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D.C. Circuit Upholds Extended Limitations Period in Intermountain

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The IRS added to its growing tally of judicial wins in the long-running fight over an extended statute of limitations period for tax returns containing overstated basis items, with the U.S. Court of Appeals for the District of Columbia issuing an opinion June 21 that reverses the Tax Court and holds that basis overstatement constitutes omission from gross income.

In *Intermountain Insurance Service of Vail LLC et al. v. Commissioner*, the D.C. Circuit concluded that the "Commissioner's regulations were validly promulgated, apply to this case, qualify for *Chevron* deference, and pass muster under the traditional *Chevron* two-step framework." That contradicts the Tax Court's grant of summary judgment to Intermountain after finding the extended limitations period inapplicable and holding the temporary regulations invalid. (For the opinion, No. 10-1204, see *Doc 2011-13510*. For the Tax Court's opinion in *Intermountain*, 134 T.C. No. 11 (May 6, 2010), see *Doc 2010-10163* or *2010 TNT 88-12*.)

The D.C. Circuit acknowledged the concern that its opinion would apply to all taxpayers with returns having overstated basis, despite the son-of-BOSS tax shelter involved in the case. Reviewing the text of section 6501(e)(1)(A) from the 1954 code and its predecessor in the 1939 code, which the Supreme Court analyzed in *Colony v. Commissioner*, 357 U.S. 28 (1958), the circuit court held that Congress intended to make some textual changes that rendered *Colony* inapplicable. "We cannot simply assume that the Congress that enacted section 6501(e)(1)(A) understood the phrase 'omits from gross income' in the same way as the Congress that originally enacted section 275(c)," the court wrote. Thus, *Colony*'s interpretation of the pre-1954 statute doesn't necessarily apply "post-1954, post-reenactment," the court said.

The addition of subsection (i) to section 6501(e)(1)(A) in the 1954 code addresses overstated basis only in the context of trades and businesses, leaving instances of omission beyond the scope of subsection (i), the circuit court held. Consequently, both the IRS and Intermountain posited reasonable interpretations of the statute, but in the end "we think the Commissioner's reading quite possibly better," the court wrote. "Congress does not add provisions that simply replicate what the statute already does."

The continuing ambiguity of section 6501(e)(1)(A) does not foreclose the IRS from interpreting omissions from gross income as including basis overstatements, the circuit panel concluded.

Intermountain argued that the IRS's litigation posture drove its regulation position, but the D.C. Circuit held that whether "the agency promulgating the regulation is a party in the very case that prompted the regulation" is irrelevant to *Chevron* analysis.

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Responding to the argument that the IRS's statute of limitations regulation does not deserve deference because it interprets a general legal concept not needing Treasury expertise, the circuit court observed that the regulations establish a "complex administrative system for assessing tax deficiencies" that could be best handled by the IRS. Although Treasury developed a "fairly cryptic applicability provision" in the regs, the court granted a high level of deference to the IRS, particularly because "the Commissioner intended from the moment these regulations issued to apply them to cases pending" as of the chosen effective date, the court said.

The D.C. Circuit remanded the case to the Tax Court for a determination consistent with its opinion, as well as consideration of Intermountain's alternative argument that the extended limitations period was not triggered because it adequately disclosed its tax bases on its tax return.

Patrick J. Smith of Ivins, Phillips & Barker called the circuit's decision "the best-crafted opinion" of the cases so far decided on the section 6501 regs. "The D.C. Circuit does a good job supporting the interpretation they arrive at, even if I still disagree with that conclusion," he said. The court was mistaken to interpret the gross receipts test in the 1954 code as being at odds with *Colony*'s analysis of the old statute, he said.

Alan I. Horowitz of Miller & Chevalier told Tax Analysts that "by providing a more detailed analysis of the background of the *Colony* decision and the legislative history of the 1954 Code provision, the D.C. Circuit's opinion supplements the reasoning of the other court of appeals cases that have agreed with the government that *Colony* does not unambiguously resolve the issue."

Robert E. McKenzie of Arnstein & Lehr LLP, who represented the *Beard* taxpayers in the Seventh Circuit, said his clients would be seeking certiorari. "The issue will only be resolved with a Supreme Court decision," he said. (For *Beard v. Commissioner*, No. 09-3741 (7th Cir. Jan. 26, 2011), see *Doc 2011-1764* or *2011 TNT 18-10*.)

Partner's Limitations Period

In a companion case, the same panel of D.C. Circuit judges held that the six-year limitations period applied because of overstated basis on a partnership's tax return, but determined that a final partnership administrative adjustment tolled an individual partner's limitations period under section 6501. (For *UTAM, Ltd. v. Commissioner*, No. 10-1262, see *Doc 2011-13514*.)

The court looked at the interaction of the section 6229 minimum limitations period for partnership returns with the section 6501 period for individual partners. Citing the Tax Court's prior opinion in *Rhone-Poulenc*, the circuit court said that section 6229 "suspends the running of an individual partner's 6501 limitations period when that period is open on the date the IRS mailed the FPAA." (For *Rhone-Poulenc Surfactants and Specialties, L.P., et al. v. Commissioner*, 114 T.C. No. 34 (2000), see *Doc 2000-17996* or *2000 TNT 127-13*.)

The court followed its precedent in *Andantech, LLC v. Commissioner*, 331 F.3d 927 (2003), in which it held that section 6229(a) did not provide a maximum assessment

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period. A different interpretation would "be converting the minimum period in many cases into a limitation period, in contravention of the premise of *Andantech*," the court wrote. "We therefore hold that the assessment period suspended pursuant to [section] 6229(d) is the partner's open assessment period under [section] 6501."

George M. Clarke III of Miller & Chevalier said the *UTAM* decision was important in showing that courts "may have boxed themselves in" with their section 6229 jurisprudence. If section 6229(a) is a "minimum period" as held by *UTAM*, *AD Global*, and *Rhone-Poulenc*, the issuance of an FPAA "triggers section 6229(d) to extend only that same minimum period," he said. After all, under all of these decisions, the minimum period is apparently the only period that, in the language of section 6229(d), is "specified in subsection (a)," he said. "If this is correct, then there is no section anywhere in the Code that provides for the issuance of an FPAA to extend the section 6501(a) period itself since all the courts have said that section 6229(a) merely specifies a minimum period."

If the partnership minimum period is already closed when the FPAA is issued, the FPAA cannot extend anything, Clarke said. The problem "is caused by viewing section 6229(a) as the minimum period as opposed to the period of limitations for assessment of partnership items and is a problem in statutory construction that should have been resolved prior to the courts all staking out their positions that section 6229(a) plainly is a minimum period," he said. "There is nothing whatsoever plain" about the meaning of the partnership provisions **of** the Tax Equity and Fiscal Responsibility Act of 1982, he added.

Mark D. Allison of Caplin & Drysdale told Tax Analysts that "the decisions further drive a wedge in the circuit split on the overstatement of basis issue and will no doubt give the IRS additional confidence in their use of retroactive-type regulations to bolster its litigation tactics." The regulations seem unclear as to whether they really changed the definition of gross income or the phrase "omission from gross income," which "makes a potentially significant difference in the impact and interpretation of the regulations," he said. (For a special report by Allison, see *Doc 2010-3180* or *2010 TNT 45-4*.)

Josh O. Ungerman of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP said that even with a number of circuits already addressing the overstated basis issue, the D.C. Circuit's opinions are not necessarily controlling in other Tax Court cases. And despite the adverse rulings in the D.C. Circuit, "taxpayers still have the arrow of adequate disclosure in their quiver," he said.

The D.C. Circuit "merely adds to the already existing split in the circuit courts that will drive the six-year statute omission issue back to the Supreme Court," Ungerman said. "Once cert is granted, the Supreme Court can choose to apply its *Colony* analysis to the present-day version of the statute," he said. "Regardless of the D.C. Circuit's treatment of the Tax Court decision in *Intermountain*, the Supreme Court may still choose to follow the Tax Court's analysis of the current version of the six-year statute."