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No. 09-9015

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UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

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SALMAN RANCH, LTD. and  
FRANCES S. KOENIG, TAX MATTERS PARTNER

Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent-Appellant

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On Appeal from the United States Tax Court, Docket No. 13677-08  
Honorable James S. Halpern, Presiding

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**APPELLEES' PETITION FOR REHEARING *EN BANC***

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**TABLE OF CONTENTS**

Statement Pursuant to Rule 35(b)(1) of the Federal Rules of Appellate  
Procedure .....1

Background .....2

Argument.....7

I. The Panel Decision Is Contrary To The Decision Of The United States  
Supreme Court In *Colony* .....7

II. The Panel Decision Conflicts With Authoritative Decisions Of The  
Fourth Circuit And The Fifth Circuit .....9

III. The Panel Decision Is Contrary To Decisions Of The Supreme Court  
And This Court With Regard To The Application Of The Doctrine  
Of Collateral Estoppel .....11

Conclusion .....15

## TABLE OF AUTHORITIES

### CASES

<i>Allen v. McCurry</i> , 449 U.S. 90 (1980).....	2, 12-13
<i>Bakersfield Energy Partners v. Commissioner</i> , 128 T.C. 207 (2007), <i>aff'd</i> 568 F.3d 767 (9th Cir. 2009) .....	5, 10
<i>Beard v. Commissioner</i> , 633 F.3d 616 (7th Cir. 2011), <i>petition for cert. filed</i> (Jun. 23, 2011) (No. 10-1553) .....	11
<i>Burks v. United States</i> , 633 F.3d 347 (5th Cir. 2011) ( <i>reh'g en banc denied</i> <i>and application for extension of time within which to file petition for</i> <i>cert. granted to August 13, 2011</i> ) .....	1-2, 10, 15
<i>Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.</i> , 467 U.S. 837 (1984).....	6, 8, 12-14
<i>Colony, Inc. v. Commissioner</i> , 357 U.S. 28 (1958) .....	1-4, 6-12, 15
<i>Grapevine Imports, Ltd. v. United States</i> , 636 F.3d 1368 (Fed Cir. 2011) .....	10-11
<i>Estate of H.A. True v. Commissioner</i> , 390 F.3d 1210 (10th Cir. 2004) .....	2, 12-13
<i>Home Concrete &amp; Supply, LLC v. United States</i> , 634 F.3d 249 (4th Cir. 2011) ( <i>reh'g en banc denied and application for extension of</i> <i>time within which to file petition for cert. granted to August 3, 2011</i> ) .....	1, 9-10, 15
<i>Intermountain Insurance Serv. v. Commissioner</i> , No. 10-1204, ___ F.3d ___, 2011 U.S.App. LEXIS 12476 (D.C. Cir. 2011) .....	10
<i>Montana v. United States</i> , 440 U.S. 147 (1979) .....	2, 12-13
<i>Northern Natural Gas Co. v. Grounds</i> , 931 F.2d 678 (10th Cir. 1991) .....	2, 12-14
<i>Salman Ranch Ltd. v. Commissioner</i> , No. 13677-08 (T.C. Aug. 7, 2009).....	5-6

<i>Salman Ranch Ltd. v. United States</i> , 573 F.3d 1362 (Fed Cir. 2009), <i>reh'g denied</i> .....	4-6, 10, 12-14
---	----------------

**FEDERAL STATUTES**

Internal Revenue Code of 1939, Section 275(c).....	7, 12
Internal Revenue Code of 1986, Section 6229(c)(2) .....	2
Internal Revenue Code of 1986, Section 6501(a).....	2
Internal Revenue Code of 1986, Section 6501(e)(1)(A) .....	2

**MISCELLANEOUS**

Fed. R. App. P. 35(b) .....	1, 9, 11, 15
Treas. Reg. § 301.6501(e)-1 .....	6
Treas. Reg. § 301.6229(c)(2)-1 .....	6

**STATEMENT PURSUANT TO RULE 35(B)(1)  
OF THE FEDERAL RULES OF APPELLATE PROCEDURE**

Salman Ranch Ltd. and Frances S. Koenig (collectively, “Salman Ranch”) respectfully petition this Court for rehearing *en banc*. The panel decision in this federal income tax case (attached as Addendum A to this Petition for Rehearing *En Banc*) conflicts with decisions of the United States Supreme Court and this Court and involves a question of exceptional importance.

First, the panel decision conflicts with a decision of the United States Supreme Court with regard to whether an alleged overstatement of basis constitutes an omission from gross income that gives rise to an extended period during which an assessment of federal income tax may be issued. *Colony, Inc. v. Comm’r*, 357 U.S. 28 (1958).

Second, the panel decision conflicts with authoritative decisions of two other United States Courts of Appeals with regard to whether an alleged overstatement of basis constitutes an omission from gross income that gives rise to an extended period during which an assessment of federal income tax may be issued. *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (4th Cir. 2011) (*reh’g en banc denied and application for extension of time within which to file petition for cert. granted to August 3, 2011*); and *Burks v. United States*, 633 F.3d 347 (5th Cir. 2011) (*reh’g en banc denied and application for extension of time within which to*

*file petition for cert. granted to August 13, 2011*). Therefore, this case involves a question of exceptional importance.

Third, the panel decision conflicts with decisions of the United States Supreme Court and this Court with regard to the proper application of collateral estoppel where a court decided a legal issue in prior litigation between the same parties. *Allen v. McCurry*, 449 U.S. 90 (1980); *Montana v. United States*, 440 U.S. 147 (1979); *Estate of H.A. True v. Comm’r*, 390 F.3d 1210 (10th Cir. 2004); *Northern Natural Gas Co. v. Grounds*, 931 F.2d 678 (10th Cir. 1991). Consideration by the full Court is therefore necessary to secure and maintain uniformity of the Court’s decisions.

## **BACKGROUND**

Under the Internal Revenue Code of 1986 (the “Code”), the Internal Revenue Service is generally limited to a three-year period after the filing of a federal income tax return in which to issue a tax assessment. Code Section 6501(a). The three-year period is extended to a six-year period if the taxpayer “omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return.” Code Sections 6501(e)(1)(A) and 6229(c)(2) (the “Omission Statutes”).

In *Colony*, the Commissioner of Internal Revenue (the “Commissioner”) asserted that a taxpayer had overstated its basis (cost) in certain property that the

taxpayer sold, and that the taxpayer had therefore understated its gain on the sale of the property. The Commissioner further asserted that the taxpayer's overstatement of its basis in the property constituted an omission from gross income that extended the period during which the Commissioner could issue an assessment of federal income tax under a predecessor to the Omission Statutes, which contained language substantially identical to the language in the Omission Statutes quoted above. The Supreme Court concluded that the legislative history of the predecessor statute showed that Congress intended an exception to the three-year period only in limited situations that did not include overstatement of basis. 357 U.S. at 36. The Supreme Court held that the taxpayer's overstatement of basis was not an omission from gross income, and that the Commissioner's assessment of federal income tax against the taxpayer was invalid because it was issued more than three years after the taxpayer filed its tax return for the tax year. 357 U.S. at 36-37.

In 2006, the Commissioner issued a notice adjusting the income tax return of Salman Ranch for 1999, claiming that Salman Ranch had overstated the basis of property that it sold in that year. Salman Ranch filed suit against the United States (the "Government") in the United States Court of Federal Claims, asserting, *inter alia*, that the Commissioner's notice was invalid because it was issued outside of the three-year period during which an assessment of tax for 1999 was permitted.

The Government contended that the extended six-year period for assessing tax applied because Salman Ranch's alleged overstatement of its basis was an omission from gross income under the Omission Statutes. Salman Ranch asserted that, under *Colony*, the alleged overstatement of basis was not an omission from gross income that gave rise to the extended period for assessing tax. The Government argued, *inter alia*, that *Colony* applied only in cases of sales of property in a trade or business of selling goods, and that Salman Ranch's sale was not made in a trade or business of selling goods.

After the Court of Federal Claims ruled in favor of the Government, Salman Ranch appealed that ruling to the United States Court of Appeals for the Federal Circuit. The Federal Circuit reversed the Court of Federal Claims. *Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (Fed Cir. 2009), *reh'g denied* ("Salman Ranch I") (attached as Addendum B to this Petition for Rehearing *En Banc*). The Federal Circuit held that the congressional intent and purpose of the language in the predecessor statute, as found by the *Colony* Court, was not limited to overstatement of basis from sales occurring in a trade or business of selling goods. 573 F.3d at 1372-73. The Federal Circuit further held that the *Colony* Court's construction of the predecessor statute applied to the Omission Statutes, which contain substantially identical language to the language in the predecessor statute. 573 F.3d at 1373-76. The Federal Circuit held that *Colony* controlled the



disposition of the case, and that the Commissioner's notice adjusting Salman Ranch's tax return for 1999 was invalid. 573 F.3d at 1377. The Government did not seek further review of the Federal Circuit's decision.

This case involves the same parties as *Salman Ranch I* (the Commissioner being a part of the Government) and the same transaction as the one involved in *Salman Ranch I*, but with respect to the second and final part of the sale of the property, which closed in 2001 and 2002. The Commissioner issued notices adjusting the 2001 and 2002 federal income tax returns of Salman Ranch outside of the three-year period during which an assessment of tax for those years was permitted. Salman Ranch sought review of the notices in the United States Tax Court, asserting, *inter alia*, that the notices were invalid because they were issued outside of the three-year period. The Commissioner again argued that the three-year period was extended to six years under the Omission Statutes, because Salman Ranch allegedly overstated its basis in the property. The Tax Court, following its precedent in *Bakersfield Energy Partners v. Commissioner*, 128 T.C. 207 (2007), *aff'd* 568 F.3d 767 (9th Cir. 2009), and the Federal Circuit's decision in *Salman Ranch I*, held that the notices were invalid. *Salman Ranch Ltd. v. Comm'r*, No. 13677-08 (T.C. August 7, 2009) ("*Salman Ranch II*").

Having lost the argument that overstatement of basis is an omission from gross income in the Tax Court, the Ninth Circuit, and the Federal Circuit, the

Commissioner issued his litigation position in the form of temporary regulations, then appealed the Tax Court’s decision in *Salman Ranch II* to this Court. After this case was briefed and argued in this Court, the Commissioner issued the temporary regulations as final regulations. Treas. Reg. §§ 301.6501(e)-1 and 301.6229(c)(2)-1, 75 Fed. Reg. 78,897 (Dec. 17, 2010) (the “New Regulations”).

Based entirely on the New Regulations, the panel decision reversed the Tax Court and held that the six-year period for issuing tax assessments under the Omission Statutes applied. The panel decision first concluded that the New Regulations were entitled to judicial deference under the two-step analysis set forth in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *Slip Op.*, at 15-23. As described in Parts I and II of the Argument, below, this conclusion conflicts with the Supreme Court’s decision in *Colony* and with decisions issued by two other Circuit Courts of Appeals. The panel decision then rejected *Salman Ranch*’s argument that the Federal Circuit’s decision in *Salman Ranch I* had a collateral estoppel effect on the issue in this case. As described in Part III of the Argument, below, this conclusion conflicts with Supreme Court precedent and precedent in this Court defining when and how the doctrine of collateral estoppel applies.

## ARGUMENT

### I. THE PANEL DECISION IS CONTRARY TO THE DECISION OF THE UNITED STATES SUPREME COURT IN *COLONY*.

In *Colony*, the Supreme Court considered whether an overstatement of basis constituted an omission from gross income under Section 275(c) of the Internal Revenue Code of 1939, which provided for an extension of the period in which a tax assessment could be issued if a taxpayer “omit[ted] from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return.” The Court stated that, although it was “inclined to think that the statute on its face lends itself more plausibly to the taxpayer’s interpretation, it cannot be said that the language is unambiguous.” 357 U.S. at 33. The Court therefore reviewed the legislative history of the statute and found “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.” 357 U.S. at 33. The Court was “unable to find any solid support for the Government’s theory [that overstatement of basis should be considered an omission from gross income] in the legislative history,” and instead concluded that “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,” which did not include overstatement of basis. 357 U.S. at 36. Thus, the Supreme Court in *Colony* determined that Congress did not intend that an overstatement of basis was an omission from gross income giving rise to the extended period in which to issue a tax assessment.

The panel decision’s holding, that Salman Ranch’s alleged overstatement of its basis in the property that it sold was an omission from gross income, is directly contrary to the Supreme Court’s holding in *Colony*. The panel decision relied on the New Regulations, which provide that an overstatement of basis is an omission from gross income outside of the trade or business context. The panel decision gave deference to those New Regulations, in reliance on *Chevron*. This was error, however, because *Chevron* provides that deference is given to a regulation only when the intent of Congress is not clear with respect to the issue addressed by the regulation. 467 U.S. at 842-43 (“If the intent of Congress is clear, that is the end of the matter.”). In determining whether the intent of Congress is clear with respect to an issue addressed by a regulation, the courts employ “traditional tools of statutory construction.” 467 U.S. at 843 n.9. The Supreme Court, employing the traditional statutory construction tool of legislative history, determined in *Colony* that Congress did not intend for an overstatement of basis to constitute an omission from gross income. *Colony*, 357 U.S. at 36-37 (stating that acceptance of the Commissioner’s interpretation of the statutory language “omits from gross income

an amount properly includible therein” would not only read that language “more broadly than is justified by the evident reason for its enactment, but also create a patent incongruity in the tax law”).

The Supreme Court in *Colony* determined Congress’ intent with respect to the issue of whether overstatement of basis was an omission from gross income. The Commissioner cannot, by regulation, change that congressional intent. By giving deference to the New Regulations, the panel decision allowed the Commissioner to change the intent of Congress as determined by the Supreme Court. The panel decision directly conflicts with *Colony*, and a rehearing *en banc* should be granted to correct that conflict. Fed. R. App. P. 35(b).

## **II. THE PANEL DECISION CONFLICTS WITH AUTHORITATIVE DECISIONS OF THE FOURTH CIRCUIT AND THE FIFTH CIRCUIT.**

Since the issuance of the New Regulations, five other Circuit Courts have considered the issue of whether an overstatement of basis constitutes an omission from gross income that gives rise to the extended period in which a tax assessment may be issued. The Fourth Circuit rejected the arguments that the Commissioner made in this case, and held that a taxpayer’s overstatement of basis was not an omission from gross income under the Omission Statutes. *Home Concrete*, 634 F.3d at 255 (holding that there is “no ground to conclude that the holding in *Colony* is limited to cases involving a trade or business selling goods or services”

and that “*Colony* forecloses the argument that [the taxpayer’s] overstated basis . . . resulted in an omission from its reported gross income”) and 258 (because the New Regulations interpret the Omission Statutes and “the Supreme Court declared that statute unambiguous, we do not believe that the [New Regulations are] entitled to controlling deference”). Similarly, the Fifth Circuit rejected the arguments that the Commissioner made in this case, and held that a taxpayer’s overstatement of basis was not an omission from gross income under the Omission Statutes. *Burks*, 633 F.3d at 355 (“We join the Fourth, Ninth, and Federal Circuits by finding that *Colony*’s holding with respect to the definition of ‘omits from gross income’ remains applicable in light of the revisions to the Code”) and 360 (“Because we hold that [the Omission Statutes are] unambiguous and [their] meaning is controlled by the Supreme Court’s decision in *Colony*, we need not determine the level of deference owed to the [New] Regulations”). *See also Salman Ranch I*, 573 F.3d 1362 (holding prior to the issuance of the New Regulations that *Colony* required the conclusion that an overstatement of basis is not an omission from gross income under the Omission Statutes); *Bakersfield*, 568 F.3d 767 (same).

The panel decision does align this Court with the District of Columbia Circuit, the Federal Circuit, and the Seventh Circuit with regard to the New Regulations. *Intermountain Ins. Serv. v. Comm’r*, No. 10-1204, \_\_\_ F.3d. \_\_\_, 2011 U.S. App. LEXIS 12476 (D.C. Cir. 2011); *Grapevine Imports, Ltd. v. United*

*States*, 636 F.3d 1368 (Fed. Cir. 2011); *Beard v. Comm’r*, 633 F.3d 616 (7th Cir. 2011), *petition for cert. filed* (Jun. 23, 2011) (No. 10-1553). These Circuit Courts held that the New Regulations support an extension of the period in which a tax assessment may be issued when basis is overstated. This significant split among the Circuit Courts establishes that the issue involved in this case is one of exceptional importance. A rehearing *en banc* should be granted so the entire Court can consider that issue. Fed. R. App. P. 35(b)

**III. THE PANEL DECISION IS CONTRARY TO DECISIONS OF THE SUPREME COURT AND THIS COURT WITH REGARD TO THE APPLICATION OF THE DOCTRINE OF COLLATERAL ESTOPPEL.**

As noted above, the panel decision relies entirely on the New Regulations in concluding that Salman Ranch’s alleged overstatement of basis was an omission from gross income that gave rise to the extended period in which tax assessments could be issued. The New Regulations restate the Commissioner’s litigation positions that *Colony* is not applicable outside of the trade or business of selling goods, and that the Omission Statutes are ambiguous with respect to the question of whether an overstatement of basis is an omission from gross income outside of the trade or business of selling goods. The New Regulations purport to fill the alleged gap resulting from that claimed ambiguity. The panel decision accepted

these premises, *Slip Op.* at 16-20, and then applied step two of the *Chevron* analysis to give deference to the New Regulations. *Slip Op.* at 20-23.

The Court, however, was not free to accept the premises that *Colony* is not applicable outside of the trade or business of selling goods, and that the Omission Statutes are ambiguous with respect to the question of whether an overstatement of basis is an omission from gross income outside of the trade or business of selling goods. As between *Salman Ranch* and the Commissioner, those legal issues were fully litigated and decided – adversely to the Commissioner’s position here – in *Salman Ranch I.* 573 F.3d at 1372-73 (“We conclude that *Colony* controls the disposition of this case. . . We do not discern any basis for limiting *Colony*’s holding concerning the ‘omits from gross income’ language of [1939 Code] § 275(c) to sales of goods or services by a trade or business. . . The [Supreme] Court interpreted the language of § 275(c) based upon what it viewed as congressional intent and purpose, without ever mentioning the taxpayer’s trade or business.”).

The panel decision’s refusal to give a collateral estoppel effect to the Federal Circuit’s holding on these legal issues is contrary to *Allen v. McCurry*, *Montana v. United States*, *Estate of H.A. True v. Commissioner* and *Northern Natural Gas Co. v. Grounds*. In those cases, the Supreme Court and this Court established that “[u]nder collateral estoppel, once a court has decided *an issue of fact or law*



necessary to its judgment, that decision may preclude relitigation *of the issue* in a suit on a different cause of action involving a party to the first case.” *Allen*, 449 U.S. at 94 (emphasis added). *See also Montana v. United States*, 440 U.S. at 153; *Estate of H.A. True*, 390 F.3d at 1232; *Northern Natural Gas Co.*, 931 F.2d at 681.

The panel decision justified its failure to give a collateral estoppel effect to the Federal Circuit’s decision in *Salman Ranch I* on the ground that the New Regulations “changed the legal atmosphere” and rendered collateral estoppel inapplicable. *Slip Op.*, at 25-26. In reaching this conclusion, the panel decision failed to identify and consider the specific issue of law decided by the Federal Circuit, that the Supreme Court’s determination of Congress’ intent with respect to the predecessor to the Omission Statutes applied to the Omission Statutes and specifically to the transaction in which *Salman Ranch* engaged (which is the same transaction that is at issue in this case). 573 F.3d at 1372-73. The Federal Circuit had no reason to describe its holding in *Chevron* terms (because the New Regulations had not been issued when the Federal Circuit issued its decision in *Salman Ranch I*), but it is clear that the Federal Circuit’s holding on the congressional intent of the Omission Statutes relates to step one of the *Chevron* analysis.

While an agency may have authority to fill in gaps in ambiguous statutes under step two of the *Chevron* analysis, an agency has no power to create an

ambiguity in a statute where none exists under step one of the *Chevron* analysis. Since the New Regulations cannot change the congressional intent of the Omission Statutes, they cannot constitute a “change in the legal atmosphere” with regard to that issue.

The panel decision erroneously applied the New Regulations first and then reviewed the case under the shadow of the New Regulations to determine whether collateral estoppel applied. The panel decision should have defined the issue of law decided in *Salman Ranch I* and then applied that decision to this case. The Federal Circuit decided the legal issue of congressional intent with respect to the Omission Statutes. The New Regulations cannot change congressional intent in order to create a statutory ambiguity. Under *Salman Ranch I*, no ambiguity exists in the Omission Statutes as applied to the *Salman Ranch* transaction. There is, therefore, no gap in the Omission Statutes to be filled by the New Regulations, and it was not appropriate to give deference to the New Regulations.

Collateral estoppel is a bedrock of common law that “relieve[s] parties of the cost and vexation of multiple lawsuits, conserve[s] judicial resources, and, by preventing inconsistent decisions, encourage[s] reliance on adjudication.” *Northern Natural Gas Co.*, 931 F.2d at 681. By failing to apply collateral estoppel to the legal issue decided by the Federal Circuit, the panel decision deviated from settled precedent of both the Supreme Court and this Court defining the doctrine of

collateral estoppel. A rehearing *en banc* should be granted in order to secure and maintain uniformity of the Court's decisions. Fed. R. App. P. 35(b).

### CONCLUSION

Salman Ranch respectfully requests that the Court vacate the panel decision and grant *en banc* review. Such review is necessary due to the conflict between the panel decision and the Supreme Court's decision in *Colony*, because of the exceptional importance of the issue involved in the panel decision as established by the conflict between the panel decision and the decisions of the Fourth Circuit in *Home Concrete* and the Fifth Circuit in *Burks*, and because of the panel decision's failure to apply the doctrine of collateral estoppel as such doctrine has been defined by the Supreme Court and by this Court.

Dated: July 14, 2011.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that on July 14, 2011, using the Court's ECF system, I submitted/served a copy of the foregoing Appellees' Petition for Rehearing *En Banc* to:

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I hereby certify that: (1) all required privacy redactions have been made to said document, and, with the exception of those redactions, every document submitted in digital form or scanned PDF format is an exact copy of the written document filed with the Clerk; and (2) the digital submission has been scanned for viruses with the most recent version of a commercial virus scanning program (Trend Micro OfficeScan Client – Version 10.0) and, according to the program, is free of viruses.

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