

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

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to: Jennifer S. McGinty, Attorney (SB/SE)
(Buffalo, New York)

from: Susan Mosley, Senior Technician Reviewer
(Branch 7, Procedure and Administration)

subject: Applicability of the Mitigation Provisions to Open Tax Year A for Refund

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Tax year A =
Tax year B =
Tax year C =
Tax year D =
Tax year E =
Person 1 =
Person 2 =
Person 3 =
Person 4 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Year 1 =
Year 2 =

Trust =
Amount 1 =
Amount 2 =
Amount 3 =
Amount 4 =
Amount 5 =
Amount 6 =
Amount 7 =
Amount 8 =
Amount 9 =
Amount 10 =
Amount 11 =

ISSUE

Whether Internal Revenue Code sections 1311-1314 (“mitigation provisions”) allow the taxpayers to re-open tax year A, to correct what they claim is a reporting error caused by the appreciation of basis in property received by gift that was sold in tax year A?

CONCLUSIONS

No. The mitigation provisions require, among other things, a circumstance of adjustment provided for under section 1312. Here, the circumstances under which an adjustment under section 1311 is authorized are not present.

FACTS

a. Personal Tax Liability of Estate Transferees

Person 1, mother of Person 2 died in Year 1. On Date 1, gift tax returns were filed for Person 1 for tax years C, D, and E. These returns were audited on Date 2 and, as a result, additional gift tax for tax years C through E and income tax for tax years B through D was determined. The Service attempted to collect the additional tax owed by the estate from the transferees of Person 1’s estate. Transferees of estate property included Person 2, Person 3, Person 4, and a trust established for Person 2, Person 3, and Person 4 known as Trust. The Service sent notices of transferee liability to all four transferees on Date 3. Federal tax liens were filed and Person 2 and Person 3 requested a Collection Due Process hearing.

On Date 4, all transferees entered into a closing agreement with the Service to determine the maximum amount of transferee liability exposure. The closing agreement stated that for tax years C through E the estate owed the following gift tax amounts respectively: Amount 1, Amount 2, and Amount 3. Furthermore, the closing agreement provided that the estate owed income tax for years B through D in the following amounts respectively: Amount 4, Amount 5, and Amount 6. The amounts were to be

collected from the estate transferees per the closing agreement as follows: Person 2 an amount not to exceed Amount 7, Person 3 an amount not to exceed Amount 8, Person 4 an amount not to exceed Amount 9, and Trust an amount not to exceed Amount 10. The closing agreement did not address the treatment of any estate property, rather, it addressed solely the personal liabilities of Person 2, Person 3, Person 4, and Trust as transferees.

b. The Basis in Gift Property Received from the Estate

Person 2 and Person 3 received property by gift from the estate of Person 1 that they sold in tax year A. Based on the sale of that property, Person 2 and Person 3 submitted a first amended return for tax year A on Date 5, while the period of limitations on assessment for tax year A remained open. The first amended return claimed a refund based on the taxpayers' claim that their basis in the gift property appreciated after they filed their original tax year A return. Specifically, Person 2 and Person 3 allege their "basis in the property received was increased by its prorated share of gift tax paid attributable to the net appreciation in value of the gift". (See Statement 1, First Amended Return tax year A). They asserted that the increased basis caused a decreased gain on the sale of the gift property in tax year A and entitled them to a refund for overpayment in tax year A. The Service issued a refund for tax year A to Person 2 and Person 3 in the amount of Amount 11 on Date 6.

A second amended return for tax year A was filed by Person 2 and Person 3 on Date 7. The period of limitations for tax year A expired on Date 8. The second amended return attempts to invoke the mitigation provisions to re-open tax year A and serves as a protective claim for refund. Person 2 and Person 3 allege that their basis in the gift property continued to appreciate in value because more gift tax was paid after Year 2. Person 2 and Person 3 argue that the Date 4, closing agreement constituted a final determination under the mitigation provisions, thereby allowing tax year A to be re-opened and allowing them to seek a refund.

It is our understanding that your office has coordinated the tax issue with PSI, which has advised that Person 2 and Person 3 are not entitled to favorable adjustments based on additional basis appreciation, as alleged in the second amended return. However, you asked whether the mitigation provisions would allow the taxpayers to re-open tax year A assuming they would be entitled to a favorable adjustment in that year.

LAW AND ANALYSIS

Under certain limited circumstances, the mitigation provisions allow the Service to correct an error, provided for under section 1312, caused by a determination when correction of the effect of the error is prevented by operation of law. When the adjustment to correct the error results in an overpayment by the taxpayer, the error must result from the adoption of a position maintained by the Service that is inconsistent with the position in the now closed year. The party seeking to invoke the mitigation

provisions bears the burden of proof. Fruit of the Loom, Inc. v. Commissioner, 72 F.3d 1338, 1341 (7th Cir. 1985), citing O'Brien v. U.S., 766 F.2d 1038, 1042 (7th Cir. 1985).

The provisions of a closing agreement constitute a determination for mitigation purposes. I.R.C. § 1313(a)(2). In this case Person 2 and Person 3 entered into a closing agreement with the Service on Date 4. This satisfies the first requirement of the mitigation provisions that a determination be made. Person 2 and Person 3 must also show that an error, referred to as a circumstance of adjustment has occurred. Circumstances of adjustment are described in section 1312. This case does not involve the double inclusion of income or double disallowance of a deduction. The only two circumstances of adjustment that would apply to these facts are sections 1312(5), correlative deductions and inclusions for estates and beneficiaries, and 1312(7), basis of property after erroneous treatment of a prior transaction.

A circumstance of adjustment under section 1312(5) occurs when a determination allows or disallows any additional deductions allowable in computing taxable income of estates or trusts or requires or denies any inclusions in computation of taxable income of beneficiaries, heirs or legatees and the correlative inclusion or deduction has been treated erroneously with respect to the related taxpayer. Here there is no such erroneous treatment. The closing agreement determined Person 2 and Person 3's transferee liability with respect to Person 1's estate. There was no correlating erroneous treatment of the estate's liability as that liability was determined in the Date 2 audit.

Similarly, Person 2 and Person 3 also may not seek to invoke the mitigation provisions under section 1312(7). Section 1312(7) requires in part that a determination "determine the basis of property". See also Treas. Reg. 1.1312-7(a) (stating section 1312(7) applies "if the determination establishes the basis in property"). The closing agreement Person 2 and Person 3 entered into with the Service did not determine their basis in the gift property at issue, the closing agreement only addressed the monetary liability of Person 2 and Person 3 for gift and income tax owed by the estate.

In addition, Person 2 and Person 3 cannot show that the determination adopts an inconsistent position maintained by the Service as required by section 1311(b). For mitigation to apply, the determination would have to adopt a position in the open year that was maintained by the Service and that was inconsistent with the erroneous adjustment in the closed year. I.R.C. § 1311(b)(1)(B). In this case the closing agreement did not adopt a position of the Service for the years at issue that is contrary to a position the Service is taking against Person 2 and Person 3 in tax year A, the closed year. The Service has not treated the basis of Person 2 and Person 3's gift property inconsistently as basis was not addressed in the closing agreement.

In sum, the conditions necessary for adjustment do not exist in this case. Person 2 and Person 3 have failed to establish that the mitigation provisions apply. Accordingly, the mitigation provisions are inapplicable.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Sarah Sheldon at (202) 622-7950 if you have any further questions.