No. 11-139

In The
Supreme Court of the United States

UNITED STATES OF AMERICA,

Petitioner,

v.

HOME CONCRETE & SUPPLY, LLC, *et al.*,

Respondents.

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

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether this case rises to the level of importance worthy of the Supreme Court's consideration in light of the enactment of 26 U.S.C. § 6501(c)(10) (2004) by Congress.

2. Whether an understatement of income resulting from an overstatement of the tax basis of sold property can qualify as an omission from gross income for purposes of the extended, six-year assessment period set forth in 26 U.S.C. § 6501(e)(1)(A) (1999).

3. Whether a final regulation promulgated by the Department of Treasury during the appeal of this case in direct conflict with Supreme Court precedent in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958), is entitled to deference by the Supreme Court.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Supreme Court Rules of Procedure, taxpayers state that there is no parent corporation or publicly held corporation that owns 10% or more of the stock of any of the corporate taxpayers.

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STATEMENT OF THE CASE

This case involves an attempt by the Internal Revenue Service ("IRS") to address a statute of limitations issue that has already been addressed by Congress and this Court. The petition for writ of certiorari should be denied for the reasons set forth herein.

Home Oil & Coal Company, Inc. ("Home Oil") was a small family business in Salisbury, NC that had been in operation for over 50 years before the transactions underlying this case took place. Robert Pierce worked for the family business part-time as a teenager before beginning work there fulltime in 1968. Steven Chandler began working there in 1972. Mr. Pierce and Mr. Chandler were the only two shareholders of Home Oil in 1999. Mr. Pierce owned approximately 81 percent, and Mr. Chandler owned approximately 19 percent of the outstanding shares at the time. The business evolved from selling home heating oil to primarily selling concrete for residential construction.

By early 1999, Mr. Pierce had decided he wanted to retire and sell the business. Given the importance of the sale for himself and his family, Mr. Pierce sought financial planning assistance from several highly recommended financial and legal professionals. Upon advice of those professionals, the taxpayers sold the business in 1999 and reported the sale in their tax returns which were timely filed in April 2000. Unfortunately, the advice of those professionals, and the transactions that took place

upon the sale of the family business, are what have lead to this litigation.

The family business was sold by a partnership that was formed on April 15, 1999, called Home Concrete & Supply, LLC ("Home Concrete"). For federal income tax purposes, the income tax treatment of partnership items is determined at the partnership level. 26 U.S.C. § 6221 (1999). If, on audit, the Internal Revenue Service ("IRS") determines that an adjustment should be made in an income tax return filed by a partnership, it issues a Federal Partnership Administrative Adjustment ("FPAA"). 26 U.S.C. § 6223(a)(2) (1999). The issuance of the FPAA stops the running of the applicable statute of limitations for the assessment of additional taxes. 26 U.S.C. § 6229(d) (1999).

Petitioner issued the FPAA to Home Concrete for its 1999 tax year on September 7, 2006, well beyond the three year period for assessing income tax specified in 26 U.S.C. § 6501(a) (1999). The FPAA proposed to reduce the reported basis in the assets of Home Concrete at the time of Home Concrete's sale of such assets in 1999. Home Concrete correctly reported on its income tax return the gross sales price from the sale of its assets, and disclosed an itemized increase in basis for each class of assets in the partnership, but petitioner asserts that Home Concrete overstated its basis in such assets in a transaction that it later labeled a "Son-of-BOSS" tax shelter.

Respondents filed their complaint in this action with the Eastern District of North Carolina on

December 5, 2006, seeking a declaration that the FPAA was barred by the three-year statute of limitations. In addition to declaratory relief, respondents sought the return of the $1,392,118.00 deposited with the trial court below, plus any accrued interest. Petitioner contended that the FPAA was timely because the six-year statute of limitations contained in § 6501(e)(1)(A) had not run, and the trial court agreed, entering partial summary judgment for petitioner on March 9, 2009.

On September 28, 2009, the Secretary of Treasury promulgated Temporary Treasury Regulation § 301.6501(e)-1T (2009) (the "Regulation"), in which the Treasury concludes that "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)." *Id.* The Secretary published the Regulation in final form without any material changes on December 17, 2010. Treas. Reg. § 301.6501(e)-1 (2010).

On February 7, 2011, after briefing and oral argument, the Court of Appeals for the Fourth Circuit reversed the trial court, concluding that this Court's decision in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958), "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 & Supply, LLC v. U.S.*, 634 F.3d 249, 255 (4th Cir. 2011). The Court of Appeals also refused to apply the Regulation retroactively to this case because it was both inapplicable by its own terms and purported "to

establish a rule contrary to *Colony* to subject the taxpayers to the extended limitations period ten years later." *Id.* at 257. Petitioner filed a petition for rehearing en banc, which was denied in an order dated April 5, 2011. On August 3, 2011, petitioner filed a petition for writ of certiorari with this Court.

REASONS FOR DENYING WRIT

I. Congress addressed petitioner's concerns when it enacted 26 U.S.C. § 6501(c)(10).

The threshold question is whether the issue presented in this case, and other similar cases, is worthy of consideration by this Court. The answer is no.

Petitioner has labeled the transaction entered into by respondents in this case a "Son-of-BOSS" tax shelter,[1] which begs the question—What is the appropriate statute of limitations for assessing additional tax when a taxpayer engages in an alleged "Son-of-BOSS" tax shelter? That issue was answered definitively by Congress in 2004 when it enacted 26 U.S.C. § 6501(c)(10) (2004) as part of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 814(a) (the "2004 Act").[2] Section 6501(c)(10) provides as follows:

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[1] For purposes of this brief only, respondents use the terms "tax shelter" and "listed transaction" interchangeably.

[2] Pursuant to the 2004 Act, § 6501(c)(10) is effective for tax years with respect to which the period for assessing a deficiency did not expire before October 22, 2004. Because, under *Colony*, respondents' statutes of limitations were closed before October 22, 2004, this provision is inapplicable to this case.

> (10) Listed transactions.—If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction (as defined in section 6707A(c)(2)) which is required under section 6011 to be included with such return or statement, the time for assessment of any tax imposed by this title with respect to such transaction shall not expire before the date which is 1 year after the earlier of—
>
> (A) the date on which the Secretary is furnished the information so required, or
>
> (B) the date that a material advisor meets the requirements of section 6112 with respect to a request by the Secretary under section 6112(b) relating to such transaction with respect to such taxpayer.

The term "listed transaction" means a transaction which is the same as, or substantially similar to, a transaction specifically indentified by the Secretary as a tax avoidance transaction for purposes of 26 U.S.C. § 6011 (2011). 26 U.S.C. § 6707A(c)(2) (2011).

IRS Notice 2000-44, 2000-36 I.R.B. 255, to which petitioner cites in its petition at footnote 1, was issued in response to the type of transaction at issue in this case—which, as mentioned above, has

since been labeled with the moniker "Son-of-BOSS". In that Notice, the IRS advised that "[t]ransactions that are the same as or substantially similar to the transactions described in this Notice 2000-44 are identified as "listed transactions" for the purposes of section 1.6011-4T(b)(2) of the Temporary Income Tax Regulations and section 301.6111-2T(b)(2) of the Temporary Procedure and Administration Regulations."

Thus, Congress has enacted a separate statute of limitations for all alleged tax shelters, including "Son-of-BOSS," entered into after the effective date of § 6501(c)(10). Congress added this provision to address a concern with respect to listed transactions without changing the six-year statute of limitations or overruling this Court's decision in *Colony*. Since *Colony* was decided, Congress has amended § 6501(e) nine times[3], yet it never changed the relevant language that was considered in *Colony*, and is controlling in this case. Congress certainly could have changed the law to overturn the rule in *Colony* if it saw fit. In fact, the same 2004 Act overturned the rule that resulted from *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C.

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[3] *See* Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147, § 513(a)(1); American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 413(c)(28); Revenue Act of 1978, Pub. L. No. 95-600, § 701(t)(3)(A); Black Lung Benefits Revenue Act of 1977, Pub. L. No. 95-227, § 4(d)(4); Tax Reform Act of 1976, Pub. L. No. 94-455, §§ 1307(d)(2)(F)(vi) and 1906(b)(13)(A); Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 1016(a)(14); Excise, Estate, and Gift Tax Adjustment Act of 1970, Pub. L. No. 91-614, § 102(d)(8); Tax Reform Act of 1969, Pub. L. No. 91-172, § 101(g)(3); Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, § 810(b).

197 (2000), *aff'd per curiam*, 255 F.3d 495 (8th Cir. 2001), with respect to the costs of entertainment, amusement or recreation-related goods, services, and facilities provided by private and publicly-held companies to "specified individuals". *See* 26 U.S.C. § 274(e)(2)(B), as enacted by Pub. L. No. 108-357, § 907 (2004). Congress chose to leave *Colony* intact and limit the new provision's application to certain tax shelters, including "Son-of-BOSS," going forward. If the transaction in this case had occurred after the effective date of this new statute, then § 6501(c)(10)—and not the six-year statute or the Regulation promulgated thereunder—would have dictated the period of limitation. Congress's decision to extend the statute of limitations for listed transactions prospectively supports the conclusion that Congress intended to leave the rule established in *Colony* intact for all other cases.

This is not the only case in which alleged "Son-of-BOSS" tax shelters are being litigated. Petitioner has alleged that other taxpayers, including those in *Beard v. Commissioner*, 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), *Grapevine Imports, Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011), *petition for cert. filed*, 80 U.S.L.W. 3090 (U.S. Aug. 5, 2011) (No. 11-163), *Burks v. United States*, 633 F.3d 347 (5th Cir. 2011), *petition for cert. filed*, 80 U.S.L.W. 3090 (U.S. Aug. 11, 2011) (No. 11-178), *Salman Ranch, Ltd. v. Commissioner*, --- F.3d ---, 2011 WL 2120044 (10th Cir. 2011) ("*Salman Ranch II*") and *Intermountain Insur. Servs. of Vail, LLC v. Commissioner*, --- F.3d ---, 2011 WL 2451011 (D.C.Cir. 2011), have

also engaged in the "Son-of-BOSS" tax shelter. These cases all involve essentially the same issue – the appropriate statute of limitations for a "Son-of-BOSS" transaction. In each case, petitioner contends that the six-year statute contained in § 6501(e)(1)(A) applies. The question is merely academic for taxpayers other than the parties involved in these cases because Congress has resolved the issue for future cases by enacting § 6501(c)(10).

This case is one that is important for the parties involved, but its resolution is not important for the public at large. *See Rice v. Sioux City Mem'l Park Cemetery*, 349 U.S. 70, 76, 77 n.1 (1955) (dismissing petition for certiorari because matter was no longer of public importance where underlying statute had been changed). Because Congress addressed petitioner's concerns raised by alleged "Son-of-BOSS" transactions in future cases when it enacted § 6501(c)(10), judicial economy dictates that this case does not rise to the level of public importance for this Court to grant petitioner's petition for writ of certiorari.

II. This Court's decision in *Colony* controls the statute of limitations period in this case.

The Fourth Circuit correctly decided that the outcome of this case is governed by *Colony*, in which this Court held that an overstatement of basis does not equate to an omission from gross income and, thus, cannot trigger the extended statute of limitations period set forth in § 6501(e)(1)(A). The

petition in this case is limited in substantive content, presumably due to the fact that petitioner would prefer the Court to hold this case in abeyance pending the Court's final disposition of petitioner's case of choice to address the issues raised here—*Beard*.[4] Nevertheless, respondents must address the issues, and the arguments raised by petitioner in both this petition and filings with the Court in similarly situated cases—such as *Beard*, *Grapevine* and *Burks*.[5]

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[4] Although the petition for writ of certiorari in *Beard* was filed first in this line of cases, respondents disagree that it would be the best case for a petition to be granted if the Court is so inclined to review the issues present in these similarly situated cases. The Seventh Circuit's opinion in *Beard* is somewhat of an outlier because it only addresses the application of *Colony* to the facts, and fails to address the Regulation. Thus, *Beard* lacks sufficient analysis of all of the issues that have been analyzed and discussed in other cases.

[5] The Ninth Circuit followed this Court's decision in *Colony*, but did so prior to the promulgation of either the temporary or final Regulation. *See Bakersfield Energy Partners, LP v. Comm'r*, 568 F.3d 767 (9th Cir. 2009). The Fourth Circuit, here, and the Fifth Circuit have followed *Colony* in ruling against the IRS, even after the issuance of the temporary and final Regulation. *See Home Concrete*, *supra*; *Burks*, *supra*. The Federal, Seventh, Tenth, and District of Columbia Circuits—have declined to follow *Colony*. *See Grapevine*, *supra*; *Beard*, *supra*; *Salman Ranch II, supra*; *Intermountain*, *supra*. Interestingly, the Federal Circuit has an intra-circuit conflict in that it has also held in favor of the taxpayers with respect to the application of *Colony*—once before the Regulation became final, and once after. *See Salman Ranch, Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009); *Grapevine*, *supra.*

In the event that the Court grants petitioner's request to hold this case in abeyance and, instead, issues a writ of certiorari in *Beard*, *Grapevine*, *Burks* or another case with similar questions presented, respondent respectfully request that the Court consider the law set forth herein.

With respect to the underlying issue of whether an overstatement of basis is an omission of gross income, petitioner makes strikingly similar arguments here to those it made in *Colony*—most notably, petitioner focuses on the statutory definition of "gross income" as opposed to the entire phrase "omits from gross income" and Congress' true intent exemplified in the legislative history when it enacted the statute. Petitioner has also consistently argued that this Court's decision in *Colony* is limited in application to situations involving sales of goods or services by taxpayers in a trade or business. These arguments continue to miss the target.

In order to understand the purpose of the statute in issue, it is imperative to have some knowledge of the pertinent cases that preceded *Colony* and led both to this Court's decision in that case and the additional subparagraphs to the statutory language in what is now § 6501(e)(1)(A).[6] Section 6501(e)(1)(A) as it existed in 1999 was enacted as part of the reform that resulted in the 1954 Internal Revenue Code, and was a recodification of 26 U.S.C. § 275(c) (1939). The earlier statute provided as follows:

> If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percentum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection

[6] Subparagraph (i) of § 6501(e)(1)(A) is generally referred to here as the "gross receipts provision," while subparagraph (ii) is referred to as the "adequate disclosure provision".

> of such tax may be begun without assessment, at any time within 5 years after the return was filed.

Id.

Prior to *Colony*, several Circuit courts addressed the issue of whether an overstatement of cost or basis, resulting in an understatement of "the final figure in [the] gross income computation" constituted an "omi[ssion] from gross income" as contemplated by Congress when it added 26 U.S.C. § 275(c) (1939). *See, e.g.*, *Uptegrove Lumber Co. v. Comm'r*, 204 F.2d 570 (3d Cir. 1953). One of the first cases to address this issue was decided by the Court of Appeals for the Sixth Circuit. *Reis v. Comm'r*, 142 F.2d 900 (6th Cir. 1944). In *Reis*, the Sixth Circuit found that there was an omission of gross income where the taxpayer in question overstated his basis in certain pieces of property that he sold. Citing *Ewald v. Comm'r*, 141 F.2d 750 (6th Cir. 1944), a case in which there was no overstatement of basis involved, the court summarily determined that the taxpayer in *Reis* omitted gross income. *Reis*, 142 F.2d at 903.

Years later, in *Uptegrove Lumber*, the Court of Appeals for the Third Circuit faced a similar issue to that faced in *Reis*, where the taxpayer was a manufacturing corporation and inappropriately included a reserve for retroactive wage increases in its cost of goods sold—thus, arriving at an incorrect gross profit from sales. *Uptegrove Lumber* was the first case where the question of whether "the language 'omits from gross income any amount

properly includible therein' should be read broadly as if it read 'understates the final figure in [a taxpayer's] gross income computation'" was thoroughly addressed by a court in an opinion. *Uptegrove Lumber*, 204 F.2d at 571.

In its review of what constitutes an omission from gross income, the Third Circuit noted Treasury Regulation 111, 29.22(a)-5, now found in substantially similar form in Treasury Regulation § 1.61-3(a), which provided "[i]n the case of a manufacturing, merchandising, or mining business, 'gross income' means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources***." *Id.* The court also cited to the "numerous provisions of 26 U.S.C. § 22 [(1939)]," which preceded the current provision defining gross income in 26 U.S.C. § 61 (1999), as "controlling the computation of gross income, generally."[7] *Id.* Despite specifically

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[7] Paragraph (a) of 26 U.S.C. § 22 (1939) provided as follows:

> (a) GENERAL DEFINITION. – "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross

recognizing the regulatory definition of gross income for purposes of certain trades or businesses and the statutory definition of gross income generally, the Third Circuit reviewed the legislative history[8] and 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.

In the three years following *Uptegrove Lumber*, the Ninth, Fifth and Eighth Circuits each issued opinions barring an extension of the statute of limitations in situations where the taxpayers included their gross receipts, but erred in their computation of taxable income. *See Slaff v. Comm'r*, 220 F.2d 65 (9th Cir. 1955); *Davis v. Hightower*, 230

> income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.

Both 26 U.S.C. § 22 (1939) and 26 U.S.C. § 61 (1999) notably include "gains" in the definition.

[8] In *Uptegrove Lumber*, the court addressed the IRS's reference to Congress's occasional use of the phrase "understates gross income" in the relevant Committee reports, and reasoned: "wherever this language appears it is used in the generality of an introductory statement and is immediately restricted by specific explanation that the Committee is talking about 'failure to disclose' income or ' leaving out items.'" *Id.* at 572. The court then points to a particularly striking instance in the House Subcommittee Report where the reference to "understatement" is "'that the limitation period on assessments should not apply *to certain cases* where the taxpayer has understated the gross income'". *Id.*

F.2d 549 (5th Cir. 1956); *Goodenow v. Comm'r*, 238 F.2d 20 (8th Cir. 1956). The foregoing cases set the stage for this Court's opinion in *Colony*. In *Colony*, the IRS alleged that a taxpayer "understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the 'basis' of such lots by erroneously including in their cost certain unallowable items of development expense." *Id.* at 30. After the Tax Court found that the extended statute should apply, the Sixth Circuit again faced the question it had addressed in *Reis* 13 years earlier. Despite the clear conflict in interpretation of the statute with the Third, Fifth, Eighth and Ninth Circuits, the Sixth Circuit held firm, 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." *See Colony, Inc. v. Commissioner*, 244 F.2d 75 (6th Cir. 1957). Ultimately, however, the court deferred to the authority of its precedential decision in *Reis* and affirmed the Tax Court's decision.

After granting certiorari, this Court began its review with the "critical statutory language," focusing on the definition of the word "omits" and approving the dictionary definition "to leave out or unmentioned; not to insert, include, or name." *Colony*, 357 U.S. at 32. Although the Court was "inclined to think that the statute on its face lends itself more plausibly to the taxpayer's interpretation," it turned to the legislative history to determine Congress's intent. The legislative history confirmed that the statute should be extended only in specific situations when taxpayers "leave out

items" or a taxpayer "overlooks an item," "failed to report a dividend," or "might report as income for one year an item of income which properly belonged in another year." *Id.* at 33-35. The Court cited these instances as "persuasive indications that Congress merely had in mind failures to report *particular income receipts and accruals*, and did not intend the five-year [now six-year] limitation to apply whenever gross income was overstated." *Id.* at 35 (emphasis added). In the end, this Court agreed with the taxpayer's position 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." *Id.* at 33 (emphasis added).

This Court found that Congress's purpose for enacting the extended assessment period was "no broader…than to give the Commissioner an additional two years [now three years] to investigate tax returns in cases where because of the taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors." *Id.* The extended assessment period applies only in instances where "the return on its face provides no clue to the existence of the omitted item." *Id.* The Court concluded, "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.* Citing *Uptegrove Lumber*, the Court later stated that to accept the Commissioner's interpretation of the statute "not only would be to read s 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." [9] *Colony*, 357 U.S. at 36-37.

Although the version of the Code that this Court interpreted in *Colony* had been revised and renumbered between the tax years in issue and the year of the decision, the Court noted that its conclusion was "in harmony with the *unambiguous* language of § 6501(e)(1)(A)," the same statute at issue in the present case. *Id.* at 37 (emphasis added).

A. Colony is not limited to cases involving the sale of goods or services in a trade or business.

Petitioner argues that *Colony* is distinguishable from this case because its holding is *limited* to cases involving a trade or business selling

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[9] The citation to *Uptegrove Lumber* is to page 573, which provides in relevant part:

> For 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. If such errors are made in good faith at any place other than the gross income section, it is clear that the government must challenge them, if at all, within the normal three year limitation period. No reason appears or has been suggested why Congress would wish to allow a longer time to discover errors of the same type in the gross income section of the return. Yet this would be the strange result of the construction which the Commissioner would give to Section 275(c).

goods or services.[10] Petitioner's argument is untenable for several reasons. First, the assertion that land can constitute a "good"—which is required in order to fall under the authority of the gross receipts provision—is simply incorrect. More importantly, petitioner's argument conflicts directly with its historical position on the classification of land and buildings as other than merchandise or "goods."[11] Specifically in the context of overstated basis cases, the IRS argued that a ranch could not constitute a "good" in its brief in *Salman Ranch I*, which was decided in favor of the taxpayers:

> Ordinarily, the term "goods" does not encompass a ranch. The term "goods" typically means "tangible movable

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[10] In *Colony,* the IRS alleged that a taxpayer "understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the 'basis' of such lots by erroneously including in their cost certain unallowable items of development expense." *Id.* at 30. While there is no definition of "goods" in the Internal Revenue Code, it is doubtful that real property would be included. "Goods" in other areas of the law have traditionally only included personal property. *See*, *e.g*., U.C.C., Art. 9, § 9-102(a)(44) ("'Goods' means all things that are moveable when a security interest attaches.").

[11] *See* Patrick J. Smith, *"Omissions From Gross Income and 'Numerators and Denominators'"* SPECIAL REPORT TAX NOTES, 157, 161-163 (July 11, 2011) (citing *W.C. & A.N. Miller Dev. Co. v. Commissioner*, 81 T.C. 619, 630 (1983) ("In our view, real property should not be considered as 'merchandise' within the contemplation of the regulation….In its commonly accepted usage, the term 'merchandise' is defined to encompass wares and goods, not realty"); *Homes by Ayres v. Commissioner*, 795 F.2d 832, 835 (9th Cir. 1986) ("The Commissioner has consistently maintained that real property cannot be inventoried for tax purposes")).

> personal property having intrinsic value usually excluding money and other choses in action." Webster's Third New Int'l Dictionary 978 (1969). See also Black's Law Dictionary at 701 (7th ed. 1999) (defining "goods" as "[t]angible or movable personal property other than money; especially articles of trade or items of merchandise," as in "goods and services").
>
> …
>
> [The taxpayers'] reliance (Br. 34) on the definition of "goods or services" in the unrelated context of charitable contributions in Treas. Reg. § 1.170A-13(f)(5) is misplaced….In that context, § 1.170A-13(f)(5) defines "goods or services" as "cash, property, services, benefits, and privileges." Significantly, real estate is not included; thus, even if the regulation somehow applied here, it would not make the ranch a "good[ ] or service [ ]."

Brief for the Appellee at 45-49, *Salman Ranch I*, No. 2008-5053 (citations omitted).[12] The same definition of "goods" would have applied to the land sold in *Colony*. Thus, petitioner's argument that *Colony*'s holding is limited to situations involving the sale of goods or services in a trade or business defies reason when *Colony* itself would not have fallen within that category.

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[12] *See also* Smith, *supra* at n.11.

Furthermore, the Court in *Colony* stated that its "construction of s 275(c) accords with the interpretations in the more recent decisions of four different Courts of Appeals. *See* note 2, *supra*." *Colony*, 357 U.S. at 37. Note 2 in *Colony* cites to *Uptegrove Lumber*, *Slaff*, *Davis* and *Goodenow*, decided by the Third, Ninth, Fifth and Eighth Circuits, respectively. *Colony*, 357 U.S. at 32, n.2. Of particular note is *Slaff*, which had nothing to do with the sale of goods or services in a trade or business. To the contrary, the taxpayer in *Slaff* reported an amount he received while working for the American Red Cross while serving in Europe during World War II, but claimed that it was exempt from taxation—resulting in an understatement of taxable income. If *Colony* was intended to be limited to cases involving the sales of goods or services in a trade or business, then it certainly would not have accorded its decision with the Ninth Circuit's decision in *Slaff*.

Finally, the Court's opinion includes no language limiting its opinion to particular situations involving sales of goods or services in a trade or business to the exclusion of other situations. The more reasonable view is that *Colony* was intended to bar the extension of the statute of limitations where the taxpayer overstated its basis, resulting in an understatement of taxable income, but not an omission of items of gross income. As Judge Wynn poignantly stated in the Fourth Circuit opinion in this case "the Supreme Court in *Colony* straightforwardly construed the phrase 'omits from gross income,' unhinged from any dependency on the taxpayer's identity as a trade or business selling

goods or services." *Home Concrete*, 634 F.3d at 255. Accordingly, *Colony* properly controls the outcome of this case.

B. The gross receipts and adequate disclosure provisions are not superfluous.

The petition focuses on the statutory definition of "gross income", and particularly on the inclusion of "gain" in such definition, in § 61, and the underlying regulations. Petitioner also confuses "gross income" with "taxable income", just like it did more than 50 years ago, when it states: "[b]ecause the *taxable income* from a property sale is generally determined by subtracting the taxpayer's basis from the property's sale price, an overstatement of basis will typically decrease the amount of the taxpayer's gain (and thus the amount of federal income-tax liability) that is attributable to the sale." Pet. Cert. 2-3. As this Court and the circuit courts that faced this issue prior to *Colony* made very clear, the statutory definition of "gross income" and § 275(c) had not yet been considered together. This Court focused on the entire phrase "omits from gross income," not just the statutory definition of "gross income"—which is substantially the same as it was at the time *Colony* was decided—when it concluded that an omission only occurs when items of income are left out of the return. Petitioner's rehashed argument was unpersuasive when this Court decided *Colony* and should not prevail here.

Petitioner has argued that, if *Colony*'s decision applies to all cases, and the general rule is that an overstatement of basis cannot give rise to an

omission of gross income, then the amendments added to the statute in 1954 would be superfluous. *See Beard* Pet. Cert. 12 (citing *Intermountain*). The foregoing discussion of the cases leading up to *Colony* demonstrates that such is not the case; rather, those amendments were added to clarify that "omits" means "failure to disclose" income or "leaving out items" of income no matter who the taxpayer is.

The reasoning for the inclusion of the gross receipts provision is best demonstrated in the Third Circuit's opinion in *Uptegrove Lumber*, which was a case involving a manufacturing corporation decided in 1953—the year prior to the amendment to the statute. As mentioned above, the Third Circuit decided that despite the definition of gross income in 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 the intent of Congress was 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 same error in computation simply had not come along in the case of a non-trade or business—i.e., there *was no need to clarify* the statute for cases other than trades or businesses.

It is important to note that there is no discussion in the legislative history to the statutory amendments, and no evident policy reason for treating the sales of goods or services in a trade or business differently (and, arguably, more favorably) than income derived by an individual or trade or

business that makes an error in computation of their taxable income. The better, more sensible, explanation for the gross receipts provision of § 6501(e)(1)(A)(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 gross receipts provision.

In 1956, the Fifth Circuit in *Davis*, which preceded *Colony* but, as mentioned above, was cited as being in accord with this Court's decision,[13] explained the purpose of adding the adequate disclosure provision now found in § 6501(e)(1)(A)(ii):

> It cannot be thought that if a taxpayer accurately fills in every blank space provided for his use in the income tax form, giving every "gross" or maximum figure called for, and arrives at an incorrect computation of the tax only by reason of a difference between him and the Commissioner as to the legal construction to be applied to a disclosed transaction, the use of a smaller figure than that ultimately found to be correct in one stage of the computation amounts to an omission from 'gross income' of the difference between the correct and incorrect item.
>
> …

[13] *See Colony*, 357 U.S. at 37.

> To [the] legislative history is now added the amendment contained in the 1954 Internal Revenue Code, under the terms of which it is now clear that the inclusion of the statement made by appellee in his return here would be sufficient to prevent application of the five year statute. In view of the confusion as to the meaning of the statute prior to the adoption of the 1954 Code, we think it plain that the new language was enacted to *clarify the existing law*.

Davis, 230 F.2d at 553-554 (emphasis added). In other words, "gross" means "gross", not "net" as petitioner argues.[14] Accepting petitioner's argument would create precisely the "patent incongruity" in the tax law that this Court specifically rejected in *Colony*.

The Fifth Circuit's interpretation of the proper application of the statute was confirmed in this Court's opinion in *Colony*. The purpose of the amendments was to clarify that, notwithstanding statutory or regulatory definitions of gross income or prior cases to the contrary, if all "gross" items are disclosed in the return of any taxpayer, then the statute should not be extended. Accordingly, neither

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[14] As the Fifth Circuit stated in *Davis* with respect to the general understanding of what constituted "gross income," "such figure as used *in an ordinary or accounting sense* is not an ingredient in the total that is finally subject to the application of the tax rates." *Davis*, 230 F.2d at 553 (emphasis added).

amendment to the current statute is made superfluous by applying this Court's decision in *Colony* to cases other than those involving the sale of goods or services in a trade or business.

III. <u>The Regulation is inapplicable to this case.</u>

On September 28, 2009, soon after the Ninth and Federal Circuits followed this Court's decision in *Colony* and held in favor of the taxpayers in *Bakersfield* and *Salman Ranch I*, *supra*, the Treasury rushed to issue a new temporary Treasury Regulation in an attempt to overturn the rule set forth in *Colony* that an overstatement of basis cannot create an omission from gross income. Temp. Treas. Reg. § 301.6501(e)-1T. The temporary regulation was made immediately effective by the Treasury without notice or an opportunity for comment by the public. *Id.* The Treasury published the regulation in final form without any material changes on December 17, 2010. Treas. Reg. § 301.6501(e)-1. In relevant part, the Regulation provides that "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)." *Id.*

The Regulation represents a sweeping change from the clear intent of Congress in the legislative history as discussed in this Court's opinion in *Colony*. Prompted by losses in *Bakersfield* and *Salman Ranch I*, each of which also allegedly involved a "Son-of-BOSS" tax shelter, the Treasury claimed in the preamble to the temporary Regulation

that it would merely "clarify" the meaning of § 6501(e)(1)(A).[15] To the contrary, the Regulation is a blatant attempt to overturn the rule set forth in this Court's opinion in *Colony*, and would have a much broader application to all cases where an error might result in an understatement of taxable income. *See*, *e.g.*, *Wilmington Partners L.P., et al. v. Comm'r*, Tax Court Docket No. 15098-06, appeal filed No. 10-4183 (2d Cir. filed Oct. 13, 2010) (involving the question of whether an alleged overstatement of basis creates an omission of gross income such that the statute of limitations should be extended where no tax shelter transaction occurred).

A. **The Regulation does not apply by its own terms, is an abuse of executive power and violates due process.**

The Regulation provides that it "applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009." Treas. Reg. § 301.6501(e)-1(e)(1). By its terms, it is inapplicable to this case. Despite the Treasury's claim that a six-year statute remains open for all cases pending before a court of competent jurisdiction—the question whether the period for assessing tax was open more than three years after the relevant returns were filed in this case is precisely what is in question and must be decided by this Court. Even if the Regulation were

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[15] *See* T.D. 9466 (citing *Bakersfield* and *Salman Ranch I* as wrongly interpreting *Colony*); *see also* T.D. 9511 (preamble to final Regulation).

deemed valid, it is moot if the six-year period applies here without reference to it.

Should the Court determine that the Regulation is viable despite Congress's enactment of § 6501(c)(10) and the circular logic resulting from its effective date provision, respondents contend that it should be rendered invalid based on the hardship and prejudice its retroactive application would cause. The IRS's authority to issue retroactive regulations is subject to review for abuse of discretion. *Chock Full O'Nuts Corp. v. U.S.*, 453 F.2d 300, 302 (2d Cir. 1971). "'The Internal Revenue Service does not have *carte blanche*. Its choice must be a rational one, supported by relevant considerations.'" *Id.* (citing *Int'l Bus. Machs. Corp. v. U.S.*, 343 F.2d 914, 920 (Ct. Cl. 1965)).

> [C]ourts have declined to give retroactive effect to regulations or rulings of the Commissioner when retroactivity would work a change in settled law relied on by the taxpayer and implicitly approved by Congress, *Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110…(1939), when it would lead to inequality of treatment between taxpayers, [*Int'l Bus. Machs. Corp.*, *supra*], when litigation involving the area clarified by the regulation had already begun, *Commissioner of Internal Revenue v. Goodwyn Crockery Co.*, 315 F.2d 110, 113 (6th Cir. 1963), or when, in general, the result of retroactivity in a particular case would be unduly harsh, *Lesavoy Foundation v.*

> *Commissioner*, 238 F.2d 589, 594 (3d Cir. 1956); cf. *Woodward v. United States*, 322 F.Supp. 332, 335 (W.D.Va. 1971).

Id. at 302, n. 6.

Respondents filed suit in December 2006, more than six years after the relevant returns were filed with the IRS and nearly three years before the Regulation was promulgated in temporary form. The Regulation was issued in an attempt to guarantee a win for the IRS in this case, in which it is a party, and to revive and overturn various losses suffered in similarly situated cases in other jurisdictions. Respondents clearly relied on *Colony* when they filed their complaint in this case.

Petitioner argues that it is not changing the law retroactively. Rather, it maintains it is merely "clarifying" the law with its Regulation. As discussed above, and as recognized by the Fourth Circuit below, the Regulation changes the law that was settled by this Court over 50 years ago, while Congress has remedied any abuse that might result from an undisclosed listed transaction in the future. Respondents have expended substantial time, energy, and financial resources (in litigation costs, including legal fees and, potentially, in continuously accruing interest) with the expectation that they were fighting on a level playing field, and would ultimately prevail on the statute of limitations issue based on longstanding Supreme Court precedent. The Regulation purports to dictate the outcome

without any regard for due process[16] or fair treatment of the taxpayers. Accordingly, the regulation should be struck down.

B. The Regulation does not deserve *Chevron* deference.

Even if the Regulation is analyzed under the test set out in *Chevron U.S.A Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), it is not entitled to deference. *Chevron* provides a two-step analytical framework. "First, always, is the question whether Congress had directly spoken to the precise question at issue. 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." *Id.* at 842-43. This Court clarified step one in the analysis in a footnote:

> The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent.... If a court, employing *traditional tools of statutory*

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[16] In *United States v. Carlton*, 512 U.S. 26, 32-33 (1994), this Court held that, under the Due Process Clause of the Fifth Amendment in the Constitution, Congress may adopt retroactive tax rules only when they are rationally related to a valid government purpose and only when the period of retroactivity is "modest." The Regulation was issued more than 9 years after the returns were filed here and would be trumped by 26 U.S.C. § 6501(c)(10) with respect to Son-of-BOSS transactions in the future. Given the extended period of retroactivity and lack of a valid government purpose, the Regulation violates due process.

> *construction*, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.

Id. at 843, n.9 (emphasis added). If the Court cannot determine that "Congress had an intention on the precise question at issue," the second step in the analysis requires the Court to answer whether the agency's interpretation is permissible or reasonable. *Id.* at 843-844.

This Court in *Chevron* utilized legislative history as part of its step one analysis, and has continued to do so in more recent opinions. *Id.* at 862; *see also Zuni Pub. Sch. Dist. No. 89 v. Dept. of Educ.*, 550 U.S. 81, 90-91 (2007); *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 587-90, 600 (2004). The IRS has persistently cited the Supreme Court's statement that "it cannot be said that the language is unambiguous" when referring to the term "omits from gross income" in arguing that such language remains ambiguous. However, reliance on this statement ignores this Court's subsequent review of the statute's legislative history—and the importance placed on Congress's intent found in the legislative history in the cases that preceded *Colony*. In *Colony*, this Court confirmed the plain meaning of the statutory language "omits from gross income" by referring to legislative history and repeatedly emphasizing Congress's intent that the statute should be extended only in specific situations when taxpayers "leave out items" or a taxpayer "overlooks an item," "failed to report a dividend," or "might report as income for one year an item of income which properly belonged in another year." *Colony*,

357 U.S. at 33-35. The Court cited these instances as "persuasive indications that Congress merely had in mind *failures to report particular income receipts and accruals*, and did not intend the five-year [now six-year] limitation to apply whenever gross income was overstated." *Id.* at 35 (emphasis added).

After reviewing the legislative history, this Court clarified that the only reasonable interpretation of the term "omits from gross income" involves leaving out an actual item of income, and not an overstatement of tax basis. Any uncertainity was resolved by the Court over 50 years ago. In addition, Congress has consistently refused to change the relevant language in § 6501(e), and has affirmatively acted by enacting § 6501(c)(10). The Regulation conflicts directly with this Court's construction of the statutory language and the unambiguous intent of Congress. Accordingly, the Regulation fails under *Chevron* step one.[17]

C. ***Brand X* does not control.**

In *Brand X*, this Court found that the circuit court's prior decision held only that the *best reading* of the statute in question was that a cable modem service was a "telecommunications service," not that it was the *only permissible reading* of the statute. *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982, 984 (2005). The Court added that "[a] court's prior judicial construction of a

[17] If it is determined that the Regulation passes muster under *Chevron* step one, as we argue here, it is nevertheless unreasonable in light of Congress' enactment of § 6501(c)(10). If a "gap" remained in the statute, Congress has filled it. *See Chevron*, 467 U.S. at 842.

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." *Id.* at 982.

In a concurring opinion, Justice Stevens suggested that the majority's explanation of "why a court of appeals' interpretation of an ambiguous provision in a regulatory statute does not foreclose a contrary reading by the agency…would not necessarily be applicable to a decision by [the Supreme] Court that would presumably remove any pre-existing ambiguity. *Id.* at 1003 (J. Stevens, concurring).

In *Colony*, this Court stated:

> "[w]e find in that [legislative] history persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes…
>
> *We have been unable to find any solid support of the Government's theory in the legislative history.* Instead…, this history shows to our satisfaction that the Congress intended an exception to the usual three-year statute of limitations *only* in the restricted type of situation already described.

Colony, 357 U.S. at 33, 36 (emphasis added). This statement demonstrates that this Court's interpretation was the *only permissible reading* and not only the *best* reading. While the Court did not use the explicit language described in *Brand X*, it is unreasonable to expect, or require, that the *Colony* decision would give the terms 'ambiguous' and 'unambiguous' the special meaning assigned to them by the *Chevron* decision 26 years later.[18] More pointedly, this Court ultimately concluded in *Colony* that the language of § 6501(e)(1)(A) was unambiguous, and its decision therein was "in harmony" with the current statute. *Colony*, 357 U.S. at 37.

The Regulation blatantly oversteps the authority of an agency by attempting to retroactively legislate a substantive change in the law in order to force a victory in this case and other similarly situated cases—while Congress has remedied any concern with respect to cases involving a "Son-of-BOSS" statute of limitations issue going forward. There is no question that this Court's jurisprudence has developed over the years to give substantial deference to agencies in interpreting ambiguities in the law. *See Chevron*; *see also Mayo Found. For Med. Educ. & Research v. United States*, 562 U.S. ___ (2011); *Brand X*. However, there must be a line drawn where an agency's powers end, and those more appropriately controlled by Congress or this Court take over. As Judge Wilkinson stated succinctly in his concurrence below:

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[18] *See* Patrick J. Smith, *Brand X and Omissions from Gross Income*, TAX ANALYSTS, 665, 670 (Feb. 1, 2010).

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

Home Concrete, 634 F.3d at 259. Accordingly, the Regulation cannot overturn this Court's decision in *Colony*.

CONCLUSION

Because *Colony* controls, and the conflict in issue would likely not exist if the same facts existed today due to the enactment of § 6501(c)(10), judicial economy dictates that granting the petition for writ of certiorari in this case would be a waste of this Court's time and resources. Accordingly, respondents respectfully request that the Court deny the petition for writ of certiorari in this case.

Respectfully submitted.

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