***23 T.C. 1058 (1955)***

For purposes of determining if a taxpayer omitted over 25% of gross income and thus extends the statute of limitations, "gross income" is defined as the amount originally stated on the return, without adjustments for items improperly reported as part of the cost of goods sold.

**Summary**

The U.S. Tax Court considered whether the statute of limitations for assessing tax deficiencies was extended due to the taxpayer's omission of gross income exceeding 25% of the amount stated on the return. The court held that in determining if the omission threshold had been met, "gross income" means the amount reported on the return. The taxpayer argued that certain costs of goods sold were incorrectly classified and should have been categorized as other business deductions, thus increasing reported gross income and altering the 25% calculation. The court rejected this argument, stating that the original, unadjusted gross income figure from the return was controlling. Because the taxpayer had omitted from his gross income an amount properly includible which was in excess of 25 per centum of the amount of gross income stated in the return, the statute of limitations was extended.

**Facts**

H. Leslie Leas, the taxpayer, was engaged in the business of manufacturing concrete products, road surfacing contracting, and operating a stone quarry. The Commissioner of Internal Revenue asserted deficiencies in income tax for the years 1947, 1948, and 1949, with the main issue being whether the statute of limitations barred the assessments for 1947 and 1948. The taxpayer reported gross profit on his returns, calculated by subtracting the cost of goods sold from total receipts. The taxpayer's correct adjusted gross income was higher than reported. The notice of deficiency was issued more than three, but less than five years after the returns for 1947 and 1948 were filed. The taxpayer had omitted from his gross income amounts properly includible therein which exceeded 25% of the amount of gross income stated in the return for that year.

**Procedural History**

The case originated in the U.S. Tax Court. The Commissioner of Internal Revenue asserted deficiencies, and the taxpayer contested the assessment for 1947 and 1948, arguing the statute of limitations had expired. The Tax Court considered the case to determine if the assessment was timely under the statute of limitations.

**Issue(s)**

1. Whether the statute of limitations for assessing income tax deficiencies for 1947 and 1948 was extended under Section 275(c) of the Internal Revenue Code of 1939, due to an omission from gross income exceeding 25% of the reported gross income.

 

**Holding**

1. Yes, because the court found that the taxpayer omitted from his gross income amounts which exceeded 25% of the gross income stated in the returns for 1947 and 1948.

**Court's Reasoning**

The court focused on the interpretation of Section 275(c) of the Internal Revenue Code of 1939, which provides for an extended statute of limitations if the taxpayer omits from gross income an amount exceeding 25% of the amount stated in the return. The court examined the taxpayer's reported gross income and the amount of income omitted. The taxpayer argued that certain items were improperly included in the cost of goods sold, and that the gross profit should be recalculated. The court held that the determination of gross income for purposes of Section 275(c) must be based on the return as filed by the taxpayer, and that the Commissioner was not obligated to revise or reconstruct the return. "Section 275(c) provides that if the taxpayer omits from gross income an amount properly includible which is in excess of 25 per cent of the amount of gross income stated, the deficiency tax may be assessed at any time within five years. Therefore, the amount of $ 7,000.47 which the taxpayer stated in his return is the controlling figure." The court, therefore, held that the gross profit originally reported in the return should not be increased and concluded that the 5-year statute of limitations applied.

**Practical Implications**

This case highlights the importance of accurately reporting gross income on tax returns. For tax attorneys, the case emphasizes that for purposes of applying Section 275(c), the starting point is the gross income as stated in the return, even if the taxpayer later claims errors in categorization. This means that if a client makes an error in categorizing items that result in the understatement of gross income, the potential for a longer statute of limitations exists. Furthermore, the case directs tax practitioners to advise clients of the potential consequences of misclassifying expenses, particularly those that affect the calculation of gross income. This case also clarifies how to calculate omitted gross income. Later cases should follow the principle in Leas when applying the extended statute of limitations under similar circumstances.