AMERICAN COLLEGE OF TAX COUNSEL

February 16, 2010

The Honorable Michael F. Mundaca
Acting Assistant Treasury Secretary (Tax Policy)
Department of the Treasury
Room 3120 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Douglas Shulman
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
Room 3026 IR
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Messrs. Mundaca, Shulman and Wilkins:

On behalf of the American College of Tax Counsel ("ACTC"), I am writing to express concern over the September 28, 2009 release of retroactively effective Temporary Regulations under Sections[1] 6229(c)(2) and 6501(e). See 74 FR 49321 (T.D. 9466) (the "Temporary Regulations"). The ACTC is a nonprofit professional association of tax lawyers in private practice, in law school teaching positions and in government, who have been licensed for at least 15 years at the time of their admission and who are recognized for their excellence in tax practice and for their substantial contributions and commitment to the profession. This letter was prepared by the members of the Board of Regents of the ACTC who are not involved in matters that are the subject hereof.

As discussed below, ACTC questions the validity of the retroactive effectiveness of the Temporary Regulations, and questions whether a reviewing tribunal would grant any deference to this aspect of the Temporary Regulations. More importantly, however, ACTC believes that the decision to make the Temporary Regulations retroactively effective is contrary to sound tax

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[1] References to "Section" are references to sections of the Internal Revenue Code of 1986, as amended.

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administration. ACTC strongly recommends that the Internal Revenue Service (the "Service") and Treasury reconsider the Temporary Regulations and make them prospective only.

Background

Generally, the Service must assess any additional tax with respect to a tax return within three years of the later of the date on which the return was due or the date on which the return was filed. Section 6501(a). A similar three year rule applies in the context of the Service's ability to assess additional tax with respect to a partner's share of any "partnership item." Section 6229(a). In either case, the three year statute of limitations is extended to six years if the taxpayer's return contains an undisclosed omission from gross income in excess of 25 percent of the amount of gross income stated on the return. Sections 6229(c)(2), 6501(e)(1)(A).

In recent years, the Service has actively pursued many tax shelters, including the infamous "Son of Boss" tax shelter. The three year statute of limitations has expired for many Son of Boss tax shelters, but the Service's litigating position has been that an overstatement of basis alone can constitute an "omission from gross income" for purposes of the 25 percent test. Two Federal Circuit Courts of Appeals have disagreed with the Service's position, and refused to extend the statute of limitations from three to six years. See, Bakersfield Energy Partners v. Commissioner, 568 F.3d 767 (9th Cir. 2009); Salman Ranch Ltd. v. United States, 573 F.3d 1362 (Fed. Cir. 2009). These cases rely primarily on the United States Supreme Court's decision in Colony v. Commissioner, 357 U.S. 28 (1958) (holding under a predecessor to Section 6501(e)(1)(A), that an understatement from income resulting from an overstated basis does not constitute an omission from gross income).

The Temporary Regulations

The Temporary Regulations adopt the Service's litigating position that, outside of the trade or business context, any basis overstatement that leads to an understatement of income constitutes an "omission from gross income" for purposes of the six year statute of limitations under Sections 6229(c)(2) and 6501(e)(1)(A). It is questionable whether the retroactive effective date is valid under §7805(b) and whether a reviewing tribunal would grant any deference whatsoever to the Temporary Regulations. The Temporary Regulations run counter to the Supreme Court's decision in Colony and the decisions of the Courts of Appeals cited above, which hold that a basis overstatement does not constitute an "omission from gross income." See Bakersfield Energy Partners and Salman Ranch, supra. Moreover, courts have frowned upon prior attempts by the Service to bootstrap its litigating position in the form of regulations. See Chock Full O' Nuts Corp. v. United States, 453 F.2d 300 (2d Cir. 1971) ("the Commissioner may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations."); Sala v. United States, 552 F.Supp.2d 1167 (D. Colo. 2008) (invalidating the retroactive effectiveness of Treas. Reg. 1.752-6, and noting that the promulgation of Treas. Reg.

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1.752-6 was "an obvious effort to bootstrap the government's litigating position" with respect to Son of Boss cases)[2].

The Temporary Regulations are effective for all tax years with respect to which the statute of limitations has not closed (taking into consideration the Temporary Regulations) as of September 24, 2009 (the date the Temporary Regulations were filed with the Federal Register). The Temporary Regulations thus apply with retroactive effect, in that taxable years which had closed are now reopened. The House Committee Report accompanying the Taxpayer Bill of Rights expresses the general belief of the House Ways & Means Committee (and presumably the 104th Congress) that "it is generally inappropriate for Treasury to issue retroactive regulations."[3] Thus, under Section 7805(b), retroactively effective Treasury regulations are impermissible, with limited exceptions. Under Section 7805(b)(3), regulations may be issued retroactively to prevent abuse, but the Temporary Regulations do not purport to rely on this exception, presumably because the retroactive feature of the Temporary Regulations cannot prevent abuse, the targeted transactions and tax returns having been completed years before the Temporary Regulations were promulgated. None of the other exceptions under Section 7805(b) appear to apply to the Temporary Regulations.

Sound Tax Administration

ACTC has long and vocally supported the Service's attacks on abusive tax shelters. We agree with the Service's desire to discover and stop these schemes.

Our distaste for tax shelters notwithstanding, the prohibition against retroactive regulations is derived from the sound tax policy that the rules of tax administration should not be altered without notice and comment, and that taxpayers are entitled to rely on the law, including Treasury Regulations, as it exists at the time they engage in transactions or file their tax returns. Looking in particular at the policy of the statute of limitations, Congress properly decided that it was not in the best interests of the tax system to have tax cases begun more than three years after returns are filed, with all of the attendant issues relating to recordkeeping and reconstruction of transactions, subject only to an exception if the taxpayer's return omits substantial gross income and thereby justifies a tolling of the otherwise effective statute of limitations. The Service's effort in pursuing tax shelters is laudable, but in this case, the end does not justify the means.

In promulgating retroactive regulations to support ongoing litigation, the Service sends the wrong message to the taxpaying (and self-reporting) public. Statutes of limitations are an important

2 But see, *Anderson, Clayton & Co. v. United States* ,562 F.2d 972 (5th Cir. 1977), *cert. denied*, 436 U.S. 944 (1978), reversing *Anderson, Clayton & Co. v. United States,* 387 F. Supp. 601 (S.D. TX 1975), a district court decision in favor of the taxpayer by following a regulation promulgated after the district court decision was rendered and while the appeal was pending, based on Section 7805(b) prior to its amendment in1996 (Taxpayer Bill of Rights 2, P.L. 104-168, §1101(a)).

3 H.R. Rep. 104-506, 104th Cong. 2d Sess. 44 (1996).

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aspect of tax administration, and all taxpayers should be allowed to rely on them when they have closed, regardless of one's view of the propriety of the result occasioned by the running of the limitations period. The Temporary Regulations may allow the Service to pursue taxpayers who engaged in abusive transactions, but the public policy rationale for the prohibition on retroactive regulations outweighs these benefits. Statutes of limitations are an important aspect of tax administration, and sound administration of the tax system justifies allowing tax years to close in accordance with law even if in individual cases a potential tax liability is thereby left uncollected.

The Son of Boss tax shelters, in their various permutations, have been determined by courts to be unsound, and we applaud the Service for vigorously pursuing such transactions. We cannot, however, support, through retroactive regulations, an effort to pursue taxpayers who engaged in these transactions for whom the statute of limitations has otherwise lapsed.

We urge you to re-consider the retroactive application of the Temporary Regulations.

Very truly yours,

Richard M. Lipton
Chair
American College of Tax Counsel