



Tax Reduction Letter

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Treasury Decision 9466

DATE: September 28, 2009

ACTION: Final and temporary regulation.

SUMMARY: This document contains temporary regulations (replacing an existing final regulation) defining an omission from gross income for purposes of the six-year minimum period for assessment of tax attributable to partnership items and the six-year period for assessing tax. The temporary regulations resolve a continuing issue as to whether an overstatement of basis in a sold asset results in an omission from gross income. The regulations will affect any taxpayer who overstates basis in a sold asset creating an omission from gross income exceeding twenty-five percent of the income stated in the return. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the Federal Register .

EFFECTIVE DATE: Effective date: These regulations are effective on September 24, 2009.

Applicability date: The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

FOR FURTHER INFORMATION CONTACT: William A. Heard III at (202) 622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

These temporary regulations amend the Procedure and Administration Regulations (26 CFR part 301) relating to sections 6229(c)(2) and 6501(e). Section 6229(c)(2) provides that if a 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, the minimum period for assessing tax attributable to its partnership items is extended to six years. The quoted language is identical to language used in section 6501(e). An omission from gross income is not further defined in section 6229(c) as it is in section 6501(e)(1)(A). But, as noted by the courts, section 6229(c) merely serves to extend the section 6501 period for each separate partner to a minimum expiration date computed from the date the partnership return is filed or due to be filed, whichever is later. See section 6501(n)(2). In extending each partner's section 6501 period under section 6229, Congress is presumed to give the language in section 6229, which is identical to language in section 6501, identical meaning. Having defined a phrase in section 6501, Congress need not redefine the same phrase when it is later used to extend that same statute of limitations. Ascribing a different interpretation to an identical phrase would result in partners being treated

differently based on the happenstance of whether the transaction is reported on a partnership return rather than on a partner's return. For instance, in *Son of Boss* transactions described in Notice 2000-44, 2000-2 CB 255 (Sept. 5, 2000), gross income can be generated by the partnership when it sells an inflated basis asset, or directly by the partner if the asset is first distributed to the partner before being sold. Thus, section 6501(e)(1)(A) defines an omission from gross income both for purposes of section 6501 and for any extension of section 6501 under section 6229. The temporary regulations confirm this point. Further, in light of the different interpretations given by courts to the meaning of section 6501(e)(1)(A), the temporary regulations clarify the meaning of this section. See § 601.601(d)(2)(ii)(b).

Section 6501(e)(1)(A) provides that if the taxpayer omits from gross income an amount properly includible therein that 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. Subsection (i) of this provision provides that, in the case of a trade or business, the term gross income means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services.

These temporary regulations clarify that, outside of the trade or business context, gross income for purposes of sections 6501(e)(1)(A) and 6229(c)(2) has the same meaning as gross income as defined in section 61(a). Under section 61(a), gross income includes "gains derived from dealings in property" and the regulations under section 61(a) further explain that gain equals "the excess of the amount realized over the unrecovered cost or other basis for the property sold or exchanged." Accordingly, outside the context of a trade or business, any basis overstatement that leads to an understatement of gross income under section 61(a) constitutes an omission from gross income for purposes of sections 6501(e)(1)(A) and 6229(c)(2).

Relying on the Supreme Court's opinion in *Colony v. Commissioner*, 357 U.S. 28 (1958), which dealt with an omission from gross income in the context of a trade or business, the United States Court of Appeals for the Ninth Circuit and Federal Circuit recently construed section 6501(e)(1)(A) in cases outside the trade or business context contrary to the interpretation provided in these temporary regulations, holding that an "omission" does not occur by an overstatement of basis. *Bakersfield Energy Partners v. Commissioner*, 568 F.3d 767 (9th Cir. 2009); *Salman Ranch Ltd v. United States*, 573 F.3d 1362 (Fed. Cir. 2009). The Treasury Department and the Internal Revenue Service disagree with these courts that the Supreme Court's reading of the predecessor to section 6501(e) in *Colony* applies to sections 6501(e)(1)(A) and 6229(c)(2). When Congress enacted the 1954 Internal Revenue Code, it was aware of the disagreement among the courts that existed at the time regarding the proper scope of section 275(c) of the 1939 Internal Revenue Code. The changes that Congress enacted as part of the 1954 Internal Revenue Code predated the Supreme Court's opinion in *Colony* and were intended to resolve the matter for the future. Therefore, by amending the Internal Revenue Code, including the addition of a special definition of "gross income" with respect to a trade or business, Congress effectively limited what ultimately became the holding in *Colony*, to cases subject to section 275(c) of the 1939 Internal Revenue Code. Moreover, under section 6501(e)(1)(A) of the 1954 Internal Revenue Code, which remains in effect under the 1986 Internal Revenue Code, when outside of the trade or business context, the definition of "gross income" in section 61 applies. In this regard, the Treasury Department and the Internal Revenue Service agree with the opinions in *Home Concrete & Supply, LLC v. United States*, 599 F.Supp.2d 678, 690 (E.D.N.C. 2008) (overstatement of basis can constitute an omission from

gross income for purposes of the six-year period of limitations) and *Brandon Ridge Partners v. United States*, 2007-2 U.S.T.C. (CCH) 50,573, 100 A.F.T.R.2d (RIA) 5347, 5351-53 (M.D. Fla. 2007) (same).

Consistent with the Ninth Circuit's suggestion in *Bakersfield*, these temporary regulations clarify what constitutes an "omission from gross income" under sections 6501(e)(1)(A) and 6229(c)(2), as amended in connection with the enactment of the 1954 Internal Revenue Code and continuing in effect under the 1986 Internal Revenue Code. The reasonable interpretation of the provisions of sections 6501(e)(1)(A) and 6229(c)(2) provided in these temporary regulations, acknowledged by both the Ninth and Federal Circuits to be ambiguous, is entitled to deference even if the agency's interpretation may run contrary to the opinions in *Bakersfield* and *Salman Ranch*. See *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982-83 (2005); *Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162, 170 (3rd Cir. 2008). Because these temporary regulations are a clarification of the period of limitations provided in sections 6501(e)(1)(A) and 6229(c)(2) and are consistent with the Secretary's application of those provisions both with respect to a trade or business (that is, gross income means gross receipts), as well as outside of the trade or business context (that is, section 61 definition of gross income applies), they are applicable to all cases with respect to which the period for assessing tax under the applicable provisions has not expired before the date of filing of these regulations with the Federal Register .

Although these temporary regulations do not provide guidance on this issue, section 6501(e)(1)(A)(ii) additionally provides that the amount omitted from gross income does not include any amount disclosed on the return, or in a statement attached to the return, in a manner adequate to apprise the Internal Revenue Service of the nature and amount of the item. This adequate disclosure exception to the six-year statute of limitations applies to omissions from gross income resulting from basis overstatements (as provided for in these temporary regulations) in the same manner as it applies to other omissions from gross income. Accordingly, taxpayers who adequately disclose the nature and amount of the omissions from gross income resulting from dealings in property will not be subject to the extended six-year statute of limitations.

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble of the cross-reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the Federal Register . Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is William A. Heard III of the Office of the Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301--PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding the entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.6229(c)(2)-1T is also issued under 26 U.S.C. § 6230(k). * * *

Par. 2. Section 301.6229(c)(2)-1T is added to read as follows:

§ 301.6229(c)(2)-1T Substantial omission of income (temporary).

(a) Partnership return --(1) General rule. (i) If any partnership omits from the gross income stated in its return an amount properly includible therein that is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) of section 6229 shall be applied by substituting "6 years" for "3 years."

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

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6229(c)(2).

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

(2) [Reserved]

(b) Effective/applicability date. The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

(c) Expiration date. The applicability of this section expires on or before September 24, 2012.

§ 301.6501(e)-1 [Removed].

Par. 3. Section 301.6501(e)-1 is removed.

Par. 4. Section 301.6501(e)-1T is added to read as follows:

§ 301.6501(e)-1T Omission from return (temporary).

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

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

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A).

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

(2) [Reserved]

(b) Effective/applicability date. The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

(c) Expiration date. The applicability of this section expires on or before September 24, 2012.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Approved: September 23, 2009.

Michael Mundaca,

Acting Assistant Secretary of the Treasury (Tax Policy).

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