income. For consolidated groups, the 50% limitation is calculated based on the consolidated taxable income.

The temporary regulations also impose a limitation when a consolidated group absorbs an NOL extended to the fifth year of the Extended Carryback Period, even if the consolidated group has not made a section 172(b)(1)(H)(iv) election. The temporary regulations use the example of a loss where the Separate Return Limitation Year (SRLY) limitation of Regulation section 1.1502-21(c) would apply.

Election to Waive a Pre-Consolidation Prior NOL Election

The temporary regulations permit a consolidated group to revoke a prior election for NOLs that can be attributed to an acquired member. This allows a taxpayer to waive an election made under the previous carryback rules. The carryback may be waived only for the years prior to the acquisition and only if the Regulation section 1.1502-21(b)(3)(ii)(B) election was filed.

Temporary Regulation section 1.1502-21T(b)(3)(ii)(C) allows a consolidated group two waiver options. Each option requires that (1) the acquiring group makes a section 172(b)(1)(H)(iv) election; and (2) a portion of the CNOL can be attributed to a member acquired from outside the group.

The first waiver allows a group to waive a portion of the Extended Carryback Period for the time which the acquired member was a member of another group. This waiver is available only if none of the Extended Carryback Period was used by the previous group. If part of the Extended Carryback Period was used by the previous group during the first or second carryback years, the taxpayer may make an election using the second waiver. This election applies only to the third, fourth, and fifth carryback years. These elections to waive apply only to the NOLs for which the taxpayer makes a 172(b)(1)(H) election.

Conclusion

Consolidated groups must continue to be careful in analyzing and applying the extended NOL carryback rules. Among the issues that must be considered are the application of the SRLY limitation in Regulation section 1.1502-21(c), the Corporate Equity Reduction Transaction rule, and whether the NOL carryback is subject to a section 382 limitation (and if so, if the company was in a net unrealized built-in loss position at the time of the limitation). ■

Limitation by Regulation: Heads the Service Wins, Tails the Taxpayer Loses?

By Leandra Lederman* and Stephen W. Mazza**

When an Internal Revenue Code section does not contain an express deadline, or contains a limitation period that is at least arguably ambiguous in scope, the Treasury Department may promulgate regulations to fill the gap. A couple of recent cases, *Lantz v. Commissioner*, 132 T.C. 131 (2009) (reviewed by the court), *rev'd and remanded*, 607 F.3d 479 (7th Cir. 2010), and *Intermountain Ins. Serv. of Vail*, *LLC v. Commissioner*, 134 T.C. No. 11 (2010), 2010 WL 1838297, provide an interesting contrast because, in one, the Treasury imposed a deadline on a taxpayer benefit, where none existed in the statute, and, in the other, the Treasury tried to expand the scope of an extended statute of limitations on assessment.

Lantz involved an ultimately successful attempt by the Treasury to impose a deadline. The plaintiff in *Lantz*, whose husband had been convicted of Medicare fraud, sought equitable innocent spouse relief under section 6015(f). The Service denied relief on the ground that she failed to satisfy Regulation section 1.6015-5(b)(1), which mandates that a spouse request relief within two years of the Service's first collection action. *Lantz*, 132 T.C. at 133.

A majority of the Tax Court judges sided with the taxpayer and invalidated the time limitation in the Treasury regulations. Unlike the two other forms of relief from joint and several liability in sections 6015(b) and (c), section 6015(f) does not include a deadline. Relying on this statutory difference, the majority found that Congress did not intend for a limitation period to apply to section 6015(f): "We find that by explicitly creating a 2-year limitation in subsections (b) and (c) but not subsection (f), Congress has 'spoken' by its audible silence." *Id.* at 139. It concluded that the regulation was not entitled to deference. *Id.* The Service disagreed. It appealed to the Seventh Circuit, and also advised its attorneys to continue to argue that relief under section 6015(f) is unavailable if the taxpayer files outside the two-year period. Notice CC-2009-012 (Apr. 17, 2009).

The Seventh Circuit agreed with the Service's position and upheld the regulations' provision of a two-year limitations period. *Lantz*, 607 F.3d 479 (7th Cir. 2010) (reversing and remanding to the Tax Court). Judge Posner wrote for the court, "[P]robably because [section 6015(f) is] a safety-valve provision for innocent spouses who fall through cracks in (b) or (c)," Congress left the details, including the deadline, up to the Treasury Department. *Id.* at 484. Judge Posner also took issue with the Tax Court's "audible silence" argument:

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"[T]he Tax Court's basic thought seems to have been that since some statutes (in this case, some provisions of a statute) prescribe deadlines, whenever a statute (or provision) fails to prescribe a deadline, there is none. That is not how statutes that omit a statute of limitations are usually interpreted." *Id.* at 481. Bolstered by its win in the Seventh Circuit, the Service has advised its attorneys to continue to argue that a two-year deadline applies, and not concede the issue in any Tax Court case. Notice CC-2010-011 (June 18, 2010).

Lantz was not the first case in which the Treasury sought to impose a deadline on the availability of a taxpayer benefit and was sustained on appeal. In *Swallows Holding, Ltd. v. Commissioner*, 126 T.C. 96 (2006), *rev'd*, 515 F.3d 162 (3d Cir. 2008), the Tax Court considered Regulation section 1.882-4(a)(3)(i), which provides that a foreign corporation conducting business within the United States must timely file its tax return—generally defined as within 18 months of the return's due date—in order to deduct certain expenses. Section 882 itself does not explicitly contain such a requirement. *See Swallows Holding*, 126 T.C. at 97–98 & n.2. The Tax Court found that "the timely filing requirement in the disputed regulations does not harmonize with the plain language, origin, or purpose of the relevant text" of the Code section, *id.* at 132, and invalidated the regulations, *id.* at 99. But, as in *Lantz*, the appellate court reversed the Tax Court. According to the Third Circuit, "drawing [a] temporal line is a task properly within the powers and expertise of the IRS." *Swallows Holding*, 515 F.3d at 172. Moreover, the 18-month limitation period was not unreasonable in that it "served as a balance between [the Service's] desire for compliance with the federal tax laws and a foreign corporation's desire to obtain valuable tax deductions." *Id.*

As noted above, Treasury has also used its regulatory power to try to lengthen the statute of limitations on assessment of tax, which generally is three years under section 6501(a). By statute, a six-year period applies where "the taxpayer omits from gross income an amount properly includible therein and . . . such amount is in excess of 25 percent of the amount of gross income stated in the return . . . ." I.R.C. § 6501(e)(1)(A)(i). In *Colony, Inc. v. Commissioner*, 357 U.S. 28, 30, 36 (1958), the Supreme Court found that the extended period did not apply to an overstatement of basis in certain lots. The transaction predated section 6501(e), but the Court noted, "we observe that the conclusion we reach is in harmony with the unambiguous language of § 6501(e)(1)(A)," *id.* at 37, which stated, "In the case of a trade or business, the term 'gross income' means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services," *id.* at 37 n.3 (now I.R.C. § 6501(e)(1)(B)(i)).

The Service has tried to limit *Colony*'s reach, arguing that in cases not involving the goods and services of a trade or business, "gross income is determined after reducing sales proceeds by basis," CCA 200537029, which results in an omission from gross income where a business sold non-inventory property with an inflated basis. However, the Court explained in *Colony* that the Service received a longer period where "the Commissioner is at a special disadvantage in detecting errors. . . . [T]he return on its face provides *no clue to the existence of the omitted item*." *Colony*, 357 U.S. at 36 (emphasis added). This rationale is consistent with section 6501's determination of the amount omitted; it provides an exception for disclosed items. *See* I.R.C. § 6501(e)(1)(B)(ii).

To bolster its position that section 6501(e) encompasses inflated basis transactions where the property disposed of did not constitute the inventory of a trade or business, the Treasury Department promulgated regulations providing that, in that context, "an understated amount of gross income resulting from an overstatement of . . . basis constitutes an omission from gross income . . . ." Temp. Treas. Reg. § 301.6501(e)-1T(a)(1)(iii) (Sept. 28, 2009); Temp. Treas. Reg. § 301.6229(c)(2)-1T(a)(1)(iii) (Sept. 28, 2009). The regulations apply to "taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009." Temp. Treas. Reg. § 301.6501(e)-1T(b); Temp. Treas. Reg. § 301.6229(c)(2)-1T(b). The Service argued, "To determine whether the temporary regulations are applicable . . . the Court must determine whether a six-year statute of limitations would be open . . . as of September 24, 2009 . . . ." *Intermountain*, 2010 WL 1838297 at *5. The government thus tried to apply the regulations retroactively. The Tax Court disagreed with this approach and found that the regulations did not apply under the plain language of the effective date provision, which was inconsistent with the Service's "convoluted interpretation." *Id.* at *4–6. The court also found the regulations invalid. *See id.* at *8 (substantive invalidity); *see also id.* at *21–22 (Cohen, J., concurring in the result) (procedural invalidity).

Intermountain is currently on appeal to the Court of Appeals for the District of Columbia, so it remains to be seen whether sauce for the goose is sauce for the gander. However, if *Intermountain* follows the pattern in *Lantz* and *Swallows Holding*, the Circuit Court will uphold the regulations' substantive validity. It might find, as others have argued, that the temporary regulations are procedurally invalid because they were not promulgated with a notice and comment period. *See, e.g.*, Steve R. Johnson, *Tax Court Invalidates New Section 6501(e) Regulations*, NewsQuarterly, Summer 2010, at 13, 15. Treasury would then face a delay but could ultimately have its way, benefitting from the extended statute of limitations on assessment in future overstated basis cases. *See id.* ■