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A New Batboy to Change the Outcome of the World Series: The Correct Application of *United States v. Home Concrete & Supply, LLC* and Treasury Regulation § 301.6501(e)-1 to Future Overstatement of Basis Cases

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Note*

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* Bryson K. Gregory: JD/MBA Candidate, 2013, University of Nebraska College of Law; B.A. Brigham Young University, 2009. I would like to express my gratitude to my friends and colleagues on the *Nebraska Law Review* for their diligence, patience, attention to detail, and constant encouragement throughout the writing process. In particular, I would like to thank Cassidy R. Ellis and his family for entertaining my own family and providing a sounding board for ideas. I am also especially grateful to my tax professors, William H. Lyons and Brian D. Lepard, for inspiring me to delve deeper into tax concepts that I would not have dared to investigate without their encouragement. Most of all, I owe an infinite amount of gratitude to my wife Mickelle and our crazy children, Akoy and Lily, for constantly staying positive and upbeat even though they often went days or even weeks without seeing me.

I. INTRODUCTION

At the end of *The Natural*, the main character, Roy Hobbs, has the chance to win the pennant for his baseball team, the Knights.[1] Prior to reaching the big game, Hobbs had established himself as a great baseball player by consistently hitting well.[2] Many onlookers attributed Hobbs's success to a bat called "Wonderboy," which he had made from a tree that had been split in half by a bolt of lighting.[3] Unfortunately, at the big game, Hobbs struck out on his first two at bats.[4] His third time at bat, however, with the game on the line, Hobbs's luck turned around. His first swing resulted in a foul ball that broke the glass of the announcer's box.[5] On his second swing, he hit a ball that looked to be a home run but instead veered off as a foul.[6] On his way back to the plate, Hobbs noticed that "Wonderboy" had split in half from the impact of the baseball.[7] Devastated, Hobbs turned to his batboy, Bobby Savoy.[8] Bobby returned from the dugout with a bat he had made with Hobbs called the "Savoy Special."[9] Using the "Savoy Special," Hobbs knocked the next pitch out of the park high enough to shatter the lights that illuminated the stadium.[10]

1. THE NATURAL (Tri-Star Pictures 1984).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*

Justice Breyer argued in his majority opinion in *United States v. Home Concrete & Supply, LLC*[11] that relying on a single word in a statute would be like "hoping that a new batboy will change the outcome of the World Series."[12] He was referring to the IRS's argument that, by leaving the word "amount" in a statute regarding the statute of limitations in tax cases, Congress intended for a certain group of taxpayers to be subject to a longer statute of limitations than the typical three years that is allowed for normal tax matters.[13] However, just as Hobbs managed to win the big game with the help of his batboy, the Supreme Court should defer to its own batboy, the IRS, when determining the meaning of a statute the Court has not previously interpreted.

Generally speaking, taxpayers may legally seek to reduce their tax liability by creating the appearance of a financial loss.[14] This practice is referred to as a "tax shelter" and is a strategy that is often promoted in the business world.[15] Although most tax shelters, such as transferring money to personal retirement accounts, are permissible,[16] some have been outlawed.[17] The Bond Option Sales Strategy (Son of BOSS) is one such shelter.[18] A Son of BOSS shelter generally refers to a transaction in which a taxpayer artificially inflates his or her basis in a piece of property in order to show a loss in the subsequent sale of such property.[19] President Barack Obama recently brought more attention to Son of BOSS tax shelters by issuing a press release implying that Mitt Romney was involved in various Son of BOSS schemes while on the board of Marriott International.[20]

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11. 132 S. Ct. 1836 (2012).
12. *Id.* at 1842.
13. *Id.*
14. Derek B. Wagner, *Who's the (Son of) BOSS?: The Struggle Between the Federal Circuit and Treasury to Define "Omits from Gross Income" in Son of BOSS Tax Shelters and Other Overstatement-of-Basis Tax Cases*, 21 FED. CIR. B.J. 45, 45 (2011).
15. *Id.* "[A] tax shelter is any transaction or investment entered into solely for the purpose of reducing the investor's tax liability by creating the appearance of a financial loss, when, in fact, the taxpayer has retained dominion and control over the assets." *Id.*
16. *See* Chaka Fattah, *Déjà Vu All Over Again: Reexamining Fundamental Tax Reform and Evaluating the Feasibility of a Transaction Tax in the 111th Congress*, 47 HARV. J. ON LEGIS. 327, 330 (2010).
17. Wagner, *supra* note 14, at 45.
18. *See* I.R.S. Notice 2000-44, 2000-2 C.B. 255 (prohibiting deductions for losses generated by Son of BOSS transactions).
19. *See, e.g.*, Kornman & Assocs. v. United States, 527 F.3d 443, 446 n.2 (5th Cir. 2008).
20. Callum Borchers, *President Obama's Campaign Repeats Call for More Mitt Romney Tax Returns, Citing Tax Shelter Used by Marriott When Romney Was on Board*, BOSTON.COM (Aug. 9, 2012, 1:53 PM), http://www.boston.com/politicalintelligence/2012/08/09/president-obama-campaign-repeats-call-for-more-mitt-

In 2000, the IRS effectively prohibited Son of BOSS tax shelters by enacting Notice 2000-44.[21] This notice provides examples of partnership transactions that must be reported to the IRS.[22] If partnerships do not report these transactions, known as "listed transactions," the partnerships "may be subject to the penalty under § 6707(a) and to the penalty under § 6708(a)."[23] Although it is clear that the use of Son of BOSS tax shelters is illegal, there remains a question of whether the IRS has longer than the typical three-year statute of limitations to prosecute a taxpayer who takes advantage of a Son of BOSS tax shelter.[24]

The Supreme Court first addressed the issue of whether the statute of limitations is extended for Son of BOSS cases in *Colony, Inc. v. Commissioner*.[25] In *Colony*, the Court determined that a Son of BOSS transaction did not constitute an omission of income; therefore, the IRS only had three years to prosecute such cases.[26] The Court in *Colony* based its decision on language from § 275(c), which Congress enacted as part of the 1939 version of the Internal Revenue Code to prevent taxpayers from omitting income from their tax returns.[27] Unfortunately, this left the question of whether § 6501, the successor statute to § 275(c), should also be read to prohibit the IRS from prosecuting Son of BOSS transactions after the three-year statute of limitations.[28]

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romney-tax-returns-citing-tax-shelter-used-marriott-when-romney-was-board/oXkbpYDEbE1kdJvyGgGzSJ/story.html.

21. "[A] loss is allowable as a deduction for federal income tax purposes only if it is bona fide and reflects actual economic consequences." I.R.S. Notice 2000-44, 2000-2 C.B. 255 (citing ACM P'ship v. Comm'r, 157 F.3d 231, 252 (3d Cir. 1998)).
22. *Id.* at 2–5.
23. *Id.* at 7. *See also* I.R.C. § 6707(b)(2) (2006) (providing a fine of $200,000 or up to 75 percent of any gross income derived from a listed transaction that a taxpayer fails to report); I.R.C. § 6708 (a)(1) (2004) (imposing a fine of $10,000 per day for taxpayers who fail to provide a list of advisees as required under I.R.C. § 6112(a) within twenty days of carrying out a reportable transaction).
24. *See, e.g.*, Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 650 F.3d 691 (D.C. Cir. 2011) (holding that the IRS has six years to file a claim), *vacated*, 132 S. Ct. 2120 (2012); Burks v. United States, 633 F.3d 347 (5th Cir. 2011); Beard v. Comm'r, 633 F.3d 616 (7th Cir. 2011), *vacated*, 132 S. Ct. 2099 (2012); Salman Ranch Ltd. v. United States, 573 F.3d 1362 (Fed. Cir. 2009) (holding that the IRS only has three years to file a claim); Bakersfield Energy Partners, LP v. Comm'r, 568 F.3d 767 (9th Cir. 2009).
25. 357 U.S. 28 (1958).
26. *Id.* at 38.
27. *Id.* at 37. *See* I.R.C. § 275(c) (1939).
28. Congress adopted § 6501 into the Internal Revenue Code in 1954, nearly four years before the Supreme Court decided *Colony*. However, because the Supreme Court referred to § 6501 in the *Colony* decision, many courts determined that the Court interpreted both § 275(c) and § 6501 in the *Colony* case. *Id.* at 37 ("[T]he conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954.").

The IRS issued a regulation interpreting § 6501 to mean the IRS could prosecute taxpayers for Son of BOSS transactions after the typical three-year statute of limitations.[29] However, the Court in *United States v. Home Concrete & Supply, LLC*[30] refused to recognize the regulation and instead held that the Court in *Colony* had already interpreted § 6501; therefore, there was no more room for the IRS to interpret the statute.[31] By extension, the Court in *Home Concrete* held that the IRS should only be allowed three years to prosecute a taxpayer who unlawfully takes advantage of a Son of BOSS tax shelter.[32]

This Note argues the Court in *Colony* did not interpret § 6501 regarding Son of BOSS shelters,[33] and therefore, the IRS was free to issue its own interpretation of the statute before the *Home Concrete* decision.[34] Furthermore, the *Home Concrete* Court should have relied on the IRS's interpretation of the statute, and that interpretation should now be the governing authority regarding Son of BOSS shelters.[35]

This Note analyzes two issues presented in the *Home Concrete* decision: First, it examines whether the language "omits from gross income" as found in I.R.C. § 6501(e) includes Son of BOSS shelters. Second, it discusses whether the Court should grant deference to the IRS regarding treasury regulations it releases during pending litigation. Part II of this Note gives the history and background of the dispute regarding the correct statute of limitations on Son of BOSS tax shelters. Part III describes the *Home Concrete* case. Finally, Part IV explains why courts should grant an extended statute of limitations for overstatement of basis cases and why courts should give deference to IRS regulations even if they are proposed while the IRS is a party in pending litigation.

29. Treas. Reg. § 301.6501(e)-1 (2011).
30. 132 S. Ct. 1836 (2012).
31. *Id.* at 1842 (2012) ("[A] 'court's prior judicial construction of a statute trumps an agency construction otherwise entitled to Chevron deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute.'" (citing Nat'l Cable & Telecomms. Ass'n. v. Brand X Internet Servs., 545 U.S. 967, 982 (2005))).
32. *Home Concrete*, 132 S. Ct. at 1841 (reasoning the Supreme Court in *Colony* resolved the dispute over the statute of limitations regarding Son of BOSS shelters).
33. I.R.C. § 6501(e) (2006).
34. *See infra* subsection IV.A.1.
35. *See infra* section IV.B.

II. BACKGROUND

A. Section 275(c) of the 1934 Revenue Act

When Congress enacted § 275(c) as part of the Revenue Act of 1934, it opened the floodgates for litigation regarding the proper statute of limitations for overstatement of basis cases.[36] Section 275(c) states in pertinent part:

> If the taxpayer *omits from gross income* an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.[37]

Congress incorporated virtually the same language into the 1939 Internal Revenue Code, which later became the statute at issue in *Colony*.[38]

Gross income includes the "[t]otal income from all sources before deductions, exemptions, or other tax reductions."[39] A taxpayer's basis is "the total cost of acquiring [an] asset, including the purchase price plus commissions and other related expenses, less depreciation and other adjustments."[40] In a Son of BOSS transaction, a taxpayer inflates the basis he or she has in a piece of property, which effectively reduces the amount of income the taxpayer receives on paper for the transaction.[41]

Almost immediately after Congress created § 275(c), courts began to question whether the phrase "omits from gross income" included the inflation of basis.[42] In *Reis v. Commissioner*[43] the Sixth Circuit determined that because the taxpayer had adopted an incorrect basis

36. *See, e.g.*, Goodenow v. Comm'r, 238 F.2d 20, 22 (8th Cir. 1956) (three-year statute of limitations); Uptegrove Lumber Co. v. Comm'r, 204 F.2d 570, 573 (3d Cir. 1953) (three-year statute of limitations); Reis v. Comm'r, 142 F.2d 900, 903 (6th Cir. 1944) (five-year statute of limitations); Estate of Gibbs v. Comm'r, 21 T.C. 443, 447 (1954) (five-year statute of limitations).
37. I.R.C. § 275(c) (1934) (emphasis added). Section 276(a) extends this limitations period from five years to an unlimited amount of time if a taxpayer submits a false or fraudulent return in an attempt to evade taxation. I.R.C. § 276(a) (1939); I.R.C. § 6501(c) (2006). Although inflating basis to achieve a lower tax liability is improper under the current tax code, it does not fall under the false or fraudulent language of § 276(a). *See* I.R.C. § 276(a).
38. I.R.C. § 275(c) (1939).
39. BLACK'S LAW DICTIONARY 831 (9th ed. 2009). *See also* I.R.C. § 61 (2006) (describing how to calculate gross income).
40. BLACK'S LAW DICTIONARY 171 (9th ed. 2009).
41. Sebastian Watt, Comment, *Abolishing the Shelter of Ambiguity: A New Framework for Treasury Regulation Deference Clarifying* Chevron *and* Brand X, 117 PENN ST. L. REV. 617, 626 (2012) (citing Wagner, *supra* note 14, at 46–48).
42. *See, e.g.*, Goodenow v. Comm'r., 238 F.2d 20, 22 (8th Cir. 1956); Uptegrove Lumber Co. v. Comm'r, 204 F.2d 570 (3d Cir. 1953); Reis v. Comm'r, 142 F.2d 900, 903 (6th Cir. 1944); Estate of Gibbs v. Comm'r, 21 T.C. 443 (1954).
43. 142 F.2d 900 (6th Cir. 1944).

in his property, he illegally omitted from his tax return an amount totaling over 25 percent of his income.[44] The Sixth Circuit determined the incorrect basis was an omission from gross income and granted the IRS up to five years to assess a penalty.[45] The tax court similarly interpreted the phrase "omits from gross income" to include an inflation of basis.[46] The tax court and Sixth Circuit both reasoned that, had the taxpayers not improperly increased the basis in their property, they would have been required to include the excess amount in gross income.[47] Because the excluded amount exceeded 25 percent of the taxpayers' gross income, the courts held that each transaction was an omission from gross income and that the five-year statute of limitations applied.[48]

A number of courts, however, disagreed with the interpretation of the Sixth Circuit and the tax court.[49] The Third Circuit in *Uptegrove Lumber Co. v. Commissioner*, for example, did not interpret the phrase "omits from gross income" to include an inflation of basis.[50] The court analyzed the legislative history behind § 275(c) and determined the five-year exception only applied "where the taxpayer had failed to make a return of some taxable gain."[51] The Third Circuit did not include an increase in basis under that distinction.[52] The *Uptegrove* court reasoned that an inflation of basis does not constitute an omission of gross income because Congress gave no indication in the legislative history of § 275(c) that an omission from gross income includes anything other than failing to include some receipt or accrual.[53]

Similarly, the Eighth Circuit held that overstatement of deductions for cost basis of assets sold, resulting in insufficient gross income on return, did not constitute "omission from gross income" for purposes of the extended statute of limitations provision in § 275(c).[54] The Eighth Circuit reasoned that improper calculations of gross income do not rise to the level of an omission Congress sought to prevent

44. *Id.* at 903. *See also* Ketcham v. Comm'r, 142 F.2d 996, 997 (2d Cir. 1944) (holding that the five-year statute of limitations applies for an omission of gross income involving the increase of basis).

45. *Reis*, 142 F.2d at 903.

46. *See, e.g.*, Estate of Gibbs v. Comm'r, 21 T.C. 443 (1954); Am. Liberty Oil Co. v. Comm'r, 1 T.C. 386 (1942).

47. *Reis*, 142 F.2d at 902; *Ketcham*, 142 F.2d at 997; *Gibbs*, 21 T.C. at 447.

48. *Id.*

49. *See, e.g.*, Goodenow v. Comm'r., 238 F.2d 20, 22 (8th Cir. 1956); Uptegrove Lumber Co. v. Comm'r, 204 F.2d 570 (3d Cir. 1953).

50. *Uptegrove*, 204 F.2d at 572

51. *Id.*

52. *Id.*

53. *Id.*

54. *Goodenow*, 238 F.2d at 22.

by enacting § 275(c).[55] Other courts have followed a course similar to the Third and Eighth Circuits, holding that an increase in basis does not constitute an omission from gross income.[56]

The Supreme Court sought to settle this circuit split in *Colony, Inc. v. Commissioner*.[57] In *Colony*, the IRS assessed deficiencies in the taxpayer's income based on "certain lots of land . . . [upon which the taxpayer] overstated the 'basis' . . . by erroneously including in their cost certain unallowable items of development expense."[58] The Court, recognizing that § 275(c) was ambiguous,[59] looked to the legislative history behind the statute and concluded that it only supported a definition of "omit" that included "some income receipt or accrual in [the taxpayer's] computation of gross income," but this definition did not include "errors in [that] computation arising from other causes."[60] The Court continued its discussion by citing various statements from Congress that supported its conclusion regarding § 275(c).[61] In dictum, the Court muddied the waters for the statute of limitations debate by saying that the "conclusion [it] reached [was] in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954."[62] As discussed below,[63] this conclusion was erroneous because the only legislative history discussed in the *Colony* opinion was that of § 275(c) and not that of § 6501. Although § 6501 had been enacted by the time of the *Colony* decision, it was not in place at the time the taxpayer filed his return in *Colony*, thereby forcing the Court to rely on § 275.[64]

B. The Court in *Colony* Failed to Prevent Future Circuit Splits Regarding § 6501 of the 1954 Version of the Modern Tax Code

Because *Colony* does not directly address the 1954 Tax Code's version of § 275(c), courts began to wrestle with whether *Colony* was controlling precedent for § 6501 "omissions from gross income."[65] Section 6501 states in relevant part:

55. *Id.*
56. *See, e.g.*, Slaff v. Comm'r, 220 F.2d 65, 68 (9th Cir. 1955) ("How such a plain statement can be construed as an omission is difficult for us to understand under the circumstances.").
57. 357 U.S. 28 (1958).
58. *Id.* at 30.
59. *Id.* at 33 ("[I]t cannot be said that the language is unambiguous.").
60. *Id.*
61. *Id.* at 33–36.
62. *Id.* at 37.
63. *See infra* section II.B.
64. Colony, Inc. v. Comm'r, 357 U.S. 28, 32 (1958).
65. *See, e.g.*, Salman Ranch v. United States, 573 F.3d 1362 (Fed. Cir. 2009).

> If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 *percent* of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within *6 years* after the return was filed. For the purposes of this subparagraph—
>
> (i) In the case of a *trade or business*, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and
>
> (ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.[66]

Although the language § 6501 is very similar to that of § 275(c), it includes a number of key changes and additions. More specifically, § 6501 now includes subparagraph (i), which provides a different definition of "gross income;" and subparagraph (ii), which provides a safe haven for taxpayers who warn the IRS about possible overstatements of basis. Additionally, § 6501(e)(2) uses the word "item" as opposed to "amount," and § 6501 extended the statute of limitations from five to six years. In *Salman Ranch v. United States*,[67] the IRS pointed out many of these changes to bolster its claim that Congress intended the six-year statute of limitations to apply in cases involving § 6501.[68]

First, the IRS noted that Congress added subparagraph (i) to the statute.[69] Subparagraph (i) gives a different definition for the term "gross income" for cases where a trade or business is involved.[70] According to the IRS, subparagraph (i) "gross income" only includes the amounts received from a sale instead of the difference between the amount received and the taxpayer's basis in a piece of property.[71] The IRS argued that applying that definition of "gross income" outside the trade or business context would make subparagraph (i) superfluous to the opening paragraph of § 6501(e)(1)(A).[72] Therefore, the IRS determined that the term "gross income" in § 6501(e)(1)(A) should follow a

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66. I.R.C. § 6501(e)(1)(A) (1954) (emphasis added). Section 6229(c)(2) includes virtually identical language to § 6501 but directs its language more specifically to partnerships. I.R.C. § 6229(c)(2) (1983) ("If any partnership omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) shall be applied by substituting '6 years' for '3 years.'"). *See also* Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 650 F.3d 691, 699 (D.C. Cir. 2011), *vacated*, 132 S. Ct. 2120 (2012) (questioning whether § 6229 has a different meaning than § 6501 in overstatement of basis cases but leaving the issue open for another court to resolve).
67. 573 F.3d 1362 (Fed. Cir. 2009).
68. *Id.*
69. *Id.* at 1371.
70. I.R.C. § 6501(e)(1)(B)(i) (2006).
71. *Salman*, 573 F.3d at 1371.
72. *Id.* *See also* Platt v. Union Pac. R.R. Co., 99 U.S. 48, 58 (1878) ("[A] legislature is presumed to have used no superfluous words.").

more general definition of gross income, which only includes the amount retained after subtracting basis from receipts.[73]

Next, the IRS addressed the addition of subparagraph (ii) to § 6501. Subparagraph (ii) gives a safe haven to taxpayers for adequately apprising the Secretary of Treasury of the amount omitted from income.[74] The IRS argued that, by adding this safe haven, Congress effectively "eliminated the Supreme Court's primary justification for its ruling in *Colony*."[75] The Court's primary justification for its decision in *Colony* was that disclosing an inflation of basis is enough of a disclosure to avoid putting the IRS "at a special disadvantage in detecting errors."[76] Therefore, if a taxpayer discloses an inflation of basis, the IRS should not be granted an extended statute of limitations.[77] In § 6501 the safe haven requires the taxpayer to identify the specific amount omitted to avoid an extended statute of limitations.[78] Under § 6501 the IRS claimed that "[subparagraph (ii)] render[ed] moot the Court's rationale for stating that an overstated basis does not constitute an omission of gross income."[79]

Finally, the IRS argued that § 6501 differs from § 275(c) by the addition of § 6501(e)(2).[80] Paragraph (2) provides that "if the taxpayer omits from the gross estate . . . *items* includible in such gross estate . . . a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years."[81] Because Congress used the term "item" instead of "amount," the IRS argued Congress did not intend the six-year statute of limitations to apply with regard to the estate and gift tax for "differences as to the valuation of property."[82] The IRS instead argued that because the language in § 6501(e)(1) uses the word "amount" rather than "item," Congress intended an omission from gross income to occur "not only when a taxpayer completely leaves an item of income out of the return, but also when the taxpayer overstates the basis of an asset."[83]

In opposition to the IRS, taxpayers have argued that *Colony* is guiding precedent for § 6501 cases and that § 275(c) is substantially similar to § 6501.[84] For example, the plaintiff in *Phinney v. Chambers*

73. *Salman*, 573 F.3d at 1371.
74. I.R.C. § 6501(e)(1)(A)(ii) (1954).
75. *Salman*, 573 F.3d at 1371.
76. *Id.* (citing Colony, Inc. v. Comm'r, 357 U.S. 28, 36 (1958)).
77. *Id.*
78. I.R.C. § 6501(e)(1)(A)(ii).
79. *Salman*, 573 F.3d at 1372.
80. *Id.*
81. I.R.C. § 6501(e)(2).
82. *Salman*, 573 F.3d at 1372.
83. *Id.*
84. *See, e.g.*, CC & F W. Operations Ltd. P'ship v. Comm'r, 273 F.3d 402 (1st Cir. 2001); Phinney v. Chambers, 392 F.2d 680 (5th Cir. 1968).

argued unsuccessfully that subparagraph (ii) should apply when the plaintiff at least lists the item with the increased basis on his tax return.[85] Other plaintiffs have argued that *Colony* should apply based on Justice Harlan's reasoning that the additional two-year statute of limitations was meant to aid the Commissioner when a "return on its face provide[d] no clue to the existence of the omitted item."[86]

Both the government and taxpayers have raised these competing arguments in a number of federal courts, with varying results. Some courts have held that *Colony's* reasoning that an overstatement of basis is not an omission from gross income does not apply to cases involving § 6501.[87] Others found differently.[88] The debate continued even after the IRS attempted to curb the use of Son of BOSS tax shelters in year 2000 with its I.R.C. Notice 2000-44.[89]

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85. *Phinney*, 392 F.2d at 683.

86. Colony, Inc. v. Comm'r, 357 U.S. 28, 36 (1958). *See also CC & F W. Operations Ltd. P'ship*, 273 F.3d at 408 (ruling against plaintiff who argued that an increase in basis sufficiently alerts the Commissioner to omitted items).

87. *See, e.g.*, Beard v. Comm'r, 633 F.3d 616, 620 (7th Cir. 2011) ("Colony's holding is inherently qualified by the facts of the case before the Court, facts which differ from our case, where the Beards' omission was not in the course of trade or business."), *vacated*, 132 S. Ct. 2099 (2012); Cardinal Life Ins. Co. v. United States, 425 F.2d 1328, 1329 (5th Cir. 1970) (holding there is an omission of gross income if the statement in the return is not "adequate to apprise the government of the nature and amount of such item.").

88. *See, e.g.*, *Salman*, 573 F.3d at 1373 ("We recognize that the Supreme Court in *Colony* did not purport to interpret I.R.C. § 6501(e)(1)(A). In our view, however, several considerations weigh in favor of extending the *Colony* interpretation."); Bakersfield Energy Partners v. Comm'r, 568 F.3d 767, 771 (9th Cir. 2009) (holding *Colony* applied because the language from § 275(c) was virtually identical to the language in § 6501(e)); *CC & F W. Operations Ltd. P'ship*, 273 F.3d at 407 (following *Colony* but clarifying that the "clue test" is a much stiffer test than most circuits normally apply); Ketchum v. Comm'r, 697 F.2d 466, 473 (2d Cir. 1982) (reasoning that because the taxpayer made adequate disclosure in his return, the amounts included could not be taken into account in determining an amount omitted from gross income); Benderoff v. United States, 398 F.2d 132, 136 (8th Cir. 1968) ("The proper test thus appears to be whether the return provides a clue as to the omitted item."); Brandon Ridge Partners v. United States, 2007 U.S. Dist. LEXIS 54922, at *27–28 (M.D. Fla. July 30, 2007) (applying the adequate disclosure test from *Colony* to determine that the partnership had not disclosed enough information to limit the statute of limitations to only three years); George Edward Quick Trust v. Comm'r, 54 T.C. 1336, 1347 (1970) (deciding in favor of the taxpayer who provided the Commissioner with enough of a "clue" to become aware of the existence of an error in the tax return).

89. *Compare Beard*, 633 F.3d at 620 ("Colony's holding is inherently qualified by the facts of the case before the Court, facts which differ from our case, where the Beards' omission was not in the course of trade or business."), *vacated*, 132 S. Ct. 2099 (2012), *with Salman*, 573 F.3d at 1373 ("We recognize that the Supreme Court in *Colony* did not purport to interpret I.R.C. § 6501(e)(1)(A).").

C. Level of Deference to Give IRS Regulations Issued During Pending Litigation

The debate between circuits over whether and how to apply *Colony* to inflated basis cases effectively ended with the Supreme Court's recent decision to apply *Colony* to overstatement of basis cases in *United States v. Home Concrete & Supply*.[90] Although the Supreme Court resolved the issue of whether *Colony* applies to overstatement of basis cases, albeit incorrectly,[91] courts might find it difficult to determine when and how to apply IRS regulations to similar cases in the future.

Between 2009 and 2010, the few courts relying on *Colony* as precedent had determined the extended statute of limitations did not apply to Son of BOSS cases.[92] While a number of similar cases were waiting to go up on appeal, the IRS issued Temporary Treasury Regulation § 301.6501(e)-1T(b).[93] On December 14, 2010, after the notice and comment period, the regulation was made final.[94] The regulation "define[s] 'omission from gross income' as including 'an understated amount of gross income resulting from an overstatement . . . of basis for purposes of sections 6501(e)(1)(A) and 6229(c)(2).'"[95] The regulation essentially limited *Colony's* holding to trade or business contexts and ensured that the six-year statute of limitations would apply in all Son of BOSS cases.

Chevron v. NRDC[96] gives the framework for determining whether a court should grant deference to an agency regulation.[97] When confronted with the question of whether to grant deference to a particular regulation, a court must ask first "whether Congress has directly spoken to the precise question at issue."[98] If the statute is clear as to Congress's intent, the court should apply Congress's interpretation of the statute, and that will typically be the end of the matter.[99] However, if Congress did not speak directly to the precise question at issue, the court should determine "whether the agency's [interpretation of the statute] is based on a permissible construction of the statute."[100]

90. 132 S. Ct. 1836 (2012).
91. *See infra* section IV.A.
92. *See, e.g.*, Burks v. United States, 2008 U.S. Dist. LEXIS 109876 (N.D. Tex. June 13, 2008), *rev'd*, 633 F.3d 347 (5th Cir. 2011); Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 134 T.C. 211 (2010), *rev'd*, 650 F.3d 691 (D.C. Cir. 2011), *vacated*, 132 S. Ct. 2120 (2012).
93. *Intermountain Ins. Serv.*, 650 F.3d at 700.
94. *Burks*, 633 F.3d at 359.
95. *Id.* (citing Treas. Reg. § 301.6501(e)-1(a)(1)(iii) (2010)).
96. 467 U.S. 837 (1984).
97. *Id.*
98. *Id.* at 842.
99. *Id.*
100. *Id.* at 843.

The Court provided clarification in *National Cable & Telecommunications Ass'n v. Brand X Internet Service*[101] about how to apply *Chevron* in a case where a previous court has already interpreted an ambiguous statute before an agency issues a regulation.[102] "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute."[103] This reading is justified by the idea that when Congress leaves an ambiguity in a statute, it means for the agency to correct that ambiguity when it implements regulations that flow therefrom.[104] The Court in *Home Concrete* conceded that the Court in *Colony* determined § 275(c) was ambiguous.[105] However, instead of granting the agency deference, as *Brand X* would have required for normal pre-*Chevron* decisions, the *Home Concrete* Court added another stipulation to *Chevron*. According to the Court in *Home Concrete*, if a pre-*Chevron* Court decision is based on an *ambiguous* statute, instead of granting agency discretion as *Chevron* requires, a deciding court must ask whether Congress wanted "*the particular ambiguity in question*" to be resolved by the agency.[106] By including that stipulation, the *Home Concrete* Court unnecessarily added more complication to an already complex *Chevron* analysis.[107]

III. *UNITED STATES v. HOME CONCRETE & SUPPLY, LLC*

During the 1990s, before the IRS released Notice 2000-44, partnerships often took advantage of Son of BOSS tax shelters to avoid federal tax obligations on capital gains from the sale of a business or other appreciated assets.[108] One such Son of BOSS shelter involves transferring capital assets into a partnership to increase the basis in the partnership.[109] After the asset has lost value, the taxpayer then sells the partnership or the asset, reporting a loss on the sale.[110] Stephen R. Chandler and Robert L. Pierce carried out a similar transaction in *Home Concrete & Supply, LLC. v. United States*.[111]

101. 545 U.S. 967 (2005).
102. *Id.*
103. *Id.* at 982.
104. *Id.* (citing Smiley v. Citibank, 517 U.S. 735, 740–41 (1996)).
105. United States v. Home Concrete & Supply, 132 S. Ct. 1836, 1842 (2012).
106. *Id.* at 1847 (Scalia, J., concurring) (emphasis added).
107. *See infra* section IV.B.
108. John D. McKinnon, *IRS Loses Tax-Shelter Case*, WALL ST. J., Apr. 25, 2012, *available at* http://online.wsj.com/article/SB10001424052702303990604577366312132335038.html.
109. *See* Home Concrete & Supply, LLC. v. United States, 599 F. Supp. 2d 678, 681–82 (E.D.N.C. 2008), *rev'd*, 634 F.3d, 249 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012).
110. *See id.*
111. *Id.*

A. The Facts

Home Concrete & Supply, LLC was a limited liability company formed on April 15, 1999, as a pass-through entity for tax purposes.[112] The sole shareholders were Pierce, Chandler, and a corporation they owned called Home Oil and Coal Company, Inc.[113] Pierce indicated to his accountants, Arthur Andersen LLP (Andersen) and Jenkens & Gilchrist, P.C. (Jenkens), that he was interested in selling his share in Home Oil, and they counseled Pierce and Chandler to form Home Concrete as a means of avoiding difficult federal tax obligations on capital gains from the sale of the business interest.[114]

After forming the LLC, Chandler, Pierce, and Home Oil initiated short sales of United States Treasury Bonds on May 13, 1999.[115] A short sale involves "the sale of a security that the seller does not own or has not contracted for at the time of sale, and that the seller must borrow to make delivery."[116] With regard to the U.S. Treasury Bonds, the parties in *Home Concrete* received proceeds of $7,472,405, which they transferred into Home Concrete as capital contributions.[117] By transferring the funds into Home Concrete, the capital contributions created "outside basis"[118] equal to the amount of contributions.[119] On May 18, 1999, Home Concrete closed the short sales by returning identical bonds that it purchased for $7,359,043.[120] Up to this point, the taxpayers had not done anything that would have alerted the Commissioner of a Son of BOSS transaction.

However, on June 11, 1999, and over the following week, Home Oil transferred its assets to Home Concrete in return for Chandler and Pierce's partnership interests in Home Concrete.[121] This essentially provided Home Oil with a large outside basis as a result of the previ-

112. Home Concrete & Supply, LLC v. United States, 634 F.3d 249, 251 (4th Cir. 2010), *aff'd*, 132 S. Ct. 1836 (2012). Jenkens and Gilchrist, the accounting firm under which Anderson LLP and Jenkens operated, closed while *Home Concrete* moved through the appeals process. Patrick Temple, *"Son of Boss" Crackdown Lands in Supreme Court*, REUTERS, Jan. 13, 2012, *available at* http://www.reuters.com/article/2012/01/13/us-usa-tax-court-idUSTRE80C1UC20120113. Two of the firm's partners were found guilty of tax fraud. *Id.*
113. *Home Concrete*, 634 F.3d at 251.
114. *Id.*
115. *Id.*
116. BLACK'S LAW DICTIONARY 1456 (9th ed. 2009). *See Home Concrete*, 634 F.3d at 251 n.1.
117. *Home Concrete*, 634 F.3d at 251.
118. Outside basis represents a partner's basis in the partnership itself. Whereas, the inside basis represents the partnership's basis in the assets in the partnership. *See, e.g.*, Sally Anne James, Comment, *Partnership Basis Adjustments and Allocations Following a Section 708 Deemed Liquidation and Recontribution*, 34 UCLA L. REV. 1905, 1905 (1987).
119. *Home Concrete*, 634 F.3d at 251.
120. *Id.*
121. *Id.* at 252.

ous short sale and previous partnership interests once held by the taxpayers, while leaving Home Concrete with assets it could sell. The partners sold Home Concrete's assets to a third-party purchaser on August 31, 1999, for $10,623,348, but on their April 2000 tax return, they only reported a gain of $69,125.08 from the sale.[122] They managed to achieve such a small amount of gain by electing to "step up" Home Concrete's "inside basis under 26 U.S.C. (I.R.C.) § 754 to equal the taxpayers' outside bases."[123]

B. District and Appellate Court Proceedings

The IRS began looking into the transaction after it issued a summons to Jenkens & Gilchrist, P.C. on June 19, 2003.[124] After the investigation, the IRS issued a Final Partnership Administrative Adjustment (FPAA) on September 7, 2006, which essentially retroactively decreased the partners' outside bases in Home Concrete to zero at the time the assets were sold.[125] The IRS reasoned first that the partners formed Home Concrete as a sham to avoid federal taxes on capital gains and second that the shifting of partnership interests and assets between Home Oil and Home Concrete lacked economic substance.[126] To avoid further penalties, Home Concrete deposited $1,392,118 with the IRS and filed suit pursuant to I.R.C. §§ 6226(e)(1) and 6501 against the Commissioner in district court to recover that amount.[127]

Chandler, Pierce, their wives, and Home Oil (Plaintiffs) alleged the FPAA was time barred by the three-year statute of limitations under §§ 6229[128] and 6501.[129] In response, the IRS argued that a six-year statute of limitations applied pursuant to § 6501(e)(1)(A) because the plaintiffs "omitted" more than 25 percent of their income from their tax return.[130] Plaintiffs made a motion for judgment on the pleadings and the IRS made a motion for partial summary judgment, both of

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122. *Id.*
123. *Id.* (citing I.R.C. § 743(b)(1) (West 2004)).
124. *Id.*
125. *Id.*
126. *Id. See also* Gregory v. Helvering, 293 U.S. 465 (1935) (providing the framework for the economic substance doctrine requiring transactions to have a purpose besides tax evasion in order for the IRS to recognize them as legitimate transactions).
127. *Home Concrete*, 634 F.3d at 252–53. *See* Home Concrete & Supply, LLC v. United States, 599 F. Supp. 2d 678, 680 (E.D.N.C. 2008).
128. Section 6229(c)(2) includes virtually identical language to § 6501 but directs its language more specifically to partnerships. I.R.C. § 6229(c)(2) (1983) ("If any partnership omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) shall be applied by substituting '6 years' for '3 years.'")
129. *Home Concrete*, 599 F. Supp. 2d at 680.
130. *Id.*

which were denied.[131] The district court thereafter permitted limited discovery, and plaintiffs subsequently made a new motion for summary judgment, while the IRS countered with its own motion for partial summary judgment.[132]

In holding for the IRS, the district court first determined *Colony* did not apply and that an increase in basis like the one performed by plaintiffs was considered an omission of income.[133] In reaching that decision the district court first looked at the language of § 6501 and the statute interpreted in *Colony*, § 275(c).[134] The court reasoned that by adding subsection (i), Congress exempted trades or businesses from the six-year statute of limitations in § 6501(e)(1)(A).[135] The district court concluded Congress's purpose behind adding the subsection was not to be redundant, but instead, to include an exception for trades or businesses because of the likelihood they might make an accidental accounting mistake.[136]

After the district court determined that the taxpayers had in fact omitted over 25 percent of their income from the return and that the six-year statute of limitations applied, it then looked to whether the taxpayers' omission was nonetheless exempted under § 6501(e)(1)(B)(ii).[137] Section 6501(e)(1)(B)(ii) states that income that is adequately disclosed is not included in the calculation of omitted gross income.[138] After the district court asked the parties to prepare a brief regarding the issue of adequate disclosure, the court held in favor of the IRS, saying not only that the six-year statute of limitations applied, but also that plaintiffs were not exempted from their omissions under § 6501(e)(1)(B)(ii) because they did not "disclose the substance of the transaction that created the overstatement."[139]

On appeal, plaintiffs again argued that they did not omit an amount equaling more than 25 percent of their gross income.[140] They further argued that, even if they had omitted over 25 percent of their

131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.* at 684–85.
135. *Id.*
136. *Id.* at 680. "The *Colony* Court's declaration that section 275(c) is 'limited to situations in which specific receipts or accruals of income items are left out of the computation of gross income' makes eminent sense because The Colony, Inc. was a trade or business selling goods or services." *Id.* at 685 (quoting Salman Ranch, Ltd. v. United States, 79 Fed. Cl. 189 (2007)).
137. *Id.* at 688–90.
138. I.R.C. § 6501(e)(1)(B)(ii) (1954).
139. Home Concrete & Supply, LLC v. United States, No. 7:06-CV-181-FL, 2009 U.S. Dist. LEXIS 127250, at *21 (E.D.N.C. Mar. 9, 2009), *rev'd*, 634 F.3d 249 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012).
140. Home Concrete & Supply, LLC v. United States, 634 F.3d 249, 253 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012).

gross income, the omission was exempted because they disclosed the amount in the return adequately enough to alert the Commissioner of the omission.[141] During the pendency of the appeal, the IRS created another issue for the court to resolve by promulgating a temporary regulation on September 28, 2009.[142] This temporary regulation essentially interpreted § 6501 in favor of the IRS's position, and the IRS claimed it applied retroactively to the plaintiffs' case.[143]

The Fourth Circuit first reversed the district court by holding 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."[144] The court first determined that *Colony* should apply, despite the fact that the *Colony* transaction involved a trade or business and the *Home Concrete* transaction did not.[145] The court determined the regulations did not warrant *Chevron* deference because the Supreme Court already determined § 6501 was unambiguous and Congress left no room for the Treasury to interpret it.[146] Further, the court reasoned the regulations should not apply because they would essentially overturn the Supreme Court's interpretation in *Colony*.[147]

C. *Home Concrete* Reaches the Supreme Court

The IRS appealed the Fourth Circuit's decision and the Supreme Court granted certiorari.[148] The Supreme Court ultimately affirmed the Fourth Circuit's opinion and held that Congress did not grant the IRS the authority to interpret § 6501 any further than the statute itself and *Colony* already had.[149] At the time the Supreme Court decided to review the case, there were at least thirty other companies similar to Home Concrete that were waiting to learn if the IRS could be successful in suits that arise more than three years after they filed their returns.[150] The Supreme Court's ruling effectively eliminated

141. *Id.*
142. Temp. Treas. Reg. § 301.6501(e)-1T(a)(1)(iii) (2010).
143. *Home Concrete*, 634 F.3d at 255–56. The regulation promulgated by the IRS stated that "an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A)(i)." Temp. Treas. Reg. § 301.6501(e)-1T(a)(1)(iii).
144. *Home Concrete*, 634 F.3d at 255.
145. *Id.* at 255–57.
146. *Id.*
147. *Id.* at 257.
148. *See* United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012).
149. *Id.*
150. Patrick Temple-West, *Supreme Court Restrains IRS in Tax Shelter Case*, CHI. TRIB. (Apr. 25, 2012), http://articles.chicagotribune.com/2012-04-25/news/sns-rt-us-usa-tax-supreme-courtbre83o119-20120425_1_tax-shelter-case-son-of-boss-tax-irs.

the government's chances of collecting the over one billion dollars withheld by those thirty companies.[151]

In reaching its decision, the majority first analyzed the plain language and legislative history behind §§ 275(c) and 6501.[152] In analyzing the plain language of the statutes, the Court indicated that Congress clearly did not intend an increase of basis to be considered an omission.[153] It reasoned that if Congress had wanted the inflation of basis to be included under § 6501, it would have used words such as "reduces" or "understates," instead of "omits," to indicate something other than "'[t]o leave out or unmention[ ].'"[154] The Court further noted that congressional reports discussing the statute indicated Congress "merely had in mind failures to report particular income receipts and accruals, and did not intend the [extended] limitation to apply whenever gross income was understated."[155]

The Supreme Court then responded to concerns raised by the IRS, namely that Congress may have been redundant in providing for cases such as *Colony* in the operative paragraph of § 6501 and providing the same protection in § 6501(e)(1)(B)(i).[156] The Court first explained that Congress might have retained both clauses because it wanted to ensure that the decision in *Uptegrove Lumber Co. v. Commissioner* that did not include trade or business transactions in the definition of omission would remain the law.[157] Congress enacted § 6501 in 1954 and could not have known that a case such as *Colony* would come up shortly thereafter, in 1958. The Supreme Court also explained that, in addition to protecting trade or business transactions, § 6501 also provides the framework for calculating gross income.[158]

Finally, the majority looked at whether it should grant deference to the IRS regarding Treasury Regulation § 301.6501(e)-1.[159] The Court determined first that *Colony* already interpreted the statute[160] and next that Congress had never granted the IRS the authority to fill any

151. *Id.*
152. *Home Concrete*, 132 S. Ct. at 1839–41.
153. *Id.* at 1840 ("'Congress intended an exception to the usual three-year statute of limitations only in the restricted type of situation already described,' a situation that did not include overstatements of basis.").
154. *Id.* (quoting Colony, Inc. v. Comm'r, 357 U.S. 28, 32 (1958)).
155. *Id.* (citing Colony, Inc. v. Comm'r, 357 U.S. 28, 35 (1958)).
156. *Id.* at 1850.
157. *Id.* at 1841. *See also* Uptegrove Lumber Co. v. Comm'r, 204 F.2d 570 (3d Cir. 1953) (holding that because there is a good chance for taxpayers in the trade or business context to make arithmetic errors, there should be an exemption allowed under § 275(c) for those taxpayers). *But see* Reis v. Comm'r, 142 F.2d 900 (6th Cir. 1944) (applying the five-year statute of limitations to a business case).
158. *Home Concrete*, 132 S. Ct. at 1842.
159. *Id.* at 1842–44.
160. *Id.* at 1843.

gaps in § 6501 because of the unambiguous language of the statute.[161] Because the Court had already interpreted § 6501 in *Colony*, it reasoned that granting deference to a Treasury Regulation, which effectively overruled the *Colony* decision, would oppose the "principles of *stare decisis*."[162] Justice Scalia expanded on the majority's decision in his concurrence by explaining that, although he agreed with the majority's outcome, they should distance themselves from the holding in *Brand X* and instead hold that "[o]nce a court has decided upon its *de novo* construction of the statute, there no longer is a different construction that is consistent with the court's holding and available for adoption by the agency."[163]

Justice Kennedy, joined by Justices Ginsburg, Sotomayor, and Kagan, dissented.[164] The dissent opined that the Court should have granted deference to the IRS regarding its regulations because the *Colony* Court never interpreted the amendments to § 275(c) that showed up in § 6501.[165] Further, the dissent argued for a different interpretation of the *Uptegrove* decision than did the majority.[166] The dissent argued Congress may have included the § 6501(e)(1)(B)(i) language about trades or businesses to solidify its stance that any overstatement of basis should be considered an omission outside of that small trade or business context.[167] Finally, the dissent cited *Brand X* for support that an agency can issue its own interpretation of a statute even if the Court has already interpreted a statute created by Congress.[168]

IV. ANALYSIS

The Court in *Home Concrete* mistakenly relied on *Colony* as precedent for a case involving § 6501. Besides the fact that § 6501 contains a number of amendments made by Congress in 1954 to the original § 275(c),[169] there are other reasons the Court should not have relied on *Colony* as precedent. This Part addresses why the Court should

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161. *Id.* "The fact that a statute is unambiguous means that there is 'no gap for the agency to fill' and thus 'no room for agency discretion.'" *Id.* (citing Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982–83 (2005)).

162. *Id.* at 1844.

163. *Id.* at 1846 (Scalia, J., concurring) (citing Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 1017 n.12 (2005) (Scalia, J., dissenting)).

164. *Id.* at 1849.

165. *Id.* at 1850 (Kennedy, J., dissenting).

166. *Id.* at 1849.

167. *Id.*

168. *Id.* at 1851–52 ("[J]udicial construction of an ambiguous statute [does] not foreclose an agency's later, inconsistent interpretation of the same provision.") (citing Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982–83 (2005)).

169. *See supra* section II.B.

not have relied on *Colony* in making its decision in *Home Concrete* and further explains why the Court should have relied on Treasury Regulation § 301.6501(e)-1.

A. The *Home Concrete* Court Should Not Have Relied on *Colony* as Precedent

1. *Son of BOSS Transactions Are Still Considered Omissions From Gross Income Under § 275(c)*

Courts that have relied on *Colony* for Son of BOSS transactions after Congress enacted § 6501 focus on Justice Harlan's reference to § 6501 at the end of the decision: "[T]he conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A) of the Internal Revenue Code of 1954."[170] The reliance courts place on Justice Harlan's statement is misplaced and ignores the legislative history behind §§ 6501(e)(1)(A) and 275(c). Rather, Justice Harlan was likely referring to the two subsections in § 6501(e)(1)(A) granting exceptions to certain businesses and taxpayers who disclose omitted items on their returns.

By looking at the legislative intent behind § 275(c), it becomes clear that Congress has been concerned since as early as 1934 with transactions such as Son of BOSS that have no economic substance and constitute an omission of a large *amount* of gross income from a return. Before enacting § 275(c) in 1934, Congress was interested in extending the three-year limitation to five years to assess tax returns of taxpayers who omitted more than 25 percent of their income from their returns.[171] Congress noted that prior to 1934 the IRS was permitted to assess the tax without regard to the statute of limitations in the case of a failure to file a return or in the case of a fraudulent return.[172] Extending the statute of limitations to curb abuses amounting to large amounts of income was a natural extension of that previous law.[173] Members of Congress also noted that extending the limitations period might prove unfair to taxpayers who make an "honest mistake" in filing a tax return.[174] *Colony* clarified that an "honest

170. Colony v. Comm'r, 357 U.S. 28, 37 (1958). *See* Burks v. United States, 633 F.3d 347, 352–53 (5th Cir. 2011); Bakersfield Energy Partners, LP v. Comm'r, 568 F.3d 767, 778 (9th Cir. 2009); Salman Ranch Ltd. v. United States, 573 F.3d 1362, 1373 (Fed. Cir. 2009); Bakersfield Energy Partners, LP v. Comm'r, 128 T.C. 207, 212–13 (2007).

171. H.R. REP. NO. 73-704, at 35 (1934), *reprinted in* J. S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 390 (2003).

172. *Id.*

173. *Id.* Note that Congress used the word "amount" as opposed to "item," alluding to Congress's intent to extend the statute of limitations when an amount over 25 percent of gross income is not included in a tax return. *Id.*

174. J. S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 391 (2003) (statement of Samuel B. Hill).

mistake" might include "errors in . . . computation," such as the miscalculation of cost of goods sold.[175] Finally, Congress hoped to make the Commissioner aware of possible abusive transactions that lacked economic substance.[176] In fact, *Colony* based its decision on that premise.[177]

Unfortunately, Congress failed to codify all of its concerns in § 275(c). After the statute was adopted, courts began to question its application.[178] For example, shortly before Congress amended § 275(c), the Supreme Court looked at whether the five-year statute of limitations should apply to a taxpayer who improperly calculated his cost of goods sold.[179] The IRS, with support from the tax court, argued "the language 'omits from gross income any amount properly includible therein' should be construed broadly" to include any understatement of gross income.[180] The taxpayer argued that § 275(c) should only apply when an individual leaves an "item" off the return.[181] The Court ultimately sided with the taxpayer,[182] which satisfied Congress's concern about prosecuting a taxpayer who makes an "honest mistake" on a return in a trade or business context.[183]

Perhaps to ensure future courts followed the decision in *Uptegrove*, Congress included subsections (i) and (ii) in § 6501(e)(1)(A).[184] These new sections essentially limit *Uptegrove*'s favorable decision for the taxpayer to misstatements of basis in the trade or business context.[185] Subsection (i) provides an exception to § 6501(e)(1)(A) that allows trades or businesses to calculate their "gross income" by looking at the amount received from the sale of goods or services before subtracting the cost of goods sold.[186] This was a logical means of protecting trades and businesses involved in calculating inventory costs. Justice Kennedy noted that there are "unique complexities involved in calculating inventory costs," making it unfair to extend the statute of limitations

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175. *Colony*, 357 U.S. at 33.
176. *Statute of Limitations, Assessment and Collection of Taxes and Penalties: Hearing Before the H. Comm. On Ways and Means*, 83d Cong. 1354 (1953) (statement of H. Ober Hess, Chairman, Fed. Tax Comm., Taxation Section, Pa. Bar Ass'n).
177. *Colony*, 357 U.S. at 36 ("Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors.").
178. *See supra* section II.A.
179. Uptegrove Lumber Co. v. Comm'r, 204 F.2d 570, 571 (3d. Cir. 1953).
180. *Id.* (quoting I.R.C. § 275(c) (1934)).
181. *Id.*
182. *Id.* at 573.
183. *Id.*
184. *See* United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836, 1850 (2012) (Kennedy, J., dissenting).
185. *Id.*
186. I.R.C. § 6501(e)(1)(A)(i) (1958).

period for a mistake in calculation at these firms.[187] In fact, although § 275(c) did not expressly grant a business exception, as § 6501 does, *Colony* reached its decision by looking at legislative history showing that Congress intended for these difficult business calculations to be exempt.[188]

Congress also provided for its concern that the IRS should have enough time to investigate *improper* returns that are not improper on their face. Congress granted the IRS six years to prosecute taxpayers who improperly show a high basis on their returns.[189] To provide an escape for taxpayers who knowingly but not improperly increase their bases, Congress also granted an exception to the six-year statute of limitations period for taxpayers who disclose *specific amounts* on their returns that lead to an inflated basis.[190]

By granting these special exceptions in § 6501, Congress did not limit the reach of the statute's main operative clause. The legislative history indicates that when Congress passed § 6501, it was still concerned about taxpayers failing to report over 25 percent of their income.[191] Further, the fact that the circuit courts were having to correct the tax court and district courts,[192] made it more important for Congress to clarify that it intended § 6501 to grant the IRS extra time to prosecute taxpayers who were failing to report income.

2. *Congress's Intent to Prosecute Son of BOSS Transactions After Three Years Is Clear*

Not only does the legislative history behind §§ 275(c) and 6501 indicate that Congress intended for inflation of basis to fall under the definition of "omission of an amount from gross income,"[193] but the language from § 6501 shows that intent, as well. In addition to providing two new subsections to § 275(c), Congress also extended the length of the statute of limitations from five to six years.[194] At the time § 6501 was passed, the statute of limitations for many criminal offenses was five years.[195] To extend the statute of limitations longer

187. *Home Concrete*, 132 S. Ct. at 1850 (Kennedy, J., dissenting) (citing O. WHITTINGTON & K. PANY, PRINCIPLES OF AUDITING AND OTHER ASSURANCE SERVICES 488 (15th ed. 2006)).
188. *See* Colony v. Comm'r, 357 U.S. 28, 34 (1958).
189. I.R.C. § 6501(e)(1)(A)(ii)(II).
190. Salman Ranch Ltd. v. United States, 573 F.3d 1362, 1372 (Fed. Cir. 2009).
191. H.R. REP. NO. 73-704, *supra* note 171, at 390.
192. *See, e.g.*, Uptegrove Lumber Co. v. Comm'r, 204 F.2d 570 (3d. Cir.1953); Reis v. Comm'r, 142 F.2d 900 (6th Cir. 1944).
193. *See supra* subsection IV.A.1.
194. I.R.C. § 6501(e)(1)(A)(ii)(II).
195. *Statute of Limitations, Assessment and Collection of Taxes and Penalties: Hearing Before the H. Comm. On Ways and Means*, 83d Cong. 1347 (1953) (statement of Clarence O. Schlegel, Secretary-Treasurer, Reliable Bldg. & Loan Assoc., Clay City, Ind.).

than three years for the IRS to review tax returns indicates Congress felt there was something more serious than accounting mistakes going on—something that needed to be stopped.[196] Most courts that research the legislative history behind §§ 6501 and 275(c) posit Congress was concerned about prosecuting taxpayers for transactions that lack economic substance.[197]

The term "economic substance" refers to "an objective and subjective determination of whether a transaction has real, non-tax economic benefit."[198] The fact that a transaction is solely tax-motivated does not necessarily mean that it lacks economic substance;[199] however, a Son of BOSS transaction is normally both solely tax-motivated and lacking in economic substance.[200] Indeed, the taxpayer in *Home Concrete* did not even know he wanted to create a new entity and transfer assets until after he talked to his accountants about his desire to sell his share in the Home Concrete partnership.[201] The transaction in *Home Concrete* lacked economic substance and was exactly the type of transaction Congress was trying to prevent by its initial enactment of § 275(c) and its subsequent modifications to it in § 6501.

Perhaps more importantly than extending the statute of limitations by a year, Congress purposefully did not change the phrase "omits from gross income an *amount*" to "omits from gross income an *item*."[202] At the same time that Congress chose the word "amount" for the operative clause of § 6501, it used the word "item" in another clause of the same statute.[203] In § 6501(e)(2), Congress allowed for an extended limitations period in cases where taxpayers left omitted "items" from an estate or gift tax return.[204] Congress's decision to use "amount" as opposed to "item" in the operative clause supports the idea that Congress was not solely concerned about a taxpayer leaving an item off of his or her tax return. Instead, "amount" captures any transaction that affects the amount of gross income reported on the

196. *See id.*

197. *See, e.g.*, Salman Ranch Ltd. v. United States, 573 F.3d 1362, 1381–82 (Fed. Cir. 2009) ("Transactions that are economically meaningless in the context for which tax benefits are claimed are not, by virtue of the Court's holding in *Colony*, validated by simply designating the costs as 'basis' for unrelated property." (citing Kornman & Assocs. v. United States, 527 F.3d 443, 456, 462 (5th Cir. 2008))).

198. Yoram Keinan, *The Many Faces of the Economic Substance's Two-Prong Test: Time for Reconciliation?*, 1 N.Y.U. J.L. & BUS. 371, 372 (2005) (citing David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW. 235 (1999)).

199. *Id.*

200. *Salman Ranch*, 573 F.3d at 1382.

201. Home Concrete & Supply, LLC v. United States, 634 F.3d 249, 251 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012).

202. *See* Russello v. United States, 464 U.S. 16, 23 (1983).

203. I.R.C. § 6501(e)(2) (1958).

204. *Id.*

return. Inflating basis can diminish the amount of gain from a transaction, just like omitting an item can do.

B. Courts Should Grant Deference to Treasury Regulation § 301.6501

1. The Operative Language in §§ 275(c) and 6501 Is Ambiguous, and the IRS Provided a Permissible Construction of These Regulations

Even if a court concludes it is unclear whether Congress intended Son of BOSS transactions to fall within the operative language of § 6501, the *Home Concrete* decision improperly precludes that court from applying Treasury Regulation § 301.6501 to Son of BOSS cases. The Supreme Court in *Chevron* provided a two-step method for determining whether a court should grant deference to an agency regulation over a court decision.[205] First, a court must ask "whether Congress has directly spoken to the precise question at issue.[206] If the intent of Congress is clear, that is the end of the matter."[207] If Congress's intent is not clear or the statute is ambiguous, it can be inferred that Congress granted interpretive authority to an agency.[208] If Congress granted interpretive authority, a court then proceeds to *Chevron's second* step, which asks "whether the agency's answer is based on a permissible construction of the statute."[209]

The Court incorrectly applied *Chevron* to its decision in *Home Concrete*. Arguably, Congress's intent behind §§ 275(c) and 6501 was fairly clear.[210] However, courts split regarding how broadly the operative clause in those statutes should be interpreted.[211] This supports the idea that there was at least some ambiguity in the statutes that Congress had left open for the IRS to interpret. Indeed, the Court in *Colony* even admitted that § 275(c) was ambiguous.[212]

Because § 275(c) was ambiguous, *Chevron* should have required the *Home Concrete* Court proceed to step two and determine "whether the agency's answer [was] based on a permissible construction of the statute."[213] Had the Court deferred to the IRS regulation, it likely would have held the IRS's interpretation of §§ 6501 and 275(c) was

205. Chevron, U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984).
206. *Id.*
207. *Id.*
208. *Id.*
209. *Id.* at 843.
210. *See infra* section IV.A.
211. *See supra* section II.A.
212. Colony v. Comm'r, 357 U.S. 28, 33 (1958) ("[I]t cannot be said that the language is unambiguous.").
213. *Chevron*, 467 U.S. at 843.

reasonable.[214] Indeed, as noted above, the legislative history clearly suggests Congress wanted to include an overstatement of basis within the statute's scope.[215] However, instead of asking whether the IRS regulation was a permissible construction of the statute, the Court in *Home Concrete* improperly never moved on to *Chevron's* second step.

2. Home Concrete *Decision Further Complicates* Chevron *Analysis*

To avoid passing to *Chevron's* second step, the Court determined that, in addition to *Chevron*, the *Brand X* test should apply to cases that occurred before *Chevron* was decided.[216] The *Brand X* test allows a judicial construction of a statute to trump an agency's interpretation "otherwise entitled to *Chevron* deference *[o]nly if* the prior court decision holds that its construction follows from the *unambiguous* terms of the statute."[217] Even though Justice Harlan indicated that the statute was *ambiguous*, the *Home Concrete* Court still determined that the *Colony* decision was derived from the *unambiguous* terms of the statute.[218] The Court in *Home Concrete* reasoned that Courts such as *Colony* "had no inkling that [they] *must* utter the magic words 'ambiguous' or 'unambiguous'" and therefore, decisions to move to *Chevron* step two should not be based on whether the Court uses those words.[219]

Justice Scalia's concurring opinion in *Home Concrete* suggests that the majority's opinion fails to harmonize the *Brand X* and *Colony* decisions.[220] Indeed, by relying on both *Chevron* and *Brand X* as precedent, the Court requires future courts to assume that ambiguities in pre-*Chevron* statutes do not equate to Congress delegating gap-filling authority to agencies, while a finding of ambiguity in post-*Chevron* statutes automatically means Congress delegated gap-filling authority to agencies.[221] Under *Home Concrete*, to determine if Congress did grant authority to an agency to interpret a pre-*Chevron* ambiguous statute, not only does a court need to find that the statute is ambiguous, but the court must also determine whether "Congress wanted *the particular ambiguity in question* to be resolved by the agency."[222]

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214. Intermountain Ins. Serv. of Vail v. Comm'r, 650 F.3d 691, 705–06 (D.C. Cir. 2011), *vacated*, 132 S. Ct. 2120 (2012).
215. *See supra* section IV.A.
216. Home Concrete & Supply, LLC v. United States, 132 S. Ct. 1836, 1846 (2012) (Scalia, J., concurring).
217. Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005) (emphasis added).
218. *Home Concrete*, 132 S. Ct. at 1846 (Scalia, J., concurring).
219. *Id.*
220. *Id.* at 1846–48.
221. *Id.* at 1847.
222. *Id.*

The question *Chevron* requires courts to ask is not whether Congress wanted a particular ambiguity in a statute resolved by an agency, but whether the agency's interpretation of the statute is a permissible construction.[223] To solve the problem *Home Concrete* had in relying on both *Colony* and *Brand X*, the Court had two different options. First, the Court could have determined that Harlan's reference to § 6501 as unambiguous and § 275(c) as ambiguous only referred to the ambiguity in the statutes with regard to trades or businesses. Indeed, *Colony* itself can be considered a business transaction case. In *Colony*, the taxpayer's miscalculation of the basis in his land resulted in a deficiency in the amount of income he reported on his return.[224] *Home Concrete*, on the other hand, involved a complex Son of BOSS transaction.[225] The ambiguity regarding trades or businesses and miscalculations of costs of goods sold was an ambiguity that was resolved by *Colony*. The question of whether a Son of BOSS transaction specifically should be considered an omission from gross income was an ambiguity that *Colony* did not necessarily answer for either § 275(c) or § 6501.

The second option the Court had in *Home Concrete* was to overrule *Brand X* and grant deference to courts like *Colony* that interpret a statute before an agency has the opportunity.[226] Scalia argues that by distancing itself from *Brand X*, the Court would make the application of *Chevron* to pre-*Chevron* statutes more clear.[227] By overruling *Brand X*, "there no longer [would be] a different construction [of a statute] available for adoption by [an] agency" after a court like *Colony* interprets an ambiguity.[228]

Ultimately, the *Home Concrete* Court acquiesced that § 275(c) was ambiguous with regard to the question of whether an inflated basis constitutes an omission from gross income.[229] A strict interpretation of *Chevron* would have required the Court to grant deference to the IRS regulations. Even if the Court chose not to grant deference to the regulations with regard to § 275(c), the Court should have granted deference because the regulations interpreted ambiguities involved in § 6501, which the Court did not directly interpret *in Colony* and which was the actual statute at issue in *Home Concrete*.

223. Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843 (1984).
224. Colony v. Comm'r, 357 U.S. 28, 30 (1958).
225. *Home Concrete*, 132 S. Ct. at 1836.
226. *Id.* at 1848 (Scalia, J., concurring).
227. *Id.* at 1846–48.
228. *Id.* at 1846.
229. *Id.* at 1840; Colony, Inc. v. Comm'r, 357 U.S. 28, 33 (1958).

V. CONCLUSION

Since Congress first introduced § 275(c) into the Internal Revenue Code in 1934, courts have struggled to find the meaning behind the language "omits from gross income an amount."[230] However, Congress has always made it clear that its purpose behind the statute was to give the IRS more time to prosecute taxpayers who omit large amounts of income from their tax returns by carrying out transactions with no economic substance.[231] In searching for taxpayers who violated § 275(c), Congress also noted that the IRS should be careful not to prosecute taxpayers who mistakenly over calculate the cost of goods sold in business transactions.[232] Modern courts like the *Home Concrete* Court mistakenly believe that *Colony* involved a transaction similar to a Son of BOSS transaction. This has led many courts to rely on *Colony* as if it is the immortalization of the 1934 and 1954 Congress's mind in creating § 275(c) and § 6501.

Relying on *Colony* for Son of BOSS cases is similar to Hobbs batting with his broken "Wonderboy" bat. *Colony* was helpful in illustrating the exception that Congress intended for businesses and trades in § 275(c). However, the *Colony* Court never interpreted the statute applicable to the current § 6501. Because § 6501 was somewhat ambiguous with regard to the question of whether Son of BOSS transactions constitute an omission of gross income, the *Home Concrete* Court should have relied on the IRS's interpretation of the statute. Indeed, *Chevron* required that the Court rely on the IRS's interpretation.[233] Instead, the *Home Concrete* Court muddied the waters for future courts by creating new steps to follow in determining whether an agency should be granted deference in its regulations. Had the Court instead relied on its batboy and his "Savoy Special," the IRS and its regulation, courts would have a clearer idea of which transactions constitute omissions from gross income and when to grant deference to IRS regulations enacted during pending litigation.

230. I.R.C. § 6501(e)(1)(A) (1954).
231. *See supra* section IV.A.
232. *See supra* section IV.A.
233. *See supra* section IV.B.