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Statute of Limitations for Overstatements of Basis

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STATUTE OF LIMITATIONS FOR OVERSTATEMENTS OF BASIS

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I. QUESTION PRESENTED

In *United States of America v. Home Concrete and Supply, LLC*,__U.S__, 132 S.Ct. 1836, 182 L.Ed.2d 746 (2012), the United States Supreme Court addressed the following issue:

> Whether the IRS has three years or six years to assess a deficiency against a taxpayer when the taxpayer overstates his basis in property that he has sold, thereby understating the gain that he received from its sale.

On April 25, 2012, the Supreme Court followed its prior holding in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958) by holding that the three year - not the six year - statute applies.

II. THE STATUTE

The Internal Revenue Code requires the IRS to assess additional tax within three years of the date a tax return is filed, unless a statutory exception applies. 26 U.S.C. § 6501(a) (2000 ed.). The exception that became the focus in the *Home Concrete* case is the one found in 26 U.S.C. § 6501(e)(1)(A) which extends the three year period to six years when a taxpayer:

> omits from gross income an amount properly includable therein which is in excess of 25 percent of the amount of gross income stated in the return.

A. The quoted language is materially indistinguishable[1] from the provision originally enacted by Congress in 1934 when

[1] In 1954, "percentum" was replaced with "percent." *See* 26 U.S.C. § 6501(e)(1)(A) (2000 ed.).

the normal three year limitations period was extended from three years to five years for cases involving taxpayer omissions from gross income. 26 U.S.C. § 275(c) (1940 ed.).

B. The relevant version of the statute for the *Home Concrete* case was recodified in 1954, when Congress reenacted the entire Internal Revenue Code. As mentioned, the quoted provision was carried forward and recodified as §6501(e)(1)(A).[2] However, Congress also added two new subparagraphs to §6501(e)(1)(A), which provided:

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 appraise the Secretary or his delegate of the nature and amount of such item.

III. CASE LAW BEFORE *COLONY*

The meaning of the phrase "omits from gross income an amount properly includable therein" was the subject of

[2] The new statute changed the extension from two years to three.

considerable litigation before the Supreme Court addressed the issue in *Colony*, as follows:

A. In *Reis v. Commissioner*, 142 F.2d. 900 (6th Cir. 1944), the Sixth Circuit found that there was an omission from gross income where the taxpayer in question overstated his basis in certain pieces of property that he sold, thus extending the statute of limitations from three years to five years.

B. In *Uptegrove Lumber Co. v. Commissioner*, 204 F.2d. 570 (3rd Cir. 1953), the Third Circuit addressed the same language in a case where the taxpayer was a manufacturing corporation that inappropriately included a reserve for retroactive wage increases in its cost of goods sold - thus, arriving at an incorrect gross profit from sales. After reviewing the legislative history, the Third Circuit concluded that:

> The history of Section 275(c) persuasively indicates that Congress was addressing itself particularly to the situation where a taxpayer shall fail to include some receipt or accrual in his computation of gross income and not in a more general way to errors of whatever kind in that computation.

Id. at 572.

Accordingly, the Third Circuit held that the three year, not the five year, statute of limitations applied.

C. The Ninth, Fifth and Eighth Circuits agreed with *Uptegrove Lumber*, holding that the statute of limitations could not be extended in situations where the taxpayers included their gross receipts, but erred in their computation of taxable incomes. *See Slaff v. Commissioner,* 220 F.2d. 65 (9th Cir. 1955);

Davis v. Hightower, 230 F.2d. 549 (5th Cir. 1956); *Goodenow v. Commissioner*, 238 F.2d. 20 (8th Cir. 1956).

IV. THE *COLONY* DECISION

A. FACTS AND PROCEEDINGS BELOW

Colony involved a situation where the taxpayer allegedly "understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the "basis" of such lots by erroneously including in their costs certain unallowable items of development expense." 357 U.S. at 30.

After the Tax Court found that the extended (five year) statute should apply, the Sixth Circuit again faced the question it had addressed in *Reis* thirteen years earlier. Despite the clear conflict in interpretation of the statute with the Third, Fifth, Eighth and Ninth Circuits, the Sixth circuit adhered to this earlier ruling, noting that the "reasoning of these cases is not without considerable persuasive force, and if the question were here for the first time, we might be disposed to follow them." *Colony, Inc. v. Commissioner*, 244 F.2d 75 (6th Cir. 1957). However, because of *Reis* Sixth Circuit declined to follow the other circuits and affirmed the Tax Court's decision.

B. SUPREME COURT ANALYSIS

After granting *certiorari*, the Supreme Court began its review with the "critical statutory language, "omits from gross income an amount properly includable therein." *Id*. at 32. The IRS argued that the Court should focus on the word "amount" which suggested a concentration on a quantitative aspect of the error - *i.e.*, whether or not gross income was understated by as much as 25 percent. The Supreme Court noted that “[t]his view is somewhat reinforced if, in reading the above -- quoted phrase, one touches lightly on the word “omits” and bears down hard on the words “gross income,” for where a cost item is overstated, as in the case before us, gross income is affected to the same degree as when a gross-receipt item of the same amount is completely omitted from the tax return.” *Id*.

The taxpayer, on the other hand, argued that the IRS’s reading failed to take full account of the word “omits,” which Congress selected when it could have chosen something else, such as “reduces” or “understates.”

The Court agreed with the taxpayer’s argument that “omit” is to be given the standard dictionary definition: “to leave out or unmentioned; not to insert, include or name.” Relying on this definition, the taxpayer argued that the statute should be limited to situations in which specific receipts or accruals of income are *left out* of the computation of gross income. The Supreme Court agreed with this position. *Id.* at 33.

While the Court preferred the taxpayer’s interpretation, it did note that “it cannot be said that the language is unambiguous.”*Id.* In order to resolve any ambiguity, the Court turned to the legislative history of the statute. When it did so, the Court found in that history “persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some receipt or accrual in its computation of gross income, and not more generally to errors in that computation arising from other causes.” *Id*.

Justice Harlan, who wrote for the Court, said that in enacting the provision:

> Congress manifested no broader purpose than to give the Commissioner an additional two [now three] years to investigate tax returns in cases where, because of a taxpayer's omission to report some tangible item, the Commissioner is at a special disadvantage in detecting errors. … [W]hen, 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. To accept the Commissioner's interpretation and to impose a five-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 as justified by the evident reason for its enactment, but also to create a patent incongruity in the tax law. *Id.*

Thus, the Supreme Court reversed the Sixth Circuit and sided with the Third, Fifth, Eighth and Ninth Circuits in its construction of the phrase "omits from income" to mean failure to include specific receipts or accrual of income in excess of 25 percent of the amount stated in the return, and not where the income and receipts are all stated but then reduced by an overly large basis as disclosed on a return.

The Court also noted that, while it was construing former Section 275(c) of the 1939 Tax Code, "we observe that the conclusion that we reach is in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954." *Id.* at 38.

V. HISTORY AFTER COLONY

A. LAW BEFORE 2000

For a number of years following Colony, the issue of extending the statute of limitations from three years to six in an "overstated basis" case appeared to have been settled. Other than attempting to distinguish Colony in a few other cases, the IRS seemed content to abide by the Court's ruling. *See, e.g., Phinney v. Chambers*, 392 F.2d 680 (6th Cir.), *cert denied*, 391 U.S. 935 (1968); *CC&FW Operations Ltd. v. Commissioner*, 273 F.3d 402 (1st Cir. 2001). In 1976, the IRS recognized *Colony* as "[t]he landmark" case construing § 6501(e), while acknowledging that *Colony*'s holding is "in harmony with" § 6501(e)(1)(A). IRS Gen. Couns. Mem. 36856 (Sept. 21, 1976).

B. SON-OF-BOSS

The IRS's position on *Colony* changed, however, in the early 2000s, with the advent of a transaction that became known as "Son-of-BOSS." In a Son-of-BOSS transaction a taxpayer uses some mechanism, often a short sale, to increase his basis in an asset before the asset is sold. In August 2000, the IRS issued notice 2000-44, 2000-2 C.B. 255, which set forth, in some detail, the IRS's position that tax consequences claimed by taxpayers in connection with Son-of-BOSS transactions were contrary to the intent of the Code. The IRS contended – and several courts have agreed – that these transactions lacked "economic substance" and, in the ensuing months and years, the IRS took several steps to identify and educate its examiners about transactions fitting the Son-of-BOSS pattern. Brief for Respondents p. 10.

Meanwhile, the IRS began an aggressive program of asserting tax deficiencies related to Son-of-BOSS in similar transactions, even when the three year limitations period had expired. In such cases, the IRS advanced the argument that the Supreme Court holding in Colony applied only in the context of the sale of goods or services by a trade or business and not to a taxpayer's basis in property. The Tax Court rejected that argument, and the Ninth Circuit affirmed. *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767 (9th Cir. 2009). The Federal Circuit agreed with the Ninth Circuit. *Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009).

VI. FACTS RELEVANT TO *HOME CONCRETE*

A. Home Concrete began as a small business in Salisbury, North Carolina that had been in operation for more than 50 years before the transactions at issue in the case occurred. Robert Pierce and Stephen Chandler became the principal owners and day-to-day managers of the company in 1985. By 1999, Mr. Pierce, who owned approximately 81% of the outstanding shares, decided to retire and sell the business. Being a small business owner with no expertise in such matters, Pierce sought financial planning advice from several highly recommended financial and legal professionals. Upon advice from those professionals, the following transactions occurred prior to the sale of the business:

(1) Home Concrete & Supply, LLC was formed on April 15, 1999. Home Concrete's initial members were Pierce, Chandler, Home Oil, and two trusts for the benefit of Pierce's children (collectively, the "partners").

(2) On May 13, 1999, each partner commenced a short sale of Treasury notes.

(3) On May 17, 1999, each partner contributed the proceeds from the short sales of Treasury notes, together with the short Treasury note positions and margin cash, to Home Concrete as capital contributions.

(4) On May 18, 1999, Home Concrete closed its Treasury note short positions by purchasing Treasury notes in the open market.

(5) On June 11, 1999, Home Oil transferred substantially all of its business assets to Home Concrete as a capital contribution.

(6) On June 14, 1999, each partner transferred a percentage of its membership interests in Home Concrete to Home Oil as a capital contribution to Home Oil.

(7) In connection with such transfers, Home Concrete made an election pursuant to 26 U.S.C. § 754 to step up the basis of its assets.

(8) On August 31, 1999, Home Concrete sold substantially all of its assets to a third party for a gross sales price of $10,623,348.

Brief for Respondents, pp. 12-13.

Home Concrete timely filed its partnership tax return on or before April 17, 2000. That return reported the sale of Home Concrete's assets, including the gross sales price ($10,623,348), the partnership's original basis ($4,542,824.36), the election to adjust its basis, and the resulting stepped-up basis ($10,527,350.53). Home Concrete also attached Form 8594 (Asset Acquisition Statement Under Section 1060), on which it reported the third-party purchaser's information and the fair market value of the sold assets. Brief for Respondents p. 13. The partners also filed their returns which, among other things, disclosed that "during the year the proceeds of a short sale not closed by the taxpayer were received." *Id*. at 14.

For unknown reasons, the IRS did not begin auditing Home Concrete's 1999 return until almost six years after it was filed. In a letter dated February 23, 2006, the IRS notified Mr. Pierce that Home Concrete's return had "been selected for examination" because of a Son-of-BOSS transaction. On September 7, 2006, the IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA), in which the IRS asserted that Home Concrete's claimed basis in the sale of its assets was grossly overstated. The IRS did not allege that the 1999 returns were fraudulent. *Id.*

VII. THE *HOME CONCRETE* LITIGATION

A. On December 5, 2006, Home Concrete filed a Complaint in the Eastern District of North Carolina, seeking a declaration that the FPAA was bared by the three year statute of limitations. In addition to declaratory relief, Mr. Pierce (the tax matters partner) sought the return of $1,392,118 he deposited with the Court, plus any accrued interest. The IRS argued that the FPAA was timely because the six year statute of limitations contained in § 6501(e)(1)(A) had not run. Both parties filed cross-motions for summary judgment.

B. On March 9, 2009, the district court agreed with the IRS, granting partial summary judgment in its favor and rejecting Home

Concrete's argument that *Colony* required a different result.

VIII. THE NEW TREASURARY REGULATIONS

A. In September 2009, during the pendency of the *Home Concrete* case, and following losses on this issue in the Ninth and Federal Circuits, the IRS issued new temporary regulations under § 6501[3], purporting to limit the statutory language at issue in *Colony* to situations involving the sale of goods or services by a trade or business. 74 Fed. Reg. 49, 321 (September 28, 2009).

B. In December, 2010, the IRS withdrew the temporary regulations and issued virtually identical final regulations. 755 Fed. Reg. 78, 897 (December 17, 2010).

IX. FOURTH CIRCUIT DECISION IN *HOME CONCRETE* AND CIRCUIT SPLIT

A. On February 7, 2011, the Fourth Circuit reversed the trial court, concluding that the Supreme Court decision in *Colony* "forecloses the argument that Home Concrete's overstated basis in its reporting of the short sale proceeds resulted in an omission from its reported gross income." *Home Concrete and Supply, LLC v. U.S.*, 634 F.3d 249, 255 (4th Cir. 2011). The Fourth Circuit also refused to apply the new IRS regulations retroactively because the regulations appear to be prospective only and purported "to establish a rule contrary to *Colony* to subject the

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[3] In 1982, Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), which created a unified procedure for determining the tax treatment of all partnership items at the partnership level. TEFRA added § 6229(c)(2), which contains language substantively identical to that of § 6501(e)(1)(A), but applies only to partnerships. Section 6229(c)(2) does not contain the language that appears in subparagraphs (i) and (ii) of § 6501(e)(1)(A). The new temporary and final regulations discussed herein purport to apply to § 6229 as well as § 6501.

taxpayers to the extended limitations period ten years later." *Id.* at 257.

B. Judge Wilkinson joined the Court's opinion in full but wrote separately to stress that the IRS' attempt to limit the holding in *Colony* "pass[es] the point where the beneficial application of agency expertise gives way to a lack of accountability and risk of arbitrariness." *Id*. at 259.

C. The Fourth Circuit's opinion in *Home Concrete* was in accord with decisions from the Fifth and Ninth Circuits. *See Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767 (9th Cir. 2009); *Burks v. United States*, 633 F.3d 1347 (5th Cir. 2011). By contrast, the Seventh, Tenth and DC Circuits adopted the IRS' view and/or followed the new regulations, thus declining to following *Colony. See Beard v Commissioner*, 633 F.3d 616 (7th Cir. 2011); *Salman Ranch, Ltd. v. Commissioner*, 647 F.3d 929 (10th Cir. 2011); *Intermountain Insurance Services of Vail, LLC v. Commissioner*, 650 F.3d 619 (D.C. Cir. 2011).[4]

Thus, there was a clear conflict among the circuits when the Supreme Court granted *certiorari* in *Home Concrete*.

X. THE PARTIES' ARGUMENTS BEFORE THE SUPREME COURT

A. IRS Arguments. The IRS focused on three arguments:

(1) The Code defines "gross income" for federal tax purposes as all income from whatever source derived, specifically including "gains

[4] Interestingly, the Federal Circuit had an intra-circuit conflict in that it held in favor of the taxpayers with respect to the application of *Colony* before the IRS regulations became final but ruled against the taxpayers after the regulations took effect. *See Salman Ranch, Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009); *Grapevine Imports, Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011).

derived from dealings in real property," which, in turn, is defined as "the excess of the amount realized over the unrecovered cost or other basis for the property sold or exchanged." 26 U.S.C. § 61(a)(3). Because a gain on a sale of property is determined by subtracting the taxpayer's basis from the sale price, a taxpayer can improperly report income from a property sale either by overstating his basis in the property or by understating the property's sale price. In this case, the taxpayer "stepped-up" its basis pursuant to the Son-of-BOSS transaction described above. According to the IRS, overstating basis has the same effect as understating the partnership's sale price. Both scenarios, according to the IRS, fit squarely into the definition of an "omission from gross income."

(2) The IRS argued that two adjacent statutory provisions within Section 6501(e) support the conclusion that an overstatement of basis amounts to an omission from gross income:

(a) Subparagraph (i) of Section 6501(e)(1)(A), added in 1954, creates an "exception" to the general rule that applies only to a trade or business. That subparagraph, according to the IRS, was enacted to eliminate the possibility that a trade or business could trigger the six year assessment period by overstating its basis in property sold. This special rule for trades and businesses would be unnecessary, according to the IRS, if the phrase "omits from gross income an amount properly included therein" already excluded understatements of income attributable to overstatements of basis. Brief for the United States, p. 21.

(b) Section 6501(e)(2), which applies to estate and gift taxes, gives the IRS six years from the filing of a return to assess additional tax "if the taxpayer omits . . . *items* includable" in the gross estate. 26 U.S.C. § 6501(e)(2) (emphasis added). According to the IRS, Congress used the term "items" to "make it clear that the six-year period is not to apply merely because of differences between the taxpayer and the Government as to valuation of property." Brief for the United States, p. 23. By contrast, Section 6501(e)(1)(A) provides for a six year assessment period "if the taxpayer omits from gross income an *amount* properly includable therein." 26 U.S.C. § 6501(e)(1)(A) (emphasis added). The IRS argued that Congress's reference to "amounts" rather than "items" strongly suggests that the six year assessment period applies both in cases where an item of income is completely left off and situations where the amount of gross income is understated due to an error in the calculation. *Id*.

(3) Finally, the IRS argued that the new regulations resolve the dispute in the IRS's favor once and for all. *Colony* was construing the older statute, not the new one; and the Court expressly stated that it was not addressing the statute as enacted in 1954. In any event, *Colony* recognized that the statutory language was ambiguous, thus leaving room for the IRS to clarify the ambiguity by regulation, which regulation is, in turn, entitled to deference under *Chevron USA, Inc. v. MRDC*, 467 U.S. 837 (1984). *See Mayo of Foundation v. United States*, 131 S. Ct. 704 (2011); *National Cable & Telecoms Association v. Brand X Internet Services*, 545 U.S. 967 (2005).[5]

B. Taxpayer Arguments. The taxpayer rebutted the IRS arguments as follows:

(1) *Colony* controls the outcome of this case. *Colony* construed the very language at issue in this case in the taxpayer's favor, holding that an overstatement of basis does not

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[5] There were additional arguments, argued vigorously by both sides, regarding the promulgation, effective date and retroactivity of the new regulations, but these were not reached by the Supreme Court.

constitute an omission from gross income in order to extend the statute of limitations. The IRS's reliance on the Code's definition of "gross income" is the same argument that the IRS made in the Supreme Court in *Colony* which was rejected because the Court chose to focus instead on the word "omits," which is not defined in the Code but is instead entitled to its ordinary meaning, which the Court said means "to leave out" or "to fail to include or mention." Brief for Respondents, p. 23. In this case, the taxpayer included all income and receipts from the sale of its business on its return, as well as including the original basis, the election to step up the basis, and the increased basis on the face of the return. Thus, under *Colony*, there was no "omission" at all.

(2) The relevant statutory language "omits from gross income an amount properly includable therein" was enacted in 1934 and carried forward by Congress not only in the 1954 Code but also through a total of six substantive amendments to the 1954 Code thereafter. Brief for Respondents, p. 9.

(3) Subparagraph (i) to Section 6501(e)(1)(A) is not an "exception" to the general rule but rather a clarification of it. That subparagraph was added shortly after the Third Circuit's decision in *Uptegrove Lumber v. Commissioner*, 204 F.2d 570 (3d Cir. 1953). The Third Circuit decided that despite the definition of gross income and

the regulations for a manufacturing, merchandising or mining business, which included the total sales, less the cost of goods sold, the legislative history was clear that Congress intended to extend the statute only in situations where an item of income was left out, not when there was an error in the computation. Thus, the Third Circuit decided the case in favor of the taxpayer, who happened to be a trade or business. The better, more sensible, explanation for the addition of (i) is simply that it was added to codify the result in *Uptegrove Lumber* in the context of a trade or business – because a need for a clarification in that particular circumstance had been brought to the attention of Congress immediately prior to enacting the new provision. Brief in Opposition to Petition for Writ of Certiorari p. 22.

Additionally, *Colony* cannot be limited in the way the IRS contends because *Colony* involved the sale of real property, which is neither a "good" nor a "service," as referred to in (i). Because subparagraph (i) would not have applied on the facts of *Colony*, it is inconceivable that the Supreme Court's statement that its interpretation of the prior statute was "in harmony with" the new one embraced the government's reading of the statute – which would wipe out *Colony*. Brief for Respondents p. 32.

(4) The IRS's reliance on Section 6501(e)(2) is misplaced. Congress

added paragraph (e)(2) as part of the 1954 amendments, to cover estate and gift taxes. This section has no application to income taxes. Moreover, *Colony* already considered the IRS's "amount" argument and specifically rejected it. Congress's post-*Colony* change in 1965 to the heading of Section 6501 – from "omission from gross income" to "substantial omission of items" – underscores that Congress understood and affirmatively endorsed the *Colony* holding. Brief for Respondents, P. 35.

(5) The new regulation does not, and cannot, compel a different result here. The Court's decision in *Colony* definitely declared "what the law is" with respect to the key statutory question at issue. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177 (1803). Applying the traditional tools of statutory construction, the Supreme Court in *Colony* concluded that Congress had "directly spoken to the precise question at issue," and had instructed that an "omission from gross income" occurred *only* when item of gross income had been left out entirely. Brief for Respondents, P. 37. For purposes of *stare decisis*, the statutory holding must govern. Since the Court has spoken to the precise question at issue, there is no room for the agency to overrule *Colony* by "reinterpreting" the statute because there is no gap for the agency to fill. For that reason alone, the IRS's reliance on *Brand X* is misplaced. Congress's ratification

> of the Supreme Court's interpretation removes any doubt that the agency is not free to adopt a different one. Brief for Respondent pp. 38-9.

XI. SUPREME COURT DECISION

In a five to four decision, with Justice Scalia filing a separate concurring opinion, the Supreme Court affirmed the Fourth Circuit's ruling in favor of the taxpayer.

A. THE OPINION

The Court agreed with the taxpayer that *Colony* determines the outcome of this case. 132 S.Ct. at 1841. The Justice Breyer, writing for the Court, said:

> The provision before us is a 1954 reenactment of the 1939 provision that *Colony* interpreted. The operative language is identical. It would be difficult, perhaps impossible, to give the same language here a different interpretation without effectively overruling *Colony*, a course of action that basic principles of *stare decisis* wisely counsel us not to take.

Id.

The Court rejected the IRS's argument that the inclusion of (i) in the relevant section and the mention of "items" in the gifts and estates section in the 1954 Code changes the outcome. Justice wrote that "these points are too fragile to bear the significant argumentative weight the Government seeks to place upon them." *Id.*

With respect to (i), the Court agreed with the taxpayer's argument that a plausible reason why Congress added (i) was to settle the then-current debate over how the statute operated with respect to the sale of goods and services by a trade or business and to codify *Uptegrove Lumber*. The Court also pointed out that (i) explains how to calculate whether or not the taxpayer has exceeded the 25 percent threshold in the trade or business context. *Id.* at 1842.

The Court viewed the IRS's argument regarding the estate and gift tax "item" language as an even weaker one. The opinion pointed out that a similar argument had been raised and rejected by the Court in *Colony* itself. As Justice Breyer put it:

> But to rely in the case before us on this solitary word change in a different subsection is like hoping that a new bat boy will change the outcome of the World Series.

Id.

Dealing with the IRS's new regulation, the Court recognized the IRS's argument that the regulation was entitled to *Chevron* deference but pointed out that the regulation is "entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the *unambiguous* terms of the statute … . *National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967, 982 (2005) (emphasis in original)." Although the Court recognized that *Colony* itself had characterized the statute as "not unambiguous," this did not mean that the IRS is automatically entitled to win the case by enacting the regulation:

> We do not accept this argument. In our view, *Colony* has already interpreted the statute, and there

> is no longer any different construction that is consistent with *Colony* and available for adoption by the agency.

Id. at 1843.

Although not joined by Justice Scalia in the remaining reasoning, the Court went on to explain why the IRS was not entitled to change the outcome where the statute had been declared “not unambiguous” in *Colony*. The Court reasoned that it does not automatically follow from a pre-*Chevron* reference to a linguistic ambiguity that Congress has delegated gap-filling power to the agency. *Id*. at 1844. This was true because the *Colony* court examined the statute carefully, finding that the taxpayer had the better side of the textual argument (regarding the definition of “omission”); and it examined the legislative history and concluded that Congress had decided the question definitively, leaving no room for the agency to reach a contrary result. *Id*. The Court also agreed with the *Colony*’s conclusion that the IRS’s interpretation would “create at patent incongruity in the tax law” (by treating overstated basis differently from overstated deductions). *Id*. Finally, *Colony*’s finding that its interpretation of the 1939 Code was “in harmony with the [now] unambiguous language” of the 1954 Code, suggests that the *Colony* Court saw nothing in the new Code as being inconsistent with its conclusion. *Id*.

Thus, the Court reasoned that the Court in *Colony* concluded that the statute left no gap to be filled by the IRS. The Court concluded:

> Given principles of *stare decisis*, we must follow [*Colony*’s] interpretation. And there being no gap to fill, the government’s gap-filling regulation cannot change

> *Colony*'s interpretation of the statute. We agree with the taxpayer that overstatements of basis, and not the resulting understatement of gross income, do not trigger the extended limitations period of § 6501(e)(1)(A).

Id.

B. JUSTICE SCALIA'S CONCURRENCE

Justice Scalia concurred in part and concurred in the judgment. In his view, *Colony* determines the outcome in this case because of "justifiable taxpayer reliance" on that decision.

However, Justice Scalia took the opportunity to amplify his dissent in *Brand X* by pointing out the difficulty in evaluating the ambiguous/non-ambiguous determination of statutes made in cases decided pre-*Chevron*. He pointed out that pre-*Chevron* Courts had no idea that their rulings might be changed by an agency regulation if they found the statute to be ambiguous. *Id*. at 1846. He also argued that the plurality's rationale for finding that there was no gap to be filled (textual argument, legislative history, patent incongruity, in harmony with new statute) are the sorts of arguments that courts use in *resolving* ambiguities. *Id*. at 1848. Justice Scalia concluded:

> "Rather than making our judicial-review jurisprudence curiouser and curiouser, the Court should abandon the opinion that produces these contortions, *Brand X*. I join the judgment announced by the Court because it is indisputable that *Colony* resolved the construction of the statutory language at issue here, and that construction must

> therefore control. And I join in the Court's opinion except for part IV-C."

Id.

C. THE DISSENT

Justice Kennedy wrote the dissent, joined by Justices Ginsburg, Sotomayor and Kagan. Essentially, these Justices agreed with the IRS that the amendments to the 1954 Code (the addition of (i) and the "items" provision in the estate and gift tax section) "may not compel the opposite conclusion under the new statute, but they strongly favor it. As a result, there was room for the Treasury Department to interpret the new provision in that manner." *Id*. at 1851.

In other words, the dissent agreed with the IRS's position that "a judicial construction of an ambiguous statute did not foreclose an agency's later, inconsistent interpretation of the same provision." *Id*. The dissent would avoid saying that the IRS can overrule the prior Supreme Court decision in *Colony* by concluding that *Colony* did not interpret the same statute, with its amendments, as it is being interpreted today. Justice Kennedy concluded that:

> The Court goes too far, in my respectful view, in constricting Congress's ability to leave agencies in charge of filling statutory gaps.

Id. at 1852.

Thus, the dissent would give full effect to the new IRS regulations, which in turn would dictate that the six-year statute, not the three-year statute, applies in this case. *Id*. at 1853.

XII. CONCLUSION

The clear holding by the *Home Concrete* majority is that an overstatement of basis in sold property does *not* qualify as an "omission from gross income" for purposes of extending the period for assessment of a deficiency against a taxpayer from three years to six years. This ruling should apply generally to "overstatement of basis" cases – not just Son-of-BOSS cases—unless another statutory exception applies.[6] *See*, *e.g.*, *Wilmington Partners, LP, et al. v. Commissioner*, 2012 U.S. App. Lexis 18941(2d Cir. Sept. 10, 2012) (partnership's increase in basis outside the context of Son-of-BOSS transactions did not qualify as an "omission from gross income" under 26 U.S.C. § 6229(c)(2)).

Beyond the specific holding of *Home Concrete*, the Supreme Court has left doubt as to the gap-filling authority of the IRS and other federal agencies by regulation in pre-*Chevron* cases. The plurality would deny the agencies the authority to fill gaps where the pre-*Chevron* court examined the statute and gave it a clear interpretation under traditional rules of statutory construction, despite apparent ambiguity in the statutory language. Justice Scalia would take a different approach by abandoning the ambiguous/unambiguous analysis in pre-*Chevron* cases altogether. And four of the current Justices would grant the regulatory agencies authority to change the outcome of judicial decisions where the Court has found a relevant statutory ambiguity. It remains to be seen which of these views will prevail in the future.

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[6] In 2004, Congress amended € 6501 by adding a new subsection (c) (10) which provides that, in the case of a "listed" transaction like "Son-of-BOSS," the limitations period for assessing tax does not expire until one year after the taxpayer submits certain information. However, this exception only applies to tax years with respect to which the period for assessing a deficiency "did not expire" before October 22, 2004.

As for post-*Chevron* cases, the message seems to be clear: the best way to avoid unwanted agency regulation of areas within its expertise is for the court to find that Congress has addressed the precise question at issue by unambiguous statutory pronouncement.