Fordham Law Review

Volume 30 | Issue 2 Article 1

1961

Mysteries of Mitigation: The Opening of Barred Years in Income Tax Cases

Daniel Candee Knickerbocker, Jr.

Follow this and additional works at: https://ir.lawnet.fordham.edu/flr

Part of the Law Commons

Recommended Citation
Daniel Candee Knickerbocker, Jr., *Mysteries of Mitigation: The Opening of Barred Years in Income Tax Cases*, 30 Fordham L. Rev. 225 (1961).
Available at: https://ir.lawnet.fordham.edu/flr/vol30/iss2/1

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

Mysteries of Mitigation: The Opening of Barred Years in Income Tax Cases

Cover Page Footnote
Member of the New York Bar.

This article is available in Fordham Law Review: https://ir.lawnet.fordham.edu/flr/vol30/iss2/1

MYSTERIES OF MITIGATION: THE OPENING OF BARRED YEARS IN INCOME TAX CASES

*DANIEL CANDEE KNICKERBOCKER, JR.**

Introduction

SECTIONS 1311 through 1315 of the Internal Revenue Code of 1954 are entitled "Mitigation of Effect of Limitations and Other Provisions."[1] In the limited circumstances specified therein, these sections permit the opening of a taxable year otherwise barred "by the operation of any law or rule of law,"[2] in order to validate a taxpayer's claim for refund of an income tax overpayment or the Government's assessment of an income tax deficiency.

Originally enacted as Section 820 of the Revenue Act of 1938,[3] and included in the 1939 Code as section 3801,[4] the form and wording of the statute have changed very little during the past twenty-three years.[5] By

* Member of the New York Bar.

1. Int. Rev. Code of 1954, subtitle A, ch. 1, subchapter Q, pt. II. These provisions will sometimes hereinafter be referred to as the "mitigation statute" or the "mitigation sections."

2. See Int. Rev. Code of 1954, § 1311(a).

3. Revenue Act of 1938, ch. 289, § 820, 52 Stat. 581.

4. Int. Rev. Code of 1939, ch. 38, § 3801, 53 Stat. 471.

5. The changes may be summarized as follows: Revenue Act of 1942, ch. 619, § 504(a), 56 Stat. 957 (conforming changes required by reason of change of name of Board of Tax Appeals to Tax Court); Revenue Act of 1944, ch. 210, § 14(b), 58 Stat. 246 (conforming changes in § 3801(d) with respect to definition of "tax previously determined"); Revenue Act of 1950, ch. 809, § 208(c), 64 Stat. 544 (addition of subsection (g) in order to expressly exclude employment taxes from operation of statute); Revenue Act of 1953, ch. 512, § 211(a), 67 Stat. 625 (added new categories (6) and (7) to the enumeration of circumstances of adjustment in § 3801(b)—the former dealing with the disallowance of deductions or credits properly allowable (but not allowed) for some other taxable year, and the latter involving the exclusion from gross income of some item properly includable in some other year's or other taxpayer's gross income); Int. Rev. Code of 1954, § 1313(a)(4) (provision for special agreements between Service and taxpayer qualifying as determinations for purpose of statute); Int. Rev. Code of 1954, § 1314(b) (revision of computation method to reflect net operating loss carryback); Int. Rev. Code of 1954, § 1311(a) (addition of words "or rule of law" to make it clear that closed year barred by operation of res judicata, etc., may also be opened under statute); Int Rev. Code of 1954, § 1312(3)(A) (expansion of description of cases involving double exclusions from income to include both those in which taxpayer has included the income in his return for the wrong year, and those wholly omitted from a return); Int. Rev. Code of 1954, § 1312(6) (expansion of basis circumstance to include determinations of basis for any purpose and to include among errors, transactions erroneously treated as affecting basis and erroneous allowances of deductions for expenses properly chargeable to capital account or erroneous charges of deductible expenses to capital account; also makes corrections available to taxpayer who owned property at time of error); Technical Amendments Act of 1958,

judicial gloss, however, its scope and meaning have been both expanded and contracted.

This law-making by the courts is not the result of the ordinary extension of old language to fit new circumstances. In this instance, it appears to spring, first, from what has been called a "pronounced dichotomy in judicial attitudes" whereby some courts have construed the statute strictly and others liberally to produce "a concurrent development of conflicting case law . . . ";[6] and, second, from the complexity of the law's provisions.

In support of their views, the strict constructionists rely on the canon that enactments in derogation of a fundamental principle of law—here, the statute of limitations—should be held strictly within their original language and express scope. This position in the case of the mitigation statute has most frequently been taken by the Tax Court,[7] but there are also examples of the same position being adopted in a number of district courts and courts of appeals.[8] The Court of Claims, on the other hand, has characterized the mitigation statute as "a relief provision" which "should, if necessary, be given a liberal interpretation in order fully to carry out its apparent purpose."[9] This view has also been accepted by some of the federal district courts and some of the courts of appeals.[10]

---

ch. 866, § 59(a)(b), 72 Stat. 1647 (amending Int. Rev. Code of 1954, § 1312, to add a new circumstance of adjustment involving correlative deductions and credits of certain related corporations, and amending Int. Rev. Code of 1954, § 1314(c) to make it impossible for either taxpayers or Government to recover amounts of adjustments in lawsuits not based solely on the item which was the subject of the adjustment). These changes have been listed at length to indicate their very insignificant nature.

6. Note, 72 Harv. L. Rev. 1536, 1543 (1959).

7. E.g., D. A. MacDonald, 17 T.C. 934 (1951), acq., 1952-1 Cum. Bull. 3. "[T]he party who invokes an exception to the basic statutory limitation period must . . . assume the burden of proving all of the prerequisites to its application." 17 T.C. at 940; accord, J. C. Bradford, 34 T.C. 1051 (1960), acq., 1961 Int. Rev. Bull. No. 11 at 7; Estate of Mary B. Warburton, 30 T.C. 34 (1958); James Brennen, 20 T.C. 495 (1953), acq., 1954-1 Cum. Bull. 3.

8. E.g., United States v. Rushlight, 291 F.2d 508 (9th Cir. 1961), reversing 60-1 U.S. Tax Cas. ¶ 9309 (D. Ore. 1960); First Nat'l Bank v. Commissioner, 205 F.2d 82 (3d Cir. 1953), affirming 18 T.C. 899 (1952); Cain v. Campbell, 59-2 U.S. Tax Cas. ¶ 9610 (N.D. Tex. 1959); Sherover v. United States, 137 F. Supp. 778 (S.D.N.Y.), aff'd per curiam, 239 F.2d 766 (2d Cir. 1956); Dubuque Packing Co. v. United States, 126 F. Supp. 796 (N.D. Iowa 1954), aff'd, 233 F.2d 453 (8th Cir. 1956).

9. Gooch Milling & Elevator Co. v. United States, 111 Ct. Cl. 576, 587, 78 F. Supp. 94, 100 (1948); cf. M. Fine & Sons Mfg. Co. v. United States, 144 Ct. Cl. 46, 168 F. Supp. 769, vacating 144 Ct. Cl. 56, 162 F. Supp. 763 (1958); Moultrie Cotton Mills v. United States, 138 Ct. Cl. 208, 151 F. Supp. 482 (1957); H. T. Hackney Co. v. United States, 111 Ct. Cl. 664, 78 F. Supp. 101 (1948).

10. Olin Mathieson Chem. Corp. v. United States, 265 F.2d 293 (7th Cir. 1959),

Considering the statute in purely historical terms, and in the light of the extant evidence of its draftsmen's intent, one is impelled to the conclusion that those who construe it strictly are correct in their attitude. A much-quoted paragraph of the Senate Finance Committee's description of the bill proposed in 1938, reads in part:

> In each case, under existing law, an unfair benefit would have been obtained by assuming an inconsistent position and then taking shelter behind the protective barrier of the statute of limitations. Such resort to the statute of limitations is a plain misuse of its fundamental purpose. The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running of the statute. . . . Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.[11]

This language is crystal clear. Congress was creating a penalty, not passing an act for anybody's relief. The draftsmen adopted the most direct method imaginable; if, after the statute had run, the Commissioner or the taxpayer stirred things up again, the new law came into play to exact a forfeit.

The same conclusion as to congressional intent is implicit in what the legislature did not do as well as in what it did. A vast body of law was left untouched by the new section. As the authors of one of the first commentaries observed, a double inclusion in income or a double deduction is no more unfair to the taxpayer or to the Government than a single erroneous inclusion or deduction.[12] The loss is identical. Only the erroneous item produces too much or too little tax. Nevertheless, no one has suggested lifting the statutory bar in every instance of over or underpayment. However cruel the workings of limitations, Congress

affirming 58-2 U.S. Tax Cas. ¶ 9740 (S.D. Ill. 1958); United States v. Rosenberger, 235 F.2d 69 (8th Cir. 1956), affirming 138 F. Supp. 117 (E.D. Mo. 1955); Esterbrook Pen Co. v. United States, 60-2 U.S. Tax Cas. ¶ 9609 (D.N.J. 1960); Rushlight v. United States, 60-1 U.S. Tax Cas. ¶ 9309 (D. Ore. 1960), rev'd, 291 F.2d 508 (9th Cir. 1961). Many, if not most, of the commentaries on the mitigation statute view it as a relief measure. E.g., Burford, Basis of Property After Erroneous Treatment of a Prior Transaction, 12 Tax L. Rev. 365, 366 (1957); Holland, Tax Consequences of Inconsistent Positions—A Review of Section 3801, N.Y.U. 10th Inst. on Fed. Tax 807, 808 (1952); Note, 72 Harv. L. Rev. 1536, 1546 (1959).

11. S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938). But cf. H.R. Rep. No. 2330, 75th Cong., 3d Sess. 56 (1938), which talks of "mitigation of some of the inequities under the income-tax laws . . . which now prevent equitable adjustment of various income-tax hardships." The history of the mitigation statute and a description of the situation that prompted its enactment are contained in Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L.J. 509-15 (1939).

12. Maguire, Surrey & Traynor, supra note 11, at 515.

has not, either in 1938 or since, evinced any desire to abolish them or make them less effective. Rather, it seems generally recognized that "it probably would be all but intolerable . . . to have an income tax system under which there never would come a day of final settlement. . . ."[13]

Equally cogent is the argument on practical grounds. If, in spite of the contrary evidence, you choose to regard the mitigation sections as a species of bonanza and therefore eligible for liberal construction, how do you go about being liberal with the complex, technical, and highly detailed provisions of sections 1311 through 1315? Here either liberalism cannot be applied meaningfully,[14] or its meaning is that you will casually ignore whatever statutory language will not permit the desired result.

A final objection to liberalism arises from the anomalous way in which we have chosen to distribute the jurisdiction in determining tax controversies, *i.e.*, turning the taxpayer who wishes to contest an unpaid deficiency to the Tax Court, but reserving the litigation of his denied refund claims to the district courts and Court of Claims. As already noted, the principal seat of strict construction in mitigation cases is the Tax Court;[15] the liberal view has been most often voiced by the Court of Claims.[16] The consequence is that the Government enters these cases with a sort of built-in handicap. To assert the applicability of sections 1311 through 1315, the Commissioner must appear before the Tax Court with its insistence upon rigid adherence to the statute; but if the reopening of the closed year is initiated by the taxpayer, appearance is before a court where his claim "will, at least, receive a more sympathetic hearing" than would ever be given his adversary.[17] The danger of revenue loss in such a situation is only too obvious. Though intended originally as a two-edged sword to be wielded by an impartial justice, the penalty of mitigation has come, by judicial division, more nearly to resemble a spear in the hands of the taxpayers.

The law's second disability is its complexity. Sections 1311 through

13. Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 301 (1946).

14. Cf. Note, 72 Harv. L. Rev. 1536, 1546 (1959).

15. See note 7 supra and accompanying text.

16. See note 9 supra and accompanying text. The attitude of the Court of Claims in these and similar cases has been attributed to an "extraordinarily evident desire . . . to disregard technical rules . . . if the taxpayer can make a convincing case that he has paid to the Government more tax than it is in good conscience entitled to retain. . . ." Pavenstedt, The United States Court of Claims as a Forum for Tax Cases, 15 Tax L. Rev. 201, 228 (1960).

17. Burford, Basis of Property After Erroneous Treatment of Prior Transaction, 12 Tax L. Rev. 365, 370 (1957).

1315, like their predecessors, are long, detailed and specific. They abound in what Judge Charles Clark has called "the complicated form of expression which seems an occupational trait of revenue legislation."[18] Moreover, their key terms are most imprecisely defined and used.[19] For these reasons, it is neither surprising nor cause for criticism when error creeps into the argument and decision of cases. Who can blame the lawyer or judge who, occasionally, instead of reading the law, merely guesses at what it says?

We should expect lapses of this sort when we ask our courts to deal with such highly technical enactments. The cases already decided, and those to come, construing the rules relating to, say, collapsible corporations, or optional adjustments to the basis of partnership property, will undoubtedly reveal oversights just as egregious as those shortly to be catalogued. And the inevitability of error may be our strongest argument in favor of a shorter, simpler code whose broadly drawn provision need only be implemented rather than rewritten at the administrative and judicial levels. On the other hand, the particularity of the sections here considered conforms to the legislative intent underlying their adoption. The exception to the operation of the statute of limitations was deliberately confined to a few predetermined cases. This then was no early emanation from the drafting philosophy of "specificity at all cost."[20] Rather, it was an attempt to draw the boundaries of a very circumscribed territory. In this light, the statute's minutiae, however, regrettable, are seen also as necessary.

Code Provisions

In simplest terms, before a closed year may be reopened for adjustment under sections 1311 through 1315, the following conditions must have been met:

First, there must have been a "determination." This is a defined term. It includes a court decision that has become final, a closing agreement, the final disposition of a claim for refund, or a special agreement between taxpayer and Government for the specific purposes of the mitigation statute.[21] The first and second types of determination are, of course, final dispositions of tax controversies, and the third is relatively final, being subject only to the infrequently invoked remedy of the suit to recover an erroneous refund provided in section 7405. The special

18. Cory v. Commissioner, 261 F.2d 702, 704 (2d Cir. 1958).
19. Note, 72 Harv. L. Rev. 1536, 1547 (1959).
20. Cary, Reflections Upon the American Law Institute Tax Project and the Internal Revenue Code: A Plea for a Moratorium and Reappraisal, 60 Colum. L. Rev. 259 (1960).
21. Int. Rev. Code of 1954, § 1313(a).

agreements, which were first authorized in 1954, are not final; as long as the year remains open, both taxpayer and Commissioner are free to "pursue any of the procedures provided by law to secure a further modification of the tax liability for such year . . . ," including the adoption of "a position with respect to the item that was the subject of the adjustment that is at variance with the manner in which said item was treated in the agreement."[22] The special agreements, then, depart from the original concept of the mitigation statute, which was kept inoperative until final disposition because "an inequity resulting from a decision in a prior stage of consideration . . . may disappear upon final action . . . ;"[23]

Second, the determination must effect one or more of the seven types of change in the taxable income of the taxpayer (or of a related taxpayer) enumerated in section 1312;[24]

Third, except in two specific cases,[25] the determination must adopt a position maintained either by the Commissioner or by the taxpayer, as the case may be, which is inconsistent with an error made in some other taxable year or an error made by some related taxpayer;[26]

Finally, the correction of the error must be barred by operation of some law or rule of law.[27]

It is the purpose of this article to examine a number of the decisions to ascertain, if possible, how closely these statutory requirements have been observed.

DETERMINATIONS

This requirement has been ignored in a number of cases, both in the Tax Court and elsewhere. For reasons that are not apparent, there is

22. Treas. Reg. § 1.1313(a)-4(d) (1956); cf. Rev. Rul. 60-287, 1960-2 Cum. Bull. 188. Whether these special agreements have been extensively used is not, and apparently cannot, be known. Authority to make the agreements has been delegated to the district directors. Action with respect to them does not, therefore, "ordinarily come to the attention of the National Office." Letter from J. B. Sefert, Director of Audit Division (Symbols O:A:P) to Author, July 5, 1960.

23. Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L.J. 719, 720 (1939).

24. Int. Rev. Code of 1954, § 1312 lists the following circumstances under which adjustment is authorized: "(1) Double inclusion of an item of gross income . . . (2) Double allowance of a deduction or credit . . . (3) Double exclusion of an item of gross income . . . (4) Double disallowance of a deduction or credit . . . (5) Correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs . . . (6) Correlative deductions and credits for certain related corporations . . . (7) Basis of property after erroneous treatment of a prior transaction. . . ."

25. The two situations that are excepted are described in paragraphs 3(B) and 4 of Int. Rev. Code of 1954, § 1312.

26. Int. Rev. Code of 1954, § 1311(b).

27. Int. Rev. Code of 1954, § 1311(a).

a tendency among lawyers to urge and, occasionally, among judges to accept the proposition that tax overpayments or underpayments of prior closed years may be used to adjust the tax liability actually being considered.[28]

In *Suckow Borax Mines Consol., Inc.*,[29] the taxpayer, as lessor of a mine, was obligated to pay half of the cost (but not more than $12,000 per year) of all capital improvements made by the lessee. In 1934, improvements in the indicated amount were made and the lessee recovered the lessor's share of the cost thereof by withholding it from the rent. On its tax return for 1934, the lessor included in income only the net rental received by it. Nevertheless, when the mine was sold in 1942, the taxpayer-lessor computed its taxable gain by including in its basis its share of the 1934 improvement cost. In the instant proceeding, arising from the assertion of a deficiency for the year of sale resulting from the exclusion of such 1934 cost from basis, the court held that the taxpayer had properly reported its gain. However,

> petitioner . . . will be required to recompute its income tax for 1934 under section 3801 of the Code by including therein, in income, the amount . . . [by which basis has been adjusted in this proceeding]; and there must be added to depletion allowances from 1935 to December 31, 1942, an amount with respect to this addition to mine development. . . . Effect will be given to this adjustment of depletion under Rule 50.[30]

The issue in *J. Rogers Flannery, Jr.*[31] was the deductibility, as a loss, of expenses incurred in developing an invention in which the taxpayer, in 1941, was held to have had no interest. Some of such expenses had been treated as current expenditures, deducted on the taxpayer's returns for 1937 and 1938, and never questioned by the Internal Revenue Service. The taxpayer now argued, however, that, because these expenses were really part of his cost, they constituted part of the loss he had suffered in 1941. He further asserted that it was immaterial that they had previously (and erroneously) been deducted. Presumably it was these erroneous deductions that the court had in mind when, in

28. It is believed that the major share of the blame for this erroneous practice must be borne by taxpayers' counsel who cannot abandon the habit of urging offsets. See, e.g., Herman Paster, 20 CCH Tax Ct. Mem. 1239 (1961); W. L. Loback, 9 CCH Tax Ct. Mem. 333 (1950); Anton Dolenz, 41 B.T.A. 1091 (1940), acq. on other issue, 1940-2 Cum. Bull. 2. There appears, however, to be some feeling in the Tax Court that, with proper pleading, the determination requirement can be avoided. See, e.g., Irving Segall, 30 T.C. 734 (1958); Kenosha Auto Trans. Corp., 28 T.C. 421, acq., 1957-2 Cum. Bull. 5; Roscoe Lilly, 15 CCH Tax Ct. Mem. 1087 (1956); Sam D. Hecht, 16 T.C. 981 (1951).

29. 12 CCH Tax Ct. Mem. 786 (1953).

30. Id. at 793-94.

31. 5 CCH Tax Ct. Mem. 332 (1946).

allowing the deduction as claimed, it held that the amount thereof "must be adjusted in accordance with section 3801 of the Internal Revenue Code."[32]

In *Bauman v. United States*,[33] the original pleadings did not involve a mitigation issue. During the trial, however, the taxpayer, attempting to establish the basis of securities sold during the year in question, argued that payments received by her in earlier closed years had been taxable dividends which did not reduce such basis. In connection with this argument, she conceded that, since the dividends had not been included in her reported income for the closed years and no tax had been paid thereon, the Government could recover the tax under section 3801. Thereafter, the court announced judgment for the taxpayer but gave the Government thirty days in which to interpose a counterclaim based on the concession. Nowhere in the report of the case is there any recognition that the validity of the Government's claim depended upon a judgment on the taxpayer's complaint, and then, only if such judgment had become final.

But this was not the end. The taxpayer's concession in *Bauman* was turned into a bootstrap operation in *Rosenberger v. United States*.[34] There the argument was made that the judgment on the Government's counterclaim in the earlier case was a determination which opened yet another barred year. This entitled the taxpayer to a refund on the same theory that had prevailed in *Bauman*. One wonders here if mitigation cannot, on occasion, take us into a hall of mirrors where each decision is reflected in yet another lawsuit. Is a judgment under the mitigation statute a determination of the sort required by the statute itself? The *Rosenberger* case certainly so holds. Moreover, there is nothing in the statute that expressly prohibits such a result. On the other hand, the thought of endless actions to correct errors all the way back to 1931[35] is somewhat appalling. We might well consider here an amendment of the law which would permit the correction of all related errors in a single lawsuit.

This is not to suggest that Congress overrule the decision in *First Nat'l Bank of Philadelphia*.[36] There the issue was the proper year of deduction for a state tax. Having sustained the Commissioner's disallowance of the deduction for the year for which taxpayer claimed it,

32. Id. at 336.

33. 106 F. Supp. 384 (E.D. Mo. 1952).

34. 138 F. Supp. 117 (E.D. Mo. 1955), aff'd, 235 F.2d 69 (8th Cir. 1956).

35. Adjustments under the mitigation statute may be made in respect of any taxable year beginning on or after January 1, 1932. Int. Rev. Code of 1954, § 1314(d).

36. 18 T.C. 899 (1952), aff'd, 205 F.2d 82 (3d Cir. 1953).

the court refused to extend the principle to earlier years as urged by the taxpayer. The fact that the deductions claimed for those earlier years were for taxes imposed by the same statute was not a sufficient relationship with the deduction being disallowed to bring mitigation into operation.

But a statutory change of the sort here suggested might prevent errors like those involved in *SoRelle*[37] and *Gill*[38] discussed later in this article.

The case of *H. T. Hackney Co. v. United States*[39] is frequently cited as an example of what not to do in deciding a mitigation case. One of its disabilities is its strained application of the determination requirement. The plaintiff in 1939 discovered that over a period of years one of its store managers had been systematically reporting overstated inventories. This had had the effect of erroneously increasing income (and, therefore, the amount of tax paid) for most of the years involved. The taxpayer filed and was allowed a refund claim for 1938. The Commissioner determined a deficiency for 1939 which was paid. In 1943, after the period of limitations had run, refund claims for 1933, 1934, 1935, and 1936 were filed. After these were disallowed, the taxpayer sued in the Court of Claims which gave judgment for the taxpayer on the ground that the mitigation statute applied. In answer to the Government's contention that there had been no determination to produce this effect, the court replied:

> We think it is clear that there was a final determination . . . when the Commissioner, in a final determination on the claim for refund for 1938, gave authoritative sanction to the inconsistent treatment by plaintiff in its amended returns for 1938 and 1939 with that which had occurred in the years 1933 to and including the fiscal year ending June 30, 1938.[40]

Thus, the Commissioner had opened the barred years by accepting the taxpayer's view of the matter for an open year. Although the grant or denial of a claim for refund is listed in the statute as one of the actions constituting a determination, the statute makes it quite clear that mitigation is not touched off by every determination. The determination relied on must be one that adopts a position maintained by the party (Commissioner or taxpayer) who will be adversely affected by the mitigation claim.[41] The determination in *Hackney,* of course, adopted a position maintained by the taxpayer, the beneficiary of mitigation, and was therefore clearly outside the statute.

37. 31 T.C. 272 (1958), acq., 1959-1 Cum. Bull. 5.
38. 35 T.C. 1208 (1961).
39. 111 Ct. Cl. 664, 78 F. Supp. 101 (1948).
40. Id. at 680-81, 78 F. Supp. at 110.
41. See note 26 supra and accompanying text.

The determination requirement, if properly applied, would have made unnecessary the very obvious soul searching of the court in *Sherover v. United States*[42] with respect to other provisions of the mitigation statute. In the earlier case of *Worth S.S. Corp.*,[43] the Tax Court had decided that income from the operation of a ship was not taxable to the corporation which held title thereto. Having so decided, the court was not required to make any finding as to the amount of such income or as to the liability of the real owners of the ship (one of whom was Sherover) as transferees, for the corporation's taxes. Nevertheless, on the supposition that such findings might be necessary, the parties stipulated in advance of decision as to the amount of the income. Since the stipulation involved a concession by the Government that certain expenditures originally charged to capital account had actually been deductible expenses, it was also stipulated that taxpayers, in determining their gains upon disposition of the ship in a subsequent year, would reduce the ship's basis by the amount of the allowed deductions. The stipulations were made a part of the record[44] and, in the light of the court's decision, were wholly irrelevant.

Following the decision, the Commissioner assessed, and Sherover paid, a deficiency for the year of the ship's sale based upon the reduction of basis and resulting increase in gain in accordance with the stipulation. It was at this point that Sherover sought to reopen the closed year to obtain a refund of taxes overpaid because he had not claimed the deductions stipulated in the Tax Court proceeding to have been allowable. The court quite properly held that the closed year could not be reopened. Its ground for so holding, however, was not the absence of a determination, but rather the taxpayer's failure to show that one of the circumstances of adjustment was present. Would it not have been easier for the court if it had addressed itself to the determination question? There were only two events to which taxpayer could look that resembled a determination, and neither qualified; the irrelevant stipulation in the Tax Court had no more force than dictum, and the assessment of additional tax for the year of sale, having been paid, had never achieved the required finality.

Granting that there is no special primacy given to any of the requirements of the mitigation statute—either by the statute itself or as a principle of construction—it does seem desirable to look to the easiest requirements first and to refrain, wherever possible, from deciding the more difficult issues that arise when we try, for example, to construe the enumerated circumstances of adjustment.

42. 137 F. Supp. 778 (S.D.N.Y.), aff'd per curiam, 239 F.2d 766 (2d Cir. 1956).

43. 7 T.C. 654, acq., 1946-2 Cum. Bull. 5.

44. Brief for Appellant, p. 5, and Reply Brief for Appellant, p. 1, Sherover v. United States, 239 F.2d 766 (2d Cir. 1956).

The most recent decision in this area, *Esterbrook Pen Co. v. United States*,[45] seems on its face almost to invent the required determination. The court first disallowed a deduction for 1952 (on the ground that it should have been claimed for 1953), and found that such disallowance constituted a "determination." It then held that 1953 could be opened pursuant to section 1311(a) "because the required determination had occurred."[46]

It is at least arguable that the determination requirement is unduly harsh. Although the rule is logically defensible on the ground that both Government and taxpayer are entitled to have the issues in the open year finally decided before proceeding to correct errors in closed years, the rule can, nevertheless, produce hardship. Suppose, for example, the case of an item of income which should properly be included on this year's return and which was inadvertently included on a return for some previous (and now barred) year. There appears to be no way in which the taxpayer can correct his error without being out of pocket, for a rather extended period, an amount equal to two years' tax on the income in question. To obtain the determination that will open the earlier year, he must first pay the correct tax for this year. (Assuming the facts are now known to him, he really has no alternative to correct reporting since his return will be signed "under the penalties of perjury.") Thereafter, he can proceed, either by way of a claim for refund (again "under the penalties of perjury") or a section 1313(a)(4) special agreement, to obtain a determination that this payment was correct. Only after all this will he be able to seek the refund to which he is entitled, and how soon such refund will be forthcoming is problematical. In the meantime, he may well have been faced with a serious working capital shortage.

The possibility of such a delay and the judiciary's traditional abhorrence of multiple lawsuits probably account in large measure for the way in which the determination requirement has been ignored, particularly in those cases in which the party who will be adversely affected by mitigation is willing to concede its applicability. It does seem, however, as if the problem might be solved without recourse to judicial amendment. Even without a change, should not both Government and taxpayers be content with whatever exception to limitations the legislature has seen fit to give them?

Inconsistent Positions

The courts appear to have encountered even more difficulty in applying the statutory rule that mitigation is available only if there

45. 60-2 U.S. Tax Cas. ¶ 9609 (D.N.J. 1960).
46. Id. at 77,603.

has been adopted, in the determination, a position inconsistent with "the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be . . . ." in the barred year.[47] Where adjustment under the mitigation sections will result in a refund, the inconsistent position must have been maintained by the Commissioner; where it will result in a deficiency, it is the taxpayer who must have been inconsistent.

In *Heer-Andres Inv. Co.*,[48] the taxpayer, as lessor of certain business property, was entitled to receive, within ten days after the close of its fiscal year each January 31st, a rental payment determined by reference to the lessee's net sales for the twelve month period ended on the same date. Although taxpayer kept its books and filed its returns on the accrual basis, it regularly reported these payments in the taxable years in which they were actually received. Finally, upon audit of its return for the year ended January 31, 1946, the Commissioner determined a deficiency by adding to income for that year the rent paid February 10, 1946. The case went to the Tax Court. There the taxpayer argued first, that its method of reporting the rentals only when received had been correct and, alternatively, that if the payment received February 10, 1946 must be included in 1945-1946 income, then the one received February 10, 1945 must be excluded therefrom.

It was the second view of the matter that was adopted by the Tax Court.[49]

Thereafter, the Commissioner returned to the lists with a new deficiency notice. This time it was for fiscal 1944-1945 and the issue was the includability of the rent collected February 10, 1945. Since the statute had run on this taxable year, the mitigation section was invoked. The Tax Court held the remedy unavailable.

Pointing out the statutory requirement of an inconsistent position, the opinion of Judge Withey expressly found that it was the Commissioner, not the taxpayer, who had been inconsistent. The Commissioner's position in the original case, in which he sought, unsuccessfully, to tax in one fiscal year the rent for both fiscal 1944-1945 and fiscal 1945-1946 was inconsistent with his position for fiscal 1946-1947 in which he collected the tax with respect to the rent for that year alone. On the other hand, the court pointed out that the taxpayer had always been consistent: it had always wanted to have the rent taxed in the fiscal year in which it was received.

47. Int. Rev. Code of 1954, § 1311(b)(1).

48. 22 T.C. 385 (1954), acq. as to result only, 1955-2 Cum. Bull. 6.

49. Heer-Andres Inv. Co., 17 T.C. 786 (1951), nonacq., 1952-1 Cum. Bull. 5.

It should be noted that the court never even mentioned the statutory language.

A case that reached the right result on apparently fallacious reasoning is that of *Daniel M. Cory*,[50] where the court held that, upon a determination that certain income was properly excludable from a return for 1944, it was possible to reopen the return for 1945 when such income was properly taxable and assess the tax. The taxpayer's position in the prior proceeding had been that this income should be excluded from his 1944 return. Such position was clearly inconsistent with the erroneous exclusion of the income from the return for 1945. By ruling in his favor, the Tax Court adopted his inconsistent position.[51] To this extent, therefore, the statute was satisfied. But the court did not discuss this inconsistency. What the court found inconsistent were the two positions the taxpayer had taken for 1944—including the income on his return as originally filed and later claiming that the income should be excluded.

In the first of the inventory cases, *Gooch Milling & Elevator Co. v. United States*,[52] the Court of Claims took an equally confusing stand:

> The Commissioner acted inconsistently. In his determination . . . with respect to the fiscal year 1936, the Commissioner adopted a position which was inconsistent with the position the taxpayer had maintained with respect to the erroneous inclusion of "option wheat" in its inventories, and which determination was also inconsistent with the basis on which the Commisioner had audited and closed the plaintiff's returns for years prior to the fiscal years 1935 and 1936.[53]

Three inventory cases following *Gooch* present their own peculiar problems.

In the *Hackney*[54] case, referred to earlier, the court spoke of the treatment of inventories by the plaintiff-taxpayer, in its 1938 and 1939 tax returns, as "inconsistent . . . with that which had occurred in the [earlier] years. . . ."[55] But, as this was a case in which the adjustment sought would involve a refund, the statute expressly required that the inconsistent position be maintained by the Commissioner, not the taxpayer.

In *Dubuque Packing Co. v. United States*,[56] the court went similarly astray on the inconsistency issue and held that the taxpayer was not

50. 29 T.C. 903, aff'd, 261 F.2d 702 (2d Cir. 1958), cert. denied, 359 U.S. 966 (1959).

51. 23 T.C. 775 (1955), aff'd, 230 F.2d 941 (2d Cir.), cert. denied, 352 U.S. 828 (1956).

52. 111 Ct. Cl. 576, 78 F. Supp. 94 (1948).

53. Id. at 587, 78 F. Supp. at 100.

54. H. T. Hackney v. United States, 111 Ct. Cl. 664, 78 F. Supp. 101 (1948); see note 39 and accompanying text.

55. 111 Ct. Cl. at 681, 78 F. Supp. at 110.

56. 126 F. Supp. 796 (N.D. Iowa 1954), aff'd, 233 F.2d 453 (8th Cir. 1956).

entitled to a section 3801 adjustment. "The Commissioner," it stated, "throughout consistently computed the taxpayer's taxes based upon the taxpayer's election [to include additional items in its LIFO inventories] . . . ."[57]

And finally, in *Moultrie Cotton Mills v. United States*,[58] the necessary inconsistency was found in the fact that, for the years barred by the statute of limitations, the Commissioner had denied refund claims "based on the same required calculation" as that used in determining refunds allowed for years not so barred.[59]

In *Heer-Andres*[60] and *D. A. MacDonald*,[61] the Tax Court found it unnecessary to deal with a most intricate question of inconsistency. The requisite prior determinations[62] had approved the Commissioner's position as to the proper method of accounting for the taxpayers' incomes, but agreed with the taxpayers that the Commissioner's application of this method for a particular year was incorrect. In each case, the taxpayer had offered this view as an alternative to his primary argument that the method used had been correct. Since the alternative was argued before the court, and the court had sustained it, the Commissioner was thereafter able to say that the taxpayer had maintained a position inconsistent with the erroneous reporting method used by him, and on the basis of which his tax had been computed, for earlier years.

Suppose, however, that the taxpayer had remained silent on this issue until the court had decided which accounting method was correct and, only then, in connection with the Rule 50 computation, had contested the manner of determining income. Or suppose, instead of advancing the argument over method as an alternative, counsel had pointed out the absurdity of the Commissioner's position by showing the peculiar results that he reached. With this before it, might not the court, on its own motion, have made a proper computation?

The inconsistency arguments of the parties, and the court's reference thereto, in *James Brennen*,[63] can only be ascribed to confusion. There, the Commissioner, having disallowed certain deductions affecting the basis of securities owned by the taxpayer, voluntarily recomputed the gain realized upon their sale in a subsequent year and refunded the tax overpayment thus found to have been made. The taxpayer filed no

57. 126 F. Supp. at 807.

58. 138 Ct. Cl. 208, 151 F. Supp. 482 (1957).

59. Id. at 214, 151 F. Supp. at 485.

60. 22 T.C. 385 (1954).

61. 17 T.C. 934 (1951), acq., 1952-1 Cum. Bull. 3.

62. Heer-Andres Inv. Co., 17 T.C. 786 (1951); Omah MacDonald, 8 CCH Tax Ct. Mem. 212 (1949).

63. 20 T.C. 495 (1953), acq., 1954-1 Cum. Bull. 3.

claim for this refund, nor did he execute any agreement accepting the Commissioner's finding. But he did cash the refund check and retain its proceeds. The questioned deductions having subsequently been sustained,[64] and the taxpayer's original computation of gain thus shown to be correct, the Government in the instant action was trying to recover the refund it had made. Briefs for both taxpayer and Government discussed "the question whether the action of the petitioner in accepting and retaining the refund . . . amounted to the maintenance of an inconsistent position. . . ."[65] What they, and the court, ignored was that, under the mitigation statute, it does not matter how the error in a barred year arose or who committed it. The requirement is that the determination adopt a position inconsistent with the error and not with whatever position had been maintained with respect thereto by either of the parties.[66]

It will be recalled that the required inconsistent position of the Commissioner upon which the taxpayer's victory in *Rosenberger*[67] depended was taken in an earlier case by way of counterclaim in an amended answer, after the court had announced it was prepared to give judgment for the taxpayer. It was held that the judgment in favor of the Government on this counterclaim was a determination adopting the inconsistent position. But the counterclaim itself was based on the mitigation statute and, as already stated, was improperly allowed because not preceded by a determination in the form of a judgment that had become final. How, therefore, could that allowance be treated as the required adoption of an inconsistent position?

Items

Among the "circumstances of adjustment" enumerated in Code section 1312 (the kinds of determination for one year which will, if other requirements are satisfied, open the otherwise barred return for another year or another taxpayer), two involve the erroneous treatment of "an item" of gross income. Adjustment is authorized, the section declares, if a determination:

requires the inclusion in gross income of an item which was erroneously included in

64. Decision entered on stipulation, Docket No. 14104 (T.C., Jan. 16, 1951).

65. 20 T.C. at 500.

66. Albert W. Priest Trust, 6 T.C. 221, acq., 1946-1 Cum. Bull. 4; cf. Note, 40 Va. L. Rev. 773, 776 (1954). As here pointed out, however, the position adopted in the determination cannot be that of the party claiming a mitigation adjustment. The Commissioner's voluntary allowance of a refund could not, therefore, have served as ground for reopening the year in which the original deductions were claimed.

67. Rosenberger v. United States, 138 F. Supp. 117 (E.D. Mo. 1955); see note 34 supra and accompanying text.

the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer . . . [or]

requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer; or . . .

requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

As used elsewhere in the Internal Revenue Code, the word *item* is qualitative—is synonymous with "type." The surmise, made soon after the enactment of section 820,[68] that the usage there was similar, was probably a correct one. But, in the mitigation statute, the usage appears to be (and the early commentary just referred to describes it as) somewhat more restricted than, for example, the usage of "item" in the definition of "gross income" itself.[69] For the latter purpose, all of the salaries, all of the dividends, all of the rents received by a taxpayer in any year are each, as an aggregate, an "item" of gross income. But, as the word is used in section 1312, these aggregates are not the items. In addition to its examination into types of income, the statute is interested as well in sources and other identifying features.

It was the *Gooch Milling*[70] case which first demonstrated the difficulties of the item concept. On audit of the taxpayer's return for the 1935-1936 fiscal year, it was found that opening and closing inventories had been overstated by reason of the inclusion therein of wheat to which taxpayer did not have title. Eliminating this wheat from inventory increased income for the year and produced a tax deficiency. The resulting assessment was sustained by the Board of Tax Appeals[71] and, ultimately, the Supreme Court.[72] The taxpayer then sued in the Court of Claims to recover a refund for the year 1934-1935 on the theory that, by making the same sort of adjustment to inventories in the earlier year (which was closed), the effect would be to reduce income. Holding in favor of the taxpayer, the court summarized and answered the Government's arguments in these words:

[I]t is insisted . . . that the term "item" . . . has reference only to such specific

68. Maguire, Surrey & Traynor, Section 820 of Revenue Act of 1938, 48 Yale L.J. 719, 751 (1939).

69. Int. Rev. Code of 1954, § 61.

70. Gooch Milling & Elevator Co. v. United States, 111 Ct. Cl. 576, 78 F. Supp. 94 (1948).

71. Gooch Milling & Elevator Co., 10 P-H B.T.A. Mem. 1356 (1941).

72. 320 U.S. 418, reversing 133 F.2d 131 (8th Cir. 1943).

identifiable items as dividends, salaries, a profit on the sale of specific property, a loss or bad debt.

We think . . . that the section should not be given such a limited interpretation. . . . [I]nventories . . . are vital in the determination of gross income, and when their cost or value . . . is changed, gross income is . . . directly affected and the result and amount by which income is affected and the amount in which it is increased or decreased, through an increase or decrease in the operating profit or loss, is as specific and identifiable as an item or [sic] dividends, salaries, loss or the like.[73]

It is believed that the court's view of an item of gross income as anything "specific and identifiable" by which such income is "directly affected," is not only reasonable but correct. Nonetheless, the *Gooch* case has led to difficulty.

The case of *H. T. Hackney Co. v. United States*[74] was decided on the very same day as *Gooch* and looked to the latter for authority. *Hackney*, too, involved erroneous overstatements of inventory, beginning in 1933 and ending with the closing inventory for fiscal 1937-1938. The error was discovered and corrected during fiscal 1938-1939, and such correction, the court observed, "had the effect of shifting an item of income to 1939, that is, portions of the operating profits computed for such prior years. . . ."[75]

We may take it that the item said to have been shifted, "operating profits," was the court's misnomer for "gross profit" or "gross margin," the term accountants use to describe the intermediate balance produced by charging the total of sales with the cost of goods sold. As such, in a sense, it certainly is an item of income, but, it is believed, one of insufficient particularity. It could represent, for example, the gross profit realized in a variety of operations or with respect to a number of different and unrelated stocks of goods. Surely a determination with respect to the gross profit from the sale of buttons in one year could not give rise to an adjustment in a prior closed year in the gross profit from the sale of paper clips. Here, then, we see the first departure in words, though not in fact, from the concept of the "specific and identifiable" as a test of what constitutes an item.

The most recent word from the Court of Claims in this area came in *M. Fine & Sons Mfg. Co. v. United States.*[76] In 1944, the taxpayer was given a factory by a local chamber of commerce. In 1947, the factory was sold. During the period in which taxpayer had held the property, "it was the established policy of the Commissioner of Internal Revenue to deny . . . a right to a deduction for depreciation on property" acquired

73. 111 Ct. Cl. 576, 585-86, 78 F. Supp. 94, 99-100 (1948).

74. 111 Ct. Cl. 664, 78 F. Supp. 101 (1948).

75. Id. at 679, 78 F. Supp. at 109.

76. 144 Ct. Cl. 46, 168 F. Supp. 769, vacating 144 Ct. Cl. 56, 162 F. Supp. 763 (1958).

as this had been.[77] No depreciation was claimed and, upon sale, the entire proceeds, unreduced by any basis, were treated as gain. After the Supreme Court's decision in *Brown Shoe Co. v. Commissioner*,[78] the Fine Company filed a claim for refund for the year of sale on the ground that its basis for the factory had been the cost thereof to the generous chamber of commerce. Such claim was allowed in part and disallowed in part. The Commissioner admitted that taxpayer's basis had not been zero, but insisted that, for the purpose of computing gain, the basis to the donor must be reduced by the depreciation allowable (but not claimed) for the years in which the factory was held by the taxpayer prior to sale. These years being barred by the statute of limitations, the Court of Claims action was brought to recover the taxes which would not have been paid had the depreciation charges been allowed as deductions. The result was a taxpayer victory founded solidly on the position foreshadowed in *Gooch* and definitely enunciated in *Hackney*. As a constituent element of the cost of goods sold, the court held, the depreciation in question directly affected a portion of gross profit. By reason of the Commissioner's partial disallowance of the 1947 refund claim, this profit was shifted into the year in which the factory was sold.[79]

As has been suggested by at least two commentators, this decision may point the way to a solution of the difficult mitigation problems which are created by basis adjustments.[80] But, when examined standing alone and judged in terms of the item concept, the *Fine* case is not satisfactory. There the depreciable property involved was a factory building so that the depreciation deduction was a constituent element of the cost of goods sold.[81] Not all depreciation, however, is of this character.

77. 144 Ct. Cl. at 57, 168 F. Supp. at 771.

78. 339 U.S. 583 (1950), holding that a taxpayer which received property from a community as an inducement to locate or expand its operations in the area was entitled to depreciation deductions in respect thereof because, as a gift, the property took as basis in the donee's hands its cost to the donating community. See Int. Rev. Code of 1939, Ch. 1, § 113(a)(8), 53 Stat. 42; O'Meara, Contributions to Capital by Non-shareholders, 3 Tax L. Rev. 568 (1948).

79. With respect to a second plant acquired in the same manner by the Fine Company but not sold, the court found no ground for reopening the closed years to allow depreciation deductions because the Government, having allowed depreciation thereon for all years open at the time of the Brown Shoe decision, had taken no position inconsistent with the earlier error.

80. Sarner, Adopting an Inconsistent Position May, Though Rarely, Open a Closed Tax Year, 11 J. Taxation 35, 38 (1959); Note, 72 Harv. L. Rev. 1536, 1545 (1959).

81. Prior to 1953, the Service took the position that "in determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold." Treas. Reg. 111, § 29.22(a)-5 (1943). The word "depreciation" was retroactively deleted from this section and the non-deductibility of depletion was limited to percentage and discovery types by

The write-off of a bookkeeping machine, for example, or of a salesman's automobile, would be a charge to the general category of selling and administrative expense: thoroughly deductible, but not a part of the computation of the item of income known as gross profit. Surely our courts cannot stop here. And yet, if the term "item" is to have the restricted, qualitative meaning intended for it by the draftsmen of section 820 of the 1938 Act, the extension made by the *Fine* decision is probably as far as we can go. It is not necessary that one be an advocate of strict construction to appreciate the dangers of unlimited generalization of the *Fine* principle.

Such an extension was urged in the recent case of *United States v. Rushlight.*[82] The taxpayer was a stockholder in a corporation known as A. G. Rushlight & Co. During the years 1942 through 1945, the corporation purchased certain farm machinery for his account and charged the cost to its own expense. A 1953 Tax Court decision sustained the Commissioner's disallowance of deductions claimed by the corporation for this cost and his inclusion of the amounts thereof in Mr. Rushlight's income as dividends.[83] Having paid the resulting tax deficiency, Rushlight claimed refunds for each of the years involved on the theory that, since the cost of the farm machinery had been added to his income, he was entitled to deductions for depreciation of such cost. The refunds were denied because the statute of limitations had run. Rushlight sued and won in the district court, but the decision was reversed on appeal by the Ninth Circuit.[84] Before the latter, one of the arguments made was the applicability, on the strength of *Gooch, Hackney*, and *Fine*, of 1939 Code section 3801(b)(1) which provided for adjustment when a determination required the inclusion in gross income of an item erroneously included in gross income for some other taxable year. Answering the Government, the Brief for Appellee declared:

On page 22, the government says that a depreciation deduction is not an "item" which is a part of gross income. For this proposition three Tax Court cases are cited. None of these cases involve depreciation. However, there is a Section 3801 case

T.D. 6028, 1953-2 Cum. Bull. 100. Rev. Rul. 141, 1953-2 Cum. Bull. 101, explained this change as merely for the purpose of conforming the gross income regulations to those dealing with inventory valuation. "The amendment merely permits the subtraction of depreciation and cost depletion in determining gross income in accordance with accepted accounting practice in the particular trade or business and does not require such subtraction. Any change by a taxpayer from the method consistently used in the past with respect to the treatment of such items in determining gross income constitutes a change in accounting method which requires the consent of the Commissioner . . . ." Rev. Rul. 141, 1953-2 Cum. Bull. at 102.

82. 291 F.2d 508 (9th Cir. 1961), reversing 60-1 U.S. Tax Cas. ¶ 9309 (D. Ore. 1960).

83. Decision entered on stipulation, Docket Nos. 20022 & 20023 (T.C., Aug. 6, 1953).

84. Note 82 supra.

squarely holding that depreciation is an item, i.e., *M. Fine & Sons Manufacturing Co., Inc. v. United States.* . . . The government's restricted view as to what constitutes an "item" is also contrary to the holding in *Gooch Milling & Elevator Co. v. United States* . . . which points out that the term "item" is not defined or limited by Section 3801 and therefore it would cover any recurring deduction that has the effect of increasing or decreasing gross income. . . . Although *Gooch* involves inventory adjustment, the rationale of the case would extend, as *Fine* holds, to depreciation. . . . If the term "item" covers recurring inventory adjustments, why doesn't it cover similar situations such as depreciation?[85]

The appellate court refused to consider this argument, saying, through Judge Jertberg:

We view this appeal as presenting basically problems of inconsistent treatment of basis, and as such, we think it should be considered under Section 3801(b)(5), a circumstance of adjustment addressed specifically to problems of basis, although we are aware of the decision of the Court of Claims in M. Fine & Sons Mfg. Co. v. United States, . . . in which a somewhat analogous situation was treated under Section 3801(b)(1).[86]

Purported analyses like these are wholly inadequate. To cite a case like *Fine* for a proposition broader than the one it states, or to mention it but refuse to follow it without saying flatly that it is either wrong or distinguishable, is no aid in the development of the law. Doctrine should be branded as heresy or given its proper place in the canon. And it does seem that the *Fine* decision can be read as a natural, if extreme, elaboration of the item concept as intended by the draftsmen of section 820.

Support for this view may be found in the Tax Court's landmark decision in *D. A. MacDonald.*[87] The owner of a retail furniture store, taxpayer kept her books and filed her tax returns on the basis of cash receipts and disbursements. The Internal Revenue Service took the position that the business income could be properly reflected only by use of the accrual method and assessed deficiencies for 1942 and 1943. One of the taxpayer's arguments in contesting these was that, if the accrual method were correct, effect should be given in the computation of income for the earlier of the two years to the opening (as well as the closing) inventory, accounts payable, and accounts receivable balances. The Tax Court agreed with the Service that the accrual method was proper, but sided with the taxpayer as to the manner of computation.[88] As soon as this ruling had become final, additions to Mrs. MacDonald's 1938, 1939, and 1940 taxes were assessed, all on the ground that the

85. Brief for Appellees, pp. 9-10, United States v. Rushlight, 291 F.2d 508 (9th Cir. 1961).

86. Id. at 515.

87. 17 T.C. 934 (1951), acq., 1952-1 Cum. Bull. 3.

88. 8 CCH Tax Ct. Mem. 212 (1949).

court's determination with respect to 1942 required the "exclusion from gross income of an item" which, as a result of taxpayer's erroneous use of the cash basis for the earlier years, had also been excluded from the income of those years. This view the Tax Court rejected, saying:

Section 3801 . . . provides for an adjustment as to "an item" or "items" with respect to which a determination has been made. . . . "The item" with respect to which a determination was made . . . was an adjustment of the 1942 opening figures . . . which consisted of opening inventory . . . accounts receivable . . . [and] accounts payable. . . . In his determination of deficiencies in this proceeding the respondent does not attempt to trace back into the prior years the adjustment affected by our decision as to the year 1942. Instead, he has determined increases in income for the years 1938-1940 on the basis of the records . . . for each of those years and has computed a deficiency based on such increases. He has not determined "the increase . . . in the tax . . . which results *solely* from" the adjustment to 1942 opening figures. . . . For all that we know, the 1942 adjustment may have resulted entirely from transactions that occurred in the year 1941. . . . If so, then no part of the accruable items or inventory can properly be carried back to prior years. . . .

Section 3801 does not purport to permit adjustments for prior years for items that are merely similar to those with respect to which a determination has been made for another year.[89]

The *MacDonald* opinion establishes as clearly and precisely as possible that the Tax Court has not rejected the *Gooch* principle that a change in gross income resulting from changes which directly affect its computation is an "item" for the purpose of the mitigation statute. On the contrary, when it refused to sustain the Government's position, all the court was saying was that there had been a failure of proof: it had not been demonstrated that the years which the Government sought to reopen were, in fact, the years in which the claimed errors had occurred. Such a demonstration seems clearly required by the wording of the statute.

The facts in *Dubuque Packing*[90] and *Moultrie Cotton Mills*[91] are strikingly similar; the decisions, the first refusing, and the second granting the mitigation adjustment, are equally deplorable for both fail to recognize the nature and effect of inventory changes. In both instances, the taxpayers, who had elected to value certain of their inventories under the LIFO method for 1941 and subsequent years, made new elections in accordance with *T. D.* 5407[92] to change the class of inventories to which LIFO would apply. This made necessary a recomputation of income for all the LIFO years and resulted in each case in the assessment of a deficiency for the latest of such years. For the

89. 17 T.C. at 940-41.

90. Dubuque Packing Co. v. United States, 126 F. Supp. 796 (N.D. Iowa 1954).

91. Moultrie Cotton Mills v. United States, 138 Ct. Cl. 203, 151 F. Supp. 482 (1957).

92. 1944 Cum. Bull. 83, amending Treas. Reg. 111, § 29.22(d)-1 (1943).

earlier years, the effect of the adjustment was to reduce income, but the indicated refunds could not be allowed because the years were barred by the statute of limitations. Both taxpayers sued and both of the courts before which they appeared accepted the proposition that items of income were involved.

What neither court attempted was a reconstruction of the gross income computations for the several years involved to determine whether, and to what extent, income taxed under the inventory valuation method previously in use was, under LIFO as revised, being taxed in some other year. LIFO is merely an assumption as to which particular items remain in inventory at the end of the year. Such an assumption necessarily involves also an assumption as to which items have been sold. In an era of rising prices it means that the lowest priced—that is, the earliest acquired—items remain, and the highest priced or most recently acquired items have been sold. The alternatives to LIFO, *i.e.*, valuation at cost or market, or on the FIFO basis, would have produced a diametrically opposite result, and it is the shift from one of these methods to LIFO that generally effects a lowering of income by increasing the cost of goods sold. Because each inventory method does involve an assumption as to the particular goods sold during each taxable year, it seems perfectly possible to determine, upon a change in method, both the year in which such goods were originally deemed sold and the year in which, under the new method, they are deemed sold.[93]

This is the sort of determination which the court in *MacDonald* insisted was necessary and which the courts that heard *Dubuque* and *Moultrie* failed to make. It would seem to be a *sine qua non* in inventory and similar cases. In *Dubuque* its use might also have forestalled the court's infelicitous statement that

> prior to the redeterminations . . . the inventories for the years 1941, 1942 and 1943 did not contain or include any "erroneous" item of gross income. The inventory valuations were then proper and correct. . . . The election of the taxpayer . . . permitted the Commissioner to adjust the inventory values for those years. . . . When the inventory valuations were adjusted . . . the closing inventory for 1941 was in accord with the opening inventory for 1942 and the closing inventory for 1942 was in accord with the opening inventory for 1943.[94]

93. This is not to suggest that there is never any difficulty in identifying the income shifted by an inventory adjustment. In one case, a manufacturer which owned its sources of raw material was required by the Service to record such raw material at an earlier point in time than that at which it had previously been recorded. This meant the addition of a number of units bearing a lower cost (because less had been done to them) and a consequent reduction in total inventory. Over the years involved, the net effect of this was to raise income in some years and reduce it in others. That income had been shifted was obvious. But whether increases had come from one year or another was almost anybody's guess.

94. 126 F. Supp. at 806-07.

This obviously was not the question. The question was whether, through adjustments of inventories for both open and closed years, the Commissioner had put the taxpayer in the position of being deemed to have sold—that is, included the income from—items in an open year which, under the previous method, he was deemed to have sold and included in one of the years now closed.

In *Revenue Ruling* 58-327,[95] the Service, apparently thinking it was doing no more than acquiescing in the item formulation of *Gooch* and *Dubuque*, announced that, for the purposes of sections 1311 through 1315 of the 1954 Code, "inventories constitute items of gross income."[96] This, of course, goes well beyond the range of anything said in *Gooch* but is implicit, perhaps, in *Dubuque*. It gives neither the taxpayer nor the courts any guide as to the proper approach to these problems.

Some of the more recent decisions suggest that the Tax Court is forgetting what it learned in *MacDonald*. A case in point is *Estate of A. W. SoRelle*.[97] In an earlier 1954 decision,[98] in respect of the taxable years 1946 and 1947, it was held that the taxpayer's inventories had been valued incorrectly. Revaluation produced an increase of $27,000 in the opening inventory for 1946 and a concomitant reduction in income for such year. The instant case arose as a result of the Commissioner's attempt, under 1939 Code section 3801, to add this $27,000 and certain other amounts to taxpayer's income for 1945. The Commissioner was successful on the inventory point and the $27,000 was added to the 1945 ending inventory (thus decreasing cost of goods sold and increasing income for that year) without, as the taxpayer had urged, a corresponding adjustment to the opening inventory. Said the court:

> The estate attacks the adjustment . . . upon the ground that correction of the closing inventory for 1945 is not permissible without at the same time revaluing the opening inventory for 1945. We disagree. The application of the statutory provisions does not contemplate a reopening of the tax liability for the barred year except to the extent that it is affected by the *item* that is being shifted from one year to another.[99]

This holding is objectionable, not because it arrives at the wrong result (for, on the facts stated, the result may be correct), but because its approach to the problem is fallacious. Inventory is not, and can never

95. 1958-1 Cum. Bull. 316.

96. 1958-1 Cum. Bull. at 317.

97. 31 T.C. 272 (1958), acq., 1959-1 Cum. Bull. 5.

98. Elsie SoRelle, 22 T.C. 459 (1954).

99. 31 T.C. at 276. An alternate ground for decision was that the inventory balance which taxpayer sought to adjust was non-existent, in which case, of course, even if taxpayer won on the law he could gain no benefit. But see Heer-Andres Inv. Co., 17 T.C. 786 (1951), nonacq., 1952-1 Cum. Bull. 5.

be, an item of income. It is merely a factor that goes into the computation of such an item. And whether, in order to make the adjustment required by the mitigation statute, one must correct one inventory balance or half a dozen depends upon an analysis of the error to determine its true effect.

Although *Estate of Sarah Louise Gill*[100] was not an inventory case, its central problem was analogous to that presented by such cases. For a considerable period of time, taxpayer had erroneously reported the income of his business (a sole proprietorship) on the basis of a fiscal, rather than the calendar year. On being advised that this method was incorrect, he recomputed his 1949 income by adding thereto a fraction (two-thirds) of the business income on his 1950 return, and subtracting the identical fraction of the business income reported on his 1949 return, the latter now being assumed to have been earned in 1948. The result of this computation was to decrease 1949 income and to make the taxpayer eligible for a refund for which he thereafter successfully sued.[101] To make good its loss, the Government promptly assessed a deficiency for 1948 based on the addition to that year's income of the two-thirds of 1948-1949 business income removed from income for 1949. The deficiency was collectable, however, only if the mitigation statute was applicable, since 1948 was a barred year. It is believed that the Tax Court was on solid ground in deciding the case in the Government's favor, holding that the mitigation statute did apply and that the amount by which 1949 income had been reduced should be shifted back into 1948. But it is impossible to accept the further holding that mitigation would not permit a correct computation of 1948 income by removing therefrom the portion of 1947-1948 business profit which under taxpayer's erroneous accounting method had been incorrectly included. As in the inventory cases, the exclusion effected by the determination was of an item, not an amount, and the item was the correct business profit for the year. Accordingly, it was error here, as in *SoRelle*, to refuse to take into account all elements of the equation.

This view is in no sense contrary to the position taken by the Tax Court and the Third Circuit in *First Nat'l Bank of Philadelphia*.[102] There, it will be recalled, the bank over a long period of time accrued and deducted the annual capital stock levy paid to the Commonwealth of Pennsylvania in the year before the year in which it was paid. In *G. C. M.* 21329,[103] the Service announced that, because this tax had been

100. 35 T.C. 1208 (1961).

101. Gill v. United States, 258 F.2d 553 (5th Cir. 1958), reversing 57-2 U.S. Tax Cas. ¶ 10,054 (N.D. Ala. 1957).

102. 18 T.C. 899 (1952), aff'd, 205 F.2d 82 (3d Cir. 1953).

103. 1939-2 Cum. Bull. 179.

held to be imposed on the banks' shareholders rather than the banks themselves, it would be deductible by the banks only in the year of payment, irrespective of the method of accounting employed. Upon audit of this taxpayer's 1944 and 1945 returns, it was found that the rule of the *G. C. M.* had not been followed. Therefore, deductions claimed for the tax accruals in each of the years were disallowed and deductions for the actual payments were substituted. Taxpayer thereafter filed a refund claim in respect of the year 1943, based on a deduction of the prior year's tax. This claim having been allowed, the Government then assessed a deficiency for the closed year, 1942, on the theory that the allowance of the 1943 deduction at taxpayer's behest permitted a correction under 1939 Code section 3801 of the erroneous deduction for 1942. Taxpayer's defense rested in part on the contention that if one error could be corrected, all should be, and that the court should accompany its disallowance of the 1942 accrual with an allowance of the 1942 payment and at the same time go back through time concurrently disallowing accruals and allowing payments as deductions. To the court this was absurd. Citing the express instructions of section 3801(d),[104] it pointed out that its work was limited to the particular error which had served to open the closed year. There was no question of the identity of the item to be considered. A specific tax payment had been deducted in the wrong year, taxpayer had actively and successfully sought a deduction for the same payment for the right year, and the determination in its favor permitted an opening of the closed year in which the error had occurred. Once the closed year error had been corrected, the mitigation statute had run its course.

The item problem arises in another context. The draftsmen of the mitigation statute made it clear at the outset that each correction provided for was to be "made only with respect to the *item* involved in the determination,"[105] and that the bar of the statute of limitations would not be lifted as to "any other item, even though such other item also had been erroneously treated in the same year."[106]

This was the ground for the Government's opposition to the claim for refund in *Olin Mathieson Chem. Corp. v. United States*.[107] The taxpayer on its 1944 return deducted an ordinary loss of $168,000. This was disallowed on audit and the resulting deficiency was paid. The taxpayer then brought suit for refund, but the court held against it. The

104. Int. Rev. Code of 1939, ch. 38, § 3801(d), 53 Stat. 473 (now Int. Rev. Code of 1954, § 1314).

105. S. Rep. No. 1567, 75th Cong., 3d Sess. 52 (1938). (Emphasis added.)

106. Ibid.

107. 265 F.2d 293 (7th Cir. 1959), affirming 58-2 U.S. Tax Cas. ¶ 9740 (S.D. Ill. 1958).

court agreed that the taxpayer had sustained a loss, but it was a capital, not an ordinary, loss. This was of no benefit to the taxpayer because in 1944 it had realized no capital gains against which the loss could be offset.[108] There had, however, been substantial long term gains in 1945 and, if the 1944 loss could be carried over, the taxpayer would benefit after all. The difficulty was that such a carryover was barred by limitations. The present action, therefore, was an attempt to bring the carryover under the mitigation umbrella.

The Government urged that there had been no determination disallowing "a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year."[109] On the contrary, the determination had allowed a loss (of the long term capital sort); the loss which had been disallowed was an ordinary one, a creature quite unidentifiable in a qualitative sense with the capital loss carryover here asserted.

The court brushed this argument aside. "[T]here is no requirement in § 1312(4)," it said, "that they [the deductions] be the same type."[110] It is difficult, if not impossible, not to find such a requirement in the section referred to. Even if it be absent, however, how can we avoid the prescription for adjustment which directs that we ascertain "the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error . . . ?"[111]

An even more curious mixture of related but not identical "items" was involved in *The Budd Co.*[112] There the taxpayer suffered an operating loss in 1946 of nearly $11,000,000. This was carried back first to 1944 where it wiped out that year's entire income and resulted in a refund (made in 1947) of more than $8,000,000 in excess profits tax. There having been a small loss in 1945, the next year against which the 1946 loss could be applied was 1947. In computing the amount available for

108. Olin Industries, Inc. v. Dallman, 56-1 U.S. Tax Cas. ¶ 9188 (S.D. Ill. 1956).

109. Int. Rev. Code of 1954, § 1312(4).

110. 265 F.2d at 296. It is clear, of course, that the amount of income involved need not be identical for both year of determination and year of error. First Nat'l Bank v. Commissioner, 205 F.2d 82, 85 (3d Cir. 1953); see Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L.J. 719, 752 (1939). It is also clear that the items must be more than merely similar. D. A. MacDonald, 17 T.C. 934, 940-41 (1951). The question, then, is whether a difference in tax character falls between these two extremes or is governed by the latter rule. The language of the court in First Nat'l Bank, supra, suggests that the latter rule is applicable.

111. Int. Rev. Code of 1954, § 1314(a).

112. 33 T.C. 813, acq., 1960-1 Cum. Bull. 4; accord, Lockheed Aircraft Corp., 19 CCH Tax Ct. Mem. 347 (1960).

carryover, taxpayer considered as having been used against 1944 income only the amount of such income remaining after deduction of the excess profits tax accrued for that year, even though such tax had, by reason of the carryback, been subsequently refunded. When taxpayer filed its claim for refund for 1947, the Commissioner was faced with the dilemma of an apparent duplication of deductions on the one hand and, on the other, the approval of the method of computation by the Supreme Court in *Lewyt Corp. v. Commissioner*.[113] His denial of the refund, therefore, was not on the ground of an improper computation, but rather that 1947 income should include the amount of the refund of 1944 tax. Taxpayer's subsequent suit for refund established that the refund was not income.[114] As a result the Commissioner sought a deficiency for 1944 on the theory that, to the extent the 1946 loss had been used as a carryover to 1947, it had erroneously been availed of as a deduction (by way of carryback) in 1944. For the Tax Court, the connection was too tenuous, and, said Judge Murdock:

> The fact that the petitioner received this benefit in 1947 is not justification for going back to 1944 and making compensating changes just to prevent a double benefit, particularly when such compensating changes are not authorized by, but are contrary to, the provisions of section 122 in respect to how the 1946 net loss shall be applied to 1944 net income.[115]

How could the Government have won this case? That there had been an error is clear. That the taxpayer, in asserting its 1947 refund claim, maintained a position wholly inconsistent with the error is equally apparent. It is also true that this position was adopted when the courts allowed the 1947 claim. The only question, then, was whether there was any circumstance of adjustment described in the mitigation sections which would open the year of error and permit its correction. To attack the method of computing carrybacks prescribed in the regulations and endorsed by court decisions was hardly the way, although a different forum—*i.e.*, a district court sitting in a suit to recover an erroneous refund under 1954 Code section 7405—might have proved more hospitable to the idea. Perhaps the outrage is inherent in the rule of the *Lewyt* case. But is it not possible to say here that the mitigation statute makes its own rules; that by maintaining the position it took for 1947, the taxpayer was abandoning that taken for the earlier year, and was, in effect, withdrawing its 1944 refund claim? In such a posture, the Government would not be asking the court, in exchange for an

113. 349 U.S. 237 (1955).

114. Budd Co. v. United States, 148 F. Supp. 792 (E.D. Pa.), aff'd, 252 F.2d 456 (3d Cir. 1957).

115. 33 T.C. 813, 817 (1960).

exclusion from income, to disallow a deduction and thus distort the precision of the statute.

The novel and, it is believed, mistaken application of the item concept in *John Hamilton Perkins*[116] is probably traceable to the same confusion between identity of amounts and identity of items that was present in *Gill* and *Budd.*

In 1949, at a time when he was a stockholder and one of the principal officers of a corporation, Perkins withdrew nearly $40,000 from the corporate treasury and gave his promissory note in exchange. Two years later, the corporation was dissolved and Perkins, who by this time had become the sole stockholder, received all of the assets, including his own $40,000 note, as a liquidating distribution.

The 1949 withdrawal was not reflected in any way on Perkins' federal income tax return for that year. The receipt of the note upon liquidation of the corporation in 1951 was included in the computation of the amount of the liquidating dividend but did not increase the gain reported on the 1951 return because, as a result of an accountant's error, the face amount of the note was also included in the computation of the taxpayer's basis for his stock in the corporation.[117]

In 1954, the Commissioner assessed a deficiency against taxpayer for 1949 on the ground that the withdrawal from the corporation in that year had constituted a dividend rather than a loan. The case went to the Tax Court which, in 1957, held that the transaction had in fact been a loan and that taxpayer had realized no income therefrom.[118]

The Commissioner then undertook to reopen the question of taxpayer's liability in respect of the year 1951, which year, unless the mitigation statute applied, was barred by limitations. Here the Commissioner was successful. In the words of the court:

> The facts which we have hereinbefore found, disclose a double exclusion by petitioner from his gross income of an item of $39,367.42. This item represents an amount which petitioner withdrew from Realty Corporation in 1949, when he was one of the principal stockholders and officers thereof, and also when said corporation had substantial earnings and surplus. He did not include said item as a *taxable dividend* in his 1949 gross income, on the ground that the same was a bona fide loan, evidenced by his promissory note for the same amount which the corporation thereafter carried in its assets until the time of its dissolution in 1951. Also petitioner did not include

116. 36 T.C. 313 (1961).

117. These appear to be the facts upon which the court based its decision. Actually, an audit of taxpayer's 1951 return had resulted in the substitution for the erroneously calculated basis of a new cost for his stock which did not include the face amount of the note. There was, therefore, no ground for the court's finding "that no portion of the amount of said promissory note was included either in the amount of the reported gain from such liquidation, or elsewhere in petitioner's 1951 reported income." 36 T.C. at 319.

118. John Hamilton Perkins, 16 CCH Tax Ct. Mem. 548 (1957).

any portion of the amount of said unpaid promissory note in his gross income for the year 1951, when said promissory note was distributed to him as sole stockholder of said corporation, upon final liquidation of the corporation in the latter year. . . . The particular paragraph of section 1312 which is here pertinent, is paragraph (3)(B) thereof. This paragraph applies, under its own terms, if the "determination" (here, this Court's decision in the interrelated case involving the year 1949) requires the exclusion from gross income (here, the gross income for 1949) of an item not included in a return filed by the taxpayer and in respect of which the tax was not paid; but which is includible in the gross income of the taxpayer for *another taxable year* (here, in the gross income for 1951).[119]

The fallacy of this decision becomes evident when we reread the governing law. The activating determination required in this instance was "the exclusion from gross income of an item."[120] "Item," as here used, seems clearly to mean an "item of income" and not a mere receipt which may or may not be income. This is the way in which the term is understood by the regulations,[121] the Tax Court itself,[122] and the commentators.[123] So interpreted, section 1312 provides no ground for the *Perkins* decision. The earlier holding that taxpayer's 1949 receipt was not income could not possibly give the Government the right to make an untimely assessment of tax for 1951.

But even if "item" is broad enough to include non-income receipts, the *Perkins* case presents a problem, for there is no qualitative similarity between a loan and a liquidating distribution and none but an accidental connection between the two events.

The expansion of the item concept to include the effect of inventory revaluations and the like on the computation of income and expense has illuminated a possible conflict between Code sections. If the errors supposed to be corrected under sections 1311 through 1315 are the product of a change in accounting method, will the correction be made by adjustment under section 1314 or under section 481? If the latter section governs, both taxpayers and Commissioner will be much more limited than they would be under the mitigation statute. For example, any increase in tax arising as a result of the required transitional adjustments is limited under section 481 by an averaging device.[124] Moreover, to the extent that a transitional adjustment corrects errors in

119. 36 T.C. at 322-23.

120. Int. Rev. Code of 1954, § 1312(3)(B).

121. Treas. Reg. § 1.1311(a)-1(b) (1956).

122. E.g., Estate of Sara Louise Gill, 35 T.C. 1208, 1216 (1961).

123. E.g., Maguire, Surrey & Traynor, Section 820 of the Revenue Act 1938, 48 Yale L.J. 719, 752 (1939).

124. Int. Rev. Code of 1954 § 481(b); see S. Rep. No. 1622, 83d Cong., 2d Sess. 68 (1954).

years before 1954, no change in tax is permitted if the change in accounting method was initiated by the Commissioner.[125]

One may argue plausibly on the side of either section. If the purpose of mitigation is to serve in all cases in which the bar of limitations is lifted, then the adjustment rules of section 1314 are surely preemptory. On the other hand, it has been said that application of section 481 is preferable in the case of accounting adjustments because this is the more specific of the two provisions.[126] The Internal Revenue Service has apparently chosen this second view,[127] although its long expected official ruling on the question remains in enigmatic limbo.

Congressional intent in enacting section 481 is not readily apparent. The possibility of conflict was nowhere considered. Nevertheless, the stated purpose of confining section 481 adjustments, in the case of involuntary changes in accounting method, to 1954 and subsequent years suggests that where mitigation is applicable, another rule would obtain. Prior to 1954, the committee reports point out, the courts had refused to permit adjustments "where the Commissioner forces a taxpayer to change his method of accounting."[128] It was to prevent "results . . . [which] would be harsher on taxpayers in most instances of involuntary change . . ." than were being allowed by the courts that the limitation was imposed.[129] This situation did not occur under the mitigation section where adjustments back to 1931 had been expressly authorized. Moreover, it is the taxpayer and not the Government who would suffer if the pre-1954 period were barred in all events. Under such a rule, the Commissioner would always, in the area of accounting changes, be free to take positions inconsistent with those taken before 1954, knowing that tax overpayments for the earlier years would remain with the Government.

On balance, it would seem, to the extent that changes in accounting method produce increases or decreases of income for barred years of the sort described in Code section 1312, that adjustments for such years should be made under the mitigation statute. Only here do we find a comprehensive system for, and a reasonable limitation upon, the correction of error.

---

125. Int. Rev. Code of 1954, § 481(a)(2).

126. Fletcher, Section 481: Changes in Accounting Method, N.Y.U. 18th Inst. on Fed. Tax 161, 174 (1960).

127. Graves, What Constitutes a Change in Accounting-Practice: The Service's Changing Concept, N.Y.U. 16th Inst. on Fed. Tax, 553, 555 (1958).

128. S. Rep. No. 1622, 83d Cong., 2d Sess. 307 (1954).

129. Id. at 65.

ERRORS AFFECTING BASIS

It is a reasonable inference from the pattern of the decisions that, unless the courts ignore the statutory language, many, if not most, of the errors involving basis will go uncorrected. This is so because, both in its original and its present form, the basis provision of the mitigation statute contains two substantial obstacles to its frequent application.

The first such obstacle is that the activating determination must determine basis, and this does not mean a determination as to some item of income or a deduction which affects basis. Moreover, the basis determination must be with respect to the same property as to which the barred year error is alleged. These are the principles underlying the strict constructionist cases of *American Foundation Co.,*[130] *Central Hanover Bank & Trust Co. v. United States,*[131] *James Brennen,*[132] and *Sherover v. United States.*[133] In the first of these there had been a determination that no gain had been realized upon the receipt of securities in a reorganization exchange. The corollary of such a holding was that the securities received must have had the same basis as those for which they had been exchanged and that taxpayer had been in error when, in computing its gain on their sale, it had used as basis the higher fair market value at time of receipt. Nevertheless, the case holds that the Commissioner could not use the mitigation section to reopen the closed years in which sales had occurred and assess additional taxes on the increased gains. Underlying *Brennen* and *Sherover* were determinations as to the deductibility of amounts which, if deductible, would necessarily be applied in reduction of the basis of specific property and thus increase the amount of gain taxable upon the sale of such property. And the courts held in both cases that determinations as to the propriety of deductions, however much such deductions might affect basis, were not determinations of basis which would make the mitigation section operative. Finally, in the *Central Hanover* case it was held that a correction in the basis of part of a block of stock which had been sold in one year was no ground for reopening another year in which more of the stock had been sold to correct the basis used in that year, even though it was clear that the first correction implied the second.

Opposed to the foregoing are *Rosenberger v. United States*[134] and the lower court decision in *Rushlight v. United States.*[135] In *Rosenberger* it was held that a determination that certain receipts were taxable divi-

130. 2 T.C. 502, nonacq., 1943 Cum. Bull. 26.
131. 163 F.2d 60 (2d Cir. 1947).
132. 20 T.C. 495 (1953), acq., 1954-1 Cum. Bull. 3.
133. 137 F. Supp. 778 (S.D.N.Y.), aff'd per curiam, 239 F.2d 766 (2d Cir. 1956).
134. 138 F. Supp. 117 (E.D. Mo. 1955), aff'd, 235 F.2d 69 (8th Cir. 1956).
135. 60-1 U.S. Tax Cas. ¶ 9309 (D. Ore. 1960).

dends, and not payments in liquidation of indebtedness, permitted application of the mitigation statute to recover the tax paid on the assumption that basis had been reduced by such receipts. *Rushlight* granted refunds based on the allowance of depreciation deductions in barred years with respect to: (a) equipment originally bought by a corporation in which the taxpayer was a stockholder and which the determination relied upon had held was actually purchased for his account so that its cost constituted a dividend; and, (b) equipment with respect to which the determination disallowed an abandonment loss.

It is impossible to reconcile these cases. Either the statute means exactly what it says and the determination relied upon must arise out of a controversy over basis, or it means that adjustment will be permitted whenever basis has been affected by a determination. In this connection, Judge Turner's dissent in *Brennen* may suggest a compromise solution. He would have allowed the Government's claim in this instance because 1939 Code section 113(b)(1)(H)[136] expressly provided for reductions in basis on account of deductions of the sort which taxpayer had previously been allowed. It follows, therefore, that the court's previous decision allowing such deductions "was by statutory fiat a determination of the taxpayer's basis" for the property in question.[137] It might be argued that if a determination is as to some item of income, deduction, or the like, which under the Code's basis provisions is expressly required to be added to or applied in reduction of basis, then the determination will be deemed to have determined basis. It has been suggested, indeed, that in 1954 Congress thought it had amended the law to make adjustments certain in these circumstances.[138] Such a reading of the committee reports seems dubious. It is true that the non-technical discussions contained therein state that under the amended mitigation sections

> adjustment will be available, in cases involving the determination of the basis of property, where either the taxpayer or the Commissioner assumes an inconsistent position with respect to the expensing of items which are properly chargeable to capital account, or the capitalizing of items which should have been expensed.[139]

However, an almost identical statement is made in the so-called "Detailed Discussion of the Technical Provisions of the Bill" and this is followed by two examples which indicate the legislators' awareness that the activating determination must still be one of basis.[140]

---

136. Int. Rev. Act of 1939, § 113(b)(1)(H), added by ch. 619, 56 Stat. 824 (1942) (now Int. Rev. Code of 1954, § 1016(a)(5)).

137. 20 T.C. at 502 (Turner, J., dissenting).

138. Note, 72 Harv. L. Rev. 1536, 1548 (1959).

139. H.R. Rep. No. 1337, 83d Cong., 2d Sess. 86 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 117 (1954).

140. H.R. Rep. No. 1337, supra note 139, at A292; S. Rep. No. 1622, supra noto 139, at 448.

The Ninth Circuit's reversal in *United States v. Rushlight*[141] assumed that the precedent determinations had been determinations of basis and that their only disability lay in not determining such basis for gain or loss, a requirement of prior law which was eliminated in 1954. The court suggests, therefore, that under the present mitigation statute the taxpayer would have won his refund. This opinion seems clearly wrong.

The second stumbling block in the basis provision is its requirement that the error for which correction is sought be one "in respect of" a transaction on which the determined basis "depends"[142] or, alternatively (since 1954), a transaction "which was erroneously treated as affecting" the determined basis.[143] In other words, as the regulations expressly declare, the error complained of must have occurred prior to the event which is the subject of the determination.[144] None of the cases discussed in this section could have been decided in favor of mitigation if this rule had been applied. Yet, only in *Rosenberger* and *Rushlight* did the courts take cognizance of the requirement. Their treatment of it was hardly reassuring. In the latter case, it was assumed that Congress had "corrected their mistake in 1954."[145] In *Rosenberger* the court observed:

> When the Government concedes that our former judgment did determine basis "in respect of the 1946 distribution" and consequent erroneous tax return by plaintiff, and that it was in the same action and on the foundation of the same finding, and under Section 3801, that it recovered the taxes lawfully due it on its counterclaim, we cannot agree that now in this action the finding on the complaint in the former action should be ignored. And it must be to sustain defendant's position.[146]

The spectre of a third possible preventive to its application hovers over the basis provision. It has been suggested that, even if the other conditions are met, even if the determination established basis and such basis depended on something erroneously treated in the barred year, if the "something" were a failure to claim allowable depreciation the taxpayer might still be outside the ambit of the statute.[147] This is because "depreciation would seem to constitute a 'transaction affecting basis' only in an economic or accounting sense; [not] in a physical sense. . . ."[148] The objection seems unrealistic. If the transaction requirement does

141. 291 F.2d 508 (9th Cir. 1961).

142. Int. Rev. Code of 1939, ch. 38, § 3801(b)(5), 53 Stat. 472 (now Int. Rev. Code of 1954, § 1312(6)).

143. Int. Rev. Code of 1954, § 1312(7).

144. Treas. Reg. § 1.1312-6(a) (1956).

145. 291 F.2d at 518.

146. 138 F. Supp. at 120.

147. Burford, Basis of Property after Erroneous Treatment of a Prior Transaction, 12 Tax L. Rev. 365, 377 (1957).

148. Id. at 378.

mean that there must be some physical act, can we not look to the physical failure to do whatever is necessary to claim the deduction? That such a point could be raised, however, demonstrates how very much we expect of detailed enactments like the mitigation statute. As such, it serves as an argument in favor of a broad drafting technique in which so much of the law is left unwritten that no one can ever contend that what the legislature did not say it did not intend.

The decisions of the Court of Claims in *Moultrie Cotton Mills*[149] and *M. Fine & Sons Mfg. Co.*,[150] as well as in the earlier *Gooch*[151] and *Hackney*[152] cases, did not purport to be constructions of the basis adjustment provision, although the three inventory cases have been described as "in a sense . . . determination[s] of basis,"[153] and it has even been suggested that

> the Gooch case, although correct in granting relief, erred in basing its result on the income sections rather than on the basis provisions in view of the analogous functions served, in calculating gross income, by a determination of costs of goods sold for inventory and a determination of basis for depreciable property.[154]

On the other hand, it has also been said that in cases of this sort counsel might argue that the basis provisions were meant to apply only where the activating determination determined basis, and that in all other instances decision should be reached under the income provisions.[155]

The preferable view would seem to be that the basis provision as it stands is wholly inadequate; that it cries for amendment; and, that until amendment comes, we are likely to see some hard cases decided in harsh ways and others in total disregard of the statute.

RELATED TAXPAYERS

Four of the seven types of errors in barred years which it is the purpose of sections 1311 through 1315 to correct may have been committed either by the taxpayer in respect of whom the activating determination is made or by a "related taxpayer."[156] This is in conformity with the

149. 138 Ct. Cl. 208, 151 F. Supp. 482 (1957).

150. 144 Ct. Cl. 46, 168 F. Supp. 769, vacating 144 Ct. Cl. 56, 162 F. Supp. 763 (1958).

151. 111 Ct. Cl. 576, 78 F. Supp. 94 (1948).

152. 111 Ct. Cl. 664, 78 F. Supp. 101 (1948).

153. Sarner, Adopting an Inconsistent Position May, Though Rarely, Open a Closed Tax Year, 11 J. Taxation 35, 37 (1959).

154. Note, 72 Harv. L. Rev. 1536, 1549 (1959).

155. Id. at 1548 n.90.

156. The circumstances are the first four enumerated in Int. Rev. Code of 1954, § 1312, i.e., double inclusions of items of gross income, double allowances of deductions or credits, double exclusions of items of gross income, and double disallowances of deductions or credits. The term "related taxpayer" also appears in the descriptions of the fifth and

principle expressed when the mitigation statute was first proposed that "corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer."[157] In this, as in the statute as a whole, Congress attempted to leave nothing to chance. The 1954 Code, section 1313(c), defines the term "related taxpayer" as

> a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:
> (1) husband and wife,
> (2) grantor and fiduciary,
> (3) grantor and beneficiary,
> (4) fiduciary and beneficiary, legatee, or heir,
> (5) decedent and decedent's estate,
> (6) partner, or
> (7) member of an affiliated group of corporations (as defined in section 1504).

Construing this definition most literally, the Internal Revenue Service has long been of the opinion that, if one of the specified relationships existed at any time during the year of error, "it is not essential that the error involve a transaction made possible only by reason of the existence of the relationship."[158] The present regulations give, as an example, an assignment of rents between two taxpayers who happen to be partners. A determination affecting one of these two may, it is stated, permit an adjustment with respect to the taxes of the other even though "the assignment had nothing to do with the business of the partnership."[159]

The committee reports on the 1938 Act lead one to doubt the soundness of this administrative interpretation. The related taxpayer definition, it is there declared, "covers those situations in which, for reasons apparent from the nature of the relationship, the problems dealt with by this section are likely to arise."[160]

Nor does it appear that the Tax Court accepts the Service's view. In the case of *Sam D. Hecht*,[161] the taxpayer's interest in certain businesses

---

sixth circumstances of adjustment, but in these the error can have been made only by the related taxpayer who, by the terms of the description, must stand in a particular relationship to the taxpayer. The basis adjustment rules of § 1312(7) limit the persons who can avail themselves of the statute to the taxpayer himself and those from whom he derived title.

157. S. Rep. No. 1567, 75th Cong., 3d Sess. 50 (1938).

158. Treas. Reg. § 1.1313(c)-1 (1956); accord, Treas. Reg. 118, § 39.3801(a)(3)-1 (1953); Treas. Reg. 111, § 29.3801(a)(3)-1 (1943).

159. Treas. Reg. § 1.1313(c)-1 (1956).

160. S. Rep. No. 1567, 75th Cong., 3d Sess. 50-51 (1938); cf. H.R. Rep. 2330, 75th Cong., 3d Sess. 58 (1938).

161. 16 T.C. 981 (1951).

had been concealed, ostensibly because his employer would not have approved of his being engaged in ventures of this nature. His income and losses therefrom for the years in question were therefore reported, not on his own tax returns, but rather on those of three other persons who, of course, were reimbursed by him for the increased tax payments they were required to make. Two of these persons were partners with Mr. Hecht in the ventures in question. In the instant proceeding, which arose from the Commissioner's assessment against Mr. Hecht of taxes on his entire income for 1943, 1944, and 1945 (including that reported on these other persons' returns), the taxpayer claimed he was entitled, under section 3801, to offset against the asserted deficiencies the taxes paid on account of the other returns. This the court denied, saying that "in so far as those persons acted as dummies for Hecht, they were not his partners."[162]

Unhappily, Judge Murdock's opinion in the *Hecht* case makes no reference to the position taken in the regulations. Moreover, it goes on to observe that "section 3801 was never intended to cover a situation where, in order to conceal the truth, one person reports income which he and the other party know belongs to the other party. . . ."[163] From this, the Treasury, it is understood, deduces not a rejection of its administrative stand, but rather a much more general holding that the mitigation sections do not apply in cases of fraud.[164] Needless to say, such a view has even less support in the statute than the liberal one espoused by the regulations.

Both the Service and the courts have recognized that the related taxpayer definition is conceived in terms of general law and not in any sense peculiar to the tax statute. Thus, in *Lovering v. United States*,[165] the taxpayer, who, as sole beneficiary of a trust, had paid taxes on her distributive share of its income, was held entitled to refunds after taxes on the same income had been assessed against the trust on the ground that it was an association taxable as a corporation.

Similarly, *I. T.* 3986[166] declared that, for the purposes of section 3801, the members of a family partnership, not recognized for federal income tax purposes but valid under local law, were related taxpayers.

On the other hand, in *Taxeraas v. United States*,[167] it was held that the taxpayer's failure to affirmatively prove validity of a partnership

162. Id. at 986.
163. Ibid.
164. A.B.A. Rep., Section of Taxation, pp. 98-99 (1955).
165. 49 F. Supp. 1 (D. Mass. 1943).
166. 1949-2 Cum. Bull. 108.
167. 269 F.2d 283 (8th Cir. 1959), affirming 165 F. Supp. 81 (D. Minn. 1958).

under local law precluded his claim to related taxpayer status in order to be eligible for a refund under section 1314.

Both the *Taxeraas* decision and *I. T.* 3986 seem to be misconstructions of the related taxpayer definition. In a mitigation case, the existence of the required relationship cannot be tested against facts wholly independent of the case. Rather, the very finding of inconsistency implies a finding that, for the purposes of mitigation, the relationship must be deemed to have existed because, by keeping the tax money in question, taxpayer or Commissioner, as the case may be, has, in effect, admitted such existence.

This argument is objectionable, of course, on at least two grounds. First, it can be availed of only where the error complained of involves "a transaction made possible only by reason of the existence of the relationship."[168] This, the Service has insisted, is not required by the statute.[169] It has already been pointed out, however, that the view of the regulations on this issue may very well not be the law. Moreover, most of the cases which are likely to arise in this area will surely be those in which the relationship is a moving force. To restrict the definition to such cases would not, it is believed, unduly limit the law.

A second objection is that there is being invoked in aid of the statute a form of estoppel. This may be so, but the mitigation statute was designed to supplement, not to replace, the older equitable remedies;[170] in fact, these are still in use.[171] Moreover, an examination of the cases under sections 1311 through 1315 and their predecessors suggests that the statute itself is construed quite frequently with the aid of equity.[172]

Favoring the suggestion here made is the realization that tax errors often spring from mistaken beliefs as to the facts or the law or both. The officers of a corporation may think it owns eighty per cent or more of the stock of another corporation when, in fact, its title to all or some part of that stock is not good. A man and woman may believe they are married only to hear the Supreme Court declare they have been living in sin. If these mistaken beliefs produce tax consequences, it would be absurd, as well as contrary to congressional intent, to deny their effect for the purposes of a tax statute.

Ross v. United States[173] is usually cited for the proposition that the

168. Treas. Reg. § 1.1313(c)-1 (1956).

169. Note 158 supra and accompanying text.

170. S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938).

171. E.g., Daugette v. Patterson, 250 F.2d 753 (5th Cir. 1957), cert. denied, 356 U.S. 902 (1958). But see Maguire, Surrey & Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L.J. 719, 773-75 (1939).

172. See, e.g., Cain v. Campbell, 59-2 U.S. Tax Cas. ¶ 9610 (N.D. Tex. 1959).

173. 148 F. Supp. 330 (D. Mass. 1957).

related taxpayer definitions do not depend upon formal actions for their creation. A father, using money belonging to his son, bought some real estate. Less than six months later, he sold it. The proceeds were deposited in the son's bank account and the short-term gain was included in a tax return filed for the son. Thereafter, the Commissioner refunded the tax paid by the son and assessed a deficiency against the father on the theory that the father had really been dealing for his own account. The deficiency having been paid, the father sued for a refund and won.[174] According to Judge Wyzanski, the use of the son's money had, under Massachusetts law, created a resulting trust. In consequence, it would have been legally impossible for the father to have acted for his own account.

The next step was the Commissioner's successful attempt to recover the refund paid to the son. The son, the court held, was a related taxpayer so that the determination with respect to the father was sufficient to reopen the son's closed year.

> In order [said the court] for § 3801(b) to be applicable here, the Rosses . . . must be related taxpayers. . . [as was found] in the father's action . . . when the father took title in his own name in 1944 to an interest in land paid for with the son's money, a resulting trust arose under Massachusetts law. . . . It is true that a resulting trust differs from an express trust. . . . Nevertheless, a true trust arises. . . . Hence, in their relationship as trustee and beneficiary of a resulting trust, the father and son here stood in the relationship of fiduciary and beneficiary.[175]

The only trouble with this decision is that, in its anxiety to establish an admittedly sound principle, the court completely overlooked a statutory requirement which puts the Commissioner at a disadvantage in related taxpayer cases. In the 1939 Code, section 3801(b) provided (and 1954 Code section 1311(b)(3) now provides) that an adjustment with respect to a related taxpayer, which would be assessed as a deficiency, "shall not be made . . . unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position. . . ." Can it possibly be said that the resulting trust which produced the necessary relationship here was still in existence when the father first took his inconsistent position? The entire proceeds of sale of the property were deposited in the son's bank account, presumably (although the courts were not explicit) at the time of the sale in August of 1944.[176] The deposit obviously was made at least a matter of months before the father filed his own return for the year in question, and years before he claimed a refund. The court itself admits that the only duty of the trustee of a resulting trust is to transfer title

174. Ross v. United States, 122 F. Supp. 642 (D. Mass. 1954).

175. 148 F. Supp. at 332.

176. Id. at 331.

to the property or its proceeds to the beneficiary.[177] This act terminates the trust and the relationship.[178] On these facts, it is submitted, the *Ross* case was wrongly decided.

The related taxpayer provision brings into sharp focus a condition present to some degree in all the mitigation cases. One has the uneasy feeling in reading the opinions that neither counsel nor the courts have given much attention to the merits of the purely tax question. All too often, it seems as if no one has really considered whether, if the statute had not run, the additional tax or the refund would be payable.

Doubtless this apparent carelessness is the result in part of the prior determination requirement. If the issue of includability of income or allowability of deduction has already been argued, it need not be raised in the mitigation proceeding. The difficulty, however, is that very different considerations may obtain in the original litigation. If, for example, I am contesting an assessment on the ground that an item of income was taxable, if at all, in some year other than that under review, I may not even raise the issue of taxability and the argument may be confined strictly to accounting questions. Nevertheless, the decision in this controversy may assume, or even expressly assert, that the item is includable in gross income. This finding will then serve as the starting point for the Commissioner's assessment of a deficiency or my claim for refund of tax on the same income in the closed year.

The problem assumes its most acute form when the mitigation proceeding is brought by or against a related taxpayer who was not a party to the action in which the determination was made.

Consider, for example, the much cited case of *Albert W. Priest Trust*.[179] There, a decedent had willed two-thirds of his residuary estate to a trust for one beneficiary (Itola), and the balance outright to a second individual (Gwendolyn). A final decree of the probate court, entered October 11, 1938, ordered distribution. For the year 1938, two returns were filed, one for the estate to the date of the final decree and the other for the trust. The estate return showed gross income of $37,000, deductions of $75,000, and a resulting loss of $38,000, which was allocated two-thirds to Itola and one-third to Gwendolyn. The trust return reported about $4,000 in income, all of which was distributed to and reported by Itola. Upon audit, the Commissioner disallowed over $52,000 of the deductions and, on the theory that the estate was no longer in administration during any part of 1938, treated all but $2,000 of the resulting income as having been distributed to

177. Id. at 332.

178. 4 Scott, Trusts § 410 (2d ed. 1956).

179. 6 T.C. 221, acq., 1946-1 Cum. Bull. 4.

the two individual beneficiaries, against whom deficiencies were thereupon assessed. Gwendolyn accepted this finding, largely, we may assume, because even though nearly $8,000 had been added to her income for the year, her individual deductions were great enough to limit her tax to about $60. Similarly, the trustees did not protest. After giving effect to the deductions allowed for distributions, the $52,000 increase in trust income produced no substantial increase in the tax payable by the trust. Itola, however, faced with a deficiency of more than $1,000, opposed the finding. She grounded her opposition, however, on the argument that the estate administration had, in fact, continued to the date of the final decree and that it was error, therefore, to treat the income as having been distributed. She did not contest the Commissioner's disallowance of deductions on the estate return. The Tax Court adopted Itola's position.[180] The instant case arose when the Commissioner assessed a deficiency against the trust, as a related taxpayer, seeking to tax to the trustees the income which Itola had established was not taxable to her. Without once appearing to consider the earlier, rather wholesale, disallowance of estate deductions, the Tax Court held for the Commissioner.

It is possible, of course, that the taxpayer had as much review of the basic tax issues in this case as was necessary. But the opinion of the court certainly fails to make this evident. By the time the original disallowance of deductions assumed real significance they seem no longer to have been the subject of argument.

RES JUDICATA

The principal problem which the mitigation statute was expected to solve was that of the error in a year barred by the statute of limitations. In point of fact, however, the statute applies to any error described in the "circumstances of adjustment" section whose correction "is prevented by the operation of any law or rule of law, other than this [mitigation] part and other than section 7122 (relating to compromises)."[181] Thus:

> Examples of provisions preventing such corrections are sections 6501, 6511, 6532, and 6901(c), (d) and (e), relating to periods of limitations; sections 6212(c) and 6512 relating to the effect of petition to the Tax Court of the United States on further deficiency letters and on credits or refunds; section 7121 relating to closing agreements; and sections 6401 and 6514 relating to payments, refunds, or credits after the period of limitations has expired. Section 1311 may also be applied to correct the effect of an error if, on the date of the determination, correction of the error is prevented by the operation of any rule of law, such as *res judicata* or *estoppel*.[182]

180. Itola M. Evans Ransom, 2 T.C. 647 (1943), acq., 1944 Cum. Bull. 23.
181. Int. Rev. Code of 1954, § 1311(a).
182. Treas. Reg. § 1.1311(a)-2(a) (1956).

The courts do not seem to have been particularly troubled in applying the mitigation sections where the question is whether to lift some statutory bar. A recent case, however, suggests that there may be considerable difficulty where correction is prevented by a rule of law. Reference to such rules was inserted in the statute in 1954, ostensibly for the sole purpose of clarifying existing law.[183] The recent case referred to—*J. C. Bradford*[184]—leads us to believe that further clarification will be necessary.

In 1938, at a time when taxpayer owed more than $300,000 to a local bank on three secured promissory notes, his wife endorsed two of the notes having a combined face amount of $100,000, and substituted her own note for that of taxpayer to evidence the balance of the indebtedness. The collateral previously securing the entire debt was shifted to secure only the wife's note. In 1940, the wife's note was replaced by two new ones, also signed by her, in the respective face amounts of $105,000 and $100,000. Three years later, the bank, having been ordered by examiners to write off half the face amount of the $100,000 note, advised taxpayer that it would sell such note to anyone for $50,000. Taxpayer thereupon persuaded his brother-in-law to make the purchase with funds supplied by taxpayer and his wife.

In 1951, the Commissioner assessed additional taxes against both taxpayer and his wife on the theory that one of them had realized $50,000 in income upon the purchase of the $100,000 note from the bank. The cases went to the Tax Court which consolidated them and in 1954 decided that the wife had, and taxpayer had not, realized the $50,000 in income.[185] The wife appealed this decision to the Sixth Circuit which reversed the Tax Court, finding that the wife had not realized any income from the discharge of indebtedness.[186] The Commissioner, who had not appealed the decision in favor of the taxpayer-husband, now sent him a new deficiency notice on the theory that if the income had not been realized by the wife it must have been realized by him. The taxpayer again went to the Tax Court and this body again found in his favor: this was not, the court thought, the situation that Congress had in mind when it provided for reopening barred years.[187] Congress intended, said Judge Drennen,

to cover only situations which included some mitigating circumstances to justify dis-

183. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A291 (1954).

184. 34 T.C. 1051 (1960), acq., 1961 Int. Rev. Bull. No. 11 at 7.

185. J. C. Bradford, 22 T.C. 1057 (1954), acq., 1955-2 Cum. Bull. 4, rev'd, 233 F.2d 935 (6th Cir. 1956).

186. 233 F.2d 935 (6th Cir. 1956). The court of appeals based its decision exclusively upon the net economic consequences to the wife and noted that the question of the husband's tax liability was not before it.

187. 34 T.C. 1051, 1058 (1960).

regard of the statute of limitations. Here none appear. . . . The "error," if any, in this case was not discovered by the Commissioner "after expiration of the period of limitations." He litigated this claim against this taxpayer in the Tax Court before the statute of limitations had run. Nor was there here any "exploitation" of the statute of limitations or any dilatory action on the part of petitioner to justify any modification of the statute of limitations. There is no equitable principle to aid the Commissioner.

Although neither petitioner nor Eleanor reported this item, nevertheless, the Commissioner included it in income of each one by his notice of deficiency . . . and he had his day in court on each of those determinations. His determination with respect to petitioner was reversed in the Tax Court, but the Court sustained his determination with respect to Eleanor. Eleanor took an appeal . . . and won in the Court of Appeals for the Sixth Circuit. The Commissioner could have carried petitioner's case to that same court . . . and thus protected himself fully without the need of any aid from sections 1311-1315 of the 1954 Code. Sections 1312(3)(B) and 1311(b)(2)(A) were not intended to allow the Commissioner under such circumstances to go back and relitigate the alleged liability of petitioner for tax on this very same item.[188]

Thus the Tax Court held, apparently, that res judicata is not susceptible of avoidance through the mitigation statute. The point is not discussed, and it is not known, therefore, whether this means that the congressional attempt of 1954 was wholly ineffective or merely that the courts will give it a somewhat restricted application. The situation is one that will bear watching.

CONCLUSION

When Congress enacted the mitigation statute, it intended to accomplish a particular result in a particular way. The decisions and rulings here studied indicate, it is believed, that the statute in its present form is at once too specific and too vague to permit satisfactory implementation. In the process of construction, there has been confusion and error. Extraordinary difficulties have arisen. These, it is suggested, make necessary a reexamination of the purpose, content, and form of the statute. Are we certain that we need, and want, a provision for reopening closed years in tax cases? If such a provision is desirable, is inconsistency the proper ground for applying it? Are we satisfied also that, once we have established an inconsistency, we should limit the application of our rule to the arbitrary list of errors in section 1312, or, indeed, to any list of errors? Finally, must we have such an elaborate enactment in this area? Is there not something to be said for a law that confines itself to the statement of principle and leaves its incidence to the agencies regularly charged with interpretation?

Questions like these should be asked before we ever embark on legislation. They seldom are. We can hope, however, for some such inquiries in connection with the sort of tax revision that now seems in prospect.

188. Ibid.