

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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To: Manager, Supervisory Revenue Agent
Agent, Revenue Agent
Large Business & International Division

From: Associate Area Counsel,
Large Business & International Division

Subject: EIN: XX-XXXXXXX

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ISSUE:

Whether the mitigation provisions contained in Internal Revenue Code ("IRC") sections 1311 to 1314 apply to XYZ (the "taxpayer"), so that it may carryback its Year 3 net operating loss to the taxable years Year 1 and Year 2, years barred by the statute of limitations.

FACTS:

On or about Date 3, the taxpayer filed its Year 3 income tax return. On its Year 3 income tax return, the taxpayer reported a net operating loss ("NOL") of \$X. On Schedule K, the taxpayer checked the box on line 11 to forgo the carryback period, and therefore purportedly elected to carryforward the NOL generated in tax year Year 3. Attached to the taxpayer's return is a NOL Summary, which indicates that the taxpayer intended to carryforward its Year 3 NOL to a future year. The taxpayer claimed the Year 3 NOL as a net operating loss deduction on its Year 4 income tax return. However, the taxpayer did not attach the statement required by Treas. Reg. §1.1502-21(b)(3) to its Year 3 income tax return relinquishing the carryback period. Because the taxpayer failed to attach the statement required by Treas. Reg. §1.1502-21(b)(3), the taxpayer made an invalid election to waive the carryback period.

Exam subsequently communicated its position to the taxpayer that the taxpayer's election to forego the carryback period was ineffective. In response, the taxpayer sent Exam a letter, dated Date 6, claiming among other things that the mitigation provisions permit it to carryback the Year 3 NOL to Year 1.

The taxpayer filed its Year 1 income tax return on or about Date 1; its Year 2 income tax return on or about Date 2; its Year 3 income tax return on or about Date 3; and its Year 4 income tax return on or about Date 4. Currently, the statute of limitations for claiming a refund for taxable years Year 1, Year 2, and Year 3 has expired. The statute of limitations for filing refund claims for taxable year Year 4 has been extended by the taxpayer, and it is currently still open.

LAW AND ANALYSIS:

IRC section 1311(a) states that "[i]f a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of

the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (related to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and manner specified in section 1314." IRC §1311(a). Therefore, in order for the mitigation provisions to apply, there must be a determination, the determination must result in a circumstance of adjustment (Section 1312), and the taxpayer must satisfy other requirements as described below.

The first requirement for the mitigation provisions to apply is that there must be a "determination" as defined in IRC section 1313. See IRC §1311(a). A determination is defined to include: (1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction; (2) a closing agreement entered into under section 7121; (3) a final disposition by the Secretary of a claim for refund; or (4) an agreement entered into by the Secretary and a taxpayer. See IRC §1313(a). In the instant case, there is currently not a determination. However, the taxpayer could eventually obtain a determination either pursuant to a decision by the Tax Court, or a final disposition by the Secretary of a claim for refund. The determination requirements could also be satisfied by the parties entering into a closing agreement. In our view, the Service should enter into a closing agreement that the taxpayer is not entitled to the claimed net operating loss deduction in Year 4 because the taxpayer could ultimately secure such a determination in court. Therefore, the remainder of the analysis below is based upon the assumption that the Service will agree to enter into such a closing agreement, so the "determination" requirement in sec. 1313 is met.

The next requirement is that the taxpayer must satisfy one of the circumstances of adjustment provided for in IRC section 1312. The applicable provision in the instant case is IRC section 1312(4), which states that "the determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer." IRC §1312(4). In the instant case, the determination that the Year 3 NOL cannot be carried forward to the Year 4 tax year is the disallowance of a deduction that should have been allowed to the taxpayer for the Year 1 or Year 2 tax years. The statute of limitations is closed for the Year 1-Year 3 tax years; thus, the NOL cannot be carried back to Year 1 or Year 2. Because there is an invalid election, the taxpayer would be permitted to carryback the Year 3 NOL to the Year 1 or Year 2 tax years; however, because those years are barred by the statute of limitations, there is a double disallowance.

The denial of the NOL carryforward in Year 4 is the denial of a deduction, because a NOL becomes a deduction in the years that it is carried forward or carried back. See IRC §172(a). Therefore, the taxpayer satisfies the criteria of IRC section 1312(4).

Because the taxpayer is claiming that there is a double disallowance of a deduction, the requirements of IRC §1311(b)(2)(B) also need to be evaluated. That section states that “[i]n the case of a determination described in section 1312(4) (relating to disallowance of certain deductions and credits) adjustment shall be made under this part only if credit or refund of the overpayment attributable to the deduction or credit described in such section which should have been allowed to the taxpayer or related taxpayer was not barred, by any law or rule of law, at the time the taxpayer first maintained before the Secretary or before the Tax Court, in writing, that he was entitled to such deduction or credit for the taxable year to which the determination relates.” IRC §1311(b)(2)(B). Treas. Reg. §1.1311(b)-2 explains that a taxpayer “will be considered to have first maintained in writing before the Commissioner or the Tax Court that he was entitled to such deduction or credit when he first formally asserts his right to such deduction or credit as, for example, in a return, in a claim for refund, or in a petition (or an amended petition) before the Tax Court.” Treas. Reg. §1.1311(b)-2(b).

The taxpayer filed its Year 1 income tax return on or about Date 1; its Year 2 income tax return on or about Date 2; its Year 3 income tax return on or about Date 3; and its Year 4 income tax return on or about Date 4. The taxpayer claimed the Year 3 NOL as a deduction on its Year 4 income tax return, which was filed with the Service on or about Date 4. Therefore, it needs to be determined if the statute of limitations was open for purposes of claiming a refund on the carryback of the Year 3 NOL to the Year 1 and Year 2 tax years on Date 4 (the date when written notice was first provided to the Commissioner).

IRC section 6511(d)(2)(A) prescribes the limitations period with respect to net operating loss carrybacks. That section states in relevant part that “the period shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss ..., or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later.” IRC §6511(d)(2)(A). Therefore, because the NOL relates to the Year 3 tax year, the taxpayer had until Date 5 to file a refund claim carrying back the Year 3 NOL to its Year 1 and Year 2 tax years. Because the taxpayer had until Date 5 to file a refund claim, the filing of its Year 4 income tax return on Date 4 was within the limitations period for which the taxpayer could have claimed a refund to carryback the Year 3 NOL to its Year 1 and Year 2 tax years.

Because the taxpayer can eventually obtain a determination under IRC section 1313(a), meets the definition of a double deduction under IRC section 1312(4), and satisfies the requirements of IRC sections 1311(a) and 1311(b)(2)(B), the taxpayer can qualify for mitigation.

The conclusion that the taxpayer can qualify for the benefits of mitigation is supported by the Service’s position in *Plauche-Locke Securities, Inc. v. United States*, 1972 WL 386 (W.D. La. 1972). In *Plauche-Locke*, the plaintiff recognized

a NOL in 1965. Instead of carrying back the 1965 NOL to its 1962 tax year, the plaintiff erroneously carried forward one-eighth of the 1965 NOL to taxable year 1967. The Service concluded that the plaintiff was not permitted to carryforward its 1965 NOL, and by the time the parties entered into an agreement determining that the plaintiff was not entitled to the 1965 NOL deduction claimed on its 1967 return, the statute of limitations precluded the plaintiff from carrying back its 1965 NOL to taxable year 1962. Additionally, at the time that the plaintiff filed its 1967 return, upon which it claimed a deduction for one-eighth of its 1965 NOL, the statutory period within which the plaintiff could have obtained a refund of its 1962 tax as a result of the 1965 NOL had not expired.

The narrow issue before the court was whether the plaintiff could apply the mitigation provisions to all, or only one-eighth of its 1965 NOL. The Government contended that the mitigation provisions applied to only one-eighth of the plaintiff's 1965 NOL.

The court ruled in favor of the Government, and determined that the plaintiff was only entitled to apply the mitigation provisions to the portion of its NOL that it erroneously carried forward to taxable year 1967. This is because that was the only portion of the deduction in which the determination agreement between the parties disallowed. The remainder of the NOL was not subject to the determination agreement, thus, there was not a double disallowance of this amount. Importantly, in the instant case, the facts of *Plauche-Locke* support that the mitigation provisions can apply to the taxpayer.

CONCLUSION:

The Service should enter into a closing agreement with the taxpayer providing that the taxpayer is not entitled to the NOL carryforward deduction in Year 4. The mitigation provisions of IRC sections 1311 to 1314 will then apply so that the taxpayer is permitted to carryback its Year 3 NOL to its Year 1 and Year 2 tax years. Assuming that the taxpayer paid tax during those years, the statute of limitations for filing refund claims would be open for those years under the mitigation provisions.

AAC
Associate Area Counsel (LB&I)

By: _____
Signing
Attorney (City)
Large Business & International