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By

JOHN M. MAGUIRE, STANLEY S. SURREY
and ROGER JOHN TRAYNOR

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SECTION 820 OF THE REVENUE ACT OF 1938

By JOHN M. MAGUIRE †, STANLEY S. SURREY †
and ROGER JOHN TRAYNOR ‡

A. GENERAL DESCRIPTION OF THE PROBLEM AFFECTED BY THE SECTION

Section 820 of the Revenue Act of 1938 is the first fruits of the following recommendation by the Subcommittee on Internal Revenue Taxation of the House Committee on Ways and Means:

"It is recommended that there be prepared suitable provisions under which the statute of limitations should be so adjusted as to insure the taxation of income, and the allowance of deductions, in the year to which properly allocable." ¹

The statutory section does not exactly carry out the subcommittee's recommendation. In some respects it falls short of full compliance with the mandate; in other respects it extends the principle of the recommendation beyond the precise wording. It is a serious effort to deal decisively with certain aspects of a very extensive and irritating income tax question which has so long remained unanswered that many well-qualified lawyers, administrators, and legislators have come to think it insoluble.² Any advance toward a sound solution of this problem should be warmly welcomed; any move in the wrong direction has dangerous

† Professor of Law, Harvard Law School.
‡ Assistant Legislative Counsel, United States Treasury Department.
§ Professor of Law, University of California School of Jurisprudence.

Although one of the writers, Stanley S. Surrey, is employed by the United States Treasury Department, the views set forth herein are entirely those of the writers and in no way indicate the views of the Treasury Department.


possibilities. The American Bar Association's Standing Committee on Federal Taxation, in its report to the Sixty-first Annual Meeting of the Association, expresses unqualified disapproval of Section 820, damning it by implication as not even embodying a "constructive suggestion", and strongly urges its repeal. With all due respect to the distinguished authors of this report, the present writers have reached the conclusion that its treatment of Section 820 is not only inadequate but seriously inaccurate. The section deserves something better than hasty misjudgment, since it was "the result of research by Treasury experts and conferences with members of the bar extending over a period of many months." The purpose of this paper is to offer frank and careful analysis and criticism of the strength and weakness of Section 820. While we are in favor of the section, and do not pretend to write a merely neutral article, we appreciate the sincerity and strength of some counter-arguments, and feel that there should be amendatory and supplementary legislation.

As an introductory matter, it is necessary to characterize the field in which the legislation is intended to operate and to summarize briefly prior efforts to cope with the difficulties there encountered. By and large, the situations for which the subcommittee sought relief have appeared in two general forms. In the first form, a taxpayer has mistakenly returned income or mistakenly failed to claim a deduction in a year later closed by some provision of law, typically the statute of limitations; then, for another year, the same taxpayer has either been required to return the same income over again, and pay further tax with respect to it, or has been denied the benefit of the deduction on the ground that it was allocable only to the closed year. In the second form, difficulty has arisen from uncertainty as to taxpayers rather than as to chronology. For example, one of two spouses has erroneously included as taxable income an item which should have been attributed to the other spouse; then the Bureau of Internal Revenue has discovered the mistake while time still remained to correct the appropriate return of the second spouse by inserting the item, but after the statute of limitations has run upon a claim for refund by the first spouse. It has of course been equally possible for the government to suffer in complementary situations taking either form, as where a single deduction has been used to benefit the same taxpayer in two different years or to benefit both of two taxpayers whose relationship caused fiscal confusion. Cases of hardship to taxpayers being thus matched by cases of hardship to the government, no relief measure can be truly adequate unless it works both ways.

3. "We recommend that this provision be repealed, and that this committee cooperate with the Treasury in working out constructive suggestions, looking to the best possible solution." ADVANCE PROGRAM OF AMERICAN BAR ASSOCIATION, 61st Annual Meeting (1938) 104.

B. Failure to Solve the Problem by Judicial Action

Prior to 1938 legislative proposals had been unavailingly offered to meet the difficulties outlined in the preceding paragraph. Dilemmas in concept and draftsmanship prevented affirmative action.\(^5\) Lacking Congressional assistance, the Bureau and taxpayers tried step-by-step methods of litigation. The principle invoked, to use the broad terms of Mr. Justice Cardozo, was "that no one should be permitted to found any claim upon his own inequity or to take advantage of his own wrong."\(^6\) In the field of Federal tax procedure this concept, under one name or another, has done much to prevent technical slip-ups from being fatal to the government's interests.\(^7\) Applied to alleviate the effect of errors respecting the timing or proprietorship of income or deductions, it has led to appreciable consequences. Where, for instance, a taxpayer has claimed the benefit of a deduction for some open year, and investigation shows that he has already taken the same deduction for another year which is now closed, the government commonly contends that he has estopped himself to take the deduction over again in the open year. After a period of hesitation, the Board of Tax Appeals began to decide such controversies in the Treasury's favor.\(^8\)

Turning to cases of a different kind, we find one where a taxpayer failed to disclose as income constructively received in years prior to 1923 certain items of salary and dividends unqualifiedly credited and made available to him during those prior years. In 1923 he actually received the amount of these items, and for that year returned these receipts as gross income. Then, after the statute of limitations had closed the prior years, he sought a refund for 1923 on the ground that the items referred to belonged in the closed earlier years. The Court of Claims denied the refund; "... the plaintiff cannot now...be heard to say that such credits do not constitute taxable income in the year in which he chose to receive them in a physical sense."\(^9\) This result is rested on the decision of a somewhat similar controversy before the Board and the Court of Appeals for the First Circuit which really pressed the same principle further, because the taxpayer in that controversy was resisting a deficiency instead of seeking a refund.\(^10\)

\(^{5}\) E.g., the discussion and proposals referred to in note 2, supra.
\(^{6}\) Stearns Co. v. United States, 291 U. S. 54, 61 (1934).
technical tax law; refunds rest upon equitable principles. Equity is more touchy about unconscionable behavior.\textsuperscript{11} In a related case the taxpayer was a lessor; his lessee erected improvements on the demised premises; the taxpayer never returned any gross income on account of this accession in value. Seven years after completion of the improvements he sold his interest in the premises and, when reporting the sale for income tax, claimed as part of his basis the depreciated value of the improvements. The Commissioner rejected this increase of basis, imposed a deficiency, and won the case.\textsuperscript{12}

Most famous of all the government’s victories in this connection is \textit{Stone v. White},\textsuperscript{13} where the issue was “whether . . . testamentary trustees, who have paid a tax on the income of the trust estate, which should have been paid by the beneficiary, are entitled to recover the tax, although the government’s claim against the beneficiary has been barred by the statute of limitations.” Recovery was refused, the successful defense being described as a denial of the trustees’ “equitable right to undo a payment which, though effected by an erroneous procedure, has resulted in no unjust enrichment to the government, and in no injury to [the trustees] or their beneficiary”, the beneficiary being the only person who would have been in pocket by the refund.

Winning these cases was a real achievement by government counsel, but their decisions cover only a thin scattering of the situations constantly encountered. This fact so abundantly appears from our later discussion that no elaborate detail is offered here. It is enough to indicate the limits upon, and various qualifications of, the decisions just set forth. If, in \textit{Stone v. White}, neither beneficiary nor trustees had ever paid the tax voluntarily, the trustees having duly taken a deduction for their payment of income to the beneficiary, it seems highly doubtful whether an attempt to deny this deduction by asserting a deficiency against the trustees, after the statute had run in favor of the beneficiary, would have succeeded. In a later case where other trustees apparently should have paid, but unquestionably did not pay, tax with respect to certain receipts, and no part of those receipts was ever passed on to the beneficiary, the latter, having erroneously paid tax with respect to the receipts, recovered his payment after the statute had run in favor of the trustees.\textsuperscript{14} Where an income beneficiary should have paid tax, but did not, and fiduciaries


\textsuperscript{12} William Merriam Crane, 27 B. T. A. 360 (1932), aff’d, Crane v. Commissioner, 68 F. (2d) 640 (C. C. A. 1st, 1934). Here, of course, there is a fundamental problem as to whether and when lessees’ improvements constitute taxable income to lessors. This problem is aside from the immediate discussion. See Blatt Co. v. United States, 59 Sup. Ct. 186 (U. S. 1938).

\textsuperscript{13} 301 U. S. 532, 533, 539 (1937).

should have claimed a corresponding deduction, but failed to do so, it was held that the running of the statute in favor of the beneficiary did not prevent recovery of the fiduciaries' overpayment by the remainderman to whom the trust corpus had ultimately been distributed. With respect to the lessee improvement situation in which the lessor was not allowed to augment his basis by the value of the improvement, because he had paid no income tax on account of its acquisition, we find the effect of the case in some degree weakened by the tone of a later United States Supreme Court opinion and by the actual decisions of later cases in the lower Federal courts. There is a tendency to offer specialized explanations for the lessee improvement result and also for the two constructive receipt cases described above in the same connection. The government's most common formula in these matters has been that taxpayers are "estopped". In fact, it would not be seriously misleading to term this part of our exposition a discussion of the practical consequences of the estoppel theory. With increasing frequency the courts point out that no estoppel can be found where all facts have been honestly

15. Sewell v. United States, 85 Ct. Cls. 512, 524, 19 F. Supp. 657, 663 (1937); cf. Schlemmer v. United States, 94 F. (2d) 77, 78 (C. C. A. 2d, 1938), where the court could not tell who would have borne increased tax burden if an improper deduction had not been taken; and said, moreover, "we do not believe that the eventual incidence of the tax which has been lost, may be traced back, however indirectly, to the taxpayer in court so that his recovery shall be diminished pro tanto." Contrast Smith v. United States, 22 F. Supp. 1011, 1015 (E. D. Pa., 1938), where the remaindermen inherited from the life tenant as well as from the creator of the trust.

16. Helvering v. Salvage, 297 U. S. 106, 109 (1936), where the taxpayer disclosed in his return for 1922 no gain from certain profitable acquisition and exchange transactions during that year, but in connection with a partial closing out of his investment in 1929 resisted a deficiency by asserting a basis enhanced on account of the 1922 transactions. The lower court, says the opinion, held "that the failure to disclose 1922 taxable gain apparently resulted from innocent mistake of law; there was no false representation of fact; nothing gave support to the claim of estoppel." And the defense of estoppel not having been properly raised, "the court should have passed the point. Furthermore, the facts disclosed give it no support." (Italics added).


disclosed to the Bureau of Internal Revenue, or—this being probably an alternative wording of the same idea—where the taxpayer's erroneous conduct finds its sole basis in a mistake of law (or of "mixed law and fact") contemporaneously shared by the Bureau. The concept of "estoppel" is quite intricate. With a few standardized exceptions, such as estoppel by deed, cases in which this concept is claimed to apply present individual problems. Nothing could show this more vividly than the variations of facts, arguments, and results in the many Federal estoppel controversies, and the consequent extreme difficulty in classification. The whole estoppel situation makes for dubiousness very unfitting to tax law. Citizen and Bureau alike should be able to find their legal positions more clearly and broadly forecast.

Some criticisms of estoppel and related remedies in this connection are themselves subjects of controversy. It is said, for instance, that estoppel is objectionable because it freezes or perpetuates an error instead of setting matters aright according to the substantive requirements of the tax laws. Where a taxpayer ten years ago wrongly took a deduction which he should be taking now, it is truer to Congressional desires to open up and correct the decade-old return, than to fix the mistake immutably by an estoppel respecting the current year. But other critics vigorously take Section 820 to task because it embodies this very view. Orderly development of our topics demands postponement of such contested points. One fundamental objection to estoppel and the like as an exclusive cure, however, is open to no contest. Estoppel is hopelessly lop-sided. For reasons well enough understood, whether they be good or bad, it is practically impossible, or at least very difficult, for the taxpayer to make an estoppel operate against the government. So in the main he who erroneously paid tax on supposed income for a year subsequently closed has had no hope of relief when, prior to the effective date of Section 820, he has been called upon to pay over again for the technically correct year. Neither has he had a better hope if, in connection with a capital transaction, he has tried to build into his basis a sum erroneously taxed as income. The nearest approach to a taxpayer's success in any such case occurred under most unusual circumstances when, by virtue of the doctrine of recoupment, a deficiency collected, on an open income-tax item was reduced and ordered partly refunded because of an erroneous and inconsistent estate tax payment made in connection with another aspect of the same

19. Grand Central Public Market, Inc. v. United States, 22 F. Supp. 119, 126 et seq. (S. D. Cal., 1938), contains an instructive review of the cases and allows recovery of an overpayment traceable to the return of income in the wrong year, despite the closing of the right years.

20. See Maguire and Zimet, supra note 7, at 1299 et seq.; PAUL AND MERTENS, op. cit. supra note 7, §§ 53.07, 53.11, 53.12 (1938 Cum. Supp.).

asset in a year which had been closed.\textsuperscript{22} This peculiar case does not aid the broad situation and leaves the purely judicial remedy condemned as inadequate under the test stated at the close of the preceding section. Working often \textit{against}, and never, or substantially never, \textit{for}, the taxpayer, prosecution of this remedy was sure to cause growing resentment unless justly supplemented or replaced. Enactment of some legislative relief has become more emphatically imperative with each passing year.

\section*{C. Reasons for Specialized Treatment of the Problem}

Before proceeding to discuss the nature of possible legislative remedies and of the particular remedy actually afforded by Section 820, it is necessary to deal with a fundamental question hitherto put aside with tacit assumption of a favorable answer. What warrants specialized treatment of cases such as those which have been indicated? Mention of hardship and financial loss is unconvincing. The world at large, and the income-tax world in particular, are full of hardship and loss despite which it is deemed sound policy to enforce general rules inflexibly. Our Federal income-tax is already most intricate and every additional complexity demands clear affirmative justification. Indeed, the present modification occurs at a particularly sensitive spot in the administrative plan. Probably no informed person would deny the general desirability of a statute of limitations in connection with the Federal income-tax. The classical justifications for such laws apply well enough in this particular area. Speaking of possessory actions respecting real property, Blackstone says "there is a time of limitation settled, beyond which no man shall avail himself of the possession of himself or his ancestors, or take advantage of the wrongful possession of his adversary. For, if he be negligent for a long and unreasonable time, the law refuses afterwards to lend him any assistance, to recover the possession merely, both to punish his neglect \ldots{} and also because it is presumed that the supposed wrongdoer has in such a length of time procured a legal title, otherwise he would sooner have been sued."\textsuperscript{23} The great commentator does not here explain the reasons for the presumption, but suggests them at a later point, where he is talking about personal actions: "The use of these statutes of limitation is to preserve the peace of the kingdom, and to prevent those innumerable perjuries which might ensue, if a man were allowed to bring an action for any injury committed at any distance of time."\textsuperscript{24} Speaking more exactly of the Federal income-tax, we deem it self-manifest on the government side that without the aid of periods of limitation the Bureau of Internal Revenue might become so hopelessly involved in old contro-

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23. 3 Bl. Comm., c. X. \\
24. \textit{Id.}, c. XX.
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versics as to make its dealings with instant problems nowhere near current. On the taxpayers' side, statutes of limitation give at least rough assurance that demands for tax will usually not lag too far behind receipt of income from which payment may be made.

Now it is true that taxpayers, Bureau, and courts have with remarkable unanimity sought some modification of the rigidity of periods of limitation in the present connection. But even to a complaisant legislature mere general demand can furnish only an inadequate standard of action. Technical administrative provisions of tax laws should be soundly explicable; besides, legislation cannot be effective or even safe until the causes of demands for it have been explored to determine how far relief should be carried. Hence we examine critically the explanations officially offered for the action of Congress in passing Section 820. The House Subcommittee, already quoted, backed its recommendation by saying that existing rulings and decisions "often permit taxpayers or the Commissioner to obtain a two-fold advantage by assuming in one year a position different from that taken in another year with respect to which the period of limitations has expired, so that adjustment of the tax liability for the earlier year is impossible. The sole purpose of the statute of limitations is to prevent the litigation of stale claims. Its use to obtain a two-fold advantage, whether by double deduction or double taxation, is not in keeping with its fundamental purpose."{25}

This employment of the terms "two-fold" and "double" naturally suggests the necessity of special relief because unusually serious financial consequences are involved. The suggestion is fallacious. Assuming the same taxable gross income, it costs the government not one cent more to have a taxpayer (a) take a deduction twice, once erroneously and once correctly, than it does to have the same taxpayer (b) take a completely unauthorized deduction once and once only. Likewise, the taxpayer is no more deeply out of pocket for having (a) to include the same item in gross income, once erroneously and once correctly, in two taxable years, than for having (b) to include in one year alone an item not properly taxable at all. But no seasoned tax man would seriously propose special tinkering of the statute of limitations to relieve the victims of the (b) cases above.

The term "double" has another possible connotation, namely that of duplicity. This is suggested in the first part of the foregoing quotation from the Subcommittee report, and appears again in the Statement of the House Managers following the conference: "Under the income-tax laws it is possible for a taxpayer or the Commissioner, after operation of the statute of limitations or some other provision of the internal-revenue laws prevents correction of an error, to obtain a double advantage

by taking a position contradictory to that which caused the error.” 26 But the idea of misrepresentation, followed by something in the nature of an estoppel or reparation, will not explain nearly all the cases in which relief against the rigidity of the statute of limitations has been felt desirable. Sometimes, but only sometimes, it is determinative. We feel certain that some situations in which all the actors had behaved with entire frankness would give rise to loud demands for special amelioration. Imagine, for instance, that under a view of law honestly shared by taxpayer and Commissioner tax has been paid with respect to an item supposed to be income for an earlier year, the statute of limitations has closed that year against refund, the Supreme Court has unexpectedly announced a different rule controlling the situation, and under that rule a second tax has had to be exacted for a later year with respect to the same item. 27 If we wish a truly comprehensive justification for specialized provisions in this connection, we must look beyond notions of deception. Also, talk of duplicity inevitably involves some implication of bad moral tone. Surely it is no worse morally to take a deduction ahead of time in 1939 and again at the proper time in 1940, than to claim as a deduction in either year some expense or loss not covered by the deduction sections of the statute.

But “double” or “duplicate” does supply a significant clue to one explanation of the demand which gave rise to Section 820. In each of these “two-fold” cases concerning insertion of an item first in a closed year and second in an open year, the correspondence of issues and evidence as to both present and past eliminates the reasons behind provisions for periods of limitation. Stale claims are bad because the passage of time obscures the facts about them. Witnesses die, witnesses forget, other evidence is lost, the check on perjury disappears. They are bad because they force men who would defend against them to delve in the past and thus fall behind a progressing world. They are bad because, if sustained, they impose upon these men crippling liabilities. But as to categories of old claims not subject to these condemnations, the legislature may wisely make exceptions to the rules of limitation. 28

27. Bigelow v. Bowers, cited supra note 21, is not far from this situation, and the dissenter in the Circuit Court of Appeals plainly expressed his indignation. Consider also the long drawn out episode as to the placement of tax when a widow is beneficiary of a trust under her dead husband’s will, which episode culminated in Stone v. White, discussed supra, p. 4.
28. The importance of the considerations here suggested by our text deserves double emphasis. Much criticism of § 820 has been based on the sanctity of statutes of limitations. Thus Percy W. Phillips, an eminent practitioner: “But the fundamental error of this statute, as I see it, which requires that it should be repealed and a new start made rather than an attempt made to amend the section is the provision which requires that the statute of limitations be removed on years which are closed. That idea seems fundamentally wrong. Statutes of repose are necessary; business cannot be run without statutes of repose. They should not be removed nor enlarged after they have expired.” (1938) 16 TAX MAG. at 694. Has Mr. Phillips paused adequately to consider the funda-
It is possible to assert reasonably that we deal here with such a category, as examples easily demonstrate. If the Commissioner has for 1933 taxed an officer of a corporation on the ground that stock received by the officer from the corporation in that year was an item of compensation, and then in 1938, when the officer sells the stock, reverses himself by insisting that the stock was a gift to the officer, and refuses to allow the 1933 value as a basis, he has or ought to have the full facts in hand. Indeed, his very action seems an admission that he has reviewed the first tax and found it erroneous. On principle, he is in no position to meet the taxpayer's demand for some sort of adjustment or allowance as to that first payment with the reply that this means digging up long-buried dry bones or unduly interfering with the currency of tax administration. The antiquarian job, he necessarily asserts, has already been done, the adequate evidence collected and appraised. As to having funds to make the adjustment, the Commissioner proposes to put himself in pocket by the impending deficiency assessment. And so, of course, if some taxpayer deducts for a bad debt in his 1934 return and repeats the deduction in his 1938 return on the ground that he timed it wrongly to begin with, he has little excuse for whimpering about being made to pay up too late if the Commissioner seeks a deficiency for 1934. In neither of these situations can the litigant who has precipitated trouble by seizing an advantage in the open year appeal to any of the reasons underlying rules of limitations. He who seeks repose should practice it by letting sleeping dogs lie.

The specialized arguments just made for inapplicability of the ordinary rules of limitations apply, it will be observed, only where the party who takes the offensive is the one against whom, if he had remained passive, enforcement of the stale demand would have been prevented. Turn either case the other way about, and the consequences are entirely different. If the corporate officer finds that he will save money by getting back his tax for 1933 and taking a lower or zero basis for 1938, the Commissioner can conscientiously stand his ground on the statute of limitations and say: “I am not called upon to search old files, resurrect dead witnesses or try the hazy memory of forgetful ones, or spend the Bureau’s time and money over buried issues.” The taxpayer in the second case, assuming he has treated the deduction as over and done with when used in 1934, may properly respond likewise if the Bureau tries to force the deduction on him for 1938 and collect a deficiency by taking it away for 1934. These are neither more nor less than the “(b) cases” referred to on a previous page. Section 820 carefully respects this distinction by mental reasons for statutes of limitations, and the possibility that they may be inapplicable here? Our own respect for wise periods of limitations is, we hope, as great as his. But blind worship of a legal institution is very dangerous both to the community and to the institution itself. Injustice results when even the wisest doctrine is pressed beyond its proper application, and obstinate persistence in such excess may cause a damaging rebellion against the doctrine as a whole.

29. P. 8, supra.
refusing to open a closed year except for reversal of position by the party whom the closing would otherwise safeguard.

While we consider the fundamental reason for special legislation in the immediate connection to be the one just explained, some subsidiary considerations point toward the same conclusion. The courts rather often assert that a taxpayer who claims a deduction in a certain year, or even a taxpayer who fails to return a possible income item in a certain year, is making a representation as to the propriety of his getting the deduction or the impropriety of charging him with tax respecting the income for the particular fiscal period. Present judicial tendencies seem, as noted above, to be toward arguing thus only where a representation of "fact" can be found. But the idea can surely be enlarged to cover a representation as to the practical effect of a whole situation. If the Bureau accepts the return, it manifests reliance upon the representation as meaning in the first case that the claim of deduction will not be repeated or in the second that the income is to be returned for some other year. Whenever such a taxpayer repudiates or retracts his representation and, because limitations have closed the original year, succeeds in avoiding any sort of counterclaim or offset against the saving thus realized, he has put the statute of limitations to an unintended and improper use. It serves not merely as a shield to protect his passivity when threatened with a tardily asserted liability, but as part of his offensive apparatus in an active attempt to profit at the Treasury's expense. Whether this contention applies fully to a case in which the government has received and retained erroneously paid tax for an earlier year, and later seeks to enforce a technically correct tax respecting the same item in a later year, is by no means certain. Bearing in mind the great mass of cases which the Bureau must handle in any taxable year, it is at least excusable and perhaps essential that many really doubtful points should be passed over untested. That is, merely accepting a return and a check in payment of the indicated tax can scarcely be considered in every instance as a representation that all items have been scrutinized and finally approved. Here, however, it is necessary to remember that the taxpaying constituency will demand what seems to it symmetrical justice, and that advocacy of adjustment where a deduction has been twice claimed will cause indignant reaction unless it includes a corresponding possibility where income has been twice taxed.

The suggestion just offered about the impracticability of a complete annual official check-up of returns has, however, definite significance in

30. Pp. 5-6, supra.

31. The leading case of Dickerson v. Colgrove, 100 U. S. 578, 579, 580-581 (1880), involved defenses based upon both the statute of limitations and estoppel. Mr. Justice Swayne said that the court's "remarks will be confined to the point of estoppel . . . . It [estoppel] is available only for protection, and cannot be used as a weapon of assault . . . . It is akin to the principle involved in the limitation of actions, and does its work of justice and repose where the statute cannot be invoked."
another aspect. It is clear enough that successful administration of income-tax laws depends largely upon the government's ability to minimize the detective work required to discover concealed items. Further, successful administration is much more likely if the quantity of litigation can be held down. An unyielding statute of limitations, with risks of uncompensated second taxes on debatably-timed income, discourages frank, early disclosure of such income. Thus it tends to compel more governmental detective work, and of course it compels prompt litigation by taxpayers against whose claims administrative rulings are made. Administration should be easier with the backing of statutory assurance that, if first impressions are reversed in the light of later examination and experience, corrective adjustments extending to the entire transaction will become possible. Furthermore, this same assurance, operating with respect to debatably-timed deductions, would reduce the necessity of obstinate contests by the Commissioner in connection with the initial making of deduction claims.

Down to this point no explicit attempt has been made to justify on principle a special modification of the statute of limitations in cases where the proprietorship, instead of the proper timing, of income or deductions is in doubt. All the argument of the preceding paragraph clearly applies to such situations. As to the antecedent arguments, their application is also clear and easy whenever the government seeks two or several taxes from two or more taxpayers with respect to the same item of income, or successively denies to two or more taxpayers the benefit of a deduction which certainly belongs to one of the pair or group. The same sort of culpable retraction of a representation and of misuse of the statute of limitations can be found. But when the error is costly, instead of profitable, to the Commissioner and its rectification involves making taxpayer A render compensation for the success of taxpayer B, our problem has plainly become complicated by a new consideration. Why, to put the matter more specifically, should A be deprived of the normal benefit of the statute of limitations simply because he and a separate person B have both taken advantage of a deduction properly attributable to B alone? Where this description is complete, and no other relevant fact appears, we do not believe that a special modification of the principle of limitation of actions can be justified. Addition of other factors, though, may properly change the conclusion. For example, if A has put himself in a position of vicarious responsibility, as by concocting and executing with B a scheme to trick the government into a double allowance, it will not be hard to justify a device for stripping A of the statutory shelter and compelling him to set matters straight. So, too, where A is the beneficiary of B's success, as in trustee—life tenant cases. Upon these fundamental situations for exceptional treatment Section 820 has elaborated with the idea
of "related taxpayers". Whether this idea covers too much or too little ground is left for later discussion.

The recommendation of the Subcommittee quoted at the opening of this paper suggests that only the statute of limitations gives rise to the kind of controversy under discussion. In fact, several other provisions of the internal-revenue laws, and some more general principles of legislation or of judicial decision, such as res judicata, accomplish or appear to accomplish similar results. Examples derived from the internal-revenue laws include (a) the collateral effects of petitions to the Board of Tax Appeals in preventing further deficiency letters, or credits or refunds; (b) statutory closing agreements; (c) tax compromises; and (d) provisions barring voluntary, as distinguished from compelled, refunds or credits after the periods of limitations have expired. So far as the underlying reasons for existence of these restrictive provisions resemble the reasons underlying the ordinary action of the statute of limitations, the preceding discussion applies equally well to them. Where different reasons control or additional considerations color the picture, the conclusions as to modification of such statutory or common law provisions in the present connection may vary from those put forward above. Here again is a topic better postponed than treated fully at this point.

The conclusions from this particular part of our discussion are that there is justification for specialized legislative treatment of the types of controversies being considered, so far as each controversy involves but one taxpayer; that this justification extends within limits to such controversies involving two or more taxpayers; and that it also extends to a number of restrictive principles different from but allied with the statute of limitations. Our next and final preliminary task, before taking up in detail the content of Section 820, is to sketch in broad general terms the various possible lines or philosophies of legislative attack upon the problem which the section might have followed.

D. POSSIBLE GENERAL LINES OF LEGISLATIVE ATTACK UPON THE PROBLEM

Suppose taxpayer $A$ erroneously returns as income in 1933 a sum of $1,000 and pays for that year $150 more income-tax than if he had omitted the item. In 1938 the item actually becomes taxable, the Bureau discovers it, and $A$ is called upon to pay a consequent deficiency of $300 for 1938. Meanwhile, the statute of limitations has run against a refund for 1933. Rectification might be accomplished in any one of several ways:

32. See Regulations prescribed with respect to § 820, especially Art. 820(b)—0. Regulations 101, Appendix, T. D. 4856.
First, by application in the taxpayer's favor of a statutory estoppel theory which freezes the mistake into permanent acceptability. The result will be that by paying $150 for 1933, A escapes a liability of $300 for 1938. Even allowing for five years' interest (or discount), this result is calculated to make $A$ quite happy. It is calculated to sadden the Commissioner and the community, for $A$ has avoided paying his full share of the price of civilization. But if the tax figures are reversed—$300 for 1933 and $150 for 1938—and the same freezing principle applied, A will be very unhappy. To be sure, he escapes a double payment, but the tax paid in error greatly exceeds the theoretically correct tax. Yet the government retains the whole payment.

Second, by application in the taxpayer's favor of a theory of recoupment. In the case first put, he will have $150 plus interest applied to reduce the $300 deficiency, and will have to pay the remainder with new money. This result seems beyond criticism. It accurately carries out the tax obligation which Congress imposed upon $A$. Reverse the figures once more, however, and we get a result unsatisfactory to $A$ in precisely the same degree and for the same reasons as in the reversal under the estoppel theory.

Third, by application in the taxpayer's favor of a rule that this situation must be comprehensively adjusted so that $A$ will pay no more and no less than the theoretically correct amount of tax (and interest) respecting the contested item. Here, no matter in which order the smaller and larger tax payments are put, $A$ ends up by having paid exactly what is found to have been required by statute, and with respect to the right year. There has been no undeservedly lucky escape and no unlucky subjecting to disproportionate burden.

An additional factor may be made to affect the result under either the second or the third method. Change the original hypothesis by imagining that, although A's tax return for 1933 shows only an overpayment of $150 by inclusion of the doubtful item, he has failed to claim a loss of $1,500 properly deductible in the same return. Had this loss been claimed, his tax would have shrunk another $200. Should the taxable year 1933 be opened up completely, so that this second error is taken into account as well as the first? If the answer be affirmative, $A$ would, under the recoupment theory, pay nothing at all on the deficiency asserted for 1938; and under the third or accurate correction theory he would actually receive a net refund representing $50 plus interest, probably for somewhat more than five years, on his 1933 overpayment of $350.

Section 820 has in fact adopted the accurate correction method, and rejected consideration of the additional factor just described. Much of the adverse criticism by the American Bar Association's Standing Committee on Federal Taxation is directed toward both of these fundamental points. The Committee's report says that the method "proceeds on the
unreliable assumption that the Bureau of Internal Revenue, whenever it takes a position inconsistent with something it has done in an earlier year, is conscious of such inconsistency, and likewise that taxpayers are conscious of their inconsistencies”; and since “the new liability for the reopened year may involve a much larger sum in tax than was involved for the open year” the method “requires reaudits for years with which the Government Departments have finished.” Also: “By making it risky for a taxpayer to file claims for refund . . . it induces taxpayers to exercise the greatest care never to overpay—a state of mind which creates new and difficult problems for the taxation authorities.” Then, striking at the refusal by Congress completely to open the taxable year in which the foundation of the inconsistency was laid, “it may involve a much larger sum in tax as to the reopened year than would be indicated for that reopened year on a complete and correct recalculation as to that year.”

An appealing illustration for the last contention is: Taxpayer A for 1933 claims a deduction of $1,000 to which he will not legally be entitled until 1938; this reduces his taxable income to zero; therefore he does not take the trouble to claim another and immediately legitimate deduction of $500; for 1938 he again claims the $1,000 deduction; his inconsistency is discovered and he is subjected to a deficiency assessment for 1933 which discards his erroneously taken $1,000 deduction but gives him no benefit for the potentially valuable $500 deduction.

None of the foregoing criticisms seems to deny the theoretical soundness of the proposition that if erroneous treatment of an income item or a deduction is to be corrected, the correction should produce the same result as if the error had never been made. The contention seems to be that income-tax administration cannot be operated upon purely ideal hypotheses. Practical difficulties must have recognition. The suggestions of such difficulties made above amount to a collective assertion that inadequate protection is afforded by the rule, which Section 820 has adopted, of refusing to open a closed year unless the party who takes the offensive by claiming a deduction, seeking a refund, asserting a deficiency, or otherwise “is the one against whom, if he had remained passive, enforcement of the stale demand would have been prevented.” There is, says the Committee, too much risk that the inconsistent party will move in ignorance of his inconsistency and find himself trapped, at least unless he exercises inordinate pains to safeguard his steps.

Take first the counter-argument with respect to the government. Reaudits for closed years, which the Committee mentions as raising a problem, are necessary whenever the Bureau puts forward the familiar contention that a taxpayer is estopped by something he did in a year

33. Op. cit. supra note 3, at 106. The Committee makes its various points in an order somewhat different from that followed above.

34. See p. 10, supra.
now beyond reach of correction. The auditing problem has never, apparently, proved an insurmountable or even a serious barrier in such litigation. Requiring a reaudit of one or more earlier years to protect the government’s interests when a decision is being made about assertion of a deficiency involving items which may affect such years as well as the immediate year should commend itself to taxpayers, if such requirement be practicable. The Bureau is often criticized for attacking situations without first surveying them comprehensively, thus subjecting citizens to extended series of annoyances and demands which might have been consolidated. As to practicability, the Bureau replied affirmatively, while Section 820 was before Congress, when asked if it would be able to do the necessary reauditing. It seems possible that the perils to the Treasury outlined in the quoted passages are meant to give outward symmetry to an argument at bottom solely for the taxpayers’ interests.

Of course, if the argument is sound and just, it should be none the less acceptable because one-sided. But the Committee makes no specifications as to undue risk imposed upon taxpayers. Why is not $A$ in a dilemma if he claims a deduction for 1938 and, faced with evidence that he erroneously took the same deduction for 1933, answers that the situation should continue unrectified because he has forgotten all about 1933 or never knew of his claim with respect to that year? Either his affairs are simple, in which case forgetfulness or ignorance is unreasonable, or his affairs are complicated, in which case it is scarcely unjust to say that he or his lawyers or accountants should check over what has been done in past returns before claiming a benefit from the government in the present return. The Committee’s argument has not been cordially received by the courts or the Board of Tax Appeals in estoppel cases of this type.\(^{35}\) It seems even less convincing where basis in capital transactions is involved, for here the ascertaining of basis implies a search of the past, and conscientious men, making such search, do not come back with only the profitable facts, neglecting the unprofitable ones. We venture the assertion that if substantial numbers of double deduction cases and analogous basis cases were fully analyzed, it would be found that the ultimate inconsistent positions had generally been taken not because of ignorance but because of acute advice from lawyers or accountants who knew perfectly well the whole genesis and development of the situations. It is highly pertinent to reassert the taxpayer’s duty of reasonable care to the United States in making his income-tax returns, because that duty, adequately discharged, will nearly always warn him of self-inconsistency. Nor, it may be added, is correction of these inconsistency situations under the third method a matter of onerous and unjust penalty, even when there is exacted “a much larger sum in tax than was involved for the open year.” That sum represents simply an amount by which the tax-

\(^{35}\) Cf. note 8, supra.
payer concerned failed initially to bear his share of the common burden. The last assertion seems to be specially challenged by the Committee on the ground that Section 820 does not provide complete recomputation of tax for the reopened year. While the section was being shaped, precisely the reverse argument prevailed. In Lewis v. Reynolds, it will be remembered, a taxpayer to whom a certain deduction had been improperly denied was refused a refund because, after the running of the statute of limitations, the Commissioner discovered and relied upon an improper deduction taken with respect to the same tax, which improper deduction more than counterbalanced the one that should have been permitted. This principle, if inserted in Section 820, and enforced by ingenious and determined reauditing, might be employed to block most refunds unless taxpayers were willing to carry their litigation out of the Bureau and into the courts. Whether any such use would actually be made of the principle is rather beside the point. Many taxpayers, lawyers, and accountants would have thought the risk substantial enough to detract seriously from the merits of the legislation. The American Bar Association's Committee would scarcely have failed to take that side of the argument.

So far as the omission or mistreatment of other items in the reopened year is unconnected with the item involved in the inconsistency, the reasons for specialized modification of the statute of limitations do not extend to them. Hence on principle there is good ground for refusing to reopen as to such items. Of course this involves distinct departure from the concept that income-tax liability for each year is a unitary matter, not to be split into subordinate fractions. The Bar Association Committee, however, seems to us to speak soundly when it says: "Statutes of repose are based on such practical reasons that exceptions should be rare and should be closely limited in their effect." (Italics supplied.) Precisely this consideration justifies close limitation by the unusual procedure of splitting liability in the present unusual situation. So far as omission or mistreatment of items in the reopened year is connected with the item involved in the inconsistency, different considerations apply. One possible example has been given in the form of a deduction omitted because it seemed superfluous, as the original return for the reopened year disclosed no tax liability. Special provision might be made for such situations. It should be borne in mind, however, that they will ordinarily involve comparatively slight tax burdens because the operation of such deductions, if duly asserted, would as a rule be only to reduce or cancel liability for normal tax. Few individuals, surely, fail to report deductions

36. 284 U. S. 281 (1932).
as large as $4,000 and the requirements of corporation returns are such that this kind of omission will not occur. Then, too, reasonably careful individual taxpayers, working with Section 820 in mind, will not from now on make these omissions but will set out the whole story. Consequently the risk of any injustice from this cause will steadily decrease as old returns are finally disposed of, and is likely to be negligible with respect to situations relevant to tax returns made after the middle of 1938. Unless and until experience demonstrates otherwise, it would seem sound to avoid complicating this part of the Revenue Acts with a special protective clause. In weighing this conclusion, the reader should remember that the Commissioner will never be able to collect additional tax for a closed year under Section 820 except when inconsistent action on the taxpayer's side clears the way for reopening. He should also note that the foregoing remarks deal with other items, whether related or unrelated to the items directly involved in inconsistencies. They do not deal with computations based upon items, either singly or in the aggregate. Correction of the erroneous treatment of one item may have far-reaching consequences in diverse computations. That problem is discussed hereafter.

We regard as extremely important the effect of any tax provision upon the willingness of taxpayers to make payments without goading by the collecting authorities. It seems plain beyond argument that the Federal income-tax cannot continue to function successfully unless the bulk of the revenue receipts from it are paid in voluntarily. In a preceding section of this article the point is made that statutory assurance of correction in case of mistake will encourage voluntary tax payments. But the American Bar Association's Committee report asserts that the particular kind of assurance given by Section 820 will cause taxpayers to minimize their voluntary payments because of the risks involved in claims for refund that may conceivably disclose inconsistencies and open up remote years to damaging recomputations of tax.

Stated in these general terms the contention has a delusive suggestion of importance which rapidly fades out when concrete, practical terms are substituted. To begin with, most items involved in income-tax returns are clear both as to timing and proprietorship. By no reasonable flight of imagination can it be assumed that willingness to make due disclosure of, and pay tax with respect to, these items will decrease because corrective machinery exists exclusively applicable to items of an entirely different nature.

So far as doubtful items or plainly mishandled items are concerned, claims for refund create risk of the reopening of closed years in only two situations. First, a taxpayer who seeks a refund as to an open year by asserting a deduction not claimed in his original return for that year will run this risk if he has taken the deduction already for a year now
closed. But neither this situation, nor the analogous ones which may arise in basis cases or cases involving related taxpayers, can be thought of as having any bearing upon willingness to return income and pay tax correspondingly. Here, the corrective principle merely discourages the double use of subtractions from gross income which may not legitimately be used more than once. Second, a taxpayer who seeks a refund as to an open year by asserting that an income item included in his original return for that year really pertains to another year, now closed, will run the risk of reopening if he omitted the item from his return for the closed year. The analogous situation involving related taxpayers, in which a claim of refund by A may, if successful, have the effect of laying B open to a deficiency assessment, can raise a substantially identical problem if A is under a legal obligation, or considers himself under a moral obligation, to reimburse or exonerate B. When, as will usually be the case, A's responsibility is less than this, his reluctance to disclose the income item will also be less marked. Hence we can do full justice to the contention of the Committee report by discussing it in terms of a single taxpayer.

If a single taxpayer is not aware of the existence of Section 820, or has no suspicion that any income item with which he is dealing has been improperly omitted from his return for some closed year, he will of course have no greater incentive to suppress this item than would exist if Section 820 had never been enacted. If he becomes certain, either with or without legal advice, that the item pertains exclusively to a closed year, his conduct with or without Section 820 will be identical. Should he be an extremely sensitive man about income-tax liability, he will seek to correct the outlawed return; should he be a normal person, he will do nothing at all about disclosing the item. This statement must be understood as implying absence of fraud in connection with the old return. Otherwise that year will not be closed. If this hypothetical taxpayer, with or without legal advice, becomes reasonably doubtful as to whether the item pertains exclusively to a closed year, his natural action, entirely aside from Section 820, will be to withhold the item from his current return, thus paying no tax with respect to it unless the Bureau discovers the omission and a deficiency assessment results. Should he be too honorable or too timid to pursue this reticent course, it seems to us practically certain that he will act no less openly with Section 820 in the statute than without it. Let any lawyer test the general soundness of this analysis by considering what advice he would give a client who came to him with each of the varying shadings of the problem. If the analysis is sound, this particular criticism by the Committee has been quite completely evaporated.

Just as the willingness of taxpayers to make voluntary payments is a matter of the highest importance, so must it be essential to avoid profuse tax litigation, in the achievement of really satisfactory administration. One obvious shortcoming of the judicial “estoppel” remedy for the prob-
lem under discussion is that its application has required incessant litigation. Dozens of estoppel cases have been decided one way or the other during the past eight or ten years without attainment of anything like reasonable certitude. When possible statutory methods of relief are canvassed, one prime consideration must be that of reducing litigated controversy. The best way to cut down litigation is to abolish or lessen the incentive to do the things which lay bases for law suits. The adverse critics of Section 820 seem to assert that its fundamental theory tends to increase this incentive, and that other fundamental theories are therefore preferable.

Of course the action which causes law suits in the present connection is the taking of inconsistent positions on either the government's or the taxpayers' sides. Remedial theories which make inconsistency attractive or at least harmless would be likely in practice to continue the recent disputatious conditions. Remedial theories which make inconsistency impossible or costly would tend to change these conditions. Let us consider the theories one by one in the light of this thesis:

1. The theory of recoupment or set-off. Under this it will be remembered that when an item is twice taxed, the erroneous tax paid for the closed year is to be credited against the tax correctly exacted for the open year. Correspondingly, where a deduction has been twice used, the tax saving by its correct use for the open year is to be reduced by the saving resulting from its erroneous use for the closed year. This process produces a theoretically correct result only where the two taxes or the two savings are exactly equal (taking into account an allowance for

39. This seems to enlist the support of Mr. Phillips, already quoted in note 28 supra, although his terminology is different: "For myself, I believe that there is (a legislative solution). There will not be time to permit an exposition of the full idea, but if my memory serves me correctly, a draft of such an idea was proposed by Congress some ten years ago. At that time it died because Congress did not have the time to complete the draft in satisfactory form. The principle underlying that draft was one of equitable estoppel, applying equally to the taxpayer and to the government, making an adjustment in the open year which would correspond with the tax liability which was escaped, and adjusting the open year with respect to the tax liability which might have been but was not imposed during the closed year; at the same time not increasing the tax liability beyond that which would be equitable under a proper adjustment of the liability as between both years. The idea is very difficult to work out." (1938) 16 Tax Mag. 694. This reference seems to be to the proposal of Mr. Satterlee's committee in 1927, which reads: "Provided, That whenever the commissioner determines an additional tax for a taxable year, the effect of which determination is to decrease the tax for some other year or years, the refund or credit of which tax would be barred by limitation, such refund or credit, up to the amount of said additional tax, shall be allowed, notwithstanding such limitation: And provided further, That whenever the commissioner reduces the tax for a taxable year, the effect of which reduction is to increase the tax for some other year or years, the assessment or collection of which additional tax would be barred by limitation, such additional tax may be assessed and collected up to the amount of said reduction, notwithstanding such limitation." Hearings, supra note 2, at 544; cf. 535 and 548.
interest by reason of the time spread), or the tax or saving for the closed year is smaller than the tax or saving for the open year. When the tax or saving resulting from erroneous action for the closed year is larger than the correct tax or saving, the Commissioner in the first instance and the taxpayer in the second instance may retain the improper excess. In other words, under this theory inconsistency never results in any loss with respect to income-tax either to government or taxpayer. Since there is always a chance that inconsistency will pass undetected, or unredressed even to the limited extent permitted, the theory does not end the Commissioner's incentive to tax doubtfully-timed income twice or the taxpayer's incentive to claim doubtfully-timed deductions twice. And so, of course, in related taxpayer cases, where proprietorship instead of timing is the problem. Like any rule of "heads I win, tails we tie", the recoupment theory does not tend to decrease litigation.

2. The theory of recoupment or set-off modified by an application of the principle of Lewis v. Reynolds in favor of as well as against the taxpayer, and with respect to deficiencies as well as refunds. Perhaps a simpler way to state this theory is to say that the closed year shall be completely reopened, the tax for that year recomputed so as to correct all errors discoverable therein, and any relevant balance disclosed by this computation used for recoupment. The balance may fall the wrong way and, therefore, not be relevant. For example: For the year now closed the taxpayer erroneously took advantage of a deduction, which saved him $1,000; he also erroneously failed to claim another deduction, with the net result that he overpaid his tax; for the open year he correctly, but for a second time, claims the first deduction and saves $900 thereby; the inconsistency is detected and a correction sought; but, because a net overpayment (irrelevant for recoupment in the government's favor) appears when the closed year is completely reaudited, the taxpayer reaps the full benefit of his inconsistency. Suppose, to put things the other way around, the Commissioner had erroneously compelled the taxpayer to include for the closed year an income item which increased the tax $1,000; the Commissioner also erroneously failed to disallow a deduction for personal (not business) expense which saved the taxpayer $1,500; and for the open year the Commissioner correctly, but for the second time, insists upon including the income item and thus increases the tax by $750. The Commissioner, this time, will be able to reap the full benefit of his inconsistency, since the taxpayer cannot produce from the closed year a single cent for recoupment. Under this theory there is a most dangerous incentive to inconsistency and litigation because so far as the Bureau can dig out for use in connection with an open year an item of income subjected to untimely taxation for a closed year, it can with respect to that closed year at least partially resurrect tax liability as to erroneously omitted income items. In the converse situation, the taxpayer has a like golden
opportunity with respect to erroneously omitted deductions. Very likely these possibilities were among the considerations which moved Hugh Satterlee to say in 1927, when speaking to the Committee on Ways and Means about our general problem, that the Committee on Federal Taxation of the American Bar Association did not "think that simply because there is one change to be made in a return for a year, it should be given the effect of opening up the return for the previous year wide open." 40

3. The theory of correct adjustment—that is, the theory of Section 820—modified by a similar application of the principle of Lewis v. Reynolds. Under such a scheme the possibilities are just as alarming as under the scheme just described. Both these schemes obviously offer strong incentives to inconsistency and litigation whenever with respect to closed years ordinary erroneous omissions or inclusions can be revivified in collateral consequence of an attack on the timing or proprietorship of other items.

4. The theory which freezes the mistake permanently and which might be termed the estoppel notion carried over into statute, made to work both ways, and operated under less intricate requirements than those of judicial estoppel in pais. In broad terms this means that a taxpayer who takes the advantage of a deduction for one year under one theory of timing may not, after that year has closed, shift position and take advantage of the same deduction for another year under another theory; correspondingly, that the Commissioner, having accepted payment of tax with respect to an income item, is similarly bound. Sweepingly and rigidly applied, this discourages litigation with a vengeance by prohibiting inconsistency. It would operate to the benefit of designing taxpayers who, avoiding fraud and failure to file returns, chose the least expensive method of return despite possible incorrectness, with a hope that the year might be closed by limitations or otherwise before their method was questioned. Such an application of the estoppel notion really makes the limitation period for each year potentially a limitation period for some problems of other years. As the other years will usually be later ones, the result is highly anomalous. It demands vigilance and quickness of decision by the Bureau far beyond what has hitherto been necessary and probably beyond what is possible with the present personnel and scheme of administration. No such acute celerity has been required of the government in connection with judicial estoppels because these cannot be fastened upon the Treasury. The taxpayer, too, may have good reason to complain of specially abbreviated limitation periods. Suppose, for instance, that in compliance with existing judicial decision a deduction far exceeding gross income of 1935 is

40. Op. cit. supra note 2, at 535. Mr. Satterlee's remarks may, however, be read simply as an expression of preference for recoupment or set-off as contrasted with thoroughgoing correct adjustment.

claimed as a business expense for that year. In 1940 the Supreme Court reverses the earlier cases, and lays down the rule that such deductions must be prorated over a series of years, these years running in our particular case through 1945. So prorated, the deduction would be more valuable to the taxpayer than as applied in a lump to 1935. Yet, under the estoppel or freezing rule, he will be told that as to past years still generally open and even as to future years he may not have the benefit of the Supreme Court’s decision.\textsuperscript{42}

5. The actual theory of Section 820, which is the theory of correct adjustment uncomplicated by the principle of Lewis v. Reynolds. This rule, “by taking the profit out of inconsistency”\textsuperscript{43} removes the incentive of undue advantage which has obviously caused most inconsistency and most litigation in the past, and has given rise to most discontent with the old conditions. It does not further restrict the Treasury’s opportunity to detect and deal with income-tax returns in which items have been manipulated for the purpose of reducing tax rather than of complying with the law. At the same time, in cases such as the hypothetical situation described at the end of the last paragraph, this rule does not prevent matters from being completely straightened out. The American Bar Association’s Committee complains because such readjustments are possible even though the taxpayer has “negligently allowed the statute to expire against him.”\textsuperscript{44} If distinctions between the diligent and non-diligent were easily and surely made, a differentiation might be worded and added to the section. But of course such distinctions are neither easy nor certain of application. Congress can hardly be blamed for establishing a broad rule based on the view that it is wisest to permit the correction of clear injustices, accepting the risk that some comparatively undeserving persons may take advantage of the opening.

One further consideration should be touched upon with particular reference to the foregoing paragraphs 4 and 5. The Supreme Court has told us that it is a violation of due process to charge a husband with tax liability for his wife’s income, assuming that he has not in any fashion

\textsuperscript{42} The American Bar Association’s Committee of 1938 seems to favor estoppel. At least its report says that a statute of limitations “should be simple and understandable,” and talks about “the simple estoppel solution which has been attempted by some courts.” \textit{Supra} note 3, at 106. Contrast Paul (1938) 16 \textit{Tax Mag.} at 694 ("I do want to emphasize the seriousness of the subject, and I don’t believe that the cure can be effected through the operation of the estoppel principle. I tried myself to deal with estoppel one time and I ran into sixty or seventy pages on the subject, and I don’t believe we are going to be able to put that into a comprehensible statute.").

\textsuperscript{43} \textit{Report}, \textit{supra} note 37, at 49.

\textsuperscript{44} \textit{Supra} note 3, at 105. Such insistence upon due care is strikingly at variance with the Committee’s implied insistence in the very next page that taxpayers owe the Government no perceptible duty to be careful about taking identical deductions twice over. See pp. 16, 17 \textit{supra}. 
consented to being thus charged.45 For this reason it seems highly questionable whether the statutory estoppel doctrine of paragraph 4 can be invoked with respect to related taxpayers, except so far as there is a special agency relationship between them, as in cases of collusion to defeat the revenues, or when one of them is proprietor of the whole beneficial interest involved, as in *Stone v. White*. It has been suggested that forced application of the correct adjustment principle to related taxpayers would also be unconstitutional.46 While the issue is not beyond doubt, we believe this suggestion unsound. Statutes of limitation may be modified and amplified by particular exceptions, provided the modifications and exceptions are reasonable. The general notion of proper classification as not violating equal protection is relevant here, although the Fifth Amendment contains no explicit equal protection clause.47 Nor is it a violation of due process to revive a remedy by legislation passed after the statute of limitations has run against enforcement.48 So the application of the correct adjustment principle with respect to related taxpayers for years already past seems to present no peculiar difficulty. If these constitutional views are correct, and (as we contend hereafter) it is desirable to extend to related taxpayers whatever ameliorative doctrine Congress employs for the immediate purpose, the correct adjustment rule seems in this respect preferable to the statutory estoppel rule.

Our general conclusion on the problem of choosing one corrective principle rather than another as a basis of legislation is that the correct adjustment rule has perceptible theoretical and practical advantages over the other possible rules, and that the criticisms leveled against it are not convincing.

46. Mr. Phillips raised the point. (1938) 16 Tax Mag. at 694.
E. THE MECHANICS OF SECTION 820

With the above discussion of the theory underlying Section 820 as a background, we may proceed to a consideration of the mechanics of the section. The exposition will be intricate, because the Congressional device with which it deals is an elaborate one. This elaboration is intended to forestall any abuse of equitable possibilities which Congress has for the first time presented to taxpayers and the Treasury. It was obviously anticipated that Section 820 would by its very completeness discourage the kind of juggling which had become so unpleasant a feature of income tax administration where doubtful timing or proprietorship of income was encountered. Obviously the legislators realized that the section would be a liability rather than an asset if it were so frequently invoked as to increase the bulk of litigated controversies. Hence the reader should at all times consider the details of this legislation in the light of safeguards against and discouragements to litigation.

The basic conditions to the operation of the section are: (1) The case must fall within one of the categories specified in subsection (b); (2) there must be a “determination under the income tax laws” within the meaning of subsection (a)(1); (3) correction of the “error” by means of the normal procedure must be prevented; (4) an inconsistent position must have been asserted in the manner described in subsection (b); (5) the amount of the adjustment must be computed in accordance with subsection (d); (6) the adjustment must be made in the manner prescribed in subsections (c) and (e) and be with respect to a taxable year beginning on or after January 1, 1932. Consideration of the

49. The full text of § 820 is quoted in an Appendix, at p. 82. This section is now § 3801 of the INTERNAL REVENUE CODE. As this article was written prior to the adoption of the Code, no attempt has been made to alter the statutory references.

50. Subsection (f) imposes this requirement. No reasons are advanced in the Committee Reports for so limiting the operation of § 820. Apparently, it was thought inadvisable to allow the successful maintenance of a position inconsistent with the result reached in a previous year to produce an adjustment if the latter year were too far in the past, perhaps because the returns and other pertinent documents may have been lost, etc. The year 1932 was arbitrarily chosen as the dividing line. Since a party by refusing to take an inconsistent position, however, can prevent an adjustment for a closed year, the taxpayer, or the Commissioner, would thus be delving into the past only
initial condition—the types of cases in which relief is provided—is postponed to a later point; the other conditions will first be considered in detail.

1. Determination under the Income Tax Laws.

Section 820 is designed to offer relief where the tax results of an earlier year and a later year combine to present an inequitable burden or avoidance in the manner described in subsection (b). It would be impossible to ascertain whether the prescribed inequity exists until the tax result for the later year has become final, for an inequity resulting from a decision in a prior stage of consideration with respect to the tax for the later year may disappear upon final action. Consequently, Section 820 does not become operative until there has been a final determination with respect to the later year. Three types of such a determination are recognized in subsection (a)(1) defining the term "determination under the income tax laws"—a final court or Board of Tax Appeals decision, a closing agreement, and a final disposition by the Commissioner of a claim for refund. The designation of judicial action as providing the requisite determination requires no comment, except to note that in each particular case it is necessary to ascertain whether the decision, judgment, decree, or order has become final.51 The remaining two "determinations" relate to administrative action and their limited number is an interesting commentary on the extent to which finality is delayed under present tax procedure.52 Thus, the assertion of a deficiency in a 90-day letter does not mark a final step, as the taxpayer may appeal to the Board of Tax Appeals; even payment of the deficiency does not end the controversy, as a claim for refund may be filed within two years.

because he chose to do so by taking an inconsistent position, and consequently would not be in a position to protest against the inconveniences resulting from lapse of time. While the party claiming the adjustment might suffer on account of difficulties of proof, at least he is given an opportunity under § 820 to recover the amount of the adjustment where it can be established, whereas under the prior law no such opportunity was afforded. For these reasons the limitation of subsection (f) is inadvisable.

51. As the Regulations under this section indicate [Regulations 101, Appendix, T. D. 4856, Art. 820(a)-2], the date upon which a Board of Tax Appeals decision becomes final is prescribed in § 1005, Revenue Act of 1926, as amended. Since a variety of statutory provisions and court rules affect the question as to when a court decision becomes final, the Regulations merely state that while the date must in each case be determined upon the particular facts, ordinarily a decision of a lower court becomes final upon the expiration of the time for taking an appeal. Section 407(a), Revenue Act of 1938, in providing for a deficiency dividend credit, similarly rests upon a final Board decision, a final judgment in a suit to which the United States is a party, or a closing agreement to establish the deficiency. Under both §§ 820 and § 407(a), a final Board decision entered upon stipulation after settlement of the proceeding without the necessity of a hearing by the Board would satisfy the requirement of a final determination.

Consequently, neither the issuance of a notice of deficiency nor payment of tax is accepted by Section 820 as a final determination. The disposition by the Commissioner of a claim for refund, however, if acquiesced in by the taxpayer as respects the items as to which the disposition is unfavorable to him, is considered final action. As the taxpayer’s acquiescence must be evidenced by his failure to bring suit within the time allowed for instituting suit with respect to a denial of a refund claim, further action with respect to the tax liability is largely impossible and a definitive decision exists. Where the disposition with respect to an item favors the taxpayer, no waiting period is required and such disposition becomes final for the purposes of Section 820 upon the date of allowance of refund or credit, or upon the date of mailing notice of disallowance if the allowed items have been offset by other items advanced by the Commissioner. In accepting such a disposition as a final determination, the section disregards the right of the Commissioner to upset the determination by a successful suit for erroneous refund. Two reasons for such disregard may be advanced—the relative infrequency of suits for erroneous refund, and the fact that in the rare case where the determination is upset, the correct result may be reached under Section 820 through a second adjustment.

The complexity of the language designating the time when a disposition of a claim for refund becomes final results from the necessity of covering both the items with respect to which the taxpayer is seeking refund, as to which his contentions (the statutory term is “claim”) may be allowed or disallowed in whole or in part, and the items which the Commissioner is applying, either in partial or full reduction of those claims of the taxpayer which are allowed, or even to establish a deficiency. The statutory language utilized to solve this problem is based upon what

53. The date on which the schedule of overassessments is signed by the Commissioner is the date of allowance of refund or credit. Cf. § 1104, Revenue Act of 1932; MeEachern v. Rose, 302 U. S. 56 (1937); United States v. Wurts, 303 U. S. 414 (1938).

54. § 610, Revenue Act of 1928.

55. Thus, suppose the taxpayer failed to include an item of income in his return for 1935. He included the item in his return for 1936, but after the expiration of the period of limitations on assessments for 1935, filed a refund claim for 1936. The claim is allowed, and the Commissioner secures an adjustment for 1935, under subsection (b)(3). The Commissioner then files suit for erroneous refund with respect to the refund for 1935 and recovers such refund, as the item of income properly belongs in gross income for 1936. The taxpayer may then secure an adjustment for 1935, under subsection (b)(1), as an item of income has been included twice, once erroneously by reason of the previous adjustment under § 820 and a second time by reason of the court decision with respect to 1936. It may be observed that § 407(a) chose the other alternative and did not consider a disposition of a claim for refund as a final determination. See note 51, supra.

56. The Regulations under this section expressly provide for the varying combinations which may occur. Regulations 101, Appendix, T. D. 4856, Art. 820(a) 3.
may be termed the “item” aspect of tax liability. Thus, if a taxpayer files a refund claim for $5,000, this section requires a breakdown of that claim into the various “items” making up the total claim, e.g., a deduction for interest not claimed in the return, exclusion of dividend income erroneously included in the return, a credit for dependents not claimed in the return, etc. Each item, and the contention made with respect to it, is considered a separate matter for the purpose of this section, so that while the fate of the refund claim as a whole may be significant in ascertaining the time when the disposition of the contention with respect to an item becomes final, the section concerns itself primarily with that disposition. As a consequence, several determinations whose times of finality differ may result from action on a single refund claim. If the contention as to deduction for interest be allowed and the contentions as to the exclusion of dividend income and the credit for dependents disallowed, either in whole or in part, the former disposition becomes final on the date of allowance of refund or credit, while the latter disposition becomes final on the expiration of the time allowed the taxpayer for instituting suit. If the refund claim as a whole had been disallowed by reason of offsetting items applied by the Commissioner, as the failure to include rental income in the return, the disposition as to the allowed deduction for interest would become final upon the date of mailing notice of disallowance of the claim for refund; the disposition as to the remaining two contentions would become final as in the previous situation, on the expiration of the time allowed the taxpayer for instituting suit; the disposition as to the rental income would similarly become final at that time, unless such offsetting item resulted in a deficiency, in which case its finality would depend upon its future course.57

57. See Regulations 101, Appendix, T. D. 4856, Art. 820(a) -3(b)(iii), indicating that any difference in the extent of the deduction or in the computation of the overpayment which produces an amount less than the taxpayer’s claim with respect to the deduction constitutes a disallowance.

58. The phrase “items applied by the Commissioner in reduction of the refund or credit,” used in subsection (a) (1) (C)(ii), covers a reduction of the amount of the claims allowed down to and including zero, but does not extend to items whose application produces a minus result and consequently a deficiency. In the latter case, the deficiency is treated as is any other deficiency, i.e., it may eventuate in a determination by way of court or Board decision, closing agreement, or even disposition of claim for refund (where the deficiency is later paid and another claim for refund filed). In the former case the amount thereof was reduced by the offsetting items, is affected only as to the date of its finality by the question whether the offset produces a deficiency—if some refund or credit is allowed, the date is the date of allowance of refund or credit. If none is allowed, the date is the date of mailing notice of disallowance. See Statement of the House Managers, H. R. Rep. No. 2330, 75th Cong., 3d Sess. (1938) 57.
The other type of administrative action designated as a determination for the purposes of this section, a closing agreement,\(^59\) permits the parties at any time to dispense with the necessity of running the gamut of administrative procedure through to a disposition of a claim for refund, or of resorting to final judicial action, in order to obtain a determination. A taxpayer who desires to acquiesce in a deficiency letter and pay the tax need not, in order to secure a determination, pay such tax and then file a refund claim, or refuse to pay the tax and obtain a Board decision, but may telescope the entire procedure by entering into a closing agreement. Similarly, after a claim for refund has been denied, the necessity of waiting for the expiration of the two-year period provided in Section 3226 may be avoided by a closing agreement.\(^60\) Inasmuch as the party desiring a closing agreement is in effect offering to concede the issue with respect to the later year in order to secure an adjustment under Section 820 with respect to an earlier year, and as he could in any event force the issue for the later year eventually to a conclusion in the form of one or the other of the specified determinations,\(^61\) it is to be expected

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59. § 606, Revenue Act of 1928, as amended. A closing agreement becomes final on the date of its approval by the Secretary, Under Secretary, or an Assistant Secretary.

60. Regulations 101, Appendix, T. D. 4856, Art. 820(a)-1, state that a closing agreement may be used if "it becomes necessary or desirable to effect a determination in order to obtain or accelerate an adjustment authorized by section 820," and (Art. 820(a)-3), points out that the two-year waiting period provided in § 3226 may be avoided by the use of a closing agreement. A Commissioner's Mimeograph with respect to closing agreements, No. 4821, August 19, 1938, states that "a closing agreement should be executed and submitted for approval whenever such action is deemed appropriate under the provisions of section 407 or section 820 of the Revenue Act of 1938." Cf. Regulations 101, Appendix T. D. 4855.

It has been contended [see note 98, infra] that § 820 is an open invitation to litigation as the taxpayer, in order to be in a position to obtain an adjustment, must litigate to a finish the controversy for the open year. This criticism plainly overlooks the specification of a closing agreement as a determination, and the fact that through such agreement the parties may avoid all litigation for the open year.

61. Thus, if the taxpayer erroneously includes an item in gross income for 1935 and, after the expiration of the period of limitations for refund claims for 1935, the Commissioner asserts a deficiency because of the failure to include the item in gross income for 1938, the taxpayer in requesting a closing agreement for 1938 on the basis of the inclusion of the item in gross income is thus conceding the deficiency. If the Commissioner, in order to prevent an adjustment under § 820, refuses the closing agreement, the taxpayer can refuse to pay the deficiency, and litigate the issue in the Board, or pay the deficiency and file a refund claim, obtaining a determination in either event. As a closing agreement need not relate to the total tax liability for a particular year but may concern itself with one or more separate items affecting that tax liability (Form 906), the closing agreement for the purposes of § 820 need not be impeded by the desire of either party to avoid entering into a closing agreement with respect to the total tax liability. Cf. Regulations 101, Appendix, T. D. 4856, Art. 820(a)-1; Commissioner's Mimeograph No. 4821, August 19, 1938.
that closing agreements for the purpose of the section will be employed frequently.\textsuperscript{62}

2. Prevention of the Correction of the Error.

An adjustment under Section 820 is authorized only if correction of the effect of the error under normal procedure is impossible on the date the determination becomes final,\textsuperscript{63} so that if correction may be accomplished under other sections of the internal revenue laws, Section 820 is inoperative. Section 820, accordingly, does not prescribe an exclusive method for correcting errors.\textsuperscript{64} For example, if an interest deduction were erroneously allowed for 1934 and again taken for 1936, and at the time the determination authorizing the allowance for 1936 became final, the period of limitations with respect to assessments for 1934 had not expired, Section 820 would not be applicable inasmuch as the Commissioner could correct the error by asserting a deficiency for 1934.\textsuperscript{65}

\textsuperscript{62} Under Secretary Magill, in approving the Regulations under § 820, stated that “closing agreements would be entered into wherever necessary to effect an adjustment under the section.” Treasury Press Release No. 14-38, 383 C. C. H. 1938 Fed. Tax Serv. ¶ 6502. This announcement, together with the statements quoted in note 60 supra, should allay taxpayers’ fears, based on prior experience with closing agreements, that such agreements will not be forthcoming from the Bureau for the purposes of § 820. The necessity, from the taxpayer’s side, for assurance that such agreements will be entered into derives in part from the Bureau practice of closing settlements by a special form 870 waiver, under which the taxpayer, in addition to waiving his right to petition to the Board, also waives his right to file a refund claim. See Baldwin v. Higgins, 383 C. C. H. 1938 Fed. Tax Serv. ¶ 6093 (S. D. N. Y. 1937). Such a specialized waiver would prevent the taxpayer from obtaining a determination through either route, so that a determination by way of closing agreement is his only method of securing an adjustment under § 820. The Commissioner’s Mimeograph, referred to in note 60 supra, indicates that a form 906 closing agreement may be used along with the waiver in these cases.

\textsuperscript{63} The terminology in subsection (b), “on the date the determination becomes final,” was not well chosen, inasmuch as “determination” in subsection (a) (1) is defined in terms of a final determination: \textit{e.g.}, a decision “which has become final,” a “final disposition” of a claim for refund, a closing agreement (as § 606 of the \textit{Revenue Act of 1928}, as amended, provides that if an agreement is approved, such agreement shall be final and subsection (a) (1) in effect refers to an approved agreement). Consequently, when the action forming the basis for the determination becomes final, a determination results, so that it is tautological to say that a determination becomes final. In a later part of subsection (b), the phrase “time of the determination,” and in subsection (c), the phrase “date of the determination,” are used to connote the same point of time as the phrase “on the date the determination becomes final”; Regulations 101, Appendix, T. D. 4856, Art. 820(b)-0, use the phrase “date of the determination.” Moreover, the phraseology in subsection (a) (1), “The term ‘determination under the income tax laws’ means,” is also not well chosen as that phrase appears only at the beginning of subsection (b), whereas elsewhere only the word “determination” is used. The term “determination” alone should have been defined in subsection (a) (1). The Regulations throughout use only the word “determination.”


\textsuperscript{65} In the example in the text, if the period of limitations with respect to deficiency assessments for 1934 had expired, but the taxpayer had obtained the deduction for 1934
Section 820 is not confined to statute of limitations cases, although they will undoubtedly form the largest group of cases in which it will be involved. Although the period of limitations may not have expired with respect to the earlier year, the taxpayer and the Commissioner may have entered into a closing agreement with respect to the tax liability for that year, which agreement, under Section 606 of the Revenue Act of 1928, as amended, would prevent correction of any error for that year. Section 820 thus adds the successful maintenance of an inconsistent position to the fraud, malfeasance, or misrepresentation of a material fact which render vulnerable a closing agreement. While at first thought such an inroad upon the finality of closing agreements may seem undesirable, it will be recognized that a party seeking shelter behind a closing agreement for the earlier year at the time he asserts an inconsistent position in the later year is in reality making use of that agreement in a manner no different from the conduct thought undesirable where the statute of limitations is the protective shield. The finality which

by way of refund and such refund at the time the determination became final could be recovered by a suit for erroneous refund, § 820 would not be operative; while one method of correcting the error is prevented, another avenue is open and correction of the effect of the error is therefore not prevented. This argument stresses the word "prevented" in the phrase "correction of the effect of the error is prevented by the operation . . . of any provision of the internal-revenue laws" and assumes that the word "any" was used merely to indicate that not all of the provisions barring correction had to be operative, i.e., both the expiration of the statute of limitations and a closing agreement were not required, if the operation of one alone resulted in the closing of all methods of correction.


67. Section 606 of the Revenue Act of 1928 in its original as well as its amended form expressly provides for the finality of closing agreements; endowed with this quality, such agreements constitute by virtue of the internal revenue laws a bar to the correction of errors. It is specious to regard the bar as arising simultaneously from the principles of the law of contracts and to argue accordingly that § 820 removes only the bar of the statute but not that of contract law. The binding effect of a closing agreement arises from the authority granted under § 606. The particularity with which that section defines the formalities, scope and effect of closing agreements is clear evidence that it contains within itself the complete law governing such agreements. In any event the reports of the Congressional Committees [see Report of the Senate Committee on Finance, supra note 64, at 56] leave no room for doubting that Congress intended that adjustments should be made under § 820 in these cases and that it considered the bar of a closing agreement as arising from the operation of a provision of the internal revenue laws. Where an adjustment would operate to the detriment of the taxpayer and the barrier to correction of the error is a closing agreement executed prior to the effective date of § 820, it may be argued that the binding force of the agreement cannot be impaired without violation of the due process clause of the Fifth Amendment. Cf. Choate v. Trapp, 224 U. S. 665 (1911). Only by virtue of the taxpayer's own inconsistent conduct would the closing agreement be affected by § 820, which seeks to hold the parties to the positions taken and prohibits an inequitable use of the agreement. Certainly that section lacks the unreasonable, arbitrary and whimsical characteristics that usually must be present to find an act of Congress in violation of due process.
the closing agreement sought with respect to the treatment of the items making up the tax liability has not resulted; as one party has in effect departed from the agreement by again utilizing one of the items to obtain a tax advantage in a later year, the other party is entitled to avail himself of such departure to correct the error. 68 Sections 607, 608, and 609 of Revenue Act of 1928, relating to payments, refunds or credits after the period of limitation has expired, likewise constitute obstructions to the correction of errors. 69 Sections 272(f) and 322(c) of the Revenue Act of 1938, and corresponding provisions of the earlier Revenue Acts, prohibit deficiency letters or credits or refunds after the taxpayer has duly filed a petition with the Board of Tax Appeals. Here again provisions of the internal revenue laws prevent the correction of errors. In the cases in which such sections would apply, the doctrine of res judicata, 70 including the doctrine with respect to split causes of action, may also operate as a bar to correction. Under these circumstances there may be uncertainty as to whether or not an adjustment could be made under Section 820. Because of its bearing upon the operation of Sections 272(f) and 322(c) and because it may constitute the only bar to the correction of errors that does not arise from the operation of a provision of the internal revenue laws, res judicata must be considered in some detail in its relation to Section 820.

Where the same right or fact is placed in issue and directly adjudicated and is again at issue between the same parties or their privies in a subsequent suit, it is well established 71 that the first determination concerning

68. See Report of the Senate Committee on Finance, supra note 64, at 49.

69. These provisions were recently applied by the Supreme Court in McEachern v. Rose, 302 U. S. 56 (1937). The decedent had sold stocks and elected to return the profit on the installment basis. After his death in 1928, his administrator erroneously reported annually a profit on each yearly payment and then brought suit for overpayments of income tax for 1929, 1930, and 1931. Under §44(d), REVENUE ACT OF 1928, the capital gain included in the value of the unpaid installments was income taxable to the decedent for 1928. While collection of the unpaid tax for 1928 was barred, as it exceeded the sum of the overpayments for 1929, 1930, and 1931 the collector contended that the administrator could not recover. The Court held that, while equitable principles might preclude recovery in the absence of statutory provisions to the contrary, §§ 607 and 609(a), REVENUE ACT OF 1928, made void a credit against a barred liability, and consequently the overpayments could not be credited against the unpaid 1928 tax. See discussion of this case in Traynor, Tax Decisions of the Supreme Court, 1937 Term (1938) 33 ILL. L. REV. 371; Comment (1939) 52 HARV. L. REV. 496. Section 820 would authorize adjustment under these circumstances, assuming that it could be said that the relationship of decedent and decedent's estate existed with respect to the year as to which the error was made. See note 186, infra.

70. See the excellent discussions of this subject in Griswold, Res Judicata in Federal Tax Cases (1937) 46 YALE L. J. 1320 and Paul, Selected Studies in Federal Taxation (2d Series 1938) 104 et seq.

that right or fact is conclusive upon the parties and their privies with respect to the same or a different taxable year. The doctrine of res judicata does not stop there but goes on to embrace the rule against splitting causes of action. If the right or fact involved in the subsequent suit might have been put in issue to sustain the claim or demand involved in the previous suit, the previous judgment concludes the parties and their privies as to this fact or right as well as to those which actually were put in issue. In a federal income tax case the cause of action is ordinarily the tax liability of the taxpayer for a particular year; matters which are or might be put in issue to sustain or defeat that action must be presented at that time for consideration for they cannot be raised again in a subsequent action relating to the same year. 

"Whether the second suit involves an income tax on the same year's income, or an estate tax on the same estate, the courts quite consistently hold that a cause of action cannot be split up and litigated in separate parts."

It should be observed at the outset that res judicata may prevent the successful maintenance of an inconsistent position—the sine qua non of an adjustment under Section 820. If, for example, the inclusion of an item of income in a particular year were governed by res judicata because it had already been in issue and adjudicated, the defense of res judicata, if established, would prevent its inclusion in a later year and there would be no occasion for Section 820 to operate. If, however, res judicata were not relied upon, even though it might well have been,

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72. For example, the taxpayer received a dividend, and there was a controversy as to whether he received it in 1932 or 1933. The Commissioner won either a Board of Tax Appeals or court decision holding that it was received in 1932. After the judgment has become final the Commissioner attempts to include the dividend in gross income for 1933, the correct year, using the deficiency machinery for this purpose. Res judicata will block this move.

73. For example, the taxpayer received in 1932 a stock dividend of common on preferred in the sum of $10,000. He returned the dividend as taxable income for 1932. Later he sought a refund because he had included in his gross income for 1932 compensation paid him by a State for special legal services. He wins this refund by a district court judgment but does not raise, at any time in the progress of the case, the overpayment resulting from the inclusion of the stock dividend. Res judicata will bar subsequent recovery on a suit for that overpayment as the judgment in the suit on the compensation adjudicated the tax liability for 1932.

74. Griswold, supra note 70, at 1328-9.

75. Thus, in the example in note 72 supra, while there is a determination with respect to the year 1933, that determination, as a consequence of res judicata, prevents the inclusion of an item previously included for 1932, and the case therefore does not fall within subsection (b) (1).

76. "Very little attention has been paid to the question whether a prior judgment claimed to be conclusive must be pleaded, offered in evidence, or whether it may be the subject of judicial notice. One court has determined that it will take judicial notice of its own records for the purpose of res judicata [Bowe-Burke Mining Co. v. Willcuts, 45 F. (2d) 394 (D. Minn. 1930)] and the Board has taken judicial notice of a prior decision 'under the circumstances' [Woodley Petroleum Co. v. Commissioner, 16 B. T. A. 253
and a determination were obtained under which the item was again included in gross income, res judicata would then present a serious obstacle to the effective operation of Section 820. If the determination were obtained by way of a closing agreement or final disposition of a claim for refund (as distinguished from judicial action), it could not be established, in view of the decision, that the item was erroneously treated in the earlier year. If the determination again including the item were obtained by way of a final decision of the Board of Tax Appeals or of a court of competent jurisdiction, this second decision would control if the question again arose and would establish that the item was erroneously treated in the earlier year, but it would not impeach the earlier judgment insofar as the purpose of the proceeding in which the prior judgment was rendered is concerned, i.e., the determination of tax liability for the year with respect to which it was rendered. That liability being fixed by res judicata, correction of the error would be prevented and an adjustment would be made under Section 820 if such prevention arises from the operation of a provision of the internal revenue laws, a problem subsequently considered.

Res judicata in its aspect of forbidding the splitting of a cause of action cannot prevent the successful maintenance of an inconsistent position. The year with respect to which the determination may be sought is a different year from that of the previous adjudication, so that a different cause of action is involved. The split cause of action rule becomes applicable, however, after the determination with respect to an item in a later year, whenever an effort is made to correct the erroneous treatment of that item for the year affected by the previous adjudication with respect to other matters for that year. As the previous judgment

(1929)]. The Supreme Court has recently passed over the question of the exact form and time in which res judicata must be presented. [Blair v. Commissioner, 57 Sup. Ct. 330, 331-32 (U. S. 1937)]." Griswold, supra note 70, at 1339.

77. Donald v. J. J. White Lumber Company, 68 F. (2d) 441 (C. C. A. 5th, 1934) and cases cited therein at page 442.

78. See Freeman on Judgments (5th ed. 1925) 1327, § 629. The opposing contention is that the second decision has become the controlling judgment, completely displacing the first decision and therefore wiping out altogether the possibility of claiming res judicata on the basis of that decision.

79. Thus, in the example in note 73 supra, suppose that the taxpayer in 1938 sold the dividend stock and claimed $10,000 as its basis. As a different cause of action is involved, the tax liability for 1938, and as the treatment of the stock dividend was not in issue in the cause of action with respect to 1932, the taxpayer obviously cannot rely on res judicata when the Commissioner claims a deficiency for 1938 on the ground the stock had a zero basis.

80. Thus, in the example in note 79 supra, after the determination that the stock has a zero basis, indicating thereby the erroneous treatment of the dividend upon receipt in 1932, the fact that the suit on the compensation adjudicated the taxpayer's liability for 1932 would bar correction of such error.
could not be affected by the determination, even where the latter is in the form of a court or Board decision, the former would prevent any further adjudication with respect to the tax liability of the previous year and consequently would bar correction of the error. The problem is therefore squarely presented, in any attempt to secure an adjustment under Section 820, whether the barrier to correction of the error thus created by res judicata arises from the operation of a provision of the internal revenue laws.

In the case of court decisions equally plausible arguments may be advanced for the proposition that res judicata arises independently of any provision of the internal revenue laws and for the proposition that it arises from the operation of such laws. In support of the former it may be urged that res judicata is a doctrine inherent in the judicial process owing neither its origin, scope nor force to any provision of the internal revenue laws. In support of the latter it may be urged that the judicial process with respect to internal revenue taxes is very closely linked with provisions of the internal revenue laws and that court decisions are rendered in income tax cases pursuant to the authorization and limitations prescribed in such provisions. While they do not ex-

81. See Freeman, loc. cit. supra note 78.

82. The Tucker Act, 24 St. 505 (1887), 28 U. S. C. § 41(20) (1934) grants authority to sue the United States in the District Courts upon claims founded upon "any law of Congress," interpreted to authorize suits for the recovery of internal revenue taxes [Greenport Basin Construction Co. v. United States, 260 U. S. 312 (1923)], and expressly provides for recovery of sums wrongfully collected "under the internal revenue laws" even if the claim exceeds $10,000 when the collector is dead or out of office. Another act gives the right to sue in the Court of Claims [10 Stat. 312 (1855), 28 U. S. C. § 250(1) (1934)] upon claims founded upon any law of Congress, interpreted to authorize suits for claims which may arise under the internal revenue laws. United States v. Savings Bank, 104 U. S. 728 (1881). While suits against collectors for the recovery of internal revenue taxes are personal [Sage v. United States, 250 U. S. 33 (1919)] they are authorized by acts of Congress. See George Moore Ice Cream Co. v. Rose, 289 U. S. 373, 380 (1933), and cases there cited. Rev. Stat. § 3148 [26 U. S. C. § 1544(b) (1934)] provides that "each collector shall in every respect, be responsible both to the United States and to individuals, as the case may be, for all moneys collected, and for every act done or neglected to be done, by any of his deputies while acting as such." Rev. Stat. § 771 [28 U. S. C. § 485 (1934)] imposes the duty upon district attorneys to defend suits against collectors for the recovery of internal revenue taxes and Rev. Stat. § 989 [28 U. S. C. § 842 (1934)] authorizes the payment by the United States of a judgment against a collector where there was probable cause for his act or where he acted under the directions of a proper superior officer, and prohibits the issuance of execution against him in such cases. Even if some of the provisions cited in this note were held not to be provisions of the internal revenue laws, despite their authorizing or determining the scope and effect of suits for the recovery of internal revenue taxes, there can be no doubt that Rev. Stat. § 3148 supra, is a provision of the internal revenue laws. Nor can there be any doubt that Rev. Stat. § 3226, supra, is a provision of the internal revenue laws, governing all suits for the recovery of internal revenue taxes, including suits against collectors. Tucker v. Alexander, 275 U. S. 228 (1927). It should be noted that the Revenue Act of 1924, § 1014, amending Rev. Stat. § 3226, supra, to provide that pay-
pressly provide for the doctrine of res judicata, they set in motion the judicial process with all the trappings of judicial doctrines. When one of these doctrines is the finality of court decisions rendered pursuant to a statutory provision, it is difficult to determine where the operation of the statute ends and that of the doctrine begins. The existence of the doctrine antedates that of the statutory provision, yet the provision is necessary to animate the doctrine for the particular situation which the provision controls. Any provision authorizing judicial determinations inevitably operates to bring into action judicial doctrines involved in that procedure. Section 820 authorizes an adjustment whenever correction would otherwise be prevented not simply by the express language of any provision of the internal revenue laws but by its "operation." Hence it could plausibly apply when the correction is barred by res judicata.

New considerations arise when correction of an error is prevented by the conclusive effect of a Board of Tax Appeals decision. Whatever the rule may be with respect to decisions of the courts, which are part of the judicial structure and have internal revenue tax cases within the ambit of their general jurisdiction, the Board of Tax Appeals is an integral part of the internal revenue tax structure designed exclusively for the consideration of internal revenue taxes. It seems well established that a decision of the Board under the Revenue Act of 1924 is not res judicata in subsequent controversies. It seems equally settled that decisions of the Board of Tax Appeals under the Revenue Act of 1926 and subsequent Acts are conclusive, both as to a later case involving the same tax year and as to a later case involving the same issues arising in a different tax year. The basis for the change after 1926 is found

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83. Usually where there is a court decision with respect to the year as to which the error was made the period of limitations will have expired with respect to refunds or deficiencies for such year. In such cases there will be a provision of the internal revenue laws, operating independently of res judicata, to prevent correction of errors. Section 820 directs that "the effect of the error shall be corrected" by an adjustment under that section if, "on the date the determination becomes final, correction of the effect of the error is prevented by the operation of any provision of the internal revenue laws." It contains no yielding proviso as to other bars that may prevent correction of errors. It is arguable that, under the literal wording of the section, the existence of a provision of the internal revenue laws operating as a bar suffices and makes operative the mandate of § 820 that the error "shall be corrected," overriding ipso facto res judicata as well as any other impediment. See, however, the interpretation of this phrase discussed in note 65, supra.

84. See Griswold, supra note 70, at 1323, and cases cited therein at notes 20, 21 and 23.

85. See Griswold, supra note 70, at 1325, and cases cited therein at notes 30, 31, 32 and 33.
in the provisions of the Revenue Act of 1926 enlarging the jurisdiction of
the Board. Since 1926 "the Board of Tax Appeals, while not a court . . .
has by statute been endowed with capacity to render decisions final and
binding on both Commissioner and taxpayer unless reversed on appeal." 86
The Board has been so endowed by provisions of the internal revenue
laws. It is believed, therefore, that an adjustment must be made under
Section 820 when correction of errors is prevented by the operation of
Sections 272(f) and 322(c). These sections provide expressly for the
split cause of action rule in the case of Board decisions and seem
definitely designed to occupy the whole field in this respect. Whatever
question there may be as to whether the bar of res judicata in its split
cause of action aspect arises from the operation of provisions of the
internal revenue laws in the case of court decisions, there can be none
here where provisions of the internal revenue laws expressly provide for
the application of that doctrine. 87 Certainly it is evident from the Com-
mittee Reports that Congress intended Section 820 to apply where cor-
rection of errors was prevented by the operation of Sections 272(f)
and 322(c). 88 While the application of Section 820 may be clouded by
doubts where res judicata involves a court decision, it would seem to
be beyond question in the case of a Board decision.

If the bar of res judicata can be maintained against the application
of Section 820, therefore, it will be only because of the fortuitous choice
of the tribunal rendering the judgment constituting the bar. The Com-
missioner has no way of controlling which course the taxpayer will fol-
low in initiating litigation. Should the latter elect to conduct the action
in the courts rather than the Board, the Commissioner would be forever
precluded from correcting any errors which might later appear to have
occurred with reference to the year affected by the judgment. A tax-
payer who found himself in doubt about the deductibility of a particular
item claimed in his return might contemplate a later change of position
with regard to this item. Under such circumstances he would find it
greatly to his advantage to conduct any litigation concerning an un-
related item of the same return in the courts rather than before the
Board so as to preclude the application of Section 820 by the Commis-
sioner in the event of a subsequent change of position.

86. American S. S. Co. v. Wickwire Spencer Steel Co., 8 F. Supp. 562, 566 (S. D.
N. Y. 1934).
87. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-0, list §§272(f) and 322(c)
as provisions of the internal revenue laws preventing the correction of errors. Art.
820(b)-1, Example 2, and Art. 820(b)-2, Example 2 indicate that adjustments would be
made where §§272(f) and 322(c) were applicable.
88. See Report of Senate Committee on Finance, supra note 64, at 50; Statement
of the House Managers, op. cit. supra note 58, at 56. The Senate Committee referred
to §§272(f) and 322(c) as the "collateral consequences of a board of tax appeals pro-
ceeding."
Conversely, situations might arise where the taxpayer would be at a disadvantage because he could not invoke the application of Section 820 in his particular case. Whenever litigation had been initiated before the enactment of the Revenue Act of 1938, the availability of Section 820 to the taxpayer would depend upon the manner in which that litigation was conducted. The taxpayer not being able to foresee the result might unwittingly have precluded himself from obtaining the benefits of Section 820. Even with regard to litigation initiated subsequent to the enactment of the Revenue Act of 1938 he might similarly place himself at a disadvantage, because of an unawareness of the effect of res judicata upon Section 820 or because other considerations controlled the choice of the tribunal.

Certainly Section 820 did not contemplate anomalous consequences. It is unlikely therefore that it will receive a judicial interpretation creating such an eccentric obstruction to the accomplishment of its objectives. All the reasons for the enactment of Section 820 to supplement "the equitable principles applied by the courts" by "taking the profit out of inconsistency" despite the bar of the statute of limitations, of closing agreements and of the "collateral consequences" of a Board decision apply with full force to the collateral consequences of court decisions. The doubts on this matter, however, might well be removed by an amendment to Section 820 eliminating "by the operation of any provision of the internal revenue laws." The section would then clearly require an adjustment whenever correction of the effect of errors was prevented regardless of the sources of the prevention. It should be noted that such an amendment would disturb the conclusive force of res judicata where proper treatment of the item in question had been in issue and adjudicated only, as pointed out above, in the rare instance of inconsistent Board or court decisions arising from the failure to rely upon res judicata in the later proceeding. If a determination other than by court or Board decision were obtained sanctioning inconsistent conduct, no adjustment could be made under Section 820 as by its terms an adjustment is possible only in the event of an earlier erroneous treatment of the item and the adjudication would conclusively establish that the item had not been previously erroneously treated.

Section 820 is operative even though the correction of the effect of the error was prevented prior to the enactment of the Revenue Act of 1938, for subsection (b) refers to the operation of any provision of the internal revenue laws, "whether before, on, or after the date of enactment of this Act," and is thus in a sense a retroactive section. But although the barrier preventing correction may have existed at the time of the passage of the Revenue Act of 1938, as where the error was made with respect to the year 1932 and the period of limitations for that year had expired prior to 1938, the section is not operative unless
there is inconsistent conduct after the enactment of the section, so that
the retroactive application of the section is entirely in the control of
the party who is protected by the expiration of the period of limitations.
In this sense the section is prospective in operation.89

As in many instances more than one of the provisions mentioned above
may prevent correction of the error, Section 820 lifts all the barriers,
with the exception of a compromise, to such correction. This is true
even where at the time the determination becomes final only one barrier
is present but thereafter other barriers appear, as where at such time
the expiration of the period of limitations with respect to the earlier year
prevents correction and one week later a final Board decision would also
prevent correction under Section 272(f). If the prerequisite of a barrier
closing all methods of correction at the time the determination becomes
final is satisfied, the mandatory language of the section—"then the effect
of the error shall be corrected by an adjustment made under this section"
—suffices to override other barriers that may spring up to prevent cor-
rection, for otherwise the section would defeat its purpose.90 The method
of adjustment prescribed by the section, however, permits the prevention
of adjustment by such barriers as may arise from inept conduct in pur-
suing such method, as where the Commissioner fails to mail a deficiency
letter within the time prescribed in subsection (c). Finally, the barrier
of Section 3229 of the Revised Statutes, relating to compromises, is
not lifted by Section 820.91

89. Where the inconsistent position was asserted prior to the enactment of § 820, as
the section provided in subsection (a)(1) for a ninety-day waiting period in which either
taxpayer or Commissioner might withdraw from a previously asserted inconsistent posi-
tion, continuation of the proceeding to a final determination which adopts the inconsis-
tent position is thus the equivalent of assertion of such position after the enactment of
§ 820. See Statement of the House Managers, op. cit. supra note 58, at 58. The
waiting period is provided by excluding from the definition of determination any conduct
otherwise constituting a determination if it became final prior to ninety days after the
date of the enactment of this Act. In interpreting this provision, the Regulations restrict
the section to determinations made on or after August 27, 1938. Regulations 101, Ap-
pendix, T. D. 4856, Art. 820-1. Both the section and the Regulations tacitly assume that
a claim for refund could be safely withdrawn by the taxpayer in the ninety-day period
under these circumstances.

90. The Statement of the House Managers, op. cit. supra note 58, at 56, states
that the section becomes operative if correction is prevented "by the operation of one
or more provisions of the internal revenue laws." See note 65, supra.

91. Rev. Stat. § 3229, as amended by § 815, Revenue Act of 1938, permits the com-
promise of any civil or criminal case arising under the internal revenue laws. The Com-
missioner, with the approval of the Secretary of the Treasury, or an Under Secretary
or Assistant Secretary, may effect the compromise prior to the institution of suit; if suit
has been instituted, the compromise may only be effected by the Attorney General. Execu-
tive Order, No. 6166, June 10, 1933, § 5. Section 820 makes no reference to the other
statutory provision for compromises made by the Secretary of the Treasury, Rev. Stat.
§ 3469, or to compromises made by the Attorney General under the powers inherent in
his office. It is expected that compromises so effected will also provide a barrier to adjust-

This phase of the subject may best be introduced by an example. Suppose that the taxpayer had erroneously included in his gross income for 1934 an item of interest which increased his tax $500 and that the period of limitations for refund claims had expired. The taxpayer then voluntarily included such item in his gross income for 1938, increasing his tax, however, by only $100. If the taxpayer were permitted to claim that an adjustment was authorized because an item of income was included in gross income which had been erroneously included in an earlier year now closed, the statute of limitations on refund claims would be a nullity in many tax cases. Similarly, if the Commissioner by voluntarily allowing a deduction in a year in which it was not claimed by the taxpayer could thereby obtain an adjustment for an earlier closed year in which the deduction had been erroneously allowed, the statute of limitations on assessments would offer little protection to taxpayers. This danger was recognized by Congress, as the following quotations from the Report of the Senate Committee on Finance indicate:

"The legislation here proposed is based upon the following principles:

"(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustment should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency . . . ." 92

This problem was met in two ways. As pointed out above, a determination is prerequisite to the operation of Section 820. In neither of the examples just presented is a determination present, as a return and a voluntary refund because of an overpayment are not determinations under subsection (a) (1), so that an adjustment would not be authorized. The definition of determination thus serves to exclude most of the situations where the remedy afforded by Section 820 is not justified. As a precaution, the section in addition specifically provides in subsection (b) that:

The reason for excluding compromises in § 820 is perhaps the difficulty of computing the adjustment in such a case. Where the tax liability has been compromised and a lesser amount accepted, it would be unfair to compute the amount of the adjustment without regard to such compromise. While it might be provided that if the amount of the adjustment computed without regard to amounts abated or assessed by reason of compromise represents a decrease in the tax previously determined, such amount shall be reduced in the ratio that the amount of tax actually paid for such taxable year bears to the tax previously determined without regard to the compromise, Congress evidently thought that the small number of compromises did not merit introduction of such complexity into § 820. It cannot always be assumed, moreover, that a compromise will be final so as to prevent correction of an error. Cf. Cloister Printing Corporation v. United States, 100 F. (2d) 355 (C. C. A. 2d, 1938). On the subject of compromises, see Paul, op. cit. supra note 70, at 53 et seq.

92. Supra note 64, at 49.
“Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.”

Thus, if the Commissioner would, under the adjustment, obtain a deficiency for the barred year, such adjustment is not permitted unless the taxpayer has taken the inconsistent position in the later year. The Commissioner may not therefore use Section 820 as a lever to pry open the statute of limitations and correct erroneous action where the taxpayer is quite content to leave the past undisturbed. Likewise, if the Commissioner does not awaken the sleeping dog, the taxpayer cannot under Section 820 obtain a refund as a consequence of his own inconsistent action.

The inconsistency of the position is ascertained by reference to what was actually done in the earlier year rather than to what the taxpayer or the Commissioner may have urged at that time. Thus, suppose the taxpayer in his return for 1934 included a rental item in gross income. The Commissioner, however, voluntarily refunded an overpayment on the ground that the item was income for 1935. The taxpayer then included the item in gross income for that year but later, after the expiration of the period of limitations with respect to deficiencies for 1934, filed a claim for refund based on the ground that the item was income for 1935. The taxpayer then included the item in gross income for that year but later, after the expiration of the period of limitations with respect to deficiencies for 1934, filed a claim for refund based on the ground that the item was properly includible in 1934 and the claim is allowed. Although the taxpayer with respect to 1935 has successfully maintained a position consistent with the position taken by him with respect to 1934, an adjustment is nevertheless authorized under subsection (b) (3), as the taxpayer’s later position is inconsistent with the tax result reached for 1934, the erroneous exclusion of the item from gross income.

93. It is arguable that the section fails to cover cases where an officer of the United States other than the Commissioner maintains the inconsistent position. Suppose that the taxpayer erroneously included an item in gross income for 1934, included it again in gross income for 1938 and then is allowed a refund claimed for 1938 because of such later inclusion. Suit for erroneous refund is then instituted in which it is maintained that the item properly belonged in gross income for 1938. As this suit is in the name of the United States, § 610, Revenue Act of 1928, and is conducted by the Attorney General, is not that official the one who is maintaining the inconsistent position? As the intent of the section is clear, the adjustment should be obtained under such circumstances.

94. The disposition of a claim for refund may under some circumstances constitute the maintenance of an inconsistent position by the Commissioner, as where the taxpayer has erroneously included an item in gross income for 1934, has again included such item in gross income for 1935 and then filed a refund claim which is denied by the Commis-
A problem is suggested by an example in Article 820(b)–7(a) of the Regulations under this section. It is there stated that if, in the case of a taxpayer who had been erroneously allowed a deduction for a closed year, the Commissioner issued a deficiency for a later year based upon other items and then in his answer to the taxpayer's petition to the Board of Tax Appeals voluntarily proposed the allowance of the same deduction for the later year, no adjustment is authorized if the Board, referring to the answer of the Commissioner, takes the deduction into account in its redetermination of the tax for the later year “as the Commissioner, and not the taxpayer, has maintained a position inconsistent with the allowance of" the deduction for the earlier year. The Regulations thus assert that silence on the part of the taxpayer and his acquiescence in the allowance of the deduction under such circumstances are not equivalent to the maintenance of an inconsistent position. By inference, if the taxpayer had objected to the allowance of the deduction but had accepted the benefit of the allowance under the Board’s redetermination of tax liability, the case would not be altered. Presumably, however, if the taxpayer before the Board affirmatively adopted the inconsistent position taken by the Commissioner in the latter's answer, an adjustment would be authorized. While it is arguable that silence plus acceptance of benefits does not differ materially from this last case, it must be remembered that we are discussing a normally unreal situation made real only if the Commissioner, or the taxpayer in the converse situation described in Article 820(b)–7(b) of the Regulations, attempts to use Section 820 in an inequitable manner. The statutory language in question must consequently be so interpreted as to prevent the taxpayer or the Commissioner from unfairly forcing the other party into an inconsistent position so as to obtain a pecuniary advantage through an adjustment under this section.

It has been said that the section authorizes adjustment where an inconsistent position asserted by the appropriate party during the course of the proceeding has later been withdrawn prior to its termination. Thus, suppose a taxpayer who erroneously obtained a deduction for interest for 1937 claimed, inter alia, the same deduction in a claim for refund filed for 1938 after the expiration of the period of limitations on assessment. Speaking generally, the determination and maintenance of the inconsistent position are here embodied in the same action; more precisely, the disposition of the claim for refund constitutes both a determination and the maintenance of the inconsistent position, and such disposition becomes a determination upon the expiration of the time for instituting suit with respect to the denial of the claim for refund.

95. If the Commissioner did not place the deduction in issue through his answer but chose to leave it undisturbed and the Board sustained the deficiency and in its redetermination of the tax allowed the deduction on its own motion, there is a determination which allows the deduction, but no adjustment is authorized as the taxpayer has not maintained an inconsistent position. Such action on the part of the Board, however, would be contrary to the purpose of Congress in enacting § 820. See discussion infra, p. 44 et seq.
ments for 1937. The refund claim constitutes an assertion of an inconsistent position. The taxpayer, however, then notifies the Commissioner that he withdraws the claim with respect to the interest deduction, but that the refund claim should remain in force as regards the other items. The Commissioner nevertheless allows the refund claim for the full amount claimed, including the interest deduction, and then asserts that Section 820 authorizes an adjustment with respect to 1937. It has been stated that such adjustment is permitted and that the section thus constitutes a trap for the unwary taxpayer. But an interpretation that would make meaningless and ineffective a withdrawal from an inconsistent position previously taken appears unwarranted. The requirement of adoption in the determination of a position "maintained" by the taxpayer presupposes a position persevered in to the end by the taxpayer and not a position abandoned in the course of the controversy. Thus, the Statement of the House Managers explains that the inconsistent position must be "successfully maintained." While the Regulations do not consider this question, Under Secretary Magill in approving them pointed out that "Section 820 was designed to provide equitable relief and will not be applied to penalize taxpayers in cases in which an inconsistent position is inadvertently taken and then withdrawn prior to a determination." This policy, which implies that the section permits the safe withdrawal of an inconsistent position, is a frank recognition of its purpose and should lay at rest any fears that may have been aroused.

Section 820 is designed to nullify the advantages which ordinarily followed shifts of position by either taxpayer or Commissioner and to operate in such fashion that when a shift is made an adjustment is

96. Op. cit. supra note 58, at 58; also Report of the Senate Committee on Finance, supra note 64, at 50. As indicated in note 89, supra, a waiting period was provided in which inconsistent positions asserted prior to the enactment of § 820 could be withdrawn. As the purpose of this waiting period was to avoid the unfairness that would exist if an inconsistent position antedating § 820 were to result in an adjustment if the determination occurred after enactment of the section but before the party had a chance to appreciate its potentialities and withdraw, this provision does not offer support to a contention that withdrawals after the expiration of the ninety-day period are not effective. Rather, it merely assumes that with respect to any determination occurring after the ninety-day period, the parties will have had sufficient time to withdraw from the inconsistent position if they so desired and thus avoid adjustment.

97. Treasury Press Release, supra note 62. Consideration is given later to the problem whether the Commissioner can refuse a refund where the taxpayer to avoid an adjustment withdraws from a position taken in a claim for refund and it is clear that the claim is a proper one. Infra, p. 46.

98. The Report of the Committee on Federal Taxation, ADVANCE PROGRAM OF AMERICAN BAR ASSOCIATION, 61st Annual Meeting (1938) 104, included in its parade of horribles under § 820 the hosts of taxpayers who innocently take inconsistent positions. Experience would seem rather to point to the conclusion that it is generally the shrewd taxpayer, or rather his attorney or accountant, who sees the tax advantage to be gained from the inconsistent position and consequently asserts it.
authorized which, interest considered, might not only cancel but outweigh any advantage gained by the subsequent shift. So far as the taxpayer is concerned, he would be discouraged from taking inconsistent positions if the end result were a net loss. While taxpayers might soon become aware that it cost more to commit than to forego shifts of position, the effect of Section 820 upon the Commissioner is not so clear. The taxpayer is concerned merely with protecting his own interest, and is free to change his position or maintain it, according to what best serves his interest. The Commissioner, on the other hand, is bound to two purposes: the protection of the revenues and the administration of the internal revenue laws uniformly in accordance with their terms. Usually the two purposes coincide but they sometimes conflict. Under normal circumstances the obligation to protect the revenues must yield. Does Section 820 require a different answer in the circumstances in which it applies? The nature of this problem can perhaps be best illustrated by an example. A taxpayer erroneously included an item of rent in gross income for 1933 and failed to include it in gross income for 1934 where it properly belonged. If the Commissioner were to assert a deficiency with respect to the rent for 1934, after the expiration of the period of limitations for 1933, and a determination requiring its inclusion in gross income for 1934 eventuated, the taxpayer would be able to secure an adjustment. If the amount of the deficiency for 1934 were $100 and the amount of the adjustment $300, has the Commissioner the right to withhold a notice of deficiency with respect to 1934 and thereby avoid the pecuniary disadvantage consequent upon an adjustment? Or suppose the taxpayer had again included the item in gross income for 1934 but had filed a claim for refund so that a denial of the claim would permit the taxpayer to secure the adjustment for 1933. Could the Commissioner avoid this consequence by allowing the claim for refund?

It has been contended that in such cases the Commissioner must follow the mandate of the substantive statute and is obligated to assert the deficiency or deny the refund, although such action results in the maintenance of an inconsistent position. At the outset, however, it must be realized that in fact few cases of this type clearly call for the assertion of a deficiency or the denial of a refund, the answer usually being so debatable as to turn on opinion. The examples above present a typically doubtful question as to the correct year for which the item should be returned. Usually neither Commissioner nor taxpayer could state with confidence that inclusion in 1933 was erroneous and inclusion in 1934

99. The taxpayer does not have this problem. Even assuming that a negligence or fraud penalty might be imposed for failure to include the rent item in 1934 a way is always afforded the taxpayer to avoid the problem by including the item and filing a claim for refund, thereby throwing the burden of taking an inconsistent position upon the Commissioner.

100. Report of the Committee on Federal Taxation, op. cit supra note 98.
would be proper. The taxpayer himself usually has plausible reasons for including an item in the one year rather than the other by which the Commissioner may be convinced despite other reasons for including the item in a different year. Even if the Commissioner were not so convinced he may nonetheless believe that the very difference of opinion so beclouds the issue that he is free to follow whichever reasoning best serves the protection of the revenues. Certainly he would be warranted in taking the position that as the item has actually once been included the doubts may be resolved by closing the matter on that basis. This position would involve an exercise of the same reasonable discretion that precedes the daily decisions as to whether a particular deficiency letter should be issued or claim for refund allowed.

In rare cases, however, the issue may be clear—as where an existing regulation, or stronger still, a Supreme Court decision is directly in point. Such cases would squarely present the problem whether the Commissioner is compelled to shift his position or is authorized by Section 820 to refrain from doing so. The Congressional Committee Reports make four things plain:101 (1) The taking of inconsistent positions by either taxpayer or Commissioner is deplored; (2) the taking of inconsistent positions is to be discouraged by making them pecuniarily inadvisable where the amount of the adjustment plus interest is greater than the tax advantage gained by the shift of position; (3) shifts of position are nevertheless permissible and presumably will still be made where a monetary advantage would be gained, though here equitable relief by way of an adjustment will be afforded to the other party; and (4) the section is to operate ever-handedly as respects Commissioner and taxpayer. Section 820 thus offers definite directions by which the Commissioner may chart his course, and seems clear Congressional authorization for the Commissioner, in the exercise of his duty to safeguard the revenues, to be governed by the same tests that control the taxpayer. The Commissioner would be free, therefore, to follow in these situations the course financially most profitable to the Treasury under Section 820, even where the result would be the assertion of a deficiency with respect to one taxpayer and the withholding of such assertion against, or even the granting of a refund to, another taxpayer, solely to avoid the taking of an inconsistent position which Congress so strongly disapproved.102 Although Congress did not prohibit shifts of positions entirely for reasons given above, it clearly thought that the undesirable effect of such shifts demanded corrective action by nullifying the advantages which formerly they created, even where it meant a departure otherwise from the command of the statute.

101. See Report of Senate Committee on Finance, supra note 64, at 48-52; Statement of the House Managers, op. cit. supra note 58, at 56-59.

102. The criticism of § 820(b) (1) in Comment (1938) 52 Harv. L. Rev. 300, 304, fails to take account of the fact that the deficiency need not be asserted.
To achieve its purpose it adopted a single standard for both taxpayer and Commissioner, namely the pecuniary test implicit in Section 820, making this adoption practically explicit by the 90-day provision for the withdrawal of pending proceedings.\textsuperscript{103} The justification for authorizing this departure from an otherwise uniform application of the law lies in the conditions, described in the early part of this article, which gave rise to the need for Section 820.

The foregoing discussion concerning the right of the Commissioner to depart from an otherwise uniform application of the law to avoid the maintenance of an inconsistent position would seem likewise to indicate that Section 820 authorizes the Commissioner, as well as the taxpayer, to take the necessary procedural steps to secure an adjustment even though such steps involve action for which there would otherwise be no justification. Thus, if a taxpayer took a deduction erroneously for 1933 and took it again for 1934, the Commissioner, even in the rare case where it was clear that the deduction was properly taken for 1934, could assert a deficiency for the sole purpose of obtaining a determination to pave the way to an adjustment for 1933. Likewise, Section 820 authorizes the Commissioner to withhold voluntary refund of an overpayment with respect to which the taxpayer could have claimed a refund had he been willing to take an inconsistent position. Thus, in the preceding example if the taxpayer had not taken the deduction in 1934 the Commissioner on audit of the return would not be obligated to refund the overpayment.


The principle underlying subsection (d), which deals with the ascertainment of the amount of the adjustment, is a simple one: the tax for the year with respect to which the error was made is determined, the error is then corrected, and the difference between the corrected tax result and the first figure constitutes the amount of the adjustment. Whether the datum point—the tax previously determined for the taxable year with respect to which the error was made—may be readily ascertained depends on the extent to which the tax liability of the taxpayer for that year was altered after the return was filed. Subsection (d), by providing that alterations by way of deficiency should be added to the amount shown on the return and those by way of refund or credit should be subtracted, adopts, nearly verbatim, the language used in Section 271 to define the term "deficiency" and to this extent is on familiar ground.\textsuperscript{104} The step

\begin{footnotesize}
\textsuperscript{103} It is provided that the section will not become operative by reason of determinations made prior to 90 days after the effective date of the act. This affords taxpayers and the Commissioner a reasonable time to decide whether they desire to discontinue proceedings already begun which may lead to determinations as defined in this section.\textsuperscript{104} Cf. Report of the Senate Committee on Finance, supra note 64, at 51. Regulations 101, Appendix, T. D. 4856, Art. 820(d)-1. Subsection (d), by increasing the
\end{footnotesize}
in the computation that may prove difficult is the correction of the error in the tax previously determined. Subsection (d) states that "There shall then be ascertained the increase or decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error." The key word in this provision is "solely," and when reference is made to the Committee Reports to ascertain its significance, it will be seen that "solely" bears a heavy burden. The Report of the Senate Finance Committee includes as one of the principles underlying Section 820 the policy that the corrective adjustment should "under no circumstances affect the tax save with respect to the influence of the particular items involved in the adjustment." Further in the Report there appears the statement that "correction is made only with respect to the item involved in the determination" and examples are given wherein erroneous treatment of other items, as to which there was no inconsistent position, is not corrected when the amount of the adjustment is ascertained. It was thus clearly the desire of Congress to depart from the principle of Lewis v. Reynolds in so far as the operation of Section 820 is concerned. The amount shown on the return by amounts previously assessed as a deficiency, would literally require addition of any addition to the tax assessed under § 293, as it is assessed "in the same manner as if it were a deficiency." Section 271, however, has never been so construed.

To a large extent, subsection (d) assumes that records are available with respect to taxable years beginning after December 31, 1931 [see subsection (f)], and, more important, that in any settlements made with respect to the tax liability for those years lump-sum dispositions were avoided and the various changes in the tax return were carefully detailed. Both assumptions appear justifiable as general propositions. The present Bureau practice favors such treatment of tax settlements and § 820 will undoubtedly encourage it for the future.

105. Report of the Senate Committee on Finance, supra note 64, at 49.

106. Id. at 51. If the taxpayer erroneously included an item of rent and an item of interest in gross income for 1934, and erroneously took a deduction for depreciation, and the Commissioner by way of deficiency sustained by the Board again included the rent item in gross income for 1938, the adjustment would be with respect to the rent item, and the error as to the interest item and the depreciation deduction would not be corrected. Similarly, if deductions for a casualty loss and a bad debt loss were erroneously allowed for 1934 and an item of salary erroneously included in gross income, and the casualty loss again allowed for 1938, the adjustment would correct the error as to the casualty loss but not as to the bad debt loss or the salary item.

107. 284 U. S. 281 (1932). In this case, the Court said: "While the statutes authorizing refunds do not specifically empower the Commissioner to reaudit a return whenever repayment is claimed, authority therefor is necessarily implied. An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded." Id. at 283. Under this case, in the first example stated in note 106 above, the Commissioner could presumably, if § 820 had been silent on this point, offset the adjustment with respect to the rent item.
justification for this departure has been stated earlier in the article; our concern here is with the manner in which the statutory language expresses such Congressional policy.

The term "solely" in subsection (d), aided by the language of subsection (e), discussed infra, was used to reach the desired result. While that term would seem adequate for this purpose, its use may give rise to difficulties, which an example will illustrate. Suppose the item erroneously included is the taxpayer's salary for 1937. In his return for that year the taxpayer had naturally included such salary in computing his earned income credit. In ascertaining the amount of the adjustment must the earned income credit be recomputed—in the words of subsection (d), does "correct exclusion" of the salary item cover both the elimination of the salary item from gross income and the collateral consequences of that elimination? The Regulations, following closely the language of the Statement of the House Managers, answer this inquiry in the affirmative:

"If the treatment of any item upon which the tax previously determined was based, or if the application of any provisions of the internal revenue laws with respect to such tax, depends upon the amount of income (e.g., charitable contributions, foreign tax credit, earned income credit), readjustment in these particulars will be necessary . . . in conformity with the change in the amount of the income which results from the correct treatment of the item or items in respect of which the error was made." This interpretation, which emphasizes the word "correct" in subsection (d), is a desirable one. Such correction of the collateral

by the amount of tax due because of the erroneous deduction for depreciation. And a taxpayer might argue that the principle of Lewis v. Reynolds should be extended to allow him, in the second example, an offset based upon the salary item. Cf. Bull v. United States, 295 U. S. 247 (1935), crediting a barred overpayment under the estate tax against a deficiency in income tax where the same item was involved. See Comment (1938) 52 HARV. L. REV. 300.

108. The policy underlying subsection (d) may work a hardship in cases where the taxpayer has a large number of deductions but only takes on his return deductions sufficient to produce no tax liability, and the adjustment has the effect of disallowing one of the deductions taken, so that a tax becomes due; or where the taxpayer has taken many deductions and the Commissioner does not check all as a few of them are sufficient to create no tax liability and the adjustment has the effect of including an item in gross income but it is still offset by the unchecked deductions which turn out to be improper. It must be remembered that the requirement of inconsistent position permits a party to avoid adjustment in most of these cases; the taxpayer in the illustration above by simply not asserting the inconsistent position could allow the matter to stay at rest. Cf. p. 40 supra.


110. Regulations 101, Appendix, T. D. 4836, Art. 820(d)-1, and example thereunder.

111. The correction of the error may, of course, have the effect of placing the taxpayer in a higher, or lower, surtax bracket. Other matters, not mentioned in Regulations
consequences of the error, however, is limited to the year with regard to which the error was made, and does not extend to the influence of the error on other years. While subsection (b) states broadly that "the effect of the error shall be corrected by an adjustment made under this section", this mandate is qualified by the requirement of subsection (d) that the amount of the adjustment be determined with reference to the year with respect to which the error was made, which requirement in turn refers to the specific errors described in subsection (b)(1)–(5).  

101, Appendix, T. D. 4856, affected by the adjustment in net income are percentage depletion and taxation as a personal holding company. If the return of a corporation for 1938 showed that it had received 65 per cent of its income from the sources specified as material to taxation as a personal holding company under Title IA, Revenue Act of 1938, and, as a result of the inclusion of an item of income under the adjustment, the percentage is increased to 80 per cent, the corporation would be taxed as a personal holding company if the other requisites under Title IA were present, even though such taxation involves proof of matters not previously involved in the computation of the tax, as the fact that more than 50 per cent in value of the outstanding stock was owned, directly or indirectly, by or for not more than five individuals [see § 402(a)(2), Revenue Act of 1938]. The Regulations, and likewise the Statement of the House Managers, op. cit. supra note 58, thus do not distinguish between a case where, for example, a charitable deduction has been claimed on the return, computed by taking 15 per cent of the net income therein shown, and the adjustment either increases or decreases such net income, so that the amount of the deduction must be increased or decreased if the proper percentage is to be maintained, and the case where the return shows a gift to a supposed charitable organization but no deduction for such gift as the return shows no net income, and the adjustment, by including an item in gross income, produces net income, so that a charitable deduction to the extent of 15 per cent of such net income becomes allowable if it can be shown that the organization was in fact a charitable organization. In the first case, as a deduction has already been allowed by the Commissioner, he could not in the computation of the amount of the adjustment raise the question whether the recipient of the gift was in fact a charitable organization, and the problem of computing the amount of the adjustment is simply a mathematical one; in the second case the question of the status of the recipient of the gift for the first time becomes important and the computation of the amount of the adjustment involves proof by the taxpayer on this issue. It might be argued that as the return did contain an enumeration of the gift as a charitable one, although no deduction was claimed therefor, the Commissioner could not assert that the gift was not in fact to a charitable organization.

112. For example, taxation of a corporation as a personal holding company in a given year depends upon the percentage of income derived from certain sources in previous years. Revenue Act of 1938, § 402(a)(1). Thus, if a corporation receives 80 per cent of its income from the designated sources in its taxable year beginning in 1937 and only 70 per cent in 1938 it remains taxable in 1938 as a personal holding company under Title IA of the Revenue Act of 1938 because of the 80 per cent in 1937. Suppose that a corporation was taxed as a personal holding company for 1937 but an adjustment for that year under § 820 reduced the percentage to 60 per cent, the corporation being allowed a refund on account of both the erroneous inclusion of an item in gross income and the consequent erroneous taxation of the corporation as a personal holding company. If the corporation had already been taxed as a personal holding company for 1938, where the percentage in that year was 70 per cent, and that year is closed, the adjustment for 1937, being restricted by the terms of § 820 to 1937 would not extend to a reopening of the return for 1938. If the 1938 taxable year were still open, no problem arises under § 820 regarding the effect of the
Subsection (d) provides that there be added to the amount of the decrease in tax any amounts wrongfully collected, as additions to the tax or interest, as a result of the error. Thus, if the item erroneously included in gross income had not been stated by the taxpayer on his return but was later included by way of deficiency assessment, together with six per cent interest, the amount of the interest is to be added to the decrease in tax resulting from exclusion of the item. An addition to the tax under Section 293(a) on account of negligence would be similarly treated.

The discussion so far has been in terms of the income tax under Title I. As the unjust enrichment tax, the excess-profits tax, and the Title IA surtax on personal holding companies, are all income taxes, the question arises whether Section 820 is applicable to these taxes, and if so, in what manner. The heading of the section speaks of “income adjustment upon the tax for 1938, as the taxpayer or the Commissioner could, as respects the 1938 tax, prove the proper percentage in 1937 whether or not the year 1937 was closed. The existence or nonexistence of the proper percentage in 1937 is a question of fact, proof of which is not affected by the expiration of the period of limitations on refunds or deficiencies for 1937. Thus, in the above example, where the 1938 taxable year is still open, the taxpayer, independently of § 820, could prove that the proper percentage in 1937 was 60 per cent; or, regardless of the reduction to 60 per cent effected by the adjustment, the Commissioner could prove that the proper percentage was 80 per cent or more, if a larger item of income, not involved in the adjustment, had been improperly omitted.

113. Regulations 101, Appendix, T. D. 4856, Art. 820(d)-1, omit the word “wrongfully,” implying that all interest or additions to the tax collected as a result of the error were “wrongfully collected.” As § 292 of each Revenue Act since 1932 authorizes interest on “the amount determined as a deficiency,” it is arguable that interest collected in literal compliance with that section has not been “wrongfully collected,” so that the term “wrongfully” would have meaning where there has been a departure from § 292. This narrow interpretation, however, would seem contrary to the purpose of § 820 to restore to the taxpayer those sums of money which had been taken from him as a consequence of the error, here both the amount of the erroneous deficiency and the interest thereon. But as this broad interpretation would render meaningless the inclusion of the term “wrongfully,” it may be that subsection (d) proceeds on the assumption that the failure to include an item of income erroneously included by way of deficiency in the earlier year might under some circumstances be negligent and thus justify a § 293(a) addition to the tax, which addition would not be “wrongfully collected.”

While the Regulations are silent, the word “collected” would seem to refer to interest collected by the Commissioner from the taxpayer and not to the reverse situation, so that interest obtained from the Commissioner by the taxpayer on an erroneous overpayment is not added to the amount of the adjustment. The presence of “additions to the tax” which are obtained only by the Commissioner, is persuasive; moreover, the Report of the Senate Committee on Finance, supra note 64, at 51, unqualifiedly refers to “amounts wrongfully collected from the taxpayer, as additions to the tax or interest.” See note 123, infra.

114. Title III, Revenue Act of 1936.
115. Section 602 of Title III, Revenue Act of 1938, and corresponding provisions of prior Revenue Acts.
116. Title IA, Revenue Act of 1938, and corresponding provisions of prior Revenue Acts.
tax cases" and it is applicable to determinations under the "income tax laws." Moreover, each of the titles imposing the above taxes contains a provision making applicable thereto all provisions of law applicable in respect of the taxes imposed by Title I, in so far as not inconsistent. Section 820 itself appears in Title V of the Revenue Act of 1938, covering "Miscellaneous Provisions." As there is no express language in that section limiting its applicability to the Title I tax, and as its provisions are consistent with the other income taxes, the section would seem operative with respect to determinations under those taxes. While the Committee Reports are silent on this point, the Regulations take this position with respect to the determination and state that a determination may occur with respect to any one or more of these taxes. A more difficult question arises in connection with the extent of the adjustment. Suppose that an item of income was erroneously included in gross income for 1934 and a Title I tax and an excess-profits tax were paid for that year. A determination with respect to only the Title I tax for 1938 again requires the inclusion of the item in gross income. Does the adjustment under Section 820 extend only to the Title I tax for 1934, or to both the Title I tax and the excess-profits tax? On the one hand, it may be argued that the effect of the erroneous inclusion cannot be fully corrected unless both taxes are adjusted as both depend on the same income. On the other, it may be contended that subsection (d) speaks of the tax to be adjusted in the singular—"the tax previously determined," "the tax shown by the taxpayer . . . upon his return" —and the Committee Reports use similar terminology, implying an adjustment within the framework of a single tax. Moreover, the first position would lead to difficulties where correction of the Title I tax

117. E.g., § 409, Revenue Act of 1938 (Title IA); § 602(c), Revenue Act of 1938 (excess-profits tax); § 503(a), Revenue Act of 1936 (unjust enrichment tax).

118. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-0. Although the tax on transfers of silver bullion [48 Stat. 1178, § 8 (1934)] was validated as an income tax in United States v. Hudson, 299 U. S. 498 (1937), it is phrased as an excise stamp tax and its exclusion from the group of income taxes reached by § 820 seems proper. See also L. T. 2899, XIV-1 Cum. Bull. 67 (1935); Min. 4587, 1937-1, Cum. Bull. 74 (1937). While the excess profits under the Vinson Act, 48 Stat. 503 (1934), 49 Stat. 1926 (1935), are collected in accordance with the methods employed to collect Federal income taxes, the tax is not considered an income tax.

119. While "the tax" might be stretched to mean all of the income taxes paid for the year with respect to which the error was made, "return" would not permit such construction. While the Title I tax and the excess-profits tax are filed on one physical return, this is not true of the other taxes, and even in the case of the former taxes, two legal returns are present. Cf. Will County Title Company, 38 B. T. A. No. 182 (1938), holding that where the Commissioner had determined a deficiency in income tax for 1934 and an overassessment of excess-profits tax for the same year, a notice of deficiency with respect to the income tax had been issued, and the taxpayer had filed a petition with the Board, it had jurisdiction over the deficiency in income tax but not the overassessment of excess-profits tax.
was prevented but the excess-profits tax could be adjusted under the customary methods, as where the periods of limitations had expired only with respect to the former tax. The Regulations resolve this question in favor of the second position and provide:

"Section 820 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which corresponds to the tax or taxes with respect to which the determination relates. Thus, if the determination relates to the tax imposed by Title I of the Revenue Act of 1938, the adjustment may be only with respect to the tax imposed by Title I of the Revenue Act applicable to the year with respect to which the error was made; if the determination relates to section 602 of Title III of the Revenue Act of 1938, the adjustment may be only with respect to the tax imposed by the corresponding provisions of the Revenue Act applicable to the year with respect to which the error was made."  

5. Method of Adjustment.

Subsection (c) provides the method of adjustment. As in the case of the computation of the amount of adjustment, the plan is a simple one: if the amount is an increase over the tax previously determined, it is recovered in the same manner as a deficiency determined by the Commissioner; if a decrease in that tax, in the same manner as an overpayment claimed by the taxpayer. The deficiency or overpayment, as the case may be, is for the taxable year with respect to which the error was made, and the coordination with the procedural tax machinery relating to that year is accomplished by the expedient of assuming that on the date of the determination one year remained before the expiration of the period of limitations upon assessment or filing claim for refund for such year. Thus, if the error is with respect to the year 1933, the determination became final in 1938 and the amount of the adjustment is an increase over the tax previously determined for 1933, it is to be assessed and collected in the same manner as would a deficiency for 1933 if properly asserted by the Commissioner in 1938—a notice of deficiency, unless waived, must be sent to the taxpayer (within one year after the date of the determination) if it is a deficiency for 1933.

120. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-0. The language in Art. 820(d)-1(1) to the effect that the tax previously determined may consist of tax imposed by Title I, Title IA, etc., or "by any one or more of such provisions" must be construed in harmony with the explicit rule of Art. 820(b)-0 to refer in the latter regard to a case where the determination related to more than one of these income taxes.

121. Subsection (c), in using the language "as if it were a deficiency determined by the Commissioner," thus ties in with § 272(a) of the Revenue Act of 1938 and corresponding provisions of prior Revenue Acts, "If in the case of any taxpayer, the Commissioner determines that there is a deficiency ... the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail." The Senate Draft, in stating [subsection (d)] that the amount of adjustment "shall be considered as a deficiency," left it doubtful whether there could be any possibility of recourse to judicial review with respect to the deficiency.
year from the date of the determination); if he fails to petition to the Board within 90 days the tax may be assessed, etc. The deficiency letter would, in accordance with the applicable statutory provisions, suspend the running of the one-year period of limitation provided by subsection (c), and similarly the period of limitations upon collection would commence to run from the date of assessment of the amount of the adjustment. If the taxpayer paid the deficiency, he could file a claim for refund within two years from the date of payment, and if such refund were denied, suit could be brought within two years of the denial. In similar fashion, where the amount of the adjustment represents a decrease in tax and consequently is treated as if it were an overpayment claimed by the taxpayer, the customary refund procedure would be followed—filing of refund claim, allowance or disallowance by Commissioner, suit for refund by the taxpayer in the event of a disallowance. As the adjustment is assessed and collected as if it were a deficiency, or refunded or credited as if it were an overpayment, the amount of the adjustment will bear the same interest and be subject to the same additions to the tax, as would orthodox deficiencies and overpayments for the year with respect to which the error was made.


The Committee Reports and the Regulations are silent on the question whether subsection (c), by assuming that one year remained before the expiration of the period of limitations upon assessment, authorizes the Commissioner to proceed under §311 of the Revenue Act of 1938, and corresponding provisions of prior Revenue Acts, against a transferee of the taxpayer with respect to whom the deficiency is authorized by §820, although previously the period of limitations on assessment had expired as respects such transferee. As §311 provides that the period of limitations for assessment of transferee liability is one year after the expiration of the period of limitations against the taxpayer, and as §820 assumes for the purpose of the adjustment that one year of such later period still remains, it is arguable that the period of limitations for assessment of transferee liability has not expired. On the other hand, it may be said that express language is necessary to make a transferee liable for the amount of the adjustment where the normal period of limitations provided by §311 had expired. Where that period had not expired, transferee liability for the amount of the adjustment would exist.

123. Report of the Senate Committee on Finance, supra note 122, at 51-52; Regulations 101, Appendix, T. D. 4856, Art. 820(c)-1. The statutory justification for the imposition of interest and additions to the tax is the phrase “in the same manner as if it were a deficiency . . . or an overpayment.” Even if “manner” be defined as referring to the method or machinery of assessment and collection so that subsection (d) incorporates only the notice of deficiency procedure, as §§291 and 292 are an integral part of that machinery, they are included within the sweep of subsection (d); a similar contention can be made with respect to interest on the overpayment. A contrary conclusion would force Congress to provide specifically for interest and additions to the tax, and such specification would in turn cast doubt on the incorporation of the other sections relating to the deficiency procedure which were not specifically mentioned. Moreover, §293, Revenue Act of 1938, after requiring that an addition to the tax shall be assessed in the same manner as if it were a deficiency, specifically states that “section 292, relating
of limitations thus provided may operate to shorten the otherwise applicable period of limitations, as where the error is with respect to the taxable year 1937, correction is barred by a closing agreement executed in 1938 and the determination occurs in March, 1939, so that two years of the normal period of limitations for 1937 remain unexpired. Under such circumstances, the Commissioner would nevertheless have only one year within which to assert the deficiency. 124

Subsection (e) provides an exception to the rule of subsection (c) that the established procedure is to be utilized in making the adjustment. The exception, however, is introduced solely to buttress the principle of subsection (d) that the adjustment is only with respect to the item which was the subject of the error. Thus, subsection (e) provides that (1) the amount of adjustment cannot be diminished by any credit or set-off based upon any other item and (2) that if the amount is paid, it cannot be recovered by a claim or suit for refund, or suit for erroneous

interest on deficiencies, shall not be applicable," thus indicating that without this exception the treatment of an addition to the tax as a deficiency would result in interest on the addition to the tax.

The specific inclusion of interest previously collected by the Commissioner in the amount of the adjustment under subsection (d) is made necessary by the different dates specified in the Revenue Acts for the computation of interest. As interest on an overpayment runs from the date of the overpayment (§ 614, REVENUE ACT OF 1928), so that the interest in effect provided for by subsection (c) where the amount of the adjustment is an overpayment runs from the date the taxpayer paid the erroneous deficiency and the interest thereon, the interest so paid on the deficiency would not have been recovered by the taxpayer unless it were included in the amount of the adjustment; interest on interest thereafter is proper as the taxpayer has been wrongly deprived of the use of the interest paid by him on the erroneous deficiency. In view of the reason for the specific mention of interest in subsection (d), it therefore does not follow from such explicit reference that Congress did not intend to provide for interest in connection with subsection (c). Interest on a deficiency, however, runs from the date prescribed for payment of the tax (§ 292), so that if an amount had erroneously been refunded in the earlier year together with interest thereon, subsection (c), by providing in effect, where adjustment is by way of deficiency, for interest, on the amount erroneously refunded, for the period between the date the tax was due and the date of the refund payment, as well as for thereafter, restores to the Commissioner the interest wrongly paid to the taxpayer with respect to that period and thereby makes it unnecessary to add that amount to the amount of the adjustment. If the amount of such interest had been added to the amount of the adjustment, as in the case of an overpayment, the Commissioner would have twice obtained interest for the period between the payment of the tax and the date of the refund. But the Commissioner fails to obtain interest on such interest for the period from the date of the prior refund to the date of assessment of the amount of the adjustment, although the taxpayer by virtue of subsection (d) would obtain interest on such interest for the corresponding period. 124

124. Regulations 101, T. D. 4856, Art. 820(c)-1. The STATEMENT OF THE HOUSE MANAGERS, op. cit. supra note 122, at 59, that "the Commissioner has at least one year within which to issue a notice of deficiency in respect of the amount of the adjustment" would seem inaccurate unless the "at least" assumes that a waiver of the one-year period has been obtained.
refund, based upon any other item. The Commissioner cannot offset against the taxpayer's claim for refund of the amount of adjustment, where it is a decrease in tax, the amount of tax due on account of erroneous treatment of another item; nor can the Commissioner, after the amount of the adjustment is refunded, accomplish the same result in a suit for erroneous refund. Similarly, the taxpayer cannot, where the adjustment is treated as if it were a deficiency, in a contest of such deficiency before the Board claim an offset because of erroneous treatment of another item; nor can he, if he paid such deficiency, utilize such payment to support a claim for refund with respect to that item. This subsection also operates as a limitation upon the powers of the courts and the Board of Tax Appeals. While the established procedure is thus made available under subsection (c), careful safeguards have been inserted to prevent the amount of the adjustment from being affected by other items. 125

While Section 820, in utilizing established procedure to effect the adjustment authorized, provides for a notice of deficiency or a claim for refund, with the possibility of subsequent litigation in the Board or the courts with respect to the adjustment, 126 it does not follow that this procedure must be pursued in its entirety to obtain an adjustment. In most cases, as a consequence of the determination, there will be no question as to the propriety or amount of the adjustment, so that the parties may accomplish in one transaction both the settlement of the tax liability for the year with respect to which the determination is made and the adjustment authorized under Section 820. If there is a deficiency for the later year because the item is required to be included in gross income, the amount of the adjustment will represent a decrease in tax, because of correction of the erroneous inclusion of the item in gross income for the earlier year, and that amount, treated as if it were an overpayment, may be credited against the deficiency in accordance with the customary practice. 127 Similarly, if there is an overpayment for the year with respect to which the determination is made because of the allowance of a deduction, such overpayment may be credited against the amount of the adjust-  

126. See p. 58 infra, pointing out that litigation may be necessary to establish the error with respect to the earlier year. Other controversial questions relating to the adjustment may also arise in particular cases, e.g., whether the amount of the adjustment was properly computed, whether at the time the determination became final correction under the usual methods was barred, etc.  
127. Section 322(a) of the Revenue Act of 1938, and corresponding provisions of prior Revenue Acts, provide that "Where there has been an overpayment of any tax imposed by this title, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer."
ment, here an increase in tax. The crediting of or against the amount of the adjustment is not limited to tax due, or overpayments, for the year with respect to which the determination is made, but extends to any year, even the year of the adjustment, provided that any tax due for that year or any overpayment has been ascertained and is still collectible. As such action does not constitute a departure from the principle expressed in subsection (d), it is not prohibited by subsection (e); adjustments under Section 820 may consequently be made expeditiously and without the necessity of a separate proceeding.

We proceed now to consider the kinds of cases, enumerated in subsection (b), to which the section extends.

F. Classes of Cases in Which Adjustment Is Authorized

Double Inclusion of an Item in Gross Income.

Subsection (b)(1) specifies the case where the determination requires "the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer." The general situation falling under subsection (b)(1) is illustrated by the example given in the Regulations: a lessor-taxpayer, who kept his books on a cash basis, erroneously included an item of accrued rent in his return for 1933. In 1938, after the expiration of the period of limitations on refunds for 1933,

128. See note 127, supra.

129. Thus, the crediting must not be prohibited by § 609, REVENUE ACT OF 1928.

130. The crediting of the amount of the adjustment, where it represents an overpayment against an income tax then due, does not in legal effect diminish such amount, as it is used to pay the tax due; likewise the crediting of an overpayment against the amount of the adjustment, where it is treated as if it were a deficiency, does not diminish such amount as it is in effect being paid by the credit. Subsection (e) must thus be read in the light of its purpose, and the phrase "the amount . . . shall not be diminished by any credit," must be interpreted as prohibiting, not the crediting referred to in the text, but rather any attempt to defeat the principle of subsection (d). In this regard, the STATEMENT OF THE HOUSE MANAGERS makes this plain: "Subsections (d) and (e) indicate, however, that the adjustment, both with respect to the ascertainment of the amount of the adjustment and the later proceedings for its collection or refund, is unaffected by any other items not taken into consideration in computing the tax previously determined. The amount of the adjustment, if an overpayment, may of course under established procedure be credited against any income tax then due from the taxpayers, or if a deficiency may correspondingly be set off against any refund of income tax due to the taxpayer." Op. cit. supra note 122, at 57-58.

131. In approving the Regulations, Under Secretary Magill stated that "so far as possible such adjustment would be expedited by settling the tax liability for the open year and the adjustment for the closed year in one proceeding." Treasury Press Release No. 14-38, 383 C. C. H. 1938 Fed. Tax Serv. ¶ 6502. There is therefore no foundation for the fear expressed in the Report of the Committee on Federal Taxation, ADVANCE PROGRAM OF AMERICAN BAR ASSOCIATION, 61st Annual Meeting (1938) 104, that § 820 "contemplates in every case of inconsistency two separate proceedings."
the Commissioner ascertained that the rent was received in 1934 and asserted a deficiency for that year, which is sustained in 1941 by the Board of Tax Appeals. As the determination — the Board decision — requires the inclusion in gross income\textsuperscript{132} of an item — rent received in 1934 — erroneously included in gross income for another year, an adjustment is authorized.\textsuperscript{133} As the Regulations point out, the determination need not arise from the assertion of a deficiency in the later year, for if the taxpayer himself had included the rent in gross income for 1934 and had filed a claim for refund which was denied, an adjustment would also be authorized.\textsuperscript{134} Nor need the erroneous inclusion be made by the taxpayer in his return, for if the inclusion in gross income for 1933 had resulted from the taxpayer's payment of a deficiency asserted for 1933 because of the non-inclusion of the rent in the return for that year, an adjustment would still be authorized.

Subsection (b) (1) emphasizes the reliance placed by Section 820 upon the "item" concept of tax liability. The tax liability for a year is generally a unitary matter, and the concern is whether the correct dollars and cents total has been determined.\textsuperscript{135} Section 820, however, fastens upon the treatment accorded a particular item in different years regardless of the correct dollars and cents tax liability for those years. Some difficulty, therefore, may arise in ascertaining what is an "item." The term is not a new one in the income tax — Section 42 refers to the "amount of all items of gross income," Section 22(b) provides that the "following

\textsuperscript{132} The term "requires" in subsections (b) (1) and (3), like the term "allows" in subsections (b) (2) (3) and (4), and the terms "denies" and "disallows" in subsections (b) (4) and (5), refers to action compelled by the determination and not, for example, to what should be done in accordance with dicta in a court decision. Thus, if an item of income is included in gross income for 1933 and the Commissioner asserts a deficiency stating that the item belongs in gross income for 1935, no adjustment is authorized if the court rules that the item does not belong in 1935 as it is properly includible in 1934. If, however, the taxpayer had brought suit for refund for 1934 based upon an unrelated item and under Lewis v. Reynolds, 284 U. S. 281 (1932), the Commissioner successfully offset the refund by the amount of tax owing because of the failure to include the item in gross income for 1934, the determination here requires the inclusion of an item in gross income and an adjustment is authorized; this follows even if such amount of tax is greater than the refund sought.


\textsuperscript{134} While it may be argued that the taxpayer has maintained an inconsistent position in his return, the Commissioner, by the denial of the claim for refund, has clearly maintained an inconsistent position, and the condition in subsection (b) is therefore met. See note 94, supra.

\textsuperscript{135} The concepts of deficiency and overpayment clearly envisage tax liability as a unitary matter. The rules that a notice of deficiency may be sustained if tax is owing on a theory different from that relied upon in the notice, that only a single suit for refund may be maintained, that set-off is permissible in a suit for refund or erroneous refund, similarly rest upon such a unitary concept.
items shall not be included in gross income.” The term “item” thus refers in a qualitative sense to the various matters which make up gross income—salary, dividends, rent, gain on sale of a capital asset, distributed trust income, interest, etc.\textsuperscript{136} Salary for 1937 and salary for 1938 are two different items, though in each case the amount may be $10,000. But if the item is qualitatively the same, as salary for 1937 included in gross income for 1937 and again for 1940, it is immaterial that there is a quantitative difference. Hence, if the salary was paid in property and when included for 1937, the property was valued at $10,000 and when again required to be included in 1940 it was valued at $8,000, the inclusion of the entire $10,000 is to be adjusted under Section 820. But if a salary of $5,000 was received from A and a salary of $5,000 received from B, and both are included for 1937, and if later the $5,000 salary from B is included again for 1940, an adjustment is authorized only with respect to the $5,000 salary from B included for 1937—salary from A and salary from B are different items, even though they relate to the same year.\textsuperscript{137}

It will be observed that subsection (b)(1) refers to the erroneous inclusion of the item in the earlier year,\textsuperscript{138} and the remaining categories in subsection (b) also turn on erroneous action. The inclusion required by the determination with respect to the later year does not under Section 820 ipso facto establish the error for the earlier year. The coverage

\textsuperscript{136} The term “item” is used in this sense—an item of gross income—in subsections (b)(1), (b)(3), (d) and (e). In subsection (a)(1)(C), however, the term “items” is used loosely to cover not only an “item,” as used in the above subsections, but also a deduction, a credit, an inclusion [as used in subsection (b)(3)], etc. As pointed out above, subsection (a)(1)(C), in its tracing of the disposition of the various items in the claim for refund, likewise departs from a unitary tax concept.

\textsuperscript{137} Where an item of income such as bond premium is erroneously included in its entirety for a single year and thereafter the bond premium is properly allocated over a number of years, the inclusion in gross income for a later year of the amount allocated to that year would provide the identity of items required in subsection (b)(1) and an adjustment would be authorized with respect to the entire sum erroneously included. Conversely, if the amount had previously been erroneously allocated over a number of years, and the entire amount is properly included in a later year, an adjustment would be authorized for each of the prior years in which an allocated amount had been included.

\textsuperscript{138} While the discussion throughout has assumed that the adjustment is made with respect to a year chronologically earlier than that with respect to which the determination is made, subsection (b)(1), as well as subsections (b)(2) and (3), do not impose such a temporal limitation. Although most of the cases under these subsections will follow this time pattern, it is possible that the determination may be with respect to the earlier year and the adjustment for the later year, where the former has been held open, by waiver for example, even after the latter has been closed. See also note 140, infra. In subsections (b)(1)(2) and (3), where related taxpayers are involved, determination and adjustment may relate to the same calendar year. In subsection (b)(4), determination and adjustment will generally relate to the same calendar year (see note 157, infra) and in subsection (b)(5), the determination will relate to the same or a later year, but never an earlier year, because of the special cases covered by these subsections.
of related taxpayers within the scope of the section made any such automatic rule impossible, as will be explained later. Accordingly, even after the determination requiring the inclusion in gross income is obtained, the adjustment depends upon the question whether the earlier inclusion was erroneous. But, while the structure of Section 820 thus permits two proceedings, in practice the proceeding culminating in the determination will usually establish the error. If the determination is a court or Board decision, res judicata will tie the error to the determination.\footnote{139} if the determination is a closing agreement or disposition of a claim for refund, the joint conduct of the parties (a disallowed claim for refund must be acquiesced in by the taxpayer) for the year of the determination will serve to link determination and error.\footnote{140} While the determination will thus generally dispose of the question whether the earlier action was erroneous, where the question must be decided independently of the determination, the standard is that of the internal revenue laws applicable to the year with respect to which it is alleged the error occurred. The fact that at the time the item was included in gross income for the earlier year such inclusion was in accordance with the then prevailing administrative or judicial interpretation of the internal revenue laws is not finally determinative of the question, for if such interpretation is later authoritatively altered, by court decision, the inclusion is erroneous within the

\footnote{139} See p. 34 supra. Where related taxpayers are involved, however, see p. 79, infra.

\footnote{140} The text assumes that in most situations involving a determination by way of closing agreement or disposition of a claim for refund, the parties will likewise be in agreement as to the adjustment for the earlier year. In cases where such complete agreement is not present, an additional step may be necessary under § 820. Thus, suppose the taxpayer by closing agreement acquiesced in the inclusion of an item of rent in gross income for 1935, although he had erroneously included such item in gross income for 1934 and the period of limitations for refund claims for 1934 had expired. The taxpayer then files a refund claim for the amount of the adjustment for 1934, but the Commissioner contends that the inclusion in 1934 was proper and that it is the inclusion for 1935 which was erroneous. The court agrees with the Commissioner. An adjustment would then be authorized for 1935 under subsection (b)(1). In some instances, however, § 820 may not permit the second adjustment. Suppose the taxpayer has erroneously taken a deduction for 1934 and after the period of limitation on assessments for 1934, files a claim for refund for 1935 in which he again claims the deduction. The deduction is allowed, but the Commissioner offsets the amount of the refund by a deficiency based upon other items, so that the claim for refund is disallowed and a deficiency asserted. As the allowance of the deduction is a determination under subsection (a)(1)(C)(i), the Commissioner is entitled to an adjustment for 1934 under subsection (b)(2). Assume that such adjustment is obtained. Thereafter, the taxpayer contests the deficiency for 1935 before the Board. The Commissioner then asserts in his answer an additional deficiency for 1935 because of the allowance of the deduction, now stating such allowance was erroneous. The Board sustains the Commissioner. As the failure to obtain a deduction in any year is not covered in subsection (b), no adjustment is authorized. The taxpayer, however, could protect himself in this rare case by refusing to pay the adjustment for 1934 until he obtained a closing agreement with respect to the deduction for 1935.
meaning of Section 820. Any other interpretation would in large part nullify the effect of the section, for it is just such shifts in judicial interpretation which principally give rise to the successful maintenance of inconsistent positions.

**Double Allowance of Deduction or Credit.**

Subsection (b)(2) is the complementary paragraph to subsection (b)(1), for it covers the case where the determination allows a deduction or credit erroneously allowed to the taxpayer for another taxable year or to a related taxpayer. The terms “deduction” and “credit,” like the term “item,” embody the same divisible concept of tax liability and follow the terminology of Section 23 (“there shall be allowed as deductions”) and Section 25 (“there shall be allowed . . . the following credits against the net income.”). Also, as in subsection (b)(1), the manner in which the allowance occurred or in which the proceeding leading to the determination arose are immaterial. The taxpayer in the earlier year may have taken the deduction in his return, or obtained it by way of claim for refund or voluntary refund on the part of the Commissioner; he may have again taken the deduction in his return for the later year, or obtained it by way of a refund.

**Exclusion of Item of Gross Income With Respect to Which Tax Was Paid.**

Subsection (b)(3) deals with a more difficult situation—the determination requires “the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or

141. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-5. Cf. the language in the STATEMENT OF THE HOUSE MANAGERS, op. cit. supra note 122, at 56, that there is required “a final ‘determination’ . . . which . . . indicates that the previous treatment of the item was erroneous under the applicable provisions of the internal-revenue laws.” The word “indicates” merely refers to the effect that will be given to the determination in general practice.

142. Suppose that an item of gross income were erroneously omitted for 1934, though its omission was thought proper at that time. Thereafter, the taxpayer included such item in 1935 and then was successful in a refund suit, the Supreme Court stating that the item should properly have been included in gross income for 1934. For administrative reasons the Commissioner acts under § 506 of the REVENUE ACT of 1934 and prescribes that the decision should be applied without retroactive effect. While the omission of the item for 1934 is erroneous, whether the Commissioner will seek an adjustment depends upon whether his action under § 506 extends to § 820 situations.

143. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-2. Comment (1938) 52 HARV. L. REV. 300, 306, contends that § 820 may not apply where the deduction in the later year is taken in the return, as the determination following the assertion of a deficiency would not provide a credit which the taxpayer could apply against the adjustment for the earlier year. It is difficult to see any basis for this contention. The taxpayer obtained a monetary advantage by taking the deduction in the return; § 820 does not necessitate that the determination requires a passage of money. Cf. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-1, Example (1), last sentence.
omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer." Here again the manner in which the error occurred is immaterial—the taxpayer may not have included the item in his return or he may have returned it and obtained its exclusion by a claim for refund, or the refund may have been made voluntarily by the Commissioner. But the manner in which the exclusion in the later year occurred is highly important, for the subsection applies only where a tax has been paid for the later year with respect to the item. The tax may have been paid in only two ways—the item was included by the taxpayer in his return or he paid a deficiency which was asserted because of his failure to include the item. Consequently, where the item was not included in the return and any deficiency asserted because of such omission has not been paid but contested as a deficiency throughout, this subsection will not be applicable.\footnote{144}

While the taxpayer who thus wishes to avoid an adjustment under Section 820 is required to contest the matter in the Board\footnote{145} and may not proceed by way of refund suit in the District Courts or the Court of Claims, a sound reason exists for such rigid dichotomy. Suppose the following case: a taxpayer received payments in 1937 under a contract for the performance of services and included the payments in his return for that year. After the expiration of the period of limitations on assessments for 1936, the taxpayer filed a claim for refund for the year 1937, asserting that he kept his books on the accrual basis and that, as the payments had accrued in 1936, they were properly taxable in that year. Although the taxpayer may have honestly thought he was acting properly when he included the payments in his return for 1937, such inclusion may well have lulled the Commissioner into not taking action with respect to 1936 while such action would have still been timely. The omission for 1936 and the inclusion for 1937 are objective indications that the taxpayer intended to pay some tax on the payments: he first thought 1937 was the proper year, and then realized that he could take advantage of the running of the statute of limitations to avoid tax entirely. Consequently, the shift of position properly gives rise to an adjustment. But suppose the taxpayer either thought he did not owe a tax at all with respect

\footnote{144 Where the taxpayer has filed claim for refund on an unrelated deduction and the Commissioner allows the claim but reduces the amount claimed by the amount of tax allegedly due because of the failure to include the item in gross income, and the taxpayer thereafter successfully recovers the difference between his original claim and the amount allowed, the court holding that the item does not belong in gross income, tax has not been paid with respect to that item—rather, the proper amount due the taxpayer because of the deduction had not been refunded.}

\footnote{145 The taxpayer cannot avail himself of §§322(d) and 809 of the Revenue Act of 1938, permitting the filing of a petition even where there is payment of the deficiency after the mailing of the notice of deficiency, and authorizing the Board to find an overpayment, if otherwise proper, in such case, as such payment would bring the case within subsection (b)(3). Regulations 101, Appendix, T. D. 4856, Art. 820(b)-3, Example (1).}
to the payments and consequently omitted them from his returns for
1936 and 1937, or negligently failed to include them for 1936, the proper
year. In either case, after the period of limitations has expired, the
policy underlying the statute of limitations would give repose to such a
situation. The taxpayer here has not taken an inconsistent position—
he has simply failed to pay a tax. But if subsection (b)(3) were ex-
tended to the case where a determination required the exclusion of an
item from gross income which had previously been erroneously excluded
or omitted, so that an adjustment would be authorized without regard
to the payment of tax with respect to the item, the statute of limitations
would be swept aside. In the second situation presented above, if the
Commissioner discovered the omission after the period of limitations had
expired on assessments for 1936, he could simply assert a deficiency for
1940, or 1941, and so on, although knowing full well that such deficiency
could not be upheld, thereby forcing the taxpayer to contend that the
item belonged in 1936, and thus to take a position inconsistent with its
omission in that year. After the Board had ruled against the deficiency,
the Commissioner could then claim an adjustment for 1936. Section 820
would thus have offered an easy method to open the statute of limitations
on assessments, with the result that there would simply be no statute of
limitations on assessments for failure to include items in gross income.
In restricting subsection (b)(3) to the case where the tax had been paid
in the later year, Congress was simply acting to “preserve unimpaired
the essential function of the statute of limitations,” though this meant

146. In view of the prima facie effect of the notice of deficiency, the risk of simply
defending on the ground that the item did not belong in the year asserted by the Com-
missioner would generally be too great, so that the taxpayer would be forced to defend
on the ground that the item belonged in the year in which it was erroneously omitted.
If his defense did not rest upon the ground that the item properly belonged in such year,
there would be no maintenance of an inconsistent position.

147. Report of the Senate Committee on Finance, supra note 122, at 49. Subsec-
tion (b)(3) may in part be analogized to decisions of the Supreme Court to the effect that
it would be inequitable to permit the taxpayer to recover money from the Government
when tax is still owed to it on the same transaction. “It must be owned that there is
much justice in this; and the argument would be particularly strong, were the taxpayer
seeking to get back what he had paid, since he could then recover only ex aequo et bono.
Stone v. White, 301 U. S. 532 . . . Yet even then, McEachern v. Rose, 302 U. S. 56
(1938), would stand in the way, since under . . . section § 609(a) of the Revenue Act
of 1928 the credit of any sums due in the later year would be ‘void’ against an assessment,
payment of which would have to be refunded under . . . section § 607 of the Revenue
Act of 1928. But no deficiency is justified for another and more fundamental reason. The
question is of the validity of a tax, in computing which the net income—calculated by
deducting what the statute allows—must be the multiplicand, regardless of whether any
of the deductions have already been wrongfully taken in earlier years. The doctrines of a
court of equity are irrelevant to the levyng of taxes; Congress alone lays down the con-
ditions, and has not attempted to bring other years into hotch-pot. Quite other considera-
tions decide whether a sum, once paid as a tax, shall be recovered; the mere payment
creates no obligation to return it, the taxpayer makes it at the peril of showing that in
allowing some taxpayers—as the taxpayer who thought in 1936 that the payment belonged in 1937 but then changed his mind before filing his return for 1937—to avoid a tax. Where the taxpayer failed to include the item in his return for the later year but paid when the deficiency was asserted for the later year solely because he preferred to litigate in the District Court rather than the Board, it may seem that no adjustment should be authorized as the payment of tax does not here serve as an objective manifestation of the course of conduct charted by the taxpayer. Another taxpayer, however, may have paid the deficiency because he thought it correct but later decided to change his position because of the favorable opportunity presented by the expiration of the period of limitations for the earlier year. As there is no feasible method of differentiating between the two cases, and as the taxpayer against whom the deficiency is asserted can protect himself from an adjustment under Section 820 simply by not paying the deficiency, no unjustifiable hardship is worked by the rule adopted in subsection (b) (3).

This underlying desire of Congress to maintain unimpaired the purpose of the statute of limitations is evidenced when we consider the complementary case of deductions. The report of the House Subcommittee stressing the need for corrective action in cases involving misuse of the statute of limitations, noted the following situation:

"Taxpayers frequently claim deductions which the Commissioner denies because he believes that, although the deductions are allowable under the revenue act, they should be taken in a different year" and recommended that "there be prepared suitable provisions under which the statute of limitations should be so adjusted as to insure the taxation of income, and


148. An interesting situation may develop in this connection under subsections (b) (1) and (2). Suppose a deduction has been taken in 1937 and again in 1938 but the period of limitations with respect to both years has expired. A deficiency is then asserted with respect to 1938 on the ground that the deduction was improper. The taxpayer contends that the period of limitations had expired and the Board sustains this position. Section 906(e) of the Revenue Act of 1924, as amended, provides that 'if the assessment or collection of any tax is barred by any statute of limitations, the decision of the Board to that effect shall be considered as its decision that there is no deficiency in respect of such tax.' May the Commissioner then contend that by virtue of this section there is a determination that allowed the deduction for 1938, as there is no deficiency for 1938, and accordingly an adjustment is authorized with respect to 1937? It is obvious that Congress did not intend the answer to be in the affirmative. As the taxpayer has not maintained an inconsistent position and as the determination does not adopt an inconsistent position even if the taxpayer had defended on the double ground of the statute of limitations and the propriety of the deduction in 1938, § 820 would seem inapplicable. It may be noted that in the complementary situation, that of overpayments, there is no provision comparable to § 906(e) of the Revenue Act of 1924, as amended.

the allowance of deductions, in the year to which properly allowable." 180 And the Senate Report stated that "Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer . . . ." 151 As a result, many tax attorneys thought that Section 820 would remedy the bad debt situation by providing an adjustment where a taxpayer who claimed a bad debt deduction for 1938 finally discovered, after controversy with the Commissioner or litigation in the courts, and after the expiration of the period of limitations for 1935, that the debt had become worthless in 1935. Section 820, however, in neither initial nor final form, covered the situation where the determination disallows a deduction which was erroneously disallowed or omitted in another taxable year. The omission of this case from Section 820 has given rise to severe criticism of the section, and yet from the discussion above it is clear that its inclusion would have had the effect of destroying the statute of limitations with respect to deductions. The taxpayer who neglected to take a deduction properly allowable for 1935, as to which year the period of limitations on refund claims had expired, could take that deduction in his return for 1940, or 1941, etc., or claim a refund for those years, force the Commissioner to take a position inconsistent with the omission of the deduction in 1935, 153 and then, after the Commissioner had won the case, claim an adjustment for 1935. Congress recognized that Section 820 was not the proper vehicle for solving the bad debt problem, for the cure would have been worse than the disease, and consequently the "failure to obtain a deduction" case is not found in subsection (b). 184 Congress, however, did

150. Id. at 79.
151. Report of the Senate Committee on Finance, supra note 122, at 49.
152. For a discussion of the bad debt problem and suggestions for its solution, see Paul, Studies in Federal Taxation (1st Series 1937) 255 et seq.
153. The text assumes that the Commissioner to win the case would be forced to specify the year in which the deduction was properly allowable, here 1935, so that he would thereby be maintaining an inconsistent position. If, as is the situation in most bad debt and stock worthlessness cases, the Commissioner successfully defended solely on the ground that the debt did not become bad, or the stock worthless, in the year claimed by the taxpayer, and did not specify the year in which the deduction was properly allowable, there would not be a maintenance of an inconsistent position by the Commissioner and an adjustment could not be obtained by the taxpayer even if the "failure to obtain a deduction" situation were covered in subsection (b).
154. While a shift of position was evident in the omission of income cases where tax was later paid, so that subsection (b)(3) could be included, Congress apparently thought that there was no comparable standard in the deduction cases. It may be possible to provide that, if the deduction had been denied by the Commissioner for the earlier year, later disallowance, where the Commissioner had maintained that the deduction was allowable for the year for which it had previously been claimed and denied, would result in an adjustment, as here the earlier denial indicates the shift of position on the part of the Commissioner and thus provides a standard whereby the case in which the Commissioner took no action with respect to the earlier year may be differentiated. If, however, the later disallowance did not involve the maintenance of an inconsistent position, but simply
attempt to ameliorate the problem by providing in Section 801 that a closing agreement could relate to a taxable year not yet closed. Under this section, a taxpayer who claims a bad debt deduction for 1938 which is disallowed in 1939 on the ground that the debt has not yet become worthless can protect himself to some extent against a later shift in position by obtaining a closing agreement providing that if the deduction is disallowed when claimed again for a later year on the ground that it was properly allowable for 1938, an adjustment would be made for 1938.

Correlative Deductions and Inclusions Specified in Section 162(b) and (c), Revenue Act of 1938, and Corresponding Provisions of Prior Revenue Acts.

Subsection (b)(4) covers the special class of cases involving the allocation of tax between trust or estate on the one hand and beneficiaries, heirs and legatees on the other. Section 162(b) of the Revenue Act of 1938, in harmony with prior Acts, provides that the trust shall be allowed as an additional deduction in computing net income the amount which is to be distributed currently to the beneficiaries, but that the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed or not. Similar treatment is provided by Section 162(c) for income received by the estate during the period of administration and income which may be either

resulted from the successful assertion by the Commissioner that the deduction was not allowable in the later year, no adjustment could be secured. See note 153, supra. It has been suggested, Comment (1938) 52 HARV. L. REV. 300, 304, that adjustment be allowed to the taxpayer who claimed a deduction in the wrong year when he could prove that he had acted in good faith. The academic merit of such a plan is outweighed, however, by practical administrative difficulties.

155. Section 801, REVENUE ACT OF 1938, amending § 606(a), REVENUE ACT OF 1928, which limited closing agreements to years “ending prior to the date of the agreement.”

156. Regulations 101, Appendix, T. D. 4855; Commissioner's Mimeograph, No. 4821, August 19, 1938, stating that “A closing agreement as to specific matters, Form 906, should be secured whenever the taxpayer and the Commissioner have concurred in the disposition of an item and such closing agreement is considered necessary to insure consistent treatment of such item in any other taxable period.” Here again, however, compare note 153, supra.

Similarly, the closing agreement device may be used in the “failure to include income” cases not covered by subsection (b)(3) as tax has not been paid. Another administrative device has been suggested to ameliorate situations in which taxable items have been completely omitted or the benefit of lawful deductions denied. This proposal in substance is that a deficiency letter with respect to the alleged improper omission of an item of income for a particular year shall have the same effect in tolling the statute of limitations as if corresponding deficiency letters had been duly issued for every taxable year then open; and, correspondingly, that a claim to the benefit of a deduction made in a return or a claim for refund shall be given like effect with respect to every open taxable year. Full consideration of this suggestion would involve a prolonged excursion into matters foreign to the main topic of the present article.
distributed or accumulated in the discretion of the fiduciary. Subsection (b)(4) relates solely to the special deductions and inclusions thus provided for in Section 162(b) and (c), and by authorizing an adjustment makes possible the correct allocation of trust income in situations where such allocation is prevented by the statute of limitations or some other provision of the internal revenue laws. Thus, suppose a trustee claimed in the trust return for 1935 a deduction for amounts distributed to the beneficiary. The beneficiary included the amounts in his return for that year. In 1938, the Commissioner asserted a deficiency against the trustee on the ground that the amounts distributed to the beneficiary represented a charge against the trust corpus and did not constitute a distribution of income. The deficiency is sustained by final decision of the Board of Tax Appeals in 1941, after the expiration of the period of limitations for filing claim for refund by the beneficiary for 1935. Subsection (b)(4) authorizes an adjustment with respect to the beneficiary's tax for 1935.

All of the tax possibilities inherent in the trustee-beneficiary relationship are not covered by Section (b)(4). As fiduciary and beneficiary

157. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-4, indicate the various types of cases that may arise under subsection (b)(4). Suppose the beneficiary erroneously failed to include income distributable by the trust but the trustee properly took the additional deduction. The beneficiary's case is closed by a closing agreement but the period of limitations has not yet expired with respect to the trustee. The Commissioner asserts a deficiency against the trustee, claiming that the deduction was improper but final decision of the Board is rendered against the contention. The Commissioner may secure an adjustment with respect to the beneficiary. As the Commissioner, however, could have asserted the deficiency against the trustee, although realizing it would fail, solely for the purpose of securing a determination with respect to the deduction which he could then use under § 820 to pry open the beneficiary's closed year, it may be thought that subsection (b)(4) permits a procedure which was deemed improper under subsection (b)(3). In the normal case, however, the periods of limitations with respect to trustee and beneficiary expire at the same time, so that if it is too late to proceed directly against the beneficiary, it will likewise be too late to proceed against the trustee solely to obtain a determination. A safeguard is thus generally present in these cases which does not obtain in subsection (b)(3) cases, or in the total failure to obtain a deduction situation, for in the latter no such temporal limitation prevails with respect to the proceeding to obtain a determination. The net result of subsection (b)(4) is that, with respect to the additional deductions and inclusions specified in § 162(b) and (c), taxpayers and the Commissioner may avail themselves of the longer period of time within which action is permitted either with respect to the trustee's or beneficiary's tax liability, so that if the trustee's return may still be affected by assessment or refund, the beneficiary's return may likewise be affected. Suppose, however, that where the trustee took an additional deduction for 1934 but the beneficiary did not return the income in his return for that year, after the expiration of the period of limitations with respect to both trustee and beneficiary for 1934, the Commissioner then, with malice aforethought, asserted a deficiency for 1936 against the beneficiary on the ground that the 1934 distribution should be included in gross income for that year. After the Commissioner loses, he claims an adjustment against the trustee under subsection (b)(4). No adjustment would be authorized as the beneficiary could here defend on the ground that the income was not taxable in 1936 but, if taxable to him at all, properly taxable in 1934, and thus avoid maintaining a position inconsistent with the deduction by the trustee.
constitute related taxpayers, they are also affected by subsections (b) (1), (2) and (3), and, in addition, they may fall under subsection (b)(5) in an appropriate case. For example, if the beneficiary erroneously obtains an allowance for depreciation and later, after the expiration of the period of limitations on assessment against the beneficiary, a determination requires that the trust be given the deduction for depreciation, an adjustment is authorized by subsection (b)(2) with respect to the beneficiary. As Section 162(b) and (c) provide for the special deduction of amounts which must in any event be included in the gross income of the trust and as the complementary item for the beneficiary is an inclusion, these situations could not be subsumed under subsections (b) (1), (2) and (3) and a special category was necessary.

**Determination of Basis of Property Where There Has Been Erroneous Treatment of a Transaction Upon Which Such Basis Depends.**

Subsection (b)(5), which relates to basis problems, involves, by far the most difficult cases covered by Section 820. It provides an adjustment where the determination establishes the basis of property, either for gain or loss on its disposition or for depreciation or depletion, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from gross income or an erroneous recognition or nonrecognition of gain or loss. It thus deals with situations where either a stepped-up or reduced basis is obtained by reason of a determination of basis predicated on proper treatment of the transaction upon which the basis depends and prompted by the assertion of a position inconsistent with the earlier, and erroneous, treatment of that transaction. The subsection carefully provides, however, that while the person, either transferee or vendee, who acquired the property in that transaction is affected by later inconsistent action either on his own part, or that of his successors in title, or the Commissioner, such inconsistent action does not affect the transferor or vendor in that transaction. Stated


159. The language of subsection (b)(4) includes a specific reference to § 162(b) and (c) of the **Revenue Act of 1938**, so that each succeeding Revenue Act containing provisions similar to that section will necessitate amendment of subsection (b)(4) to bring it up-to-date. Rewriting of the subsection to eliminate such reference is a difficult task. The following phrasing may be helpful as a suggestion:

“(4) Allows or disallows to the fiduciary in computing the net income of the trust or estate an additional deduction in respect of income included in the gross income of the trust or estate and the correlative item has been erroneously excluded or omitted from, or included in, as the case may be, the gross income of the beneficiary, legatee, or heir; or requires the inclusion in or the exclusion from the gross income of a beneficiary, legatee, or heir of an item of income and the correlative additional deduction has been erroneously disallowed to or omitted by, or allowed to, as the case may be, the fiduciary in computing the net income of the estate or trust; or . . .”
differently, the error must have been either with respect to the taxpayer as to whom the determination is made or with respect to a person who, in the transaction erroneously treated, acquired title to the property involved in the determination and from whom, mediatelY or immediately, the taxpayer with respect to whom the determination is made derived title, with a substituted basis, subsequent to the transaction. As a consequence, the transferor and transferee of the erroneous transaction cannot affect each other by later inconsistent conduct but can only subject themselves to an adjustment; any successor in title whose basis depends on the basis in the hands of the party to the erroneous transaction from whom his title is derived may affect that party, with the proviso that the chain of title is not traced through the transaction.

These situations can best be expressed by a series of examples: 160

Suppose that in 1934 taxpayer A exchanged his Blackacre property, having a $10,000 basis and a fair market value of $20,000, for the Whiteacre property of taxpayer B, having a $15,000 basis and also a fair market value of $20,000. In their returns for that year both taxpayers treated the exchange as one in which gain or loss was not recognized, under Section 112(b)(1). The period of limitations with respect to 1934 having expired:

1. In 1939, taxpayer B claims that gain should have been recognized on the exchange and that Blackacre has a $20,000 basis for depreciation in his hands. His contention is sustained in a final Board of Tax Appeals decision. An adjustment is authorized with respect to B's tax for 1934 as the basis for depreciation depends on the transaction in 1934 and, as concerns that transaction, there was an erroneous nonrecognition of gain with respect to the taxpayer, B, as to whom the determination is made. 161 No adjustment is authorized as to A, however, although there had also been an erroneous nonrecognition of gain in his case, as A was not the taxpayer with respect to whom the determination is made, nor does the determination relate to property which A acquired in the exchange, but rather to property which he transferred. While B derived title to the property from A, the derivation was not subsequent to the transaction but in the transaction itself. Likewise, if B had for the first time claimed the higher basis on a sale to C in 1940, adjustment would be authorized with respect to B but not to A. 162

160. See the examples in Regulations 101, Appendix, T. D. 4856, Art. 820(b)-5.
161. The amount of the adjustment would be the full amount of the tax on the gain from the exchange even though the taxpayer in claiming the higher basis for depreciation purposes did not, unlike the effect of a claim of higher basis on a sale, obtain in the year to which the claim related the full effect of the higher basis.
162. If B had previously claimed a higher basis for the purpose of depreciation and the Commissioner had obtained an adjustment, use of the higher basis by B on the sale to C would not result in a second adjustment, since, as a result of the earlier adjustment (see note 161, supra), there is neither an inconsistent position nor an erroneous nonrecognition of gain with respect to the transaction in which B acquired the property.
(2) In 1940, A gives Whiteacre to D. Thereafter, in 1941 D sells this property and claims a $20,000 basis, stating that as gain should have been recognized on the 1934 transaction the basis in the hands of A, his donor, was $20,000. This position is sustained by a final Board decision. An adjustment is authorized with respect to A’s tax for 1934, as the basis in the hands of D depends on the 1934 transaction and with respect to that transaction there was an erroneous nonrecognition of gain to A, a person who acquired title to Whiteacre in the transaction, and from whom immediately the taxpayer, D, derived title subsequent to the transaction. But as subsection (b)(5) does not permit tracing of title through the erroneously treated transaction, there is no adjustment authorized with respect to B because of D’s action.

The words “or any person who acquired title to such property in such transaction and from whom mediatel or immediately the taxpayer derived title subsequent to such transaction” thus perform two functions: (1) Together with the words “any transaction upon which such basis depends” they provide that the subsequent conduct of a donee or other taxpayer with a substituted basis shall affect the predecessor in title who acquired the property in the transaction; (2) They ensure that the subsequent conduct of the transferee or vendee who acquired title in the transaction, or of any of his successors in title, shall not affect the transferor of the property in the transaction.63 With respect to the first result, the section has been criticized on the ground that where the donee of property takes a position, to his advantage, inconsistent with the treatment accorded the transaction in which his donor acquired the property, an adjustment is authorized with respect to the donor under which he will be obliged to pay a deficiency. While it is recognized that most donees would not thus bite the hand that fed them, it is argued that an embittered donee might well advance an advantageous claim although its success would mean that the donor would be subjected to a deficiency. Such critics do not deny the merit of subsection (b)(5) where the taxpayer who adopts the inconsistent position is the one that is thereby subjected to the adjustment. But it is obvious that if the subsection had not been extended to the donee, a serious loophole would have been afforded. A taxpayer who failed to recognize gain on the acquisition of property and who later desired to obtain the higher basis without an adjustment, could through a gift permit his donee to assert the inconsistent position and thereby

63. The words “who acquired title to such property in such transaction” were added to the Senate draft to accomplish this purpose. See the Statement of the House Managers, op. cit. supra note 122, at 58. It would seem that this addition makes the words “subsequent to such transaction” superfluous as the derivation of title would necessarily be subsequent. While the wording of the Senate draft prevented the transferee’s action from affecting the transferor, it did not protect the transferor from adjustment where the inconsistent position was taken by a transferee of the transferee.
avoid the adjustment. Congress quite properly recognized that the advantage of tax stability afforded by this subsection was not to be sacrificed because in a rare case a donor who misplaced his trust might come to grief.

The second result of the words quoted in the preceding paragraph is significant in exchanges under Section 112(b). If partners A, B, C, and D transfer their business to corporation X in return for an original issue of its stock and all parties treat the exchange as tax-free, a subsequent successful claim by A that the exchange was one in which gain should have been recognized, as the stock each partner received was not substantially in proportion to his interest in the property, will result in an adjustment with respect to A but not to B, C, D, or corporation X. A contrary rule would have made the scope of adjustments too broad: corporation X’s depreciation account, for example, would be uncertain until all of the partners had disposed of the stock by sale or death; likewise, each partner would be insecure until all of the others had parted with their stock. The limited scope of the subsection in this regard may be clearly seen in connection with the change in interpretation effected by the decision of the Supreme Court in United States v. Hendler. Previous to this decision, an assumption of indebtedness by the transferee was not considered other property or money received as taxable boot by the transferor under Section 112(d), so that tax was not paid by transferors with respect to such assumptions of indebtedness. The Hendler decision, however, held such a construction was erroneous, and while it may be argued that the decision is restricted to the facts of immediate payment by the transferee of a due debt, there are indications that it may extend to all assumptions of indebtedness. As a consequence, transferors and transferees are now in a position to claim a stepped-up basis to the extent of the gain that should have been recognized because of the assumptions of indebtedness. If the transferor claims such basis, he will be subject to an adjustment under subsection (b)(5); but if the transferee claims the higher basis, the transferor will not be affected nor will the transferee itself be subject to an adjustment, as

164. See Report of the Senate Committee on Finance, supra note 122, at 50. By adopting this rule, however, the subsection fails to cover other exchanges where adjustments would seem proper, as where a parent corporation liquidates a subsidiary by acquiring its assets and later successfully claims a stepped-up basis. No adjustment is authorized with respect to the tax of the subsidiary, although as the parent corporation in practice assumes the liability of the dissolved subsidiary, the adjustment would have been borne by the parent.

165. 303 U. S. 564 (1938).


under the circumstances there could be no erroneous nonrecognition of
gain to it at the time of the transfer. 168

While it was apparently contemplated that subsection (b)(5) extended
only to cases where the transaction erroneously treated involved the
acquisition of property, 169 it literally covers certain cases where the trans-
action affecting the basis occurred after the acquisition of the property.
Suppose a corporate distribution has been erroneously taxed as a dividend.
Later, when the stockholder sells the stock, the Commissioner success-
fully contends that the basis of the stock should have been reduced under
Sections 115(d) and 113(b)(1)(d), Revenue Act of 1938, as the dis-
tribution was applicable in reduction of basis. An adjustment would
seem authorized, as there has been an erroneous inclusion in gross income
in respect of a transaction upon which the basis depends. But if the
stockholder had made a gift of the stock and the determination had been
with respect to the donee, no adjustment would be authorized, as the donor
did not acquire the stock in the erroneously treated transaction upon
which the basis depends. Consequently, the description of the predecessor
in title as a person “who acquired title to such property in such transac-
tion” is too narrow when applied to transactions affecting basis occurring
after the acquisition of the property. In the converse situation, where
the corporate distribution had been erroneously treated by the stockholder
as non-taxable, but he later successfully obtained the full basis by con-
tending that the distribution should have been taxed, no adjustment is
authorized with respect to the previous treatment of the corporate dis-
tribution; while with respect to the receipt of such distribution there
was an erroneous omission from gross income, it was not in respect of
any transaction upon which the basis depends, for correct treatment of
such distribution divorces the basis from the distribution. 170 Thus, where
the previous transaction is erroneously treated as resulting in taxable
income and not as affecting basis, adjustment is authorized; where it

and (c).

169. Report of the Senate Committee on Finance, supra note 122, at 49, states that one
of the principles upon which § 820 is based is that “Disputes as to the basis of property
should not allow the taxpayer or the Commissioner to obtain an unfair tax advantage by
taking one position at the time of the acquisition of property and an inconsistent position
at the time of its disposition.” The title of the Article in the Regulations dealing with
subsection (b)(5), Regulations 101, Appendix, T. D. 4856, Art. 820(b)-5, is “Deter-
mination of basis of property in case of erroneous treatment of transaction relating to
acquisition thereof.” Subsection (b)(5) includes all types of acquisition within its scope,
whether by purchase, exchange, receipt of property as payment for services rendered
[Example (3) under Art. 820(b)-5 of the Regulations], etc.

170. The text thus strictly interprets the phrase “any transaction upon which such
basis depends” as limited to transactions upon which the basis actually depends—trans-
actions which have the effect of increasing or reducing the basis—and as not including
transactions with respect to which there is a controversy over whether they do or do not
affect basis and it is finally determined that they do not.
is erroneously treated as affecting basis, and not as resulting in taxable income, adjustment is not authorized. As an adjustment would seem desirable in the latter situation where the taxpayer claims the full basis, subsection (b)(5) is also too narrowly drafted in this regard. It should be noted, however, that while the first situation is similar to subsection (b)(1)—an item is taxed once because of its inclusion in gross income and again as part of the gain on the sale, the second is similar to subsection (b)(3)—an item is erroneously omitted from gross income and later excluded from the gain on the sale, so that to preserve the statute of limitations in this case an adjustment would be proper only if tax calculated upon the reduced basis had first been paid by the stockholder and he then had claimed the full basis.

Transactions intermediate between the acquisition and disposition of property may also serve to increase the basis. Suppose an expenditure in connection with property is erroneously deducted from gross income as an ordinary expense but on later sale of the property the taxpayer

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171. While these situations are similar to subsections (b)(1) and (3), they are not covered by those subsections. Thus, although the item included in gross income when the distribution is made is also deducted from the basis of the stock when it is sold, it is not thereby again included in gross income as a separate item, but rather, as the basis is reduced by the item, a larger profit on the sale results and it is this item—gain on the sale—that is included in gross income in the later year.

172. It may be noted, however, that subsection (b)(5) in respect to errors pertaining to the acquisition of the property disregards the limitation effected in subsection (b)(3) through the requirement that tax be paid. Thus, in a case where a taxpayer who had acquired stock in a transaction erroneously treated as nonrecognizable later sells the stock and uses the stepped-up basis, the Commissioner may utilize § 820 to open the statute of limitations with respect to the year of the earlier transaction simply by asserting a deficiency, admittedly unfounded, urging the lower basis, thereby obtaining a determination and consequent adjustment. In objective outline the situation involves merely the failure to include an item, here the gain on the earlier transaction, in gross income and in this sense does not differ from the basic situation considered in subsection (b)(3).

The fact that but for the payment of tax requirement in subsection (b)(3) the Commissioner could in any later year have used § 820 to pry open the statute of limitations, whereas in subsection (b)(5) he is forced to wait until the taxpayer claims the stepped-up basis perhaps does not distinguish the two situations. It may be argued, however, that as the basis accorded by the revenue acts to property for the purpose of gain or loss or other disposition assumes proper tax treatment of the transaction upon which such basis depends, departures from the statute of limitations are justified whenever a basis predicated upon proper treatment has been obtained, but in fact such treatment of the earlier transaction had not been made. Thus, § 113(a)(6), in increasing the basis by the amount of gain to the taxpayer “that was recognized upon such exchange under the law applicable to the year in which the exchange was made,” assumes that in fact such gain will be taxed. If it is not taxed and the increased basis is later obtained, proper functioning of the basis provisions requires the opening of the statute of limitations effected by subsection (b)(5). Similarly, subsection (b)(5) permits a taxpayer who failed to take a loss on an exchange erroneously treated as nonrecognizable to open the statute of limitations, after unsuccessful claim of the higher basis on later disposition, and obtain the deduction for the loss, although the situation involves a “failure to obtain a deduction” case.
successfully contends that it should have been capitalized and the basis increased. In this situation no adjustment is authorized; although the basis depends upon a transaction erroneously treated, the error is not of the nature described in subsection (b)(5), an erroneous allowance of a deduction not being specified. This case is similar to subsection (b)(2), a deduction erroneously allowed has been allowed again as an increase in basis,\(^{173}\) and consequently should have been included in subsection (b)(5). The converse situation is also not covered by subsection (b)(5), so that if the expenditure had erroneously not been deducted as ordinary expense, the taxpayer believing it to be a capital expenditure, and later the Commissioner had successfully contended that the basis was not increased, no adjustment is authorized; the basis, as evidenced by the Commissioner’s contention, does not depend upon the transaction erroneously treated, and, moreover, an erroneous omission of a deduction is not one of the described errors. But this situation is similar to the case of a complete failure to obtain a deduction—a deduction erroneously omitted has not been allowed as an increase in basis, and proper preservation of the statute of limitations would make adjustment undesirable in this situation.\(^{174}\)

Subsection (b)(5) presents an interesting problem where the transaction erroneously treated concerns the disposition of only part of the

\(^{173}\) The case is not covered by subsection (b)(2) for the deduction erroneously allowed is not again allowed as an independent deduction, but serves instead to reduce or increase the amount of the item or deduction, gain or loss on the sale, that is included in or deducted from gross income.

\(^{174}\) The treatment of depreciation under subsection (b)(5) is governed by the rules stated in the text. Where the taxpayer successfully claims a higher basis because of erroneous nonrecognition of gain with respect to the transaction in which the property was acquired, and the claim relates either to the basis for depreciation or for gain or loss on a sale of the property, he would not obtain adjustment with respect to the intervening years in which depreciation was taken at the lower basis, as such depreciation is not a transaction upon which the basis later determined depends. While the incorrect allowances for depreciation are traceable to the error for the year of acquisition, such collateral effects of an error in other years are not corrected by §820. See p. 49, supra. In the case of the sale, as the adjustment of the basis for depreciation cannot be less than the amount allowable in the intervening years [§113(b)(1)(B), Revenue Act of 1938], an amount greater than that previously allowed would be deducted from the basis where the taxpayer claimed the stepped-up basis. The taxpayer, however, invited these consequences by voluntarily asserting the inconsistent position. Similarly, if the error were a failure to recognize a loss on the earlier exchange, and the Commissioner with respect to the basis for sale successfully contended that it should be reduced because of the loss that should have been recognized, no adjustment would be made for the intervening years in which depreciation had been taken on the higher basis. Where the Commissioner, in adjusting the basis for the sale, deducts for depreciation an amount greater than that actually allowed in accordance with the provision that the adjustment for depreciation cannot be less than the amount allowable, no adjustment is authorized by §820 for the intervening years. Section 113(b)(1)(B), Revenue Act of 1938, reinforces the period of limitations on annual deductions for depreciation and the situation is thus in effect similar to the complete failure to obtain a deduction, discussed supra, p. 63.
property. Suppose that the taxpayer in 1932 acquired land at a cost of $100,000. In 1934 he sold one-half of that land and computed his gain on a cost basis of $50,000. In 1938 he sold the remaining portion but claimed that as in 1934 it was the more valuable half, it should have a $65,000 basis, computed on an allocation based upon the market values in 1934 of the respective portions. If his contention is sustained, subsection (b) (5) would permit the Commissioner to obtain an adjustment with respect to 1934, as the basis for the 1938 sale depends upon the transaction in 1934. 175 Would the result be different if the property originally acquired consisted of two distinct lots, and after an erroneous allocation of basis for the purpose of computing gain on the sale of one of them, the properly allocated basis is obtained on the sale of the second lot? It would appear that no adjustment would be authorized; the basis for the second lot does not depend on the sale of the first inasmuch as the erroneous allocation in legal effect antedates the sale of the first lot, being based on the respective market values at the time the lots were acquired, while in the preceding example the allocation was made at the time of, and because of, the sale of a portion of the previously undivided lot. 176 This contention would be forcefully illustrated if depr-

175. But, as previously indicated, if a donee of a taxpayer had made the sale in 1938, no adjustment would be authorized as the donor did not acquire title in the erroneously treated transaction.

A similar situation is presented in the following example: the taxpayer in 1934 assigned his interest, which had a $100,000 cost basis, in oil and gas property in return for a cash payment of $100,000 plus an additional $300,000 to be paid out of the oil and gas, if and when produced. The transaction was treated as a sale of the taxpayer's entire interest in the property and no gain was recognized as the cash payment did not exceed the basis. In 1936 the taxpayer received $100,000 out of the proceeds of the sale of oil and gas and claimed that, as the original transaction really involved a sale of his interest only to the extent of the cash payment, he had retained an economic interest in the oil and gas in place to the extent of the additional consideration to be paid out of the proceeds of the oil and gas later sold, and therefore the basis should be allocated one-fourth to the cash payment and three-fourths to the later payments. Accordingly, as respects the 1936 payment, he was entitled to a deduction for depletion based on one-fourth of the original basis. Cf. Fleming v. Commissioner, 82 F. (2d) 324 (C. C. A. 5th, 1936).

If the taxpayer is successful, the Commissioner could claim that the basis for depletion depends on the erroneously treated transaction of 1934 and that an adjustment is authorized under subsection (b) (5), in that as the portion then sold had a basis of $25,000, there was an erroneous nonrecognition of $75,000 gain.

176. Suppose the taxpayer received a stock dividend in 1934 which he treated as nontaxable under § 115(f), Revenue Act of 1934. He sold the stock dividend in 1935 and computed his gain in accordance with the basis resulting from the allocation of the basis of his original stock between it and the dividend stock. He then sold his original stock in 1938 and claimed its entire cost as the basis, relying on Koshland v. Helvering, 298 U. S. 441 (1936). If he is successful, is an adjustment authorized with respect to the sale of the dividend stock, assuming that it properly had a zero basis? Cf. Helvering v. Gowran, 302 U. S. 238 (1937). Apparently not, as the decision that the dividend stock has a zero basis establishes that the basis of the original stock does not depend upon either the receipt or sale of the dividend stock. Next, suppose that the method of allo-
ciable property were involved. The argument against adjustment is even stronger where the property acquired consists of separate identical units, so that the allocation is purely arithmetical. As such an interpretation, however, would prevent an adjustment in that no transaction is present upon which the erroneous allocation may be said to depend, and as the sale is a transaction which is directly affected by the erroneous allocation, it is possible that a contrary construction may be adopted. Where the error is not with respect to the method or manner of allocation of a correctly determined basis, as in the above situations, but involves a mistake in the basis to be allocated, a different question is presented. If the allocation *qua* allocation is correct but the erroneous original basis has been used for allocation purposes on the first sale and the proper original basis on the second, so that the second sale is inconsistent with the treatment of the transaction involving the acquisition of the property, while an adjustment is authorized under subsection (b) (5) with respect to such transaction, no adjustment would seem authorized with respect to the first sale, even in the situation where allocation was necessary because of such sale.

**Related Taxpayers.**

The discussion so far has been largely in terms of a single taxpayer and the Commissioner as the parties to a determination and an adjustment. Section 820, however, is also applicable to “related taxpayers,” so that the determination may involve one of the taxpayers in the relation and the adjustment involve the other. Our first inquiry here is as to the relationships covered by Section 820.

(1) **Relationships Subject to Section 820.** Six relationships are specified in subsection 820(a) (3): husband and wife, partners, decedent and decedent’s estate, and the trust relationships of grantor and fiduciary, grantor and beneficiary, fiduciary and beneficiary, legatee or heir.

177. The amount of the adjustment, being computed on the basis of complete correction of the error, would be equal to the entire amount of the gain or loss not recognized on the transaction involving the acquisition of the property, and is not limited to an aliquot portion determined by reference to the relation between the entire property acquired and the portion later sold as to which the inconsistent position was asserted. See Regulations 101, Appendix, T. D. 4856, Art. 820(b)-5, Example (4).

178. See Regulations 101, Appendix, T. D. 4856, Art. 820(b)-5, Example (4), which takes this position in a situation where the property acquired consisted of identical shares of stock.

179. The Senate draft included the additional relationships of assignor and assignee, donor and donee, lessor and lessee, and claimants to ownership of the same property or income.
Congress thought that the nature of these relationships was such that in most cases in which they were present it could safely be presumed that the parties would act in unison and would present a single approach to their tax problems. In most part it was merely reiterating for the purposes of Section 820 a conclusion earlier reached with respect to the tax consequences of other transactions. Thus, among other cases, losses are now disallowed if they result from sales or exchanges of property between members of a family, a grantor and a fiduciary, a fiduciary and a beneficiary. Again, a somewhat similar presumption is made in the case of a trust which is revocable by the grantor in conjunction with a person not having a substantial adverse interest in the disposition of its corpus or income. Moreover, as these relationships give rise to difficult problems concerning the allocation of income to the proper party, especially where the relationship is further complicated by assignments between the parties, the ensuing tax litigation has frequently resulted in the inequities sought to be eliminated by Section 820. The proper background for this phase of Section 820 is therefore not that presented by the problem of correctly taxing partner A’s dividend income from stock which he owns and partner B’s rental income from his personally owned property, but by the question of the proper apportionment of partnership income between partners A and B; nor is it the taxation of the husband on income from property owned by his wife merely for the purpose of treating the family as a unit, but rather the problem of properly taxing insurance commissions assigned by the husband to the wife.

Related taxpayers are specifically covered in the first four types of cases specified in subsection (b). The fourth case, however, deals only

The inclusion of the fiduciary as a related taxpayer has been criticized on the ground that an executor who closes an estate may years later become personally liable for an adjustment under § 820 because of the provisions of Rev. Stat. § 3467 (1875), as amended, making an executor personally liable for debts due to the United States by the estate where he pays any other debt of the estate prior to satisfaction of the former debt. If the adjustment, however, were authorized after the payment of the debts of the estate, the amount of the adjustment would not be a debt due to the United States at the time of such payment, so that personal liability may occur only where the adjustment was authorized prior to payment of the other debts of the estate.

180. Section 24(b), Revenue Act of 1938.
181. Sections 166 and 167, Revenue Act of 1938.
182. Report of the Senate Committee on Finance, supra note 122, at 50; Statement of the House Managers, op. cit. supra note 122, at 58.
183. The erroneous transaction need not be one possible solely by reason of the existence of the relationship, but rather need only concern taxpayers who are related, so that the erroneous treatment of an assignment of rents from partner A to partner B is covered, though neither the rents nor assignment were partnership matters. Regulations 101, Appendix, T. D. 4856, Art. 820(a)-4. See Statement of the House Managers, op. cit. supra note 122, at 58, stating that assignor and assignee, donor and donee, lessor and lessee, and claimants to ownership of the same property are eliminated as “independent categories” of related taxpayers.
with one of these relationships, that of fiduciary and beneficiary, legatee or heir, as it is limited to the special situations considered in Section 162(b) and (c). While subsection (b)(5) in effect extends to taxpayers who are related by reason of a substituted basis, such as donor and donee, transferor and transferee in Section 112(b)(4) and (5) transactions, etc., it does not concern itself with related taxpayers as the term is defined in Section 820. For the purposes of subsection (b) the term “taxpayer” refers to the individual with respect to whom the determination is made, the term “related taxpayer” refers to the individual with respect to whom the adjustment is authorized. 185

(2) Time at Which Relationship Must Exist. The principal problem in connection with related taxpayers concerns the time at which the relationship must exist. Subsection (a)(3), by including in the definition of “related taxpayer” the words “in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance . . . was made” specifies one temporal requirement. The Regulations interpret these words to mean “at some time during that taxable year,” so that it is not necessary for the relationship to exist throughout the entire taxable year. 186 This requirement in reality is little more than a restatement of the existing situation, as it is the presence

184. Consequently, the omission of the donor-donee category from the definition of related taxpayers (see notes 179 and 183, supra), does not prevent the application of subsection (b)(5) to donor-donee cases.

185. Cf. subsection (a)(3), indicating that as to subsections (b)(1), (2), (3), and (4) the “taxpayer” is the person with respect to whom the determination is made. While the wording is not explicit, the term “taxpayer” in subsection (b)(5) is similarly used. In subsections (c) and (d) the term “taxpayer” is used generally to refer to the taxpayer with respect to whom the error was made. Statement of the House Managers, op. cit. supra note 122, at 59. The definition of “taxpayer” in subsection (a)(2) was necessary to cure the problem created by § 901, which confines the term, when used in the Revenue Act of 1938, to persons subject to a tax imposed by that Act.

186. Regulations 101, Appendix, T. D. 4856, Art. 820(a)-4. The relationship of decedent and decedent’s estate presents an interesting problem in connection with this requirement. If the error occurred in respect of a taxable year during which the decedent was alive and the determination is with respect to the return filed by the decedent’s estate on behalf of the decedent, no problem of related taxpayer would seem to be present, but rather the error and determination relate to the same taxpayer, the decedent. If, however, the determination is with respect to the return of the decedent’s estate, related taxpayers are involved but obviously the relationship could not exist with respect to the year as to which the error was made, so that no adjustment would be possible in this case. If the error occurred with respect to the return of the decedent’s estate and the determination is with respect to the return filed by the decedent’s estate on behalf of the decedent, the relationship existed at the requisite time. But if the reverse be the case, the error occurring with respect to the return filed by the decedent’s estate on behalf of the decedent and the determination is with respect to the return of the decedent’s estate, it would seem that the case is no different from that where the error occurred with respect to a return filed by the decedent during his lifetime and that the temporal test of subsection (a)(3) is not satisfied.
of the relationship which results in the doubt as to the choice of the proper taxable person, which doubt, in turn, causes the error requiring adjustment.\textsuperscript{187} The second temporal requirement is specified in the latter part of subsection (b) where it is provided that if the adjustment constitutes a deficiency, the relationship must exist when the inconsistent position is maintained. In such a situation it is the taxpayer who has maintained the inconsistent position, and as the inclusion of the related taxpayer categories rests on the presumption that with respect to the original error and the later inconsistent treatment the two taxpayers will act in unison, it follows that the requirement of the existence of the relationship at the later time is essential. If the relationship had terminated prior to the taking of the inconsistent position, no adjustment is authorized although the result of the successful maintenance of the inconsistent position is that both taxpayers obtain a deduction, for example, to which only one is entitled.\textsuperscript{188} Where, however, the inconsistent position is taken by the Commissioner, so that the adjustment would constitute an overpayment, the basis for the adjustment is not the presumption of unison but the fact that the Commissioner by his inconsistency has in effect taxed two persons on the same income, or disallowed to each a deduction which one properly should have. In this situation, the adjustment should be made even though the relationship has been terminated;\textsuperscript{189} Section 820 so provides by limiting the requirement of continuation of relationship to cases where the adjustment constitutes a deficiency. In those cases, the time at which the relationship must exist

\textsuperscript{187}. As explained previously, \textit{supra} note 157, subsection (b) (4) disregards the limitation of payment in an “income never included” situation, and permits adjustment in a “deduction never allowed” situation. Inasmuch as the period of limitations will normally expire at the same time as respects both trustee and beneficiary, an adequate safeguard is present. It is arguable that the same situation exists with respect to other classes of related taxpayers, so that § 820 is thus too narrowly drafted, both because in subsection (b) (3) it applies the limitation of payment to related taxpayers, and it also fails to cover a “deduction never allowed” with respect to related taxpayers.

\textsuperscript{188}. The \textit{STATEMENT OF THE HOUSE MANAGERS, op. cit. supra} note 122, at 58, in timing the requirement to cases where the relationship is “terminable” overlooks the fact that all of the relationships specified in subsection (a) (3) are terminable, so that no limitation actually results from such requirement. The Regulations are not so qualified. Regulations 101, Appendix, T. D. 4856, Art. 820(b)-8.

Section 820 would seem operative in the rare case where the taxpayers stood in one relationship in the earlier year, as that of partners, and in a different relationship, as that of husband and wife, at the time of the inconsistent position, inasmuch as either relationship is presumed under subsection (a) (3) to result in unity of action. Query, if in the case of the fiduciary-beneficiary relationship, the fiduciary in the earlier year had been replaced by a different fiduciary, would an adjustment be authorized under the wording of subsection (a) (3)?

\textsuperscript{189}. For the same reasons, the careful selection of the categories covered by the term “related taxpayer” likewise seems excessively cautious where the Commissioner has maintained the inconsistent position, for, regardless of the nature of their relationship, an adjustment should be made.
is described as follows: if the inconsistent position is asserted in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals, the requisite date is the date of filing of the document in which the position was asserted, or, if asserted in more than one such document, the date of filing of the document in which it was first asserted. 190 While these documents are the typical documents in which the inconsistent position would be maintained, it is possible that it may be otherwise maintained, as where a closing agreement allows the taxpayer a deduction not claimed in any of the above three documents. Consequently, if the inconsistent position is not so maintained, the requisite relationship must exist on the date of the determination. Section 820, finally, affords an additional safeguard where the related taxpayers become unfriendly, in that the determination with respect to one of the taxpayers is not conclusive as to the error with respect to the other. Under subsection (c) the Commissioner, unless a waiver is obtained, must proceed by way of notice of deficiency against the other taxpayer in order to establish the error and obtain the amount of the adjustment, so that the latter is afforded a judicial hearing in which he can assert any defenses at hand, regardless of the prior determination. 191

Effect of Section 820 Upon Judicial Doctrines Previously Applied.

There remains for consideration the effect of Section 820 upon the doctrines applied by the courts in this field prior to the enactment of Section 820. 192 Three broad questions may be asked: (1) Does Section 820 displace the judicial solution in those situations described in subsections (b) (1)-(5); (2) Does it prevent application of the judicial solution in those cases intentionally excluded by Congress from a general class to which Section 820 applies; (3) Does it prevent application of the judicial solution to those classes of cases to which Section 820 does not purport to apply? The following example illustrates the first ques-

190. The document must relate to the year with respect to which the determination is made, so that an inconsistent position taken in a return for an earlier year is not to be considered in fixing the time at which the relationship must still be in existence.

191. Suppose partner A took a deduction for 1935 to which he was properly entitled. Partner B claims the deduction in a refund claim and the Commissioner erroneously allows the deduction. He then seeks to obtain an adjustment with respect to A under subsection (b) (2), claiming that A erroneously took the deduction. A contests the adjustment and is successful in the Board of Tax Appeals. The Commissioner may then seek an adjustment with respect to B, likewise under subsection (b) (2). B may also contest the adjustment, and while it is probable that the decision in A's case will be persuasive, it is not binding and the court or Board may decide that B is entitled to the deduction. In that event, the Commissioner can proceed no further, as res judicata would bar another attempt at adjustment with respect to B. Similarly, if A had in the first instance obtained a court decision, the Commissioner could not proceed under § 820 after B had successfully defeated the adjustment.

192. See 48 YALE L. J. 509, 511 et seq.
tion: Suppose a taxpayer had erroneously failed to include an item in gross income for 1936, had erroneously included it in gross income for 1938 and had then brought suit for refund. Assume that the facts were such that a court would hold prior to Section 820 under established principles that the taxpayer was estopped from claiming that the item belonged in the barred year, so that his suit must fail. After the enactment of Section 820, should the court follow the precedents and estop the taxpayer or should it permit recovery of the refund on the ground that Section 820 was intended by Congress to provide an exclusive solution for this case, as it falls under Section 820(b)(3)? By its terms Section 820 applies only after a determination of the specified type has been made; it does not prescribe any rules as to when or in what cases such a determination shall be reached. It may be argued, therefore, that this section does not require a departure from any rules governing the determination established prior to its enactment. Accordingly, if the precedents require an estoppel, the court should deny the refund in the above example. Under this argument, Section 820 would apply only where the precedents would not justify an estoppel, i.e., where the court allowed the refund and thus brought about a determination under subsection (b)(3). This argument rests upon too narrow a conception of the purpose of Section 820. It is evident from the Committee Reports that Congress was motivated by three considerations: (1) the judicial doctrines offered an inadequate solution because of their uncertainty and one-sidedness; (2) a uniform, systematic statutory solution was desirable in those situations which lent themselves to such treatment; (3) for reasons previously described, the solution to be made uniform by the section in those situations was not to be that offered by the judicial doctrines but a procedure which enabled the party, either Commissioner or taxpayer, to shift his position if he so desired and thereby reach the correct result under the tax law, with the proviso that a compensatory adjustment was to be made. The Congressional purpose, therefore, can be fully executed only if the statutory solution thus adopted is permitted to operate exclusively in the classes of cases designated by Congress in subsections (b)(1)–(5) as permitting such uniform treatment. It necessarily follows from this view of Section 820 that it is a Congressional declaration that the judicial doctrines previously evolved are not to be applied by the court in those situations described in subsections (b)(1)–(5). In other words, if strict application of the revenue acts would produce a determination of the type enumerated in subsection (b)(1)–(5), the statutory law shall be applied. Moreover, a judicial estoppel is a matter of last resort. It will not be created where the aggrieved party


194. See supra, p. 3 et seq.
can otherwise be saved from unjust damage. Section 820 provides orderly and adequate relief in the cases which it covers. Consequently, as to those cases, the need for the estoppel doctrine is removed. In the foregoing example, therefore, the refund should be allowed by the court inasmuch as upon allowance, there would be a determination within the category described in subsection (b) (3). 195

The second of the questions above would be present if in the example given the taxpayer had correctly omitted the item from gross income for 1938 but the Commissioner had asserted a deficiency for that year. Assume, again, that the facts were such that a court would allow the deficiency by estopping the taxpayer from asserting that the item belonged in gross income for 1936. 196 Should the court still allow the deficiency or should it deny the deficiency on the ground that, as Congress had intentionally excluded from subsection (b) (3) a case where tax was not paid, it intended thereby that a strict application of the revenue acts should be made in such a case? It is believed, however, that these cases were excluded because, for the reasons stated above, 197 Congress realized they did not lend themselves to this particular systematic statutory solution. The solution in each case, therefore, was left to depend as formerly upon its particular facts. Accordingly, the established judicial doctrines are here left unaffected by Section 820. 198 For like reasons, and even more unhesitatingly, the same answer must be given to the third question above stated. 199

CONCLUSION

Obviously no attempt should be made to summarize the foregoing discussion in the ordinary sense. It is, however, in order to state very generally the conclusions toward which our exposition tends. First we desire to reiterate the hope and belief that the presence of Section 820 in the internal revenue laws will have the effect of tranquillizing most con-
troversies about double allowance of deductions, double inclusion of items of gross income, and such related matters as fall within the scope of the legislation. So far as difficult and doubtful cases which may come within the field of Section 820 necessitate litigation, it is the part of frankness to admit that formidable problems of interpretative application may arise. Some of these problems, omitted from or inadequately guarded against by the original terms of the enactment, should be met by clarifying and supplementing amendatory action. The section deserves fair trial and for the purpose of testing its utility the Bureau of Internal Revenue, the Department of Justice, and to such extent as is practicable private practitioners as well, should collect and collate statistics and practical experience.

APPENDIX


(a) Definitions.—For the purpose of this section—

(1) Determination.—The term 'determination under the income tax laws' means—

(A) A closing agreement made under section 606 of the Revenue Act of 1928, as amended;²

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Commissioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which has become final, or claim for refund finally disposed of, prior to ninety days after the date of the enactment of this Act.³

(2) Taxpayer.—Notwithstanding the provisions of section 901,⁴ the term ‘taxpayer’ means any person subject to a tax under the applicable Revenue Act.

(3) Related Taxpayer.—The term 'related taxpayer' means a taxpayer who, with the taxpayer with respect to whom a determination specified in subsection (b) (1), (2), (3), or (4) is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor and beneficiary; (D) fiduciary and beneficiary, legatee, or heir; (E) decedent and decedent's estate; or (F) partner.

(b) Circumstances of Adjustment.—When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Allows or disallows any of the additional deductions allowable in computing the net income of estates or trusts, or requires or denies any of the inclusions in the computation of net income of beneficiaries, heirs, or legatees, specified in section 162 (b) and (c) of this Act, and corresponding sections of prior revenue Acts, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer; or

(5) Determines the basis of property for depletion, exhaustion, wear and tear, or obsolescence, or for gain or loss on a sale or exchange, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediatly or immediately the taxpayer derived title subsequent to such transaction—

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before, on, or after the date of enactment of this Act') of any provision of the internal revenue laws other than this section and other than section 3229 of the Revised Statutes, as amended' (relating to compromises), then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediatly or immediately the taxpayer derived title subsequent to such transaction—

5. Now § 162(b) and (c) of Chapter 1.
6. INT. REV. CODE § 3801 reads: “before, on, or after May 28, 1938.”
7. NOW INT. REV. CODE § 3761.
nonrecognition, as the case may be. In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency, the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(e) Method of Adjustment.—The adjustment authorized in subsection (b) shall be made by assessing and collecting, or refunding or crediting, the amount thereof, to be ascertained as provided in subsection (d), in the same manner as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year with respect to which the error was made, and as if on the date of the determination specified in subsection (b) one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year.

(d) Ascertainment of Amount of Adjustment.—In computing the amount of an adjustment under this section there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be (1) the tax shown by the taxpayer, with respect to whom the error was made, upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpayer upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error. The amount so ascertained (together with any amounts wrongfully collected, as additions to the tax or interest, as a result of such error) shall be the amount of the adjustment under this section.

(e) Adjustment Unaffected by Other Items, Etc.—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this section, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error.

(f) No Adjustment for Years Prior to 1932.—No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932."