



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
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CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR Ronald D. Pinsky  
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FROM: Curt G. Wilson  
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SUBJECT: Application of Mitigation Provisions

This Field Service Advice responds to your memorandum dated April 23, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Year 1 =

Year 2 =

X =

Y =

B =

ISSUE

In Year 2, X & Y reported gain from the conversion of certain stock in B. The period of limitations for filing a claim for refund for Year 2 has now expired. If there is a determination that the conversion occurred in Year 1 rather than Year 2, can an adjustment be made for Year 2?

## CONCLUSION

Yes. Once the determination is made, the mitigation provisions of sections 1311 – 1314 will authorize an adjustment.

## FACTS

X owned stock in B. The stock was convertible into a different class of securities upon occurrence of certain events. In Year 2, B was sold. X & Y treated the sale as converting their stock in B and reported taxable income on the conversion.

The Internal Revenue Service maintains that the B stock actually converted in Year 1. X & Y, which have litigated the year of conversion, now agree that the stock converted in Year 1. They wonder, however, whether an adjustment is possible for Year 2, for which the period of limitations on filing a refund claim has expired.

## LAW AND ANALYSIS

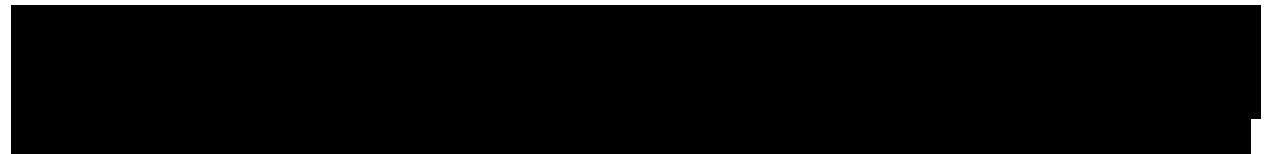
The mitigation provisions of sections 1311 – 1314 of the Internal Revenue Code were designed to palliate the effect of the period of limitations in certain meticulously and narrowly drawn situations. See Bradford v. Commissioner, 34 T.C. 1051, 1054 (1960). For an adjustment to be authorized under these provisions, four conditions must be met.

- First, an error must have occurred in a closed tax year that cannot otherwise be corrected by operation of law. See I.R.C. § 1311(a).
- Second, there must be a “determination” for an open tax year. As defined in section 1313(a), a “determination” is a final decision by a court, a closing agreement, a final disposition of a claim for refund, or an agreement under Treas. Reg. § 1.1313(a)-4.
- Third, the determination must result in a circumstance under which an adjustment is authorized by section 1312. There are seven circumstances under which an adjustment is authorized. These circumstances involve double inclusion of an item of gross income (section 1312(1)); double allowance of a deduction or credit (section 1312(2)); double exclusion of an item of gross income (section 1312(3)); double disallowance of a deduction or credit (section 1312(4)); correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs (section 1312(5)); correlative deductions and credits for certain related corporations (section 1312(6)); and basis of property after erroneous treatment of a prior transaction (section 1312(7)).

- Fourth, except for determinations described in section 1312(3)(B) and in section 1312(4), the determination must adopt a position maintained by a party that is inconsistent with the error that has occurred. See I.R.C. § 1311(b).

In this case, the four conditions necessary for mitigation have occurred or are likely to occur shortly. First, X & Y erred by reporting income from the conversion in Year 2, and this error cannot otherwise be corrected because the period of limitations on filing a claim for refund for Year 2 has passed. Second, X & Y and the government have agreed to resolve pending litigation regarding the year of conversion. X & Y and the government anticipate that their settlement will result in a determination under section 1313(a). Third, the anticipated determination will result in the double inclusion of income from the conversion, a circumstance of adjustment described in section 1312(1). Finally, the anticipated determination will adopt a position maintain by the Service that is inconsistent with taxing the conversion in Year 2. Once all four of the conditions for mitigation have been met, an adjustment will be authorized for Year 2 in the amount and by the method described in section 1314.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



Please call if you have any further questions.

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