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Legislative Reversals of Supreme Court Rulings: *United States v. Home Concrete Supply, LLC* and §6501(e)(1)

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“Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values, and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.”¹

INTRODUCTION

The Supreme Court’s statement explaining the need for finality in tax matters was disregarded by Congress last year in its legislative overturning of the Court’s decision in *United States v. Home Concrete & Supply, LLC*.² In a sharply divided 5-4 decision, the Supreme Court in *Home Concrete* held that additional

capital gain arising from a taxpayer’s overstatement of his basis in a partnership does not count in determining if the taxpayer has underreported his income by more than 25%, thereby triggering an extended six-year statute of limitations under then-§6501(e)(1)(A).³ In finding regulations⁴ governing the statute of limitations under then-§6501(e) and

³ Unless otherwise stated, all references to “Section” or “§” are to provisions of the Internal Revenue Code of 1986, as amended (the “Code”) and references to “Reg. §” are to the Treasury regulations thereunder (the “regulations”).

Section 513(a)(1) of the Hiring Incentives to Restore Employment (HIRE) Act of 2010, Pub. L. No. 111-147, redesignated §6501(e)(1)(A) as §6501(e)(1)(B) effective for returns filed after March 18, 2010. However, in *Home Concrete*, the Court referred to subparagraph (A) in its interpretation of the six-year statute of limitations because the litigation involved pre-2010 tax returns.

⁴ Reg. §301.6229(c)(2)-1, §301.6501(e)-1(a)(1)(iii). Reg. §301.6229(c)(2)-1 reads:

(a) Partnership return—(1) General rule.

(i) If any partnership omits from the gross income stated in its return an amount properly includible therein and that amount is described in clause (i) of section 6501(e)(1)(A), 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*

¹ *Rothenes v. Elec. Storage Battery Co.*, 329 U.S. 296, 300 (1946).

² *United States v. Home Concrete & Supply, LLC*, 566 U.S. ___, 132 S. Ct. 1836 (2012).

§6229(c)⁵ invalid and invoking the doctrine of *stare decisis* to find a prior decision of the Supreme Court controlling,⁶ *Home Concrete*, while leaving open a host of issues regarding taxpayer challenges to regulations in conflict with prior judicial decisions, settled the specific dispute over which numerous circuits had disagreed.⁷

No less than three years later, however, the Supreme Court's decision was legislatively reversed by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.⁸ The Act's amendment to §6501(e)(1), which effectively overturns *Home Concrete*, declares that an overstatement of ba-

for purposes of section 6229(c)(2). (Emphasis supplied.)

(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.

Reg. §301.6501(e)-1(a)(1)(iii) reads:

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)(i).* (Emphasis supplied.)

These regulations were initially issued on September 24, 2009, in temporary form and made applicable to all tax years not closed by the statute of limitations, including years in which litigation was pending and not yet final. The regulation was finalized in December, 2010.

⁵ While *Home Concrete* refers only to the six-year statute of limitations for individuals under §6501(e)(1)(A), most of the controversies in this area arose in the context of partnership filings for which there is a similar six-year rule where a partnership understates its income by more than 25%. See §6229(c)(2).

⁶ See *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958).

⁷ However, the majority in the 5-4 decision could not agree on the proper standard for finding *Colony* to be the controlling authority, leading to a concurring opinion by Justice Scalia. As a result, the opportunity to provide more comprehensive guidance regarding when regulations can overturn court decisions was lost, prompting one commentator to declare *Home Concrete* to be the "fizzle heard around the world." See Jeremiah Coder, *ABA Meeting: Butler Comments on Home Concrete, Economic Substance Guidance*, 93 Tax Notes Today 5 (May 14, 2012).

⁸ Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, §2005.

sis causing an understatement of income can trigger an extension of the statute of limitations, potentially opening many otherwise closed tax years to adjustment. Furthermore, the new law makes clear that, unlike all other circumstances which might cause an understatement of income, no degree of disclosure regarding the transaction and the determination of basis can avoid the extension.

This article reviews the history of *Home Concrete*, its legislative reversal, and the implications of the amended statute to taxpayers who may have substantially overstated their basis on property sales. While the amendment to §6501(e)(1) overturning *Home Concrete* enabled Congress to find additional revenue to fund the nation's highway system, it results in additional compliance and uncertainty that brings into question the wisdom of the change.

HOME CONCRETE AND COLONY DECISIONS

The transaction in *Home Concrete* that resulted in the understatement of income was a "Son-of-Boss" tax shelter where the IRS alleged that the taxpayer had overstated its basis in a partnership interest, resulting in an understatement of income upon the interest's sale that exceeded 25% of the taxpayer's gross income for the year.⁹ The IRS failed to issue a timely notice of deficiency within the normal three-year period of limitations for assessment, asserting that under then-§6501(e)(1)(A),¹⁰ the limitations period was six

⁹ The IRS's zeal in pursuing this taxpayer all the way to the Supreme Court was no doubt motivated by the fact that the transaction was a tax shelter. See Notice 2000-44, 2000-2 C.B. 255, describing the infamous Son-of-Boss tax shelter requiring special tax return disclosure as a listed transaction under §6707A.

¹⁰ The Hiring Incentives to Restore Employment (HIRE) Act of 2010, Pub. L. No. 111-147, §513(a)(1), redesignated subparagraph §6501(e)(1)(A) as §6501(e)(1)(B) effective for returns filed after March 18, 2010.

Before 2010, §6501(e)(1)(A) provided:

(A) General rule

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25% 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 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

years because the taxpayer had understated its income by more than 25%.¹¹

Granting certiorari because of a split among the U.S. circuit courts of appeal,¹² the Court considered whether its more-than-50-year-old ruling in *Colony, Inc. v. Commissioner*,¹³ holding that under §275(c) of the 1939 Code, an overstatement of basis did not trigger the six-year statute, precluded the IRS from issuing regulations to the contrary.¹⁴ Justice Breyer, writing for Chief Justice Roberts, and Justices Thomas, Alito, and in part, Justice Scalia, concluded that the six-year statute did not apply in this case, relying entirely upon the analysis and precedent of *Colony*.

(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 of the nature and amount of such item.

After the 2010 amendments, §6501(e)(1)(A) reads:

(A) General rule

If the taxpayer omits from gross income an amount properly includible therein and—

- (i) such amount is in excess of 25% of the amount of gross income stated in the return, or
- (ii) such amount— (I) is attributable to one or more assets with respect to which information is required to be reported under section 6038D (or would be so required if such section were applied without regard to the dollar threshold specified in subsection (a) thereof and without regard to any exceptions provided pursuant to subsection (h)(1) thereof), and (II) is in excess of \$5,000,

the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

¹¹ While *Home Concrete* only refers to the six-year statute of limitations for individuals under §6501(e)(1)(A), most of the cases arose in the context of partnership filings for which there is a similar six-year rule where a partnership understates its income by 25%. §6229(c)(2).

¹² See, e.g., *Grapevine Imps. Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011) (siding with the IRS.); *Intermountain Ins. Serv. of Vail LLC v. Commissioner*, 650 F.3d 691 (D.C. Cir. 2011) (siding with the IRS); *Burks v. United States*, 633 F.3d 347 (5th Cir. 2011) (siding with the taxpayer); and *Bakersfield Energy Partners LP v. Commissioner*, 568 F.3d 767 (9th Cir. 2009) (siding with the taxpayer).

¹³ *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958).

¹⁴ Reg. §301.6229(c)(2)-1, §301.6501(e)-1(e)(1). These regulations were initially issued on September 24, 2009, in temporary form and made applicable to all tax years not closed by the statute of limitations, including years in which litigation was pending and not yet final. The regulation was finalized in December 2010.

Following the *Chevron*¹⁵ rule that a court's interpretation of a statute may override a regulation's interpretation of a statute only when the statute is ambiguous (or when the statute is silent and the agency's interpretation is contrary to clear congressional intent), the Supreme Court found that the *Colony* decision, in fact, found the statute to be unambiguous.¹⁶ Thus, following the decision in *Nat'l Cable & Telecommunications Ass'n v. Brand X Internet Servs.*,¹⁷ the Court concluded that regulations could not overturn *Colony's* holding that an understatement of income arising from a basis overstatement does not trigger the extended statute of limitations.

While *Colony* was decided under the 1939 Code, the Court noted that the language describing the circumstances for the application of the six-year statute were identical to the words of the 1986 Code. In fact, to demonstrate the similarity of the provisions, the Court included an appendix quoting §275(c), §6501(e)(1)(A), and §6501(e)(2) in full.¹⁸

Both *Colony* and *Home Concrete* found that the rationale for the six-year statute of limitations arises

¹⁵ *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

¹⁶ According to the *Home Concrete* Court, "there is every reason to believe that the [*Chevron*] Court thought that Congress had 'directly spoken to the question at hand,' and thus left '[no] gap for the agency to fill.'" *Home Concrete*, 132 S. Ct. at 1844 (citing *Chevron*, 467 U.S. at 842-43).

¹⁷ 545 U.S. 967, 982 (2005) (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").

¹⁸ Section 275(c) of the 1939 Code provided:

(c) OMISSION FROM GROSS INCOME.—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.

Section 6501(e)(1)(A) provides:

If the taxpayer omits from gross income an amount properly includible therein and—

6501(e)(1)(A)(i)

such amount is in excess of 25 percent of the amount of gross income stated in the return, or

6501(e)(1)(A)(ii)

such amount—

6501(e)(1)(A)(ii)(I)

is attributable to one or more assets with respect to which information is required to be reported under section 6038D (or would be so required if such section were applied without regard to the dollar threshold specified in subsection (a) thereof and without

from the difficulty of detecting undisclosed income in cases where the taxpayer did not intentionally understate his or her income.¹⁹ As the committee report explaining the reasoning for the six-year statute upon its original enactment in 1933 declared:

Your subcommittee is of the opinion that the limitation period on assessments should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25% of the amount of the gross income stated in the return. The Government should not be penalized when a taxpayer is so negligent as to leave out items of such magnitude from his return.²⁰

regard to any exceptions provided pursuant to subsection (h)(1) thereof, and

6501(e)(1)(A)(ii)(II)

is in excess of \$5,000,

the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

¹⁹ This rationale explains why the six-year statute also applies to the omission from gross income of certain foreign transactions that need only exceed \$5,000. §6501(e)(1)(A)(ii).

²⁰ Preliminary Report of a Subcommittee of the Committee on Ways And Means Relative to Methods of Preventing the Avoidance and Evasion of Internal Revenue Laws Together with Suggestions for the Simplification and Improvement Thereof, Committee on Ways and Means, Prevention of Tax Avoidance (1933), available at <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/3931ECC6107ECDC8852574B80001915F?OpenDocument>.

The *Colony* decision also cited the following colloquy from the Hearing between Congressman Cooper of Tennessee, speaking for the Subcommittee, and Mr. Roswell Magill, representing the Treasury, to explain the circumstances where Congress intended the statute to apply:

“Mr. COOPER. What we really had in mind was just this kind of a situation: Assume that a taxpayer left out, say, a million dollars; he just forgot it. We felt that whenever we found that he did that we ought to get the money on it, the tax on it.

“Mr. MAGILL. I will not argue against you on that score.

“Mr. COOPER. In other words, if a man is so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25% of his gross income, that we simply ought to have the opportunity of getting the tax on that amount of money.”
See Colony, 357 U.S. at 34 (quoting the 1933 House Hearing at 149).

The *Colony* court pointed out that §275(c), like §6501(e)(1)(A), used the word “omit” to determine whether gross income was understated by more than 25%, citing Webster’s dictionary to define the term to mean that amounts must be left out of gross income to trigger the six-year rule.²¹ Consequently, to inflate the basis of an item on a tax return was not to “omit” anything from the return such that the six-year statute of limitations would apply.

STATUTORY REVERSAL

While *Home Concrete* left open many issues regarding taxpayer challenges to regulations in conflict with prior judicial decisions, it provided a final resolution of the specific dispute over which numerous circuits had disagreed, namely, whether an overstatement of basis may result in an understatement of income for purposes of triggering the six-year statute of limitations. However, no less than three years later, *Home Concrete* was legislatively overturned by Congress in the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.²² The Act amended §6501(e)(1)(B) to read as follows:

- (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;
 - (ii) *An understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission from gross income; and*
 - (iii) In determining the amount omitted from gross income (*other than in the case of an overstatement of unrecovered cost or other basis*), 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 of the nature and amount of such item.
- (Emphasis supplied.)

While Congress often amends statutes to overturn court decisions that it believes are incorrect or otherwise fail to fulfill social or economic goals beyond the ability of the judiciary to influence, reversal of a U.S. Supreme Court decision interpreting the Internal Rev-

²¹ See Webster’s *Third New International Dictionary* (Philip Babcock Grove, ed., 1961), defining “omit” as “to leave out or leave unmentioned, fail to insert, include or name.”

²² Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, §2005.

enue Code is less common. Perhaps the most significant prior statutory reversal of a Supreme Court decision interpreting a provision of the federal income tax law is *Commissioner v. Soliman*.²³ In *Soliman*, the Supreme Court denied an office-in-home deduction to a medical doctor whose practice was conducted outside the home but all administrative duties were performed in Dr. Soliman's home. Under §280A(c), an individual may claim an office-in-home deduction only if the home office constitutes the taxpayer's "principal" place of business. The Court concluded that Dr. Soliman's performance of only administrative duties in the home office did not meet this requirement.²⁴

Reacting to this decision, Congress, six years later, amended §280A(c)(1) to clarify the requirement that the home office be the taxpayer's "principal" place of business as follows:

... [T]he term 'principal place of business' includes a place of business which is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business.²⁵

Thus, the office-in-home deduction is now available where only administrative and management activities are conducted in the home, while the activities that actually generate the taxpayer's income are conducted elsewhere.²⁶ The House Committee gave the following reasons for enactment of the statutory reversal of *Soliman*:

The Committee believes that the Supreme Court's decision in *Soliman* unfairly denies a home office deduction to a growing number of taxpayers who manage their business activities from their homes. Thus, the statutory modification adopted by the Committee will reduce the present-law bias in favor of taxpayers who manage their business activities from outside their home, thereby enabling more taxpayers to work efficiently at home, save commuting time and expenses, and spend additional time with their families. Moreover, the statutory modification is an appropriate response to the computer and information revolution, which has made it

more practical for taxpayers to manage trade or business activities from a home office.²⁷

While "fairness" was the stated reason for the statutory reversal of *Soliman*, the statutory reversal of *Home Concrete* appears to be nothing more than a matter of garnering additional tax revenue for the government. Unlike the legislative history to the amendment overturning *Soliman*, there are no committee reports explaining the reasoning for reversing *Home Concrete*.²⁸ Tellingly, the amendment to §6501(e)(1)(A) was included in the Act's revenue provisions, in which the Joint Committee on Taxation estimated the revenue impact of the amendment to be \$26 million in the current budget year (2016) and \$1,190 million for the 2015-2025 period.²⁹

Other than generating additional tax revenue, the only stated rationale for the change was the Joint Committee's statement that it prevents:

rewarding taxpayers who were less than complete and candid in preparing returns or claiming aggressive positions. Here, a basis overstatement can have the same ultimate effect of understating a taxpayer's income and therefore should be treated as such.³⁰

However, the abusive tax shelters that generated the dispute in *Home Concrete* are generally no longer being promoted given the increased scrutiny and disclosure requirements imposed on such transactions.³¹ Thus, these revenue estimates are questionable in that, effectively, the amendment serves only to close the barn door after the horse has escaped.

IMPACT OF AMENDED §6501(e)(1) ON EQUITY AND DISCLOSURE

As mentioned, the 2015 amendment to §6501(e)(1) now provides that an overstatement of basis may result in an understatement of income for purposes of applying the six-year statute of limitations. Specifically, §6501(e)(1)(B) was amended by inserting a new clause (ii) as follows:

²⁷ H.R. Rep. No. 105, 105th Cong., 1st Sess. 148 at 407 (1997).

²⁸ See <https://www.congress.gov/bill/114th-congress/house-bill/3236/committees>. There are committee reports for related bills, none of which appear to be relevant.

²⁹ Joint Committee on Taxation, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2016 Budget Proposal* (JCX-50-15), Mar. 6, 2015, Item XVI.C.9.

³⁰ Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in The President's Fiscal Year 2016 Budget Proposal* (JCS-2-15), Sept. 29, 2015, p. 274.

³¹ See §6662A (penalty on understatements arising from "reportable" transactions such as tax shelters), §6707A (penalty for failure to disclose reportable transactions on the taxpayer's return).

²³ 506 U.S. 168 (1993), *rev'g* 935 F.2d 52 (4th Cir. 1991).

²⁴ *Id.* at 178.

²⁵ Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §932(a).

²⁶ §280A(c)(1) (flush language).

(ii) An understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission of gross income;³²

Most importantly, the new law provides that the general provision that adequate disclosure of an understatement of income can avoid the extension of the statute of limitations does not apply to cases of basis overstatement. Thus, clause (iii) of §6501(e)(1)(B), which provides the opportunity to avoid the six-year limitations period by disclosing the circumstances in which income may be underreported, is specifically made inapplicable in the case of an overstatement of basis, as follows:

In determining the amount omitted from gross income (*other than in the case of an overstatement of unrecovered cost or other basis*), 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 of the nature and amount of such item.

(Emphasis supplied.)³³

As discussed below, not affording taxpayers the same disclosure exception to the six-year limitations period in cases of overstated basis that is available to all other cases of underreported income is unwarranted and effectively creates a trap for the unwary who in good faith made every effort to properly report the adjusted basis of property on their returns.

In light of Congress's original intent³⁴ in extending the statute of limitations — to uncover unintentional omissions of gross income — adjustments to income attributable to basis overstatements should not be counted in reaching the 25% threshold for the six-year limitations period. That said, however, Congress is not prohibited from extending the six-year limitations period to other circumstances, such as where income is underreported due to basis being overstated.³⁵

But, while Congress has the power to extend the reach of the six-year statute to cases arising from an overstatement of basis, there remain equitable concerns against such an extension, as illustrated in the

examples below; two taxpayers understate taxable income by more than 25%, but only one is subject to the extended statute of limitations under §6501(e)(1)(B).

Example 1: An individual reports gross income of \$100,000, and expenses of \$45,000. Upon examination by the IRS, the expenses were found to be only \$19,000, resulting in taxable income being understated by \$26,000 (\$45,000 – \$19,000). Although taxable income is understated by more than 25% of gross income, gross income itself was not overstated by more than 25%, so the six-year statute of limitations does not apply.

Example 2: An individual reports gross income of \$100,000, including a gain of \$5,000 related to the sale of an asset for \$50,000. Upon examination by the IRS, it was determined the asset's basis was, in fact, only \$19,000, not \$45,000 as reported on tax return. Therefore, the gain should have been \$31,000, and gross income on the return was understated by \$26,000. Under the new law, the overstatement of basis constitutes a more than 25% omission of gross income for the purposes of the six-year statute. Disclosure, if any, of the transaction and how basis was arrived at and reported on the return is irrelevant.

In both cases, the amounts adjusted were fully disclosed on the face of the tax return. Nevertheless, different periods of limitations apply to otherwise similarly situated taxpayers solely because the adjustment in the first case arises from an overstatement of expenses, while the adjustment in the second case is due to an overstatement of basis.

Generally, under §6501(e)(1)(B)(iii), the taxpayer may avoid the six-year limitations period by including a disclosure statement attached to the return the circumstances around which an underreporting of income may exist. However, where the taxpayer overstates his basis but discloses the possibility of inaccuracy on the return, the new law denies the use of disclosure to avoid the extended statute,³⁶ creating yet another set of inequities, as illustrated below:

Example 3: For a tax year, an individual reports gross income of \$100,000, including the sale of an asset for \$50,000 with a basis of \$45,000. Upon examination by the IRS,

³² §6501(e)(1)(B), as amended by the Surface Transportation and Veterans Care Choice Improvement Act of 2015, Pub. L. No. 114-41, §2005(a)(1)(ii).

³³ *Id.* at §2005(a)(2).

³⁴ As the *Colony* Court pointed out and the *Home Concrete* Court confirmed.

³⁵ U.S. Const. amend. XVI, §8, cl. 1, (authorizes Congress to lay and collect income taxes, including defining gross income, how it is reported, and how long an administrative agency has to examine any tax filing).

³⁶ Specifically, §6501(e)(1)(B)(iii) provides that in determining the amount of omitted income, except for cases of overstatement of basis, amounts disclosed in the return sufficient to apprise the IRS of the nature and amount of the item will not be taken into account in measuring the 25% threshold.

the asset's selling price was, in fact, determined to be \$76,000 so that gross income was understated by \$26,000. If the taxpayer disclosed on the return, under §6501(e)(1)(B)(iii), that the selling price might be \$76,000, not \$50,000, the understatement is not taken into account in determining whether more than 25% gross income was omitted for purposes of the six-year statute of limitations.

Example 4: Assume the same facts as the preceding example, except that the asset's basis is determined upon IRS examination to be \$19,000, not \$45,000. Regardless of the taxpayer's disclosure regarding the uncertainty of the basis, the \$26,000 understatement of income is taken into account in determining whether the six-year statute applies.

Again, while the economic result in both cases is the same, different periods of limitations apply because one taxpayer understated the income of the asset while the other taxpayer overstated the basis of the asset.

EFFECTIVE DATE OF AMENDMENTS TO §6501(e)(1)

The overstatement of basis creating income included in measuring the 25% threshold of §6501(e)(1)(B) applies to: (1) returns filed after the date of the enactment of the Act, i.e., July 31, 2015, and (2) returns filed on or before July 31, 2015, if the period of limitations in §6501 (generally three years) with respect to the tax year has not expired as of July 31, 2015.³⁷ Also, because §6501(c)(4)(A) provides an extension of the period of limitations provided in §6501(e)(1) where the taxpayer and the IRS have entered into an agreement on Form 872 to extend the time to assess tax, the amendments to §6501(e)(1) apply to returns where a valid extension is in effect. In addition, the amendments apply where, under §6503, the statute of limitations is tolled for cases before the Tax Court or on appeal from the Tax Court.

Thus, in some cases, the six-year limitations period will result in the opening of the statute of limitations in cases that might shortly be time-barred by the general three-year period.

Example 5: A taxpayer timely filed his 2011 income return on October 15, 2012, believ-

³⁷ Surface Transportation and Veterans Care Choice Improvement Act of 2015, Pub. L. No. 114-41, §2005(b).

ing the general statute of limitations on the return would expire on October 15, 2015. However, if the taxpayer overstated his basis with regard to an asset sale, the statute now may extend to October 15, 2018.

Historically, courts have resisted the retroactive application of substantive changes to the tax law.³⁸ Thus, in *Hassett v. Welch*,³⁹ the Supreme Court held, "In view of other settled rules of statutory construction, which teach that a law is presumed, in the absence of clear expression to the contrary, to operate prospectively; [and] that, if doubt exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer. . . ." (Internal citations omitted.)

And in *Shwab v. Doyle*,⁴¹ the Court declared:

The initial admonition is that laws are not to be considered as applying to cases which arose before their passage unless that intention be clearly declared. [citations omitted] . . . "retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact."

There is absolute prohibition against them when their purpose is punitive; they then being denominated *ex post facto* laws. It is the sense of the situation that that which impels prohibition in such case exacts clearness of declaration when burdens are imposed upon completed and remote transactions, or consequences given to them of which there could have been no foresight or contemplation when they were designed and consummated.⁴²

Similarly, in *State St. Trust Co. v. United States*,⁴³ the court stated:

In matters of substantive application the rule of statutory construction is against giving

³⁸ For detailed discussions of enacting statutes with retroactive effect, see, e.g., Michael J. Graetz, *Effective Dates For Tax Legislation — Retroactivity and Transition Rules*, Nat'l Tax J., Vol. 30 Issue 3, 237-242 (Sept. 1977); Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. Pa. L. Rev. 47 (1977-1978)

³⁹ 303 U.S. 303 (1938).

⁴⁰ *Id.* at 314.

⁴¹ 258 U.S. 529 (1929).

⁴² *Id.* at 534.

⁴³ 59 F. Supp. 467 (D. Mass. 1945), *aff'd*, 151 F.2d 1022 (1st Cir. 1945).

retroactive effect to a statute in the absence of clear expression to the contrary. [Citations omitted.] The taxpayer contends, however, that the provisions as to the time for filing claims for refund relate to remedial, rather than substantive, matters, and that this rule of construction is therefore inapplicable.

Although the rule of strict construction against retroactive statutory operation cannot be automatically applied in the case of procedural or remedial legislation, there is no presumption that such enactments are to be given prospective effect. Whether the statute in such case is to be given a retroactive interpretation depends upon legislative intention.⁴⁴ [Citations omitted.]

More recently, in *United States v. Carlton*,⁴⁵ the Supreme Court was more receptive to retroactive tax legislation, noting that earlier “cases were decided during an era characterized by exacting review of economic legislation under an approach that ‘has long since been discarded.’ ”⁴⁶ The issue in *Carlton* concerned the Tax Reform Act of 1986 enactment of a deduction, for estate tax purposes, of half the proceeds of any sale of employer securities by the executor of an estate to an employee stock ownership plan (“ESOP”) applicable to any estate filing a timely return after the date of the Act, i.e., October 22, 1986.⁴⁷ To qualify for the deduction, the sale of the securities had to be made before the date the estate tax return was due, including extensions.⁴⁸

Carlton, the executor of an estate established upon the death of the decedent (September 29, 1985), purchased and sold to an ESOP qualifying securities before the return was due (December 29, 1986), deducting half the proceeds on the estate tax return. On January 5, 1987, the IRS announced that it would permit the deduction only for securities actually owned immediately before death, and bills amending the statute to that effect were introduced in both the House of Representatives and Senate on February 26, 1987. On December 22, 1987, the amendment was enacted, ef-

fective retroactively to the date of enactment of the Tax Reform Act of 1986, i.e. October 22, 1986.⁴⁹

The Court upheld the retroactive application of the amendment to *Carlton* because it was “rationally related to a legitimate legislative purpose”⁵⁰ and “curative” in nature.⁵¹ The Court concluded that Congress intended the amendment to correct a mistake in the original provision and had no improper motive. Finally, the Court reasoned that the retroactive feature of the amendment did not put taxpayers at a disadvantage because “Congress acted promptly and established only a modest period of retroactivity.”⁵²

However, Justice O’Connor, in her concurring opinion, declared, “A period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious Constitutional questions.”⁵³

Unlike the retroactive change accepted by the Court in *Carlton*, the amendments to §6501(e) were substantive revisions of the law that were not promptly enacted after the *Home Concrete* decision, thereby creating an extended period of retroactivity beyond the period suggested by Justice O’Connor. The amendments not only change what constitutes an omission from gross income under §6501(e), but also remove an affirmative defense (disclosure) to the statute being kept open. Under *Colony* and *Home Concrete*, until July 31, 2015, an overstatement of basis did not create an omission of gross income for purposes of the six-year statute of limitations, and disclosure of omitted income was an absolute defense against the application of the six-year statute of limitations.

Under the new law, if the IRS chooses to pursue otherwise closed cases that the amendment’s effective date now opens, courts will need to address taxpayer claims of justifiable reliance upon *Home Concrete* and *Colony*. In addition, taxpayers will rely upon well-established judicial doctrines that favor only prospective application of substantive changes in tax law, absent explicit retroactive wording of the amendment.⁵⁴ Finally, the government will also have to establish, as stated in *Carlton*, that any retroactive application of the amendment to a particular taxpayer is “rationally related to a legitimate legislative purpose.”⁵⁵

Despite the retroactive effective date of the legislative amendment reversing *Home Concrete*, it is un-

⁴⁴ 59 F. Supp. at 469.

⁴⁵ 512 U.S. 26 (1994), *rev’g* 972 F.2d 1051 (9th Cir. 1992).

⁴⁶ *Id.* at 34 (quoting *Ferguson v. Skrupa*, 372 U.S. 726, 730 (1963)).

⁴⁷ The deduction was repealed for estates of decedents dying after December 19, 1989. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, §7304(a).

⁴⁸ Former §2057(c)(1).

⁴⁹ Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, §10411(a), (amending former §2057(c)).

⁵⁰ *Carlton*, 512 U.S. at 34.

⁵¹ *Id.* at 31.

⁵² *Id.* at 32.

⁵³ *Id.* at 38.

⁵⁴ *Hassett*, 303 U.S. at 314; *Shwab*, 258 U.S. at 524; *State St. Trust Co.*, 59 F. Supp. at 469.

⁵⁵ *Carlton*, 512 U.S. at 34.

likely courts will revisit cases previously denied certiorari or vacated as a result of the Supreme Court's decision, even if the statute of limitations might otherwise now be open under the new law.⁵⁶ However, any case not filed at the time of the *Home Concrete* decision remains subject to the amended law, with the possibility that the government might assert the six-year period of limitations under §6501(e)(1).

FUTURE CONSIDERATIONS

The statutory reversal of *Home Concrete* will impact tax practitioners, taxpayers, and policymakers. With the exception of the removal of the adequate disclosure defense, the amendment to §6501(e)(1)(B) will have little or no impact on transactions where basis is known. However, for transactions where there may be uncertainty regarding the basis of property, taxpayers and their return preparers will now need to pay special attention to basis given that its inaccuracy can create an extension of the statute of limitation, regardless of the taxpayer's disclosure of the transaction that in all other circumstances would avoid the extension.

Example 6: An individual reports gross income of \$100,000, which includes \$5,000 of gain related to the sale of an asset with a basis of \$45,000. Upon examination by the IRS, the asset's basis was found to be only \$19,000, such that the gain should have been \$31,000, and income on the return was understated by \$26,000. Under prior law, the understatement of basis did not constitute a substantial omission of gross income for the purposes of the six-year statute of limita-

⁵⁶ See, e.g., *Beard v. Commissioner*, 633 F.3d 616 (7th Cir. 2011); *Salmon Ranch Ltd. v. Commissioner*, 647 F.3d 929 (10th Cir. 2011); *Grapevine Imps. Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011); *Intermountain Ins. Serv. of Vail LLC v. Commissioner*, 650 F.3d 691 (D.C. Cir. 2011); *Burks v. United States*, 633 F.3d 347 (5th Cir. 2011); *Bakersfield Energy Partners LP v. Commissioner*, 568 F.3d 767 (9th Cir. 2009).

tions, but under the new law, the basis understatement constitutes a substantial omission of gross income, and any disclosure made by the taxpayer regarding the uncertainty of his basis is irrelevant.

Example 7: Assume the same facts as in the example above, except that the basis (\$45,000) is correct, but the sale price is \$76,000. While still understating gross income by \$26,000, the taxpayer can avoid the six-year statute by disclosing the details regarding the transaction and how the inaccurate sale price was determined.

As analysis of basis can be an expensive, time-consuming exercise dealing with historic transactions where annual adjustments are made and documents may be difficult to obtain or are simply lost, the reversal of *Home Concrete* is likely to increase work for tax practitioners and compliance costs for taxpayers.

CONCLUSION

This review of the history of *Home Concrete* and its reversal by Congress reveals that statutory reversals arise for the same reasons many tax laws are enacted, e.g., an effort to raise revenue or improve compliance by discouraging aggressive positions on tax returns. But in the case of the amendments to §6501(e)(1)(B), the result is the removal of a statutory defense from an adjustment, additional tax reporting by taxpayers, more work for return preparers, and unnecessary uncertainty regarding the possible opening of a statute of limitation that a taxpayer believed was closed.

Whether the additional tax revenue contemplated by the amendments to §6501(e)(1)(B) will be generated is questionable, and it is unfortunate that such revenue estimates are not offset by the inevitable increase in compliance costs. But more importantly, the retroactivity of this amendment raises questions of equity in the application of the law and calls into question the larger policy issue of the wisdom of retroactive legislation in general.

READERS' SUBMISSIONS INVITED

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