No. 11-139

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

HOME CONCRETE & SUPPLY, LLC, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

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

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

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

PARTIES TO THE PROCEEDINGS

Petitioner is the United States of America.

Respondents are Home Concrete & Supply, LLC; Robert L. Pierce; Susanne D. Pierce; Stephen R. Chandler; Rebecca R. Chandler; and Home Oil and Coal Company, Inc.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 634 F.3d 249. The opinion of the district court (Pet. App. 23a-46a) is reported at 599 F. Supp. 2d 678.

JURISDICTION

The judgment of the court of appeals was entered on February 7, 2011. A petition for rehearing was denied on April 5, 2011 (Pet. App. 22a). On June 22, 2011, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including August 3, 2011, and the petition was filed on that date. The petition for a writ of certiorari was granted on September

27, 2011. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

The relevant statutory and regulatory provisions are reproduced in the appendix to the petition for a writ of certiorari. See Pet. App. 47a-72a.

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.[1]

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

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[1] References in this brief to Section 6501 are to that section as it appears in the 2006 edition of the United States Code. There were no amendments to the pertinent provisions of Section 6501 between 1999 (which is the tax year at issue here) and 2009. In 2010, Congress amended Section 6501. See Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 513, 124 Stat. 111. Those amendments redesignated a portion of Section 6501(e)(1)(A) but did not alter the text in any way material to the disposition of this case.

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 avoidance scheme, known as a Son-of-BOSS (Bond and Option Sales Strategy) transaction. In a Son-of-BOSS transaction, a taxpayer uses some mechanism, often a short sale, to artificially increase his basis in an asset before the asset is sold. A short sale is a sale of a security that the seller does not own or has not contracted for at the time of the sale. To close the short sale, the seller is obligated to purchase and deliver the security at some point in the future, often by using the proceeds from the short sale itself. Pet. App. 2a n.1. Typically in a Son-of-BOSS transaction, a taxpayer enters into a short sale and transfers the proceeds of the sale as a capital contribution to a partnership. The partnership then closes the short sale by purchasing and delivering the relevant security on the open market. See *Beard* v. *Commissioner*, 633 F.3d 616, 617-618 (7th Cir. 2011), petition for cert. pending, No. 10-1553 (filed June 23, 2011).

When the taxpayer and partnership file their tax returns for the year in which a transaction of the kind described above occurs, they are required under

26 U.S.C. 722, 723, and 752 to report their taxable bases in the partnership. The taxpayer's basis in the partnership is called an "outside basis," while the partnership's basis in its own assets is called an "inside basis." See *Kornman & Assocs., Inc.* v. *United States*, 527 F.3d 443, 456 n.12 (5th Cir. 2008). In a Son-of-BOSS transaction, when computing both "outside" and "inside" basis, the taxpayer and the partnership include the short-sale proceeds contributed as capital 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 of that asymmetric treatment, 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. See *Beard*, 633 F.3d at 618.

b. In 2000, the IRS issued a notice informing taxpayers that Son-of-BOSS transactions were invalid under the tax laws. See I.R.S. Notice 2000-44, 2000-2 C.B. 255 (describing arrangements that unlawfully "purport to give taxpayers artificially high basis in partnership interests"). Consistent with that notice, the courts of appeals have uniformly invalidated Son-of-BOSS transactions as lacking in economic substance. See, *e.g.*, *Cemco Investors, LLC* v. *United States*, 515 F.3d 749, 751 (7th Cir.) (Easterbrook, C.J.) (explaining that by accounting for the taxpayer's transfer of an asset but not a corresponding liability, a Son-of-BOSS transaction does "not accurately reflect[] * * * the deal's nature" and "seems to lack economic substance"), cert. denied, 555 U.S. 823 (2008); see also *Stobie Creek Invs., LLC* v.

United States, 608 F.3d 1366, 1376 (Fed. Cir. 2010) ("Measured either by their economic reality or their purported business purpose, the [Son-of-BOSS tax shelters] were properly disregarded under the economic substance doctrine."); cf. *Kornman & Assocs., Inc.*, 527 F.3d at 456 ("The Appellants' premeditated attempt to transform this wash transaction (for economic purposes) into a windfall (for tax purposes) is reminiscent of an alchemist's attempt to transmute lead into gold.").

In 2004, the IRS offered a settlement to approximately 1200 taxpayers. Many taxpayers who had engaged in Son-of-BOSS transactions, however, either did not qualify, chose not to participate in the settlement, or had not yet been identified. See *Beard*, 633 F.3d at 618. With respect to many of the taxpayers who did not participate in the settlement, it was critically important whether the IRS had three or six years from the filing of their returns to assess additional income taxes, because their treatment of the two parts of a Son-of-BOSS shelter (*i.e.*, the opening and closing of a short sale) as separate transactions on their tax returns made it extremely difficult for the IRS to discern that the taxpayers were in fact executing the Son-of-BOSS avoidance scheme. See J.A. 109 ("Nothing on the face of the returns connects these two disclosures together in a way that indicates that they were, in fact, the opening and closing of the same short sale transaction."); J.A. 110 ("[E]ven an IRS examiner trained in the art of divination would have been hard pressed to discern [respondents'] true actions.").

2. In this case, respondents Stephen R. Chandler and Robert L. Pierce were the sole shareholders of respondent Home Oil and Coal Company, Inc. (Home Oil),

which they planned to sell. Anticipating a substantial capital gain on the sale, they sought advice from various firms, including the law firm of Jenkens & Gilchrist, P.C., on how to minimize their tax liability. Pet. App. 2a; J.A. 41-81 (opinion letter).[2] Based on that advice, in April 1999, they formed respondent Home Concrete & Supply, LLC (Home Concrete), which was a pass-through entity designed solely for the purpose of executing the Son-of-BOSS shelter.[3] Home Concrete's five partners were Chandler, Pierce, and two trusts established for the benefit of Pierce's children (collectively, the taxpayers), as well as Home Oil. Pet. App. 2a.

On May 13, 1999, the taxpayers participated in short sales of United States Treasury Notes, receiving total cash proceeds of more than $7.4 million. On May 18, 1999, they transferred that entire amount, along with the obligation to close out the short positions, to Home Concrete. The following day, Home Concrete closed the

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[2] Jenkens & Gilchrist, P.C., marketed thousands of similar Son-of-BOSS tax shelters to wealthy individuals for tax-avoidance purposes. The firm ultimately disbanded after agreeing to a class-action settlement of $75 million, and two of its tax partners were recently convicted on a total of 35 counts of conspiracy, tax evasion, and mail fraud. See *American Boat Co.* v. *United States*, 583 F.3d 471, 477 (7th Cir. 2009); *Cemco Investors, LLC*, 515 F.3d at 750; see also Martha Neil, *Ex-Jenkens & Gilchrist Partners Paul Daugerdas and Donna Guerin Found Guilty in Tax Shelter Case*, ABA J. Law News Now, May 24, 2011, http://www.abajournal.com/news/article/former_jenkens_gilchrist_partners_paul_daugerdas_and_donna_guerin/.

[3] Home Concrete was a limited liability corporation, which for present tax purposes is treated in the same manner as a partnership. See 26 U.S.C. 752; Treas. Reg. 301.7701-3(b)(1)(i). This brief therefore refers to the ownership interests in Home Concrete as partnership interests.

short sales by purchasing and delivering Treasury Notes for slightly less than $7.4 million. In calculating their outside bases in Home Concrete, the taxpayers included the amount of the short-sale proceeds (more than $7.4 million) that had been contributed to the company, without reducing that amount to reflect Home Concrete's offsetting obligation to close the short positions. Pet. App. 3a-4a.

In June 1999, the taxpayers executed a series of transactions through which they transferred virtually all of Home Oil's assets to Home Concrete. They also transferred percentages of their respective partnership interests in Home Concrete to Home Oil. Pet. App. 3a. Those transfers triggered the termination of the existing Home Concrete partnership and the formation of a new partnership. See 26 U.S.C. 708(b)(1)(B). The formation of that new partnership, in turn, permitted Home Concrete to adjust, or "step up," its inside basis to equal the taxpayers' outside bases. See Pet. App. 3a-4a; see also 26 U.S.C. 743(b)(1), 754. Because the taxpayers had inflated their outside bases (by including the short-sale proceeds contributed to Home Concrete, without decreasing that amount by the offsetting obligation to close the short sales), Home Concrete's new inside basis was similarly inflated. In August 1999, the taxpayers sold Home Concrete for approximately $10.6 million. Pet. App. 2a-3a.

In April 2000, Chandler and his wife, respondent Rebecca R. Chandler; Pierce and his wife, respondent Susanne D. Pierce; the two Pierce trusts; and Home Concrete filed their federal income-tax returns for 1999. Home Concrete's inflated new inside basis enabled it to report only a modest gain of $69,125 on the $10.6 million

sale of its assets. And because Home Concrete's partners were required to report their respective shares of any gain, the taxpayers reported income amounts from the asset sale that were dramatically lower than they would have been if the Son-of-BOSS transactions had not been utilized. Pet. App. 3a-4a.[4]

3. In September 2006, the IRS issued a Final Partnership Administrative Adjustment (FPAA). See Pet. App. 4a-5a; J.A. 82-97. In the FPAA, the IRS determined that Home Concrete was a sham company formed solely for tax-avoidance purposes, and it decreased to zero the taxpayers' outside bases in Home Concrete. See J.A. 95-96. If this Court holds that the FPAA was timely, and if the substantive determinations contained in the FPAA are ultimately upheld, those determinations will have the effect of increasing Chandler and Pierce's taxable income for 1999 by approximately $6 million.

Respondents challenged the FPAA, arguing that it was issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). The IRS contended that the assessments were 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 there-

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[4] Partnerships do not pay federal income tax, but they are required to file annual information returns reporting the partners' distributive shares of income, gain, deductions, or credits. See 26 U.S.C. 701, 6031; *Randell* v. *United States*, 64 F.3d 101, 103 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996). The individual partners also report their respective distributive shares on their federal income tax returns. See 26 U.S.C. 701-704. Unpaid taxes are assessed against the individual partners.

in which is in excess of 25 percent of the amount of gross income stated in the return." Pet. App. 5a-6a.[5]

The district court granted partial summary judgment to the IRS. Pet. App. 23a-46a. The court ruled that "where a taxpayer overstates basis and, as a result, leaves an amount out of gross income, the taxpayer 'omits from gross income an amount properly includible therein' for purposes of [Section] 6501(e)(1)(A)." *Id.* at 39a. The court therefore concluded that the six-year period in Section 6501(e)(1)(A), rather than the three-year period in Section 6501(a), applied to the IRS's assessment. *Ibid.* The court rejected respondents' argument that this Court's decision in *Colony, Inc.* v. *Commissioner*, 357 U.S. 28 (1958) (*Colony*), required a different result. The district court explained that *Colony* had involved a predecessor version of the Internal Revenue Code, and that subsequent statutory amendments make clear that *Colony*'s holding does not apply to the current Section 6501(e)(1)(A). Pet. App. 32a-38a.

4. a. The court of appeals reversed. Pet. App. 1a-21a. The court concluded that "*Colony* forecloses the argument that Home Concrete's overstated basis in its reporting of the short sale proceeds resulted in an omission from its reported gross income." *Id.* at 11a. The court declined to apply a regulation promulgated in tem-

[5] Although the FPAA was issued in September 2006, more than six years after the taxpayers filed their returns in April 2000, the assessment period was suspended for approximately five months (between December 2003 and May 2004) due to Jenkens & Gilchrist, P.C.'s tardy compliance with an IRS summons. See C.A. App. 326 n.5; see also 26 U.S.C. 7609(e)(2). Respondents do not dispute that if the six-year assessment period applies, the FPAA in this case was timely.

porary form by the IRS in September 2009, which became final while the appeal in this case was pending, and which construes the phrase "omits from gross income" to encompass situations in which a taxpayer understates his income by overstating his basis in property. *Id.* at 16a. The court held that the regulation was inapplicable by its terms, and that this Court in *Colony* had found the relevant statutory language unambiguous and thus precluded any contrary agency interpretation. *Id.* at 12a-16a.

b. Judge Wilkinson concurred to express his agreement with the panel's understanding of *Colony*. Pet. App. 17a-21a.

SUMMARY OF ARGUMENT

A. The text, structure, and purpose of 26 U.S.C. 6501(e)(1)(A) establish that respondents "omit[ted] from gross income an amount properly includible therein" when they understated their gains from the sale of Home Concrete. The Internal Revenue Code defines the term "gross income" to include "[g]ains derived from dealings in property," 26 U.S.C. 61(a)(3), and respondents' "gains" from the sale of Home Concrete are calculated by subtracting their bases in the company from their shares of the sale price. By representing their bases in Home Concrete to be much larger than they actually were, respondents "omitted" from their returns substantial "amounts" of "gain," and thus of "gross income."

Two adjacent provisions within Section 6501(e) reinforce the conclusion that the six-year assessment period applies to substantial understatements of gross income that are attributable to overstatements of basis. Sub-

paragraph (i) of Section 6501(e)(1)(A) states that, "[i]n the case of a trade or business," the "gross income" a taxpayer derives from the sale of property is the total sale price, without any offset for the taxpayer's cost of acquiring the property. Subparagraph (i) eliminates the possibility that a trade or business could trigger the six-year assessment period by overstating its basis in sold property, and the provision would be largely superfluous if the phrase "omits from gross income an amount properly includible therein" *already* excluded understatements of income attributable to overstatements of basis. In addition, Section 6501(e)(2) gives the IRS six years from the filing of an estate- or gift-tax return to assess additional tax "if the taxpayer omits items includible in the gross estate." Congress referred in that provision to the omission of "items" in order to make clear that the six-year assessment period established by Section 6501(e)(2) is not triggered by undervaluation of items that are reported on the return. By contrast, Section 6501(e)(1)(A)'s use of the term "amount" rather than "item" reinforces the conclusion that the provision applies when a taxpayer acknowledges receipt of a particular item of gross income (here, gains from the sale of Home Concrete) but represents the amount of the gain to be much smaller than it actually is.

Cases like this one directly implicate the purpose of Section 6501(e)(1)(A)'s extended assessment period. The evident rationale for extending the assessment period in cases involving substantial omissions from gross income is that such omissions are often difficult to detect. A basis overstatement will typically be as difficult to detect as an understatement of sale price, and the taxpayers in this case engaged in extensive manipula-

tions to obscure their overstatements of their bases in Home Concrete.

B. To the extent the statutory language is ambiguous, the Treasury Department recently promulgated a final regulation that reasonably resolves that ambiguity. The final rule was validly adopted after notice-and-comment procedures. As the preamble to the final rule makes clear, the regulation applies to cases, like this one, in which challenges to the timeliness of Final Partnership Administrative Adjustments were pending in court on the rule's September 24, 2009, effective date. This Court recently confirmed that the principles of deference to agency authority announced in *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984), apply with full force to Treasury Department regulations that clarify ambiguous provisions of the Internal Revenue Code, and all the courts of appeals to reach *Chevron*'s second step have agreed that the final rule reflects a reasonable interpretation of the statutory language.

Contrary to respondents' contention, the regulation is not impermissibly retroactive. The rule clarified rather than changed existing law, and it addressed the procedures for assessing tax rather than the legality of respondents' primary conduct. In any event, the rule would be valid even if it had retroactive effect, because the Treasury Department has express statutory authority to promulgate retroactive rules in this context.

C. The Court's decision in *Colony, Inc.* v. *Commissioner*, 357 U.S. 28 (1958), does not control this case. In *Colony*, the Court construed a predecessor statute (26 U.S.C. 275(c) (1940)) that contained the language "omits from gross income an amount properly includible therein." Although the Court held that former Section

275(c) did not encompass understatements of gross income attributable to overstatements of basis, it recognized that the provision was ambiguous.

Because the language quoted above is ambiguous in isolation, its meaning (and, in particular, its application to understatements of gross income attributable to overstatements of basis) may vary depending on the broader statutory context. When it amended and recodified former Section 275(c) in 1954, Congress provided that the gross income of a trade or business would be calculated differently from the gross income of other taxpayers. The purpose and principal effect of that special computation method was to make clear that an overstatement of basis by a trade or business could not trigger the extended six-year assessment period. That amendment to the statutory scheme, which is limited by its terms to cases involving trades or businesses, belies any contention that Congress intended the same rule to apply to all taxpayers.

The *Colony* Court's recognition that the relevant language ("omits from gross income an amount properly includible therein") is ambiguous also means that the Treasury Department could by regulation adopt a different reasonable interpretation of the disputed text. See *National Cable & Telecomms. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 982-983 (2005) (*Brand X*). Under *Brand X*, the Department could have taken that step even if the current statutory scheme were identical to the scheme at issue in *Colony*. The agency's authority to act as it did is particularly clear, however, because the Department, in construing the language quoted above, could consider the implications of later-enacted, adja-

cent statutory provisions that the *Colony* Court had no occasion to address.

ARGUMENT

BY OVERSTATING THEIR BASES IN HOME CONCRETE AND THEREBY UNDERSTATING THEIR ACTUAL GAIN FROM ITS SALE, RESPONDENTS OMITTED SUBSTANTIAL AMOUNTS FROM THEIR GROSS INCOME, TRIGGERING THE EXTENDED SIX-YEAR ASSESSMENT PERIOD IN 26 U.S.C. 6501(e)(1)(A)

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 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 *Colony, Inc.* v. *Commissioner*, 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).

A. Section 6501(e)(1)(A) Establishes That An Overstatement Of Basis Can Trigger The Six-Year Assessment Period

The statutory text, structure, and purpose establish that respondents' understatement of their gain from the sale of Home Concrete was an "omi[ssion] from gross

income [of] an amount properly includible therein" that triggered the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). That is so even though respondents' 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.

1. The phrase "omi[ssion] from gross income" is naturally construed to encompass an understatement of taxable gain attributable to an overstatement of basis

Under Section 6501(e)(1)(A), 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." Respondents do not dispute that the amount of income at issue here—approximately $6 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 is whether the taxpayers "omit[ted]" that "amount" from their "gross income" when they (i) overstated their bases in Home Concrete, (ii) subtracted those inflated amounts from their shares of the sale proceeds, and (iii) thereby reported on their tax returns gains from the sale of Home Concrete that were a tiny fraction of their actual gains.

a. Section 61(a) of the Internal Revenue Code "defines 'gross income' for federal tax purposes as 'all income from whatever source derived.'" *Commissioner* v. *Banks*, 543 U.S. 426, 433 (2005). That definition "extends broadly to all economic gains not otherwise exempted." *Ibid.*; see *Commissioner* v. *Schleier*, 515 U.S. 323, 327 (1995) ("We have repeatedly emphasized the

'sweeping scope' of this section and its statutory predecessors.") (quoting *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955)); *Green* v. *Commissioner*, 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]."), aff'd, 168 F.2d 994 (6th Cir. 1948). 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) encompasses "[g]ains derived from dealings in property." 26 U.S.C. 61(a)(3); see Treas. Reg. 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.* Because a gain on a sale of property is determined by subtracting the taxpayer's basis (or capital stake in the property) from the sale price, a taxpayer can fail to report income from a property sale either by overstating his basis in the property or by understating the property's sale price.

b. In this case, respondents concealed nearly $6 million in gross income from the IRS through a scheme that consisted of three basic steps. First, the taxpayers (Chandler, Pierce, and the two Pierce trusts) transferred $7.4 million in short-sale proceeds as capital contributions to Home Concrete. In calculating their bases in the partnership, the taxpayers did not reduce those amounts to reflect the corresponding obligation that Home Concrete simultaneously assumed to close

the short positions. Moreover, they concealed the true nature of the transactions on their returns for the 1999 tax year. Chandler and Pierce stated only that "the proceeds of a short sale not closed by the taxpayer during this tax year were received." J.A. 204, 258, 286, 299. As the district court observed, "[i]mplicit in this 'disclosure' is that Pierce and Chandler retained the short sale position and the obligation to close that short sale, which was actually not the case." J.A. 109. Nothing on the taxpayers' returns suggested either that the taxpayers had transferred both an asset and an offsetting obligation to Home Concrete or that they had treated the asset and obligation differently in order to inflate their bases in the partnership.

Second, in its return for the 1999 tax year, Home Concrete reported a transaction in United States Treasury Bonds. See J.A. 128. But Home Concrete did not indicate that the transaction was a set of short sales, let alone that the taxpayers had opened the sales and contributed the proceeds to Home Concrete, which then had closed the short positions. To the contrary, Home Concrete's return conveyed the impression that the company had purchased the bonds on May 18, 1999, for $7.36 million, sold them the next day for $7.47 million, and made a profit of approximately $113,000 in the process. *Ibid.* As the district court observed, "[t]he description of the sale itself is completely misleading" because it indicates "a straight sale of Treasury Bonds instead of the back-end of a short sale transaction." J.A. 108-109; see J.A. 109 ("[T]he only reasonable conclusion a reviewer was likely to draw was that Home Concrete engaged in a straight sale of Treasury Bonds on the dates in question.").

Third and finally, Home Concrete "stepped up" its inside basis to equal its partners' artificially inflated outside bases. J.A. 150. Specifically, Home Concrete increased its basis to include the $7.47 million in capital contributions, minus $1.49 million to account for excess basis greater than the fair market value of the partnership's assets. See J.A. 151. The result was a wholly artificial increase of $5.98 million in Home Concrete's inside basis. When Home Concrete sold its assets for $10.62 million, it should have deducted its actual basis of $4.54 million and reported a capital gain of more than $6 million. See J.A. 143, 151. Because Chandler and Pierce (and his trusts) would have been taxed on 19% and 81% of that capital gain, respectively, they would have realized additional taxable income of $1.13 and $4.85 million. See J.A. 129, 158, 162, 166, 170. Instead, Home Concrete deducted its artificially inflated basis of $10.53 million and reported a modest gain of only $69,125. See Pet. App. 4a. As a result, Chandler and Pierce reported adjusted gross income of only $283,618 and $625,445. See J.A. 189, 217.

c. By understating their gain from the sale of Home Concrete in the manner described above, respondents "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." See *Webster's Third New International Dictionary of the English Language* 1574 (1993); see *Webster's New International Dictionary of the English Language* 1700 (2d ed. 1958) (defining "omit" as "[t]o leave out or unmentioned; not to insert, include, or name"); see also *The American Heritage Dictionary of the English Language* 1227 (4th ed. 2006) (same; "[t]o fail to include or mention; leave

out"); *The New Shorter Oxford English Dictionary on Historical Principles* 1994 (4th ed. 1993) (same; "[l]eave out; fail to include"); cf. *Black's Law Dictionary* 1197 (9th ed. 2009) (defining "omission" in part as "[t]he act of leaving something out" or "[s]omething that is left out").

If respondents had accurately stated their bases in Home Concrete before subtracting those bases from its sales price, they would have reported taxable capital gains totaling approximately $6 million. The difference between that sum and the gains respondents actually reported is naturally characterized as an "amount" that was "properly includible" (*i.e.*, that ought to have been included) in respondents' "gross income," but that respondents instead "le[ft] out" or "omit[ted]." As the Seventh Circuit has explained, "an improper inflation of basis is definitively a 'leav[ing] out' from 'any income from whatever source derived' of a quantitative 'amount' properly includible." *Beard* v. *Commissioner*, 633 F.3d 616, 622 (7th Cir. 2011) (brackets in original), petition for cert. pending, No. 10-1553 (filed June 23, 2011). That court correctly reasoned that "[t]here is an amount—the difference between the inflated and the actual basis—which has been left unmentioned on the face of the tax return as a candidate for inclusion in gross income." *Ibid.*

Respondents omitted an amount from their gross income by overstating their bases in Home Concrete, no less than if they had understated the partnership's sale price. Because a taxpayer's gross income (*i.e.*, the portion of his income that is taxable) from a property sale is determined by deducting his basis in the asset from its sale price, either type of misrepresentation will have exactly the same practical effect of misleading the IRS

with respect to the amount of gain (and thus the amount of federal income-tax liability) that is attributable to the sale. Here, respondents reported a total capital gain of $69,125—even though their actual capital gain was more than $6 million. Respondents thus concealed approximately $6 million in income that they had derived from the sale of Home Concrete, no less than if they had misrepresented the partnership's sale price.

2. Adjacent statutory provisions reinforce the inference that an overstatement of basis can trigger the extended six-year assessment period

Two adjacent provisions within Section 6501(e) reinforce the understanding that the phrase "omits from gross income an amount properly includible therein" encompasses understatements of income that are attributable to overstatements of basis.

a. Following the principal paragraph of Section 6501(e)(1)(A) at issue here, subparagraphs (i) and (ii) set forth 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). Thus, for a trade or business, gross income from the sale of goods or services is simply the sale price, without the offset for the seller's basis that is used to determine the gross income of non-trade-or-business taxpayers.[6]

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[6] 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."

The principal effect of subparagraph (i) is to eliminate the possibility that a trade or business could trigger the six-year assessment period by overstating its basis in sold property. That special rule for trades and businesses would be unnecessary if, as respondents contend, the phrase "omits from gross income an amount properly includible therein" *already* excluded understatements of income attributable to overstatements of basis. See *Intermountain Ins. Serv. of Vail, LLC* v. *Commissioner*, 650 F.3d 691, 704 (D.C. Cir. 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 [subparagraph] (i) largely redundant."); *Beard*, 633 F.3d at 622 ("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 [subpara-

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26 U.S.C. 6501(e)(1)(A)(ii). Subparagraph (ii) thus provides that an omission from gross income will not trigger the six-year assessment period if the taxpayer's return (or a statement attached to the return) adequately apprises the IRS of information from which the omitted amount can be ascertained. Subparagraph (ii) is not at issue in this Court. Although respondents sought to invoke subparagraph (ii) in the district court, the court found that respondents' returns did not sufficiently disclose their true gains from the sale of Home Concrete. See J.A. 106 ("[P]laintiffs' returns contain misleading statements and information that obscured the substance of the disputed underlying transactions."); J.A. 110 ("[E]ven an IRS examiner trained in the art of divination would have been hard pressed to discern plaintiffs' true actions."); pp. 25-26, *infra*. And while the court of appeals stated that "Home Concrete's 1999 tax return reported the basic components of the transactions," Pet. App. 4a, it did not suggest that respondents satisfied the requirements of subparagraph (ii).

graph] (i) would be, if not superfluous, certainly diminished.”). The most natural inference is that “Congress understood the ‘omits from gross income’ language to include basis overstatements and added [subparagraph] (i) as an exception limited to the trade or business context.” *Intermountain*, 650 F.3d at 704.

To be sure, respondents’ interpretation would not render subparagraph (i) entirely superfluous. Both for a trade or business and for any other taxpayer, the applicability of the six-year assessment period depends on whether the taxpayer has omitted an amount of gross income “in excess of 25 percent of the amount of gross income stated in the return.” 26 U.S.C. 6501(e)(1)(A). In addition to making clear that a trade or business cannot trigger the extended assessment period by overstating its basis in property, subparagraph (i), by specifying that the “gross income” of a trade or business from a property sale is simply the sale price, alters the denominator to which the “25 percent” requirement is applied. See *Salman Ranch Ltd* v. *United States*, 573 F.3d 1362, 1375 (Fed. Cir. 2009) (*Salman Ranch I*); *Bakersfield Energy Partners, LP* v. *Commissioner*, 568 F.3d 767, 776-777 (9th Cir. 2009).

As the District of Columbia Circuit has explained, however, Congress added subparagraph (i) “amidst a debate that had divided the courts of appeals and that specifically revolved around whether basis overstatements constituted omissions from gross income.” *Intermountain*, 650 F.3d at 704-705; see pp. 45-46, *infra*. Although respondents’ construction of Section 6501(e)(1)(A) would not deprive subparagraph (i) of all practical effect, it would render that subparagraph irrelevant to the issue that had spawned a circuit split, reducing it to a minor tweak in the formula used to deter-

mine the applicability of the six-year assessment period. That reading ignores the historical backdrop against which Congress acted and the nature of the problem that subparagraph (i) was intended to address. See *Babbitt* v. *Sweet Home Chapter of Cmtys. for a Great Or.*, 515 U.S. 687, 701 (1995) ("When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.") (internal quotation marks and citation omitted).

b. 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. 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, 84th Cong., 1st Sess., *Summary of the New Provisions of the Internal Revenue Code of 1954*, at 130 (Comm. Print 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, 2007 WL 2209129, at *7 (M.D. Fla. July 30, 2007). In either case, "an amount" of gross income has been omitted from the return. And once that

proposition is established, the statutory text provides no basis for distinguishing between (i) understatements of gross income that are attributable to understatements of receipts and (ii) those that are attributable to overstatements of basis.

3. The statutory purpose strongly supports extending the period for discovery of a basis overstatement

Section 6501(e)(1)(A)'s language must be interpreted in light of Congress's reasons for extending the assessment period in cases involving omissions from gross income. See *Dolan* v. *USPS*, 546 U.S. 481, 486 (2006) (statutory interpretation requires courts to "read[] the whole statutory text, consider[] the purpose and context of the statute, and consult[] any precedents or authorities that inform the analysis"); *United States* v. *Heirs of Boisdoré*, 49 U.S. (8 How.) 113, 122 (1849). The evident rationale for extending the assessment period in cases involving substantial omissions from gross income is that such omissions are often difficult to detect. Unlike (for example) a potentially improper deduction, which provides a natural trigger for IRS inquiry, an omitted amount of gross income does not appear on the face of the taxpayer's return, and it may take considerable time and effort for the government to discover from other sources of information that the taxpayer has received greater income than he reported. Congress's focus on the adequacy of notice to the IRS is confirmed by Section 6501(e)(1)(A)(ii), which provides that an omitted amount will not trigger the extended assessment period if either the taxpayer's return or an attached statement contains information "adequate to apprise the Secretary of the nature and amount of [the omitted] item." The cases to which the six-year assessment period applies

thus by definition involve returns that do *not* adequately apprise the IRS of the omitted amounts.

The rationale for Section 6501(e)(1)(A) is fully applicable to a case in which the taxpayer overstates his basis in property, because a basis overstatement will typically be at least as difficult to detect as an understatement of the property's sale price. The government has no immediate means of discerning from the face of a return that a taxpayer has underreported his gross income by (i) overstating what he invested in the property's acquisition or (ii) understating what he received in the property's divestment. In either instance, extending the assessment period from three to six years allows the government sufficient time to investigate the asset basis and sale price, and it thereby decreases the likelihood that a taxpayer will defeat his tax obligations by understating his gross income.

The circumstances of this case aptly illustrate the difficulties of detecting tax-avoidance schemes that operate through overstatements of basis in sold property. If respondents had not engaged in the Son-of-BOSS transactions, the $10.6 million sale of Home Oil would have generated a taxable capital gain of approximately $6 million (because the taxpayers' existing bases in Home Oil totaled approximately $4.5 million). Respondents therefore created Home Concrete as a vehicle for the Son-of-BOSS transactions, transferred Home Oil's assets to Home Concrete, engaged in short sales that artificially inflated their bases in Home Concrete by a total of $5.98 million, and then reported modest gains from Home Concrete's sale. See pp. 16-18, *supra*. None of respondents' returns, however, disclosed that the reason for the high bases was the taxpayers' asymmetric treatment of the short sales.

Indeed, respondents' returns did not even provide adequate notice of the short sales themselves, let alone their connection to the inflated bases. In the district court, respondents sought to invoke the safe harbor in Section 6501(e)(1)(A)(ii), arguing that they had disclosed the substance of the transactions in their returns. As the district court explained in rejecting that argument, "[n]othing about the disclosure on Pierce and Chandler's individual tax returns reasonably indicates that the opening of the short sales was related to the basis step-up by Home Concrete." J.A. 107. To the contrary, the court observed, "[t]he statement on Pierce and Chandler's tax returns indicates that those taxpayers retained the obligation to close the short sales they had opened. There is no hint that either taxpayer had transferred the obligation to close the short sale." *Ibid.*

With respect to Home Concrete's return, the district court explained that the disclosure "of a sale of Treasury Bonds in Home Concrete's Schedule D also serves as a smokescreen for [respondents'] actual activities." J.A. 107. Respondents "did not disclose a 'short sale' of Treasury Bonds or the 'close of a short sale position,' nor did they use any other descriptive moniker that accurately described the transaction." J.A. 108. Rather, respondents' description of the transaction conveyed the "misleading[]" impression that "they were reporting a straight sale of Treasury Bonds instead of the back-end of a short sale transaction." J.A. 108-109; see J.A. 109 ("[T]he only reasonable conclusion a reviewer was likely to draw was that Home Concrete engaged in a straight sale of Treasury Bonds on the dates in question."). As the district court observed, "even an IRS examiner trained in the art of divination would have been

hard pressed to discern [respondents'] true actions." J.A. 110.

This case thus illustrates why a basis overstatement that is not adequately disclosed on a taxpayer's return can be extremely difficult to detect and warrants application of the extended six-year period in Section 6501(e)(1)(A). The court of appeals' contrary holding would reward taxpayers who evade detection by the government within Section 6501(a)'s three-year assessment period by overstating their bases in property in complicated ways. See Bernard J. Audet, Jr., Note, *One Case To Rule Them All: The Ninth Circuit in* Bakersfield *Applies* Colony *To Deny the IRS an Extended Statute of Limitations in Overstatement of Basis Cases*, 55 Vill. L. Rev. 409, 432-433 (2010) (noting that the court of appeals' approach "allow[s] tax shelter abusers to escape tax liability by disclosing the amounts of their transactions but concealing the substance, nature, origin, and destination of those amounts in ways that put the Service at a disadvantage in detecting noncompliance").

B. The Recent Treasury Regulation Resolves Any Statutory Ambiguity By Specifying That An Overstatement Of Basis Triggers The Six-Year Assessment Period

To the extent that the statutory language is ambiguous, the Department of the Treasury has recently promulgated a regulation, Treas. Reg. 301.6501(e)-1, that resolves the question presented here. The regulation states that an understatement of gross income attributable to an overstatement of basis in property is an "omi[ssion] from gross income" that triggers the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). See Pet. App. 67a-72a. That regulation was validly promul-

gated, applies to this case, is entitled to deference, and is not impermissibly retroactive.

1. The final regulation was validly promulgated

a. In September 2009, the Treasury Department issued a temporary regulation to address the application of Section 6501(e)(1)(A) to cases involving overstatements of taxpayers' bases in property. See T.D. 9466, 2009-43 I.R.B. 551 (issuing Temp. Treas. Reg. 301.6501(e)-1T (2009)). The regulation provided 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." Temp. Treas. Reg. 301.6501(e)-1T(a)(1)(iii) (2009) (emphasis omitted). "Consequently," the regulation explained, "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.*

At the same time that it issued the temporary regulation, the Treasury Department issued a notice of proposed rulemaking with a 90-day comment period for an identical final regulation. See 74 Fed. Reg. 49,354 (Sept. 28, 2009). In December 2010, the Department withdrew the temporary regulation and issued the final regulation that is currently in effect. See T.D. 9511, 2011-6 I.R.B. 455 (Pet. App. 57a-72a). The text of the final regulation tracks the temporary regulation in virtually every respect. In particular, like the temporary regulation, the final regulation states 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 [S]ection 6501(e)(1)(A)(i)." Treas. Reg. 301.6501(e)-1(a)(1)(iii).

During the comment period, the Treasury Department received a single comment, which characterized the regulation as having "retroactive effect 'in that taxable years which had closed are now reopened.'" Pet. App. 62a (quoting comment). Responding to that comment in the preamble to the final regulation, the Department "disagree[d] with the characterization of the regulations as retroactive" and noted that "[t]he final regulations have been clarified to emphasize that they only apply to open tax years, and do not reopen closed tax years." *Ibid.* The Department amended the regulation's applicability clause to state that the regulation "applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009," *i.e.*, the effective date of the regulation. Treas. Reg. 301.6501(e)-1(e)(1). There was no other relevant change from the temporary regulation to the final regulation.

b. In the court of appeals, respondents and their amicus (Bausch & Lomb Incorporated) challenged the temporary regulation as procedurally invalid under the Administrative Procedure Act (APA), 5 U.S.C. 553, on the ground that it had been adopted without following notice-and-comment procedures. See Resp. C.A. Reply Br. 9-16; Amicus C.A. Br. 11-15. That argument was incorrect. See 26 U.S.C. 7805(e)(1) (granting the Treasury Department authority to issue temporary regulations); see also Gov't C.A. Br. 38-42. In any event, the prior dispute concerning the validity of the temporary regulation is irrelevant to the proper disposition of this case. In December 2010, after following notice-and-comment procedures, the Department withdrew the temporary regulation and replaced it with the current

final rule. See *Intermountain*, 650 F.3d at 709. The final regulation was therefore in effect when the court of appeals decided this case, and it continues to be in effect today.

In other cases, respondents' amicus has argued that the Department "failed to keep an 'open mind' during the notice-and-comment period." *Intermountain*, 650 F.3d at 709. As the District of Columbia Circuit explained in rejecting that argument, open-mindedness review "[o]rdinarily" applies only when an agency "issues final regulations without the requisite comment period and then tries to cure that [APA] violation by holding a post-promulgation comment period." *Ibid.* "Even assuming the applicability of this framework" when an agency issues a temporary regulation, holds a comment period, and then issues a final regulation, the Department's "searching consideration" of the single comment received during the comment period leaves "no doubt that [it] kept the requisite open mind." *Id.* at 709-710 (internal quotation marks and citation omitted).

2. *The final regulation applies to this case*

a. By its terms, the final regulation "applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009." Treas. Reg. 301.6501(e)-1(e). As the Treasury Department explained in the preamble to the final rule, "[t]he expiration of the three-year period does not 'close' a taxable year if a longer period applies." Pet. App. 63a. "Consistent with that position," the Department further explained, "the final regulation[] appl[ies] to taxable years with respect to which the six-year period for assessing tax under [S]ection * * * 6501(e)(1) was open on or after September 24, 2009." *Ibid.* That includes "all tax-

able years (1) for which six years had not elapsed from the later of the date that a tax return was due or actually filed [or] (2) that are the subject of any case pending before any court of competent jurisdiction (including the United States Tax Court and Court of Federal Claims) in which a decision had not become final (within the meaning of [S]ection 7481)." *Ibid.*; see *Intermountain*, 650 F.3d at 709 ("[T]he Commissioner announced his definitive interpretation in the preamble to the final regulations.").[7]

This case falls within the second category identified in the preamble. In September 2006, the IRS issued a Final Partnership Administrative Adjustment (FPAA) contesting the accuracy of Home Concrete's partnership return. Pet. App. 4a-5a. As of September 24, 2009, respondents' current challenge to the FPAA was "the subject of [a] case pending before [a] court of competent jurisdiction * * * in which a decision had not become final." *Ibid.*; see 26 U.S.C. 7481(a) (decisions of Tax Court become final when time for seeking further review expires); 26 U.S.C. 6230(g) (finality of district court and Court of Federal Claims decisions is determined in accordance with "the principles of section 7481(a)"). The preamble thus makes clear that, in resolving respondents' challenge to the FPAA—and, in particular, in determining whether the FPAA was timely issued—the courts should apply the final regulation's definition of the phrase "omits from gross income an amount properly includible therein."

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[7] The final regulation also applies to taxable years for which tax liability had not become fixed pursuant to a settlement between the IRS and the taxpayer. See Pet. App. 63a; see also 26 U.S.C. 7121. That application of the regulation is not at issue here.

That interpretation of the Treasury Department's own regulation is "controlling" because it is not "plainly erroneous or inconsistent with the regulation." *Pliva, Inc.* v. *Mensing*, 131 S. Ct. 2567, 2575 (2011) (quoting *Auer* v. *Robbins*, 519 U.S. 452, 461 (1997)); see *Kennedy* v. *Plan Adm'r for DuPont Sav. & Inv. Plan*, 555 U.S. 285, 295-296 (2009) (deferring to the Treasury Department's interpretation of its regulation). Even assuming that there are "other ways to interpret the regulation[]," the Department's interpretation is a permissible one, and it represents the Department's "fair and considered judgment" on the meaning of Section 6501(e)(1)(A). *Mensing*, 131 S. Ct. at 2575.

Other courts of appeals to consider the question—the Federal, Tenth, and District of Columbia Circuits—have held that the regulation applies to pending cases like this one. See *Grapevine Imports, Ltd.* v. *United States*, 636 F.3d 1368, 1383 (Fed. Cir. 2011) ("[B]y their plain terms the new Treasury regulations apply to Grapevine's 1999 return.") (*Grapevine*), petition for cert. pending, No. 11-163 (filed Aug. 5, 2011); *Salman Ranch Ltd.* v. *United States*, 647 F.3d 929, 942 (10th Cir. 2011) (*Salman Ranch II*) ("[T]he preamble to the final regulation makes clear that the regulation applies to taxpayers in the Partnership's position."), petition for cert. pending, No. 11-582 (filed Nov. 7, 2011); *ibid.* ("The straightforward application of these provisions leaves no doubt the Partnership's 2001 and 2002 tax years were open on September 24, 2009 and remain so today."); *Intermountain*, 650 F.3d at 709 (concluding that although the applicability clause is "fairly cryptic," "[the Commissioner's] interpretative solution is neither plainly erroneous nor inconsistent with the regulation"); but see *Burks* v. *United States*, 633 F.3d 347, 360 (5th Cir.

2011), petition for cert. pending, No. 11-178 (filed Aug. 11, 2011).

b. The court of appeals stated that, "[e]ven assuming *arguendo* that the six-year statute of limitations applied, pursuant to the regulation, the 'period for assessing tax' would have expired, according to the district court's unchallenged finding, on September 14, 2006." Pet. App. 13a; see note 5, *supra*. The court therefore concluded that "the period for assessing tax for the 1999 tax year expired long before September 24, 2009," and that the final regulation (which applies by its terms "to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009") was therefore inapplicable to this case. Pet. App. 13a. The court of appeals' analysis reflects a basic misunderstanding of the statutory scheme that governs the assessment of additional tax against individual partners.

When the IRS disagrees with information reported on a partnership's return, including its reported gross income, the IRS issues an FPAA to the partners. See *UTAM, Ltd.* v. *Commissioner*, 645 F.3d 415, 419 (D.C. Cir. 2011) (*UTAM*). That FPAA is not itself an assessment of additional tax; rather, the partnership's "tax matters partner" (or certain other partners) may contest the FPAA in a judicial proceeding before any additional tax is assessed against the individual partners. See 26 U.S.C. 6223(a); *UTAM*, 645 F.3d at 419. The timely issuance of an FPAA suspends the running of the applicable assessment period for any individual partner. See 26 U.S.C. 6229(d); see also *UTAM*, 645 F.3d at 419-420; *Epsolon Ltd.* v. *United States*, 78 Fed. Cl. 738, 761-762 (2007); *Rhone-Poulenc Surfactants & Specialties, L.P.* v. *Commissioner*, 114 T.C. 533, 554 (2000), appeal dismissed, 249 F.3d 175 (3d Cir. 2001). That toll-

ing rule ensures that the time to assess additional tax against individual partners does not expire while the partnership contests the FPAA.

The IRS has not assessed additional taxes against respondents, and it will not do so unless and until the FPAA is finally upheld against respondents' timeliness challenge and the adjustments in the FPAA are sustained. But if the FPAA is sustained, the IRS remains free to assess additional tax against Home Concrete's individual partners in a manner consistent with the partnership-level adjustments set forth in the FPAA. The court of appeals was therefore wrong in stating that "the 'period for assessing tax' * * * expired * * * on September 14, 2006." Pet. App. 13a. Although the period for assessing tax *would have* expired on that date if the FPAA had not been issued, the timely issuance of the FPAA suspended the period for assessing tax against the individual partners.

c. Respondents suggest (Br. in Opp. 25-26) that, to determine whether the Treasury regulation applies to this case, the Court must decide *without reference to the regulation itself* whether "the period for assessing tax was open on or after September 24, 2009." Treas. Reg. 301.6501(e)-1(e)(1). On respondents' view, the better reading of Section 6501(e)(1)(A) is that an overstatement of basis cannot trigger the six-year assessment period. On that theory, the correct assessment period was three years; the three-year period closed well before the September 2006 issuance of the FPAA; and thus the Treasury regulation is inapplicable to this case. Respondents' approach to determining the applicability of the rule is wrong for at least three reasons.

First, the final regulation's applicability clause and its substantive provisions must be read together as a

coherent whole. Cf., *e.g.*, *Robinson* v. *Shell Oil Co.*, 519 U.S. 337, 341 (1997) (Statutory interpretation requires "reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."). Thus, in determining (for purposes of the applicability clause) whether "the period for assessing tax" in a particular case "was open on or after September 24, 2009," the Court should adopt the understanding of the phrase "omits from gross income an amount properly includible therein" that is set forth in other provisions of the same final rule. Respondents, by contrast, urge the Court to utilize a *different* interpretation of that phrase—indeed, the very interpretation that the final rule was intended to reject—in construing the regulation's applicability clause. That approach would render the regulation self-defeating and is inconsistent with basic canons of construction.

Second, the preamble to the final regulation confirms the most natural reading of the regulation's text. In the preamble, the Treasury Department expressly disagreed with the interpretation of the applicability clause—adopted by the Tax Court in *Intermountain Ins. Serv. of Vail, LLC* v. *Commissioner*, 134 T.C. 211, 219-220 (2010), but subsequently rejected by the District of Columbia Circuit on appeal, see *Intermountain*, 650 F.3d at 708-709—that respondents advance in this Court. See Pet. App. 63a ("The Tax Court's majority in *Intermountain* erroneously interpreted the applicability of the temporary and proposed regulations."). The Department explained that, in determining whether the "period for assessing tax * * * was open on or after September 24, 2009," the relevant "period for assessing tax" in cases involving basis overstatement is six rather than three years because "[t]he expiration of the three-

year period does not 'close' a taxable year if a longer period applies." *Ibid.*; see *Intermountain*, 650 F.3d at 708 ("[B]ecause the pre-regulation state of the law was neither settled nor clear, the Commissioner could reasonably read each of the regulations' provisions, including the applicability provision, in light of the others."). The Department further explained that the final regulation applies to, *inter alia*, "all taxable years * * * that are the subject of any case pending before any court of competent jurisdiction * * * in which a decision had not become final" as of September 24, 2009. Pet. App. 63a. The preamble thus clearly resolves any ambiguity that might be present in the text of the applicability clause.

Third, an important purpose of the final rule was to clarify the proper resolution of several pending cases in which the choice between the three- and six-year assessment periods was likely to be dispositive. The preamble to the final rule observed that "[t]he interpretation of the phrase 'omits from gross income' as used in section 6501(e)(1) is currently pending before several United States Courts of Appeals," Pet. App. 61a, and stated that the rule would apply to cases pending in court on or after September 24, 2009, *id.* at 63a. As the District of Columbia Circuit concluded after surveying the regulatory history, there is "no doubt that the Commissioner intended from the moment these regulations issued to apply them to cases pending as of September 24, 2009." *Intermountain*, 650 F.3d at 708.

Under respondents' view of the applicability clause, however, the final regulation would be irrelevant not only to this case, but to substantially all the suits that were pending at the time the rule was promulgated. Acceptance of that view would require this Court to re-

solve without the agency's guidance the very interpretive question—whether Section 6501(e)(1)(A) encompasses understatements of gross income that are attributable to overstatements of basis—that the regulation was designed to settle. If the Court treated the regulation as inapplicable and ultimately agreed with respondents that Section 6501(e)(1)(A) is better read not to encompass such understatements, the Court's decision would not definitively resolve the issue. Rather, the lower courts would then be required to entertain an additional round of suits to decide the validity of the regulation in later cases to which the rule unquestionably applies (*i.e.*, those in which even the three-year assessment period remained open on September 24, 2009). See *National Cable & Telecomms. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 982-983 (2005) (*Brand X*) ("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."). In clarifying that the regulation applies to pending cases, the Treasury Department sought to obviate the need for such duplicative litigation.

3. The final regulation is entitled to deference

To the extent that Section 6501(e)(1)(A) is ambiguous with respect to the question presented here, the Treasury regulation resolves that ambiguity. The Treasury Department's interpretation of the statute that it administers is reasonable and entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984) (*Chevron*).

a. Last Term in *Mayo Foundation for Medical Education & Research* v. *United States*, 131 S. Ct. 704 (2011)

(*Mayo*), this Court confirmed that "[t]he principles underlying [its] decision in *Chevron* apply with full force in the tax context." *Id*. at 713. As the Court explained, "[f]illing gaps in the Internal Revenue Code plainly requires the Treasury Department to make interpretive choices for statutory implementation at least as complex as the ones other agencies must make in administering their statutes." *Ibid*. (citing *Bob Jones Univ.* v. *United States*, 461 U.S. 574, 596 (1983) ("In an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems.")). The Court therefore saw "no reason why [its] review of tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as [its] review of other regulations." *Ibid*.

Here, as in *Mayo*, the Treasury Department has promulgated a regulation pursuant to its general authority under Section 7805(a) to "prescribe all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. 7805(a); see *Mayo*, 131 S. Ct. at 713. Here, as in *Mayo*, the Department issued the regulation after conducting notice-and-comment procedures. See *id*. at 714. And here, as in *Mayo*, the regulation "easily satisfies the second step of *Chevron*, which asks whether the Department's rule is a 'reasonable interpretation' of the enacted text." *Ibid*. (quoting *Chevron*, 467 U.S. at 844); see *id*. at 711 (noting that under *Chevron*'s second step, courts "may not disturb an agency rule unless it is arbitrary or capricious in substance, or manifestly contrary to the statute") (internal quotation marks and citation omitted). For all of the reasons set forth in Part A, *supra*, treating an understatement of gross income attributable to an overstatement of basis

in property as an "omi[ssion] from gross income" comports with the statutory text, structure, and purpose.

Accordingly, every court of appeals to reach *Chevron*'s second step has held that the regulation is reasonable and entitled to deference. See *Intermountain*, 650 F.3d at 707 ("Arriving at last at *Chevron* step two, our task is easy. * * * [W]e see nothing unreasonable in the Commissioner's decision to diverge from *Colony*'s holding."); *Salman Ranch II*, 647 F.3d at 940 ("Several factors lead us to conclude the IRS's interpretation is reasonable and not arbitrary or capricious."); *ibid.* (observing that the IRS's interpretation of "gross income" in Section 6501(e)(1)(A) "is consistent with the definition of 'gross income' used elsewhere in the Tax Code" and "is consistent with legislative history suggesting Congress enacted the 'gross receipts' provision of subparagraph (i) as an exception to the general definition of 'gross income'"); *Grapevine*, 636 F.3d at 1381 ("Because the Treasury regulations are a reasonable interpretation of [Section] 6501(e)(1)(A), they must receive our deference."); but see *Burks*, 633 F.3d at 360-361 n.9 (holding that the statute is unambiguous but suggesting that "it is unclear whether the [r]egulations would be entitled to *Chevron* deference under *Mayo*").

b. Respondents' amicus argues that "the fact that the Commissioner promulgated these regulations in the midst of pending litigation, to effectively reverse judicial decisions that were running very strongly in the taxpayers' favor, raises very difficult questions under * * * the *Chevron* doctrine." Bausch & Lomb Amicus Cert. Br. 17. That argument is misconceived. This Court "has made crystal clear that it is utterly 'irrelevant' to the question of whether *Chevron* deference is due '[t]hat it was litigation which disclosed the need for the regula-

tion.'" *Intermountain*, 650 F.3d at 706 (brackets in original) (quoting *Smiley* v. *Citibank (S.D.), N.A.*, 517 U.S. 735, 741 (1996)). Indeed, just this past Term in *Mayo*, this Court "found it immaterial to [its] analysis that a regulation was prompted by litigation." 131 S. Ct. at 712 (internal quotation marks omitted). Nor does it matter that the Treasury Department, having lost in some lower courts, promulgated its regulation in part to reverse those judicial decisions. Confronting exactly that scenario in *United States* v. *Morton*, 467 U.S. 822 (1984), this Court reasoned that even "assuming the promulgation of [the regulation] was a response to this suit, that demonstrates only that the suit brought to light an additional administrative problem of the type that Congress thought should be addressed by regulation." *Id.* at 836 n.21.

4. The final regulation is not impermissibly retroactive

Respondents argue that the Treasury regulation has an impermissible retroactive effect. See Br. in Opp. 27-28. That is incorrect for several reasons.

a. The regulation is not retroactive in the relevant sense because it clarified rather than changed existing law. "[W]here a new rule constitutes a clarification—rather than a substantive change—of the law as it existed beforehand, the application of that new rule to pre-promulgation conduct necessarily does *not* have an impermissible retroactive effect." *Levy* v. *Sterling Holding Co.*, 544 F.3d 493, 506 (3d Cir. 2008), cert. denied, 129 S. Ct. 2827 (2009). That is because, as the Seventh Circuit has explained, "[a] rule simply clarifying an unsettled or confusing area of the law * * * does not change the law, but restates what the law according to the agency is and has always been: 'It is no more retro-

active in its operation than is a judicial determination construing and applying a statute to a case in hand.'" *Pope* v. *Shalala*, 998 F.2d 473, 483 (7th Cir. 1993) (quoting *Manhattan Gen. Equip. Co.* v. *Commissioner*, 297 U.S. 129, 135 (1936)), overruled on other grounds by *Johnson* v. *Apfel*, 189 F.3d 561 (7th Cir. 1999). Accordingly, where "a court is addressing transactions that occurred at a time when there was no clear agency guidance, it would be absurd to ignore the agency's current authoritative pronouncement of what the statute means." *Smiley*, 517 U.S. at 744 n.3.

Here, it was not settled at the time of the Treasury regulation whether *Colony*'s interpretation of the pre-1954 version of the statute applies equally to the post-1954 version of the statute (as respondents maintain) or whether instead the 1954 amendments affect the statutory analysis (as the government has argued). See *Intermountain*, 650 F.3d at 709 ("Because *Colony* never applied to [S]ection 6501(e)(1)(A) * * * , there was no *settled* law for the regulations to change."); *CC & F W. Operations Ltd. P'ship* v. *Commissioner*, 273 F.3d 402, 406 n.2 (1st Cir. 2001) ("Whether *Colony*'s main holding carries over to [S]ection 6501(e)(1) is at least doubtful."). The regulation therefore clarified a point that was previously unresolved by codifying the interpretation of Section 6501(e)(1)(A) that the Treasury Department had consistently advanced in prior adjudicative proceedings.

b. The fact that the regulation does not bear on the legality of petitioners' primary conduct further supports the conclusion that it is not retroactive in the relevant sense. The regulation does not speak to the question whether respondents overstated their bases in Home Concrete and consequently underpaid their taxes.

Rather, it clarifies the procedural rules governing enforcement of respondents' pre-existing tax liabilities. This Court has "generally applied new procedural rules to pending cases * * * because rules of procedure regulate secondary rather than primary conduct." *Lindh* v. *Murphy*, 521 U.S. 320, 341 (1997) (internal quotation marks and citation omitted); cf. *Landgraf* v. *USI Film Prods.*, 511 U.S. 244, 275 (1994) ("Because rules of procedure regulate secondary rather than primary conduct, the fact that a new procedural rule was instituted after the conduct giving rise to the suit does not make application of the rule at trial retroactive.").

c. Even if the regulation were properly viewed as retroactive, the Treasury Department has express statutory authority to promulgate retroactive rules. See *Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204, 209 (1988) (permitting retroactive rulemaking when there is an "express statutory grant" of such power). The relevant statute, 26 U.S.C. 7805(b)(8), authorizes the Treasury Department to "prescribe the extent, if any, to which any * * * regulation relating to the internal revenue laws shall be applied without retroactive effect." In light of Section 7805(b)(8), this Court has recognized the Department's authority to apply a regulation retroactively, subject to review for abuse of the Department's discretion. See *Automobile Club* v. *Commissioner*, 353 U.S. 180, 184 (1957) (discussing 26 U.S.C. 3791(b) (1940), which was the predecessor statute to Section 7805(b)(8)) ("[I]t is clear from the language of [Section 7805(b)(8)] and its legislative history that Congress thereby confirmed the authority of the Commissioner to correct any ruling, regulation or Treasury decision retroactively.") (footnote omitted).

In the final regulation, "[t]he Treasury Department and the Internal Revenue Service disagree[d] with the characterization of the regulation[] as retroactive." Pet. App. 62a. The Department also observed, however, that "a retroactive regulation interpreting * * * [Section] 6501(e)(1) is expressly permitted by the applicable version of [S]ection 7805(b)." *Id.* at 62a-63a; see *id.* at 62a (explaining why 1996 amendments to Section 7805(b) do not alter the Department's authority to make the final regulation at issue here retroactive); *Grapevine*, 636 F.3d at 1381 n.6 (same). The Department thus made clear that, to the extent the final regulation has any retroactive effect, the regulation is a permissible exercise of the Department's authority to promulgate retroactive rules.

The court below did not consider these arguments, but other courts of appeals have held that the regulation is not impermissibly retroactive. See *Salman Ranch II*, 647 F.3d at 943 ("We agree with the Federal Circuit that the new regulation may be properly applied to past tax years whose limitations periods remain open as recomputed under the new regulation."); *Grapevine,* 636 F.3d at 1382 ("By their terms, the new regulations will apply only to those taxpayers who are within the limitations period as computed under the new regulation, so there is no opportunity for these regulations to reach into the distant past."); *ibid.* ("[W]hile we recognize that some taxpayers whose past returns bear evidence of overstated basis may find themselves facing adjustments when they thought the limitations period had lapsed, we cannot say that the burden on those taxpayers is so great as to be an abuse of the Treasury Department's discretion.").

C. This Court's Decision In *Colony* Does Not Control The Interpretation Of The Current Version Of Section 6501(e)(1)(A)

Respondents contend (Br. in Opp. 28-33) that the regulation is not entitled to *Chevron* deference because it is contrary to this Court's decision in *Colony*. In *Colony*, this Court construed a predecessor statute, 26 U.S.C. 275(c) (1940), that also included the language "omits from gross income an amount properly includible therein." The Court held that former Section 275(c) did not encompass understatements of gross income that were attributable to overstatements of basis. See 357 U.S. at 30, 32, 36-37. Respondents contend that the Court in *Colony* held the language of the former statute to be unambiguous; that the holding in *Colony* applies equally to the current Section 6501(e)(1)(A); and that the IRS is therefore foreclosed from adopting a different construction of the current law. Those arguments lack merit. A careful analysis of the statutory history and the *Colony* decision demonstrates that *Colony* does not control this case. See *Intermountain*, 650 F.3d at 701-706 (discussing the statutory history and the limited scope of *Colony*'s holding).

1. When it amended the relevant statutory provision in 1954, Congress made clear that a basis overstatement triggers the six-year assessment period unless the taxpayer is a trade or business

Congress first established an extended assessment period in 1934 when it enacted Section 275(c). See Revenue Act of 1934, ch. 277, § 275(c), 48 Stat. 745 (26 U.S.C. 275(c) (1934)). Section 275(c) extended the assessment period from three to five years "[i]f 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." 26 U.S.C. 275(c) (1934). The language of Section 275(c) was thus similar to the current Section 6501(e)(1)(A): the extended assessment period applied if a taxpayer "omit-[ted] from gross income an amount properly includible therein" that was more than 25 percent of the gross income stated in the return.

In the 1940s and 1950s, lower courts reached differing conclusions about whether an overstatement of basis could give rise to an "omi[ssion] from gross income" for purposes of Section 275(c). Contrast *Reis* v. *Commissioner*, 142 F.2d 900, 902-903 (6th Cir. 1944) (holding that a basis overstatement could give rise to an omission from gross income), and *American Liberty Oil Co.* v. *Commissioner*, 1 T.C. 386 (1942) (same), with *Uptegrove Lumber Co.* v. *Commissioner*, 204 F.2d 570, 571-573 (3d Cir. 1953) (holding that a basis overstatement could not give rise to an omission from gross income). Although the Third Circuit in *Uptegrove Lumber* recognized "real ambiguity" in Section 275(c), it held (based on the statute's legislative history) that a taxpayer omits an amount from gross income only when the taxpayer fails to report the sale of an item altogether, not when the taxpayer overstates the cost of that item and thus understates gross income from the item's sale. *Ibid.* In a letter to the Senate Finance Committee, attorneys who endorsed the Third Circuit's reasoning urged the Committee to amend Section 275(c) to codify *Uptegrove Lumber*'s holding, and to indicate that the amendments merely clarified existing law. See *Intermountain*, 650 F.3d at 698.

The following year, Congress revised Section 275(c), which it renumbered as Section 6501(e)(1)(A) in the In-

ternal Revenue Code of 1954. Congress lengthened (from five to six years) the assessment period that applies when a taxpayer omits a substantial amount from gross income, and it added two new subparagraphs (i) and (ii) to Section 6501(e)(1)(A). As explained above, see pp. 20-22, *supra*, the first of those subparagraphs is directly relevant here. Subparagraph (i) 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). Subparagraph (i) thus provides that for goods or services sold by a trade or business, gross income is simply the sales price, without any offset for the seller's basis. Both the House and Senate Reports characterized subparagraphs (i) and (ii) as "changes from existing law." See H.R. Rep. No. 1337, 83d Cong., 2d Sess., at A415 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 584 (1954).

Subparagraph (i) thus codified the result but not the reasoning in *Uptegrove Lumber*. Although *Uptegrove Lumber* involved a manufacturing corporation, the Third Circuit's analysis did not distinguish between taxpayers who were engaged in a trade or business and those who were not. See *Intermountain*, 650 F.3d at 697-698. In enacting subparagraph (i), by contrast, Congress established a special definition of "gross income" that applies only "[i]n the case of a trade or business." 26 U.S.C. 6501(e)(1)(A)(i). Even with respect to trade-or-business taxpayers, moreover, Congress did not endorse *Uptegrove Lumber*'s conclusion that the phrase "omits from gross income" is naturally read to exclude basis overstatements. Rather, 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." *Intermountain*, 650 F.3d at 697. By contrast, it is undisputed that respondents' bases in Home Concrete must be taken into account in determining their gross income for the relevant tax year. Congress's creation of a special rule for "the case of a trade or business" belies any suggestion that Section 6501(e)(1)(A) was intended to codify the *Uptegrove Lumber* approach across the board.

2. The Court in **Colony** *construed the pre-1954 version of the statute without addressing the post-1954 version*

Because the 1954 amendments were not made applicable to prior tax years, the Court in *Colony* granted certiorari to determine "whether assessments by the Commissioner of two asserted tax deficiencies" were barred by the three-year assessment period "provided in the Internal Revenue Code of 1939." 357 U.S. at 29. The taxpayer in *Colony* "had understated the gross profits on the sales of certain lots of land * * * as a result of having overstated the 'basis' of such lots by erroneously including in their cost certain unallowable items of development expense." *Id.* at 30. The IRS therefore assessed deficiencies for the 1946 and 1947 tax years, and it did so more than three but less than five years after the taxpayer had filed its return. *Ibid.* The Tax Court held that the deficiencies were timely because the taxpayer's overstatement of basis gave rise to an omission from gross income under Section 275(c), and the court of appeals affirmed. *Id.* at 31.

This Court reversed. Focusing on "the critical statutory language, 'omits from gross income an amount properly includible therein,'" the Court stated that it

was "inclined to think that the statute on its face lends itself more plausibly to the taxpayer's interpretation." *Colony*, 357 U.S. at 32-33. The Court observed, however, that "it cannot be said that the language is unambiguous," and it therefore "turn[ed] to the legislative history of [Section] 275(c)." *Id.* at 33. The Court found in that history "persuasive evidence" that the five-year assessment period applied only to cases involving "a taxpayer's omission to report some taxable item," and not to cases in which "the understatement of a tax arises from an error in reporting an item disclosed on the face of the return." *Id.* at 33, 36. The Court therefore 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." *Id.* at 33.

Although the Court in *Colony* observed that its holding was "in harmony with the unambiguous language of [Section] 6501(e)(1)(A) of the Internal Revenue Code of 1954," the Court declined to resolve "the speculative debate between the parties as to whether Congress [in the 1954 amendments] manifested an intention to clarify or change the 1939 Code." 357 U.S. at 37. The Court's failure to address the post-1954 version of the statute was "no mere oversight," since the parties in *Colony* had vigorously debated whose interpretation of the statute Congress had endorsed in the 1954 amendments. *Intermountain*, 650 F.3d at 702; see Pet. Br. at 23-24, *Colony*, *supra* (No. 306), 1958 WL 91875; Gov't Br. at 23–24, *Colony*, *supra* (No. 306), 1958 WL 91876; Pet. Reply Br. at 6–8, *Colony*, *supra* (No. 306), 1958 WL 91877. The Court did not resolve that debate and instead limited its holding to Section 275(c) of the 1939 Code. See *Colony*, 357 U.S. at 37.

3. **Colony** ***does not control the interpretation of current Section 6501(e)(1)(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. 21-22, *supra*. 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 p. 23, *supra*. Congress's use of different terms in adjacent provisions indicates that *Colony*'s interpretation 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. See *Intermountain*, 650 F.3d at 704.

The Court in *Colony*, of course, had no need to consider the effect of the 1954 amendments. The Court was construing the statute as it existed before those 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.*, *United States* v. *Tinklenberg*, 131 S. Ct. 2007, 2012 (2011) ("[T]erms must be read in

their statutory context in order to determine how the provision in question should be applied in an individual case."); *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.

4. In any event, the Treasury regulation resolves the statutory ambiguity that **Colony** *identified*

a. Although the Court in *Colony* was "inclined to think that the statute on its face lends itself more plausibly 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 *Brand X*, 545 U.S. at 983; see also *Mayo*, 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.

Under *Brand X*, the new Treasury Department regulation would be entitled to *Chevron* deference even if that rule construed 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

1939 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 statutory provisions that the *Colony* Court had no occasion to address.

b. Respondents place weight (Br. in Opp. 16) 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. Respondents 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. But given the Court's earlier recognition that the phrase "omits from gross income an amount properly includible therein" was ambiguous, see *id.* 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. That reading depends on the unlikely premise that "within the span of just four pages of the U.S. Reports," the Court (in an opinion by Justice Harlan) "illogically described essentially identical text as both ambiguous and unambiguous." *Intermountain*, 650 F.3d at 703.

The Court's reference to the "unambiguous language of [Section] 6501(e)(1)(A)" is far more sensibly read as describing the then-new subparagraph (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. See *Intermountain*, 650 F.3d at 697. 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 apparently "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 respondents, who did not operate a trade or business, and whose overstatement of basis therefore resulted in an understatement of "gross income."

Respondents argue (Br. in Opp. 17-18) that *Colony*'s result cannot have been in harmony with recently-added subparagraph (i), because *Colony* involved the sale of land rather than goods or services. It is correct that land is normally not considered a good. See, *e.g.*, Gov't Br. at 45-46, *Salman Ranch I*, *supra* (No. 2008-5053), 2008 WL 4133498. The taxpayer at issue in *Colony*, however, was a real estate developer that was subdividing farm land into residential lots and selling those lots to individual buyers. See Pet. Br. at 3-4, *Colony*, *supra* (No. 306), 1958 WL 91875. *Colony* thus confronted the circumstance in which real property was the taxpayer-business's inventory rather than merely one of its assets. On its tax returns, the taxpayer in *Colony* reported its sales of land in the way that a business typically reports sales of goods or services. See *ibid*. The taxpayer also argued in the Tax Court that its overstatement of basis did not trigger the extended assessment period because its "omission resulted from an overstatement of *cost of goods sold*, rather than from an omission of gross receipts." *Colony, Inc.* v. *Commissioner*, 26 T.C. 30, 49 (T.C. 1956) (emphasis added). Thus, while an argument could be made that the phrase "sale of

goods or services" in subparagraph (i) does not encompass sales of land, the Court had sound reason to conclude that its disposition of *Colony* would have been no different under the amended statute.[8]

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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[8] In addition, all but one of the cases that had arisen in the lower courts involved trades or businesses engaged in the sale of goods or services. See, *e.g.*, *Goodenow* v. *Commissioner*, 238 F.2d 20, 20-21 (8th Cir. 1956); *Davis* v. *Hightower*, 230 F.2d 549, 550-551 (5th Cir. 1956); *Deakman-Wells Co.* v. *Commissioner*, 213 F.2d 894, 895 (3d Cir. 1954); *Uptegrove Lumber Co.*, 204 F.2d at 571; but see *Slaff* v. *Commissioner*, 220 F.2d 65, 66 (9th Cir. 1955). It would therefore have been reasonable for the Court to conclude that the 1954 amendments had settled the question not only in *Colony* but in virtually all other similar cases.