

UNITED STATES V. HOME CONCRETE & SUPPLY, LLC AND ITS IMPLICATIONS FOR ADMINISTRATIVE LAW

By Elizabeth Milito*

I. Introduction

On April 25, 2012, the United States Supreme Court decided United States v. Home Concrete & Supply, LLC, in a ruling that married tax and administrative law principles and ultimately invalidated the action of the Internal Revenue Service ("IRS"). Home Concrete's immediate implications in tax law could help provide some certainty to thousands of taxpayers who otherwise might have been vulnerable to charges if the statute of limitations for "overstatement of basis" actions could be extended from three to six years. Furthermore, the Court's analysis of the regulation at issue required that it review some of its seminal administrative law decisions, most notably Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., and whether or not executive agencies may issue new rules that appear to contradict Court precedent during litigation. Ultimately, the Court's decision in Home Concrete reaffirmed the past twenty-eight years of administrative law jurisprudence and did not expand executive agency deference.

II. Background

The issue in Home Concrete began in December 2006, six years before the U.S. Supreme Court heard arguments. The IRS sought to assess a deficiency against Home Concrete & Supply, LLP, and several other taxpayers, based on 1999 tax returns because those returns involved an "overstatement of basis." "Overstatement of basis," as used by the Internal Revenue Code ("I.R.C."), occurs when a taxpayer overvalues the tax basis of an asset and thereby lowers the amount of gross income reported in his or her tax return, resulting in paying less taxes. The general rule, set out in I.R.C. §6501(a), states:

Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

Thus, the statute has a three-year statute of limitations. Home Concrete's three years expired in April 2003. To salvage its attempt to collect the taxes, the IRS turned to another provision in the tax code, I.R.C. §6501(e)(1)(A), which states:

If the taxpayer omits from gross income an amount properly includible therein and—

(i) such amount is in excess of 25 percent of the amount of gross income stated in the return, or

(ii) such amount—

(I) is attributable to one or more assets with respect to which information is required to be reported under section 6038D (or would be so required if such section were applied without regard to the dollar threshold specified in subsection (a) thereof and without regard to any exceptions provided pursuant to subsection (h)(1) thereof), and

(II) is in excess of \$5,000,

the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

The IRS interpreted this provision to provide it three additional years to assess the deficiency against Home Concrete and the other taxpayers. To utilize the new law and its six-year statute of limitations, the IRS claimed that Home Concrete's overstatement of basis qualified as an omission from gross income under the I.R.C. For the IRS to succeed, therefore, it needed to show that when Congress used the word "omissions" in the statute, Congress meant to include the acts that constitute "overstatements of basis" on a tax return. Unfortunately for the IRS, two federal appeals courts had already struck down this interpretation. Those decisions were based on the Supreme Court's 1958 ruling in Colony, Inc. v. Commissioner.

In Colony, the U.S. Supreme Court concluded that an understatement of gross income was not an omission from gross income under a provision in the 1939 I.R.C., § 6501(e)(1)(A), that was substantially identical to the provision at issue in Home Concrete. The Colony Court construed "omits" by studying the context of the I.R.C. and the definition from Webster's Dictionary, and then, not finding those definitions conclusively unambiguous, by reviewing legislative history. After reviewing this history, the Court determined that the legislature's choice of the word "omits" was based on the specific intent that it would only cover actual omissions in reporting taxable items—and so only then may actions fall under the regulation with the six-year statute of limitations.

In 2009, fifty-one years after that decision, the Court of Appeals for the Ninth Circuit was faced in Bakersfield Energy Partners, LP v. Commissioner with the same issue and determined that "overstatement of basis" is not included under the umbrella of I.R.C. §6501(e)(1)(A). Accordingly, under the statute codified in 2009, the courts have held that the IRS has only three years to bring a case against parties who engage in overstatement of basis. The Supreme Court's decision in Home Concrete affirmed the holding in the Colony case and applied this holding to the 2009 provision at issue.

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III. *Chevron* Deference for Contrary Regulations?

Facing unfavorable rulings in past attempts to include overstatement of basis under I.R.C. §6501(e)(1)(A), the IRS issued a new regulation, Treasury Regulation §301.6501(e)-1, which states in relevant part: “[A]n understated amount of gross income resulting from an *overstatement of unrecovered cost* or other basis *constitutes an omission from gross income* for purposes of section 6501(e)(1)(A)(i).”¹⁴

The new regulation addressed the IRS’s timeliness issue by referring to an “overstatement of basis” as an omission from gross income, thus including it under the six-year statute of limitations umbrella. Effective on December 14, 2010, the IRS asserted that the regulation allowed it to assess the deficiency against Home Concrete for overstatement of basis while it was involved in litigation over that very subject.¹⁵ In the preamble to the Regulation, the Treasury stated that the rule merely “clarifies” the meaning of §6501(e)(1)(A).¹⁶ In response, the taxpayers argued that the IRS’s actions were an attempt to overturn *Colony*, and that they defied federal administrative agency practice and Supreme Court precedent.¹⁷ The taxpayers based their arguments on principles set forth in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, the seminal administrative law case establishing the rules of judicial deference to agency statutory interpretation.

In *Chevron*, the EPA promulgated a regulation pursuant to the Clean Air Act Amendments of 1977 relating to permits for “stationary sources” of air pollution that allowed states to categorize entire industrial groupings with multiple sources of emissions as a single source of pollution (known as the “bubble” theory) for purposes of issuing such permits.¹⁸ The NRDC challenged this regulation on the basis that it was not a “reasonable construction” of the statutory term “stationary source” as written in the law.¹⁹ The Court held that while executive agencies are charged with implementing the legislation created by Congress and need flexibility in how they do so in many cases, the discretion they are allowed in interpreting statutes is limited to those laws that have ambiguous language (*Chevron* step one), and, beyond this, to “permissible constructions” of such ambiguous laws (*Chevron* step two).²⁰ Additionally, an agency’s action is limited in that it may not issue a regulation that changes or modifies a court’s determination if the court reviewed a law and determined that the statute is *unambiguous*, and Congress did not amend the statute following the court’s interpretation.²¹ Finally, courts will not give deference to agency regulations that are deemed “arbitrary, capricious, or manifestly contrary to the statute.”²²

The *Chevron* decision recognized that, in order to carry out congressional directives, federal agencies are charged with interpreting them to some degree. But executive agencies may not exceed their interpretive powers by creating rules or regulations not warranted by the statutes. In short, agencies may implement, not legislate. In order to keep the actual law-making in the hands of Congress, *Chevron* provided specific standards for how much discretion the agencies are permitted when interpreting and then implementing the laws. The *Chevron* parameters have largely held since 1984, with subsequent decisions offering a more nuanced understanding of how to apply the parameters, without ultimately changing them.²³

According to the taxpayers in the *Home Concrete* case, *Chevron* step one—limiting agency deference to situations where the statute is ambiguous—halts the IRS’s attempt to change its interpretation of the regulation in order to assess their tax deficiencies under the longer statute of limitations. The wording of I.R.C. §6501(e)(1)(A), which sets out the six-year statute of limitations for certain circumstances, matches that of the statute that went through the two-step *Chevron* analysis in the *Colony* decision. Previously, the Court found the meaning of this language to be unambiguous.²⁴ The fact that the Court decided *Colony* prior to promulgation of the process set forth in *Chevron* is generally considered to be irrelevant, as the provision of the 1939 Tax Code at issue in *Colony* carried over to the 1954 Tax Code with substantially identical language. Moreover, the taxpayers argued, the *Colony* Court’s review fulfills the *Chevron* analysis because the Court found that Congress unambiguously included in the statute only actual omissions in reporting taxable items.²⁵ Home Concrete maintained that unless Congress amends the statute, the IRS has no discretion to interpret the corresponding section of the I.R.C., and the Court owed no deference to the IRS’s new regulation.²⁶

Both parties used the Court’s decision in *National Cable & Telecommunications Association v. Brand X Internet Services* to support their arguments. The government and taxpayers offer contradictory interpretations of *Brand X*’s holding as to when *Chevron* deference may be applied to agency decisions following a court’s construction of the statute. The Court in *Brand X* stated: “A court’s prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion.”²⁷

The government argued in *Home Concrete* that unless a statute unambiguously forecloses a specific interpretation of its language, conflicting precedent will not displace implementation of that particular interpretation by administrative agencies (within the “permissible construction” limitations).²⁸ In response, the taxpayers argued that *Brand X* means that when a court decides that a statute is unambiguous *and* issues an interpretation based on the statute’s unambiguity, then the court’s interpretation will trump an agency’s interpretation and prohibits contrary agency regulations.²⁹ Furthermore, the taxpayers contended that the Court’s holding in *Colony*—that the IRS regulation in question was unambiguous and that “overstatement of basis” is not included as an omission in the tax code—applies to the new regulation, rendering the further “clarification” provided by the new Treasury regulation moot.³⁰

Had the Court, after analyzing the statute at issue under the first step of the *Chevron* test, determined that the law was ambiguous on its face, it would have asked whether the IRS’s subsequent interpretation was a “permissible construction of the statute” under *Chevron*’s second step. The government would have been forced to show that the new regulation was a permissible reading of the statute, and, perhaps by showing that all formal processes for rule-making were followed, overcome the fact that it had issued these rules following the initiation of the *Home Concrete* lawsuit.³¹

The Supreme Court ultimately decided the case in favor of the taxpayers. The Court relied on Justice Harlan's opinion from *Colony* and principles of stare decisis in affirming the decision below. The Court reasoned that the *Colony* decision made clear that the statute in question is unambiguous and therefore there is "no gap" under *Chevron* analysis for the agency to fill. Thus, "the Government's gap-filling regulation cannot change *Colony*'s interpretation of the statute." The Court essentially preserved the status quo and held that overstatements of basis, and the resulting understatement of gross income, do not trigger the extended limitations period of §6501(e)(1)(A).³²

IV. Conclusion

What is the import of this case? It represents a victory for the taxpayers, and it would appear to maintain the status quo by reiterating the rules of *Chevron*. Further than this, the Supreme Court answered a contentious tax question affecting many citizens and businesses, and it also sent a message regarding its own role in the *Chevron* analysis. Specifically, if a court determines that a law is unambiguous and interprets the law on this basis, administrative agencies are required to adhere to the court's interpretation absent congressional action.

The outcome of this case has implications not just for the IRS but for all executive agencies tasked with implementing the will of Congress. The Court's decision holds tight to past norms expounded in *Chevron* and *Colony*. It reaffirms *Chevron*'s two-pronged analysis and its instructions on the judiciary's role when faced with shifting agency regulations. Finally, the ruling brings certainty to taxpayers as to what the tax code actually requires of them and reaffirms a regulatory position the IRS finds troubling and costly.

Endnotes

- 1 United States v. Home Concrete & Supply, LLC, No. 11-139 (U.S. Apr. 25, 2012).
- 2 Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).
- 3 See *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767, 768 (9th Cir. 2009); see also Bernard J. Audet, Jr., Note, *One Case to Rule Them All: The Ninth Circuit in Bakersfield Applies Colony to Deny the IRS an Extended Statute of Limitations in Overstatement of Basis Cases*, 55 VILL. L. REV. 409, 410-13 (2010).
- 4 26 U.S.C. §6501(a) (emphasis added).
- 5 26 U.S.C. § 6501(e)(1)(A) (emphasis added).
- 6 Brief for National Federation of Independent Business Small Business Legal Center and Cato Institute as Amici Curiae Supporting Respondents at 3-4, United States v. Home Concrete & Supply LLC, No. 11-139 (U.S. Jan. 17, 2012).
- 7 *Id.*
- 8 *Bakersfield*, 568 F.3d 767 (9th Cir. 2009); *Salaman Ranch Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009); see also Audet, *supra* note 3, at 413-14.
- 9 See *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958); Audet, *supra* note 3, at 414.
- 10 *Colony*, 357 U.S. 28; Audet, *supra* note 3, 413-14.
- 11 *Colony*, 357 U.S. at 32-36 (1958).
- 12 *Id.*

- 13 *Bakersfield*, 568 F.3d at 768.
- 14 Treas. Reg. § 301.6501(e)-1 (emphasis added).
- 15 Brief for National Federation of Independent Business, *supra* note 6, at 4, 5.
- 16 *Id.* at 4; see also Brief for the Petitioner at 13, United States v. Home Concrete & Supply LLC, No. 11-139 (U.S. Jan. 17, 2012).
- 17 See generally Brief for National Federation of Independent Business, *supra* note 6, at 3.
- 18 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 839-840 (1984).
- 19 *Id.* at 840.
- 20 *Id.* at 842-43.
- 21 *Id.*
- 22 *Id.* at 844.
- 23 See generally *Christensen v. Harris County*, 529 U.S. 576 (2000) (holding that *Chevron* deference may apply to formal agency documents which have the force of law); see also William N. Eskridge, Jr. & Lauren E. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretations from Chevron to Hamdan*, 96 GEO. L.J. 1083 (2008).
- 24 See Audet, *supra* note 3, at 414.
- 25 See Audet, *supra* note 3, at 414; Brief for National Federation of Independent Business, *supra* note 6, at 6.
- 26 Brief for National Federation of Independent Business, *supra* note 6, at 6.
- 27 Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005).
- 28 Brief for the Petitioner at 37, United States v. Home Concrete & Supply, LLC, No. 11-139 (U.S. Jan. 17, 2012).
- 29 Brief of Respondent at 38-39, United States v. Home Concrete & Supply, LLC, No. 11-139 (U.S. Jan. 17, 2012).
- 30 *Id.* at 42.
- 31 *Christensen v. Harris County*, 529 U.S. 576, 586-87 (2000).
- 32 United States v. Home Concrete & Supply, LLC, No. 11-139, slip op. at 11 (U.S. Apr. 25, 2012).

