No. 10-1553

In the Supreme Court of the United States

KENNETH H. BEARD AND SUSAN W. BEARD, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

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

BRIEF FOR THE RESPONDENT

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QUESTIONS PRESENTED

As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, if the taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The questions presented are as follows:

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

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

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 633 F.3d 616. The opinion of the Tax Court (Pet. App. 17a-26a) is reported at 98 T.C.M. (CCH) 95.

JURISDICTION

The judgment of the court of appeals was entered on January 26, 2011. A petition for rehearing was denied on April 8, 2011 (Pet. App. 16a). The petition for a writ of certiorari was filed on June 23, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, if the taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in [the taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The question presented in this case is whether that six-year assessment period applies to a tax-avoidance scheme that operated by overstating a taxpayer's basis in property.

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

This case involves a particular kind of tax shelter, known as a Son-of-BOSS (Bond and Option Sales Strategy) transaction. In a Son-of-BOSS transaction, a tax-

payer uses some mechanism, often a short sale, to artificially increase his basis in an asset before the asset is sold. A short sale is a sale of a security that the seller does not own or has not contracted for at the time of the sale. To close the short sale, the seller is obligated to purchase and deliver the security at some point in the future, often by using the proceeds from the short sale itself. Typically in a Son-of-BOSS transaction, a taxpayer enters into a short sale and transfers the proceeds as a capital contribution to a partnership. The partnership then closes the short sale by purchasing and delivering the relevant security on the open market. Pet. App. 2a-3a.

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

been a sizeable capital gain into a smaller taxable gain or even a capital loss.[1] Pet. App. 3a.

b. In August 1999, petitioner Kenneth Beard participated in a short sale of United States Treasury Notes, receiving cash proceeds of $12,160,000. Petitioner used those proceeds to buy more Treasury Notes in two transactions of $5,700,000 and $6,460,000. Petitioner then transferred those Treasury Notes, along with the obligation to close out the short positions, to two companies (MMCD, Inc., and MMSD, Inc.) of which he was the majority owner.[2] That same day, MMCD and MMSD sold the Treasury Notes and closed out the short positions. Petitioner then sold his ownership interests in the two companies to an unrelated third-party for $6,574,939 (MMCD) and $7,638,211 (MMSD). Pet. App. 4a, 18a.

In April 2000, Kenneth Beard and his wife, petitioner Susan Beard, jointly filed their federal income-tax return for 1999. On Schedule D, where petitioners were

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[1] In 2000, the IRS issued a notice informing taxpayers that Son-of-BOSS transactions were invalid under the tax laws. See Notice 2000-44, 2000-36 I.R.B. 255 (describing arrangements that unlawfully "purport to give taxpayers artificially high basis in partnership interests"). In the wake of that notice, courts largely have invalidated Son-of-BOSS transactions as lacking in economic substance. See, *e.g.*, *Jade Trading, LLC* v. *United States*, 80 Fed. Cl. 11, 45-46 (2007), aff'd in relevant part, 598 F.3d 1372, 1376-1377 (Fed. Cir. 2010). In 2004, the IRS offered a settlement to approximately 1200 taxpayers. Many taxpayers who had engaged in Son-of-BOSS transactions, however, either did not qualify, chose not to participate in the settlement, or had not yet been identified. Pet. App. 4a.

[2] MMCD and MMSD were S corporations, which for present tax purposes are treated in the same manner as partnerships. See 26 U.S.C. 752, 1367 (2006 & Supp. III 2009). This brief therefore refers to the ownership interests in MMCD and MMSD as partnership interests.

required to report "Capital Gains and Losses," they listed their "[c]ost or other basis" in MMCD as $6,161,351 and their "[c]ost or other basis" in MMSD as $6,645,463. Those high bases in MMCD and MMSD stock resulted from petitioners' asymmetric treatment of the short-sale transactions. Petitioners increased their outside bases by the amount of the short-sale proceeds contributed to MMCD and MMSD (with certain other adjustments not relevant here), without reducing those amounts to reflect the companies' offsetting obligation to close the short positions. Subtracting the outside bases from the sale prices, petitioners reported capital gains of $413,588 and $992,748 from the sale of MMCD and MMSD stock—even though those companies had sold for a combined total of more than $14 million. Pet. App. 4a, 19a.

Petitioners also reported on their return 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. Petitioners thus indicated that they had engaged in a sale of Treasury Notes, without indicating that the transaction was a short sale in which the obligation to close the short positions had been transferred to MMCD and MMSD. The 1999 tax returns of MMCD and MMSD likewise did not indicate that the companies had assumed the obligation to close short positions on a sale initiated by petitioners. Pet. App. 4a-5a.

2. In April 2006, just under six years after the filing of petitioners' 1999 return, the IRS issued a notice of deficiency to petitioners. The IRS determined that petitioners' reported bases in their MMCD and MMSD stock had been inflated because petitioners had not reduced those bases to reflect the companies' offsetting

obligation to close petitioners' short sale. The IRS therefore reduced petitioners' bases in the MMCD and MMSD stock by $5,700,000 and $6,460,00, respectively—*i.e.*, the amounts of the Treasury Notes that petitioners had transferred to the companies. The result was an increase of $12,160,000 in petitioners' capital gain from their sale of MMCD and MMSD stock. Pet. App. 5a, 19a.

Petitioners contested that deficiency in the Tax Court. They moved for summary judgment on the ground that the IRS's assessment of additional income tax was time-barred because it was issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). The IRS contended, however, that the assessment was governed instead by the extended six-year assessment period in 26 U.S.C. 6501(e)(1)(A), which applies when a taxpayer "omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return." The Tax Court granted summary judgment to petitioners. Pet. App. 17a-26a. The court viewed this Court's decision in *The Colony, Inc.* v. *CIR*, 357 U.S. 28 (1958) (*Colony*), as establishing that, even if petitioners "overstated the bases of their S corporations on their 1999 return," they "did not omit income from their return such as would subject them to the extended period of limitations." Pet. App. 25a.

3. The court of appeals reversed. Pet. App. 1a-15a. The court held that *Colony* is not controlling here because this Court in *Colony* interpreted former 26 U.S.C. 275(c) (Supp. V 1939)—the predecessor statute to current Section 6501(e)(1)(A). Pet. App. 5a, 7a. Based on its analysis of *Colony*'s reasoning and of subsequent

statutory amendments reflected in current Section 6501(e)(1)(A), the court of appeals concluded that *Colony*'s holding is limited to cases that, unlike this one, involve goods or services sold by a trade or business. *Id.* at 7a-9a.

The court of appeals then determined that "a plain reading of Section 6501(e)(1)(A) would include an inflation of basis as an omission from gross income in non-trade or business situations." Pet. App. 11a. Because the court found the statutory text clear, it did not decide what weight should be given to a Treasury regulation, which was issued in final form after notice and comment during the pendency of the appeal, and which reflects the IRS's view that "an overstatement of basis can lead to an omission from gross income" for purposes of the extended assessment period. *Id.* at 14a. The court noted, however, that "it would have been inclined" to defer to the regulation under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984). Pet. App. 14a.

ARGUMENT

As the court of appeals correctly held, an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). That is the most natural reading of the disputed language, particularly when Section 6501(e)(1)(A) is read in its larger statutory context. And to the extent that the statutory text is ambiguous, the Department of the Treasury has promulgated a regulation that resolves the question presented here. This Court's decision in *The Colony, Inc.* v. *CIR*, 357 U.S. 28 (1958), does not require a different result. The Court

in *Colony* addressed a predecessor statute rather than Section 6501(e)(1)(A) in its current form, and subsequent statutory amendments make clear that *Colony*'s holding does not apply to the current Section 6501(e)(1)(A).

Although the decision below is correct, the courts of appeals are divided on the question whether an overstatement of basis in property can trigger an "omi[ssion] from gross income" under Section 6501(e)(1)(A). The Seventh, Tenth, Federal, and District of Columbia Circuits have ruled in the government's favor on this issue. By contrast, the Fourth and Fifth Circuits have held that the IRS cannot invoke the six-year assessment period when a taxpayer's understatement of gross income is attributable to an overstatement of basis in property. In light of the square circuit conflict, and the importance of the uniform administration of federal tax law, the petition for a writ of certiorari should be granted.

1. The statutory text and structure establish that petitioners' understatement of their gain from the sale of MMCD and MMSD stock was an "omi[ssion] from gross income" that triggered the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). That is so even though petitioners' understatement of gain was attributable to an overstatement of basis in their partnership interests, rather than (for example) to an understatement of the sale proceeds.

a. Section 6501(e)(1)(A) provides that the IRS has six years from the filing of a return to assess additional taxes "[i]f 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." Petitioners do not dispute that the amount of

income at issue—approximately $12 million—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 question in this case is whether petitioners "omit[ted]" that "amount" from their "gross income" when they (i) overstated their basis in MMCD and MMSD stock, (ii) subtracted that inflated amount from the sale proceeds, and (iii) thereby reported on their tax return a gain from the stock sales much smaller than their real gain.

Section 61(a) of the Internal Revenue Code "defines 'gross income' for federal tax purposes as 'all income from whatever source derived.'" *CIR* v. *Banks*, 543 U.S. 426, 433 (2005). That definition "extends broadly to all economic gains not otherwise exempted." *Ibid.*; see *CIR* v. *Schleier*, 515 U.S. 323, 327 (1995) ("We have repeatedly emphasized the 'sweeping scope' of this section and its statutory predecessors.") (quoting *CIR* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955)); *Green* v. *CIR*, 7 T.C. 263, 277 (1946) ("'Gross income' has a well established meaning in the revenue laws, denoting statutory gross income as defined by [the predecessor statute to Section 61]."). Section 61(a) thus requires a taxpayer to treat as "gross income" any income received from any source, unless that income is specifically excepted by another provision of the Internal Revenue Code.

Of particular relevance here, the term "gross income" as defined in Section 61(a) "includ[es]," "but [is] not limited to," "[g]ains derived from dealings in property." 26 U.S.C. 61(a)(3); see 26 C.F.R. 1.61-6(a) ("Gain realized on the sale or exchange of property is included in gross income, unless excluded by law."). A "gain" from a sale of property is defined, in turn, as "the excess of the amount realized over the unrecovered cost or

other basis for the property sold or exchanged." *Ibid.* For that reason, Schedule D of petitioners' 1999 tax return required them to report in one column the "[c]ost or other basis" of their MMCD and MMSD stock, and in another column the "[s]ales price" of that stock. App., *infra*, 1a. A third column then required petitioners to calculate their capital gain by subtracting their basis in MMCD and MMSD stock from its sales price. *Ibid.*

Because a gain on a sale of property is determined by subtracting the taxpayer's basis from the sales price, a taxpayer can fail to report income from a property sale in either of two ways: by overstating his basis in the property or by understating the property's sales price. Doing either of those things on a taxpayer's Schedule D conceals the true extent of the taxpayer's capital gain from the IRS. Here, on their Schedule D, petitioners listed their "[c]ost or other basis" in MMCD stock as $6,161,351 and in MMSD stock as $6,645,463. App., *infra*, 1a. Subtracting those purported bases from the sales prices, petitioners reported capital gains of $413,588 and $992,748 from the sale of MMCD and MMSD stock—even though those companies had sold for a combined total of more than $14 million. *Ibid.* Petitioners thus concealed $12.1 million in income that they had derived from the sale of MMCD and MMSD, no less than if they had misrepresented the companies' sales prices.

By understating their gross income from the sales in the manner described above, petitioners "omit[ted] from gross income an amount properly includible therein." 26 U.S.C. 6501(e)(1)(A). The verb "omit" most commonly means "to leave out or leave unmentioned[;] fail to insert, include, or name." *Webster's Third New Interna-*

tional Dictionary 1574 (1993). If petitioners had accurately stated their basis in MMCD and MMSD stock before subtracting that basis from the sales prices of MMCD and MMSD, they would have reported capital gains of approximately $13.5 rather than $1.4 million. That additional $12.1 million increment is naturally characterized as an "amount" that was "properly includible" (*i.e.*, that ought to have been included) in petitioners' "gross income," but that petitioners instead "le[ft] out" or "omit[ted]." See Pet. App. 11a ("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.").

b. Two other aspects of Section 6501(e) reinforce that understanding of the phrase "omit[ted] from gross income an amount properly includible therein." First, following the principal paragraph of Section 6501(e)(1)(A) at issue here, Subsections (i) and (ii) establish two exceptions to the general rule. The first of those exceptions states that "[i]n 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 diminution by the cost of such sales or services." 26 U.S.C. 6501(e)(1)(A)(i). Subsection (i) thus provides that gross income from the sale of goods or services by a trade or business is not calculated in the same way as gross income realized by a non-business taxpayer. Rather, for a trade or business, gross

income from the sale of goods or services is simply the sales price, without any offset for the seller's basis.[3]

As the court of appeals explained, that "special definition" would be superfluous, or at least of extremely limited scope, if the general rule were that an overstatement of basis cannot give rise to an omission from gross income. Pet. App. 11a-12a; see *Intermountain Ins. Serv. of Vail, LLC* v. *CIR*, No. 10-1204, 2011 WL 2451011, at *10 (D.C. Cir. June 21, 2011) (*Intermountain*) ("Because Intermountain's interpretation of [S]ection 6501(e)(1)(A)'s principal paragraph would accomplish exactly the same result but for all taxpayers, including those engaged in a trade or business, its interpretation renders subsection (i) largely redundant."); *ibid*. (noting the presumption "that Congress does not add provisions that simply replicate what the statute already does"). The most natural inference is that "Congress understood the 'omits from gross income' language to include basis overstatements and added subsection (i) as an exception limited to the trade or business context." *Ibid*.

Second, Section 6501(e)(2), which applies to estate and gift taxes, gives the IRS six years from the filing of a return to assess additional tax "if the taxpayer omits * * * *items* includible" in the gross estate. 26 U.S.C.

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[3] The second exception states that "[i]n determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted * * * 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." 26 U.S.C. 6501(e)(1)(A)(ii). Subsection (ii) thus provides a safe harbor for a taxpayer who omits an amount from gross income but nevertheless sufficiently discloses the omission in his return.

6501(e)(2) (emphasis added). Congress used the term "items" to "make[] it clear that the [six]-year period is not to apply merely because of differences between the taxpayer and the Government as to the valuation of property." Staff of the Joint Comm. on Internal Revenue Taxation, *Summary of the New Provisions of the Internal Revenue Code of 1954*, at 130 (1955). By contrast, Section 6501(e)(1)(A) provides for a six-year assessment period "[i]f the taxpayer omits from gross income an *amount* properly includible therein." 26 U.S.C. 6501(e)(1)(A) (emphasis added). Congress's reference to "amount[s]" rather than "items" strongly suggests that the six-year assessment period "applies both in cases where an item of income is completely left out and in situations where the amount of gross income reported is understated due to an error in the calculation." *Brandon Ridge Partners* v. *United States*, No. 8:06-cv-1340-T-24MAP, 2007 WL 2209129, at *7 (M.D. Fla. July 30, 2007). Once that proposition is established, the statutory text provides no basis for distinguishing between understatements of gross income that are attributable to understatements of receipts, and those that are attributable to overstatements of basis.

2. To the extent that the statutory language is ambiguous, the Department of the Treasury has recently promulgated a regulation that resolves the question presented here. The regulation provides that, "as it relates to any income other than from the sale of goods or services in a trade or business," "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." 26 C.F.R. 301.6501(e)-1(a)(1)(iii) (emphasis omitted). "Consequently," the regulation explains, "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 [S]ection 6501(e)(1)(A)." *Ibid.*

Because the court of appeals found the statutory text dispositive, it did not decide whether the Treasury regulation was entitled to judicial deference. Pet. App. 14a. The court noted, however, that "it would have been inclined" to defer to the regulation under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984). Pet. App. 14a. The court's inclination was correct. As the Tenth, Federal, and District of Columbia Circuits have held, the Treasury regulation was validly promulgated, applies to pending cases like this one, and is entitled to *Chevron* deference. See *Salman Ranch, Ltd.* v. *CIR*, No. 09-9015, 2011 WL 2120044, at *9 (10th Cir. May 31, 2011); *Grapevine Imports, Ltd.* v. *United States*, 636 F.3d 1368, 1381 (Fed. Cir. 2011); *Intermountain*, 2011 WL 2451011, at *13; see also *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704, 713 (2011) (*Mayo Found.*) (holding that "review of tax regulations" should be guided "by agency expertise pursuant to *Chevron* to the same extent as * * * review of other regulations.").

Petitioners argue that the regulation was adopted "without notice or an opportunity for public comment." Pet. 11. This Court has held, however, "that the absence of notice-and-comment procedures is not dispositive to the finding of *Chevron* deference." Pet. App. 15a (citing *Barnhart* v. *Walton*, 535 U.S. 212, 222 (2002)); see *United States* v. *Mead Corp.*, 533 U.S. 218, 231 (2001). In any event, petitioners' argument would apply only to the temporary regulation that Treasury issued in Sep-

tember 2009. After a subsequent notice-and-comment period, Treasury withdrew the temporary regulation and replaced it with a final regulation in December 2010. See 75 Fed. Reg. 78,897; *Intermountain*, 2011 WL 2451011, at *15 (discussing Treasury's response to the single comment submitted on the proposed regulation). That regulation applies "to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009," 26 C.F.R. 301.6501(e)-1(e)(1), and a taxable year is "open" if it is the "subject of any case pending before any court of competent jurisdiction * * * in which a decision had not become final," 75 Fed. Reg. at 78,898. The final regulation was therefore applicable when the court of appeals decided this case, and it continues to apply today.[4]

Petitioners suggest (Pet. 20) that the Treasury regulation is not entitled to deference because it was promulgated in response to litigation in the lower courts. This Court "has made crystal clear," however, "that it is utterly 'irrelevant' to the question of whether *Chevron*

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[4] Petitioners suggest (Pet. 11, 19) that the Treasury regulation has an impermissible retroactive effect. The regulation is not retroactive in the relevant sense, however, both because it clarified rather than changed existing law, see *Intermountain*, 2011 WL 2451011, at *15 ("[T]here was no settled law for the regulation[] to change.") (emphasis omitted), and because the regulation does not bear on the legality of petitioners' primary conduct. Rather, the regulation clarifies the procedural rules governing enforcement of petitioners' pre-existing liability for underpayment of taxes. In any event, the Treasury Department had statutory authority to make the regulation retroactive. See 26 U.S.C. 7805(b) (Supp. III 1956); 75 Fed. Reg. at 78,898; see also *Salman Ranch*, 2011 WL 2120044, at *11; *Grapevine Imports*, 636 F.3d at 1381-1382; cf. *Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204, 209 (1988) (permitting retroactive rulemaking when there is an "express statutory grant" of such power).

deference is due '[t]hat it was litigation which disclosed the need for the regulation.'" *Intermountain*, 2011 WL 2451011, at *12 (quoting *Smiley* v. *Citibank (South Dakota), N.A.*, 517 U.S. 735, 741 (1996)). Just this past Term, in granting *Chevron* deference to another Treasury regulation interpreting the Internal Revenue Code, this Court "found it immaterial to [its] analysis that a regulation was prompted by litigation." *Mayo Found.*, 131 S. Ct. at 712 (internal quotation marks omitted); see *United States* v. *Morton*, 467 U.S. 822, 835 n.21 (1984) (recognizing that an agency may promulgate a regulation in response to adverse judicial decisions).

3. Petitioners principally rely (Pet. 11-16) on *Colony*, in which this Court construed a predecessor statute that contained some of the same operative language ("omits from gross income an amount properly includible therein") as current Section 6501(e)(1)(A). In *Colony*, the Court agreed with the taxpayer 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." 357 U.S. at 33. The Court rejected the government's contention that the taxpayer had "omit[ted] from gross income an amount" that should have been included when it overstated its basis in land that it had sold. See *id*. at 30, 32, 36-37. The Court acknowledged, however, that "it cannot be said that the language is unambiguous," and it "turn[ed] to the legislative history of" the predecessor statute to resolve the ambiguity. *Id*. at 33. For two principal reasons, *Colony* does not control this case. See *Intermountain*, 2011 WL 2451011, at *3-*6 (discussing the statutory history and the limited scope of *Colony*'s holding).

a. Although the words "omits from gross income an amount properly includible therein" continue to appear

in current Section 6501(e)(1)(A), the meaning of those words is now clarified by adjacent provisions of Section 6501(e) that were not part of the statutory scheme before the Court in *Colony*. Section 6501(e)(1)(A)(i), which contains a special definition of "gross income" that applies "[i]n the case of a trade or business," would be largely superfluous under petitioners' understanding of the basic rule set forth in Section 6501(e)(1)(A). See pp. 11-12, *supra*; *Intermountain*, 2011 WL 2451011, at *10. And Section 6501(e)(2), by specifically referring to omissions of "items" that ought to have been included on an estate-or gift-tax return, indicates that the term "amount" in Section 6501(e)(1)(A) should not be equated with "item." See pp. 12-13, *supra*. Congress's use of different terms in adjacent provisions indicates that the *Colony* Court's reading of Section 6501(e)(1)(A)'s predecessor, which the Court viewed as "limited to situations in which specific receipts or accruals of income items are *left out* of the computation of gross income," 357 U.S. at 33, would not be a sound interpretation of current law.

The Court in *Colony* construed the statute as it existed before the 1954 amendments, and it did not discuss the implications of current Sections 6501(e)(1)(A)(i) and 6501(e)(2) for the interpretation of the extended-assessment-period provision. Consideration of the larger statutory context, however, is essential to a proper understanding of current Section 6501(e)(1)(A). See, *e.g.*, *Morton*, 467 U.S. at 828 ("We do not * * * construe statutory phrases in isolation; we read statutes as a whole."). Because the Court in *Colony* did not (and had no occasion to) perform that contextual analysis, its decision is not controlling here.

b. Although the Court in *Colony* was "inclined to think that the statute on its face lends itself more plausi-

bly to the taxpayer's interpretation," it acknowledged that "it cannot be said that the language is unambiguous." 357 U.S. at 33. Because the *Colony* Court recognized that an ambiguity existed, its construction of the words "omits from gross income an amount properly includible therein" did not preclude the Treasury Department from adopting, through a published regulation issued after notice-and-comment rulemaking, a different interpretation of the disputed statutory language. See *National Cable & Telecomms. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 983 (2005) (*Brand X*); see also *Mayo Found.*, 131 S. Ct. at 711. "Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction." *Brand X*, 545 U.S. at 982-983. And this Court recently recognized that "[t]he principles underlying [the Court's] decision in *Chevron* apply with full force in the tax context." *Mayo Found.*, 131 S. Ct. at 713.

Under *Brand X*, the new Treasury Department regulation would be entitled to *Chevron* deference even if it interpreted precisely the same statutory provision that was before the Court in *Colony*. See *Brand X*, 545 U.S. at 982-983. But in fact, the regulation and the *Colony* decision address different statutory provisions (current Section 6501(e)(1)(A) and Section 275(c) of the pre-1954 Internal Revenue Code, respectively), albeit provisions that contain significant language in common. The Treasury Department's authority to act as it did is particularly clear because the agency, in adopting the new regulation, could consider the implications of adjacent stat-

utory provisions that the *Colony* Court had no occasion to address. See pp. 11-12, *supra*.[5]

4. Although the decision below is correct, the courts of appeals are divided on the question whether an overstatement of basis in property can give rise to an "omi[ssion] from gross income" for purposes of Section 6501(e)(1)(A). In addition to the court below, the Tenth,

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[5] Petitioners place weight (Pet. 14-15) on the Court's observation in *Colony* that its conclusion was "in harmony with the unambiguous language of [Section] 6501(e)(1)(A) of the Internal Revenue Code of 1954." 357 U.S. at 37. Petitioners view that statement as indicating that the Court's "decision in *Colony* applies equally to the identical language contained in the 1939 and 1954 Codes." Pet. 15. But given the Court's earlier recognition that the phrase "omits from gross income an amount properly includible therein" was ambiguous, see 357 U.S. at 33 ("[I]t cannot be said that the language is unambiguous."), the Court's later reference to new Section 6501(e)(1)(A) cannot reasonably be understood to refer to the same language. See *Intermountain*, 2011 WL 2451011, at *9 (rejecting the proposition that, "within the span of just four pages of the U.S. Reports," this Court "illogically described essentially identical text as both ambiguous and unambiguous").

Rather, the Court's reference to the "unambiguous language of [Section] 6501(e)(1)(A)" is far more sensibly read as describing the new Subsection (i) in that provision, which for trades or businesses defines the term "gross income" to mean total receipts from sales of goods or services, without any offset for the trade or business's basis. Pet. App. 8a-9a; see *Intermountain*, 2011 WL 2451011, at *5 ("Congress literally took basis out of [the] equation, redefining 'gross income' to mean gross receipts rather than gross receipts minus the cost of goods sold."); *id.* at *9. Under that provision, an overstatement of basis in goods or services sold by a trade or business like Colony could not trigger the six-year assessment period because such an overstatement would not affect the calculation of "gross income" as defined in Section 6501(e)(1)(A)(i). For that reason, the Court's disposition of *Colony* was indeed "in harmony with" the outcome that Section 6501(e)(1)(A)(i) would have mandated. 357 U.S. at 37. But that analysis does not apply to petitioners, who did not operate a trade or business, and whose overstatement of basis therefore resulted in an understatement of "gross income."

Federal, and District of Columbia Circuits have ruled in the government's favor on this issue, holding that the recently-promulgated Treasury regulation is reasonable and therefore entitled to deference under *Chevron*. See *Salman Ranch*, 2011 WL 2120044, at *9; *Grapevine Imports*, 636 F.3d at 1381; *Intermountain*, 2011 WL 2451011, at *13. By contrast, the Fourth and Fifth Circuits have held that, under *Colony*, an understatement of gross income attributable to an overstatement of basis in a sold asset cannot trigger the six-year assessment period. See *Home Concrete & Supply, LLC* v. *United States*, 634 F.3d 249, 255 (4th Cir. 2011); *Burks* v. *United States*, 633 F.3d 347, 354-355 (5th Cir. 2011); cf. *Bakersfield Energy Partners, LP* v. *CIR*, 568 F.3d 767, 778 (9th Cir. 2009) (holding that the three-year assessment period applied but suggesting that the IRS could promulgate a contrary regulation).

The number of recent cases in the courts of appeals reflects the importance of this issue to the IRS and taxpayers. Because the nature of Son-of-BOSS transactions makes them very difficult for the IRS to detect (see p. 5, *supra*), the IRS's ability to assess additional income tax often depends on the availability of the six-year assessment period. Resolution of the issue would also have a significant impact on the United States Treasury: this case alone involves an unreported capital gain of over $12 million. Moreover, there is a significant governmental and public interest in the uniform administration of federal tax law. Accordingly, the government agrees that this Court should grant review to resolve the conflict among the circuits.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX