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No. 2008-5090

IN THE

United States Court of Appeals for the Federal Circuit

GRAPEVINE IMPORTS, LTD., a Texas Limited Partnership, AND T-TECH, INC., as a Tax Matters Partner,

Petitioners-Appellees,

– v. –

UNITED STATES OF AMERICA,

Respondent-Appellant.

On Appeal From A Final Judgment Of The United States Court Of Federal Claims (Judge Francis M. Allegra)

PETITION FOR REHEARING EN BANC

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CERTIFICATE OF INTEREST

Counsel for Petitioners-Appellees, Howard R. Rubin, certifies as follows:

1. The full names of every party represented by me are:

- Grapevine Imports, Ltd.; and
- T-Tech, Inc.

2. The names of the real parties in interest represented by me are:

- Joseph J. Tigue; and
- Virginia B. Tigue.

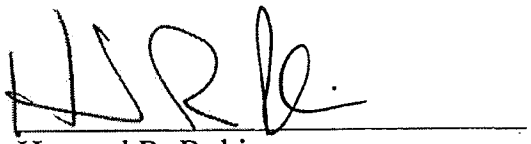
3. All parent corporations and any publicly-held company that own 10 percent or more of the stock of the parties represented by me are:

- None.

4. The names of all law firms and the partners or associates that appeared for the party now represented by me in the trial court or are expected to appear in this court are:

- Howard R. Rubin, Katten Muchin Rosenman LLP
- Robert T. Smith, Katten Muchin Rosenman LLP
- M. Todd Welty, SNR Denton US LLP
- Kenneth J. Pfaehler, SNR Denton US LLP
- Laura L. Gavioli, SNR Denton US LLP
- Josh O. Ungerman, Meadows, Collier, Reed, Cousins & Blau, LLP; and

- David E. Colmenero, Meadows, Collier, Reed, Cousins & Blau, LLP.



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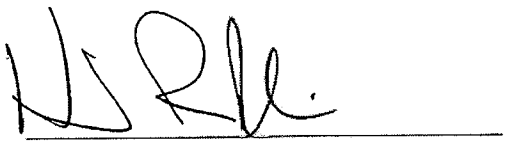
Based on my professional judgment, I believe the panel decision is contrary to the following decisions of the Supreme Court and precedent of this Court: *Colony, Inc. v. Comm'r*, 357 U.S. 28 (1958); *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005); and *Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009). Based on my professional judgment, I also believe that this appeal requires answers to two precedent-setting questions of exceptional importance, the first of which has divided the six federal appellate courts to consider the issue:

1. Whether an overstatement of basis constitutes an omission from gross income, triggering an extended six-year statute of limitations, when the Supreme Court in *Colony* rejected such an interpretation by the Government as contrary to the text, legislative history, and purpose of the governing statute.[1]

2. Whether *Chevron* deference is appropriate when, during the course of litigation in which an agency is a party, the agency promulgates regulations and seeks to apply them in an attempt to compel an appellate court to vacate a final judgment that the trial court had already entered against the agency in that very case.



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[1] *Burks v. United States*, 633 F.3d 347 (5th Cir. 2011) (refusing to apply six-year period); *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (4th Cir. 2011) (same); *Salman Ranch*, 573 F.3d at 1362 (same); *Bakersfield Energy Partners, L.P. v. Comm'r*, 568 F.3d 767 (9th Cir. 2009) (same); *but cf.* Slip Op. (applying six-year period); *Beard v. Comm'r*, 633 F.3d 616 (7th Cir. 2011) (same).

INTRODUCTION

This tax appeal presents several issues of exceptional importance—chief among them, the proper relationship between administrative agencies and the courts. The Government argued, and the Panel agreed, that the IRS could issue regulations that reinterpret a statute of limitations in a manner contrary to the Supreme Court's decision in *Colony* and this Court's decision in *Salman Ranch*, as well as every indicia of congressional intent—from the statute's text to its legislative history and purpose. In *Colony* and *Salman Ranch*, the Supreme Court and a prior panel of this Court rejected the IRS's argument that it was entitled to the benefit of an expanded statute of limitations. In so ruling, both courts determined that: (i) an "omission from gross income" only covers instances when an item is "left out" and does not encompass overstatements of basis; (ii) the legislative history did not provide "any solid support for the Government's theory," but instead provided repeated and "persuasive evidence" rejecting that theory; and (iii) the congressional purpose did not support "the Government's broad construction of the statute." *Colony*, 357 U.S. at 32-37; *Salman Ranch*, 573 F.3d at 1374. In holding that these clear expressions of congressional intent were insufficient, at *Chevron*'s first step, to foreclose the IRS's contrary interpretation, the Panel not only effectively overruled *Colony* and *Salman Ranch*, but also split from the well-reasoned decisions of the Fourth and Fifth Circuits, *Home Concrete*,

634 F.3d at 249; *Burks*, 633 F.3d at 347.

Just as troubling, the Panel sanctioned an agency's promulgation of regulations, not simply in response to litigation, but when the agency is a party to that litigation, loses the case in the lower court, and needs to change the rules of the game in order to overturn the adverse final judgment that previously had been entered against it. The Panel cited no authority for this novel proposition, *see* Slip Op. at 28, which provides an agency a blank check to overrule by regulatory fiat an adverse judgment, even after the agency agreed to submit to that judicial determination unaided by whatever regulatory authority that the agency purports to possess. In the process, the Panel ignored the full holding of *Brand X*, which disclaimed any notion that a judicial decision may be "revers[ed] by executive officers." 545 U.S. at 983. And yet, that is precisely what the IRS is seeking to accomplish here.

BACKGROUND

This appeal originally turned on a rather straightforward question—namely, whether the Government could avail itself of an extended, six-year statute of limitations. Under the Internal Revenue Code, the Government normally has only three years from the filing of a return in which to issue an adjusted tax assessment. But the three-year period is extended to six years 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." 26 U.S.C. § 6501(e)(1)(A).

On March 11, 2005, the Petitioners—Grapevine Imports, Ltd. and T-Tech, Inc. ("Grapevine")—filed in the Court of Federal Claims an action challenging as untimely an adjusted tax assessment issued more than three but less than six years after Grapevine had filed its 1999 tax return. Grapevine argued that the adjusted assessment was untimely because it was not issued within the three-year period provided in § 6501. In contrast, the Government argued that Grapevine had overstated its basis in short-sale transactions, and that this overstatement constituted an omission from gross income entitling the Government to avail itself of § 6501(e)(1)(A)'s extended statute of limitations.

The Court of Federal Claims held that the Government's adjusted assessment was untimely. *Grapevine Imports, Ltd. v. United States*, 77 Fed. Cl. 505 (2007). Applying the Supreme Court's decision in *Colony*, which construed the same statutory phrase at issue here, the court held that "an overstatement of basis that results in an understatement of income does not trigger the extended statute of limitations in section 6501(e)(1)(A)." *Id.* at 512. Accordingly, on April 23, 2008, the court entered a final judgment in favor of Grapevine.

The Government appealed and shortly thereafter, Grapevine moved to consolidate this appeal with *Salman Ranch Ltd. v. United States*, No. 2008-5053 (Fed. Cir.), because the two cases presented the same dispositive issue. The

Government opposed Grapevine's motion, arguing that, because the "Court's resolution of *Salman Ranch* may completely dispose of the issues in this case," the Court should "hold this appeal in abeyance until issuance of its decision in *Salman Ranch*." The Court followed the Government's proposal.

On July 30, 2009, the Court decided *Salman Ranch* in favor of the taxpayer. Concluding that "*Colony* controls the disposition of this case," 573 F.3d at 1372, the Court held that an overstatement of basis does "not constitute an omission from gross income," and that in such situations the IRS cannot avail itself of the six-year limitations period provided under § 6501(e)(1)(A), *id.* at 1377.

Shortly after *Salman Ranch* was decided, the IRS promulgated temporary Treasury regulations, which merely restated the Government's litigation position—a position that *Colony* and *Salman Ranch* had rejected. *See* 74 Fed. Reg. 49,321 (Sept. 28, 2009). The IRS then sought to apply those regulations to this appeal.

Before oral argument, but after the parties completed briefing in this case, the IRS promulgated final Treasury regulations. *See* 75 Fed. Reg. 78,897 (Dec. 17, 2010). The final regulations continue to express the IRS's litigation position in this case—that an overstatement of basis constitutes an omission from gross income.

On March 11, 2011, the Panel (Judges Lourie, Bryson, and Prost) applied the final regulations to reverse the final judgment of the Court of Federal Claims.

The Panel acknowledged that, unless the regulations constitute intervening authority, it was bound by *Salman Ranch*. Slip Op. at 12-13. The Panel then considered whether the regulations were binding under *Chevron, U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *Id.*

Beginning at *Chevron*'s first step, the Panel stated that its task was to "determine whether Congress's intent in enacting [§ 6501(e)(1)(A)] was so clear as to foreclose any other interpretation." *Id.* at 17. In this way, the Panel distinguished *Colony* and *Salman Ranch* because, according to the Panel, in those cases, the courts faced a different task—"to find the best (in each court's view) interpretation of the statute in light of the evidence." *Id.* at 16-17. Looking first at the statutory text, the Panel believed that *Colony* had declared "the predecessor statute ambiguous." *Id.* at 17. Because *Chevron* requires a court to employ traditional tools of statutory construction, the Panel then considered whether there were any other indicia of congressional intent "so clear that [they left] no room for [the] agency to add anything." *Id.* at 19. Applying this standard, the Panel held that, because the legislative history did not "explicitly discuss[] application of the limitations period to cases involving overstatement of basis," the IRS could issue regulations treating basis overstatement as an omission. *Id.* At the same time, the Panel ignored *Colony*'s conclusion that "Congress manifested no broader purpose" than to extend the limitations period in situations where a taxpayer failed to "report

particular income receipts and accruals." 357 U.S. at 35-36.

At *Chevron*'s second step, the Panel held that the regulations constituted "a reasonable policy choice for the agency to make." Slip Op. at 21. Though the Panel acknowledged that *Salman Ranch* had found the IRS's justifications "non-persuasive," the Panel was "unable to say that [these justifications], or the policy they support, are ipso facto unreasonable." *Id.* at 22.

Finally, the Panel dismissed out of hand Grapevine's argument that an agency abuses the litigation process when, as a party to litigation, it seeks to apply new regulations in an attempt to reverse an adverse final judgment that had been entered against it. Instead, relying on dicta from *United States v. Morton*, 467 U.S. 822, 836 n.21 (1984), the Panel held that agencies may use their regulatory authority to manipulate the judicial process "even if they are parties to the litigation in which new regulations are asserted as authority." Slip Op. at 28-29.

ARGUMENT

In the fifty-plus years since the Supreme Court decided *Colony*, the IRS has actively sought ways to limit its holding. Those efforts have largely proved unsuccessful. Congress has not changed the operative statutory language, even though the statute has been amended several times. And the courts have largely rejected the IRS's efforts to unfairly limit *Colony*'s reach.

Denied the relief it sought in the legislative and judicial arenas, the IRS now

asserts that it can use its regulatory authority in a manner contrary to every indicia of congressional intent elucidated in *Colony* and *Salman Ranch*. Just as troubling, the IRS maintains that, after agreeing to submit to a final judgment unaided by whatever regulatory authority it purports to possess, it may use that regulatory authority on appeal to obtain the reversal of the judgment that was entered against it. Because the Panel endorsed these erroneous views and departed from settled Supreme Court and Circuit precedent, *en banc* review is warranted.

I. *EN BANC* REVIEW IS NECESSARY BECAUSE THE REGULATIONS TO WHICH THE PANEL DEFERRED CONFLICT WITH CLEAR CONGRESSIONAL INTENT SET FORTH IN SUPREME COURT AND CIRCUIT PRECEDENT.

Although decided 26 years before *Chevron*, the Supreme Court's decision in *Colony* could not have been more clear: Congress manifested a clear intent that an overstatement of basis does not constitute an omission. Consistent with the first step of the *Chevron* analysis, the *Colony* Court rejected the Government's interpretation of the statutory language—the very interpretation that lies at the heart of the disputed regulations—as contrary to all indicia of legislative intent.

In *Colony*, the Supreme Court considered whether an overstatement in the basis of sold property constituted an omission under the same statutory phrase at issue here—"omits from gross income an amount properly includible therein," 26 U.S.C. § 275(c) (1939); *accord* 26 U.S.C. § 6501(e)(1)(A) (2004). The taxpayer had argued 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." *Colony*, 357 U.S. at 33. Based on the statute's use of the word "omits," which means "'to leave out or unmentioned; not to insert, include, or name,'" the Court concluded that the text "on its face lends itself more plausibly to taxpayer's interpretation," though it could "[]not be said that the language is unambiguous." *Id.* at 32-33.

Because the text favored the taxpayer, the Court could have ended its inquiry there, but it went on to examine the legislative history and purpose of the statute. Starting with the legislative history, the Court found "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." *Id.* at 33. Indeed, *Colony* found repeated instances in which Congress had stated that it "merely had in mind failures to report particular income receipts and accruals, and did not intend the [extended] limitation to apply whenever gross income was understated." *Id.* at 33-35. Moreover, the Court noted that it was "unable to find any solid support for the Government's theory in the legislative history." *Id.* at 36.

Critically, the Supreme Court *rejected* the Government's argument that the statute's purpose was to provide "for a longer period of limitations where returns contained relatively large errors adversely affecting the Treasury." *Id.* at 36. The Court rejected this "broad construction" because, "if the mere size of the error had

been the principal concern of Congress, one might have expected to find the statute cast in terms of errors in the total tax due or in total taxable net income." *Id.*

In the end, the Supreme Court held that "Congress manifested no broader purpose than to give the Commissioner [additional time] to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting the errors." *Id.* "In such instances," the Court continued, "the return on its face provides no clue to the existence of the missing item." *Id.* "On the other hand, 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.* Lastly, the Supreme Court noted that its interpretation was "in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954," *id.* at 37, the very same statute at issue here and in *Salman Ranch*.

The Panel erred in ignoring these clear indicia of congressional intent and holding that there was a "gap" for the IRS to fill. *See Gen. Dynamics Land Sys. v. Cline*, 540 U.S. 581, 600 (2004) ("deference to [an agency's] statutory interpretation is called for only when the devices of judicial construction have been tried and found to yield no clear sense of congressional intent"). The Supreme Court in *Colony* did not merely choose as "more persuasive" the taxpayer's interpretation of the statute, but, instead, rejected the Government's claim that the

statute encompassed anything beyond the "specific situation" where an income receipt or accrual was left out of the computation of gross income. *See* 357 U.S. at 33. *Colony* was also clear that adopting the Government's expansive interpretation would mean reading the statutory language "more broadly than is justified by the evident reason for its enactment . . . [and would] create a patent incongruity in the tax law." *Id.* at 36-37. Without invoking the words of *Chevron*, the Supreme Court in *Colony* unquestionably held that Congress did not intend for the statute to encompass anything more than a failure to report income receipts and accruals, and rejected the Government's contrary interpretation of the statute.[2]

The Panel also erred in holding that the addition of subsection (i) to § 6501(e)(1)(A) somehow cast in a different light the separate phrase "omits from gross income." *See* Slip Op. at 17-18. This part of the Panel's holding is in direct conflict with *Salman Ranch*, in which this Court analyzed the legislative history of the amendments to § 6501(e)(1)(A) and found that their addition did not alter the operative language that the Supreme Court had interpreted in *Colony*. *Salman Ranch*, 573 F.3d at 1375-76. If anything, the legislative history explains how these

[2] Instead of acknowledging that Congress clearly did not intend for the statute to reach beyond a failure to include some income receipt or accrual, the Panel held Congress to an artificially high standard. In the Panel's view, Congress had to expressly rule out the exact interpretation advanced by the agency, even if that interpretation was plainly beyond the scope of what Congress had intended. *See* Slip Op. at 19 (refusing to follow *Colony* because none of the excerpts of legislative history cited by the Supreme Court "explicitly discussed application of the limitations period to cases involving overstatement of basis").

amendments—embodied in subsections (i) and (ii) of § 6501(e)(1)(A)—are fully consistent with the Supreme Court's interpretation of the phrase "omits from gross income." *Id.* at 1375-76 (the phrase "omits from gross income" defines what *qualifies* as an omission, whereas the new provisions come into play only *when there has been an omission*); *Burks*, 633 F.3d at 356-57 (subsection (i) was added to resolve a conflict "about how to calculate gross income in the case of a trade or business," and was not intended to define what constitutes an omission).[3]

The IRS's promulgation of regulations does not change the fact that *Colony* controls the disposition of this case, just as it did in *Salman Ranch*, 573 F.3d at 1372. In light of *Colony*, the Panel was "not free to construe an omission from gross income as something other than a failure to report 'some income receipt or accrual.'" *Home Concrete*, 634 F.3d at 255; *accord id.* at 259 (Wilkinson, J., concurring); *Burks*, 633 F.3d at 353-54; *but cf. Beard*, 633 F.3d at 620 (holding that *Colony* does not control). The Panel erred in deferring to the regulations.[4]

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[3] If the addition of subsection (i) truly cast in a different light the language that the Supreme Court interpreted, its inclusion would create a patent incongruity in the tax law because Congress failed to make similar amendments to § 6501(e)(1)(A)'s parallel provision, 26 U.S.C. § 6229(c)(2). That provision was meant to parallel § 6501(e)(1)(A) to afford the same limitations period for partnership items.

[4] Only the Supreme Court—not a panel of this Court—can overrule *Colony* and hold that the IRS's interpretation of "omits from gross income" is not contrary to Congress's intent. *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989); *see also Home Concrete*, 634 F.3d at 260 (Wilkinson, J., concurring) ("We have been told many times to leave to the Court 'the prerogative of overruling its own decisions.' If that injunction has been issued to the circuit

II. THE FULL COURT ALSO SHOULD SET ASIDE THE PANEL'S UNPRECEDENTED HOLDING THAT AN AGENCY MAY USE ITS REGULATORY AUTHORITY TO UNDO AN ADVERSE JUDGMENT THAT HAD ALREADY BEEN ENTERED AGAINST THE AGENCY.

The Panel's further holding that an agency may use its regulatory authority to manipulate the judicial process in a case in which the agency is a party is likewise erroneous and conflicts with the Supreme Court's holdings in *Brand X* and *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988). *See* Slip Op. at 28-29. Indeed, it is impossible to reconcile the Supreme Court's decision in *Brand X* with the Government's efforts to set aside an adverse final judgment using regulations promulgated after the Court of Federal Claims entered that judgment. The *Brand X* Court specifically disclaimed any notion that a judicial decision may be "revers[ed] by executive officers," 545 U.S. at 983, but that is exactly what the IRS seeks to do here. What is more, the Supreme Court has held that "[d]eference to what appears to be nothing more than an agency's convenient litigation position" is "entirely inappropriate." *Georgetown Univ. Hosp.*, 488 U.S. at 213.[5]

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courts, it assuredly applies to agencies in situations where the Court has interpreted the plain [meaning] of a statutory command." (quoting *Rodriguez de Quijas*)).

[5] *Mayo Foundation of Medical Education & Research v. United States*, 131 S. Ct. 704 (2011), is fully consistent with these authorities. In *Mayo*, the Supreme Court clarified that, like any other agency, the IRS is entitled to *Chevron* deference where it issues a regulation that embodies a reasonable interpretation of an ambiguous portion of the statute it is charged with administering (*i.e.*, the Tax Code). *Id.* at 711-14. Contrary to an argument advanced by the Government in this case, however, *Mayo* did not hold that if the IRS is "'troubled by the consequences of [a court's] resolution of [a] case,'" it may promulgate regulations overruling an

For these very reasons, numerous federal appellate courts have recognized that it is an "abuse of the interaction between administrative agencies and the courts," and "abuse [of] the litigation process," for an agency to attempt to alter an adverse final judgment. *Tallahassee Mem'l Reg'l Med. Ctr. v. Bowen*, 815 F.2d 1435, 1452, 1456 (11th Cir. 1987); *Chock Full O' Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971) ("[T]he Commissioner may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations."); *accord Caterpillar Tractor Co. v. United States*, 589 F.2d 1040, 1043 (Ct. Cl. 1978). Moreover, in considering the validity of the regulations at issue here, the Fifth Circuit noted that, even if "*Colony* was inapplicable," deference is not owed in a "situation where, during the pendency of suit, the [IRS] promulgated determinative retroactive regulations" displacing "prior adverse judicial decisions on the identical legal issue." *Burks*, 633 F.3d at 360 n.9.

The Panel did not acknowledge any of these authorities. *See* Slip Op. at 28-29. Instead, it relied on dicta from *United States v. Morton*, 467 U.S. at 836 n.21.

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adverse judgment entered against it in that very case. *See id.* at 712-13 (quoting *United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 838 (2001)). Instead, *Mayo*'s reliance on *United Dominion* makes clear that if the IRS is not satisfied with a court's interpretation of a regulation, then the IRS can amend the regulation, but it may only seek to apply the amended regulation in a *subsequent* case. *United Dominion*, 532 U.S. at 838. Moreover, *Mayo* emphasized that "Mayo filed suit" only "[a]fter the [IRS] promulgated" the regulations at issue in that case. 131 S. Ct. at 710. *Mayo* provides no support for the IRS's radical position in this case.

Slip Op. at 29. But *Morton* did not hold that an agency may reverse an adverse judgment by regulation. Instead, the opinion in *Morton* makes clear that the Supreme Court was compelled to reverse the lower courts' decisions, and rule in the Government's favor, based on the "plain language of the statute." 467 U.S. at 826-29. The Court then went on to observe that regulations, issued after those decisions became final, provided *further support* for the Court's interpretation of "the plain language of the statute." *Id.* at 836. Thus, nothing in *Morton* establishes that an agency may use new regulations to compel an appellate court to reverse an adverse judgment that a trial court had entered against the agency.

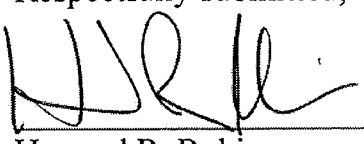
The IRS could have sought a stay of these proceedings until it promulgated the regulations at issue here. Instead, the IRS chose to proceed to a final judgment unaided by whatever regulatory authority it purports to possess. Having elected to proceed in this fashion, the IRS should not be allowed to regulate its way out of that judgment. Indeed, a contrary rule would undermine the public's confidence in the Court of Federal Claims and would render the more than three years that the parties spent litigating before that court a complete waste of time and money.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for rehearing *en banc* and affirm the final judgment of the Court of Federal Claims.

Dated: April 14, 2011

Respectfully submitted,



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