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IN THE SUPREME COURT OF THE UNITED STATES
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UNITED STATES, :
Petitioner : No. 11-139
v. :
HOME CONCRETE & SUPPLY, LLC, ET AL.:
- - - - -x
Washington, D.C.
Tuesday, January 17, 2012

The above-entitled matter came on for oral
argument before the Supreme Court of the United States
at 10:02 a.m.

APPEARANCES:
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Department of Justice, Washington, D.C.; on behalf of
the Petitioner.
GREGORY G. GARRE, ESQ., Washington, D.C.; on behalf of
the Respondents.

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P R O C E E D I N G S

(10:02 a.m.)

CHIEF JUSTICE ROBERTS: We'll hear argument first this morning in Case 11-139, United States v. Home Concrete & Supply.

Mr. Stewart.

ORAL ARGUMENT OF MALCOLM L. STEWART

ON BEHALF OF THE PETITIONER

MR. STEWART: Mr. Chief Justice, and may it please the Court:

The disputed question in this case concerns the meaning of the phrase "omits from gross income an amount properly includable therein" in 26 U.S.C. 6501(e)(1)(A). More specifically, the question is whether an omission from gross income occurs when a taxpayer overstates his basis in sold property and thereby understates the gain that results from the sale.

In December 2010, after notice and comment rulemaking, the Treasury Department issued published regulations that interpreted section 6501(e)(1)(A) to apply in overstatement of basis cases. Those regulations reflect a reasonable interpretation of ambiguous statutory language and they are accordingly entitled to deference under Chevron.

CHIEF JUSTICE ROBERTS: Well, but only if

1 your reading of the Colony decision is correct, right?

2 If we think that Colony definitively resolved the
3 question before you, the regulation can't overturn that.

4 MR. STEWART: If the Court in Colony had
5 interpreted the statutory language to be unambiguous or
6 if the Court in Colony had issued an authoritative
7 interpretation that Congress had then built upon, that
8 would be correct. But the Court in Colony stated that
9 the language was, in its words, "not unambiguous."

10 JUSTICE SCALIA: Yes, but once -- once we
11 resolve an ambiguity in the statute, that's the law and
12 the agency cannot issue a -- a regulation that changes
13 the law just because going in the language was
14 ambiguous.

15 MR. STEWART: I think -- I don't think that
16 the Court in Colony purported to give a definitive
17 definition of the phrase "omits from gross income an
18 amount properly includable therein" wherever it appears
19 in the United States Code. And the Court in the first
20 paragraph of its opinion in Colony said "The sole
21 question before us is whether the taxpayer is subject to
22 the extended assessment period under the" 19 -- "under
23 the Internal Revenue Code of 1939."

24 And as the D.C. Circuit, for instance,
25 pointed out in Intermountain, what we are interpreting

1 now is the 1954 code. It's true that, like the 1939
2 code, it includes the phrase "omits from gross income an
3 amount properly includible therein," but it also
4 includes adjacent provisions that bear upon the meaning
5 of that phrase.

6 CHIEF JUSTICE ROBERTS: Well, if they use
7 the exact same phrase, and it's a fairly detailed --
8 it's not just a normal phrase they might use
9 elsewhere -- I think it's reasonable to assume that that
10 phrase came in with the baggage it carried from the
11 Colony case; right?

12 MR. STEWART: I think it's important to
13 remember that the 1954 code was enacted in 1954, and the
14 Colony decision came in 1958. And so, I would take your
15 point that if Congress had enacted the same language
16 after this Court's decision in Colony, then the adjacent
17 statutory provisions that we're relying on would be
18 pretty indirect means of expressing an intent to change
19 the law.

20 But what Congress was reacting to in 1954
21 was not this Court's Colony decision; it was reacting to
22 a circuit conflict and trying to resolve that conflict.

23 JUSTICE SCALIA: Yes, but our -- our job is
24 not to plumb Congress's psyche and decide what they had
25 in mind. It's to interpret the statute. And if, as you

1 acknowledge, it's a pretty obscure way to change the law
2 from what we said it was, the law that's written there,
3 that's a very obscure way to change it. I'm inclined to
4 think that the law stays the way it was.

5 MR. STEWART: Well, let me -- let me point
6 to the statutory provisions that I have in mind, to
7 explain a little bit more fully why we think that the
8 context in which the new provision or the 1954 provision
9 appears bears on the proper interpretation of the
10 disputed phrase.

11 It's at page 1a of the red brief, the
12 appendix to the Respondents' brief.

13 And -- and the -- the general rule stated in
14 subsection (a) is: "If the taxpayer omits from gross
15 income an amount properly includable therein which is in
16 excess of 25 percent of the amount of gross income
17 stated in the return, the assessment period is 6 years
18 rather than 3 years."

19 And it's important to recognize that for
20 purposes of the Internal Revenue Code generally the term
21 "gross income" is defined to include gains derived from
22 dealings in property. And in that sense, it might --

23 JUSTICE SOTOMAYOR: But that -- but that
24 argument hasn't changed between the predecessor statute
25 and this statute. You made the same argument under the

1 Colony statute. It lost. So you can't go back to that
2 argument because it's already been rejected.

3 So what goes from that?

4 MR. STEWART: Well, if you look at
5 subparagraph (i), Roman (i) -- or Roman (i) after the
6 general rule, it says: "In the case of a trade or
7 business, the term 'gross income' means the total of the
8 amounts received or accrued from the sale of goods or
9 services, if such amounts are required to be shown on
10 the return, prior to diminution by the cost of such"
11 goods -- "such sales" --

12 JUSTICE SOTOMAYOR: My problem with your
13 argument as I read it in the brief, it's a bit
14 convoluted, as Justice Scalia observed. But if Congress
15 intended to change Colony, it wouldn't just have created
16 this subdivision (i); it would have changed the main
17 statement. So why don't we read this as simply saying:
18 We accept whatever Colony said, and the only thing we're
19 creating exceptions around are the following. The
20 exception argument --

21 MR. STEWART: As I say, I would agree that
22 if Congress had passed this statute after the Court's
23 decision in Colony, that this would have been a fairly
24 oblique way to reflect an intent to change what the
25 Court had done. But Congress was acting in 1954, before

1 the Court's decision in Colony, and it was reacting to a
2 circuit conflict.

3 And I think it's just as fair to say that --

4 JUSTICE SCALIA: So this language would have
5 one meaning if the very same language were adopted after
6 our decision in -- in Colony, and a different meaning if
7 it were adopted, as it was, before our decision in
8 Colony?

9 MR. STEWART: Well --

10 JUSTICE SCALIA: That's a very strange
11 approach to a -- to the meaning of a statute, it seems
12 to me.

13 MR. STEWART: It -- it may be strange, but I
14 think in a sense it's the Respondents who are striving
15 for strangeness, in the following way --

16 JUSTICE KENNEDY: But -- but you're --
17 you're saying -- and I'm just trying to supplement
18 Justice Scalia's question so you can continue to answer
19 it.

20 You're saying that the split is somehow more
21 obscure or more imprecise in its formulation than what
22 Colony did. You're saying that, oh, if Congress knew
23 about Colony, they would have done it differently, but
24 it was a split, this was close enough for government
25 work. That seems to be your argument. And --

1 (Laughter.)

2 MR. STEWART: No, I guess there are two
3 things I'm saying. The first thing I'm saying is in
4 order to construe the statute we need to not put
5 ourselves in -- attempt to put ourselves in the minds of
6 Congress, but at least be aware of the state of the
7 world at the time that Congress acted.

8 And in 1954, when Congress acted, there was
9 the circuit split. And if Congress had wanted to
10 endorse the Colony rule going forward and apply it to
11 trade -- to non-trade and business taxpayers as well as
12 trades and businesses, the most natural thing would have
13 been to change the word "amount" in the main rule to
14 "item," to make clear that the main rule would apply
15 only when an item of gross receipts had been left off
16 the return altogether.

17 It also would have been natural, if Congress
18 had wanted that rule to apply going forward, to change
19 the term "gross income" in the main rule to say "gross
20 receipts," because gross income --

21 JUSTICE KENNEDY: I still don't understand
22 why the world was different after Colony addressed the
23 split than before Colony addressed the split. The issue
24 is still the same.

25 MR. STEWART: I guess the way I would

1 respond to your question, Justice Kennedy, is to say if
2 you look at the statute in its current form, both the
3 text of the main rule and the adjacent provisions that
4 contextually bear on its meaning, than I think ours is
5 by far the better interpretation. And really,
6 what Respondents --

7 JUSTICE SCALIA: Well, by far? By a little
8 maybe, and -- and I -- I might agree with that. But --
9 but we're not writing on a blank slate here.

10 MR. STEWART: And what --

11 JUSTICE SCALIA: Indeed, I think Colony may
12 well have been wrong, but there it is. It's -- it's the
13 law. And it said that that language meant a certain
14 thing. And the issue is whether this is -- this change
15 is enough to change the meaning of the statute. And --
16 and I'm dubious about that.

17 MR. STEWART: I guess my main point is, we
18 think our reading of the text is better, and what
19 Respondents have going for them is the argument that,
20 whether or not this is the way you would otherwise
21 construe the statute, once Colony has said what the
22 statute meant, the Court is bound by it.

23 And our point is that methodology doesn't
24 really work with this provision, because the Court in
25 Colony --

1 JUSTICE KAGAN: Mr. Stewart, don't you have
2 two arguments? One is that the statute changed, but the
3 other is that even the statute remains the -- even if
4 the statute remained the same, Colony itself was a
5 decision that found ambiguity in the statute, so you
6 have the power under Brand X to go back to that statute
7 and reinterpret it, if you will?

8 MR. STEWART: We do have the power under
9 Brand X, but we -- we don't think that the Court needs
10 to reach that question. And when the Court in Colony
11 said that --

12 JUSTICE KAGAN: But if the Court thinks it
13 has to reach that question because it agrees more with
14 Justice Scalia than with you as to whether this statute
15 stays the same, then you have independent Brand X
16 arguments, don't you?

17 MR. STEWART: Yes, we do.

18 CHIEF JUSTICE ROBERTS: Well, about that
19 argument, you rely very heavily on the fact that
20 Justice Harlan used the term "ambiguous," right?

21 MR. STEWART: Yes.

22 CHIEF JUSTICE ROBERTS: But he was writing
23 very much in a pre-Chevron world. I -- he was certainly
24 not on notice that that was a term of art or would
25 become a term of art. And of course, I didn't know him,

1 but my sense is he was very gracious and polite. And
2 you can see him saying: Well, that's a good argument,
3 but. He's not the sort of person who would say: This
4 is it, this is it."

5 I don't think you necessarily can take the
6 use of the word "unambiguous" in his opinion to mean
7 what it does today.

8 JUSTICE GINSBURG: But he did say that
9 something was unambiguous and that was the little (i)
10 that was added. And he also said he wasn't taking any
11 position on the '54 code; isn't that so?

12 MR. STEWART: That's correct. And the Court
13 said that both at the end of its opinion and it also
14 said at the beginning "the only question before us is
15 whether the extended assessment period applies under the
16 '39 code."

17 CHIEF JUSTICE ROBERTS: Is there -- is there
18 a case where we applied Chevron deference to a
19 pre-Chevron opinion, in other words saying, well, the
20 Court looked at that but the Court said it was ambiguous
21 and so we apply Chevron.

22 MR. STEWART: I'm not aware of any case.
23 Obviously, Brand X is a recent decision of this Court.
24 And I would agree with you that it's -- it's perilous to
25 kind of put a Chevron overlay on decisions that were

1 issued before Chevron.

2 JUSTICE BREYER: Even without Chevron -- I
3 mean, even apply it; I would have thought the point of
4 Brand X is you look at the language of the statute and
5 you look at what Congress intended, and where they
6 intended the agency to have power to interpret, you
7 follow the agency. And you could do that after the
8 event if the basis for your decision is that it isn't
9 clear.

10 But that isn't Harlan's opinion at all. He
11 goes and looks at what Congress meant, and what they
12 meant is treat basis like you treat a deduction; and he
13 gathers that from the legislative history. And so I
14 don't see the basis for saying now the agency still has
15 power.

16 Now, forget that one. I mean, that's one
17 point you might want to address, but I may be too unique
18 in that, in which case it's not worth your time.

19 MR. STEWART: Let me give two -- let me give
20 two responses to that, Justice Breyer. I think in
21 effect what Justice Harlan did for the Court in Colony
22 was to construe the term, the reference to an amount of
23 gross income, as though it meant item of gross receipts.
24 That was the practical effect of the Court's decision.
25 And I think two of the -- two of the adjacent provisions

1 of the current code make clear that that's not a --

2 JUSTICE BREYER: No, well, I didn't think
3 that was the basis. I thought the basis is that there
4 are two kinds of things: One is you just don't put in
5 some big category of stuff in your return, and the
6 agency can never figure that one out. And the other is
7 where you don't state your deductions correctly.

8 And now, the cost of goods sold and the
9 basis are difficult cases because of the way the -- the
10 code defined "gross income." It defines it in terms of
11 gain. But Harlan says they are like deductions for
12 purposes of this statute. That's how I read it.

13 But I have a different question. You can
14 pursue this one if you want. What's really bothering me
15 about this case, and I can't quite figure out the answer
16 to this, is it seems to me when they filed that tax
17 return in April of 2000 it was a terrible loophole, but
18 these lawyers have the job of creating loopholes or at
19 least trying to take advantage of them, okay? And the
20 IRS had told them this was okay. Indeed, they had
21 informal advice to that effect.

22 Now there's a -- you don't put the date of
23 the year 2000 reg and I don't know if you are both
24 talking about the same thing. I was really surprised
25 there was no date there. Then what happens is after you

1 lose in every circuit -- not you personally -- they lose
2 in every circuit; and then in the year 2009 they say:
3 Though we lost and though we told everybody this is okay
4 at the time they filed the return, now we are going to
5 pass a new reg and we are going to penalize them, taking
6 all back this money 9 years later. That seems to me
7 pretty unfair. So I would like to know just that
8 answer.

9 MR. STEWART: Well, at the time that the
10 2009 regulation was promulgated first in temporary form,
11 we had lost cases in two courts of appeals. One was
12 Bakersfield in the Ninth Circuit, but the court of
13 appeals in that case said that because the statutory
14 language was ambiguous the agency might be able still to
15 promulgate a regulation that would get Chevron
16 deference.

17 JUSTICE KENNEDY: And what was -- what was
18 the date of that, of Bakersfield?

19 MR. STEWART: That was in, I believe,
20 either -- I believe 2008 was the Ninth Circuit decision
21 in Bakersfield.

22 JUSTICE KENNEDY: Oh, okay.

23 MR. STEWART: It was -- at any rate, it was
24 before the -- the issuance of the regulation in
25 temporary form. A couple of months before the

1 regulation was promulgated we had lost Salman Ranch in
2 the Federal Circuit, but that was by a two to one vote.
3 At that time we had won this issue in four trial courts.

4 JUSTICE KAGAN: But, Mr. Stewart, prior to
5 this latest round of litigation, had the IRS ever said,
6 ever given any indication, that it viewed Colony as not
7 controlling any -- any -- any longer?

8 MR. STEWART: Yes, I think probably the best
9 indication of our -- the position in the intervening
10 years, and we agree that there is a surprising dearth of
11 law -- was the Fifth Circuit litigation in Phinney,
12 P-H-I-N-N-E-Y, which was decided in 1968. Phinney
13 involved a situation in which the taxpayer accurately
14 reported the amount of gross receipts, approximately
15 \$375,000, but misstated the nature of the receipts as
16 proceeds of a stock sale rather than of an installment
17 sale. And the reason that that misstatement of the
18 nature of the receipt made a difference was that it
19 potentially affected the taxpayer's entitlement to take
20 a stepped-up basis. And so the court of appeals in
21 Phinney said that was subject to the extended assessment
22 period, that the misstatement of the nature of --

23 JUSTICE KAGAN: And as a result of this
24 case, the IRS suggested in any kind of guidance or
25 rulings or anything else that it viewed Colony as an

1 outdated decision? Because, you know, I'm a taxpayer
2 and I'm reading Colony, and I'm thinking the language of
3 the statute is still the same; why wouldn't Colony
4 control?

5 MR. STEWART: Well, I -- I think one reason
6 you might think that is that if you were -- you -- the
7 opinion was not oblivious to the fact that the 1954 code
8 had been enacted in the meantime and the Court went out
9 of its way to say: We are discussing only the 1939 code
10 and we are not pronouncing on the meaning of the 1954
11 code, other than to note that our conclusion in this
12 case is consistent with the unambiguous language of new
13 6501(e)(1)(A). And as the D.C. Circuit explained in
14 Intermountain, that is best read as a reference to
15 subparagraph (i), which says that for a trade or
16 business taxpayer 'gross income' will mean gross
17 receipts without an offset for the cost of acquiring
18 goods and services. So --

19 JUSTICE SCALIA: If --

20 MR. STEWART: -- as a taxpayer you would at
21 least be on notice that there was uncertainty as to the
22 proper meaning of the -- the code. Judge Boudin had
23 written for the First Circuit in a case called CC&FW.
24 Operations in 2001 that it was at least doubtful whether
25 the main holding of Colony carried over to the new --

1 the 1954 code. That was certainly dictum, but it also
2 flagged the fact that this was a subject of uncertainty.

3 And remember, the provision at issue here
4 doesn't bear on the legality of the taxpayer's
5 substantive returns. The only question is whether the
6 IRS has 3 years or 6 years to make an extended
7 assessment. So as of 2003, when 3 years from the date
8 of the return had run for these taxpayers, I think the
9 -- what was out there gave them notice that there was at
10 least uncertainty whether Colony applied.

11 JUSTICE BREYER: You say in your brief on
12 page 4: "In 2000 the IRS issued a notice informing
13 taxpayers that Son of BOSS transactions were invalid
14 under the tax law." And you cite without a date. So I
15 was sort of curious whether that particular cite came
16 before or after they filed their return.

17 MR. STEWART: I don't know whether --

18 JUSTICE BREYER: And they say that -- and
19 I -- in July 2000, 3 months after they were filed, the
20 Commissioner reiterated his view: "It has long been
21 held that the extended statute of limitations," da, da,
22 da, "is limited to when specific receipts or accruals
23 are left out of the" -- "of gross income," which is
24 basically the Colony statement.

25 MR. STEWART: Well, the --

1 JUSTICE BREYER: Are you talking about the
2 same thing?

3 MR. STEWART: No. No, those were two
4 different documents. The two documents --

5 JUSTICE BREYER: Okay. So there are two
6 different documents. So -- so in July, they are telling
7 the tax bar this is okay. And what you say is this
8 document here, which you refer to without a date, told
9 them it wasn't okay.

10 MR. STEWART: Well, first of all --

11 JUSTICE BREYER: I'd be rather curious if
12 you could sort that out.

13 MR. STEWART: Well, the 2000 notice that the
14 Respondents have cited, I think the -- the most
15 important point to make about it is that it was the view
16 of a single -- of the district counsel for a single
17 district within the IRS.

18 JUSTICE BREYER: I -- I know there are many
19 ways of downplaying that. But I am just curious as to
20 what happened. What about the one you cited? When was
21 that?

22 MR. STEWART: I don't know the exact date in
23 2000, but it -- it has long been established that
24 transactions lacking economic substance and transactions
25 motivated purely for tax avoidance purposes may be

1 disregarded from -- by the IRS. That -- that was a
2 preexisting proposition.

3 When we issued the notice with respect to
4 Son of Boss transactions in -- in particular, that was
5 simply the IRS's way of informing taxpayers that we
6 regard this particular avoidance mechanism as
7 encompassed by the general principle that transactions
8 lacking economic substance --

9 CHIEF JUSTICE ROBERTS: Well, yes, that's
10 the general principle. But the point you made just a
11 few moments ago is -- I think is responsive to that,
12 which is: We're not talking about the merits; we're
13 talking about a statute of limitation. The whole point
14 of a statute of limitation is some things that are bad
15 are -- are -- are gone.

16 MR. STEWART: That's --

17 CHIEF JUSTICE ROBERTS: You can't go back to
18 them.

19 MR. STEWART: That's correct, and that's the
20 proposition that the Respondents are citing the
21 different 2000 document for. They are citing it as
22 though it were a definitive statement of agency position
23 as to the operation of the assessment period. It -- it
24 was not that. It was a document issued by a single
25 district counsel, and in a sense the -- the reference to

1 Colony as continuing to -- as though it continued to
2 govern the -- the 1954 code was dictum, because the
3 district counsel even in that document stated that it
4 would not be inappropriate to --

5 CHIEF JUSTICE ROBERTS: At what -- at what
6 level of the IRS bureaucracy can you feel comfortable
7 that the advice you are getting is correct?

8 MR. STEWART: Well, this --

9 CHIEF JUSTICE ROBERTS: A single district
10 counsel, you go to there and say, what do you think?
11 And it tells you, and you say, well, that's fine, but I
12 know you don't count, so I want to talk to your boss --
13 your boss?

14 MR. STEWART: This is not advice to the
15 taxpayer. That document was a memorandum from the
16 district counsel to another IRS official. The other IRS
17 official was seeking guidance with regard to the
18 question of whether we needed to get within the 3-year
19 assessment period or whether it was appropriate to rely
20 on the 6-year assessment period. And although the
21 district counsel cited Colony in a way that it suggested
22 that it continued to control the operation of the 1954
23 code, the district counsel stated on the facts of this
24 case it would not be inappropriate to rely on the --

25 CHIEF JUSTICE ROBERTS: So -- so what

1 happened here is that the taxpayer came to the same
2 conclusion as the district counsel of the IRS?

3 MR. STEWART: That's correct, but not --
4 didn't come to the same conclusion as the IRS did in
5 litigating the case in Phinney, didn't come to the same
6 conclusion as the IRS did in --

7 JUSTICE BREYER: What about the -- that's
8 the July. What about this other, undated one. Now, I
9 notice what you say about it. You say that it
10 "described arrangements that unlawfully purport to give
11 them" -- If I read that piece of paper, which I might --
12 you probably read it because you cite it -- will I come
13 away with the impression, had, uh-oh; these loophole
14 arrangements, Son of BOSS, which previously seemed to be
15 okay are now not okay? Is that the impression I'll
16 have?

17 MR. STEWART: First I would say --

18 JUSTICE BREYER: Is that the impression you
19 had?

20 MR. STEWART: That notice would not say --
21 tell you anything relevant to the computation of the
22 assessment period.

23 JUSTICE BREYER: Okay, all right. That's
24 what I suspect. Then look at the unfairness of this.
25 I'm not saying there aren't worse unfairnesses in the

1 world, but nonetheless people spent a lot of money, the
2 whole Bar has gone to an enormous effort. Everything up
3 through 2000 seems to say you can do this. You have a
4 case on point in the Supreme Court. And then 9 years
5 later, after continuous litigation, the IRS promulgates
6 a regulation which tries to reach back and capture
7 people who filed their return 9 years before.

8 MR. STEWART: Again, I'm not quite sure what
9 you mean by saying, would seem to say that you could do
10 this. I don't think there were any affirmative IRS
11 statements that could lead people to believe that the
12 Son of BOSS mechanism was okay.

13 JUSTICE GINSBURG: Can you clarify,
14 Mr. Stewart, two things that Justice Breyer brought up.
15 One, he said that the IRS had given people advice that
16 Son of BOSS was okay, it would work, this tax shelter,
17 this tax scheme would work.

18 And then he said -- he suggested that a
19 basis is like deductions, and you agree that
20 overstatement of deductions don't get you the longer
21 statute of limitations. So why -- why should an
22 inflated basis get you to 6 years when inflated
23 deductions don't? That's one question.

24 And the other question is, is it so that
25 agents told people that Son of BOSS would work?

1 MR. STEWART: No. No, it's not true that
2 the IRS had advised people that Son of BOSS transactions
3 were okay. It wasn't until 2000 that the IRS issued a
4 specific document that said as a matter of agency policy
5 they are not okay. But again, that document was just a
6 kind of case-specific application of the more general
7 proposition, of the more general proposition that
8 transactions lacking economic substance can be
9 disregarded.

10 With respect to why the overstatement of
11 basis is treated differently from the overstated
12 deduction, that follows inexorably from the language of
13 the code. That is, Congress defined the conduct that
14 would trigger the general rule as an omission from gross
15 income, and because of the way that gross income is
16 defined an overstatement of basis can lead to an
17 understatement of gain, which in turn is taken into
18 account in computing gross income. A deduction may
19 ultimately affect taxable income, but it doesn't affect
20 gross income. And so there would be no way of reading
21 the statute to encompass that.

22 Now as to why Congress would have done this,
23 I think a clue is furnished by subparagraph Roman (ii)
24 which is at the bottom of page 1a, and it says: "In
25 determining the amount omitted from gross income, there

1 shall not be taken into account any amount which is
2 omitted from gross income stated in the return if such
3 amount is disclosed in the return or in a statement
4 attached to the return in a manner adequate to apprise
5 the Secretary of the nature and amount of such item."

6 And so that provides a safe harbor that says
7 even if you fall within the general rule, even if you
8 understated your gross income by more than 25 percent,
9 if at some point in the return you gave the IRS adequate
10 information to notice that the misstatement had taken
11 place, you will be off the hook for the secure
12 assessment period.

13 And I think that is highly relevant in
14 responding to the policy concern that Justice Harlan
15 identified in Colony. That is, Justice Harlan said:
16 The reason we think that Congress intended to restrict
17 the statute to situations where an item is left off the
18 return altogether is that those would be the most
19 difficult for the IRS to catch; the IRS would be placed
20 at a special disadvantage.

21 Here in subparagraph (ii), Congress has
22 accomplished the same intent, but through a different
23 mechanism. That is, it's made the general rule sweep
24 more broadly, but given taxpayers an out where the
25 disclosures are adequate.

1 If I could reserve the balance of my time.

2 JUSTICE KENNEDY: Just on that point -- and
3 we will find out in a minute -- is the Respondent going
4 to say, well, it's always implicit that you have a
5 basis; everybody knows you have a basis?

6 MR. STEWART: I don't think that --

7 JUSTICE KENNEDY: So that's -- so that's
8 necessarily what you are telling the government.

9 MR. STEWART: I don't think he will say --
10 I don't want to speculate too much on what he will say,
11 but I think his position is an overstatement of basis
12 could never trigger the assessment period because the
13 item of gross receipts would have been adequately
14 disclosed.

15 CHIEF JUSTICE ROBERTS: Thank you, counsel.

16 Mr. Garre, is it implicit that you always
17 have a basis?

18 ORAL ARGUMENT OF GREGORY G. GARRE

19 ON BEHALF OF THE RESPONDENTS

20 MR. GARRE: Your Honor, our position is the
21 one that the Court reached in Colony, which is that an
22 overstatement of basis is not an omission from gross
23 income. What the Court held in Colony is that an
24 omission -- an omission from gross income is where you
25 leave out a specific taxable item or receipt.

1 We think the court of appeals got it right
2 when it concluded that the statute of limitations on the
3 statute -- on the tax assessments at issue expired in
4 2003 and rejected the IRS's extraordinary efforts to
5 avoid that result by discombobulating this Court's
6 decision in Colony and by seeking to retroactively
7 reopen and extend the statute of limitations.

8 What the government relies on principally is
9 the addition of subparagraph (i) in the code and that
10 was added in 1954, before the Court's decision in 1958.
11 And I would like to make a few points about subparagraph
12 (i) because I think it's the crux of the government's
13 position. The first is just the anomaly of their
14 argument that by adding this subparagraph -- and it's on
15 page 1a of the addendum to the red brief -- which
16 explicates the definition of "gross income" in one
17 specific context, the sale -- the cost of goods or
18 services by a trade or business, Congress meant to
19 change the general rule -- and that's what it called it,
20 the "general rule" -- in subsection (a).

21 JUSTICE KAGAN: Well, why do you think they
22 added that paragraph? Because it seems clear that there
23 was a circuit split at that time about exactly this
24 question and that this paragraph was a response to that
25 circuit split. So what else could Congress have meant

1 by it?

2 MR. GARRE: Well, Your Honor, I think that's
3 probably right. It thought it was agreeing with the
4 taxpayer side of the circuit split. There is
5 legislative history indicating that it also thought it
6 was addressing the computational rule of how to get
7 gross income, which factors into the 25 percent trigger.

8 I think what maybe is most important is this
9 Court in Colony looked at the 1954 amendments at the
10 suggestion of the government and concluded that its
11 decision was consistent with the 1954 amendments.
12 That's in the last line of the decision.

13 JUSTICE KENNEDY: Were most of the --

14 JUSTICE GINSBURG: But that's got to --
15 that's got to refer to (i). It can't refer to -- Harlan
16 said two things. He said: It's ambiguous, therefore
17 I'm going to look at the legislative history to find out
18 what the predecessor section means.

19 And then he says: I'm not going to
20 speculate on what this new thing means, but I do want to
21 point out that the result we reach in Colony is in
22 harmony with the unambiguous language of 6501, et
23 cetera. The only unambiguous language that he could be
24 referring to is in (i) because he's just -- he had said
25 the earlier language was ambiguous.

1 MR. GARRE: Well, I don't -- I don't think
2 so, Your Honor. First of all, you are right, he
3 referred to the whole 6501(e)(1)(A), which includes both
4 subsections. It is not clear that he was identifying
5 subparagraph (i). He could have well been referring to
6 subparagraph (ii), along the lines of what my friend
7 just spelled out, because much of the Colony decision
8 was based on addressing the situation where the IRS is
9 at a special disadvantage because something's been left
10 out entirely. And that really kind of gets to the heart
11 of subparagraph (ii).

12 But the anomaly of the government's
13 construction here today is that Colony would come out
14 differently, because Colony doesn't involve a taxpayer
15 involved in the sale of goods or service; it involved a
16 taxpayer in the sale of real property. So even though
17 this Court in Colony said --

18 JUSTICE SOTOMAYOR: A real estate developer
19 in the business of buying and selling property. So I'm
20 not sure that I buy your argument that it can't be goods
21 and services, because that was the services of this
22 particular company.

23 MR. GARRE: Your Honor, the sale of real
24 property, whether in parcels or otherwise, has always
25 been treated differently than the sale of -- cost of

1 goods or services, which really is a term art. And if
2 you go back at Colony, you can see that the Court
3 referred to basis, referred to property, and that's
4 precisely what the parties did in their brief. The
5 Solicitor General in his own brief framed the question
6 presented as overstatement of basis in the sale of
7 property.

8 That's the situation that we have here
9 today. The subparagraph (i) they are referring to is
10 addressed to the specific situation of a trade or
11 business involved in the sale of cost of goods or
12 services, which is different --

13 JUSTICE KENNEDY: And I was going to ask in
14 conjunction with Justice Kagan's discussion, were the
15 pre-Colony cases that involved splits, did most of those
16 or any of those relate to the sales of goods and
17 services or were they all real estate sales.

18 MR. GARRE: Your Honor, the Uptegrove case
19 did, the Third Circuit case. But they involve -- the
20 fact is they involved both the sale of property and the
21 sale of goods and services. And at that time no one was
22 drawing this bright-line distinction.

23 JUSTICE KENNEDY: Well, but the Congress
24 drew it, as I think is implicit in Justice Kagan's
25 question, when it talks just about goods and services.

1 MR. GARRE: It did do that. There was one
2 reason for Congress to address that specific situation,
3 in that there was a regulation that had defined "gross
4 income" differently. It's appended at the end of our
5 brief and it was discussed in Uptegrove. So there was a
6 reason to single that out. And I think that the more --

7 JUSTICE KENNEDY: The other reason, it was
8 goods and services. There is always FIFO and LIFO. I
9 mean, there's -- taxpayers who sell goods have inventory
10 cushions, and so the IRS is very, very well aware that
11 that kind of judgment is involved in all these
12 statements. It's not quite the same with basis.

13 MR. GARRE: Well, Your Honor, I think it's
14 the opposite if I understand your question, which is
15 that taxpayers typically put more information which is
16 going to put the IRS on notice when you are dealing with
17 basis and the sale of property as opposed to the costs
18 of goods and services, which involve many transactions
19 and you are dealing with them in the aggregate. When
20 you are dealing with the sale of property, as in Colony
21 and here, you are dealing with specific disclosures as
22 to the basis.

23 Here if you look on page 151 of the JA, it
24 lays out the adjustment in the basis. And the same was
25 true in Colony. So to the extent that there is a

1 distinction there, I think it cuts in favor of the
2 taxpayer.

3 The problem for the government is all of the
4 amendments in 1954 were pro-taxpayer amendments as
5 relevant here and yet the government's conclusion is
6 that by adding this subsection addressing the specific
7 situation it meant to take away the general rule in a
8 way that hurt taxpayers. It's inconsistent with what
9 this Court said in Colony because the Court --

10 JUSTICE GINSBURG: But why would they be
11 redundant? I mean, if the statute without little (i)
12 meant what you said it meant, then there would be no
13 occasion to put this in, because "omission from gross
14 income" would refer to items of income items, period.
15 So what work does (i) do, if it just -- if the main
16 rule, the general rule, is as you say it is?

17 MR. GARRE: Your Honor, everyone agrees it's
18 not redundant, even the government, because what it does
19 is at a minimum, it has the computational effect of
20 affecting the 25 percent trigger. The amount to get to
21 the trigger has to --

22 JUSTICE KAGAN: But you agree that that's
23 not why Congress passed that provision?

24 MR. GARRE: Well, it's not clear, Justice
25 Kagan. The Federal Circuit in the Salman Ranch case

1 cited legislative history that suggested it was trying
2 to achieve just that result. But I think the broader
3 point I would make is, it's not at all uncommon for
4 Congress to act to provide an answer to a specific
5 situation that had come up by explicating it, and yet
6 one doesn't conclude that in doing that it's intended to
7 overstate -- override the entire general rule that's
8 stated, particularly where it doesn't touch the language
9 that's the subject of the general rule. Congress didn't
10 in any way touch the phrase interpreted in Colony,
11 "omission from gross income."

12 And the anomaly gets even greater if you
13 look at Congress's actions after Colony. In 1965
14 Congress amended the heading. Now, granted it's only a
15 heading, but it amended it, the heading to the
16 subsection, to mean "Substantial omission of items,"
17 which is perfectly consistent with Colony's
18 interpretation, directly contrary to the government's
19 interpretation.

20 In 1982 Congress re-enacted the same
21 language, "omission from gross income," found in the
22 provision at issue in Colony in 26 U.S.C. 6229, which is
23 the provision for partnerships, and yet it omitted the
24 subparagraph (i) that the government relies upon as the
25 transformative provision narrowing the general rule.

1 And so why on earth would Congress omit that
2 subparagraph if it did the transformative work that the
3 government suggests?

4 The government doesn't have a response
5 except to say that they have to be interpreted the same
6 way, which makes no sense given the emphasis it's
7 placing on subparagraph (i). I think the answer is, is
8 subparagraph (i) just doesn't have and was never
9 intended to have the transformative effect that the
10 government suggests.

11 Whatever -- we can talk about what the Court
12 meant in Colony, but I do think that it's critically
13 important that Colony is entitled to full stare decisis.
14 In fact, it's stare decisis coupled with Congressional
15 re-enactment. The government describes the world after
16 Colony, but the fact is if you go back and look, no one
17 thought that Colony was just a ship passing the night
18 that had only retrospective significance. Everybody,
19 including the IRS, appreciated that Colony was a
20 landmark decision.

21 JUSTICE KAGAN: Well, Mr. Garre where do you
22 find evidence of that? Because you cite some cases in
23 your brief that end up not really supporting your
24 position. And as far as I can see there is only one
25 case after Colony that deals with the question of

1 whether Colony continues to govern after the 1954
2 amendments. And that case, which is Phinney, seems to
3 cut in the opposite direction. So am I missing
4 something? Are there cases that favor you that say that
5 yes, Colony continues to control?

6 MR. GARRE: I think what my response would
7 be first as to Phinney, the Fifth Circuit has clarified
8 that the government's construction of Phinney is just
9 wrong. Phinney was consistent with the Colony rule, it
10 dealt with a particular application of it.

11 JUSTICE KAGAN: Well, whatever the Fifth
12 Circuit said about Phinney, when I read Phinney, it
13 seems to me to cut in the government's direction if not
14 to be entirely on all fours. But I ask are there any
15 other cases that you have that suggests that courts did
16 think that Colony was continuing to be the governing
17 rule?

18 MR. GARRE: If I could make one point on
19 Phinney and then I will address the other cases. I
20 would ask you to look at the Solicitor General's
21 opposition brief in Finney which recognized that Colony
22 was the governing principle. One would think that the
23 government thought that Colony was just a shot in time
24 and had no ongoing significance, they would have said
25 that in the opposition brief in Phinney. The Solicitor

1 General accepted that Colony is the governing rule, as
2 everyone did.

3 As to the cases, I think it's fair to say
4 that no, we can't point to a case in the 1950's, 60s or
5 70s where they specifically confronted the question
6 before the Court today. But what I can say is look at
7 the cases that we cite in our brief and all of those
8 cases discuss this Court's opinion in Colony as if it
9 continues to have lasting affect on the interpretation
10 of the omits from gross income, and yet in the
11 government's -- the IRS's own internal documents, we
12 cite two, 1976 and 2000 where the IRS internally is
13 treating Colony as a landmark decision which controls on
14 a current going forward basis.

15 JUSTICE KAGAN: Because what I was thinking,
16 Mr. Garre, and tell me what you think the consequence of
17 this would be, is that if I were a taxpayer and somebody
18 came to me and said is Colony still the rule, I would
19 have said, well, I can't tell you 100 percent. I think
20 you are good 70 to 80 percent, you know. It's the same
21 language, and there's Colony out there, and nothing the
22 IRS hasn't said that Colony doesn't control, but I
23 can't -- so I'm giving you 70 percent. Do you win if
24 that's the state of the world as I see it?

25 MR. GARRE: Well, I don't know how you would

1 put a percentage on in affect whether Colony was a step
2 I case or not.

3 JUSTICE KAGAN: Well, in terms of what a
4 taxpayer thinks, whether Colony continues to govern.

5 MR. GARRE: I think so. I mean, I think,
6 you know, the IRS's actions here really put taxpayers in
7 an extraordinary situation. I mean they are taking a
8 decision of this Court that says an overstatement of
9 basis, no, that's not an omission of gross income. They
10 are relying on the 1954 amendments to get around that.

11 Look at the Colony decision. The Colony
12 decision says the 1954 amendments, no this decision is
13 perfectly consistent with those. And here comes the
14 government --

15 JUSTICE GINSBURG: And it also says before
16 that, Mr. Garre, and without doing more than noting the
17 speculative debate between the parties as to whether
18 Congress manifested an intention to clarify or change
19 this 1939 code. So, not taking the position on whether
20 the new section changes the code and the part that is in
21 harmony, I can't see how that can be read to mean
22 anything other than the (i), which is unambiguous, and
23 certainly in harmony with the result in Colony.

24 MR. GARRE: Justice Ginsburg, the government
25 in Colony argued that the 1954 amendments compelled its

1 interpretation which is the one that the Court rejected.
2 If this Court -- this Court must have considered that
3 argument in reaching the opposite conclusion. I think
4 that you are right, that it's fair to describe that
5 language as dictum. But this Court has many times said
6 that even if something is dictum, if it explicates the
7 court's holding, the lower courts and this Court would
8 give it a great weight.

9 JUSTICE GINSBURG: But as I read it, it
10 doesn't say, as Colony controls, it's saying we are not
11 going to take the position on what the 1954 code does,
12 whether it clarifies or changes.

13 MR. GARRE: I think that the prefatory
14 language there I think you're right, that's a fair
15 characterization. But ultimately what the court said
16 was its holding was in harmony with the new statute.
17 And you can't reach that conclusion if you agree with
18 the government's interpretation.

19 JUSTICE GINSBURG: But he says "unambiguous
20 language," and he can't mean the general rule because
21 he's already said that is ambiguous. He's got to mean
22 the new position, which is certainly unambiguous.

23 MR. GARRE: I don't think it has to be (i),
24 Your Honor. I think it could be subsection (ii). We
25 don't know which one he was referring to. And the

1 reason why it could be subsection (ii) is because a
2 great deal of the court's analysis dealt with the
3 question of whether the Commissioner was at a
4 disadvantage.

5 I would like to address the rationale in
6 Colony. My friend has referred --

7 CHIEF JUSTICE ROBERTS: Before -- if I could
8 just interrupt you, before you do so, to follow up on
9 Justice Kagan's question.

10 Under our current regime, can you ever give
11 more than a 70 percent chance? Because you have, in the
12 absence of a definitive Supreme Court ruling, the IRS
13 can reach a different result and it can do that
14 retroactively. So, I mean, you don't disagree with
15 that, right? I mean, if we determine that Colony was
16 ambiguous, the IRS can change the rule in Colony, and it
17 can apply that rule, new rule, retroactively. That's
18 what our cases say, right?

19 MR. GARRE: Well, we do disagree with it --
20 I mean, I certainly accept the Brand X part of that.
21 What we disagree with is that, A, the IRS has the
22 authority to retroactively apply an interpretation of
23 its statute, which gets to the meaning of 7805(b)(1);
24 and, B, whether or not the regulation in this case on
25 its face applies retroactively. But I accept --

1 JUSTICE SOTOMAYOR: Well, they can't -- they
2 can't change the interpretation of the statute, but they
3 are the agency with expertise to define a term within a
4 statute. Why don't they have the expertise to define
5 either what the words "gross income" mean or don't mean?

6 MR. GARRE: Well, they don't have any leeway
7 to overturn this Court's decision if that decision
8 specifically addressed the question. And that's the
9 language of Chevron and --

10 JUSTICE SCALIA: Oh, if it is -- according
11 to Brand X, it specifically addressed the question and
12 said that there was no ambiguity. But according to
13 Brand X, if there is ambiguity, despite a holding of
14 this Court, the agency can effectively overrule a
15 holding by a regulation, right? Isn't that what Brand X
16 says?

17 MR. GARRE: Brand X says that --

18 JUSTICE SCALIA: So the only question here
19 is, as the Chief Justice put it, whether, whether indeed
20 Colony meant by "ambiguous," ambiguous.

21 MR. GARRE: I --

22 JUSTICE SCALIA: It depends on what the
23 meaning of "ambiguous" is, right?

24 (Laughter.)

25 MR. GARRE: I don't think so, for this

1 reason. Because Colony -- at the beginning of the
2 Court's decision, Justice Harlan in a gracious way, as
3 the Chief suggested, pointed out that there could be
4 some ambiguity in the text. But then he went on to
5 apply the traditional tools of statutory construction.

6 JUSTICE ALITO: I can hardly think of a
7 statutory interpretation question that we have gotten
8 that doesn't involve some degree of ambiguity, if we're
9 honest about it. We take a case where there's a
10 conflict in the courts of appeals. And so there was at
11 least enough ambiguity in those cases for one or more
12 courts of appeals to come to an interpretation that is
13 contrary to the one that we ultimately reach. So what
14 degree of ambiguity is Brand X referring to?

15 MR. GARRE: Well, I would, I would think
16 that Brand X refers back to Chevron and looks to the
17 first step of Chevron. What Brand X is looking to is
18 whether or not -- it's really a step one or step two
19 case. And on step one, Chevron looks to whether
20 Congress has addressed the specific question presented.
21 And if you look at the Court's decision in Colony, what
22 Justice Harlan said was, Congress was addressing itself
23 to the specific situation where a taxpayer actually
24 omitted some income receipt or accrual in its
25 computation of gross income. And that would --

1 JUSTICE KAGAN: Well, that was the specific
2 situation, but then the question was how clearly did
3 Congress speak to that specific situation. And in order
4 to get his result, Justice Harlan says first that the
5 statute is -- that the statutory text is ambiguous, goes
6 to a bunch of legislative history, and none of that
7 legislative history actually speaks to the exact
8 question before the Court, only by implication.

9 So if you look at the whole of the Colony
10 opinion, it sure seems as though there's a lot of
11 extrapolation going on and essentially a lot of
12 ambiguity.

13 MR. GARRE: Well, I would disagree with
14 that, respectfully, Your Honor. I think the holding of
15 the Court -- and again, it's entitled to stare decisis
16 effect even if this Court might approach it differently
17 today under different modes of statutory construction
18 otherwise. The holding of the Court was that Congress
19 addressed a specific situation of whether an
20 overstatement of basis was an omission from gross
21 income, and the Court said no.

22 JUSTICE KAGAN: Well, in the end there has
23 to be a resolution. But the question is, what does it
24 look like before you get to that resolution? And -- and
25 Justice Harlan is doing a lot of tap dancing there, you

1 know, going to this Senate report, going to that House
2 report, going to this colloquy, before he can come up
3 with an answer.

4 MR. GARRE: He was employing the traditional
5 tools of statutory construction, not just legislative
6 history. He talked about the structure and purpose and
7 the patent tax incongruities created by the government
8 position that an overstatement --

9 JUSTICE GINSBURG: But he did say -- he say
10 he was looking to -- he said the text isn't clear;
11 therefore, I look to the legislative history.

12 MR. GARRE: And that's the tool of statutory
13 construction.

14 JUSTICE BREYER: I agree with you on that.
15 And I agree with Justice Scalia, actually. There are
16 many different kinds of ambiguity and the question is,
17 is this of the kind where the agency later would come
18 and use its expertise. And you are saying here it was
19 up to the Congress and looking at what they had in mind.

20 All right, maybe that's the base, best
21 ground. But suppose it turns out the majority think you
22 are not right on that, okay. Now, here's my question.
23 Assuming you are wrong on that, which I'm not sure you
24 are, but assuming you are wrong, now we get to this
25 regulation. Here is my problem: One -- I have no doubt

1 at some level it seems rather unfair, but that instinct
2 is not enough. The question is what -- what's the law?

3 A, you can say the word "open" doesn't include this
4 case. But we run into the problem that an agency has
5 great authority to construe its own regulation.

6 B, you could say that, well, there's this
7 statute out there that says don't apply it, and there
8 are two routes there. One is something to do with
9 language, which I think you can think of, which seems to
10 cut very much against you if read naturally, but you can
11 strain it to read it in your favor.

12 And the other has to do with a parenthetical
13 where, once again, although they left it out of their
14 brief and they put in ellipses, I can see why they left
15 it out because when you read it it's again ambiguous.
16 We run into the same problem.

17 Then you could say: Well, they are not
18 supposed to do these things retroactively, either on
19 common law administrative law grounds or something like
20 that; they shouldn't do it; it's unfair. And they'll
21 say: But you see, it wasn't that unfair; a child of 2
22 would have known this was a loophole. That's how they
23 would have characterized it. And the IRS never said
24 anything, except for one district director in a
25 different district that really encouraged or underwrote

1 this kind of thing. So it's not nearly as unfair as you
2 think. If you live by loopholes, you will die by
3 regulation. You know, something like that.

4 So looking at those four possible grounds --
5 and I can't think of a fifth -- you take your choice.
6 Which is the strongest, and how do you reply to the
7 objection?

8 MR. GARRE: Well, I think you would first
9 look at the language of the regulation and see whether
10 or not --

11 JUSTICE BREYER: "Open," that's the term.

12 MR. GARRE: -- by its terms it applies
13 retroactively. This Court has made clear, it made clear
14 in the Bowen case, that it is not retroactively unless
15 there is a clear -- it's not retroactive unless there's
16 a clear statement of retroactivity. And our position
17 is, whatever else is true, that what the effective date
18 provision says and the preamble says, it's just unclear
19 about whether it's retroactive or not.

20 JUSTICE SCALIA: I never thought that a
21 revision of a statute of limitation was retroactive
22 legislation, just as I've never thought that a provision
23 altering rules of evidence for a crime, even for crimes
24 that were committed before that alteration, is
25 retroactive legislation.

1 MR. GARRE: Well, I --

2 JUSTICE SCALIA: You know, the crucial date
3 is the date -- at least it's not -- well, you can extend
4 the statute of limitations.

5 MR. GARRE: I think it's retroactive in the
6 worst way, for this reason: It at a minimum
7 extinguishes an affirmative defense, the statute of
8 limitations. This Court recognized that in the Hughes
9 Aircraft case.

10 JUSTICE SCALIA: So say it's unfair, but I'm
11 not sure that the rule against, presumption against
12 retroactivity, technically applies.

13 MR. GARRE: Well, again, I mean, I think if
14 you look at Landgraf and the cases talking about what is
15 retroactive, this regulation here if it is applied
16 retroactively has the consequence this Court points to
17 as the worst kind of retroactivity, which is
18 extinguishing a valid defense in litigation and imposing
19 new consequences for past actions. Hughes Aircraft
20 recognizes that, as do the many courts of appeals that
21 we've cited in our brief.

22 JUSTICE SOTOMAYOR: Presumptively because
23 you're saying that this is a new interpretation. But
24 the IRS is taking the position that the meaning hasn't
25 changed; that it's just clarifying some ambiguity that

1 the courts have had; not that it's had.

2 MR. GARRE: And with all due respect, the
3 law in 2003 when the statute of limitations expired was
4 Colony. Even if the Court -- the agency had leeway to
5 reinterpret it, it's changing the law. And the reason
6 why it's doing that is it's doing it retrospectively.

7 If you look at cases like Brand X, the
8 theory is, you have one interpretation, and then the
9 agency going forward can have another one. In Brand X,
10 the agency sought to apply its new interpretation
11 prospectively. Here, it's doing retrospectively, and
12 when it does that, it changes the law. Maybe the
13 concrete example of that is --

14 JUSTICE SOTOMAYOR: There's too many
15 presumptions in your answer. The first is that Colony
16 controls --

17 MR. GARRE: No, no --

18 JUSTICE SOTOMAYOR: -- which to me itself
19 says it's not -- it's not interpreting the new statute
20 --

21 MR. GARRE: My point on that --

22 JUSTICE SOTOMAYOR: -- whatever its footnote
23 meant.

24 MR. GARRE: No, my point on that was not
25 that Colony controlled as a step one matter, it's that

1 even if the government is right that Colony just said
2 this is one permissible reading, it was the law as -- it
3 was the permissible reading and the law until the
4 government changed it. And the government didn't change
5 it, try to change it, until 2009. The statute of
6 limitations in this case expired in 2003.

7 And so if the government can adopt a new
8 interpretation going forward, the question is can it
9 apply that interpretation retrospectively during the
10 timeframe in this case. And our position on that is
11 that they certainly haven't done so unambiguously. And
12 that -- as this Court said in *St. Cyr*, ambiguity means
13 unambiguous prospectivity. And the Court also, with
14 Justice --

15 JUSTICE KAGAN: Do you -- do you understand
16 the preamble as part of the regulation? Because if I
17 look at the preamble, the preamble seems pretty clear to
18 me. It seems to me that your view that the government
19 did not do this clearly enough must rest on looking at
20 the regulation without the preamble.

21 MR. GARRE: No, no. I mean, the Court
22 could, and certainly, I think you'd go first to the
23 regulation. And it says "was open." The preamble says
24 quote, "this is not retroactive." It says it does not
25 apply to open tax -- it only applies to open taxed

1 years, and not to reopen closed tax years. That's on 75
2 Federal Register 78, 898. The government -- the way
3 that the government gets there is to say that well, even
4 though we passed the regulation long after the statute
5 of limitations expired, because this case is pending, we
6 can apply the new interpretation in determining whether
7 the period closed long before we passed this regulation.

8 At a minimum, that's -- that's a highly
9 strained if not convoluted way to get around
10 retroactivity.

11 The way that the regulation's effective date
12 and the preamble speaks about whether this is
13 retroactive or not is really kind of nonsensical. And I
14 think at a minimum, the taxpayer ought to get the
15 benefit of that. And this Court should say that if the
16 government really wants to do -- take the extraordinary
17 step that it's taking here to retroactively reopen up
18 the statute of limitations, it ought to do so in clear
19 terms and not the convoluted way it's done here.

20 We also think that the -- the IRS just
21 lacked the authority to -- to legislate -- to -- to pass
22 a new interpretation on a statute retroactively. That
23 gets to the meaning of 7805, and whether -- which says
24 "regulations relating to a statutory provision enacted
25 after the 1906 legislation which purported to strip the

1 IRS of authority to act retroactively," whether the
2 "enacted after" clause modifies regulation or statute.
3 And we think in context, it must modify regulation,
4 because there's two types of IRS regulations:
5 Regulations relating to statutes and regulations
6 relating to internal IRS practices.

7 And what Congress said is internal
8 practices, sure, you can operate retroactively when
9 appropriate. With respect to new interpretations of
10 statutes, not retroactive. That was landmark
11 legislation as part of the Taxpayer Bill of Rights.

12 JUSTICE SOTOMAYOR: I take your point about
13 the purpose, but you would have to ignore every rule of
14 grammar that there is in order to read it your way,
15 don't -- wouldn't you?

16 MR. GARRE: Not if you read regulations
17 which relate to statutory provisions as -- as one thing.
18 Regulations which relate to statutory provisions as
19 opposed to regulations which relate to IRS provisions.
20 And if you look at the legislative history, it's clear
21 Congress was thinking about that distinction. If -- if
22 you do read that as one unit, then "enacted on or after"
23 obviously modifies that.

24 I think you have to look at it in context in
25 light of the purpose of it, to get to that conclusion.

1 But courts have adopted that conclusion. The American
2 Council on -- American College of Tax Counsel lays out
3 those cases.

4 We think Judge Wilkinson got it right when
5 he referred to IRS's position in this case as an
6 inversion of the universe, and concluded that accepting
7 IRS's position would "stretch accepted administrative
8 deference principles beyond their logical and
9 constitutional limits."

10 The IRS has the tools at its -- its disposal
11 to identify tax deficiency and take appropriate action
12 timely. Congress acted in 2004 to respond to the
13 precise situation precipitating this case with Son of
14 BOSS transactions. It amended 6501 not by changing the
15 meaning of what's an omission from gross income, but by
16 adopting a new provision which requires taxpayers
17 involved in listed transactions like Son of BOSS to
18 report many additional things, and saying that the
19 statute of limitations did not apply at all if they
20 didn't make those reporting requirements.

21 So going forward, the only impact of the
22 Court's decision in this case is going to apply to
23 everyday regular taxpayers who simply erroneously
24 misstate or overstate the basis in the sale of a home or
25 other assets. There's no reason to take the

1 extraordinary steps that the IRS takes -- asks you to
2 take in this case to reach that conclusion.

3 We would ask the Court to affirm the
4 judgment of the court of appeals to reject the IRS's
5 aggressive position on administrative power, and put an
6 end to a case that the taxpayer should have never had to
7 file in the first place.

8 CHIEF JUSTICE ROBERTS: Thank you, counsel.

9 MR. GARRE: Thank you, Your Honor.

10 CHIEF JUSTICE ROBERTS: Mr. Stewart, you
11 have 3 minutes remaining.

12 REBUTTAL ARGUMENT OF MALCOLM L. STEWART

13 ON BEHALF OF THE PETITIONER

14 MR. STEWART: Thank you, Mr. Chief Justice.

15 I'd like to make three quick points.

16 First, Mr. Garre refers to the amended
17 heading of section -- subsection 6501(e), which now
18 states "substantial omission of items," but I think the
19 heading simply points up the fact that some provisions
20 within subsection (e) refer to amounts and some to
21 items. Subsection (e)(2), which deals with estate and
22 gift taxes, refers to omission of items.

23 And the legislative history makes clear that
24 Congress chose that term precisely to make clear that
25 the understatement -- or the overstatement or

1 understatement of an item that was reported will not
2 give rise to the extended period.

3 The second thing is that at autumn,
4 Respondents argue that the phrase -- the phrase "amount
5 of gross income" should be construed to mean item -- of
6 gross receipts. And they don't offer any real textual
7 argument as to why that would be a sound reading.
8 Really, they rely exclusively on Colony. But the Court
9 in Colony said at the beginning of its opinion that it
10 was pronouncing only on the 1939 code. It said at the
11 end of its opinion that it was not generally trying to
12 construe the 1954 code.

13 And it stated that the relevant -- most
14 relevant language was not unambiguous. And I think the
15 recognition of ambiguity is relevant in part because it
16 sets up our Brand X argument, but it's also relevant
17 because saying that a particular snippet of language is
18 unambiguous is to recognize that its meaning may vary
19 depending on context.

20 CHIEF JUSTICE ROBERTS: Mr. Stewart, I know
21 you've got a -- your third point, and I want to let you
22 get it out, but you mentioned Brand X. Have we ever
23 applied Brand X to one of our decisions? Have we ever
24 said an agency by regulation can alter or change one --
25 a Supreme Court decision?

1 MR. STEWART: No, I mean -- Brand X was the
2 first case that announced the Brand X principle, and the
3 Court has not applied it since.

4 Justice Stevens --

5 CHIEF JUSTICE ROBERTS: That was applying it
6 to a court of appeals decision.

7 MR. STEWART: That was applying it to a
8 court of appeals decision.

9 CHIEF JUSTICE ROBERTS: We've never said an
10 agency can change what we've said the law means.

11 MR. STEWART: No. Justice Stevens wrote a
12 separate opinion in Brand X, suggesting that it might
13 not apply to decisions of this Court, but the Court as a
14 whole did not pronounce on that.

15 And then the third point I would want to
16 make is that Mr. Garre referred to cases, and one IRS
17 General Counsel opinion that were issued during the
18 period between 1958 and 2000 that applied Colony to the
19 current statute, but they did so in a very specific way.
20 That is, they relied on the aspects of Colony that
21 talked about Congress's purpose to reserve the extended
22 assessment period for cases in which the IRS was at a
23 special disadvantage due to inadequate disclosure.

24 And those cases applied that language in
25 elucidating current subparagraph (ii), which provides a

1 safe harbor in cases of adequate disclosure.
2 Respondents' position goes much further, though.
3 Respondent is attempting to rely on Colony for the
4 proposition that even if its disclosures were
5 inadequate, the extended period still can't be applied
6 to it.

7 And none of the decisions on which
8 Respondents rely establish that proposition.

9 Thank you.

10 CHIEF JUSTICE ROBERTS: Thank you, counsel.

11 Counsel.

12 The case is submitted.

13 (Whereupon, at 11:02 a.m., the case in the
14 above-entitled matter was submitted.)

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