Current Federal Tax Developments

Week of November 18, 2019

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SECTION: TCJA
AICPA NATIONAL TAX CONFERENCE: TREASURY TO RELEASE SIGNIFICANT TCJA GUIDANCE BY END OF JANUARY 2020

Citation: Kristen A. Parillo, "Carried Interest, SALT Among Imminent TCJA Guidance," Tax Notes Today Federal, 2019 TNTF 221-1, 11/14/19

Treasury Assistant Secretary David Kautter, speaking at the AICPA National Tax Conference in Washington, DC laid out a number of proposed and final regulations that Treasury expects to release by year end as reported in *Tax Notes Today Federal.*[1]

Kristen Parillo reported that Mr. Kautter indicated that guidance would be forthcoming by year end or in January 2020 in the following areas that may be of interest to those who read this site:

- Carried interest proposed regulations under IRC §1061;
- Proposed regulations related to the $10,000 limit on deductions for state and local taxes under IRC §164;
- Final regulations on the increased basic exclusion amount under IRC §2010;
- Final regulations on qualified opportunity zones under IRC §§1400Z-1 and 1400Z-2;
- Proposed regulations on computing UBI under §512 for tax exempt organizations' separate trades and businesses;
- Proposed regulations on withholding under IRC §3402; and
- Final regulations on the business interest limitation under IRC §163(j).[2]

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[1] Kristen A. Parillo, "Carried Interest, SALT Among Imminent TCJA Guidance," *Tax Notes Today Federal*,

2019 TNTF 221-1, https://www.taxnotes.com/tax-notes-today-federal/tax-cuts-and-jobs-act/carried-interest-salt-among-imminent-tcja-guidance/2019/11/14/2b451 (subscription required)

[2] Kristen A. Parillo, "Carried Interest, SALT Among Imminent TCJA Guidance"

Mr. Kautter noted that the §163(j) final regulation package at this point is over 550 pages long, so we'll have a lot of reading material when that package is released.[3]

Advisers should note that the Office of Information and Regulatory Affairs of the Office of Management and Budget received a set of proposed regulations from Treasury entitled "Treatment of Payments to Charitable Entities in Return for Consideration [TCJA]" on October 29, 2019 that is shown as "pending review" per the agency.[4] No additional information is provided, so it is possible these regulations may relate to the state and local tax limitation regulations Mr. Kautter discussed—or this could be another project altogether.

SECTION: 72
INVESTMENT ADVISORY FEES PAID OUT OF VARIABLE ANNUITY ARE NOT CONSIDERED TAXABLE DISTRIBUTIONS FROM THE ANNUITY

Citation: PLR 201945001, 11/11/19

In a ruling that may provide an option for a deduction of what had become otherwise nondeductible investment advisory fees, the IRS in PLR 201945001[5] (and a series of nearly identical rulings issued at the same time) allowed an insurance company to treat investment advisory fees paid out of an annuity contract as an amount not received by the owner of the annuity under IRC §72(e).

Although investment advisory fees are considered expenses related to the production of income under IRC §212, they are treated as a miscellaneous itemized deduction for individuals. For tax years beginning after 2017 and before January 1, 2026, such items are not deductible for individuals pursuant to IRC §67(g).

In order to address this issue, the insurance company in this ruling proposed to pay investment advisory fees directly out of a tax deferred annuity. The ruling describes the annuities as follows:

> Taxpayer intends to offer three non-qualified deferred annuity contracts (referred to herein as "Contracts"). The Contract will be issued to and owned by an individual, or issued to and owned by "a

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[3] Kristen A. Parillo, "Carried Interest, SALT Among Imminent TCJA Guidance"

[4] RIN: 1545-BP40, Pending Review, *RegInfo Mobile* application, October 29, 2019

[5] PLR 201945001, November 8, 2019, https://www.irs.gov/pub/irs-wd/201945001.pdf, retrieved November 11, 2019

> trust or other entity as an agent for a natural person" within the meaning of section 72(u)(1) (the "Owner").
>
> The Contract is an annuity contract under the law of the jurisdiction where issued. The Contract qualifies for treatment as an annuity contract for federal income tax purposes, including by complying with the requirements of section 72(s). One of the Contracts is a variable contract under section 817(d) while two of the Contracts are not variable contracts under section 817(d). The Contract is not part of any qualified retirement plan within the meaning of section 4974(c).
>
> The Contract is comprised of an accumulation phase and a payout phase. During the accumulation phase, the cash value of the Contract is credited with earnings or interest based on options the Owner selects from a menu provided by Taxpayer (the "Options"), consistent with applicable nonforfeiture law.[6]

The annuities are designed to be used with the assistance of an investment adviser. The ruling goes on to describe the products as follows:

> The Contract is designed for Owners who will receive ongoing investment advice from an investment adviser (the "Adviser") on how to allocate the Contract's cash value (within the meaning of section 72(e)(3)(A)(i)) among the available Options. The Adviser is expected to take into account factors such as (1) the Owner's personal risk tolerance and investment timeline, (2) the interest rate and market environment, (3) the menu of Options available under the Contract, and (4) the various other benefits and features available under the Contract. The Adviser will be an appropriately licensed professional who is in the business of providing investment advice.
>
> In consideration for its advice, the Owner will authorize investment advisory fees (the "Fees") to be paid periodically to the Adviser from the Contract's cash value (the "Authorization"). The Fees will be determined based on an arms-length transaction between the Owner and the Adviser. The Fees will not exceed an amount equal to an annual rate of 1.5% of the Contract's cash value (within the meaning of section 72(e)(3)(A)(i)), determined at the time and in the manner provided in the Authorization or other written agreement with the Adviser but in all events based on such cash value during the period to which the Fees relate. The Fees will compensate the Adviser only for investment advice that the Adviser provides to the Owner with respect to the Contract, and not for any other services. The Fees will not result

[6] PLR 201945001, pp. 1-2

> in any reduction in fees related to any other asset or for any other service.
>
> Taxpayer will pay the Fees directly to the Adviser. During any period for which the Authorization is in effect, the Contract will be solely liable for paying the Fees and the Fees will not be paid directly by the Owner. The Owner will not have the right to direct payment of the Fees for any other purpose or to any other person. The Adviser will not receive a commission for the sale of the Contract from Taxpayer.[7]

The insurance company (the Taxpayer) asked for the following ruling:

> Taxpayer requests a ruling that the Fees Taxpayer deducts from the Contract's cash value and remit to the Adviser will not be treated as an "amount received" by the Owner of the Contract for purposes of section 72(e).[8]

The IRS came to the following conclusions when applying the law to these facts:

> In this case, the Fees are integral to the operation of the Contract. During any period for which the Authorization is in effect, the Owner will receive ongoing investment advice from the Adviser with respect to the Contract so that the Owner may properly utilize the Contract. The Adviser is expected to help the Owner select Options related to the Contract. Taxpayer has represented that the Fees will not serve as consideration for anything other than investment advice provided by the Adviser in relation to the Contract. Furthermore, Taxpayer has represented that the Fees will not exceed an annual rate of 1.5% of the Contract's cash value based on the period in which the fees related. Based on Taxpayer's representations, the Fees will only be used to pay for investment advisory services relating to the Contract. Because the Contracts are designed to work with an Adviser, the Contract is solely liable for the Fees. The Fees do not constitute compensation to the Advisor for services related to any assets of the Owner other than the Contract or any services other than investment advice services with respect to the Contract. Therefore, the Fees are an expense of the Contract, not a distribution to the Owner.[9]

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[7] PLR 201945001, p. 2

[8] PLR 201945001, p. 2

[9] PLR 201945001, p. 4

Thus, the following ruling was granted:

> Based solely on the information submitted and the representations made, the Fees Taxpayer deducts from the Contract's cash value and remit to the Adviser will not be treated as an "amount received" by the Owner of the Contract for purposes of section 72(e).[10]

The caveats section does emphasize that the fees must be directly related to the management of assets in the contract, noting:

> The ruling contained in this letter does not apply to any amount paid by Taxpayer that compensate the Advisor for services related to assets other than the Contract or for any services provided other than investment advice services with respect to the Contract. Any such amount would be an "amount received" by the Owner of the Contract for purposes of section 72(e).[11]

SECTION: 170
IRS ANNOUNCES ENFORCEMENT ACTIONS AGAINST CERTAIN SYNDICATED CONSERVATION EASEMENTS, THREATENS ACTION AGAINST PREPARERS OF AFFECTED RETURNS

Citation: "IRS increases enforcement action on Syndicated Conservation Easements," IRS News Release IR-2019-182, 11/12/19

In News Release IR-2019-182 the IRS announced that it was going to increase enforcement actions against syndicated conservation easements.[12]

The IRS had put certain syndicated conservation easements on the listed transaction list in 2016. As the IRS news release describes the targeted structures:

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[10] PLR 201945001, p. 4

[11] PLR 201945001, p. 4

[12] "IRS increases enforcement action on Syndicated Conservation Easements," IRS News Release IR-2019-182, November 12, 2019, https://www.irs.gov/newsroom/irs-increases-enforcement-action-on-syndicated-conservation-easements, retrieved November 13, 2019

> In December 2016, the IRS issued Notice 2017-10[13], which designated certain syndicated conservation easements as listed transactions. Specifically, the Notice listed transactions where investors in pass-through entities receive promotional material offering the possibility of a charitable contribution deduction worth at least two and half times their investment. In many transactions, the deduction taken is significantly higher than 250 percent of the investment. Syndicated conservation easements are included on the IRS's 2019 "Dirty Dozen" list of tax scams to avoid.
>
> …In addition to grossly overstating the value of the easement that is purportedly donated to charity, these transactions often fail to comply with the basic requirements for claiming a charitable deduction for a donated easement. The IRS has prevailed in many cases involving these basic requirements and has now established a body of law that the IRS believes supports disallowance of the deduction in a significant number of pending conservation easement cases. Where it hasn't done so already, the IRS will soon be moving the Tax Court to invalidate the claimed deductions in all cases where the transactions fail to comply with the basic requirements, leaving only the final penalty amount to be determined.[14]

The IRS in the release encourages taxpayers to avoid penalties and interest by acting now to remove any tax benefits from such transactions from their returns. But see the discussion later in this article about why this action does not necessarily solve the problem.

> Taxpayers may avoid the imposition of penalties relating to improper contribution deductions if they fully remove the improper contribution and related tax benefits from their returns by timely filing a qualified amended return or timely administrative adjustment request.
>
> The IRS's comprehensive compliance efforts are focused on the abusive syndicated conservation easement transactions described in

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[13] Notice 2017-10, https://www.irs.gov/pub/irs-drop/n-17-10.pdf, retrieved November 13, 2019

[14] IR-2019-182, https://www.irs.gov/newsroom/irs-increases-enforcement-action-on-syndicated-conservation-easements, retrieved November 13, 2019

> Notice 2017-10, recognizing that there are many legitimate conservation easement transactions.[15]

The IRS also notes that it's not just participants who may face actions from the agency, noting:

> In addition to auditing participants, the IRS is pursuing investigations of promoters, appraisers, tax return preparers and others. Further, the IRS is evaluating numerous referrals of practitioners to the IRS Office of Professional Responsibility. The IRS will develop and assert all appropriate penalties, including penalties for participants (40 percent accuracy-related penalty), appraisers (penalty for substantial and gross valuation misstatements attributable to incorrect appraisals), promoters, material advisors, and accommodating entities (penalty for promoting abusive tax shelters and penalty for aiding and abetting understatement of tax liability), as well as return preparers (penalty for understatement of taxpayer's liability by a tax return preparer).[16]

Advisers who have clients that have invested in conservation easement programs should review Notice 2017-10 and consider if the program appears to be one covered by the Notice. The taxpayer is especially at risk if the taxpayer failed to timely file the disclosure forms for affected returns (Form 8886, *Reportable Transaction Disclosure Statement*). Note that a failure to file the form both keeps the statute for assessment open and subjects the taxpayer to very substantial penalties.

Even if a return was filed before Notice 2017-10 was issued, if the statute had not yet closed on the assessment of tax for the return by the date the transaction was put on the list, the statute will remain open if the form was not filed shortly after the publication date.[17]

If the adviser was involved with the preparation of that return, the adviser likely should suggest the taxpayer seek alternative counsel on the issue, since there may be conflict of interest issues under Circular 230,[18] the AICPA Code of Professional Conduct and state accountancy board regulations at play if the disclosure was missed and the professional that originally prepared the return attempts to provide representation. The potential

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[15] IR-2019-182, https://www.irs.gov/newsroom/irs-increases-enforcement-action-on-syndicated-conservation-easements, retrieved November 13, 2019

[16] IR-2019-182, https://www.irs.gov/newsroom/irs-increases-enforcement-action-on-syndicated-conservation-easements, retrieved November 13, 2019

[17] IRC §6501(c)(10)

[18] Circular 230, §10.29

conflict issue is heightened by the IRS's explicit threat to take action against preparers as part of this initiative.

As well, while the IRS suggests amending the return to solve the penalty problem, such an amended return will not solve the failure to properly disclose listed transaction problems. The taxpayer could be in a similar situation to that of the taxpayer in *Yari v. Commissioner*, 143 TC No. 7, aff'd CA9 that we discussed in 2016 on the Current Federal Tax Developments website.[19]

SECTION: 274
RULES FOR USE OF OPTIONAL MILEAGE RATES REVISED TO REFLECT TCJA CHANGES

Citation: Revenue Procedure 2019-46, 11/14/19

The IRS issued Revenue Procedure 2019-46[20] to update Revenue Procedure 2010-51 related to rules for using the optional standard mileage rates for business, charitable, medical or moving expense deductions. The modifications are made to reflect changes made to IRC §§67 and 217 by the Tax Cuts and Jobs Act (TCJA).

Those changes removed the ability for taxpayers to deduct miscellaneous itemized deductions and moving expenses through 2025. The new procedure makes clear that use of these special rules does not somehow "work around" those law changes to restore a deduction.

The Revenue Procedure describes the modifications to the rules as follows:

> (1) Section 4.02 is modified to provide that a taxpayer may not use the business standard mileage rate to claim a miscellaneous itemized deduction during the suspension period.
>
> (2) Sections 4.03 is modified to provide that a taxpayer may not claim a miscellaneous itemized deduction during the suspension period for

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[19] Ed Zollars, "Tax Shown on Original Return, Not Amount Computed on Amended Return, Used to Compute Limitation on §6707A Disclosure Penalty," *Current Federal Tax Developments* website, October 17, 2016, https://www.currentfederaltaxdevelopments.com/blog/2016/10/17/tax-shown-on-original-return-not-amount-computed-on-amended-return-used-to-compute-limitation-on-6707a-disclosure-penalty, retrieved November 13, 2019

[20] Revenue Procedure 2019-46, November 14, 2019, https://www.irs.gov/pub/irs-drop/rp-19-46.pdf, retrieved November 14, 2019

parking fees and tolls attributable to the taxpayer using the automobile for business purposes.

(3) Section 4.04 is modified to provide that, under § 1016(a)(2), a taxpayer must reduce the basis of an automobile used in business by the greater of the amount of depreciation the taxpayer claims for the automobile or the amount of depreciation allowable. If a taxpayer uses the business standard mileage rate to compute the expense of operating an automobile for any year, a per-mile amount (published by the IRS in an annual notice) is treated as the depreciation claimed by the taxpayer and the depreciation allowable for those years in which the taxpayer used the business standard mileage rate.

(4) Section 4.05(4) is added to provide that a taxpayer may not use the business standard mileage rate to claim a miscellaneous itemized deduction during the suspension period for unreimbursed travel expenses.

(5) Section 4.06 is added to provide that a taxpayer who pays or incurs unreimbursed employee travel expenses during the suspension period that are deductible by the taxpayer in computing adjusted gross income may use the business standard mileage rate to compute an adjustment to gross income.

(6) Section 5.02 is modified to provide that the deduction for moving expenses during the suspension period does not apply unless the taxpayer is a member of the Armed Forces on active duty moving pursuant to a military order and incident to a permanent change of station.

(7) Section 6.03(2) is modified to provide that in using the fixed and variable rate (FAVR) allowance, an employee may not claim a miscellaneous itemized deduction during the suspension period for parking fees and tolls attributable to the employee driving the standard automobile in performing services as an employee.

(8) Section 7.06 is added to provide that if during the suspension period, an employee's substantiated expenses are less than the employee's actual expenses, the employee may not claim an itemized deduction for the excess amount.

(9) Section 7.08 (formerly section 7.07) is modified to provide that an employee's amount computed under section 4 for the business standard mileage rate is an itemized deduction subject to the 2-percent floor and is not deductible during the suspension period.

> (10) Section 8.04 is added to clarify that amounts paid under a mileage allowance to an employee regardless of whether the employee incurs deductible business expenses are treated as paid under a nonaccountable plan.[21]

The procedure notes that while it is not officially effective retroactively, the IRC law changes do apply prior to the date this ruling was released:

> This revenue procedure is effective for (1) deductible transportation expenses paid or incurred on or after November 14, 2019, and (2) mileage allowances or reimbursements (a) paid to an employee or to a charitable volunteer on or after November 14, 2019, and (b) for transportation expenses the employee or charitable volunteer pays or incurs on or after November 14, 2019. Notwithstanding the effective date in this section 9, amendments made by the TCJA to §§ 67 and 217 are effective for any taxable year beginning after December 31, 2017, and before January 1, 2026.[22]

SECTION: 6501
SON OF BOSS TRANSACTION, EVEN IF A SHAM, DID NOT TRIGGER A LONGER STATUTE TO ASSESS TAX

Citation: Beverly Clark Collection LLC et al. v. Commissioner, TC Memo 2019-150, 11/15/19

The Tax Court took a second look at whether the IRS had been too late in attempting to collect tax from the taxpayers in the case of *Beverly Clark Collection LLC et al. v. Commissioner*, TC Memo 2019-150.[23] The Ninth Circuit had sent the case back to the Tax Court to determine if the transaction was a sham, as the IRS alleged, and, if so, whether that made any difference in seeing if there had been an omission from gross income.

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[21] Revenue Procedure 2019-46, pp. 6-8

[22] Revenue Procedure 2019-46, p. 32

[23] *Beverly Clark Collection LLC et al. v. Commissioner*, TC Memo 2019-150, November 14, 2019, https://www.ustaxcourt.gov/USTCInOP/OpinionViewer.aspx?ID=12105, retrieved November 15, 2019

The limitations period issues are explained by the Tax Court as follows:

> Ordinarily, the limitations period on assessment of tax is three years after the return was filed. Sec. 6501(a). The period is extended to six years "[i]f 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 return". Id. [*7] subsec. (e)(1)(A). In determining the amount omitted from gross income, any amounts "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" are not taken into account. Id. cl. (ii).[24]

For the year in question, the partnership was subject to the TEFRA partnership examination rules. IRC §6229 provides a statute of limitations that allows for assessments against a partner, but it does not eliminate the standard rules. Generally, if either statute is open, the IRS can assess tax in a TEFRA partnership case. In particular for this situation the Court notes:

> Partnership-level adjustments may result in a substantial omission at the partner level for purposes of section 6501(e). *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. at 551; see also *CNT Inv'rs, LLC v. Commissioner*, 144 T.C. 161, 189-191 (2015). And as we explained in *Rhone-Poulenc Surfactants & Specialties*, partnerships are not taxable entities; any income tax attributable to partnership items must be assessed at the partner level. So if the limitations period was open as to the Clarks when respondent issued the FPAA, the FPAA was not meaningless, and this case may proceed; if it was closed, the FPAA is untimely and we must enter decision for petitioner. See *CNT Inv'rs, LLC v. Commissioner*, 144 T.C. at 213; see also *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. at 534-535.[25]

The decision describes the transaction in question as follows:

> From 1987 to 2000 Nelson and Beverly Clark owned a wedding accessories business, the Beverly Clark Collection, which they operated as a sole proprietorship. On March 12, 1999, the Clarks transferred all of the assets and liabilities of the business to a newly created California limited liability company, Beverly Clark Collection, LLC (BCC). In exchange they received 100% of BCC's equity, with the Clarks each receiving 50% interests.

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[24] *Beverly Clark Collection LLC et al. v. Commissioner*, p. 7

[25] *Beverly Clark Collection LLC et al. v. Commissioner*, p. 8

> BCC's 1999 Form 1065, U.S. Return of Partnership Income, and the Clarks' 1999 Form 1040, U.S. Individual Income Tax Return, reported what they claimed to be a sale on December 31, 1999, of an 80.01% interest in BCC to Fausset Trust in exchange for a $10,401,300 Treasury note. Before that sale the Clarks had contributed Treasury notes and a small amount of cash to BCC. BCC then sold the Treasury notes, recognizing a small loss. Respondent characterized the Clarks' acquisition of the notes through a short sale, their contribution to BCC, and BCC's disposition for a small loss as a "Son-of-BOSS" transaction that artificially inflated the Clarks' outside basis in BCC.[26]

The Clarks then took the following steps in preparing their 1999 Form 1040:

> On their 1999 Form 1040 the Clarks reported a short-term capital loss of $26,813 and a long-term capital loss of $3,703 on the sale of the BCC interest to Fausset Trust. BCC's 1999 Form 1065 reported capital contributions of $13,257,425 for the year. The 1999 Schedules K-1, Partner's Share of Income, Credits, Deductions, etc., for Mr. Clark, Mrs. Clark, and Fausset Trust showed end-of-year ownership interests of 9.99%, 10%, and 80.01%, respectively. BCC's Form 1065 and the Clarks' Form 1040 for 2000 reported what they claimed to be the tax consequences to BCC and its partners, the Clarks and Fausset Trust, of the March 2000 liquidation of BCC and sale of its assets to Maplewood LF Investors, LLC. The Clarks' 2000 Form 1040 reported $2,083,976 of gross proceeds and $1,406,395 of gain from the post-liquidation sale of BCC's assets and goodwill. The Clarks also reported gross income of $811,512 for 2000. BCC's 2000 Form 1065 reported a $10,527,061 distribution of property and the Clarks' 2000 Schedules K-1 reported flowthrough losses of $7,284,835 and $7,284,837, respectively. The Schedules K-1 also reported guaranteed payments from BCC to the Clarks totaling $150,000; the Clarks did not report this amount on their 2000 Form 1040, however.[27]

The IRS issued a notice of final partnership administrative adjustment (FPAA) in August 2008, taking the position that the transactions were a sham, and that the reported basis for the computations of gain and loss were overstated by the sham. The FPAA was issued more than three years, but less than six years, after the statute of limitation had begun to run on the 1999 returns.

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[26] *Beverly Clark Collection LLC et al. v. Commissioner*, pp. 2-3

[27] *Beverly Clark Collection LLC et al. v. Commissioner*, pp. 3-4

The IRS had argued both that the understatement of basis triggered the extended six-year statute and that, since the transaction was a sham in the IRS's view, the taxpayers had also failed to report just over 80% of the ultimate sales proceeds on their return.

The Tax Court originally ruled that the six-year statute did not apply since an overstatement of basis did not equate to an understatement of gross income. The Supreme Court would issue an opinion two years later that came to the same conclusion with regard to overstatements of basis.[28] The original Tax Court opinion did not address the sham transaction question.

The IRS appealed the Tax Court's decision to the Ninth Circuit. When the Supreme Court ruled that an overstatement of basis is not an understatement of income for these purposes in the *Home Concrete* case, the IRS abandoned that argument on appeal. The Ninth Circuit found that the Tax Court needed to address the sham transaction argument to see if that could lead to an omission of gross income to trigger the six-year statute.

The Tax Court concluded that, even if the transaction is assumed to be a sham, that would not have triggered the six-year statute. The opinion looks to the Supreme Court's decisions, noting that the Supreme Court determined the key issue is if the IRS was made aware of the existence of a transaction in determining if the six-year statute rule applies:

> In considering the application of a prior version of section 6501(e)(1)(A), the U.S. Supreme Court explained that "the Commissioner is at a special disadvantage" where a taxpayer fails to report an item of tax and "the return on its face provides no clue to the existence of the omitted item." *Colony, Inc. v. Commissioner*, 357 U.S. 28, 36 (1958). The Court went on to explain: "On the other hand, when * * * the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting 'gross income' or one, such as overstated deductions, affecting other parts of the return." Id.
>
> …
>
> In *Home Concrete & Supply, LLC*, 566 U.S. at 483, the Supreme Court concluded that its interpretation in *Colony, Inc.*, applied with equal force to the current version. In both cases the Supreme Court considered and rejected respondent's argument here that the phrase "omits * * * an amount" in section 6501(e)(1)(A) should be read to include an understatement of an amount, concluding that such a

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[28] *United States v. Home Concrete & Supply, LLC*, 566 U.S. 478 (2012)

> reading would give too much weight to "amount" and too little to "omits". *Home Concrete & Supply, LLC*, 566 U.S. at 485-486; *Colony, Inc. v. Commissioner*, 357 U.S. at 32-33. In *Colony, Inc.*, the Court rejected the Commissioner's argument that the phrase "omits from gross income an amount properly includible therein" should be read to include an understatement of income arising from an overstatement of costs. And in *Home Concrete & Supply, LLC*, 566 U.S. at 490, the Court expressly rejected the Commissioner's argument that "omits" could be construed to include an understatement of income arising from an overstatement of basis.[29]

In this case, the Court decided that the taxpayers had reported the transaction, but only reported the wrong amount of gain—and that would not trigger the six-year rule:

> … [E]ven if we assume that the basis was not wrong but the sale of BCC to Fausset Trust was a sham, the Clarks did not omit an item of gain entirely; they just reported an incorrect amount of gain. See id. at 208 (concluding that when a taxpayer overstates basis and thereby understates gain, "the taxpayer has reported, not omitted, the item of gain, albeit in an incorrect amount"). We therefore reject respondent's assertion that the test in section 6501(e)(1)(A) is computational. And we find no support for respondent's claim that Colony, Inc. should not apply here because that case involved gross proceeds of a business unlike here. See *Carpenter Family Invs., LLC v. Commissioner*, 136 T.C. 373, 386 (2011).
>
> The parties agree that the Clarks reported gain attributable to the total 19.99% interest in BCC that they claimed to retain after the sham transaction. One could argue that the Clarks omitted the entire amount of gain allocated to Fausset Trust, but the result of respondent's sham-sale theory is that the Clarks should have reported 100% of the gain on the postsale liquidation rather than 19.99%. And because they reported 19.99% of the gain rather than 100%, they did not "omit" an item of gain entirely but rather reported an incorrect amount, so the six-year period of limitations does not apply.7 While the clues on the returns filed here seem "sufficient to intrigue [only] a Sherlock Holmes",8 they must suffice under the statutory framework for the reasons explained by the Supreme Court.[30]

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[29] *Beverly Clark Collection LLC et al. v. Commissioner*, pp. 10-11

[30] *Beverly Clark Collection LLC et al. v. Commissioner*, pp. 12-13