DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

March 13, 2002

Number: **200232001**
Release Date: 8/9/2002
POSTF-154188-01
CC:PA:APJP:B3
UILC: 1311.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR MARK A. O'LEARY
ASSOCIATE AREA COUNSEL
CC:LMSB:DAL:2

FROM: Curtis G. Wilson
Assistant Chief Counsel
(Administrative Provisions and Judicial Practice)
CC:PA:APJP

SUBJECT: Mitigation of Effect of Limitations

This Field Service Advice responds to your memorandum of November 5, 2001. In accordance with I.R.C. § 6110(k)(3), this Field Service Advice should not be cited as precedent.

LEGEND

X =

Y =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

ISSUE

X filed an amended return, electing under section 475 of the Internal Revenue Code to use the mark-to-market method of accounting for certain accounts receivable and notes receivable. After examining X's amended return, the Service assessed a deficiency, even though the period of limitations had expired for the year the assessment was made. Should the assessment be abated?

CONCLUSION

The assessment should be abated because it was untimely. The mitigation provisions of the Code did not authorize an adjustment.

FACTS

X was the common parent of one consolidated return group and Y, its competitor, was the common parent of another group. On Date 1, X acquired all of Y's stock. Y filed a short-year consolidated return for Year 2. Thereafter, Y and the members of its consolidated return group became members of and filed returns as part of the X consolidated return group.

Both X and Y had extensive accounts receivable and notes receivable. But neither originally elected the mark-to-market method for reporting these receivables. Instead, both companies claimed sizable bad debt deductions. Y claimed these deductions on original returns for Year 1 and Year 2; X claimed these deductions on original returns for Year 1 and Year 3.

On Date 2, X, on behalf of its consolidated return group and also as successor agent for the Y consolidated return group, filed amended returns for X's Year 1 and Year 3 and Y's Year 1 and Year 2. On these returns, the mark-to-market method of accounting was elected for certain subsidiaries' accounts receivable and notes receivable; X, on its behalf and on behalf of Y, specifically elected not to be governed by the exception under Treas. Reg. section 1.475(c)-1(b) for sellers of nonfinancial paper or the exception under Treas. Reg. section 1.475(c)-1(c)(1)(i) for negligible sales. The amended returns claimed refunds, except for X's amended return for Year 3, which showed additional tax due. The assessment statute for this year expired without an additional assessment being made.

The Internal Revenue Service examined the amended returns. On Date 3, X signed a Form 870, "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment," agreeing to a reduced refund for Year 1 and a reduced deficiency for Year 3. Y also signed a Form 870 for Year 1, agreeing to a reduced refund.

On Date 4, the Service made a refund on account of Y's amended claim for Year 1. On Date 5, the Service made a refund on account of X's claim for Year 1. On Date 6, an assessment was made against X for Year 3 in the amount of the agreed deficiency for that year. X paid that amount.

Subsequently, X filed another amended return for Year 3, claiming a refund of the amount assessed on Date 6. X claims that this assessment was barred.

The Service has determined that the mark-to-market adjustments and the bad debt deductions do not overlap.

LAW AND ANALYSIS

Generally, the amount of any tax imposed by the Code must be assessed within three years after a return is filed. I.R.C. § 6501(a). In certain circumstances, the bar imposed by this limitations period is lifted by the mitigation provisions of I.R.C. §§ 1311 through 1314. Congress has strictly limited the use of these provisions. See Bolten v. Commissioner, 95 T.C. 397, 402-03 (1990); B.C. Cook & Sons, Inc. v. Commissioner, 65 T.C. 422, 427-28 (1995), aff'd. 584 F.2d 53 (5th Cir. 1978). In Bolten, the Tax Court explained that the "mitigation provisions are written with great specificity and are not formulated to provide general equitable relief to taxpayers and the Government or to cover every situation involving a double tax benefit or detriment arising out of inconsistent treatment." Id. at 403. The party seeking to utilize the mitigation provisions has the burden of proving that they apply. Id.; Yagoda v. Commisioner, 39 T.C. 170, 178, aff'd, 331 F.2d 485 (2d Cir. 1962).

For an adjustment to be authorized under the mitigation provisions, four conditions must be met::

- First, an error must have occurred in a closed tax year that cannot otherwise be corrected by operation of law. See I.R.C. § 1311(a).

- Second, there must be a "determination" for an open tax year. As defined in I.R.C. § 1313(a), a "determination" is a final decision by a court, a closing agreement, a final disposition of a claim for refund, or an agreement under Treas. Reg. § 1.1313(a)-4.

- Third, the determination must result in a circumstance under which an adjustment is authorized by I.R.C. § 1312. The seven circumstances under which an adjustment is authorized involve double inclusion of an item of gross income (I.R.C. § 1312(1)); double allowance of a deduction or credit (I.R.C. § 1312(2)); double exclusion of an item of gross income (I.R.C. § 1312(3)); double disallowance of a deduction or credit (I.R.C. § 1312(4)); correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs (I.R.C. § 1312(5)); correlative deductions and credits for certain related corporations (I.R.C. § 1312(6)); and basis of property after erroneous treatment of a prior transaction (I.R.C. § 1312(7)).

- Fourth, depending on which circumstance of adjustment applies, either an inconsistent position must be maintained by the party against whom mitigation will operate, I.R.C. § 1311(b)(1), or the correction of the error must not have been barred at the time the party for whom mitigation will operate first maintained its position. I.R.C. § 1311(b)(2). For adjustments by way of deficiency assessment against a related taxpayer, the relationship must have existed at a specified time or times. I.R.C. § 1311(b)(3); Treas. Reg. § 1.1311(b)-3.

An adjustment authorized by the mitigation provisions is made by assessing and collecting, or refunding or crediting, the amount of the adjustment in the same manner as if it were a deficiency or an overpayment. I.R.C. § 1314(b). From the date of the determination, one year is deemed remaining before the periods of limitation upon assessment or filing a claim for refund expire. Id. Within that period of time, the Service must mail a notice of deficiency for any adjustment it proposes under the mitigation provisions. Treas. Reg. § 1.1314(b)-1(b).

The assessment on Date 6 against X was apparently not preceded by a determination for Year 3. The partial disallowance of the mark-to-market election claims is not a determination because it is not a *final* disposition of these claims; time still remains under section 6532 for instituting suit. See Treas. Reg. § 1.1313(a)-3(c)(3). But even if some event could be identified as a determination, the assessment would still be invalid, because X, in the one-year period before the assessment, neither was mailed a notice of a deficiency nor waived the restrictions on assessment. Accordingly, the assessment must be abated.

Please call if you have further questions.

By: ______________________________
Richard G. Goldman
Chief
CC:PA:APJP:B3