

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

Number: **201247011**

Release Date: 11/23/2012

CC:PA:06:

POSTN-123032-12

UILC: 6320.00-00, 6330.00-00, 1313.01-00

date: August 01, 2012

to: Vivian Lai
Appeals Officer
Office of Appeals
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from: Barbara M. Pettoni
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subject: Mitigation Claim During CDP Hearing

Issues

1. Whether the taxpayer may raise the issue of mitigation during this collection due process (CDP) hearing.
2. Whether the mitigation provisions of the Internal Revenue Code apply such that the taxpayer's refund claims for non-CDP years may be allowed despite the expiration of the statute of limitations for those years.
3. Whether the taxpayer may raise the defense of equitable recoupment during this CDP hearing.

Summary

1. To avoid a potential remand by the Tax Court for abuse of discretion, Appeals should consider the issue of whether mitigation applies.
2. The mitigation provisions do not apply because there was no determination as defined by IRC section 1313(a)(1).

3. The taxpayer may not raise the defense of equitable recoupment during this CDP hearing.

Background

The taxpayer, _____, is currently before Appeals for a CDP hearing regarding the proposed collection of a tax liability for taxable year _____. The taxpayer's argument is that refunds for unrelated years may be used to offset the liability and if those offsets are applied then there will be no amount left to collect.

The taxpayer previously received a statutory notice of deficiency for tax year _____ and filed a timely petition with the Tax Court in response. The Tax Court docket number for the deficiency case was _____; the case concluded with a stipulated decision entered by the Court on _____. The Tax Court's decision finds deficiencies for taxable years _____. While the Tax Court's decision is limited to the amount of deficiencies for the three taxable years at issue, there are stipulation paragraphs found below the Judge's signature. These paragraphs are generally referred to as "below-the-line" stipulations.

The below-the-line language in the stipulated decision states, in relevant part, that:

The parties also filed a separate Stipulation of Settled Issues on _____. The Stipulation of Settled Issues stated that the parties agree to the following regarding _____:

_____ The Decision and Stipulation of Settled Issues (final, unsigned version) are enclosed with this memo for your reference.

The taxpayer provided a letter dated April 10, 2012 addressed to Ms. Vivian Lai in the IRS Office of Appeals. In this letter, the taxpayer argues that refund claims for taxable years _____ are not barred by the statute of limitations due to the operation of the mitigation provisions in the Internal Revenue

Code. The taxpayer has separately appealed the denial of those refund claims, and Appeals is currently reviewing those claims as well.

The taxpayer provides additional relevant information in the April 10, 2012 letter. According to the taxpayer's letter, the issue during the Tax Court case for the _____ years was the appropriate tax year in which the taxpayer should report _____ were originally reported on the taxpayer's return for _____ with losses carried back to _____ forward. The IRS argued that the proper year was _____

The taxpayer also presents the alternative argument that the doctrine of equitable recoupment applies to allow relief in this case.

Discussion

1. Whether the taxpayer may raise the issue of mitigation during the CDP (Collection Due Process) hearing.

Internal Revenue Code section 6330 provides that, before the IRS may make a levy on any property pursuant to section 6331, the taxpayer is entitled to a hearing before the IRS Office of Appeals ("Appeals"). I.R.C. § 6330(a) and (b). The hearing addresses the taxable period in which the unpaid tax specified in the notice of proposed levy relates. I.R.C. § 6330(b)(2). The taxpayer may raise "any relevant issue relating to the unpaid tax or the proposed levy." I.R.C. § 6330(c)(2)(A). The taxpayer may also raise challenges to the existence or amount of the underlying tax liability at the hearing if the taxpayer did not receive a statutory notice of deficiency with respect to the underlying liability or did not otherwise have an opportunity to dispute the liability. I.R.C. § 6330(c)(2)(B). The Appeals Officer conducting the hearing must determine whether and how to proceed with collection and shall take into account: (i) whether the requirements of any applicable law or administrative procedure have been met; (ii) the relevant issues raised by the taxpayer; (iii) challenges to the underlying liability by the taxpayer, where permitted; and (iv) whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the taxpayer that the collection action be no more intrusive than necessary. I.R.C. § 6330(c)(3).

The Tax Court has jurisdiction to review a CDP determination if the taxpayer timely files an appeal of the Appeals Officer's determination with the Tax Court. The Tax Court may review issues that were properly at issue in the CDP hearing, sometimes including challenges to the underlying liability. I.R.C. § 6330; Treas. Reg. §§ 301.6320-1(f)(2) Q&A-F3, 301.6330-1(f)(2) Q&A-F3. In certain circumstances, Appeals may consider facts and issues in non-CDP years during a CDP hearing. See Freije v. Commissioner, 125 T.C. 14 (2005) (holding that the Tax Court had jurisdiction to consider facts and circumstances arising in non-CDP year that related to remittance

taxpayer believed should be applied to CDP year).¹ If a consideration of facts and issues in non-CDP years is relevant to determining whether the “unpaid tax” that is the subject of the proposed levy should have been satisfied by a remittance or available credit, then those facts and issues may be included in the Appeals Officer’s review and determination. See Freije at 26-27. The consideration of the non-CDP years extends only “insofar as the tax liability for that year may affect the appropriateness of the collection action for the [CDP] year.” Id. at 28. The Tax Court may consider a failure to consider the factual circumstances of a non-CDP year overpayment that could eliminate the CDP year liability to be an abuse of discretion on the part of Appeals. See Perkins v. Commissioner, T.C. Memo. 2008-103 (holding that Appeals should have determined whether limitations period should have been suspended because taxpayer was mentally impaired such that overpayment arising in non-CDP year could be applied to satisfy CDP liability). However, this consideration should only include “available credits,” such as nonrefunded or not yet applied credits already determined by the IRS or a court, and not merely claims of credits that have not yet materialized. See Weber v. Commissioner, 138 T.C. No. 18 (2012) (holding that Tax Court did not have jurisdiction to adjudicate a disputed refund claim that was distinct from and unrelated to the liability at issue).

The taxpayer, _____, is before Appeals for a CDP hearing relating to a proposed collection of its tax liability for the taxable year _____. Only _____ is at issue in the CDP proceeding. _____ received a statutory notice of deficiency for the tax years _____ and filed a timely petition. The Tax Court case was resolved with a stipulated decision that found deficiencies for the taxable years _____. The stipulated decision also included below-the-line stipulations that the taxpayer had net operating losses in _____ and _____ and that the taxpayer was entitled to a deduction in _____ for _____. Because _____ had a prior opportunity to dispute the _____ tax liability, it cannot raise challenges to the existence or amount of the underlying tax liability at the CDP hearing. However, the taxpayer is now arguing that mitigation would allow its refund claims for _____ and _____ to potentially satisfy the tax liability for _____ and that this argument should be heard at the CDP hearing. This argument does not go to the amount or existence of the underlying liability for _____ through _____, but rather goes to the amount that should be applied to satisfy the liability.

_____ mitigation argument should be considered in this CDP hearing. In the stipulated decision for _____, the IRS agreed that the

¹ In a recently issued Chief Counsel Notice, we discussed our disagreement with the holding of Freije: “Freije is incorrectly decided to the extent it holds that a non-CDP period liability is a relevant issue in a CDP hearing and that the Tax Court has jurisdiction to determine or otherwise review the taxpayer’s liability for a non-CDP period. The availability of an overpayment from a non-CDP period as a source of payment of the unpaid tax for the CDP period, however, may be raised as a relevant issue under section 6330(c)(2)(A) when the Service has already agreed that the taxpayer is entitled to the overpayment.” IRS CCN CC-2011-021.

taxpayer had an available net operating loss and was entitled to a deduction for . Therefore, the Appeals Officer should consider the facts and issues regarding the “available credit” that may be applied to satisfy the tax liability, even though it involves a year that is not at issue in the CDP hearing. Like in Freije and Perkins, Appeals should consider whether mitigation would allow the taxpayer’s refund claims for the non-CDP years even though the limitations period has expired. This case is not like Webster, in that the IRS has not disputed the credit, nor disallowed the refund claims. The mitigation issue is a relevant issue relating to the unpaid tax and proposed levy because, if allowed, the refund claims could eliminate the liability and negate the need for the proposed levy. To avoid a potential remand by the Tax Court for abuse of discretion, Appeals should consider the issue of whether mitigation applies.

2. Whether mitigation applies such that the taxpayer’s refund claims for barred years may be allowed and the amounts applied to the CDP year.

The mitigation provisions, found at I.R.C. §§ 1311-1314, provide an exception to the restrictions against the allowing of a refund or an assessment in limited situations. Section 1311(a) provides that if 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 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314. The mitigation provisions of the Code are limited to errors expressed in the statute and are not broadly available.

Therefore, 1) there must be a “determination” as defined in section 1313(a); 2) the determination must be described by one of the circumstances of adjustment in section 1312; and 3) on the date of the determination, correction of the error must be barred by operation of law. Depending on which circumstance of adjustment applies, either the party who prevailed in the determination must have maintained a position that was adopted there and that was inconsistent with the erroneous treatment (I.R.C. § 1311(b)(1)) or the party must have first maintained the erroneous position at a time when the correction would not have been barred (I.R.C. § 1311(b)(2)). Finally, the taxpayers must be in a relationship as defined by section 1313(c) and described in section 1311(b)(3). If all of the prerequisites for the mitigation provisions are met, then the rules for the amount and method of adjustment found in section 1314 are followed.

The first requirement is the existence of a “determination” as defined by section 1313(a). If there is no determination, then mitigation cannot apply. Section 1313(a)(1) defines determination as “a decision by the Tax Court ... which has become final.” In this case, a Tax Court decision was entered on and therefore became final on (the Tax Court docket does not indicate any post-decision motions or appeal). However, it was a stipulated decision. In order to base a mitigation adjustment on a stipulated decision, that stipulated decision must be sufficiently

detailed. See Fong v. Commissioner, T.C. Memo. 1998-181; Anthony v. Commissioner, T.C. Summ. Op. 2011-50.

In Fong, the Service argued that a Tax Court decision based on a stipulation of settled issues was a determination for purposes of section 1313(a). The Court found for the petitioner, holding that: “[w]here ... a Tax Court case is settled and a decision is entered based thereon, and where the specific underlying terms of the settlement agreement between the parties are not reflected in the stipulation of settlement that is filed with the Court and that serves as grounds for the decision that is entered, such a Tax Court decision does not satisfy ... the determination requirement of section 1313(a).” T.C. Memo. 1998-181 at 13-14.

The Tax Court decision does not satisfy the Fong requirement that a stipulated decision be sufficiently detailed in order to operate as a determination for purposes of the application of the mitigation provisions. While it is questionable whether the separately filed Stipulation of Settled Issues may also be referenced for purposes of this question, the analysis below assumes it does qualify as part of the decision and the conclusion does not change. Therefore, there is no determination in this case.

The stipulated decision and Stipulation of Settled Issues do not reference the type of adjustment made to the years at issue, nor do they reference the adjustments made to the and years. While a below-the-line stipulation does state that the petitioner is entitled to a deduction in for , there is no indication whether that deduction had been claimed in and whether the decision disallows that claimed deduction. Because the tax years at issue before the Court were , it is extremely unclear from the decision itself how the Tax Court’s decision relates to any statement regarding tax year .

The specific language of both the stipulated decision and Stipulation of Settled Issues is important, as the taxpayer appears to be arguing that the Tax Court decision created a right to file the amended returns (“The Internal Revenue Service denied the claims citing the statute of limitations, notwithstanding the language in the Tax Court decision.” Taxpayer’s April 10, 2012 letter, page 3.)

The taxpayer has referenced the language of the Tax Court decision as relevant to the refund claims. The Tax Court decision, however, consists of only the above-the-line statements. Below-the-line statements are statements to which the parties agree but they are not part of the actual court decision. A statement that the taxpayer is entitled to a deduction in another taxable period does not reach the question of whether the taxpayer may properly use that deduction.

The Stipulation of Settled Issues further caveats that the petitioner does not waive or forego rights to net operating losses “as are permitted by law.” If the taxpayer cannot show that all of the requirements of the mitigation provisions are satisfied, then the refunds remain barred. This analysis of the applicability of the mitigation provisions

does not reach the issue of whether the losses are properly claimed and is only a determination that the years are closed.

Without a determination, it is not possible to further analyze whether the facts of the taxpayer's case fall within the remainder of the mitigation requirements. Because there is no determination, mitigation cannot apply to create an exception to the statute of limitations barring the taxpayer's refund claims.

3. Whether equitable recoupment provides an alternate ground for relief.

“Equitable recoupment arises when a single ‘transaction, item or taxable event’ is subject to two inconsistent taxes. The doctrine permits a party to a tax dispute to raise a time barred claim in order to reduce or eliminate the money owed on the timely claim.” Estate of Branson v. Commissioner, 264 F.3d 904, 909 (9th Cir. 2001) (internal citations omitted).

As discussed above, because the taxpayer had a prior opportunity to dispute the tax liability, it cannot raise challenges to the existence or amount of the underlying tax liability at the CDP hearing. Equitable recoupment is a defense against the assessment of tax that goes to the amount of liability. Therefore, this argument is not properly raised during the CDP hearing.²

² If equitable recoupment could be raised during the CDP hearing, it would not be a successful argument. Without analyzing the merits of the equitable recoupment argument in this case, it is clear that equitable recoupment is a defensive doctrine that should have been raised during the Tax Court proceeding that determined the deficiency amount. Further, the Ninth Circuit, where we believe this case would be appealable, has held that when there is a statutory remedy provided in the mitigation sections of the Code, equitable recoupment is not available. Wells Fargo Bank & Union Trust Co. v. United States, 245 F. 2d 524, 526 (9th Cir. 1957).