No. 11-163

In the Supreme Court of the United States

GRAPEVINE IMPORTS, LTD., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, 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 [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The questions presented are as follows:

1. Whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the extended six-year assessment period.

2. Whether a final regulation promulgated by the Department of the Treasury, which reflects the IRS's view that an understatement of gross income attributable to an overstatement of basis can trigger the extended six-year assessment period, is entitled to judicial deference.

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OPINIONS BELOW

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

JURISDICTION

The judgment of the court of appeals was entered on March 11, 2011. A petition for rehearing was denied on June 6, 2011 (Pet. App. 54a-56a). The petition for a writ of certiorari was filed on August 5, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has under-

stated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, 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 [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The question presented in this case is whether that six-year assessment period applies to a tax-avoidance scheme that operated by overstating a taxpayer's basis in property.

a. When a taxpayer sells property, any "[g]ain[]" that he realizes from the sale contributes to his "gross income." 26 U.S.C. 61(a)(3). The taxpayer's gain, however, is not the sale price of his property. Rather, it is the sale price minus the taxpayer's capital stake in the sold asset, which is generally the amount paid to obtain the property, as adjusted by various other factors. 26 U.S.C. 1012. For tax purposes, that capital stake is commonly referred to as the taxpayer's "basis" in property. 26 U.S.C. 1011(a). Because 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.

That issue arises in this case in the context of a particular kind of tax shelter, known as a Son-of-BOSS (Bond and Option Sales Strategy) transaction. In a Son-of-BOSS transaction, a taxpayer uses some mechanism, often a short sale, to artificially increase his basis in an asset before the asset is sold. A short sale is a sale of a security that the seller does not own or has not contracted for at the time of the sale. To close the short sale, the seller is obligated to purchase and deliver the

security at some point in the future, often by using the proceeds from the short sale itself. Typically in a Son-of-BOSS transaction, a taxpayer enters into a short sale and transfers the proceeds as a capital contribution to a partnership. The partnership then closes the short sale by purchasing and delivering the relevant security on the open market. See *Beard* v. *CIR*, 633 F.3d 616, 617-618 (7th Cir. 2011), petition for cert. pending, No. 10-1553 (filed June 23, 2011).

When the taxpayer and partnership file their tax returns for the year in which a transaction of the kind described above occurs, they are required under 26 U.S.C. 722, 723, and 752 to report their taxable bases in the partnership. The taxpayer's basis in the partnership is called an "outside basis," while the partnership's basis in its own assets is called an "inside basis." See *Kornman & Assocs., Inc.* v. *United States*, 527 F.3d 443, 456 n.12 (5th Cir. 2008). In a Son-of-BOSS transaction, when computing both "outside" and "inside" basis, the taxpayer and the partnership include the short-sale proceeds contributed to the partnership, without decreasing that amount by the corresponding obligation (*i.e.*, to close the short sale by purchasing and delivering the relevant security) that the partnership has assumed. As a result, the taxpayer either generates a large paper loss that can be used to offset capital gains on other unrelated investments, or turns what would otherwise have been a sizeable capital gain into a smaller taxable gain or even a capital loss.[1] See *Beard*, 633 F.3d at 618.

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[1] In 2000, the IRS issued a notice informing taxpayers that Son-of-BOSS transactions were invalid under the tax laws. See Notice 2000-44, 2000-36 I.R.B. 255 (describing arrangements that unlawfully "purport to give taxpayers artificially high basis in partnership interests"). In the wake of that notice, courts largely have invalidated Son-of-BOSS

b. In this case, Joseph and Virginia Tigue owned an automobile dealership, petitioner Grapevine Imports, Ltd. The Tigues planned to sell the dealership for approximately $11 million while minimizing their taxable gains from the sale. On December 9, 1999, each of the Tigues executed a short sale of United States Treasury Notes in the amount of $5 million.[2] On December 10, the Tigues transferred the combined proceeds of the short sales (slightly less than $10 million) to petitioner, along with the obligation to close the short sales. That same day, petitioner closed the short sales by purchasing and delivering the requisite Treasury Notes. On December 31, 1999, the Tigues completed the sale of petitioner to a larger car dealer. Pet. App. 4a-5a; see Gov't C.A. Br. 2-4.

In 2000, the Tigues and petitioner filed their tax returns for the previous year. In computing their outside basis, the Tigues included the amount of the short-sale proceeds (nearly $10 million) that had been contributed to petitioner, without reducing that amount to reflect petitioner's offsetting obligation to close the short positions. As a result, the Tigues turned what would have been a large capital gain into a capital loss. Pet. App. 5a; Gov't C.A. Br. 4-5.

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transactions as lacking in economic substance. See, *e.g.*, *Jade Trading, LLC* v. *United States*, 80 Fed. Cl. 11, 45-46 (2007), aff'd in relevant part, 598 F.3d 1372, 1376-1377 (Fed. Cir. 2010). In 2004, the IRS offered a settlement to approximately 1200 taxpayers. Many taxpayers who had engaged in Son-of-BOSS transactions, however, either did not qualify, chose not to participate in the settlement, or had not yet been identified. See *Beard*, 633 F.3d at 618.

[2] The Tigues formed two limited liability companies, of which they were the sole respective owners, to complete the short sale transactions. Pet. App. 4a n.1.

2. In 2004, the IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA) that reduced the Tigues' outside basis in petitioner by approximately $10 million, thereby substantially increasing their taxable income for 1999. Petitioner challenged the FPAA, arguing that it was barred because it was issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). See 26 U.S.C. 6226(a). The government contended that the FPAA was governed instead by the extended six-year assessment period in 26 U.S.C. 6501(e)(1)(A), which applies when a taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return."

The Court of Federal Claims (CFC) granted partial summary judgment to petitioner. Pet. App. 34a-53a. The CFC held that, under this Court's decision in *The Colony, Inc.* v. *CIR*, 357 U.S. 28 (1958) (*Colony*), "an overstatement of basis that results in an understatement of income does not trigger the extended statute of limitations in [S]ection 6501(e)(1)(A)." Pet. App. 48a-49a. The court therefore concluded that the three-year period in Section 6501(a), and not the six-year period in Section 6501(e)(1)(A), applied to the IRS's assessment. *Id.* at 49a. In light of that holding, the court found it unnecessary to consider whether petitioner's return had adequately disclosed the short-sale transactions. *Id.* at 50a n.10.

3. The court of appeals reversed. Pet. App. 1a-33a. The court found "the relevant text" of Section 6501(e)(1)(A) to be "ambiguous as to Congress's intent concerning treatment of a taxpayer's overstated basis." *Id.* at 18a (citation omitted). The court explained that in *Colony* this Court had "expressly found the predecessor

statute ambiguous, and turned to the legislative history to resolve the question." *Id.* at 18a-19a (citing 357 U.S. at 33). The court therefore applied a regulation that was promulgated in temporary form by the IRS in September 2009 and that became final while the appeal in this case was pending. *Id.* at 22a-32a. That regulation construes the phrase "omits from gross income" to encompass situations in which a taxpayer understates his income by overstating his basis in property. See *id.* at 11a-12a. The court of appeals held that the regulation is applicable by its terms and reflects a reasonable interpretation of the relevant statutory language. *Id.* at 24a, 27a.

DISCUSSION

This case presents the question whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). That question is presented in a petition for a writ of certiorari currently pending before the Court. See *Beard* v. *CIR*, 633 F.3d 616 (7th Cir. 2011), petition for cert. pending, No. 10-1553 (filed June 23, 2011). The government agrees with the petitioners in *Beard* that this Court should grant review in that case in order to resolve a conflict among the circuits. See Gov't Br. at 19-20, *Beard*, *supra* (filed July 27, 2011). *Beard* is the earlier-filed petition, and the government is not aware of any reason why this case would present a more suitable opportunity than *Beard* for resolving the circuit conflict.

Petitioners argue (Pet. 32) that this case is a superior vehicle because the Seventh Circuit in *Beard* found the relevant statutory text unambiguous, whereas the Fed-

eral Circuit in this case found the text ambiguous and deferred to a recently issued Treasury regulation. Both cases, however, present the same two legal questions: (1) whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" within the meaning of Section 6501(e)(1)(A); and (2) to the extent that the statutory text is ambiguous, whether a recently issued Treasury regulation reasonably resolves that ambiguity. Compare Pet. at i, *Beard*, *supra* (filed June 23, 2011), with Pet. i.

If the Court grants certiorari either in *Beard* or in this case, it will be called upon to answer those legal questions by applying the familiar two-step methodology set forth in *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 842-843 (1984). To be sure, the Seventh Circuit in *Beard*, unlike the court below, found it unnecessary to proceed to the second step of *Chevron* analysis because it concluded that the text of Section 6501(e)(1)(A) unambiguously allows the IRS to invoke the six-year assessment period. See 633 F.3d at 623. But if this Court grants certiorari in *Beard* and ultimately finds the statutory language to be unclear, it can go on to determine whether the Treasury regulation validly resolves the ambiguity.

Because *Beard* fully presents both questions and is the first-filed petition, there is no reason to grant certiorari in this case instead. Nor is there any reason to "grant the petitions in both this case and *Beard*" and "hear them in tandem on the merits." Pet. 33. That course of action would unnecessarily complicate the proceedings before this Court, and would require application of the same legal principles to an additional set of facts, without any offsetting benefit. *Beard* therefore

provides a fully suitable opportunity for resolving the circuit conflict.

If the Court grants the petition in *Beard* and concludes that an overstatement of basis in sold property does trigger the extended six-year assessment period, then the administrative adjustment at issue in this case was timely, as the court of appeals correctly held. Accordingly, the Court should hold this petition pending the disposition of *Beard*, including any subsequent proceedings on the merits, and then dispose of the petition as appropriate in light of those decisions.

CONCLUSION

The petition for a writ of certiorari should be held pending the Court's final disposition of *Beard* v. *CIR*, petition for cert. pending, No. 10-1553 (filed June 23, 2011), and then disposed of as appropriate.

Respectfully submitted.

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