Barkett v. Commissioner, 140 T. C. No. 16 (2013)

In Barkett v. Commissioner, the U. S. Tax Court clarified that for the six-year statute of limitations under IRC § 6501(e), gross income includes only the gain from the sale of investment assets, not the total proceeds. This ruling, stemming from a dispute over the timeliness of a notice of deficiency for tax years 2006 and 2007, affirmed that the IRS had six years to assess additional taxes when the omitted income exceeded 25% of the reported gross income. The decision reinforces the court's interpretation of gross income and impacts how taxpayers calculate income for statute of limitations purposes.

Parties

Petitioners, Barkett Family Partners and Unicorn Investments, Inc. , represented by their shareholders and partners, filed a motion for partial summary judgment against the Respondent, the Commissioner of Internal Revenue, in the U. S. Tax Court.

Facts

Petitioners, residents of California, filed their 2006 and 2007 U. S. Individual Income Tax Returns (Forms 1040) on September 17, 2007, and October 2, 2008, respectively. They reported gross income of $271,440 for 2006 and $340,591 for 2007, excluding income from passthrough entities in which they had substantial ownership. These entities, Barkett Family Partners and Unicorn Investments, Inc. , engaged in significant investment activities, reporting capital gains of approximately $123,000 for 2006 and $314,000 for 2007, and realized amounts from the sale of investments exceeding $7 million for 2006 and $4 million for 2007. The IRS issued a notice of deficiency on September 26, 2012, asserting that petitioners omitted gross income of $629,850 for 2006 and $431,957 for 2007, unrelated to the investment activities.

Procedural History

Petitioners moved for partial summary judgment in the U. S. Tax Court, arguing that the notice of deficiency was untimely for tax years 2006 and 2007 under the three-year statute of limitations provided by IRC § 6501(a). The Commissioner countered that a six-year limitations period applied under IRC § 6501(e) due to the omission of gross income exceeding 25% of the reported gross income. The court considered the motion under Rule 121(a) of the Tax Court Rules of Practice and Procedure, which allows summary judgment when there is no genuine dispute of material fact and a decision may be rendered as a matter of law.

Issue(s)

Whether, for the purpose of determining the applicable statute of limitations under IRC § 6501(e), gross income includes only the gain from the sale of investment assets or the total proceeds from such sales?

Rule(s) of Law

IRC § 6501(a) provides a three-year statute of limitations for assessing tax or sending a notice of deficiency. IRC § 6501(e)(1) extends this period to six years if the taxpayer omits from gross income an amount properly includible therein that exceeds 25% of the amount of gross income stated in the return. IRC § 61(a) defines gross income as "all income from whatever source derived," including gains derived from dealings in property. The court has previously held that for the purpose of IRC § 6501(e), "capital gains, and not the gross proceeds, are to be treated as the 'amount of gross income stated in the return. '" (Insulglass Corp. v. Commissioner, 84 T. C. 203, 204 (1985)).

Holding

The court held that for the purpose of IRC § 6501(e), gross income includes only the gain from the sale of investment assets, not the total proceeds from such sales. Consequently, the six-year statute of limitations applied to the petitioners' tax years 2006 and 2007 because their omitted gross income exceeded 25% of the gross income they reported on their returns.

Reasoning

The court's reasoning relied on its consistent interpretation of gross income as articulated in Insulglass Corp. v. Commissioner and Schneider v. Commissioner. The court emphasized that IRC § 61(a) defines gross income to include gains from dealings in property, not the total proceeds from such sales. The court distinguished between the issue of calculating gross income and the issue of determining when gross income is omitted, as addressed in Colony, Inc. v. Commissioner and United States v. Home Concrete & Supply, LLC. The court noted that the Home Concrete decision invalidated a regulation concerning omitted gross income but did not affect the calculation of gross income for the statute of limitations. The court found support for its conclusion in dictum from Home Concrete, which discussed the general statutory definition of gross income requiring the subtraction of cost from sales price. The court also addressed an exception in IRC § 6501(e)(1)(B)(i) for trade or business income but found it inapplicable to the petitioners' case, as they were involved in investment activities, not the sale of goods or services.

Disposition

The court denied the petitioners' motion for partial summary judgment, affirming the applicability of the six-year statute of limitations under IRC § 6501(e) for tax years 2006 and 2007.

Significance/Impact

Barkett v. Commissioner reinforces the U. S. Tax Court's interpretation of gross income for the purpose of the statute of limitations under IRC § 6501(e). The decision clarifies that only gains from the sale of investment assets, not the total proceeds, are considered in determining whether the six-year limitations period applies. This ruling has significant implications for taxpayers and the IRS in assessing the timeliness of notices of deficiency, particularly in cases involving investment income. The court's distinction between the calculation of gross income and the determination of omitted income highlights the nuanced application of tax law principles and underscores the importance of precise reporting of income from investment activities.

