

## Tax Controversy Updates: Overstatement of basis does not trigger six year statute of limitations

Recently the U.S. Tax Court ruled that an overstatement of basis is not an omission from gross income for purposes of the extended period of limitations under Section 6501(e)(1)(A). *Beard et ux. v. Commissioner*, TCM 2009-184 (August 11, 2009).

### Background

In this case, the taxpayer sold his stock in two Subchapter S corporations ("S corporations") to an unrelated third party in 1999 and timely filed his 1999 return on April 11, 2000. On April 13, 2006 the IRS issued a notice of deficiency reducing the taxpayer's basis in the S corporations by \$12,160,000, thus increasing the capital gain from the sale by that amount.

The taxpayer filed a motion for summary judgment, on the ground that the notice of deficiency was issued after the period of limitations had expired. The taxpayer's position was that an overstatement of basis is not an omission from gross income for purposes of the extended period of limitations under Section 6501(e)(1)(A).

### Twenty five percent omission and the six year statute of limitations

The general rule for the statute of limitations on assessment is set forth in IRC Section 6501(a), which requires the IRS to assess tax within three years of the time the federal income tax return is filed. IRC Section 6501(e)(1)(A) extends the statute of limitations on assessment to six years if there is an undisclosed omission from gross income in excess of twenty five percent. In the case of business property, IRC Section 6501(e)(1)(A)(i) provides that gross income means amount received prior to deduction of cost of goods sold. For non-trade or business property, the predominant judicial view is that overstatement of basis is not an omission of income.

### Conclusion

In this case, the Court relied on *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958) and *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767 (9th Cir. 2009) in holding that the taxpayer's overstatement of basis in the S corporations' stock did not constitute an omission from gross income for purposes of the extended period of limitations under Section 6501(e)(1)(A).

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