine first contends that even if the new regulations control assessments for future tax years, they do not meet the legal requirements for retroactive application to 1999 tax assessments.

The Tax Code empowers the Treasury Department to promulgate retroactive regulations:

> (b) Retroactivity of regulations or rulings.— 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.

I.R.C. § 7805(b) (1995); *see also Redhouse* v. *Comm'r of Internal Revenue*, 728 F.2d 1249, 1250–51 (Fed. Cir. 1984).[6]

Grapevine claims that there is a "strong presumption against" retroactive application of certain statutes and regulations, citing Supreme Court cases from the non-tax context as support. Appellees' Br. 22–26; *see also Landgraf* v. *USI Film Prods.*, 511

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[6] The present statute places more extensive limits on retroactivity. I.R.C. § 7805(b). But there is no dispute that those limits do not apply to regulations concerning pre-1996 statutory enactments. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1101(b), 110 Stat. 1452, 1469 (1996). The statutory sections at issue here are in that category.

U.S. 244 (1994); *Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204 (1988). Grapevine urges us to undertake the various tests set forth in those cases to review the Tax Code and the new regulations, presumably out of due process and fairness concerns.

The government, on the other hand, points out that the Supreme Court has long upheld the retroactivity of tax legislation. *See, e.g.*, *United States* v. *Carlton*, 512 U.S. 26, 30 (1994) ("This Court repeatedly has upheld retroactive tax legislation against a due process challenge."). Moreover, the Supreme Court specifically endorsed the Treasury Department's power to apply rules and regulations retroactively under § 7805(b), on an "abuse of discretion" standard:

> [I]t is clear from the language of the section [precursor to § 7805(b)] and its legislative history that Congress thereby confirmed the authority of the Commissioner to correct any ruling, regulation or Treasury decision retroactively[.]

Auto. Club of Mich. v. *Comm'r of Internal Rev.*, 353 U.S. 180, 184 (1957) (footnote omitted); *see also id.* at 187 (applying abuse of discretion standard); *Redhouse*, 728 F.2d at 1251 (applying abuse of discretion standard to retroactive rule). Further, we read *Landgraf* as emphasizing a requirement of clear Congressional intent for retroactive application. 511 U.S. at 266 ("[A] requirement that Congress first make its intention clear helps ensure that Congress itself has determined that the benefits of retroactivity outweigh the potential for disruption or unfairness.") Such an intent was manifest here, by

§ 7805(b)'s straightforward endorsement of retroactive regulation.

We therefore must determine whether it was an abuse of discretion for the Treasury Department to state that the new regulations would apply to preceding tax years. We conclude that it was not. As we have already set forth above, the new regulations are a reasonable interpretation of the limitations statutes. By their terms, the new regulations will apply only to those taxpayers who are within the limitations period as computed under the new regulation, so there is no opportunity for these regulations to reach into the distant past. And while we recognize that some taxpayers whose past returns bear evidence of overstated basis may find themselves facing adjustments when they thought the limitations period had lapsed, we cannot say that the burden on those taxpayers is so great as to be an abuse of the Treasury Department's discretion. We therefore conclude that the new regulations may properly be applied to returns from past tax years whose limitations periods (as recomputed) has not yet expired.

2. The Period for Assessing Grapevine's 1999 Return Remains Open until the Close of Litigation

Grapevine next argues that the Treasury regulations, by their terms, do not apply to its 1999 return because the regulations "appl[y] to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009." Treas. Regs. §§ 301.6229(c)(2)-1(b), 301.6501(e)-1(e). Grapevine urges that the period for assessing Grapevine's tax closed on April 19, 2003, pursuant to the judgment of the Court of Federal Claims and this court's subsequent decision in *Salman Ranch*. Grapevine repeatedly describes the Court of Federal Claims' decision as a "final judgment," and contends that it is not within the Treasury Department's power to contravene such a judgment.

The government responds that the Tax Code expressly extends the period of assessment being litigated "until the decision of the court becomes final." I.R.C. § 6229(d) (2004). "Final," according to the government, means for tax assessment purposes that all appeals have been exhausted. *Id.* § 7481 (stating that a decision of the Tax Court becomes final only after appeals have been exhausted).

The government further notes that the preamble to the final regulations makes clear that the regulations will apply to entities in Grapevine's position:

> [T]he 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.

Preamble to Treas. Regs. §§ 301.6229(c)(2)-1, 301.6501(e)-1, 75 Fed. Reg. at 78,898 (emphasis added). The emphasized clause, concerning pending litigation, is at issue here.

Where, as here, a tax matters partner petitions a court for readjustment of partnership items, the Tax Code states that the limitations period is tolled "until the decision of the court becomes final." *Id.* § 6229(d)(1) (2004). In such a case, the term "final" has the meaning set forth in § 7481—that is, a decision is not "final" until it is beyond further appeal. And although § 7481 speaks in terms of a "Tax Court" decision not becoming final until opportunities for appeal are exhausted, the Code is clear that the same test applies where a partnership sues in the Court of Federal Claims. I.R.C. § 6230(g) ("For purposes of section 6229(d)(1) and section 6230(c)(2)(B), the principles of section 7481(a) shall be applied in determining the date on which a decision of a district court or the Court of Federal Claims becomes final.").

Grapevine argues that decisions of the Court of Federal Claims are different from those of the Tax Court: the Tax Court's decisions become "final" when appellate review is exhausted, but the Court of Federal Claims' decisions are final when entered. As shown above, the Tax Code clearly provides otherwise. We therefore hold that the limitations period for Grapevine's 1999 tax return remains open until this case reaches unappealable termination. It is open today, and it was open on September 24, 2009. As a result, by their plain terms the new Treasury regulations apply to Grapevine's 1999 return.

3. It is Not Improper to Apply the New Treasury Regulations to Grapevine

Finally, Grapevine argues that the government is trying to change the rules in the middle of the game. Having failed to prevail at the Court of Federal Claims, and having had the limitations period construed against it by this court in *Salman Ranch*, Grapevine argues that the Treasury Department should not be permitted to trans-form a lower court loss into an appellate win via new regulations.

While we understand Grapevine's disappointment, we disagree that this is an improper outcome. This case highlights the extent of the Treasury Department's authority over the Tax Code. As *Chevron* and *Brand X* illustrate, Congress has the power to give regulatory agencies, not the courts, primary responsibility to interpret ambiguous statutory provisions. That is what happened here. That the Treasury Department had not exercised its interpretive authority over the relevant language until after the Court of Federal Claims granted summary judgment does not diminish the Department's authority, nor its right to have its interpretations, when promulgated, respected by the judiciary—so long as they are reasonable.

Further, the Supreme Court and this court have specifically affirmed the judiciary's obligation to defer to agency interpretations even when those regulations come midstream in litigation. *Smiley* v. *Citibank (S.D.), N.A.*, 517 U.S. 735, 741 (1996) ("Nor does it matter that the regulation was prompted by litigation, including this very suit. . . . That it was litigation which disclosed the need for the regulation is irrelevant."); *see also United States* v. *Morton*, 467 U.S. 822, 836 n.21 (1984); *Motorola, Inc.* v. *United States*, 436 F.3d 1357, 1366 (Fed. Cir. 2006) ("It makes no difference to our analysis that the regulation was promulgated in 2002, after the controversy arose and after this litigation began."). Agencies retain this authority even if they are parties to the litigation in which new regulations are asserted as authority. *See Morton*, 467 U.S. at 836 n.21.

E. Application of the New Regulations to Grapevine

We therefore conclude that the Treasury Regulations are new controlling authority that may change the Court of Federal Claims' judgment. Because there are no questions of material fact, our last task is to determine whether either Grapevine or the government is entitled to summary judgment as to the FPAA's timeliness.

The Regulations state that the term "gross income," as used in the limitations statutes, has two possible meanings depending on whether the income in question is "from the sale of goods or services in a trade or business." Treas. Regs. §§ 301.6229(c)(2)-1 (a)(1)(ii)–(iii), 301.6501(e)-1 (a)(1)(ii)–(iii). Here, the understatement of income stemmed from the sale of the partnership, not a sale of goods or services in a trade or business, so the latter definition applies:

> (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 ser-vices 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 re-late 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).

Treas. Reg. § 301.6229(c)(2)-1 (a)(1)(iii); *see also id.* § 301.6501(e)-1 (a)(1)(iii) (stating same with respect to I.R.C. § 6501(e)(1)(A)(i)).

The regulation's effect is straightforward. It makes clear that Grapevine and the Tigues' overstatement of basis "constitutes an omission from gross income" for purposes of the limitations statutes. Applying that rule, we conclude that Grapevine and the Tigues' overstatement of basis triggered the extended limitations periods of § 6229(c)(2) and § 6501(e)(1)(A).

III. CONCLUSION

When the Court of Federal Claims entered judgment for Grapevine, the Treasury Department had not yet exercised its interpretive authority over the limitations periods at issue in this case. It now has, and we, like the Court of Federal Claims, are obliged to defer to that interpretation. We therefore reverse the entry of judgment for Grapevine and remand for further proceedings.

REVERSED AND REMANDED

APPENDIX C

IN THE UNITED STATES
COURT OF FEDERAL CLAIMS

No. 05-296T

(Filed: July 17, 2007)

GRAPEVINE IMPORTS, LTD, and T-TECH, INC., as Tax Matters Partner, Plaintiffs, v. THE UNITED STATES, Defendant.	* *	TEFRA partnership proceeding; Six-year statute of limitations under section 6501(e)(1)(A) of the Internal Revenue Code; Application of section 6501(e)(1)(A) where taxpayer allegedly understates gross income owing to an overstatement of basis; *Colony* – section 275(c) of the 1939 Code; Binding precedent; Colony rationale applicable to construction of 1954 Code provision; Overstating basis of property sold not an omission for purposes of section 6501(e)(1)(A); 1999 assessments time-barred under section 6501(a) of the Code; 2000 assessments unaffected.

OPINION

M. Todd Welty, Meadows, Owens, Collier, Reed, Cousins & Blau, L.L.P., Dallas, Texas, for plaintiffs.

Grover Hartt, III, Tax Division, United States Department of Justice, Dallas, Texas, with whom was Assistant Attorney General *Eileen J. O'Connor*, for defendant.

ALLEGRA, Judge:

This is the second leg of a case having its genesis in a series of transactions that purportedly gave partners a substantial positive basis in their partnership interests, ultimately leading them to claim losses upon the disposition of those interests. Two sets of potential adjustments are at issue – one set relates to the partners' 1999 taxable year, while the other involves their 2000 taxable year. As to the latter year, the court, in the first leg of this case, held that section 6229 of the Internal Revenue Code of 1986 (26 U.S.C.) (the Code) did not create an independent statute of limitations, but rather operated as a minimum period for assessment for partnership items that could extend the time period set forth in section 6501(a) of the Code. *Grapevine Imports, Ltd.* v. *United States*, 71 Fed. Cl. 324 (2006). The court now must resolve whether the limitations period for assessing taxes as to the partners' 1999 taxable year has run or instead was extended under section 6501(e)(1)(A) of the Code, which gives the Internal

Revenue Service (IRS) three additional years in which to impose assessments in the case of certain omissions from gross income. For the reasons that follow, the court concludes that the latter savings provision does not apply and that any 1999 assessments here, therefore, would be untimely.

I. BACKGROUND

In March of 1996, Joseph J. Tigue and Virginia B. Tigue formed a partnership called Grapevine Imports, Ltd. (Grapevine). On April 19, 2000, Grapevine filed its partnership return for 1999, showing a net short-term loss of $21,884. On or before April 15, 2000, the Tigues jointly filed their 1999 joint income tax return, which, owing, in part, to transactions involving the partnership, showed a total loss of $973,087. The Tigues carried this 1999 loss forward to future taxable years, along with a $1,127,481 net operating loss carryover from 1998. *See* 26 U.S.C. § 172(b) (governing net operating loss carrybacks and carryovers). On August 17, 2001, the Tigues jointly filed their 2000 tax return in which the 1998 net operating loss had the effect of eliminating what otherwise would have been taxable income of $730,161.

On June 19, 2003, the IRS issued a John Doe summons to the Tigues' tax consultants, Jenkens & Gilchrist (Jenkens). Jenkens resisted this summons, and the Department of Justice filed a summons enforcement action in the United States District Court for the Northern District of Illinois. On May 14, 2004, the court ordered Jenkens to honor the summons within three days, which it did.

On December 17, 2004, the IRS issued a notice of final partnership administrative adjustment (FPAA) to Grapevine's tax matters partner,[1] T-Tech, adjusting the partners' basis in Grapevine by $10,000,000 for the 1999 tax year. No statutory notices of deficiency were issued to the Tigues. On March 8, 2005, Joseph Tigue, as the sole owner of T-Tech, remitted deposits of $1,594,205 and $221,170 for tax years 1999 and 2000, respectively, in accordance with section 6226(e) of the Code. On March 11, 2005, plaintiffs filed their complaint in this court for readjustment of partnership items under section 6226(a) of the Code, requesting that the court either declare the FPAA invalid or, alternatively, order defendant to reverse the adjustments set forth therein.

On October 21, 2005, plaintiffs filed a motion for summary judgment asserting that the FPAA's proposed adjustment was time-barred under section 6229(a) of the Code. For purpose of this motion (and only for that purpose), plaintiffs stipulated that the basis that the Tigues used to calculate their losses with respect to the transaction involving Grapevine was overstated. On November 28, 2005, defendant responded with a cross-motion for partial summary judgment. On June 14, 2006, this court ruled that

[1] Under section 6231(a)(7) of the Code, the "tax matters partner," or TMP, generally is either "the general partner designated as the tax matters partner as provided in the regulations" or if no such partner has been designated, "the general partner having the largest profits interest in the partnership at the close of the taxable year involved." For a fuller discussion of the partnership audit provisions of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (TEFRA), *see Keener* v. *United States*, 76 Fed. Cl. 455, 458-59 (2007).

section 6229(a) does not establish a limitations period that is separate and apart from the general three-year statute of limitations on income tax assessments with respect to individual partner assessments.[2] The court accordingly found that the issuance of the December 14, 2004, FPAA suspended the running of the general three-year statute of limitations with respect to individual partner assessments for tax year 2000. As to 1999, however, the court expressed concerns that factual issues might prevent it from determining whether plaintiff was subject to the special statute of limitations contained in section 6501(e)(1)(A) of the Code, which applies a six-year assessment limitations period to any taxpayer that nonfraudulently "omits from gross income an amount properly includible therein which is in excess of 25 percent" of the reported gross income.

An evidentiary hearing regarding the applicability of section 6501(e)(1)(A) was conducted on January 18, 2007, at which plaintiffs presented expert testimony.

II. DISCUSSION

At issue is whether the IRS' proposed adjustments to the Tigues' 1999 taxable year are time-barred.

Under the general rule set forth in section 6501(a) of the Code, the IRS is required to assess tax

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[2] This correctness of this ruling was subsequently confirmed by the Federal Circuit in *AD Global Fund, LLC ex rel. N. Hills Holding, Inc.* v. *United States*, 481 F.3d 1351 (Fed. Cir. 2007), *aff'g* 67 Fed. Cl. 657 (2005).

(or send a notice of deficiency) within three years after a Federal income tax return is filed. *See Keener*, 76 Fed. Cl. at 458; *Grapevine Imports*, 71 Fed. Cl. at 328. As to the Tigues' 1999 taxable year, this three-year statute of limitations clearly ran before the issuance of the FPAA here. As noted, however, defendant has invoked an exception to this rule, contained in section 6501(e)(1)(A) of the Code, which applies a six-year assessment limitations period to any taxpayer that nonfraudulently "omits from gross income an amount properly includible therein which is in excess of 25 percent" of the reported gross income. *See Badaracco* v. *Comm'r of Internal Revenue*, 464 U.S. 386, 392 (1984). If this provision applies, the assessment here would be timely – the FPAA was sent within this six-year statute of limitations and the FPAA, by reason of section 6229(d), suspended the period of limitations applicable to the assessment of liabilities of the partners.

Section 6501(e)(1)(A) was first enacted as section 275(c) of the Revenue Act of 1934, 48 Stat. 680, 745. *See Badaracco*, 464 U.S. at 392. In 1954, Congress made several changes to this provision. *See* H.R. Rep. No. 83-1337, at A414 (1954); S. Rep. No. 83-1622, at 584-85 (1954). First, under section 6501(e)(1)(A)(i), it defined "gross income" to mean the "total of the amounts received or accrued from the sale of goods or services . . . prior to diminution by the cost of such sales or services." Second, it crafted a safe harbor under section 6501(e)(1)(A)(ii), stating that the amount omitted from gross income shall not include "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." Language paralleling section 6501(e)(1)(A) – but without the special rule and exception adopted in 1954 – may be found in section 6229(c)(2), which extends the period in section 6229(a) from three to six years "[i]f 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." *See also* 26 U.S.C. § 6248(c)(2) (providing a similar rule for certain large partnerships).

Before turning to the facts here, it is necessary to understand better what the statute requires, a path that initially takes us to *Colony, Inc.* v. *Comm'r of Internal Revenue*, 357 U.S. 28 (1958). In that case, tax deficiencies were based upon assertions that the taxpayer had understated the gross profits on sales of certain lots of land by overstating its basis therein. The taxpayer claimed that the predecessor of section 6501(e)(1)(A), section 275(c) of the 1939 Code, did not apply in this situation because Colony had not entirely omitted an item of income from its return. Agreeing, Justice Harlan, writing on behalf of the majority, focused initially on the statute's use of the word "omits," which, he noted, had commonly been defined as "'[t]o leave out or unmentioned; not to insert, include or name.'" *Id.* at 32-33 (quoting Webster's New International Dictionary (2d ed. 1939) and citing *Ewald* v. *Comm'r of Internal Revenue*, 141 F.2d 750, 753 (6th Cir. 1944)). But Justice Harlan refused to conclude, on this basis alone, that the statute covered only items that were entirely omitted from a return (rather than being listed and misreported), finding that other phrases in the statute –

for example, the reference to omitting "an amount" from "gross income" – created an ambiguity. To resolve this ambiguity, he turned to the statute's legislative history. As evidence that Congress intended the statute only to apply to items entirely omitted from returns, he cited the portion of the accompanying Senate Report that indicated that the longer limitations provision was to apply where a taxpayer "failed to report" an income item, noting that the report gave several examples, *e.g.*, "where a taxpayer failed to report a dividend." 357 U.S. at 35 (quoting S. Rep. No. 73-558, at 43-44 (1934)). Justice Harlan also quoted from the accompanying House Report, which indicated that the provision should be triggered where "'taxpayers . . . are so negligent as to leave out of their returns items of such magnitude.'" 357 U.S. at 34 (quoting H.R. Rep. No. 73-704, at 35 (1934)).

In light of this and other legislative history (principally floor debates), the Court rejected the Commissioner's claim that the statute addressed any significant error that caused the amount of gross income to be understated. This theory was not persuasive, the Court held, "[f]or if the mere size of the error had been the principal concern of Congress, one might have expected to find the statute cast in terms of errors in the total tax due or in total taxable net income." *Id.* at 36. The Court further reasoned-

> We think that in enacting § 275(c) Congress manifested no broader purpose than to give the Commissioner an additional two years [now three years] to investigate tax returns in cases where, because of a taxpayer's omission

> to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. 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 36-37.[3] It concluded that "[t]o accept the Commissioner's interpretation and to impose a five-year [now six-year] limitation when such errors affect 'gross income,' but a three-year limitation when they do not, not only would be to read § 275(c) more broadly than is justified by the evident reason for its enactment, but also to create a patent incongruity in the tax law." *Id.* at 36-37. The Supreme Court finally observed that its conclusion was "in harmony" with the then recently enacted (as part of the 1954 Code)

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[3] Previously, several circuits had narrowly construed the term "omits." *See Goodenow* v. *Comm'r of Internal Revenue*, 238 F.2d 20, 21-22 (8th Cir. 1956); *Davis* v. *Hightower*, 230 F.2d 549, 553-54 (5th Cir. 1956) (statute inapplicable where taxpayer understated income because of a "difference between him and the Commissioner as to the legal construction to be applied to a disclosed transaction"); *Slaff* v. *Comm'r of Internal Revenue*, 220 F.2d 65, 68 (9th Cir. 1955); *Deakman-Wells Co.* v. *Comm'r of Internal Revenue*, 213 F.2d 894, 897 (3d Cir. 1954) (section 275(c) "applies only where the taxpayer has failed to make a return of some taxable gain, where he has altogether omitted an item from the income reported"); *cf. Reis* v. *Comm'r of Internal Revenue*, 142 F.2d 900, 903-04 (6th Cir. 1944).

"unambiguous language" of section 6501(e)(1)(A). *Id.* at 37; *see also Grapevine Imports*, 71 Fed. Cl. at 341-42 (discussing *Colony*).

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. As this court noted in its prior opinion, 71 Fed. Cl. at 341, several cases have questioned the continuing viability of *Colony* in light of the 1954 amendments to section 6501(e)(1)(A). For example, in *CC&F W. Operations L.P.* v. *Comm'r of Internal Revenue*, 273 F.3d 402, 406 (1st Cir. 2001), the First Circuit stated that "[w]hether *Colony*'s main holding carries over to section 6501(e)(1) is at least doubtful," suggesting that Justice Harlan's gross receipts test applies only to sales of goods and services covered by section 6501(e)(1)(A)(i), but not to other types of income. *Id.* at 406 n.2; *see also In re G-I Holdings, Inc.*, 2006 WL 2595264, at *5-6 (D.N.J. Sept. 8, 2006) (reaching the same conclusion). At one point, various Tax Court cases also limited the rationale in *Colony* to the sale of goods or services by a trade or business. *See, e.g.*, *Insulglass Corp.* v. *Comm'r of Internal Revenue*, 84 T.C. 203, 210 (1985); *Schneider v. Comm'r of Internal Revenue*, 49 T.C.M. 1032, 1034-35 (1985).[4] More re-

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[4] *Inter alia*, these cases emphasize that the term "gross income" has a well-accepted meaning in the Code and, apart from the exception contained in section 6501(e)(1)(A)(i), ought to include, among other things, gains deriving from dealings in property. *See Insulglass*, 84 T.C. at 210 ("In the case of a trade or business, 'gross income' is equated with gross receipts. Otherwise, 'gross income' means those items listed in section 61(a), which includes, among other things, gains derived from dealings in property.").

cently, however, that court has rejected attempts to "distinguish and diminish the Supreme Court's holding in [*Colony*]," noting that it does "not believe that either the language or the rationale of *Colony, Inc.* can be limited to the sale of goods or services by a trade or business." *Bakersfield Energy Partners, LP v. Comm'r of Internal Revenue*, 2007 WL 1712543, at *7 (Tax Ct. June 14, 2007). In concluding that an overstated basis did not trigger the provision, the Tax Court noted that "the Supreme Court held that 'omits' means something 'left out' and not something put in and overstated.'" *Id.*

As the Federal Circuit recently reminded, "[t]here can be no question that the Court of Federal Claims is required to follow the precedent of the Supreme Court, our court, and our predecessor court, the Court of Claims," adding that this rule applies even if the "decisions of the Supreme Court have been eroded." *Coltec Indus., Inc.* v. *United States*, 454 F.3d 1340, 1353 (Fed. Cir. 2006), *cert. denied*, 127 S. Ct. 1261 (2007); *see also Hohn* v. *United States*, 524 U.S. 236, 252-53 (1998) ("Our decisions remain binding precedent until we see fit to reconsider them, regardless of whether subsequent cases have raised doubts about their continuing vitality."); *Stone Container Corp.* v. *United States*, 229 F.3d 1345, 1349-50 (Fed. Cir. 2000), *cert. denied*, *Smurfit-Stone Container Corp.* v. *United States*, 532 U.S. 971 (2001). The question here, of course, is whether the Supreme Court's construction of the 1939 Code is precedential as to the 1954 version of section 6501(e)(1)(A), so as to bind this court's construction of the latter. The answer appears to be yes, even though a few questions linger as to the correctness of the Supreme Court's ruling.[5] Several reasons militate in favor of treating this precedent as controlling.

First, the rationale employed in *Colony*, which focused on 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. From a "plain meaning" standpoint, there is utterly no indication that the common understanding of "omits," which the Supreme Court took as requiring an entire income item to be missing, somehow shifted in the two decades between the passage of the 1934 Revenue Act and the 1954 Code.[6] Second, any

[5] Among other things, the Court in *Colony* seemingly downplayed the portions of the legislative history that suggested that the statute applies simply where a taxpayer "understates gross income." S. Rep. No. 73-558 at 43-44; H.R. Rep. No. 73-704 at 35; *see* Robert J. Richards, Jr., "The Extended Statute of Limitations on Assessment," 12 Tax. L. Rev. 297, 311 (1957) (hereinafter "Richards") ("When the words of the statute are read in the light of the Committee Reports taken as a whole, it is difficult to understand why such a limited meaning is placed on 'omits.'"). Further, while the legislative history that the Court relied upon includes examples of when section 275(c) was to apply, *e.g.*, "where a taxpayer failed to report a dividend," S. Rep. No. 73-558 at 44, those same examples were less than clear in indicating when the provisions should not apply. *See Pension Ben. Guar. Corp.* v. *LTV Corp.*, 496 U.S. 633, 649 (1990) ("[T]he language of a statute . . . is not to be regarded as modified by examples set forth in the legislative history. An example, after all, is just that: an illustration of a statute's operation in practice.").

[6] Even today, the definition of "omit" is essentially the same as it was in 1934. *See, e.g.*, The American Heritage Dictionary of the English Language 1227 (4th ed. 2000) ("to fail to include or mention; leave out"); Dictionary.com, http://dictionary.reference.com/browse/omit (as viewed on July 16, 2007) ("to leave out; fail to include or mention").

notion that Congress altered the meaning of the statute in 1954 is belied not only by its failure to modify the word "omits," but also by the Supreme Court's discussion of the 1954 legislation as being "in harmony" with its interpretation of the 1939 Code. Again one might disagree with the latter observation,[7] but ultimately it leaves little room for this

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[7] As noted by this court in *Grapevine Imports*, 71 Fed. Cl. at 342, "two features that were added by the 1954 Code to the language from section 275 of the 1939 Code buttress [the] claim" that the 1954 statute is different than its ancestor. In this regard, this court explained –

> First, section 6501(e)(1)(A)(i) provides a gross receipts test similar to that adopted in *Colony*, but, by its terms, makes this test applicable only "[i]n the case of a trade or business." To conclude, as plaintiffs do, that the Colony gross receipts test applies, under section 6501(e)(1), to every sort of sale is to render surplusage Congress' reference to that same test as applying "[i]n the case of a trade or business." That result, however, would violate the canon that "a legislature is presumed to have used no superfluous words." *Platt* v. *Union Pac. R.R. Co.*, 99 U.S. 48, 58 (1878). Second, as part of the 1954 Code, Congress added a paragraph (2) to section 6501(e), which provides a rule covering estate and gift taxes, corresponding to the income tax rule. That paragraph, however, unlike section 6501(e)(1)(A), specifically refers to the omission of "items" includible in the gross estate or total gifts, apparently to make clear that the six-year period was not to apply because of differences as to the valuation of property. Of course, under other interpretative canons, the presence of the words "items" in paragraph (2) suggests that word ought not be implied into section 6501(e)(1)(A), as the latter refers only generally to omissions of "an amount" "from gross income."

Id. Ultimately, however, this court cannot conclude that these additions to the statute somehow modified section court to conclude that the modifications made in 1954, by adding sections 6501(e)(1)(A)(i) and (ii), somehow altered the meaning of the preexisting base provision.[8] Moreover, contrary to the intimation in CC&F and several other cases, this court sees no basis for limiting the Supreme Court's decision to cases involving the sale of goods or services by a trade or business. To be sure, that was the factual setting in *Colony*. But, neither the Supreme Court's construction of the word "omits," its examination of the legislative history, nor the remainder of its *ratio dicendi* reasonably can be confined to that setting. *See Bakersfield Energy Partners*, 2007 WL 1712543, at *7 ("We do not believe that either the language or the rationale of *Colony, Inc.* can be limited to the sale of goods or services by a trade or business.").

6501(e)(1)(A), which is precisely the same as the provision construed by the Supreme Court in *Colony*.

[8] Indeed, other aspects of the 1954 legislative history support the Court's conclusion. In 1954, Congress enacted a six-year period of limitations to cover estate and gift taxes. This new provision, section 6501(e)(2) of the Code is, in critical regards, essentially identical to section 6501(e)(1)(A). As such, it is significant that Congress did not interpret the estate and gift tax provision as applying where there merely was difference of opinion as to the amount of tax owed. In this regard, S. Rep. No. 83-1622, at 584-85 (1954), indicated that this provision was not to apply owing to "an increase in the valuation of an item shown on the return." This passage clearly limits the scope of the term "omits" as used in this provision, suggesting that the same term used in section 6501(e)(1)(A) should not be construed as applying to every understatement of gross income. *See* Richards, *supra*, at 317-18 ("the Committee Reports indicate that the six-year rule with respect to estate and gift taxes is not to apply merely because of the difference of opinion of the taxpayer and Government as to the valuation of property").

In the case *sub judice*, the court afforded defendant the opportunity to demonstrate, at the evidentiary hearing, that something had been omitted from the returns at issue. But, defendant failed to do so – indeed, it withdrew the only expert witness who was to provide testimony in support of its position. Without that testimony, all defendant could show is that the plaintiffs here benefitted from the partnership's presumed overstatement of its basis, which, in turn, generated the loss at issue here. As defendant admits, the Tigues' 1999 return not only specifically claimed the loss at issue, but also listed, on Schedule D thereof, the basis in the partnership interests that defendant claims was overstated.[9] *Colony*, of course,

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[9] Although arguably the best case for defendant, the First Circuit's decision in *CC&F W. Operations* is distinguishable. There, a first-tier partnership subject to the TEFRA audit rules was formed to facilitate the sale to an unrelated third party of a dozen second-tier subsidiary partnerships that owned and held real estate. By agreement of the parties, a portion of the sale proceeds was applied to satisfy the liabilities to which the real estate was subject. The sale resulted in a technical termination of the subsidiary partnerships, which accordingly filed final short-year returns that disclosed the sale. 273 F.3d at 404. The taxpayer-partnership reported the sale of "various partnership interests" on Form 4797 (Sales of Business Property) as part of its income tax return, but inadvertently understated both the aggregate basis of the partnership interests and the amount realized. The reported sales price was less than half of the total of the taxpayer's share of partnership liabilities as reflected on the Schedules K-1 of the subsidiary partnerships. The aggregate liabilities, in turn, were less than the actual sales price of the partnership interests. Construing section 6229(c)(2) of the Code, which, in critical terms, parallels section 6501(e)(1)(A), the First Circuit concluded that the taxpayer essentially had omitted an entire income item from its return – a payment made by the unrelated third party to discharge the first-tier partnership's indebtedness to a bank. On this basis, the court

specifically holds that an overstatement of basis that results in an understatement of income does not trigger the extended statute of limitations in section 6501(e)(1)(A). 357 U.S. at 36 (statute does not apply "when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return"). And, as noted, the Tax Court recently reached the same conclusion in construing not only section 6501(e)(1)(A), but the analogous provision of section 6229(c)(2). *See Bakersfield Energy Partners, LP*, 2007 WL 1712543, at *7; *see also Goodenow*, 238 F.2d at 22 (section 275(c) did not apply where overstatement of taxpayer's opening inventory resulted in understatement of gross profits); *Johnson v. Comm'r of Internal Revenue*, 32 T.C. 257, 259 (1959) (involving, in part, the alleged overstatement of cost basis on sold stock); *cf. Reis*, 142 F.2d at 903. That the alleged overstated basis here produced a claimed loss, rather than a diminished gain, neither distinguishes these precedents nor the logic from which they spring – and defendant does not argue to the contrary. Accordingly, the court sees no foundation for concluding that the six-year statute of limitations of section 6501(e)(1)(A) applies here.

Contrary to defendant's intimations, it is not for

distinguished Colony, stating that it "did not involve the failure to include attributed income; rather, all receipts were disclosed and the taxpayer's only fault was an overstatement of basis," adding that "[i]n *Colony* there was no such omission and that was decisive; here, there was." 273 F.3d at 406. Accordingly, while the First Circuit certainly questioned the Supreme Court's reasoning and the applicability of that reasoning to the 1954 provision, the court ultimately relied upon a factual ground that is absent from the case here.

this court to decide whether this construction of section 6501(e)(1)(A) makes the most sense from a tax policy standpoint. Indeed, it is far from evident that every sort of significant understatement of gross income ought to trigger a six-year statute of limitations. Nonetheless, it is for Congress, not the courts, to change the law for policy reasons. *See Sony Corp. of America* v. *Universal City Studios, Inc.*, 464 U.S. 417, 456 (1984); *BankAmerica Corp.* v. *United States*, 462 U.S. 133, 140 (1983); *United States* v. *Great N. Ry. Co.*, 343 U.S. 562, 575 (1952) ("It is our judicial function to apply statutes on the basis of what Congress has written, not what Congress might have written."). Having considered the remainder of defendant's arguments, and finding them likewise unpersuasive, the court concludes that the proposed adjustments to the Tigues' 1999 taxable year are barred by the statute of limitations.[10]

One further matter remains – plaintiffs have asserted that if the assessment against the Tigues is barred for their 1999 taxable year, any assessment must also be barred as to their 2000 taxable year. In particular, they asseverate that the losses carried forward to 2000 cannot be challenged if the event that generated those losses is in a barred year. But, the Federal Circuit held otherwise in *Barenholtz* v. *United States*, 784 F.2d 375 (Fed. Cir. 1986), in which the taxpayer asserted that because assessments against them were barred for the years 1971

[10] Based on this holding, this court need not consider whether plaintiffs' various returns adequately disclosed features of the various transactions so as to trigger the safety-valve provision of section 6501(e)(1)(A)(ii) of the Code.

through 1974, defendant was barred from making adjustments to his income for those years that resulted in decreased business loss and charitable contribution carryovers to the years 1975, 1976, and 1977. Rejecting that claim, the Federal Circuit stated –

> Barenholtz' argument is unsupported by the law. Section 6501(a) bars assessments, not calculations, and no assessments were made for the years 1971 through 1974. It is well settled that the IRS and the courts may recompute taxable income in a closed year in order to determine tax liability in an open year.

Id. at 380-81 (citing *Springfield St. Ry.* v. *United States*, 312 F.2d 754, 757-59 (Ct. Cl. 1963)). A similar rule has been applied in other cases, some of which specifically involve loss carryforwards.[11] Nor does the fact that this case involves a partnership and the specialized TEFRA provisions alter this rule, as this court recently demonstrated. *See J&J Fernandez Ventures, L.P.* v. *United States*, 2007 WL 1703439, at *2667-68 (Fed. Cl. Apr. 3, 2007).[12] Accordingly, that

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[11] *See also Phoenix Coal Co.* v. *Comm'r of Internal Revenue*, 231 F.2d 420, 421 (2d Cir. 1956) (applying this rule to loss carryforwards); *Nat'l Forge & Ordnance Co.* v. *United States*, 151 F. Supp. 937, 941 (Ct. Cl. 1957) (same); *Crocker* v. *Comm'r of Internal Revenue*, 75 T.C.M. (CCH) 2414, 2440 n.37 (1998) (applying this rule to a charitable contribution carryover); *Angell* v. *Comm'r of Internal Revenue*, 52 T.C.M. (CCH) 939, 941 (1986), *aff'd without pub. op.*, 861 F.2d 723 (7th Cir. 1988) (same).

[12] While plaintiffs contend that *Roberts* v. *Comm'r of Internal Revenue*, 94 T.C. 853, 857 (1990), is to the contrary, that case does not remotely address this issue. Indeed, it employs a cramped view of section 6229 of the Code that has now been

the assessment for 1999 is barred does not mean that the assessment for 2000 is likewise barred.

III. CONCLUSION

This court need go no farther. For the foregoing reasons, the court **GRANTS**, in part, and **DENIES**, in part, plaintiffs' motion for summary judgment, and **GRANTS**, in part, and **DENIES**, in part, defendant's partial cross-motion for summary judgment.[13] The court finds the assessment of tax against the Tigues for their 1999 taxable year is barred by the normal statute of limitations found in section 6501(a) of the Code. Any assessments as to their 2000 taxable year are not barred. On or before August 17, 2007, the parties shall file a joint status report indicating how this case should proceed, with a proposed schedule, as appropriate.

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rejected by the Federal Circuit in *AD Global*, *supra*. *See J&J Fernandez Ventures*, 2007 WL 1703439, at *2668 (discussing this point). Notably, if plaintiffs were right about this issue, the IRS would be obliged to challenge transactions that allegedly established an inflated basis for an asset even if the tax ramifications of having that basis were not significantly realized until years later, when, for example, the asset was sold. Nothing suggests that the law requires this.

[13] In its earlier ruling in this case, the court mistakenly denied, in full, plaintiffs' motion for summary judgment, when it should have denied that motion only in part. *See Grapevine Imports*, 71 Fed. Cl. at 343. The court believes that the issue discussed herein can be decided as a matter of summary judgment because the nature of the court's reliance on Colony renders irrelevant the expert testimony received at the evidentiary hearing conducted herein.

IT IS SO ORDERED.

/s/ Francis M. Allegra
Francis M. Allegra
Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

2008-5090

GRAPEVINE IMPORTS, LTD. a Texas Limited Partnership, T-TECH, INC., a Texas Corporation, as Tax Matters Partner,

Plaintiffs-Appellees,

v.

UNITED STATES,

Defendant-Appellant.

Appeal from the United States Court of Federal Claims in 05-CV-296, Judge Francis M. Allegra.

O R D E R

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

O R D E R

A combined petition for panel rehearing and for rehearing en banc having been filed by the Appellees,* and a response thereto having been invited by the court and filed by the Appellant, and the petition for rehearing and response, having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on June 13, 2011.

Circuit Judge Moore did not participate in the vote.

* The court granted leave to Bausch & Lomb Incorporated to file a brief amicus curiae in support of Appellees' petition.

FOR THE COURT,

/s/ JAN HORBALY
Jan Horbaly
Clerk

Dated: 06/06/2011

cc: Joan I. Oppenheimer
Howard R. Rubin
Roger J. Jones

GRAPEVINE IMPORTS V US, 2008-5090
(CFC – 05-CV-296)

APPENDIX D

Section 6501 of the Internal Revenue Code of 1986 provides in pertinent part:

§ 6501. Limitations on assessment and collection

(a) General rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. For purposes of this chapter, the 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).

. . .

(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. . . .

26 U.S.C. § 6501 (2000).

Section 6229, which was meant to parallel Section 6501 to afford the same limitations period for partnership items, provides in pertinent part:

§ 6229. Period of limitations for making assessments

(a) General rule

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 (determined without regard to extensions).

. . .

(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". . . .

Id. § 6229 (2000).

APPENDIX E

Section 275 of the Internal Revenue Code of 1939 provided in pertinent part:

> § 275. 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.
>
> . . .
>
> (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.
> . . .

26 U.S.C. § 275 (1938 ed., Supp. I).

APPENDIX F

Sections 301.6501(e)-1 and 301.6229(c)(2)-1 of Title 26 of the Code of Federal Regulations provide in pertinent part:

§ 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.

. . .

(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.

§ 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.

26 C.F.R. §§ 301.6501(e)-1, 301.6229(c)(2)-1 (2010).