No. 10-___

IN THE

Supreme Court of the United States

KENNETH H. BEARD and SUSAN W. BEARD,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

KENT L. JONES
Counsel of Record
N. JEROLD COHEN
THOMAS A. CULLINAN
SUTHERLAND, ASBILL & BRENNAN LLP
1275 Pennsylvania Ave., N.W.
Washington, D.C. 20530
(202) 383-0100
kent.jones@sutherland.com

ROBERT E. MCKENZIE
ADAM S. FAYNE
ARNSTEIN & LEHR LLP
120 S. Riverside Plaza
Suite 1200
Chicago, IL 60606
(312) 876-7100

Attorneys for Petitioners

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

Section 6501(a) of the Internal Revenue Code generally provides a three-year statute of limitations for the assessment of income taxes. Section 6501(e)(1)(A) of the Internal Revenue Code extends that period to six years if "the taxpayer omits from gross income an amount properly includible therein and such amount is in excess of 25 percent of the amount of gross income stated in the return." 26 U.S.C. 6501(e)(1)(A).

The questions presented in this case are:

1. Whether the overstatement of the basis of an asset in reporting a taxable transaction on an income tax return constitutes an omission "from gross income" that extends the limitations period for the assessment of tax from three to six years under Section 6501(e)(1)(A) of the Internal Revenue Code.

2. Whether a temporary regulation adopted by the Treasury without notice or the opportunity for public comment and for the purpose of reversing longstanding decisions of the Supreme Court and several courts of appeals that have rejected the government's litigating position under Section 6501(e)(1)(A) of the Internal Revenue Code is entitled to any deference.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	iv
PETITION FOR A WRIT OF CERTIORARI	1
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY AND REGULATORY PROVISIONS INVOLVED	2
STATEMENT	5
REASONS FOR GRANTING THE PETITION	10
CONCLUSION	22
APPENDIX	
APPENDIX A: *Beard v. Commissioner*, 633 F.3d 616 (7th Cir. 2011)	1a
APPENDIX B: *Beard v. Commissioner*, 633 F.3d 616 (7th Cir. 2011), *reh'g en banc denied*, Order dated April 8, 2011	16a
APPENDIX C: *Beard v. Commissioner*, 98 T.C.M. (CCH) 95 (August 11, 2009)	17a

TABLE OF AUTHORITIES

CASES Page

Bakersfield Energy Partners, LP v. Commissioner, 568 F.3d 767 (2009), *aff'g* 128 T.C. 207 (9th Cir. 2007)....................7, 10, 16, 17
Beard v. Commissioner, 98 T.C.M. (CCH) 95 (2009).. 1, 6
Beard v. Commissioner, 633 F.3d 616 (7th Cir. 2011), *reh'g en banc denied* 1, 9
Bob Jones University v. United States, 461 U.S. 574 (1983).. 17
Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988).................................. 20
Burks v. United States, 633 F.3d 347 (5th Cir. 2011)..*passim*
Carpenter Family Investments, LLC v. Commissioner, 136 T.C. No. 17 (2011)..... 11
Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984)..11, 18, 20, 21
Colony, Inc. v. Commissioner, 357 U.S. 28 (1958)...*passim*
Grapevine Imports, Ltd. v. United States, 636 F.3d 1368 (Fed. Cir. 2011)...........11, 20, 21
Home Concrete & Supply, LLC v. United States, 634 F.3d 249 (4th Cir. 2011)........*passim*
Intermountain Insurance Service v. Commissioner, 134 T.C. 211 (2010)................ 11
Lorillard v. Pons, 434 U.S. 575 (1978) 14
Mayo Foundation for Medical Education and Research v. United States, 131 S. Ct. 704 (2011).. 20
Phinney v. Chambers, 392 F.2d 680 (5th Cir. 1968)...8, 9, 18

Page

Reis v. Commissioner, 142 F.2d 900 (6th Cir. 1944)....... 15
Salman Ranch Ltd. v. United States, 573 F.3d 1362 (Fed. Cir. 2009)............10, 16, 17, 21
Salman Ranch v. United States, ___ F.3d ___, 2011 WL 2120044 (10th Cir. May 31, 2011)....... 11, 21
Slaff v. Commissioner, 220 F.2d 65 (9th Cir. 1955)....... 15
Uptegrove Lumber Co. v. Commissioner, 204 F.2d 570 (3d Cir. 1953)....... 14

STATUTES

26 U.S.C. § 275, 53 Stat. 1 86-87 (1939)...... 2, 14
26 U.S.C. § 275(c) 12, 13, 17
26 U.S.C. § 6501 .... 2, 14
26 U.S.C. § 6501(a)....... 6
26 U.S.C. § 6501(e)(1)....... 16
26 U.S.C. § 6501(e)(1)(A).......*passim*
26 U.S.C. § 6501(e)(1)(A)(i) 15, 16, 18
28 U.S.C. § 1254(1)....... 2

REGULATIONS

26 C.F.R. § 301.6501(e)-1 (2010)....... 4
26 C.F.R. § 301.6501(e)-1T (2009) 7
26 C.F.R. § 301.6501(e)-1T(a)(1)(iii) (2009). 11, 18

OTHER AUTHORITIES

74 Fed. Reg. 49321 (Sept. 28, 2009)....... 7
75 Fed. Reg. 78897 (Dec. 17, 2010)....... 7

IN THE

Supreme Court of the United States

No. 10-____

KENNETH H. BEARD and SUSAN W. BEARD,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

---

PETITION FOR A WRIT OF CERTIORARI

Petitioners Kenneth H. Beard and Susan W. Beard petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-15a) is reported at 633 F.3d 616 (2011). The opinion of the Tax Court is reported at 98 T.C.M. (CCH) 95 (2009).

JURISDICTION

The judgment of the court of appeals was entered on January 26, 2011. The timely petition for rehearing with suggestion for rehearing en banc was denied on April 8, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

1. Section 275 of the Internal Revenue Code of 1939, 53 Stat. 1, 86-87, the predecessor to the provision at issue here, provided:

> Section 275. Period of limitation on assessment and collection.
>
> Except as provided in section 276—
>
> (a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.
>
> . . .
>
> (c) Omission from Gross Income.—If the taxpayer omits 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 tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

2. Section 6501 of the Internal Revenue Code of 1986, as amended, 26 U.S.C. 6501, provides in relevant part:

(a) General rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. For purposes of this chapter, the term "return" means the return required to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).

. . .

(e) Substantial omission of items.—Except as otherwise provided in subsection (c)—

(1) Income taxes.—In the case of any tax imposed by subtitle A—

(A) General rule.—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, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of

goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item.

3. Section 301.6501(e)-1 of the Treasury Regulations, 26 C.F.R. § 301.6501(e)-1, provides:

Omission from return.

(a) Income taxes—

(1) General rule. (i) If a taxpayer omits from the gross income stated in the return of a tax imposed by subtitle A of the Internal Revenue Code an amount properly includible therein that is in excess of 25 percent of the gross income so stated, the tax may be assessed, or a proceeding in court for the collection of that tax may be begun without assessment, at any time within 6 years after the return was filed.

(ii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it

relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, 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)(i).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

. . . .

(e) Effective/applicability date—(1) Income taxes. Paragraph (a) of this section applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009.

STATEMENT

1. The Internal Revenue Service issued a notice of deficiency to Kenneth H. Beard and Susan W. Beard (the "Beards") on April 13, 2006. In the notice of deficiency, the IRS sought to reduce the Beards' basis

in the stock of two S corporations that they sold during 1999 by $12,160,000. (App., *infra*, 19a.) The "basis" of an asset is its cost, for tax purposes, and it is subtracted from the proceeds received upon the sale of the asset in determining the net gain or loss recognized from the transaction. The IRS position was that, by overstating the basis of their stock, the taxpayers had understated the taxable gain from their sales of that stock by the same amount. (*Id.*)

2. The Beards contested the asserted deficiency in the United States Tax Court. In a motion for summary judgment, the Beards claimed that the three-year statute of limitations for the assertion of tax deficiencies provided by Section 6501(a) of the Internal Revenue Code, 26 U.S.C. 6501(a), had expired prior to the date that the notice of deficiency was issued by the IRS. (App., *infra*, 19a.)

The Commissioner agreed that the generally-applicable three-year statute of limitations under Section 6501(a) had expired. The Commissioner asserted, however, that the special six-year statute of limitations provided by Section 6501(e)(1)(A) of the Internal Revenue Code applies instead. (App., *infra*, 20a.) The Commissioner argued that the special six-year statute applies because, by overstating their basis in the stock, the Beards had understated their income from the sales and thereby "omit[ted] from gross income an amount properly includible therein * * * in excess of 25 percent of the amount of gross income stated in the return." 26 U.S.C. 6501(e)(1)(A). (App., *infra*, 21a.)

3. On August 11, 2009, the Tax Court granted summary judgment to the Beards. (App., *infra*, 17a-26a.) The court concluded that, even if the Beards had overstated their basis in the stock, the over-

statement of basis does not constitute an "omi[ssion] from gross income" within the meaning of the statute. (*Id.* at 25a.) In so ruling, the Tax Court followed the decision of this Court interpreting the same statutory language in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958). The Tax Court also relied on the recent decision of the Ninth Circuit in *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767 (2009), *aff'g* 128 T.C. 207 (2007), which also reached the same conclusion. Having concluded that the six-year statute of limitations does not apply to this case, the Tax Court held that the notice of deficiency was untimely and therefore entered judgment in favor of the taxpayers. (App., *infra*, 25a.)

4. On September 28, 2009, after the Tax Court rendered its decision in this case, the Secretary of the Treasury sought to alter the result of this decision, and other similar decisions, by promulgating a new, temporary Treasury Regulation. 26 C.F.R. § 301.6501(e)-1T. That regulation states the Treasury's conclusion 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)." This temporary regulation, which was made immediately effective by the agency, was issued without notice or an opportunity for public comment. 74 Fed. Reg. 49321-23. On the same date that the temporary regulation was issued, the Secretary published a notice proposing a permanent adoption of the same rule and invited public comments. The Secretary thereafter published the regulation in final form – without any material changes – on December 17, 2010. 75 Fed. Reg. 78897-99.

5. The IRS appealed the decision of the Tax Court to the Seventh Circuit. On January 26, 2011, the court of appeals reversed the judgment of the Tax Court and held that an overstatement of basis constitutes an "omi[ssion] from gross income" for purposes of Section 6501(e)(1)(A). (App., *infra*, 13a-15a.) The court of appeals stated that, "[a]lthough it is clearly a contentious issue and a close call, the plain meaning of the Code and a close reading of *Colony* lead us to the conclusion that, given [revisions made to Section 6501(e)(1)(A) in 1954], [the decision of the Supreme Court in] *Colony* does not control here and an overstatement of basis can be treated as an omission from gross income under the 1954 Code." (App., *infra*, 7a.) In reaching that decision, the Seventh Circuit cited and relied on the decision of the Fifth Circuit in *Phinney v. Chambers*, 392 F.2d 680 (1968), as the only direct appellate support for its holding. (App., *infra*, 9a.)

The Seventh Circuit went on to state that, if it had been required to reach the issue, it "would have been inclined to grant the temporary regulation *Chevron* deference, just as we would be inclined to grant such deference to [the final regulation]." (App., *infra*, 14a.) Because the court rested its holding entirely on its reading of the plain text of the statute, however, the court concluded that it was not necessary for it to consider or address the applicability, if any, of the temporary regulation to this case. (*Id.*)

6. Less than two weeks after the decision of the court of appeals in this case, the Fourth Circuit expressly disagreed with the Seventh Circuit decision in *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (2011). In *Home Concrete*, the Fourth Circuit held that, under the 1958 decision of the

Supreme Court in the *Colony* case, and also under the uniform decisions of several other circuit courts, an overstated basis does *not* constitute an omission from gross income for purposes of Section 6501(e)(1)(A).

Similarly, in *Burks v. United States*, 633 F.3d 347 (2011), which was entered only three days after the decision of the Fourth Circuit in *Home Concrete,* the Fifth Circuit squarely rejected the reasoning of the Seventh Circuit. In addition, the Fifth Circuit held in *Burks* that the Seventh Circuit in *Beard* had erred in "incorrectly read[ing the earlier Fifth Circuit] decision in *Phinney* as limiting *Colony's* holding." *Id*. at n.5.

7. On March 7, 2011, the Beards filed a petition for rehearing with suggestion for rehearing *en banc*. In the petition, the Beards pointed out (i) that the decision of the Seventh Circuit conflicted with the decision of this Court in the *Colony* case and with the decisions of the Fourth, Fifth, Ninth, and Federal Circuits on the same statutory issue; and (ii) that the Seventh Circuit had erred in relying on the decision of the Fifth Circuit in the *Phinney* case for the reasons subsequently and clearly explained by the Fifth Circuit in the *Burks* decision. On April 8, 2011, the Seventh Circuit denied the petition for rehearing and suggestion for rehearing en banc without comment. (App., *infra*, 16a.)

REASONS FOR GRANTING THE PETITION

The decision of the Seventh Circuit in this case fails to follow the reasoning and the decision of this Court in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958). The court of appeals' decision also creates a direct conflict with the decisions of the Fourth Circuit in *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (2011), the Fifth Circuit in *Burks v. United States*, 633 F.3d 347 (2011), the Ninth Circuit in *Bakersfield Energy Partners, L.P. v. Commissioner*, 568 F.3d 767 (2009), and the Federal Circuit in *Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (2009). By holding that an overstated basis of any asset involved in any sale reported on a tax return would support application of the extended six-year statute of limitations, the decision in this case has created a conflict among the circuits on a recurring issue of substantial administrative importance. Absent review by this Court, these conflicting appellate decisions will result in the disparate tax treatment of identically situated taxpayers.

Notwithstanding the impressive weight of precedent contrary to its decision, the court of appeals asserted that its conclusion in this case was compelled by the "clear" meaning of the statute. (App., *infra*, 14a.) Based on this reading of the statute, the court stated that it did not "need [to] reach" the question of what, if any, deference was due to the temporary regulation that the Treasury had adopted in its effort to overturn the several court of appeals decisions that had ruled adversely to the government's position on this frequently recurring issue. (*Id.*) While the court thus acknowledged that its discussion of this issue was *dicta*, the court nonetheless stated that, *if* the controlling statute were

regarded as ambiguous and the issue were therefore presented, it would give "*Chevron*" deference to the temporary regulation which purports retroactively to treat an overstatement of basis as if it were an omission from gross income for purposes of this statute. 26 C.F.R. § 301.6501(e)-1T(a)(1)(iii). (App., *infra*, 14a.) In reaching this conclusion, the court did not address the fact that the Treasury had adopted that regulation without notice or an opportunity for public comment as belated support for the government's litigating position in this very case.

This aspect of the Seventh Circuit decision conflicts directly with the decision of the Fourth Circuit in *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (2011), and the Fifth Circuit in *Burks v. United States*, 633 F.3d 347 (2011). In each of those cases, the courts of appeals held that the regulation was invalid as a matter of law and was entitled to no deference. The United States Tax Court has also held, in two "fully reviewed" decisions, that the temporary and final versions of this regulation are invalid. *See Carpenter Family Invs., LLC v. Commissioner*, 136 T.C. No. 17 (2011); *Intermountain Ins. Serv. v. Commissioner*, 134 T.C. 211 (2010). In two subsequent, recent decisions, however, the Federal and the Tenth Circuits upheld and deferred to the final regulation in *Grapevine Imports, Ltd. v. United States*, 636 F.3d. 1368 (2011), and *Salman Ranch v. United States*, ___ F.3d. ___, 2011 WL 2120044 (May 31, 2011), which has further deepened the embedded split among the courts of appeals on this important and recurring statutory issue.

1. a. The Seventh Circuit erred in failing to follow the binding precedent of this Court in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958). In the *Colony*

case, this Court reviewed the same language in the predecessor version of this statute from the 1939 Code and squarely held that an overstated basis of an asset in a transaction reported in a tax return is not an "omission" of gross income from that return within the meaning of the extended statute of limitations.[1] The Court held that to "omit" an item of income for purposes of the statute means "to leave [it] out or unmentioned; not to insert, include, or name." *Id*. at 32.

In *Colony*, the taxpayer had calculated its gain from the sale of properties on its tax return by using a basis that included the costs that had been incurred in developing the properties. 357 U.S. at 30. The IRS determined that such development costs were not properly included in basis. The IRS therefore concluded that the taxpayer had overstated its basis and, as a result, had understated the amount of gain to be included in gross income. The IRS mailed notices of deficiency to the taxpayer more than three years, but less than five years, after the taxpayer filed the returns.[2] The question before the Supreme Court was whether the notices were timely. *Id.*

In the *Colony* case, the Tax Court had held – like the Seventh Circuit in the present case – that the statutory language "'omits from gross income an amount properly includible therein,' embraced not

---

[1] The tax year at issue in *Colony* was governed by the version of this statute set out in the 1939 Code. Even though the decision in *Colony* was entered in 1958, this Court therefore analyzed the phrase "omits from gross income" as it was used in Section 275(c) of the 1939 Code, the predecessor to current Section 6501(e)(1)(A). *See* pages 2-4, *supra*.

[2] At the time, the extended limitations period provided by this statute was five years, rather than six. *See* page 2, *supra*.

merely the omission from a return of an item of income received by or accruing to a taxpayer, but also an understatement of gross income resulting from a taxpayer's miscalculation of profits through the erroneous inclusion of an excessive item of cost." 357 U.S. at 31. The Sixth Circuit had agreed with the Tax Court's conclusion in *Colony*. This Court granted certiorari because the decision of the Sixth Circuit "conflicted with rulings in other Courts of Appeals on the same issue." *Id*.

This Court held in *Colony* that the term "omits" – as used in "the critical statutory language, 'omits from gross income an amount properly includible therein' – must be given its ordinary meaning as "to leave out or unmentioned; not to insert, include, or name." 357 U.S. at 32. The Court further held that this "ordinary meaning" was reinforced by the legislative history of Section 275(c), which provides "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.

Based on its analysis of the text of the statute and its review of the legislative history, the Court described the congressional purpose of the extended statute of limitations as follows:

> We think that in enacting § 275(c) Congress manifested no broader purpose than to give the Commissioner an additional two years 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 errors. In such instances the return on

> its face provides no clue to the existence of the omitted item. 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. And this would seem to be so whether the error be one affecting "gross income" or one, such as overstated deductions, affecting other parts of the return. To accept the Commissioner's interpretation and to impose a five-year limitation when such errors affect "gross income," but a three-year limitation when they do not, not only would be to read § 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.

Id. at 36-37 (citing *Uptegrove Lumber Co. v. Comm'r*, 204 F.2d 570, 573 (3d Cir. 1953)) (emphasis added).

The Court also noted in *Colony* that, even though it was interpreting the text of the version of this statute contained in the 1939 Code, "the conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954."[3] 357 U.S. at 37. The Court thus concluded in

---

[3] Section 275 of the 1939 Code was renumbered as Section 6501 in the 1954 Code. Although Congress has amended Section 6501 thirty-nine times since it was first enacted in 1954, Congress has never changed the phrase "omits from gross income" which, as this Court concluded in *Colony*, governs the correct disposition of these cases. 357 U.S. at 36-37. Because Congress has revised this statute numerous times without altering this governing language, there is no ambiguity as to its proper meaning: "*Congress is presumed* to be aware of [a] judicial interpretation of a statute and *to adopt that interpretation* when it re-enacts a statute without change." *Lorillard v. Pons*, 434 U.S. 575, 580 (1978) (emphasis added).

1958 that its decision in *Colony* applies equally to the identical language contained in the 1939 and 1954 Codes – a determination that the Seventh Circuit simply ignored in its contrary determination in this case. *See* note 3, *supra*.

b. The Seventh Circuit reasoned that it was not required to follow *Colony* in the present case because the holding in *Colony* should be limited to situations "involving" a trade or business. (App., *infra*, 11a.) In reaching that conclusion, however, the Seventh Circuit failed to recognize that *Colony* was decided by this Court for the very purpose of resolving a conflict among the courts of appeals in *all* cases, some of which did *not* involve a trade or business. *Colony*, 357 U.S. at 31 n.2 and 37 (citing *Slaff v. Commissioner*, 220 F.2d 65 (9th Cir. 1955)). Indeed, the Sixth Circuit reached *its* holding in *Colony* by adhering to its prior decision in *Reis v. Commissioner*, 142 F.2d 900 (1944), which involved casual sales of property and did not involve sales in the course of a trade or business.

In determining that the holding of *Colony* was limited to situations involving a "trade or business," the Seventh Circuit sought to rely on a clause that was added to the predecessor statute when Section 6501(e)(1)(A)(i) was enacted in 1954. This new portion of this statute provides: "In the case of a trade or business, the term 'gross income' means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services." 26 U.S.C. § 6501(e)(1)(A)(i). In seeking to rely on this clause to distinguish the statute addressed in *Colony*, however, the Seventh Circuit failed to recognize that the "gross

income" of a trade or business is routinely and properly calculated by subtracting the cost of goods sold from gross receipts. As the Fifth Circuit correctly held in the *Burks* case, Section 6501(e)(1)(A)(i) thus merely "provides an alternative to this customary definition in the context of sales of goods or services by a trade or business by defining 'gross income' as gross receipts rather than gross receipts less the cost of goods sold." 633 F.3d at 358.

2. On each of the issues addressed by the court of appeals, the decision of the Seventh Circuit directly conflicts with decisions of the Fourth, Fifth, Ninth, and Federal Circuits. The existence of this deeply embedded conflict is expressly acknowledged in the decision below. (App., *infra*, 12a-13a.)

a. In *Bakersfield Energy Partners L.P. v. Commissioner*, 568 F.3d 767 (2009), the Ninth Circuit held that *Colony* remains controlling precedent and that an overstated basis is *not* an omission from gross income for purposes of Section 6501(e)(1). The Ninth Circuit observed that "Congress did not change the language in the body of § 6501(e)(1)(A), which is identical to the language in § 275(c) that the Supreme Court construed in *Colony*. As a general rule, we construe words in a new statute that are identical to words in a prior statute as having the same meaning." 568 F.3d at 775. The Ninth Circuit expressly rejected the argument of the United States that Congress' addition of subparagraph (i) "casts the language in the body of § 6501(e)(1)(A) in a different light." 568 F.3d at 776. Instead, the court held that Congress "intended to clarify, rather than rewrite, the existing law" with that addition. *Id*.

b. In *Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (2009), the Federal Circuit expressly

agreed with the reasoning and conclusion of the Ninth Circuit in *Bakersfield Energy*. The Federal Circuit held in *Salman Ranch* that *Colony* applies to the current version of this statute of limitations because the key phrase "omits from gross income an amount properly includible therein" is identical to the same language used in Section 275(c) in the 1939 Code. The court of appeals further noted that, "in the years since *Colony*, Congress has not indicated that the Court's interpretation of the language of § 275(c) should not apply to § 6501(e)(1)(A). This is true despite the post-*Colony* debate over whether § 6501(e)(1)(A) is triggered only when an item of income is entirely omitted from a return." 573 F.3d at 1373-74 (citing *Bob Jones Univ. v. United States*, 461 U.S. 574, 600-02 (1983)). "Given that *Colony* was decided over fifty years ago, we believe that, if Congress had so desired, it would have expressed its intention to change the meaning of the relevant language." 573 F.3d at 1374.

c. Less than two weeks after the Seventh Circuit issued its decision in this case, the Fourth Circuit decided *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (2011). The Fourth Circuit held that "*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. There is, therefore, no ground to conclude that the holding in *Colony* is limited to cases involving a trade or business selling goods or services." *Id*. at 255. The court of appeals found that, "[b]ecause there has been no material change between former § 275(c) and current § 6501(e)(1)(A), and no change at all to the most pertinent language, we are not free to construe an omission from gross income as something other than

a failure to report 'some income receipt or accrual.'" 634 F.3d at 255 (*quoting Colony*, 357 U.S. at 33).

d. Three days after the decision of the Fourth Circuit in *Home Concrete*, the Fifth Circuit issued its decision in *Burks v. United States*, 633 F.3d 347 (2011). The Fifth Circuit began by explaining that is earlier decision in *Phinney v. Chambers*, 392 F.2d 680 (1968), was not on point and that the Seventh Circuit had erred in attempting to rely on that case. 633 F.3d at 353 n.5. The Fifth Circuit then found "that *Colony's* holding with respect to the definition of 'omits from gross income' remains applicable in light of the revisions to the Code." *Id*. at 355. The court expressly rejected the government's argument that the addition of subsection (i) to Section 6501(e)(1)(A) made *Colony* inapplicable to the current Code. "Under the Code, gross income of a trade or business is usually calculated by subtracting the cost of goods sold from the gross receipts of the sale. 26 U.S.C. § 61(a). Subsection (i) provides an alternative to this customary definition in the context of sales of goods or services by a trade or business by defining 'gross income' as gross receipts rather than gross receipts less the cost of goods sold. See § 6501(e)(1)(A)(i)." *Id.* at 358.

3. The Seventh Circuit created an additional circuit split in suggesting – without any analysis – that *if* the governing statute were ambiguous (which the court concluded it was not), the court would then hold that the temporary Treasury Regulation 301.6501(e)-1T(a)(1)(iii) should be respected because it is entitled to "*Chevron*" deference. (App., *infra*, 14a.) That conclusion directly conflicts with the decisions of the Fourth Circuit in *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (2011),

and the Fifth Circuit in *Burks v. United States*, 633 F.3d 347 (2011).

The Fourth Circuit held in *Home Concrete* that this temporary regulation is entitled to no deference because, in *Colony*, this Court had concluded that the phrase "omits from gross income" was unambiguous. The court of appeals further held that the regulation was not a valid interpretive rule because it did not merely clarify existing law but instead "would change the law governing the taxpayers' 1999 tax returns and thereby subject the taxpayers to liability to which they would not have been subject under pre-regulation law." 634 F.3d at 257. In a concurring opinion, Judge Wilkinson recognized the benefits of deferring to agency expertise but explained that "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 . . . . This seems to me something of an inversion of the universe and to pass the point where the beneficial application of agency expertise gives way to a lack of accountability and a risk of arbitrariness." *Id.* at 259.

The Fifth Circuit similarly held in *Burks* that the regulation is invalid because it was "an unreasonable interpretation of settled law." 633 F.3d at 360-61. The Fifth Circuit explained "that § 6501(e)(1)(A) is unambiguous and its meaning is controlled by the Supreme Court's decision in *Colony*, [so] we need not determine the level of deference owed to the Regula-

tions." 633 F.3d at 360. The government was unable to cite any authority "refuting prior case law that has held § 6501(e)(1)(A) to be unambiguous with respect to the definition of 'omits.'" *Id*. at 360 (citing *Colony*, 357 U.S. at 37, where this Court held that "the conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A)"). The Fifth Circuit expressly held these regulations to be invalid because they improperly "attempt to 'trump' what is established precedent on what constitutes an 'omission from gross income' for purposes of § 6501(e)(1)(A)." 633 F.3d at 360. *See* also note 3, *supra*.

The Fifth Circuit in *Burks* went on to note that, even if Section 6501(e)(1)(A) were ambiguous and even if *Colony* did not control, it is doubtful that these regulations would be entitled to *Chevron* deference under *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704, 711 (2011). The court explained that, "in *Mayo* the Supreme Court was not faced with a situation where, during the pendency of the suit, the treasury promulgated determinative, retroactive regulations following prior adverse judicial decisions on the identical legal issue. 'Deference to what appears to be nothing more than an agency's convenient litigating position' is 'entirely inappropriate.'" 633 F.3d at 360 n.9 (*quoting Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213 (1988)). The Fifth Circuit further explained that "*Mayo* emphasized that the regulations at issue had been promulgated following notice and comment procedures," while these regulations were made immediately effective without subjecting them to notice and comment procedures. *Id.*

In *Grapevine Imports, Ltd. v. United States*, 636 F.3d. 1368 (2011), however, the Federal Circuit

widened the circuit split on the issues presented in this case by holding that this Treasury Regulation is valid and entitled to *Chevron* deference. In contrast to the holdings of the Fourth and Fifth Circuits, the Federal Circuit found that Section 6501(e)(1)(A) was ambiguous and that the legislative history did not make Congress' "intent so clear that no reasonable interpretation could differ." 636 F.3d at 1379. *But see* note 3, *supra*. Finding no constraint on the agency in the decision of this Court in *Colony* or the Federal Circuit's own prior decision in *Salman Ranch*, the Federal Circuit determined that the regulation was a reasonable construction of the statute that could be retroactively applied. *Id*. at 1382.

Finally, and most recently, the Tenth Circuit agreed "with much" of the Seventh Circuit decision to hold that Section 6501(e)(1)(A) is ambiguous, notwithstanding this Court's decision in *Colony*, and that the regulation was entitled to *Chevron* deference. *Salman Ranch*, 2011 WL 2120044, at *7. The Tenth Circuit expressly noted that it was "not swayed by [the] contrary conclusions" of the Fourth and Fifth Circuits. *Id.* at *6 n.12.[4]

4. In the absence of a decision from this Court resolving the conflict among these several courts of appeals, the treatment of identically-situated taxpay-

---

[4] The Commissioner issued notices of final partnership administrative adjustment ("FPAAs") to Salman Ranch making adjustments to the partnership tax returns that Salman Ranch filed for 1999, 2001, and 2002. Salman Ranch challenged the 1999 FPAA in the Court of Federal Claims and the 2001 and 2002 FPAAs in the Tax Court, leading to appellate review by both the Federal and Tenth Circuits. Those circuit courts issued conflicting decisions, as explained in the text.

ers will differ based solely on geographic happenstance. Both of the issues addressed in the decision below have substantial recurring administrative importance. As the numerous cases raising this same issue reflect, the decision of the Seventh Circuit to treat an overstatement of basis as though it were an "omission" of income will incorrectly subject many routine sale transactions to the expanded statute of limitations. Moreover, the holding of the court of appeals that the Treasury is empowered to reject and overrule longstanding precedent of this Court and other courts that it disfavors, simply through the issuance of temporary regulations without notice and public comment threatens obvious, far-reaching consequences. Resolution of these recurring issues is needed to avoid continuing uncertainty and uneven application of the revenue laws.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

KENT L. JONES
Counsel of Record
N. JEROLD COHEN
THOMAS A. CULLINAN
SUTHERLAND, ASBILL & BRENNAN LLP
1275 Pennsylvania Ave., N.W.
Washington, D.C. 20530
(202) 383-0100
kent.jones@sutherland.com

ROBERT E. MCKENZIE
ADAM S. FAYNE
ARNSTEIN & LEHR LLP
120 S. Riverside Plaza
Suite 1200
Chicago, IL 60606
(312) 876-7100

Attorneys for Petitioners

APPENDIX

APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 09-3741

KENNETH H. BEARD and SUSAN W. BEARD,
Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

Appeal from
the United States Tax Court.
No. 13372-06

ARGUED SEPTEMBER 27, 2010–
DECIDED JANUARY 26, 2011

Before ROVNER, EVANS, and WILLIAMS, *Circuit Judges*.

EVANS, *Circuit Judge*. This case presents the seemingly simple question of whether an overstatement of basis in ownership interests is an omission of income under the Internal Revenue Code Section 6501(e)[1], thereby triggering a six-year, rather than

[1] Unless otherwise noted, all citations to the Internal Revenue Code are to the 1954 Code.

the standard three-year, statute of limitations. But things are not always as they appear—the answer to the seemingly simple question requires a rather lengthy discussion of a case decided more than a half-century ago, in 1958, the year Elvis Presley was inducted into the army.

At issue here is a variant on a Son-of-BOSS (Bond and Option Sales Strategy) transaction, a type of abusive (so says the government) tax shelter that was popular a few years back. On the other side of this dispute, Kenneth and Susan Beard give the transaction a much more benign handle calling it simply "a tax advantaged transaction." We think the government's characterization is closer to the mark.

In a Son-of-BOSS transaction, an individual uses a short sale mechanism to artificially increase his basis in a partnership interest prior to selling the interest, thereby limiting his capital gains tax on the sale. A short sale is a "sale in which an investor sells borrowed securities in anticipation of a price decline and is required to return an equal number of shares at some point in the future." http://www.investopedia.com/terms/s/shortsale.asp (last visited Jan. 5, 2011). As such, a short sale produces proceeds from the sale of the shares as well as an outstanding liability in the amount of the number of borrowed shares multiplied by the current price per share. This liability disappears when the short is closed out, and the hope of the usual short seller is that between the time he borrows the shares and the time he closes out the short, the price per share will have dropped so that he makes more selling the borrowed shares up front than he spends later to replace them. The tax gain or loss recognition in a short sale is delayed until the seller closes the sale by replacing the borrowed

property. *Hendricks v. Commissioner of Internal Revenue*, 51 T.C. 235, 241 (1968), *aff'd* 423 F.2d 485 (4th Cir. 1970).

Short selling is often a way to hedge against the market, but a Son-of-BOSS transaction relies on the delayed tax recognition of a short sale for a gamble of a different kind. In Son-of-BOSS, the taxpayer contributes the proceeds of the short and the corresponding obligation to close out the short to another legal entity in which he has ownership rights (usually a partnership). The taxpayer (or, perhaps more accurately, the tax-avoider) then sells his rights in the partnership, claiming an inflated outside basis in the partnership corresponding to the amount of the transferred proceeds without an offsetting basis reduction for the transferred liability. This is advantageous for the taxpayer because the capital gains tax on such a transaction is calculated by subtracting the outside basis from the amount recognized in the sale of the ownership rights, so a higher outside basis means lower capital gains tax and more money in the pocket of the taxpayer. Therefore, the gamble in the Son-of-BOSS transactions was that the participant could legally increase his outside basis in a partnership by not reporting the offsetting transferred contingent liability of the short position on his tax return.

In 2000, the IRS issued Notice 2000-444, effectively invalidating future Son-of-BOSS transactions, and courts began to invalidate these transactions as lacking economic substance. Bernard J. Audet, Jr., *One Case to Rule Them All: The Ninth Circuit in Bakersfield Applies Colony to Deny the IRS An Extended Statute of Limitations in Over-statement of Basis Cases*, 55 Villanova Law Review 409, 411-12

(2010). In 2004, the IRS offered a settlement initiative to approximately 1,200 identified taxpayers, but that left a large number of taxpayers who did not qualify or who had not yet been identified as taking part in a Son-of-BOSS transaction. *Id*. at 412.

With this in mind, we turn to the facts of this case. In 1999, Kenneth Beard participated in a short sale of U.S. Treasury Notes, recognizing cash proceeds of $12,160,000. Beard used these proceeds to buy more Treasury Notes in two transactions of $5,700,000 and $6,460,000. He then transferred these Treasury Notes to two companies in which he was majority owner, MMCD, Inc. and MMSD, Inc., respectively, along with the obligation to close out the short positions. On that same day, MMCD and MMSD sold these Treasury Notes and closed out the short positions for $7,500,000 and $8,500,000, respectively. Beard then sold his ownership interests in the two companies.

On their 1999 tax return, the Beards reported longterm capital gains of $413,588 and $992,748 from the sale of the MMCD and MMSD stock, respectively. They arrived at these numbers by subtracting bases of $6,161,351 and $6,645,463 from the sale prices of $6,574,939 and $7,638,211. The Beards also reported gross proceeds from the sale of Treasury Notes of $12,125,340, a cost basis of $12,160,000, and a resulting net loss of $34,660. The high bases in MMCD's and MMSD's stock resulted from the asymmetric treatment of the short sale transactions—Beard had increased his outside bases in the companies by the amount of the short sale proceeds contributed to each company, but had not reduced the bases by the offsetting obligation to close the short positions. The 1999 tax returns of MMCD and MMSD did not

indicate that these S-corporations had assumed the liability to cover the short positions.

In 2006, almost six years after the Beards filed their 1999 tax return, the IRS issued a notice of deficiency, reducing the Beards' bases in the MMCD and MMSD stock by the amount of the transferred Treasury Notes, and thereby increasing the Beards' taxable capital gains on the sales of the companies by $12,160,000. The Beards contested this deficiency in tax court, and, rather than disputing the facts, moved for summary judgment on the grounds that overstatement of basis is not an omission from gross income for the purpose of the extended six-year statute of limitations under Section 6501(e) of the Code, and so the IRS was out of luck as the notice of deficiency came too late. The tax court agreed and granted summary judgment, finding that the principles of *Colony, Inc. v. Commissioner of Internal Revenue*, 357 U.S. 28 (1958), applied in this case. The Commissioner of the Internal Revenue Service appeals. We review the tax court's decision *de novo*. *See Bell Federal Savings & Loan Ass'n v. Commissioner of Internal Revenue*, 40 F.3d 224, 226 (7th Cir. 1994).

Although decided after the 1954 revisions, Colony (which was decided in 1958) interprets Section 275(c) of the 1939 Code, the predecessor to current Section 6501(e)(1)(A). Section 275(c) allowed for a five-year statute of limitations for tax assessment, rather than the normal three-year limit, in cases where "the taxpayer omits 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." Essentially the same language is found in current Section 6501(e)(1)(A), although the extended

statute of limitations is now six years, rather than five.

The taxpayer in *Colony* was a real estate company which understated its business income from selling residential lots by erroneously including unallowable items of development expense in the calculation of the lots' bases. *Colony*, 357 U.S. at 30. In finding that the overstatement of basis was not an omission from gross income that triggered the longer statute of limitations, the Court noted that although "it cannot be said that the [statutory] language is unambiguous," the legislative history of Section 275(c) provides "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.

After reviewing the legislative history, the Court believed that Congress' purpose was to provide extra 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 errors. In such instances the return on its face provides no clue to the existence of the omitted item." *Id*. at 36. Finally, the Court concluded that "the conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954." *Id*. at 37. The question facing us then is: Was the tax court correct to apply the principles of Colony to this dispute involving the 1954 Code?

The question has been addressed by multiple federal courts, with differing results. Some have found that *Colony* does not apply and an overstate-

ment of basis can be an omission from gross income. *See, e.g., Phinney v. Chambers*, 392 F.2d 680 (5th Cir. 1968); *Home Concrete & Supply, LLC v. United States*, 599 F. Supp. 2d 678 (E.D. N.C. 2008), *appeal docketed*, No. 09-2353 (4th Cir. Dec. 9, 2009); *Burks v. United States*, 2009 WL 2600358 (N.D. Tex. June 13, 2008), *appeal docketed*, No. 09-11061 (5th Cir. Oct. 26, 2009); *Brandon Ridge Partners v. United States*, 100 A.F.T.R. 2d 2007-5347, 2007 WL 2209129 (M.D. Fla. Jul. 30, 2007). Others have found that Colony does apply and an overstatement of basis is not an omission of gross income. *See, e.g., Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009); *Bakersfield Energy Partners LP v. Commissioner of Internal Revenue*, 568 F.3d 767 (9th Cir. 2009); *Grapevine Imports, Ltd. v. United States*, 77 Fed. Cl. 505 (2007), *appeal docketed*, No. 2008-5090 (Fed. Cir. June 27, 2008). Although it is clearly a contentious issue and a close call, the plain meaning of the Code and a close reading of *Colony* lead us to the conclusion that, given the changes to Section 6501(e)(1)(A), *Colony* does not control here and an overstatement of basis can be treated as an omission from gross income under the 1954 Code.

Although, as we have mentioned, the language of Section 275(c) is essentially duplicated in Section 6501(e)(1)(A), the new section also has two additional subsections. They read:

> (i) in the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to the diminution by the cost of such sales or services;
>
> and

> (ii) in determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item.

Therefore, it appears that subsection (i) addresses the situation faced by the Court in *Colony* where there is an omission of an actual receipt or accrual in a trade or business situation, while subsection (ii) provides a safe-harbor for improperly completed returns where the return on its face still provides a "clue" to the omitted amount. Could the Court have been referring to this synchronicity with subsections (i) and (ii) when it concluded that its interpretation of legislative history gave the "ambiguous" Section 275(c) a meaning harmonious with that of "unambiguous" Section 6501(e)(1)(A)?

The *Salman Ranch* majority says no, stating, "We are not prepared to conclude—based simply upon the Court's reference to ambiguity in § 275(c) and the lack thereof in § 6501(e)(1)(A)—that the Court's facially unqualified holding nevertheless carries with it a qualification." *Salman Ranch*, 573 F.3d at 1373. We disagree. We think the dissent said it better:

> My colleagues on this panel hold that *Colony* requires that an erroneous overstatement of basis can never serve to extend the period of limitations. That is an unwarranted enlargement of the holding in *Colony*. In *Colony* the taxpayer reported its gross receipts as a developer and seller of real property . . . .

Id. at 1380 (Newman, J., dissenting). In other words, Colony's holding is inherently qualified by the facts of the case before the Court, facts which differ from our case, where the Beards' omission was not in the course of trade or business.

The *Salman Ranch* dissent then suggests, as do we, and as did the Fifth Circuit in *Phinney*, that subsection (ii) is on all fours with *Colony*'s suggestion that Congress' intention in enacting the longer time period was to give the IRS a fighting chance in situations where the taxpayer's return doesn't provide a clue to the omission. *Id*.; *Phinney*, 392 F.2d at 685. Said the *Phinney* court:

> [w]e conclude that the enactment of subsection (ii) as part of section 6501(e)(1)(A) makes it apparent that the six year statute is intended to apply where there is either a complete omission of an item of income of the requisite amount or misstating of the nature of an *item* of *income* which places the "commissioner . . . at a special disadvantage in detecting errors."

392 F.2d at 685 (quoting *Colony*, 357 U.S. at 36). We believe that distinguishing *Colony* as the *Phinney* court did does not "[overread] *Colony*'s brief references to Section 6501(e)(1)(A)," but rather that the facts of *Colony* and the changes from the 1939 to the 1954 Code must distinguish our case from *Colony*; "a fair reading of *Colony*," suggests that the Court was aware of as much. *Bakersfield*, 568 F.3d at 778. Therefore, we take the view that *Colony* is not controlling here.

We are now left without precedential authority and must return to the text of Section 6501(e)(1)(A) to determine whether the three-year or six-year limit should apply to the Beards' case.

> Congress did not change the language in the body of § 6501(e)(1)(A), which is identical to the language in § 275(c) that the Supreme Court construed in *Colony*. As a general rule, we construe words in a new statute that are identical to words in a prior statute as having the same meaning. We therefore interpret § 6501(e)(1)(A) in light of *Colony*.

Bakersfield, 568 F.3d at 775-76 (internal citations omitted). However, in so interpreting, we must bear in mind that Congress did add subsections (i) and (ii) to Section 6501(e)(1)(A) and that the section as a whole should be read as a gestalt.

Although *Colony* found the language of Section 275(c) to be ambiguous, the Court did feel that "the statute on its face lends itself more plausibly to the taxpayer's interpretation." *Colony*, 357 U.S. at 33. The Court considered the Commissioner's argument that use of the word "amount" rather than, for example, "item," suggests a concentration on a quantitative aspect of the error, an argument which it believed was bolstered if one "touches lightly on the word 'omits' and bears down hard on the words 'gross income.'" *Id*. at 32. However, the Court found more persuasive the taxpayer's argument that the use of the word "omits," (defined as "to leave out or unmentioned; not to insert, include, or name"), rather than "reduces" or "understates" suggests a limitation of the statute only to situations in which specific receipts or accruals of income items are left out. *Id*. at 32-33.

One key phrase in the statutory language which *Colony* does not address in depth is "gross income" which is defined generally in Section 61 of the Code as "all income from whatever source derived."[2] There is no general definition of gross income found in Section 6501(e)(1)(A), however subsection (i) does provide a special definition of gross income in a trade or business setting. Therefore, for situations not involving trade or business, we think it makes logical sense to use the Code's general gross income definition when reading Section 6501(e)(1)(A).

Using these definitions and applying standard rules of statutory construction to give equal weight to each term and avoid rendering parts of the language superfluous, we find that a plain reading of Section 6501(e)(1)(A) would include an inflation of basis as an omission of gross income in non-trade or business situations. *See Regions Hospital v. Shalala*, 522 U.S. 448, 467 (1997); *Hawkins v. United States*, 469 F.3d 993, 1000 (Fed. Cir. 2006). It seems to us that an improper inflation of basis is definitively a "leav[ing] out" from "any income from whatever source derived" of a quantitative "amount" properly includible. There is an amount—the difference between the inflated and actual basis—which has been left unmentioned on the face of the tax return as a candidate for inclusion in gross income.

Further support for this reading comes from the addition of subparagraph (i). If the omissions from gross income contemplated by Section 6501(e)(1)(A) were only specific items such as receipts and accruals, then the special definition in subsection

---

[2] Section 61(a)(3) specifically includes "[g]ains derived from dealings in property" in gross income.

(i) would be, if not superfluous, certainly diminished. The addition of this subsection suggests that the definition of gross income for the purposes of Section 6501(e)(1)(A) is meant to encompass more than the types of specific items contemplated by the *Colony* holding.

The Ninth Circuit in *Bakersfield* disagrees, saying that the addition of subparagraph (i) does not necessarily cast the language in the body of Section 6501(e)(1)(A) in a different light, but rather that "we can equally infer that Congress in 1954 intended to clarify, rather than rewrite, the existing law." *Bakersfield*, 568 F.3d at 776. The Ninth Circuit goes on to say:

> In enacting the 1954 Code, Congress was presumably aware of the dispute over the interpretation of § 275(c), and it could have expressly added a definition of "omits" if it wanted to overrule the cases that concluded, as the Supreme Court later did in *Colony*, that "omits" did not include an overstatement of basis. . . . Clarifying that an overstatement of basis is not an omission from gross income in the case of a trade or business does not establish that Congress also in-tended to alter the general judicial construction of "omits" in all other contexts. Nor has the IRS pointed to any legislative history evincing an intent to alter the law outside the context of a trade or business.

Id.

We agree with our colleagues to the west that the additions to the 1954 Code could indeed be seen as clarifications, rather than a rewriting. However, we must quickly part ways, as we don't believe a full

rewriting was necessary in order to cast the language of Section 6501(e)(1)(A) in a different light, nor do we believe that Congress needed to redefine "omits" in order to clarify the existing law. We think it is important to remember that the revisions to the 1954 Code predate the decision in *Colony*, and so the law at the time was the 1939 Code and any precedential decisions within the circuits. This means that Congress, when revising the Code, was responding not to a unifying decision such as *Colony*, but rather to the confusion throughout the circuits. We do not find it hard to believe that Congress added subsections (i) and (ii) to Section 6501(e)(1)(A) with the belief that this would clarify a plain reading of the statute and quell the confusion. Indeed, as we explain above, we think the additions did just that.

The same simplicity of statutory construction can be applied to the arguments made in *Bakersfield* and *Salman Ranch*, refuting the superfluity of subsection (i) in the face of those courts' reading of Section 6501(e)(1)(A). This argument, simply put, is that the trade or business definition contained in subsection (i) was not included to clarify what counts as an omission, but rather to clarify the calculation of whether an omission exceeded 25% of gross income. *Salman Ranch*, 573 F.3d at 1375 (quoting *Bakersfield*, 568 F.3d at 776). The Federal Circuit arrives at this conclusion via a deep-dive into legislative history, while the Ninth Circuit wades through a convoluted discussion of numerators and denominators to reach the same place. *Id.*; *Bakersfield*, 568 F.3d at 776-77.

While we are great fans of underwater archaeology, we don't believe our wetsuits are needed at this time. To us, the clear, dry line from the language to the

plain meaning of Section 6501(e)(1)(A) is preferable. To say that subsection (i) was included simply to clarify the 25% calculation diminishes the plain meaning of the statute. Certainly, we should be mindful of the applicability of subsection (i) when calculating the 25%, and we should be equally mindful of this subsection and its interplay with the rest of Section 6501(e)(1)(A) and the entirety of the Code when determining what counts as an omission from gross income. Reading Section 6501(e)(1)(A) as a gestalt, the meaning is clear, and an inflation of basis should be considered an omission from gross income such that it triggers the extended six-year statute of limitations.

Much ink has been spilled in the briefs over whether temporary Treasury Regulation Section 301.6501(e)-1T(a)(1)(iii) would be entitled to *Chevron* deference if *Colony* were found to be controlling. This temporary regulation, which was issued without notice and comment at the same time as an identical proposed regulation, purports to offer taxpayers guidance by resolving an open question and stating definitively that in the case of a disposition of property, an overstatement of basis can lead to an omission from gross income. This temporary regulation has since been replaced by a nearly identical final regulation, issued after a notice and comment period. T.D. 9511 (eff. Dec. 14, 2010), 75 Fed. Reg. 78,897. Because we find that *Colony* is not controlling, we need not reach this issue. However, we would have been inclined to grant the temporary regulation *Chevron* deference, just as we would be inclined to grant such deference to T.D. 9511. We have previously given deference to interpretive Treasury regulations issued with notice-and-comment procedures, *see Kikalos v. Commissioner of Internal*

Revenue, 190 F.3d 791, 795 (7th Cir. 1999); *Bankers Life and Casualty Co. v. United States*, 142 F.3d 973, 979-84 (7th Cir. 1998), and the Supreme Court has stated that the absence of notice-and-comment procedures is not dispositive to the finding of *Chevron* deference. *Barnhart v. Walton*, 535 U.S. 212, 222 (2002).

For the foregoing reasons, the grant of summary judgment by the tax court is REVERSED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
CHICAGO, ILLINOIS 60604

No. 09-3741

KENNETH H. BEARD and SUSAN W. BEARD,
Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

Appeal from the
United States Tax Court
No. 13372-06

April 8, 2011

Before

ILANA DIAMOND ROVNER, *Circuit Judge*
TERENCE T. EVANS, *Circuit Judge*
ANN CLAIRE WILLIAMS, *Circuit Judge*

ORDER

On March 7, 2011, the petitioners-appellees filed a petition for rehearing and petition for rehearing en banc. All of the judges on the panel have voted to deny a rehearing, and none of the judges in active service have requested a vote for rehearing en banc. The petitions for rehearing and rehearing en banc are therefore DENIED.

APPENDIX C

UNITED STATES TAX COURT

[Filed August 11, 2009.]

Docket No. 13372-06.

T.C. Memo. 2009-184

KENNETH H. AND SUSAN W. BEARD,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Robert E. McKenzie and *Adam S. Fayne*, for petitioners. *Thomas D. Yang*, for respondent.

MEMORANDUM OPINION

HAINES, *Judge*: In a notice of deficiency sent April 13, 2006, respondent determined that petitioner Kenneth Beard (Mr. Beard) had overstated his basis in two S corporations sold during the taxable year 1999, thus causing an understatement of gross income by more than 25 percent of the amount stated in petitioners' return.[1] The issue for decision is whether, under those circumstances, petitioners omitted income,

---

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code, as amended, and all Rule references are to the Tax Court Rules of Practice and Procedure. Amounts are rounded to the nearest dollar.

giving rise to an extended 6-year period of limitations. This issue has been presented by petitioners' motion for summary judgment under Rule 121 and respondent's notice of objection, and supplemental briefs from both parties.

Background

For purposes of the pending motion, the following facts have been assumed. At the time they filed their petition, petitioners resided in Illinois. Mr. Beard was a majority shareholder in two S corporations, MMCD, Inc. (MMCD), and MMSD, Inc. (MMSD). Mr. Beard had a 76-percent stock ownership interest in each entity.

On August 24, 1999, petitioners entered into short sales whereby they borrowed U.S. Treasury notes from a third party and sold them for cash to another third party. These sales generated $12,160,000 in cash.

On August 25, 1999, petitioners used this cash to buy more Treasury notes in two transactions of $5,700,000 and $6,460,000. On the same day petitioners transferred to MMCD and MMSD the purchased Treasury notes of $5,700,000 and $6,460,000, respectively, together with the short positions (the obligation following the short sale to replace the borrowed securities). On the same day MMCD and MMSD sold their Treasury notes and closed the short positions on the Treasury notes for $7,500,000 and $8,500,000, respectively.

On August 29, 1999, Mr. Beard sold his entire interest in MMCD and in MMSD to Unicom, an unrelated third-party purchaser, for $6,574,939 and $7,638,211, respectively.

On April 11, 2000, petitioners jointly filed their 1999 Federal income tax return. On their Schedule D, Capital Gains and Losses, petitioners claimed a cost basis of $6,161,351 in MMCD and $7,638,463 in MMSD and net gains from the sales of the shares of $413,588 and $992,748, respectively. Petitioners also reported gross proceeds from the sale of Treasury notes of $12,125,340, a cost basis of $12,160,000, and a resulting net loss of $34,660. There is no indication on Schedule M-2, Analysis of Accumulated Adjustments Account, Other Adjustments Account, and Shareholders' Undistributed Taxable Income Previously Taxed, of the 1999 income tax return of either MMCD or MMSD that the S corporations had assumed the liability to cover the short position in Treasury notes.

On April 13, 2006, respondent issued a notice of deficiency reducing petitioners' bases in the MMCD and MMSC stock by $5,700,000 and $6,460,000, respectively.[2] The result was a $12,160,000 increase in the capital gain from the sale. Respondent contends that the bases in the MMCD and MMSC stock were inflated because they were not reduced by the liability to close the short position.

On July 11, 2006, petitioners filed a timely petition with this Court. On September 11, 2007, petitioners filed a motion for summary judgment on the ground that the notice of deficiency was issued after the period of limitations had expired. Petitioners contend that overstatement of basis is not an omission from gross income for purposes of the extended period of limitations under section 6501(e)(1)(A).

---

[2] Respondent also disallowed $155,858 of petitioners' itemized deductions.

On February 19, 2008, respondent filed his notice of objection to petitioners' motion, agreeing that the material facts necessary to determine whether petitioners actions constitute an omission from gross income are not in dispute. Respondent contends, however, that there is a genuine issue of fact as to whether the notice of deficiency was timely issued under section 6501(e).

Discussion

Summary judgment is intended to expedite litigation and avoid unnecessary and expensive trials. *Fla. Peach Corp. v. Commissioner*, 90 T.C. 678, 681 (1988). The Court may grant summary judgment when there is no genuine issue of material fact and a decision may be rendered as a matter of law. Rule 121(b); *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), affd. 17 F.3d 965 (7th Cir. 1994); *Zaentz v. Commissioner*, 90 T.C. 753, 754 (1988). The moving party bears the burden of proving that there is no genuine issue of material fact. *Dahlstrom v. Commissioner*, 85 T.C. 812, 821 (1985); *Naftel v. Commissioner*, 85 T.C. 527, 529 (1985). The Court will view any factual material and inferences in the light most favorable to the nonmoving party. *Dahlstrom v. Commissioner*, *supra* at 821; *Naftel v. Commissioner*, *supra* at 529.

Under the general rule set forth in section 6501(a), the Internal Revenue Service is required to assess the tax (or send a notice of deficiency) within 3 years after a Federal income tax return is filed. Section 6501(e)(1)(A) extends the limitations period to 6 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".

Section 6501(e)(1)(A) was first enacted as section 275(c) of the Revenue Act of 1934 (1934 Revenue Act), Ch. 277, 48 Stat. 745. *See Badaracco v. Commissioner*, 464 U.S. 386, 392 (1984). In 1954 Congress made several changes to this provision. See H. Rept. 1337, 83d Cong., 2d Sess. A414 (1954); S. Rept. 1622, 83d Cong., 2d Sess. 584-585 (1954). Section 6501(e)(1)(A)(i) provides an exception to the general definition of gross income, stating that

> In the case of a trade or business, the term 'gross income' means the total of the amounts received or accrued from the sale of goods or services * * * prior to the diminution by the cost of such sales or services.

Also, section 6501(e)(1)(A)(ii) provides a "safe harbor" for a taxpayer who otherwise has made a substantial omission, stating that

> In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item.

Respondent argues that the overstatement of basis in a context outside of the sale of goods or services should constitute an omission from gross income and thus trigger the 6-year limitations period under section 6501(e)(1)(A).[3]

---

[3] Respondent also argues, alternatively, that petitioners' transfer of Treasury notes to the S corporations should be recast as bona fide and that petitioners' two S corporations omitted income from their returns by failing to report the close of their short positions. See sec. 1.1233-1(a)(1), Income Tax Regs. In a

In *Colony, Inc. v. Commissioner*, 357 U.S. 28, 33, 37 (1958), the Supreme Court, interpreting section 275(c) of the 1934 Revenue Act, the predecessor of section 6501(e), held that the extended period of limitations applies to situations where specific income receipts have been "left out" in the computation of gross income and not when an understatement of gross income resulted from an overstatement of basis. The facts of *Colony* dealt with a taxpayer who developed and sold lots in a subdivision. *Id*. at 30-31.

In *Bakersfield Energy Partners, LP v. Commissioner*, 128 T.C. 207 (2007), affd. 568 F.3d 767 (9th Cir. 2009), a partnership (Bakersfield) which owned oil and gas property used the Internal Revenue Code's partnership termination and transfer provisions to increase its basis in that property before selling it to a third party in 1998.[4] The Commissioner issued a

---

short sale, the timing of gain or loss recognition remains open until the seller closes the sale by replacing the borrowed property. *Hendricks v. Commissioner*, 51 T.C. 235, 241 (1968), affd. 423 F.2d 485 (4th Cir. 1970). Respondent contends that, if petitioners' bases in the S corporations were increased by their transfer of Treasury notes to MMCD and MMSD, the S corporations should have recognized gain of $12,160,000 when they closed the short sale obligation. Respondent's reasoning is flawed, however, as his analysis does not take into account the transfer of petitioners' short sale obligation to MMCD and MMSD, which lowered petitioners' bases in both S corporations by the same amount their bases were raised through the transfer of the Treasury notes. See Rev. Rul. 95-45, 1995-1 C.B. 53. Ultimately, respondent's alternative argument results in the same overstatement of basis issue present in the notice of deficiency.

[4] Specifically, four of the seven partners in Bakersfield took the following steps to increase Bakersfield's zero basis in its oil and gas property: (1) The four partners formed a new partnership, Bakersfield Resources, L.L.C. (Resources); (2) the four partners sold their partnership interests in Bakersfield to

notice of final partnership administrative adjustment (FPAA) almost 6 years after Bakersfield filed its return for 1998, and Bakersfield contended that the FPAA was untimely under *Colony*. Because Bakersfield did not omit any income receipt or accrual in its computation of gross income, we held that the Supreme Court's decision in *Colony* applied and Bakersfield's overstatement of basis did not trigger the extended limitations period. *Bakersfield Energy Partners, LP v. Commissioner*, *supra* at 215-216. As part of our holding, we stated that neither "the language or the rationale of *Colony*, *Inc.* can be limited to the sale of goods or services by a trade or business." *Id*. at 215.

Respondent contends that *Bakersfield* was wrongly decided and that *Colony* should be limited to cases where the taxpayer is involved in the sale of goods and services.[5] First, respondent argues that *Colony's*

Resources for $19,924,870. The four partners held a collective majority stake in Bakersfield and thus caused a technical termination of the Bakersfield partnership and the formation of a new partnership in which Resources held a majority interest under sec. 708(b)(1)(B); (3) the new Bakersfield partnership elected to increase its basis in partnership assets by the $19,924,870 sale price of the partnership interests sold to Resources following the transfer of partnership interest pursuant to secs. 754 and 743. Bakersfield allocated $16,515,194 of its new $19,924,870 basis to its oil and gas property and the rest to its other assets; (4) Bakersfield sold its oil and gas property to a third party for $23,898,611.

[5] Several cases have questioned the continuing viability of *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958) in the light of the 1954 amendments to sec. 6501(e)(1)(A). For example, in *CC & F W. Operations Ltd. Pship. v. Commissioner*, 273 F.3d 402, 406 n.2 (1st Cir. 2001), affg. T.C. Memo. 2000-286, the Court of Appeals for the First Circuit stated that "Whether *Colony's* main holding carries over to section 6501(e)(1) is at least doubtful",

interpretation of section 275(c) of the 1934 Revenue Act is not binding because its successor statute, section 6501(e)(1)(A), is materially different (the materiality argument). Second, respondent argues that *Colony* interpreted section 275(c) of the 1934 Revenue Act as having the same meaning as section 6501(e)(1)(A)(i) and thus *Colony* should apply only to taxpayers who realize gross receipts from sales or services in the course of a trade or business (the interpretation argument).

The Commissioner raised these same arguments with regard to *Bakersfield* in the Court of Appeals for the Ninth Circuit. *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d at 775. Addressing the materiality argument, the Court of Appeals for the Ninth Circuit noted that Congress did not change the language in the body of section 6501(e)(1)(A), which is identical to the language in section 275(c) of the 1934 Revenue Act that the Supreme Court construed in *Colony*.[6] *Id*. at 775-776. Addressing the

---

suggesting that the Supreme Court's gross income test applies only to sales of goods and services covered by sec. 6501(e)(1)(A), but not to other types of income. That position, however, was not adopted by other Courts of Appeals. Most recently, the Court of Appeals for the Federal Circuit determined that there was no "basis for limiting *Colony's* holding concerning the 'omits from gross income' language of I.R.C. § 275(c) to sales of goods or services by a trade or business." *Salman Ranch Ltd v. United States*, __ F.3d __ (Fed. Cir., July 30, 2009) (slip op. at 20) .

[6] The Court of Appeals for the Ninth Circuit also dismissed the Commissioner's sub-argument that applying *Colony* to the 1954 Code would render sec. 6501(e)(1)(A)(i) superfluous:

> Section 6501(e)(1)(A) requires a comparison of two numbers: (1) the "gross income" omitted with (2) the "gross income" stated in the return. If the first number divided by the second number is greater than 25%, then the 6-year

interpretation argument, the Court of Appeals noted that the Supreme Court expressly avoided construing the 1954 Code and "did not even hint" that its interpretation of section 275(c) of the 1934 Revenue Act was limited to cases in which the taxpayer was engaged in a trade or business. *Id*. at 778.

We believe that it would be inappropriate to "distinguish and diminish the Supreme Court's holding in *Colony*". *Bakersfield Energy Partners, LP v. Commissioner*, 128 T.C. at 215. The principles of *Colony* apply where a taxpayer overstates his basis. In both *Colony* and *Bakersfield* the taxpayers artificially inflated their bases in assets that were subsequently sold. Although *Colony* dealt with the sale of land and *Bakersfield* with the sale of oil and gas property, in neither case did the taxpayer fail to report gross income on a return for purposes of the extended limitations period.

We assume that petitioners overstated the bases of their S corporations on their 1999 return. Under *Colony* and *Bakersfield*, petitioners did not omit income from their return such as would subject them to the extended period of limitations. Accordingly, petitioners' motion for summary judgment will be granted.

> limitations period applies. Because § 6501(e)(1)(A)(i) changes the definition of "gross income" for taxpayers in a trade or business, it potentially affects both the numerator (the omission from gross income) and the denominator (the total gross income stated in the return). *Colony's* holding, however, affects only the numerator, by defining what constitutes an omission from gross income.

Bakersfield Energy Partners, LP v. Commissioner, 568 F.3d 767, 776 (9th Cir. 2009), affg. 128 T.C. 207 (2007).

In reaching these holdings, the Court has considered all arguments made and, to the extent not mentioned, concludes that they are moot, irrelevant, or without merit.

To reflect the foregoing,

An appropriate order and decision will be entered.