IRS Held to Three-Year Timeline to Audit Tax Shelters

By James F. McDonough, Jr. on May 11th, 2012 Posted in Audits, IRS, Taxes

The Supreme Court recently ruled the Internal Revenue Service is required to audit tax shelters within a three-year period, after which the statute of limitations will go into effect, despite the agency's protests.

The Court ruled in favor of Home Concrete and Supply LLC after the IRS took roughly six years to launch an audit against the company for a Son of Boss tax shelter.

The case revolved around the sale of Home Oil and Coal Co., which had been sold in 1999 by its two shareholders, Robert Piece and Steven Chandler. The shareholders filed their 1999 taxes in 2000, and the IRS audited them in 2006 after determining that they used a pass-through company to increase their cost basis when filing. After the sale was finalized, the shareholders had just a $69,000 capital gain on a $10 million sale.

The IRS argued that an extended six-year time period to audit the company was warranted based on several lower court interpretations of tax law. The tax agency also noted that an extended time period to bill businesses for unpaid taxes was authorized when the amount exceeds 25 percent of their gross income. However, the Supreme Court disagreed and ruled the IRS was confined to the three-year deadline, setting the record straight after years of mixed lower court decisions and creating a significant precedent for business taxpayers.

Son of boss (bond and option sales strategy) tax shelters function by inflating the cost basis of an asset to avoid paying higher capital gains taxes. The IRS has historically gone after these shelters for tax evasion and been successful in many cases, sometimes recouping billions of dollars in taxes, interest and penalties.

The ruling is expected to impact several similar pending cases amounting to roughly $1 billion in taxes that are currently being argued in courtrooms across the country.