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188 DTR K-1

Supreme Court

Supreme Court to Address Assessment Period For Shelters Utilizing Overstatements of Basis

By J.P. Finet

The U.S. Supreme Court announced Sept. 27 that it will resolve the split in the federal circuits over the issue of whether the Internal Revenue Service's extended assessment period applies to a partnership's use of a tax shelter transaction to avoid capital gains taxes by understating its basis in goods sold (*United States v. Home Concrete & Supply LLC*, U.S., No. 11-139, cert. granted 9/27/11).

The high court granted certiorari to *United States v. Home Concrete & Supply LLC*, 634 F.3d 249 (4th Cir. 2011), in which the U.S. Court of Appeals for the Fourth Circuit found that an overstatement of basis stemming from a partnership's use of a tax shelter transaction does not trigger tax code Section 6501(e)(1)(A)'s six-year limitations period because the overstatement was not an omission from gross income (26 DTR K-3, 2/8/11).

The Fourth Circuit also declined to apply Treasury regulations—implemented after an IRS court loss on the issue—which provide that overstatements of basis trigger the extended assessment period.

Home Concrete is one of four recent appeals asking the Supreme Court to address the 4-2 circuit split in which the majority of the courts have ruled in the government's favor.

The other three cases, which remain on the high court's certiorari docket, are the U.S. Court of Appeals for the Seventh Circuit's ruling in *Beard v. Commissioner*, 633 F.3d 616 (7th Cir. 2011) (18 DTR K-2, 1/27/11); the U.S. Court of Appeals for the Fifth Circuit's ruling in *United States v. Burks*, 633 F.3d 347 (5th Cir. 2011) (28 DTR K-5, 2/10/11); and the U.S. Court of Appeals for the Federal Circuit's ruling in *Grapevine Imports Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011) (49 DTR K-5, 3/14/11).

The limitations period issue arose from IRS's challenge to the use of tax shelters, such as the Son-of-BOSS (bond option sales strategy) tax shelter, through which participants try to avoid paying capital gains tax on the sale of appreciated property by overstating their basis in the sold property.

However, IRS failed to issue final partnership administrative adjustments (FPAAs) to many of the partnerships within the three-year limitations period. This meant that the service needed to claim it had six years to issue the adjustments under Section 6501(e)(1)(A)'s extended limitations period.

Speed of Appeal is 'Extraordinary.'

The case is being closely watched by practitioners and is notable for how quickly the Supreme

BNA Snapshot

United States v. Home Concrete & Supply LLC, U.S., No. 11-139, cert. granted 9/27/11

Key Development: U.S. Supreme Court moves quickly to resolve circuit split as to whether overstatements of basis utilized by some tax shelters are omissions from gross income triggering the six-year period for IRS to make an assessment, as opposed to the standard three-year period.

Court granted certiorari in the issue. The appeal was filed Aug. 3.

"The speed at which the issue of the regulations has traveled through the judiciary is nothing less than extraordinary," Anthony P. Daddino told BNA Sept. 27. "Within about two years of the Treasury issuing the regulations, five Circuit Courts opined on the regulations, with the issue now set to be heard by the Supreme Court."

Daddino is a partner with Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP in Dallas.

"Although the Circuit split has recently favored the Government, both the Tax Court and Fifth Circuit stood firmly on their pro-taxpayer decisions when the courts recently revisited the issue of the regulations, which likely was a factor in the Supreme Court agreeing to hear the six-year issue," Daddino said.

Review To Settle Important Issues

Beard was the first case appealed to the Supreme Court. But given that the Seventh Circuit chose not to address the regulation in its ruling—which held that the statute was unambiguous, therefore the court need not look to the regulation—practitioners told BNA it was unlikely the high court would choose to grant certiorari to that decision.

"*Home Concrete* allows the Court to address both the substantive Section 6501(e)(1)(A) definitional dispute as well as the recent 'self-help' regulation that attempted to influence the pending cases," Douglas A. Schaaf told BNA Sept. 27.

"Consistent with the Amicus Brief filed by Bausch & Lomb, it is a far superior case than *Beard* for the Court to review in order to settle two important issues: (i) what does 'omits' mean in Section 6501(e), and (ii) what are the limits on the government's authority to attempt to influence an active case (that may have advanced as far as the Circuit Court of Appeals) by issuing regulations favorable to its position."

Schaaf is chairman of the tax department at Paul Hastings in Costa Mesa, Calif.

"The *Beard* decision is difficult to defend, as the Seventh Circuit reached its decision without the benefit of any self-serving interpretive regulation in a manner that would seem to be contrary to the *Colony* precedent," Schaaf said.

"I am sure that the government would very much like the Court to grant cert. only in *Beard*, as it is a clear cut victory for the government, without the need to resort to the administrative law complications raised by the untimely issuance of the relevant regulation."

In all four of the appealed rulings, the circuit courts based their decisions on the Supreme Court's opinion in *Colony Inc. v. Commissioner*, 357 U.S. 28 (1958). In that case, the high court interpreted the phrase "omits from gross income" in Section 6501(e)(1)(A)'s predecessor to unambiguously exclude basis overstatements.

However, *Colony* addressed the 1939 version of the tax code and the dispute rests on its applicability to the 1954 code, which made changes to the provision that IRS has claimed were intended to limit *Colony* to cases involving a trade or business selling goods or services.

Schaaf said *Home Concrete* will allow the Court to address both the "omits" issue that arose in *Colony* and the impact of the recent interpretive regulation that purports to "interpret" the statutory language that was at issue in *Colony*.

Retroactive Regulation Also Challenged

In addition to challenging IRS's interpretation of the statute, the four Supreme Court petitions challenge a Treasury regulation which stipulates that an overstatement of basis is an omission from gross income.

The regulation, which applied retroactively, was promulgated after IRS lost *Intermountain Insurance Service of Vail LLC v. Commissioner*, 134 T.C. 2011 (2010), in the U.S. Tax Court. In that ruling, the Tax Court found an overstatement of basis was not an omission from gross

income.

A later ruling in the case, known as *Intermountain II*, the Tax Court again rejected IRS's position (87 DTR K-1, 5/7/10).

Eventually, the U.S. Court of Appeals for the District of Columbia Circuit addressed the issue and found both that an overstatement of basis triggered the extended limitations period and that the regulation was valid (120 DTR K-1, 6/22/11). *Intermountain* has not been appealed to the Supreme Court.

A number of tax practitioners have taken issue with the effective date of the regulations, which apply to tax years still open to assessment at the time they were issued, and are hoping the Supreme Court will address the issue.

"Many tax practitioners, myself included, believe that the regulations' effective date is the Achilles heel of the Government's argument for the regulations," Daddino said.

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ISSN 1522-8800

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