No. 11-747

In the Supreme Court of the United States

UTAM LTD., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT

DONALD B. VERRILLI, JR.
Solicitor General
Counsel of Record
TAMARA W. ASHFORD
Deputy Assistant Attorney General
GILBERT S. ROTHENBERG
MICHAEL J. HAUNGS
JOAN I. OPPENHEIMER
Attorneys

Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

QUESTIONS PRESENTED

As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, 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 [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The questions presented are as follows:

1. Whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the extended six-year assessment period.

2. Whether a final regulation promulgated by the Department of the Treasury, which reflects the IRS's view that an understatement of gross income attributable to an overstatement of basis can trigger the extended six-year assessment period, is entitled to judicial deference.

3. Whether the IRS's issuance of a notice of final partnership administrative adjustment to a partnership suspends the running of the assessment period under Section 6501 with respect to an individual partner.

TABLE OF CONTENTS

Page

Opinions below 1
Jurisdiction 1
Statement 1
Discussion 7
Conclusion 13

TABLE OF AUTHORITIES

Cases:

AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. *United States*, 481 F.3d 1351 (Fed. Cir. 2007) 10

Andantech, L.L.C. v. *Commissioner*, 331 F.3d 972 (D.C. Cir. 2003) 10, 11

Bakersfield Energy Partners, LP v. *Commissioner*, 128 T.C. 207 (2007), aff'd, 568 F.3d 767 (9th Cir. 2009) 6

Bassing v. *United States*, 563 F.3d 1280 (Fed. Cir. 2009) 8

Beard v. *Commissioner*, 633 F.3d 616 (7th Cir.), petition for cert. pending, No. 10-1553 (filed June 23, 2011) 3, 4

Curr-Spec Partners, L.P. v. *Commissioner*, 579 F.3d 391 (5th Cir. 2009), cert. denied, 130 S. Ct. 3321 (2010) 10

DSDBL, Ltd. v. *Commissioner*, 436 Fed. Appx. 384 (5th Cir.), petition for cert. pending, No. 11-581 (filed Nov. 9, 2011) 4

Epsolon Ltd. ex rel. Sligo (2000) Co. v. *United States*, 78 Fed. Cl. 738 (2007) 12

Cases—Continued: Page

Intermountain Ins. Serv. of Vail v. *Commissioner*, 650 F.3d 691 (D.C. Cir.), petition for cert. pending, No. 11-663 (filed Nov. 16, 2011) 6

Jade Trading, LLC v. *United States*, 80 Fed. Cl. 11 (2007), aff'd in relevant part, 598 F.3d 1372 (Fed. Cir. 2010) 4

Kornman & Assocs., Inc. v. *United States*, 527 F.3d 443 (5th Cir. 2008) 3

Monti v. *United States*, 223 F.3d 76 (2d Cir. 2000) 8

Randell v. *United States*, 64 F.3d 101 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996) 5, 8

Rhone-Poulenc Surfactants & Specialties, L.P. v. *Commissioner*, 114 T.C. 533 (2000), appeal dismissed, 249 F.3d 175 (3d Cir. 2001) 6, 11, 12

Statutes:

Internal Revenue Code (26 U.S.C.):

Section 61(a)(3) 2

Section 701 . . . . 5, 8

Sections 701-704 . . . . 5, 8

Section 722 3

Section 723 3

Section 752 3

Section 1001(a) 2

Section 1011(a) 2

Section 1012 2

Section 1366 4

Section 6031 . . . . 5, 8

Statutes—Continued: Page

Section 6212 8
Section 6223(a) 9, 11
Section 6225(a)(2) 9, 11
Section 6226(a) 9
Section 6226(b) 9
Section 6226(f) 9
Section 6229 10
Section 6229(a) 10, 11
Section 6229(a)(1)-(2) 9
Section 6229(c)(2) 10
Section 6229(c)(2) (Supp. IV 2010) 10
Section 6229(d) 6, 10, 11
Section 6501 . . . . 10, 11
Section 6501(a) 2, 6, 10
Section 6501(e)(1)(A) 2, 6, 7, 10

Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 9

Miscellaneous:

I.R.S. Notice 2000-44, 2000-36 I.R.B. 255 3

Staff of the Joint Comm. on Taxation, 97th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982* (Comm. Print 1982) 9

In the Supreme Court of the United States

No. 11-747

UTAM LTD., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals as amended (Pet. App. 1-11) is reported at 645 F.3d 415. The opinion of the Tax Court (Pet. App. 12-20) is reported at 98 T.C.M. (CCH) 422.

JURISDICTION

The judgment of the court of appeals was entered on June 21, 2011. A petition for rehearing was denied on September 15, 2011 (Pet. App. 62-64). The petition for a writ of certiorari was filed on December 14, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. As a general matter, the Internal Revenue Service (IRS) has three years to assess additional tax if the

agency believes that the taxpayer's return has understated the amount of tax owed. 26 U.S.C. 6501(a). That period is extended to six years, however, 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 [taxpayer's] return." 26 U.S.C. 6501(e)(1)(A). The question presented in this case is whether that six-year assessment period applies to a tax-avoidance scheme that operated by overstating a taxpayer's basis in property.

a. When a taxpayer sells property, any "[g]ain[]" that he realizes from the sale contributes to his "gross income." 26 U.S.C. 61(a)(3). The taxpayer's gain, however, is not the sale price of his property. Rather, it is the sale price minus the taxpayer's capital stake in the sold asset, which is generally the amount paid to obtain the property, as adjusted by various other factors. 26 U.S.C. 1001(a), 1012. For tax purposes, that capital stake is commonly referred to as the taxpayer's "basis" in property. 26 U.S.C. 1011(a). Because the taxable income from a property sale is generally determined by subtracting the taxpayer's basis from the property's sale price, an overstatement of basis will typically decrease the amount of the taxpayer's gain (and thus the amount of federal income-tax liability) that is attributable to the sale.

This case involves a particular kind of tax shelter, known as a Son-of-BOSS (Bond and Option Sales Strategy) transaction. In a Son-of-BOSS transaction, a taxpayer uses some mechanism, often a short sale, to artificially increase his basis in an asset before the asset is sold. A short sale is a sale of a security that the seller does not own or has not contracted for at the time of the sale. To close the short sale, the seller is obligated to

purchase and deliver the security at some point in the future, often by using the proceeds from the short sale itself. Typically in a Son-of-BOSS transaction, a taxpayer enters into a short sale and transfers the proceeds as a capital contribution to a partnership. The partnership then closes the short sale by purchasing and delivering the relevant security on the open market. See *Beard* v. *Commissioner*, 633 F.3d 616, 617-618 (7th Cir.), petition for cert. pending, No. 10-1553 (filed June 23, 2011).

When the taxpayer and partnership file their tax returns for the year in which a transaction of the kind described above occurs, they are required under 26 U.S.C. 722, 723, and 752 to report their taxable bases in the partnership. The taxpayer's basis in the partnership is called an "outside basis," while the partnership's basis in its own assets is called an "inside basis." See *Kornman & Assocs., Inc.* v. *United States*, 527 F.3d 443, 456 n.12 (5th Cir. 2008). In a Son-of-BOSS transaction, when computing both "outside" and "inside" basis, the taxpayer and the partnership include the short-sale proceeds contributed to the partnership, without decreasing that amount by the corresponding obligation (*i.e.*, to close the short sale by purchasing and delivering the relevant security) that the partnership has assumed. As a result, the taxpayer either generates a large paper loss that can be used to offset capital gains on other unrelated investments, or turns what would otherwise have been a sizeable capital gain into a smaller taxable gain or even a capital loss.[1] See *Beard*, 633 F.3d at 618.

---

[1] In August 2000, the IRS issued a notice informing taxpayers that Son-of-BOSS transactions were invalid under the tax laws. See I.R.S. Notice 2000-44, 2000-36 I.R.B. 255 (describing arrangements that unlawfully "purport to give taxpayers artificially high basis in partner-

b. In this case, David Morgan owned an insurance business, UTA Management (UTA), that he wanted to sell while minimizing his tax liability from the anticipated capital gains.[2] In January 1999, Morgan formed petitioner UTAM, Ltd. (UTAM), a Texas limited partnership. Petitioner had two partners, UTA and DDM Management (DDM), which was also a corporation controlled by Morgan and his family.[3] Morgan contributed UTA's assets to UTAM. In September 1999, Morgan executed short sales of United States Treasury Notes for a combined total of approximately $38 million. Morgan then transferred that amount to UTA, along with the obligation to close the short sales; and in turn UTA transferred both the cash proceeds and the short-sale obligations to petitioner. Petitioner subsequently closed the short sales by purchasing and delivering Treasury Notes in the requisite amounts. UTA and DDM then sold their partnership interests in petitioner for approxi-

---

ship interests"). In the wake of that notice, courts largely have invalidated Son-of-BOSS transactions as lacking in economic substance. See, *e.g.*, *Jade Trading, LLC* v. *United States*, 80 Fed. Cl. 11, 45-46 (2007), aff'd in relevant part, 598 F.3d 1372, 1376-1377 (Fed. Cir. 2010). In 2004, the IRS offered a settlement to approximately 1200 taxpayers. Many taxpayers who had engaged in Son-of-BOSS transactions, however, either did not qualify, chose not to participate in the settlement, or had not yet been identified. See *Beard*, 633 F.3d at 618.

[2] This case is related to *DSDBL, Ltd.* v. *Commissioner*, 436 Fed. Appx. 384 (5th Cir.), petition for cert. pending, No. 11-581 (filed Nov. 9, 2011). In that case, Morgan executed a different Son-of-BOSS transaction involving some of these same entities.

[3] DDM is a petitioner in this case as the tax-matters partner for UTAM, but this brief refers to UTAM as the petitioner solely for the sake of clarity. In addition, UTA and DDM are S corporations, which are pass-through entities whose tax consequences are attributable to shareholders. See 26 U.S.C. 1366.

mately $28 million and $350,000, respectively. See Pet. App. 1-2, 13-14; see also C.A. App. 24-27.

In August 2000, petitioner and UTA filed their federal income-tax returns for 1999. In computing their inside and outside bases, petitioner and UTA included the amount of the short-sale proceeds ($38 million) that had been contributed to petitioner, without reducing that amount to reflect petitioner's offsetting obligation to close the short positions. Because petitioner's partners were required to report their respective shares of any gain or loss, UTA claimed an overall loss of approximately $13 million, rather than the capital gain of approximately $25 million that would have resulted if the Son-of-BOSS transaction had not been utilized.[4] And because Morgan was required to report his share of any gain or loss from his interest in UTA, when he filed his federal income-tax return on October 16, 2000, he also reported a substantial loss rather than a sizeable gain. See Pet. App. 3-4.

2. On October 13, 2006, more than six years after the filing of petitioner's partnership return but less than six years after the filing of Morgan's individual return, the IRS issued a Final Partnership Administrative Adjustment (FPAA) that decreased petitioner's basis in its assets and thereby had the effect of substantially increasing Morgan's taxable income for 1999. See Pet.

---

[4] As explained below, see p. 8, *infra*, partnerships do not pay federal income tax, but they are required to file annual information returns reporting the partners' distributive shares of income, gain, deductions, or credits. See 26 U.S.C. 701, 6031; *Randell* v. *United States*, 64 F.3d 101, 103 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996). The individual partners also report their respective distributive shares on their federal income-tax returns. See 26 U.S.C. 701-704. Unpaid taxes are assessed against the individual partners.

App. 4. Petitioner challenged the FPAA in the Tax Court, arguing that it was barred because it was issued after the expiration of the three-year assessment period provided by 26 U.S.C. 6501(a). Petitioner argued in the alternative that even under the extended six-year assessment period in 26 U.S.C. 6501(e)(1)(A), which applies when a 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 issuance of the FPAA to petitioner did not suspend the running of the six-year period with respect to Morgan.

3. The Tax Court granted summary judgment to petitioner. Pet. App. 12-20. The court relied primarily on its earlier holding in *Bakersfield Energy Partners, LP* v. *Commissioner*, 128 T.C. 207 (2007), aff'd, 568 F.3d 767 (9th Cir. 2009), that an understatement of gross income attributable to an overstatement of basis does not trigger the extended assessment period in Section 6501(e)(1)(A). Pet. App. 17-18.

4. The court of appeals reversed. Pet. App. 1-11. For the reasons set forth by the court in a companion case, *Intermountain Insurance Service of Vail* v. *Commissioner*, 650 F.3d 691 (D.C. Cir.), petition for cert. pending, No. 11-663 (filed Nov. 16, 2011), the court held that "the six-year limitations period applies with regard to Morgan's 1999 return." Pet. App. 6. The court then rejected petitioner's argument "that the mailing of the [FPAA] * * * did not toll the running of Morgan's [Section] 6501 limitations period." *Ibid.* The court agreed with the en banc opinion of the Tax Court in *Rhone-Poulenc Surfactants & Specialties, L.P.* v. *Commissioner*, 114 T.C. 533, 543 (2000), appeal dismissed, 249 F.3d 175 (3d Cir. 2001), that 26 U.S.C. 6229(d) "sus-

pends the running of an individual partner's [Section] 6501 limitations period when that period is open on the date the IRS mailed the FPAA." Pet. App. 9.

DISCUSSION

1. The first two questions presented (Pet. ii, 6-7) involve whether an understatement of gross income attributable to an overstatement of basis in sold property is an "omi[ssion] from gross income" that can trigger the six-year assessment period in 26 U.S.C. 6501(e)(1)(A). On September 27, 2011, this Court granted the petition for a writ of certiorari in *United States* v. *Home Concrete & Supply, LLC*, No. 11-139 (argued Jan. 17, 2012) (*Home Concrete*), which presents the same issue. If the Court concludes in *Home Concrete* that an overstatement of basis in sold property can trigger the extended six-year assessment period, then the administrative adjustment at issue in this case was timely, as the court of appeals correctly held. Accordingly, the Court should hold this petition pending its decision in *Home Concrete*, and then dispose of the petition as appropriate in light of that decision.

2. Petitioner further contends (Pet. 7-14) that, even if the Court rules in the government's favor in *Home Concrete*, the court of appeals' judgment in this case should still be reversed. Petitioner argues that when the IRS contests the tax treatment of a partnership item and issues an administrative adjustment (or FPAA) to a partnership, that FPAA suspends the running of the assessment period only as to the partnership (here, petitioner) and not as to the individual partners (UTA and Morgan as UTA's owner). Petitioner thus contends that even if the six-year assessment period applies and "even though the FPAA came less than six years after Morgan

filed his 1999 return, the limitations period expired during the proceedings that followed." Pet. App. 6-7. The court of appeals correctly rejected that contention, and its decision does not conflict with any decision of this Court or any other court of appeals. Further review is not warranted.

As the court of appeals explained, see Pet. App. 7-10, petitioner's argument reflects a misunderstanding of the manner in which the IRS assesses additional taxes against partners in a partnership. Partnerships do not pay federal income tax. They are instead required to file annual information returns reporting the partners' distributive shares of income, gain, deductions, or credits. See *id*. at 7; see also 26 U.S.C. 701, 6031; *Randell* v. *United States*, 64 F.3d 101, 103 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996). The individual partners then report their respective distributive shares on their federal income-tax returns, see 26 U.S.C. 701-704, and unpaid taxes are assessed against the individual partners.

Before 1982, when the IRS contested the tax treatment of an item on a partner's return, the IRS issued separate notices of deficiency to the various partners, even if the contested item was common to all partners' returns. See 26 U.S.C. 6212. The piecemeal nature of those individual partner-level determinations created numerous problems in tax administration, including duplication of administrative and judicial effort, inconsistent results for different partners, and difficulty in reaching comprehensive settlements. See *Bassing* v. *United States*, 563 F.3d 1280, 1283 (Fed. Cir. 2009); *Monti* v. *United States*, 223 F.3d 76, 78 (2d Cir. 2000); Staff of the Joint Comm. on Taxation, 97th Cong., 2d Sess., *General Explanation of the Revenue Provisions*

of the Tax Equity and Fiscal Responsibility Act of 1982, 267-268 (Comm. Print 1982).

In 1982, Congress streamlined that procedure by authorizing the IRS to contest the tax treatment of an item at the partnership level. See Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA or Act), Pub. L. No. 97-248, 96 Stat. 324 (codified as amended at 26 U.S.C. 6221-6231). The IRS issues a notice of final partnership administrative adjustment (or FPAA) to the partners entitled to notice. See 26 U.S.C. 6223(a). If the tax-matters partner for the partnership or any notice partner wishes to contest the FPAA, he may file a petition for readjustment within a specified time. See 26 U.S.C. 6226(a) and (b). Such a petition initiates a judicial proceeding to determine all of the partnership items addressed in the FPAA. See 26 U.S.C. 6226(a) and (f). After the court in that proceeding issues its final decision, the IRS may assess additional taxes against the individual partners. See 26 U.S.C. 6225(a)(2).

TEFRA also defines the manner in which the procedure for administrative adjustment at the partnership level affects the running of the assessment period for individual partners. The Act provides that "the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item * * * shall not expire before" three years from the later of the dates when the partnership return is filed or is due to be filed. 26 U.S.C. 6229(a)(1)-(2). That period is extended to six years "[i]f 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." 26 U.S.C. 6229(c)(2).[5]

Section 6229 thus does not establish an independent limitation on the period of time during which additional taxes may be assessed. Rather, Section 6229 provides that otherwise applicable assessment periods, like the three- and six-year periods in Sections 6501(a) and (e)(1)(A), "shall not expire" before either three or six years from the filing of the partnership return. Section 6229 thus establishes a *minimum* assessment period that can serve only to extend, when necessary, other applicable time limits like those in Section 6501. See *Curr-Spec Partners, L.P.* v. *Commissioner*, 579 F.3d 391, 396 (5th Cir. 2009), cert. denied, 130 S. Ct. 3321 (2010); *AD Global Fund, LLC ex rel. North Hills Holding, Inc.* v. *United States*, 481 F.3d 1351, 1354 (Fed. Cir. 2007); *Andantech, L.L.C.* v. *Commissioner*, 331 F.3d 972, 977 (D.C. Cir. 2003). When additional tax is "attributable to any partnership item," Section 6229 ensures that the IRS has three or six years from the filing of the partnership return to assess additional taxes against individual partners if the partnership return is filed *after* individual partners' returns.

Section 6229(d) further provides that the issuance of an FPAA to a partnership suspends "the running of the period specified in subsection (a)." As the court of appeals recognized, "the period specified in subsection (a)" is "the period for assessing any tax imposed by subtitle A." 29 U.S.C. 6229(a). "Since partnerships are not

---

[5] In 2010, Section 6229(c)(2) was amended to extend the assessment period to six years "[i]f any partnership omits from gross income an amount properly includible therein and such amount is described in clause (i) or (ii) of section 6501(e)(1)(A)." 26 U.S.C. 6229(c)(2) (Supp. IV 2010). The amended version does not apply to this case.

taxed," the court of appeals correctly construed "this language to refer to a partner's generally applicable assessment period as provided in [Section] 6501." Pet. App. 9 (citing *Andantech, L.L.C.*, 331 F.3d at 976-977). The court therefore correctly held that when an amount of contested tax is attributable to a partnership item, the three- and six-year periods in Section 6501 for assessing that tax against individual partners can be extended by Section 6229(a) (if the partnership return is filed after the individual partners' returns) and suspended by Section 6229(d) (if the IRS issues an FPAA to the partnership before the period for assessing additional tax against an individual partner has expired).

Petitioner's approach would fundamentally undermine the partnership adjustment process.When the IRS adjusts an item at the partnership level and issues an FPAA, the tax-matters partner for the partnership may institute a judicial proceeding to challenge the FPAA. See 26 U.S.C. 6223(a). That is what occurred in this case and in other pending Son-of-BOSS cases. The IRS may assess additional taxes against individual partners only after a final decision in that proceeding. See 26 U.S.C. 6225(a)(2). Thus, if the issuance of an FPAA did not suspend the running of Section 6501's assessment periods for individual partners, those periods could expire during the pendency of the partnership-level proceeding. See *Rhone-Poulenc Surfactants & Specialties, L.P.* v. *Commissioner*, 114 T.C. 533, 554 (2000) (en banc) (*Rhone-Poulenc*) ("We think it highly unlikely that Congress intended to create a preassessment procedure for partners to contest partnership determinations, during which the Government is prohibited from making related assessments, while at the same time allowing the applicable period of limitations to expire during the time

those preassessment procedures are being utilized."), appeal dismissed, 249 F.3d 175 (3d Cir. 2001).

The court of appeals' holding accords with the decisions of other courts that have considered the issue. See *Rhone-Poulenc*, 114 T.C. at 552 ("[T]he period specified in subsection (a), the running of which is suspended[,] * * * is generally the period prescribed in [S]ection 6501.") (internal quotation marks omitted); *Epsolon Ltd. ex rel. Sligo (2000) Co.* v. *United States*, 78 Fed. Cl. 738, 761-762 (2007) ("In conjunction with the statutory scheme of TEFRA and persuasive authority, the court finds that the reference in section 6229(d) to 'the period specified in subsection (a)' is a reference to the limitations period in section 6501(a), as extended by section 6229."). Petitioner does not contend that any conflict in authority exists. Further review of this aspect of the decision below is therefore not warranted.

CONCLUSION

With respect to the first and second questions presented, the petition for a writ of certiorari should be held pending the Court's decision in *United States* v. *Home Concrete & Supply, LLC*, cert. granted, No. 11-139 (argued Jan. 17, 2012), and then disposed of as appropriate in light of that decision. In all other respects, the petition should be denied.

Respectfully submitted.

DONALD B. VERRILLI, JR.
Solicitor General
TAMARA W. ASHFORD
Deputy Assistant Attorney General
GILBERT S. ROTHENBERG
MICHAEL J. HAUNGS
JOAN I. OPPENHEIMER
Attorneys

FEBRUARY 2012