

WNTS Insight

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Supreme Court upholds restrictive view of six-year tax assessment provision

By a 5-4 vote without a clear majority opinion, the U.S. Supreme Court today held that the overstatement of basis of an asset does not give rise to an omission of gross income for purposes of establishing a six-year period of limitations for assessment (*United States v. Home Concrete & Supply, LLC*).

In so doing, the Court placed a restriction on last year's opinion in *Mayo Foundation for Medical Education and Research v. United States*, which has been widely read as giving Treasury broad discretion in the interpretation of tax statutes. (For discussion of *Mayo*, see WNTS Insight, "[Supreme Court addresses deference accorded tax regulations](#)," March 2, 2011.)

Background

Section 6501(e) provides that a six-year period of limitations is available for the IRS to make an assessment with respect to an income tax return that "omits gross income" in excess of 25 percent of the gross income reported on the return. The question presented in *Home Concrete* was whether an overstatement of basis of an asset that causes the understatement of gain from the disposition of that asset constitutes an "omission from gross income" that would invoke this provision. The Supreme Court in 1958, interpreting the predecessor provision to section 6501(e) in *Colony, Inc. v. Commissioner*, concluded that it did not.

Home Concrete

The first question to be addressed by the Court was whether *Colony's* interpretation even applied to current-law section 6501(e), given that there have been some subtle changes in that provision, and surrounding provisions, since the decision in *Colony*. Justice Stephen Breyer, for the majority of the Court, said *Colony's* interpretation was unaffected by the changes in the law, so under the doctrine of *stare decisis*, the earlier decision still controlled the meaning of the provision now in section 6501(e).



The broader question, however, was the effect of Reg. sec. 301.6501(e)-1, which recently had interpreted the key phrase contrary to the decision in *Colony*. The government argued that under the recent precedents of *Mayo* and *National Cable & Telecommunications Assn. v. Brand X Internet Services* (interpreting a non-tax statute), the Treasury interpretation in the regulation should receive deference even in the face of a prior Supreme Court interpretation to the contrary. In *Mayo*, the Supreme Court had ruled that a reasonable regulatory interpretation should receive judicial deference unless the statute leaves no room for agency interpretation. The Court concluded in *Brand X* that a reasonable agency construction will trump even a prior judicial construction if the statute is "ambiguous."

The *Home Concrete* majority of five Justices struck down the regulation, holding that "there is no longer any different construction that is consistent with *Colony* and available for adoption by the agency." However, Justice Scalia, part of the majority, wrote a concurring opinion, and did not join Justice Breyer's explanation as to why this is so.

Justice Breyer reasoned that under *Mayo* and *Brand X*, the key question was whether Congress had left a "gap" in the statute that it expected the agency to fill with respect to the particular issue in question. If Congress did not delegate "gap-filling" authority to the agency with respect to that particular provision or issue, then the regulation could not address that provision differently than how Congress intended. To determine whether Congress provided for "gap-filling" authority, the Court was to use "traditional tools of statutory instruction," including legislative history. Thus, referring back to *Colony's* view that the taxpayer's interpretation of the language of the statute was "more plausible" and that the legislative history strongly supported that view, the plurality concluded that in *Colony*, the Court had decided there was no gap left for the agency to fill. This view was to be followed here.

Justice Scalia voted for the taxpayer's position, but did not join in the analysis of *Mayo* and *Brand X*. Justice Scalia initially cast doubt on the wisdom of *Colony* and said that the case reasonably could be decided based on deference to the Treasury regulation. He then stated, however, without detailed explanation, that "Because of *justifiable taxpayer reliance*, I would not take that course" but rather "*Colony* determines the outcome in this case That should end the matter." (Emphasis added.) Justice Scalia did not explain what "taxpayer reliance" was at stake.

Justice Scalia's opinion, however, criticized Justice Breyer's "gap-filling" analysis as the principle to be followed when determining whether an agency interpretation should trump a prior court interpretation. Justice Scalia adhered to his dissenting opinion in *Brand X*, implying that once a court interprets a statutory provision, there is no longer any room for an agency to interpret it to the contrary. He concluded that because *Colony* interpreted the statutory provision at issue in this case, that construction must control.

Justice Kennedy wrote a dissenting opinion joined by Justices Ginsburg, Sotomayor, and Kagan. Justice Kennedy would have held that despite *Colony*, Congress had amended the statute in various ways that contradicted the view that *Colony* had continuing interpretive force. He concluded that "as a result, there was room for the Treasury Department to interpret the new provision" in the manner it did. He also disputed the existence of "legitimate settled expectations" of taxpayers. He said that taxpayers had reason to question the continuing vitality of the *Colony* interpretation, and the regulation should be upheld.

Observations

What is clear from the opinion is the substantive rule to be followed: an overstatement of basis does not constitute an omission of gross income giving rise to a six-year period of limitations; the regulation providing otherwise is invalid and will not be followed.

What is unclear is the effect on disputes over other Treasury regulations. Courts not infrequently opine on the meaning of statutory provisions before final regulations are issued. This opinion seems to leave open the argument that once the Supreme Court has opined on the meaning of a provision, there is no "gap-filling" to be done by the agency and any regulation contrary to the Court's decision may be suspect.

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