Chertkof v. Commissioner, 66 T. C. 496 (1976)

The mitigation provisions of the Internal Revenue Code allow the IRS to correct errors in closed tax years when a taxpayer maintains an inconsistent position, even if the error was not made by the taxpayer.

Summary

In Chertkof v. Commissioner, the taxpayers reported a capital gain from a stock redemption in 1966, but the IRS initially assessed it for 1965, then refunded the tax after a court ruling in favor of the taxpayers for 1966. The IRS later sought to reassess the tax for 1966, beyond the statute of limitations, using the mitigation provisions of the IRC. The Tax Court denied the taxpayers' motion for summary judgment, holding that the IRS could use these provisions to correct the error because the taxpayers maintained an inconsistent position by arguing in court for 1966 inclusion after accepting the 1966 refund. This decision underscores the broad application of mitigation provisions to prevent tax inconsistencies and their exploitation.

Facts

Jack and Sophie Chertkof reported a long-term capital gain from a stock redemption by E & T Corp. in their 1966 tax return. The IRS audited their returns for 1965, 1966, and 1967, and determined that the gain should have been reported as dividend income in 1965. After assessing a deficiency for 1965 and issuing a refund for 1966, which the Chertkofs accepted, they successfully challenged the 1965 assessment in court. The court ruled that the gain should be included in 1966. Subsequently, the IRS issued a notice of deficiency for 1966, which the Chertkofs contested, arguing that the statute of limitations barred the assessment.

Procedural History

The Chertkofs filed their 1966 tax return reporting the gain. The IRS audited and assessed the gain for 1965, refunding the 1966 tax. The Chertkofs challenged the 1965 assessment in the U. S. District Court, which ruled in their favor for 1966. The IRS then issued a notice of deficiency for 1966, leading to the Chertkofs' motion for summary judgment in the Tax Court, arguing the statute of limitations barred the assessment.

Issue(s)

1. Whether the mitigation provisions of IRC sections 1311-1315 allow the IRS to assess a deficiency for the year 1966, which would otherwise be barred by the statute of limitations, because the taxpayers maintained an inconsistent position.
2. Whether the IRS's error in excluding the income from 1966, rather than the taxpayers' error, precludes the use of the mitigation provisions.

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Holding

1. Yes, because the taxpayers maintained an inconsistent position by arguing in court for the inclusion of the gain in 1966 after accepting the refund for that year, which satisfies the requirements of the mitigation provisions.
2. No, because the mitigation provisions apply regardless of who made the error, as long as the conditions for their use are met.

Court’s Reasoning

The Tax Court relied on the mitigation provisions of IRC sections 1311-1315, which are designed to prevent taxpayers from exploiting the statute of limitations to avoid taxation. The court found that the IRS’s action in refunding the tax for 1966 constituted an erroneous exclusion of income from that year, and the Chertkofs’ argument in the District Court for 1966 inclusion was inconsistent with this exclusion. The court cited previous cases like Albert W. Priest Trust and Eleanor B. Burton, which established that the mitigation provisions apply even if the error was made by the IRS, not the taxpayer. The court emphasized that the statute requires only that the position adopted in the determination (the court ruling) be inconsistent with the erroneous treatment, not that the taxpayer actively sought to exploit the statute of limitations. The court rejected the Chertkofs’ argument that their consistent reporting and passive acceptance of the refund should preclude the use of these provisions, noting that Congress intended to “take the profit out of inconsistency, whether exhibited by taxpayers or revenue officials. “

Practical Implications

This decision broadens the application of the mitigation provisions, allowing the IRS to correct errors in closed tax years even if the error was not made by the taxpayer. Practitioners should be aware that arguing for a different tax year in court after accepting a refund for another year can trigger these provisions. This ruling may lead to increased scrutiny by the IRS of cases involving refunds and subsequent court challenges, as it seeks to ensure that income is not doubly excluded from taxation. The decision also reinforces the policy that the statute of limitations should not be used to avoid tax liabilities due to inconsistent positions. Subsequent cases have applied this ruling to similar situations, emphasizing the importance of consistent tax reporting and the potential consequences of challenging IRS assessments in court.

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