



Spring 3-1-1982

## Xii. Tax

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### Recommended Citation

*Xii. Tax*, 39 Wash. & Lee L. Rev. 808 (1982).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol39/iss2/22>

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statutory damages under the Copyright Act. Because a copyright infringement action enforces a right analogous to a right traditionally enforced at common law, and the statutory damage remedy is legal in nature, an action for statutory damages under the Act carries the seventh amendment's guarantee. In actions for statutory damages under other statutes, the Fourth Circuit will find a constitutional right to a jury trial if the statutory damage remedy sought is legal in nature, and the statutorily protected right is analogous to a right traditionally enforced at common law.

DAVID PHIPPEN

## XII. TAX

### A. *Mitigation of Limitations*

The Internal Revenue Code (IRC) of 1954 contains various statutes of limitations that bar untimely actions for recovery of tax refunds by a taxpayer or the collection of deficiencies by the Internal Revenue Service.<sup>1</sup> Under certain conditions, however, sections 1311-1314 of the IRC allow the Commission of Internal Revenue to assess or collect taxes or a taxpayer to seek refund of taxes in a tax year otherwise closed by the statute of limitations.<sup>2</sup> The mitigation provisions of sections 1311-1314 prevent inequitable taxation or tax avoidance which would result from the successful challenge of the proper tax year for the inclusion or exclu-

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<sup>1</sup> I.R.C. §§ 6501, 6511. Under the Internal Revenue Code, a three-year statute of limitations applies to the assessment and collection of taxes. I.R.C. § 6501. The limitations period starts at the time of the filing of a tax return or the filing deadline, whichever is later. *Id.* False tax returns, willful tax evasion, and failure to file a return are exempt from the statute of limitations bar to the assessment and collection of taxes. *Id.* § 6501(c); Treas. Reg. §§ 301.6501(c)-1(a) to .6501(c)-1(c) (1956); see Leo Gurdin, 33 T.C.M. 1116, 1121 (1974) (statute of limitations inapplicable to tax fraud), *aff'd*, 536 F.2d 295 (9th Cir. 1976). Taxpayer errors in excess of 25% of gross income are subject to a six-year limitations period. I.R.C. § 6501(e)(1); see *Peters v. Commissioner*, 51 T.C. 226, 230 (1968) (Commissioner allowed six years to issue deficiency notice for tax errors in excess of 25% of gross income). The taxpayer must file a claim for refund or credit within three years from the time of filing or within two years from the time the tax was paid, whichever expires later. I.R.C. § 6511. See generally 4 B. BITTKER FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶¶ 113.1-9 (1981) [hereinafter cited as BITTKER]; TAX MNGMT (BNA) § 28-3rd (1978).

<sup>2</sup> I.R.C. §§ 1311-1314. Sections 1311-1314 of the Internal Revenue Code prevent a taxpayer or the government from invoking the statute of limitations to benefit from errors made in a closed year. *Id.*; see note 6 *infra*. Section 1311(a) authorizes adjustment in circumstances that otherwise would prevent the correction of an error. I.R.C. § 1311(a). Sections 1311-1314 can apply to bars other than the statute of limitations such as *res judicata* and estoppel. Treas. Reg. § 1.1311(a)-2 (1956). See generally TAX MNGMT (BNA) § 110-2nd (1978).

sion of gross income if the correct tax year is closed by the statute of limitations.<sup>3</sup> If the requirements of section 1311 are satisfied,<sup>4</sup> section 1312(3)(A)<sup>5</sup> allows the Commissioner to make a correcting adjustment in a closed tax year<sup>6</sup> to include income excluded by a determination.<sup>7</sup> In

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<sup>3</sup> S. REP. NO. 1567, 75th Cong., 3d Sess. 48 (1938). The Senate Finance Committee in the report accompanying the Revenue Bill of 1938 stated that disputes over the correct year to include income or deductions should not result in double taxation, double reduction of tax, or double avoidance of tax. *Id.* at 49-50. The Committee, in promulgating the mitigation provisions, sought to keep the essential function of the statute of limitations intact by establishing strict requirements for the application of the provisions. *Id.* at 49; see text accompanying notes 57-61 *infra*.

<sup>4</sup> See text accompanying notes 22-26 *infra*; note 32 *infra*.

<sup>5</sup> I.R.C. § 1312(3)(A); see BITTKER, *supra* note 1, at ¶ 113.9; TAX MNGMT (BNA) § 110-2nd (1978). Section 1312(3)(A) outlines the requirements of the double exclusion of an item of gross income from taxable income. I.R.C. § 1312(3)(A). Double exclusion occurs when a determination correctly excludes an item of gross income that was included in the wrong year. *Id.* Section 1311(a) then allows the inclusion of the item of gross income in the proper year. *Id.* § 1311(a); Treas. Reg. §§ 1.1311(a)-1 to .1311(a)-2 (1956). To provide an example of a situation described by § 1312(3)(A), assume a taxpayer included \$5,000 of gross income in his 1975 tax return that he should have included in his 1972 tax return. See I.R.C. § 1312(3)(A). Then, the taxpayer realized his error, sued for, and was granted a refund for the taxes paid on the \$5,000. Assume further that the statute of limitation bars the I.R.S. from making a corresponding correcting adjustment for the 1972 taxable year. Without the mitigation provisions of §§ 1311-1314, the government could not collect the tax due in the 1972 tax year. See *id.* §§ 1311-1314. Section 1312(3)(A) authorizes an adjustment in this circumstance, and § 1311(a) mitigates the normal statute of limitations if all the requirements of the mitigation provisions are satisfied to allow assessment and collection of the tax for the otherwise closed year. See *id.* §§ 1312(3)(A), 1311(a); text accompanying notes 22-26 *infra*. Section 1312 authorizes adjustment in closed years in other situations. See I.R.C. § 1312. Section 1312(1) describes the double inclusion in taxable income of an item of gross income. *Id.* § 1312(1); see Treas. Reg. § 1.1312-1 (1956). Section 1312(2) describes the double allowance of a deduction or credit. I.R.C. § 1312(2); see Treas. Reg. § 1.1312-2 (1956). Section 1312(5) specifies correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs. I.R.C. § 1312(5); see Treas. Reg. § 1.1312-5 (1956). Section 1312(6) lists correlative deductions and credits for certain related corporations. I.R.C. § 1312(6); see Treas. Reg. § 1.1312-6 (1956).

In two situations which § 1312 describes, however, no adjustment is authorized if the statute of limitations closes the correct year. See I.R.C. § 1312. Section 1312(3)(B) describes items upon which taxes were not paid and which were not included in a tax return. *Id.* § 1312(3)(B). This occurs when a determination requires that an item not included in gross income and on which no tax was paid be excluded from gross income in that year. *Id.*; see Treas. Reg. § 1312-3(b) (1956). An adjustment correction cannot be made if the statute of limitations bars the correction. I.R.C. § 1311(b)(2); see Treas. Reg. § 1.1311(a)-1(c). Section 1312(4) describes the double disallowance of a deduction or credit. I.R.C. § 1312(4); see Treas. Reg. § 1312-4 (1956). No adjustment correction can be made if the correction is barred by the statute of limitations. I.R.C. § 1311(b)(2); see Treas. Reg. § 1.1311(a)-1(c) (1956). Additionally, certain categories of related taxpayers are subject to the mitigation provisions when the item of income is reported by the wrong taxpayer. See BITTKER, *supra* note 1, at ¶ 113.9.2; Treas. Reg. § 1.1312 (1956); *Id.* § 1.1313(c)-1, T.D. 6617, 1962-2 C.B. 199.

<sup>6</sup> See generally BITTKER, *supra* note 1, at ¶¶ 113.1-9. A closed year is a tax year in which the running of the statute of limitations bars litigation or challenge of tax items. *Id.*

<sup>7</sup> I.R.C. § 1313(a)(1). A determination is a final decree, judgment or order by a court of competent jurisdiction. *Id.* A Tax Court decision becomes final 90 days after the decision if

*Chertkof v. Commissioner*<sup>8</sup> the Fourth Circuit Court of Appeals examined the requirements of sections 1312(3)(A) and 1311 to determine whether the mitigation provisions of the IRC allowed the Commissioner to assess taxes in a closed tax year.<sup>9</sup>

In *Chertkof*, taxpayer and his wife filed a joint income tax return for tax year 1966.<sup>10</sup> The return included income resulting from a stock redemption distribution that the Chertkofs treated as a capital gain.<sup>11</sup> After an audit, the Commissioner ruled the redemption incomplete,<sup>12</sup> determined that the redemption should have been included in 1965, and treated the income resulting from the redemption as ordinary income.<sup>13</sup> The Commissioner issued a deficiency notice for 1965 and refunded the taxes the Chertkofs paid in 1966 on the redemption income.<sup>14</sup> The Chertkofs paid the deficiency for 1965 and sued for a refund.<sup>15</sup> The United

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the judgment is not appealed. *Id.* § 7481. A closing agreement pursuant to § 7121 of the IRC is a determination and becomes final on the date the Commissioner approves the agreement. *Id.* § 1313(a)(2); Treas. Reg. § 1.1313(a)-2 (1956). A final disposition of a claim for a refund by the Secretary of the Treasury also constitutes a determination. I.R.C. § 1313(a)(3). The time at which a determination becomes final depends on the type of action taken and whether the taxpayer's claim was allowed. Treas. Reg. § 1.1313(a)-3(a). See TAX MNGMT (BNA) § 110-2nd, A6 (1978). Finally, an agreement pursuant to § 1313(a)(4) of the IRC is a determination. I.R.C. § 1313(a)(4); Treas. Reg. § 1.1313(a)-4(a)(2) (1956). See BITTKER, *supra* note 1, at ¶ 113.9.4; TAX MNGMT (BNA) § 110-2nd, A1-3 (1978).

<sup>8</sup> 649 F.2d 264 (4th Cir. 1981).

<sup>9</sup> *Id.*; see text accompanying notes 28-32 *infra*.

<sup>10</sup> 649 F.2d at 265.

<sup>11</sup> *Id.* Taxpayer and his father jointly owned all the stock in E & T Realty Company (E & T). *Id.* To give Chertkof's father sole ownership of the business, Chertkof's father agreed that E & T would redeem Chertkof's E & T stock. *Id.* Taxpayer obtained a "private letter ruling" from the Internal Revenue Service stating that he would receive capital gains treatment for the stock redemption distribution. *Id.*

<sup>12</sup> *Id.* at 265-66. To receive capital gains treatment, a stock redemption must be complete and retire all taxpayer's stock. I.R.C. § 302(b)(3). Chertkof redeemed all his E & T stock. 649 F.2d at 265. The family attribution rules in § 318 of the IRC, however, determine stock ownership status for the purposes of the stock redemption requirements in § 302. I.R.C. §§ 302, 318. Therefore, unless Chertkof conformed to the additional requirements of § 302(c)(2), for tax purposes he would be considered to own the stock his father owns. I.R.C. §§ 302, 318(a). Section 302(c)(2)(A)(ii) prohibited Chertkof from acquiring any interest in E & T, including interest as an employee, director, or officer, for a period of ten years after the redemption. I.R.C. § 302(c)(2)(A)(ii). Pursuant to § 302(c)(2)(A)(iii) Chertkof filed an agreement with the Secretary that he would not acquire any interest in violation of § 302(c)(2)(A)(ii). *Id.* §§ 302(c)(2)(A)(ii)-302(c)(2)(A)(iii). Chertkof, however, operating through a corporation in which he and his wife owned 80% and 20% of the stock, respectively, executed and carried out a management agreement with E & T. 649 F.2d at 265. The Fourth Circuit in *Chertkof*, therefore, held that the execution of the management agreement through Chertkof's company violated the provisions of § 302(c)(2)(A)(ii). I.R.C. § 302(c)(2)(A)(ii); 649 F.2d at 270. Thus the *Chertkof* court taxed the stock redemption as ordinary dividend income rather than as a capital gain. *Id.*

<sup>13</sup> 649 F.2d at 266; see note 16 *infra*.

<sup>14</sup> 649 F.2d at 265-66.

<sup>15</sup> *Id.* The Chertkofs' deficiency payment was in response to a statutory notice of deficiency which the Commissioner of Internal Revenue issued. *Id.*; see I.R.C. § 6212. A tax-

States District Court for the District of Maryland held that 1966 was the correct taxable year.<sup>16</sup> Therefore, the Commissioner refunded the Chertkofs' 1965 deficiency payment<sup>17</sup> and issued a notice of deficiency for 1966.<sup>18</sup> The Chertkofs petitioned the Tax Court for a redetermination of the 1966 deficiency and moved for summary judgment, arguing that 1966 was a closed tax year and that sections 1311-1314 did not apply to mitigate the statute of limitations.<sup>19</sup> The Tax Court agreed with the Commissioner that the mitigation provisions applied and denied the Chertkofs' motion.<sup>20</sup> The Chertkofs appealed the decision of the Tax Court to the Fourth Circuit.<sup>21</sup>

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payer has 90 days to petition the Tax Court for a redetermination of a deficiency. I.R.C. § 6213(a). During the 90 day period, and during the period of litigation if the petition is filed in the Tax Court, the statute of limitations is tolled. *See* Phoenix Elec. Inc. v. United States, 164 F. Supp. 614, 615 (D. Mass. 1958). The deficiency is assessed if a taxpayer does not file a petition in the Tax Court within 90 days. I.R.C. § 6213(c). Once assessed, a taxpayer must pay the deficiency and may sue for refund in the United States Court of Claims or United States District Court. 28 U.S.C. § 1491 (1976 & 1979 Supp. III) (Court of Claims jurisdictional grant); 28 U.S.C. § 1346(a)(1) (1976 & 1979 Supp. III) (District Court jurisdictional grant).

<sup>16</sup> *Perma-Rock Products, Inc. v. United States*, 373 F. Supp. 159, 161 n.1 (D. Md. 1973). The *Perma-Rock* court held that Chertkof did not receive consideration for the stock redemption until 1966. *Id.* Since Chertkof was a cash basis taxpayer, the income was properly includable as taxable income when received. *Id.*

<sup>17</sup> 649 F.2d at 266. The Commissioner of Internal Revenue in *Chertkof* took a voluntary dismissal from the appeal of the Maryland District Court's judgment that 1966 was the correct tax year for the stock redemption. *Id.* Thus, the district court's decision became final and operated as a determination of the proper tax year. *Id.* at 267; *see* I.R.C. § 1313(a)(1); note 6 *supra*.

<sup>18</sup> *Chertkof v. Commissioner*, 66 T.C. 496, 498 (1976), *aff'd*, 649 F.2d 264 (4th Cir. 1981). The statute of limitations for the collection of tax for the tax year 1966 ran on April 15, 1970. *Id.*; I.R.C. § 6501; *see* note 1 *supra*. The Commissioner of Internal Revenue, however, relied on the application of the mitigation provisions to eliminate the statutory bar to the collection of the Chertkofs' taxes on their redemption income. 66 T.C. at 498-99.

<sup>19</sup> *Id.*; *see* text accompanying notes 43-48 *infra*. Instead of petitioning the Tax Court for a redetermination pursuant to § 6213 of the IRC, the Chertkofs could have paid the tax and sued in the Court of Claims or the District Court for a refund. 28 U.S.C. § 1491 (1976 & 1979 Supp. III) (Court of Claims jurisdictional grant); 28 U.S.C. § 1346(a)(1) (1976 & 1979 Supp. III) (District Court jurisdictional grant); *see* I.R.C. § 6213; note 15 *supra*.

<sup>20</sup> 66 T.C. at 509. The Tax Court in *Chertkof* held that the four prerequisites of the mitigation provisions were satisfied. *Id.*; *see* text accompanying notes 22-26 *infra*. The Tax Court held that the Maryland District Court's ruling in *Perma-Rock Products, Inc. v. United States*, 373 F. Supp. 159 (D. Md. 1973), which required the exclusion of the item of gross income from the 1965 tax year, operated as a determination causing an error in a closed year. *Chertkof v. Commissioner*, 66 T.C. at 499; *see* note 7 *supra*. The Tax Court held that the inconsistent position requirement of § 1311(b) was satisfied. 66 T.C. at 508; *see* *Birchenough v. United States*, 410 F.2d 1247, 1251 (Ct. Cl. 1969) (taxpayer error not required); *Yagoda v. Commissioner*, 39 T.C. 170, 179-80 (1962) (taxpayer error not required and inconsistent position satisfied), *aff'd*, 331 F.2d 485 (2d Cir.), *cert. denied*, 379 U.S. 842 (1964); *Albert W. Priest Trust v. Commissioner*, 6 T.C. 221, 226-27 (1946) (taxpayer error not required and inconsistent position satisfied); note 32 *infra*.

<sup>21</sup> 649 F.2d 264 (4th Cir. 1981).

The Fourth Circuit in *Chertkof* recognized that the statute of limitations would bar the Commissioner's deficiency assessment if sections 1311-1314 of the IRC did not apply and agreed with the Tax Court that the mitigation provisions apply only if four prerequisites to adjustment exist.<sup>22</sup> Application of the mitigation provisions requires a determination<sup>23</sup> with respect to an open tax year that gives rise to an error in a closed tax year.<sup>24</sup> The error must be one that falls into one of the circumstances of adjustment specified in section 1312, for example, potential double exclusion,<sup>25</sup> and the party who prevailed in the determination must have maintained a position inconsistent with the erroneous treatment.<sup>26</sup> Since no doubt existed that there had been a determination, and that the determination had given rise to an error in a closed tax year,<sup>27</sup> the Fourth Circuit first examined the circumstances of adjustment requirement to determine whether section 1312(3)(A) requires the taxpayer rather than the Commissioner to have erred in the original treatment of income.<sup>28</sup> The court in *Chertkof* held that section 1312(3)(A) of the IRC does not require taxpayer error for the Commissioner to apply the mitigation provisions to eliminate the statutory bar in the assessment or collection of tax in a closed year.<sup>29</sup> The Fourth Circuit next determined that the Chertkofs satisfied the inconsistent position requirement of section 1311(b).<sup>30</sup> The Fourth Circuit noted that the taxpayer's initial treatment of income is irrelevant to the inconsistent position requirement<sup>31</sup> and interpreted section 1311(b) as requiring only that the position adopted in a determination be inconsistent with the erroneous treatment of income.<sup>32</sup>

In holding that the Chertkofs satisfied the inconsistency requirements of the mitigation provisions outlined in section 1311(b), the Fourth Circuit indicated that the Chertkofs' maintenance of the 1965 refund suit constituted a position inconsistent with their payment of taxes on the 1965 distribution income, even though their payment was in response to

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<sup>22</sup> *Id.* at 266-67.

<sup>23</sup> *Id.* at 267; see I.R.C. § 1313(a)(1); note 7 *supra*.

<sup>24</sup> 649 F.2d at 267; see I.R.C. § 1311; note 6 *supra*.

<sup>25</sup> 649 F.2d at 267; see I.R.C. § 1312; note 5 *supra*.

<sup>26</sup> 649 F.2d at 267; see I.R.C. § 1311(b); note 32 *infra*.

<sup>27</sup> 649 F.2d at 267; see note 20 *supra*.

<sup>28</sup> 649 F.2d at 267-69.

<sup>29</sup> *Id.* Section 1312(3)(A) contains no language specifying taxpayer error as a requirement of § 1312(3)(A). I.R.C. § 1312(3)(A); see note 5 *supra*. Moreover, courts have explicitly rejected taxpayer error as a requirement of § 1312(3)(A). *Yagoda v. Commissioner*, 39 T.C. at 179-80; *Albert W. Priest Trust v. Commissioner*, 6 T.C. at 226-27; see note 20 *supra*.

<sup>30</sup> 649 F.2d at 267-69.

<sup>31</sup> *Id.* at 267-68.

<sup>32</sup> *Id.* Section 1311(b)(1) requires that the taxpayer maintain a position inconsistent with the erroneous treatment of income. I.R.C. § 1311(b)(1). Furthermore, the taxpayer's inconsistent position must be adopted in the determination. *Id.*; see note 7 *supra*. See generally TAX MNGMT (BNA) § 110-2nd (1978).

the Commissioner's erroneous deficiency notice for 1965.<sup>33</sup> In *Albert W. Priest Trust v. Commissioner*<sup>34</sup> and *Yagoda v. Commissioner*,<sup>35</sup> the Tax Court was confronted with the identical issue and held that the mitigation provisions applied where the taxpayers' inconsistent positions were in response to erroneous deficiency notices from the Commissioner.<sup>36</sup> In neither case did the Tax Court state whether section 1311(b) required active or passive inconsistency.<sup>37</sup> Passive inconsistency exists when the taxpayer or Commissioner adopts the other party's treatment of income and subsequently challenges the treatment as incorrect.<sup>38</sup> Active inconsistency, as asserted by the taxpayer in *Yagoda*, requires the taxpayer to adopt purposely inconsistent treatments of income to hide behind the statute of limitations.<sup>39</sup> In *Yagoda*, the Second Circuit affirmed the Tax Court's holding that section 1311(b) does not require active inconsistency.<sup>40</sup> Thus the Fourth Circuit in *Chertkof* held that section 1311(b) requires passive inconsistency and that the Chertkofs satisfied the inconsistent position requirement even though their payment of taxes was in response to an erroneous deficiency notice from the Commissioner.<sup>41</sup>

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<sup>33</sup> See 649 F.2d at 266-68.

<sup>34</sup> 6 T.C. 211 (1946). In *Albert W. Priest Trust v. Commissioner*, the Commissioner of Internal Revenue allowed the Priest estate a deduction for income distributable to beneficiaries for the taxable year 1938. *Id.* at 223. The Commissioner in turn assessed a deficiency for the beneficiary for 1938. *Id.* The Tax Court adopted the beneficiary's position that the income was not currently taxable. *Id.* at 224. The Commissioner assessed a deficiency against the estate for the amount of the deduction that the Commissioner erroneously allowed. *Id.* The Commissioner relied on § 3801 (Int. Rev. Code of 1939, ch. 38, § 3801, 53 Stat. 471) (current version at I.R.C. §§ 1311-1314) to mitigate the statute of limitations. 6 T.C. at 226. The Tax Court held that the mitigation provisions applied regardless of whether the Commissioner or the taxpayer made the initial error. *Id.*

<sup>35</sup> 39 T.C. 170 (1962), *aff'd*, 331 F.2d 485 (2d Cir.), *cert. denied*, 379 U.S. 842 (1964). In *Yagoda v. Commissioner*, the Commissioner of Internal Revenue refused to recognize the existence of two trusts and issued a notice of deficiency for income previously attributed to trust income against the individual establishing the trusts. *Id.* at 174. The District Court, however, recognized the existence of the trusts and overturned the Commissioner's decision. *Id.* at 175. The Commissioner then refunded the erroneous taxes paid. *Id.* at 175-76. Meanwhile, the statute of limitations had run on the tax returns of the trusts. *Id.* The Commissioner issued a notice of deficiency against the trust for the amount of income which was erroneously excluded from the trust's income. *See id.* (mitigation provisions of §§ 1311-1314 of the IRC authorize the adjustment of erroneous taxes for certain related taxpayers); I.R.C. §§ 1313(c), 1311(b)(3), 1312; note 5 *supra*.

<sup>36</sup> 39 T.C. at 180-81; 6 T.C. at 226; *see* notes 34 & 35 *supra*.

<sup>37</sup> 39 T.C. at 180-81; 6 T.C. at 226.

<sup>38</sup> *See Yagoda v. Commissioner*, 331 F.2d at 490-91 (detailing passive inconsistency); *Albert W. Priest Trust v. Commissioner*, 6 T.C. at 226-27 (same); TAX MNGMT (BNA) § 110-2d, A8-10 (1978).

<sup>39</sup> *Yagoda v. Commissioner*, 331 F.2d at 490-91.

<sup>40</sup> *Id.*; *see* text accompanying notes 42-53 *infra*.

<sup>41</sup> 649 F.2d at 267-69. While the Fourth Circuit in *Chertkof* did not analyze the passive inconsistency test, the court expressly rejected the Chertkofs' assertion that § 1311(b) required active inconsistency. *Id.* at 268; *see* I.R.C. § 1311(b).

The Chertkofs relied on the legislative history of the mitigation provisions<sup>42</sup> and the Third Circuit's decision in *Kappel v. Commissioner*<sup>43</sup> to argue that section 1311(b) requires that the party whose view prevailed in the correcting adjustment for the open year maintain active inconsistency in relation to the erroneous treatment of income in the closed year.<sup>44</sup> The Chertkofs contended that a taxpayer must purposely assert diametrically opposed tax treatments with the intention of benefiting from the running of the statute of limitations to satisfy the active inconsistency test.<sup>45</sup> Under the Chertkofs' reasoning, the Chertkofs' adoption of the incorrect tax year in response to the Commissioner's erroneous deficiency notice was not active inconsistency.<sup>46</sup> No court, however, has adopted the Chertkofs' active inconsistency reasoning.<sup>45</sup> Although the Court of Claims has adopted an active inconsistency test, the test requires only that the taxpayer sue for a refund claiming the tax year is incorrect after having adopted the identical tax year.<sup>48</sup> In *Birchenough v.*

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<sup>42</sup> Brief for Appellant at 8-9, *Chertkof v. Commissioner*, 649 F.2d 269 (4th Cir. 1981) [hereinafter cited as Brief for Appellant]. The Chertkofs maintained that the Senate, through the Senate Finance Committee Report on the Revenue Act of 1938, established active inconsistency as a prerequisite to the operation of the mitigation provisions. *Id.* The Chertkofs focused on the Committee's language stating that the party benefiting from the statutory bar must maintain active inconsistency to justify the mitigation of the statute of limitations. S. REP. NO. 1567, 75th Cong., 3d Sess. 48, 49 (1938); see text accompanying note 45 *infra*.

<sup>43</sup> 615 F.2d 91 (3d Cir. 1980). In *Kappel v. Commissioner* the Kappels erroneously failed to report a taxable item of income for the years 1954 and 1955. *Id.* at 93. The Commissioner of Internal Revenue issued a notice of deficiency only for 1955 because the statute of limitations barred adjustment for 1954. *Id.* The Kappels paid the deficiency and filed a refund claim for the taxes paid, alleging that the income was properly includable in 1954. *Id.* The U.S. District Court for the Western District of Pennsylvania held that a portion of the income was taxable in 1954. *Kappel v. United States*, 369 F. Supp. 267, 273 (W.D. Pa. 1974). Accordingly, the Commissioner issued a deficiency notice for 1954. 615 F.2d at 93. The Kappels petitioned the Tax Court for a redetermination. *Id.* The Tax Court held that the mitigation provisions applied because § 1312(3)(A) described the situation. *Kappel v. Commissioner*, 70 T.C. 415, 421-22 (1978), *rev'd*, 615 F.2d 91 (3d Cir. 1980). Therefore, the Tax Court held that the statute of limitations no longer barred the collection of Kappel's taxes for 1954. *Id.* at 428. The Third Circuit reversed, however, and held the mitigation provisions did not apply because § 1312(3)(B) described the situation. 615 F.2d at 97. *But see* Treas. Reg. § 1.1312-3 (1956) (mitigation provisions apply since situation described by § 1312(3)(A)). The Third Circuit stated that the taxpayers must maintain active inconsistency for the mitigation provisions to apply. 615 F.2d at 96-97.

The Fourth Circuit in *Chertkof* distinguished *Kappel* because in *Kappel* the Commissioner attempted to collect tax for a year on which the statute of limitations had run before the first deficiency notice was issued. *Chertkof v. Commissioner*, 649 F.2d at 269 n.4. See 615 F.2d at 93. *But see* Treas. Reg. 1.1312-3(a)(2)(ii) (1956) (situation described by § 1312(3)(A) warranting the application of the mitigation provisions).

<sup>44</sup> Brief for Appellant, *supra* note 42, at 8-9.

<sup>45</sup> *Id.* at 20-21.

<sup>46</sup> *Id.*; see text accompanying note 45 *supra*.

<sup>47</sup> See note 48 *infra*.

<sup>48</sup> See text accompanying note 49 *infra*. Courts generally have held that a taxpayer's maintenance of a refund suit satisfies the inconsistency requirements of the mitigation pro-

*United States*<sup>49</sup> the Court of Claims examined the section 1311(b) inconsistency requirement and held that the maintenance of a refund suit constitutes active inconsistency warranting the application of the mitigation provisions even when the refund suit is to recover a deficiency which the Commissioner erroneously assessed.<sup>50</sup> In *Chertkof*, the taxpayers brought a refund suit to recover an erroneously assessed deficiency.<sup>51</sup> Accordingly, the Chertkofs satisfied the Court of Claims formulation of the active inconsistency test as well as the passive inconsistency test.<sup>52</sup> The Fourth Circuit, therefore, correctly held that the Chertkofs fulfilled the inconsistency requirements of section 1311(b).<sup>53</sup>

Furthermore, the Chertkofs argued that section 1311(b) requires that the party seeking to avoid the application of the mitigation provisions maintain a position inconsistent with the position initially advanced.<sup>54</sup> The Chertkofs reasoned that since the Commissioner ultimately adopted their initial position that 1966 was the correct tax year for the stock redemption income, the inconsistency requirements of section 1311(b) were not satisfied.<sup>55</sup> The Fourth Circuit in *Chertkof* correctly held that for purposes of the inconsistent position requirement, the fact that the determination adopted the Chertkofs' initial position is irrelevant.<sup>56</sup> If section 1311(b) required the taxpayer to maintain a position inconsistent with his initial stance, the Commissioner would be discourag-

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visions, regardless of whether the court requires active or passive inconsistency. See *Yagoda v. Commissioner*, 331 F.2d 485, 490 (2d Cir.) (inconsistent position in response to Commissioner's erroneous deficiency notice is passive inconsistency satisfying § 1311(b)), *cert. denied*, 379 U.S. 842 (1964); *Karpe v. United States*, 335 F.2d 454, 461-62 (Ct. Cl. 1964) (maintenance of refund suit is active inconsistency satisfying § 1311(b)), *cert. denied*, 379 U.S. 964 (1965); TAX MNGMT (BNA) § 110-2nd, A9-10 (1978) (active inconsistency should only require affirmative act); Clifford, *Mitigation Provisions: Current Problems and Judicial Inconsistencies*, 47 J. TAX. 68, 68-69 (1977).

<sup>49</sup> 410 F.2d 1247 (Ct. Cl. 1969). In *Birchenough*, the Internal Revenue Service assessed deficiencies for income received in 1954 against taxpayers. *Id.* at 1249. Taxpayers paid the tax in response to the assessed deficiencies. *Id.* Taxpayers, however, prevailed in a refund suit which established the correct tax years as 1950, 1951, and 1952. *Id.*

<sup>50</sup> *Id.* at 1251.

<sup>51</sup> 649 F.2d at 265-66.

<sup>52</sup> See note 48 *supra*.

<sup>53</sup> See text accompanying notes 33-41 *supra*; note 32 *supra*.

<sup>54</sup> 649 F.2d at 267; see note 32 *supra*.

<sup>55</sup> 649 F.2d at 266. The Chertkofs' argument that the court must examine taxpayers initial position for purposes of the inconsistent position requirement of § 1311(b) is without merit. See note 32 *supra*. Section 1311(b) does not mention initial position in the inconsistent position requirements. See I.R.C. § 1311(b); note 32 *supra*; note 56 *infra*.

<sup>56</sup> 649 F.2d at 267-68. Section 1311(b) requires inconsistency with the erroneous treatment. See I.R.C. § 1311(b); note 32 *supra*. The inclusion of the Chertkofs' stock redemption income in 1965 constituted the erroneous treatment. 649 F.2d at 267. The successful refund suit for 1965 operated as a determination changing the tax year to 1966. *Id.*; I.R.C. § 1313(a)(1); see note 7 *supra*. The Chertkofs' refund suit for 1965 was inconsistent with the Chertkofs' payment of taxes for the stock redemption income in 1965. See text accompanying notes 32-52 *supra*.

ed from ever contesting the proper tax year, for if the taxpayer's original position proved correct the Commissioner would be precluded from collecting any tax for an item if the limitations period had expired.

The Fourth Circuit's holding in *Chertkof* is harmonious with the legislative history of the mitigation provisions.<sup>57</sup> The Senate Finance Committee, in a report accompanying the Revenue Act of 1938, stated that disputes over the correct year in which income is taxable should not result in inequitable tax avoidance.<sup>58</sup> In proposing the provisions, the Committee sought to prevent taxpayers from profiting by taking inconsistent positions and then hiding behind the statute of limitations to avoid taxation.<sup>59</sup> The Committee stated further that the mitigation provisions apply whether the inconsistency is fortuitous or by design.<sup>60</sup> Thus, the Committee Report does not support the Chertkofs' argument that section 1311(b) requires intentional inconsistency.<sup>61</sup>

While the Chertkofs did not argue directly that Commissioner error prevented the Commissioner from benefiting from the application of the mitigation provisions, the Chertkofs framed all arguments upon the artificial issue of Commissioner error and attempted to persuade the court that error was an actual consideration.<sup>62</sup> To support the proposition that Commissioner error precludes the application of the mitigation provisions, the Chertkofs wrongly relied on *Kappel v. Commissioner*.<sup>63</sup> In *Kappel*, the Commissioner, through the application of the mitigation provisions, sought to make a correcting adjustment in a year closed by the statute of limitations at the time of the initial deficiency notice.<sup>64</sup> The *Chertkof* court distinguished *Kappel* because the correct tax year in *Chertkof* was an open year at the time of the initial erroneous deficiency notice.<sup>65</sup> Under the Chertkofs' reasoning, the Commissioner could never benefit from the application of the mitigation provisions if the Commis-

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<sup>57</sup> See text accompanying notes 58-60 *infra*.

<sup>58</sup> S. REP. NO. 1567, 75th Cong., 3d Sess. 48, 49-50 (1938).

<sup>59</sup> *Id.* at 49.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> 649 F.2d at 267-69; see text accompanying notes 62-67 *infra*. The Chertkofs' arguments focusing on the Commissioner's error in ascertaining the correct tax year stress an artificial issue because no language in the mitigation provisions supports the arguments. See I.R.C. §§ 1311-1314; notes 5 & 32 *supra*. In addition, courts have expressly rejected the Chertkofs' arguments. See notes 29 & 48 *supra*.

<sup>63</sup> See Brief for Appellant, *supra* note 42, at 17-21; note 43 *supra*; text accompanying notes 64-67 *infra*.

<sup>64</sup> *Kappel v. Commissioner*, 615 F.2d at 93. In *Kappel*, the Commissioner, through the application of the mitigation provisions, attempted to open a year that was closed at the time of the initial deficiency notice by issuing an erroneous deficiency notice for an open year. *Id.* at 99. The decision in *Kappel* that the mitigation provisions do not apply reached a result contrary to that of § 1.1312-3 of the Treasury Regulations. Treas. Reg. § 1.1312-3 (1956); see note 43 *supra*.

<sup>65</sup> 649 F.2d at 269 n.4.

sioner erroneously issued a deficiency notice.<sup>66</sup> Similarly, the Chertkofs' argument that the taxpayer must maintain a position inconsistent with the taxpayer's initial position would preclude the application of the mitigation provisions.<sup>67</sup>

The Fourth Circuit in examining the inconsistent position requirement in *Chertkof* addressed the artificial issue of Commissioner error implicit in the Chertkofs' arguments on active inconsistency and inconsistency with the initial position.<sup>68</sup> In doing so, the *Chertkof* court confused the meaning of the inconsistent position requirement. The *Chertkof* court stated broadly that the mitigation provisions apply regardless of who maintained the inconsistent position.<sup>69</sup> Section 1311(b), however, expressly requires the party seeking to avoid the application of the mitigation provisions to maintain a position inconsistent with the erroneous treatment of income.<sup>70</sup> Thus, the court's statement that the mitigation provisions apply regardless of who maintained the inconsistent position is misleading and directly contradicts section 1311(b). In addressing taxpayers' artificial argument on Commissioner error the court in *Chertkof* obscured the requirements of the mitigation provisions. The *Chertkof* facts exemplify the situation the mitigation provisions were formulated to prevent.<sup>71</sup> Without the mitigation provisions, the Chertkofs could avoid all tax liability on an item for which they concededly owed taxes simply because the Commissioner challenged the wrong tax year.<sup>72</sup> Section 1311(b) on its face only requires inconsistency with the error by the party prevailing in the determination.<sup>73</sup> Furthermore, section 1312(3)(A) is silent as to which party must err.<sup>74</sup> The Fourth Circuit, therefore, correctly abstained from adding new requirements to the already complex mitigation provisions.

The Fourth Circuit in *Chertkof* reached the correct decision despite its confusing opinion. The passive inconsistency test the Tax Court

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<sup>66</sup> See note 67 *infra*.

<sup>67</sup> 649 F.2d at 267. If the Commissioner mistakenly issued a deficiency notice for the wrong tax year and the taxpayer conformed to the Commissioner's deficiency notice, a successful challenge of the tax year by the taxpayer would ultimately use the taxpayer's initial position if the taxpayer was correct at the outset. Therefore, under the Chertkofs' reasoning, the Commissioner could only change the tax year at his own risk, because if the taxpayer was correct initially, the taxpayer could never fulfill the inconsistency requirements. See text accompanying notes 54-56 *supra*.

<sup>68</sup> 649 F.2d at 267-69; see text accompanying notes 42-56 *supra*.

<sup>69</sup> 649 F.2d at 268.

<sup>70</sup> I.R.C. § 1311(b); see note 32 *supra*.

<sup>71</sup> See text accompanying notes 73-75 *infra*.

<sup>72</sup> 649 F.2d at 269. The Chertkofs conceded that they owed tax in either 1965 or 1966. *Id.* The mitigation provisions were promulgated to prevent the double avoidance of tax that would occur in *Chertkof* if the provisions did not apply. See S. REP. No. 1567, 75th Cong., 3d Sess. 48, 49-50 (1938); text accompanying notes 58-60 *supra*.

<sup>73</sup> See I.R.C. § 1311(b); notes 32 & 56 *supra*.

<sup>74</sup> See I.R.C. § 1312(3)(A); notes 5 & 29 *supra*.

employs correctly isolates the issue of whether inequitable taxation or tax avoidance would occur without the application of the mitigation provisions of sections 1311-1314 of the IRC.<sup>75</sup> Accordingly, the application of the mitigation provisions in *Chertkof* furthers the policy behind sections 1311-1314.<sup>76</sup> The Fourth Circuit's opinion, however, is confusing. The *Chertkof* court over-emphasized the artificial issue of Commissioner error and failed to adequately distinguish error from the real requirement of inconsistency.<sup>77</sup> The application of the mitigation provisions, while often complex and confusing in other contexts, should have been straightforward in *Chertkof*.<sup>78</sup>

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<sup>75</sup> See text accompanying notes 57-61 *supra*.

<sup>76</sup> *Id.*

<sup>77</sup> See text accompanying notes 68-70 *supra*; note 32 *supra*.

<sup>78</sup> See text accompanying notes 22-32 *supra*.