

## Statute of Limitations Regarding Overstatement of Basis

On September 28, 2009, the Treasury Department issued Temporary Regulations (TD 9466) extending the statute of limitations (“SOL”) for making tax assessments when a taxpayer understates her income as the result of overstating the basis of a sold asset. The new regulations lengthen the SOL to 6 years when a taxpayer’s overstatement of basis causes a more than 25 percent understatement of income reported on her tax return.

In general, the SOL limits the time period during which the Internal Revenue Service (“IRS”) can assess an additional income tax liability against a taxpayer. Section 6501(a) of the Internal Revenue Code (“IRC”) provides that “any tax imposed by this title shall be assessed within 3 years after the return was filed.” The three-year assessment period extends to 6 years “[i]f the taxpayer omits from gross income an amount . . . which is in excess of 25 percent of the amount of gross income stated in the return . . . .” When a substantial omission exists and the 6-year assessment period applies, the entire return is open for adjustment, not just the omission.

Under IRC § 6501(e)(1)(A)(ii), in determining the amount of gross income a taxpayer has omitted from her return, the total excluded does not include any amount disclosed in the taxpayer’s return, or in a statement attached to the return “in a manner adequate to apprise the [IRS] of the nature and amount of such item.”

There has been a continuing issue as to whether an overstatement of basis in a sold asset results in an omission from gross income such that the 6-year SOL applies. Courts have interpreted the rules differently. In *Bakersfield Energy Partners, LP v. Comm’r*, 128 T.C. 207 (2007), the Tax Court held that the 6-year SOL did not apply to a basis overstatement. However, other courts have held that the SOL is extended where an understatement of income results from basis overstatement. See *Home Concrete & Supply, LLC v. United States*, 599 F. Supp.2d 678 (E.D.N.C. 2008). Thus, the Temporary Regulations were promulgated to clarify that the 6-year SOL applies where the

overstatement of basis in a sold asset results in an understatement of income that exceeds 25% of the gross income reported on the return.

The IRS' rationale is that gross income for purposes of the SOL for tax assessment should be determined by the definition under IRC § 61. That section defines gross income as including "gains derived from dealings in property." The associated Treasury Regulations further explain that gain equals "the excess of the amount realized over the unrecovered cost or other basis for the property sold or exchanged." Hence, any overstatement of basis that causes an understatement of gross income constitutes an omission from gross income for purposes of determining the applicable SOL.

The Temporary Regulations apply to taxable years with respect to which the period for assessing tax did not expire prior to September 24, 2009.