

IRS Issues Regulations On Six-Year Limitations on Basis Overstatement

OCTOBER 13, 2009

BE IN A POSITION OF STRENGTHSM

The IRS issued proposed and temporary regulations (TD 9466, REG-108045-08) to clarify that an overstatement of basis can create a substantial omission of gross income under IRC §§6229(c)(2) and 6501(e) for purposes of the six-year extended period for assessments and collections of tax attributable to partnership items. In so doing, the Service sought to strengthen its position, which has been rejected in the Tax Court and two circuit courts this year.

The regulations, which are effective upon their release, add new Treas. Reg. §301.6229(c)(2)-IT, which clarifies that, outside the trade or business context, “gross income”, as used in section 6229, has the same meaning as in section 61(a), the general definition that includes under paragraph (3) “gains derived from dealings in property.” They also replace Treas. Reg. §301.6501 with a temporary regulation of the same number to specify that gross income can include “the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property.” 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) under the temporary regulations.

In June 2009, the Ninth Circuit Court of Appeals, affirming the Tax Court, held that no understatement of gross income had occurred where an assessment arose from an overstatement of basis (*Bakersfield Energy Partners LP* (128 TC 207, *aff'd*, 9th Cir., June 2009)). The following month, the Federal Court held similarly in *Salman Ranch Ltd. v. U.S.* (docket no. 2008-5053). The Tax Court also ruled in favor of the taxpayers on the issue in *Kenneth and Susan Beard v. Commissioner* (TC Memo 2009-195). The courts

**TEMPORARY REGULATIONS
EXPAND APPLICABILITY OF
SIX-YEAR STATUTE OF
LIMITATIONS TO COVER
OVERSTATEMENT OF BASIS.**

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held that the 1958 Supreme Court ruling in *Colony Inc. v. Commissioner* (357 U.S. 28) controlled, despite its having been decided under a predecessor statute to section 6229 of the 1939 Internal Revenue Code.

The IRS has maintained throughout these cases that Congress intended in section 6229, part of its 1954 overhaul of the IRC, to limit the holding in *Colony Inc.* to cases arising under the earlier statute.

In its preamble to the temporary regulations, the IRS noted that the Ninth and Federal circuits had acknowledged the current statute to be ambiguous, and that the Ninth Circuit suggested the Service could clarify the matter by regulation.

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